Recent Developments Affecting Estate Planning

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I. The Federal Estate Tax—What Federal Estate Tax?

A. Estate tax exemption increased to $11.18 million—for now. The Tax Cuts and Jobs Act of 2017, signed by President Trump on December 22, 2017, doubled the estate, gift and generation-skipping transfer tax exemption, by increasing the exemption from its $5 million base to $10 million in 2018—actually, $11.18 million resulting from CPI adjustments. Effectively, this means $22.36 million in exemptions for spouses.

1. Preparing and filing estate tax returns is (almost) no longer a part of the practice. A federal estate tax return is not required to be filed unless the value of the decedent’s gross estate plus “adjusted taxable gifts” (taxable gifts over annual exclusions) exceeds $11.18 million—unless a return is filed in order to make the deceased spouse’s unused exemption (DSUE) portability election.

2. Higher exemption will sunset at the end of 2025. Under the TCJA, the higher exemption will continue through 2025. Effective January 1, 2026, the exemption will revert to the former base level of $5 million per person unless Congress extends the higher exemption. For now, we know what the estate, gift and GST exemption will be for the next eight years—unless a Democratic Congress reduces the exemption in the meantime. (In, 2016 the Obama administration proposed reducing the exemption from $5 million to $3.5 million.

a. “It’s déjà vu all over again” said the noted philosopher Yogi Berra (albeit in a different context). The one constant with respect to transfer taxes has been constant change. It all began with the Tax Reform Act of 1976, which “unified” the federal estate tax and gift taxes, increased the estate tax exemption from $60,000 to $175,625, introduced the first (mercifully short-lived) version of the generation-skipping transfer tax, repealed (for a few years) the “new basis at death” rule, and made other significant changes (and some insignificant changes—remember the orphan’s deduction?). ERTA 1981 increased the estate tax exemption to $600,000, introduced the unlimited marital deduction, and gave us QTIP trusts. The Tax Reform Act of 1986 increased the exemption, reduced the maximum estate & gift tax rate, and gave us the current version of the generation-skipping transfer tax. In 1990, we were introduced to the Special Valuation Rules of Chapter 14. EGTRRA 2001 (the “Bush Tax Act”) repealed the estate tax under the Budget Reconciliation procedure’s “sunset” rule—a slow-burning fuse. After an estate-tax-free year in 2010, in 2012 Congress made the exemption “permanent” at $5,000,000 (with annual CPI adjustments).

1) And now we have an estate tax exemption that will sunset on January 1, 2026. As Yogi Berra also said, “It ain’t over ‘til it’s over.”

b. “Yes, but every past change in the exemption has resulted in an increase in the deduction!” Yeah, sure! While that is certainly true, don’t put any money on this history as being an accurate guide as to where the road will be taking us. Yogi Berra put it well: “When you come to a fork in the road, take it.”

3. Congress did not merely double the exemption; it generated a SEISMIC SHIFT IN THE ESTATE PLANNING PRACTICE! The Tax Reform Act of 1976 tripled the estate and gift tax exemption, from $60,000 to $176,525. In response to the specific provisions in the 1976 Act, other estate planning tools and techniques of course were developed—but tripling the exemption did not result in fundamental changes in the estate practice. For many clients, deferral of the estate tax (if not partial or total elimination of the tax,) remained a factor in
estate planning decisions. The same was true of the 1981 Tax Act, which also *tripled* the exemption (to $600,000), and EGTRRA 2001, which again *tripled* the exemption (from $1,000,000 to $3,500,000). After each of those Acts, a sizeable number of clients continued to have reason to be concerned about the estate tax (and the gift tax, and the generation-skipping transfer tax). Under these and other changes in the transfer tax laws, existing planning tools had to be refined and new planning tools were invented, but transfer taxes continued to be a factor in many estate planning decisions.

a. **Estate planning concern in all of those earlier years: Eliminate (or at least reduce) the estate tax.** Throughout all of these years, with estate tax rates as high as 50 or 55 percent, for many clients a planning objective was to reduce if not wholly eliminate estate taxes on the death of the client and his or her spouse. This could be accomplished through the use of not just marital deduction formula clauses and bypass trusts, but by way of some rather sophisticated planning techniques including discount planning, all designed to reduce the value of the client’s and the surviving spouse’s gross estate for estate tax purposes.

b. **Under the new law, NONE of our clients (well—very, very few clients) have ANY concern about the estate tax!** After Congress increased the exemption to $5 million in 2011, in CLE speeches I sometimes referred to “mere millionaires” who no longer had estate tax concerns—individuals with estates of $3 million to $5 million, or couples with estates of $8 million to $10 million. For the foreseeable future—or at least the immediate future, the class of “mere millionaires” includes individuals with estates of “only” $8 million to $10 million, or couples with a “mere” $15 million to $20 million of accumulated wealth.

c. **An inclusion in the decedent’s gross estate used to be a matter of concern, but now it is our friend.** To the extent that taxes are a concern in estate planning decisions, the concern will be securing, for the client’s beneficiaries, the benefits of the “new basis at death” rule. Many planning decisions will involve efforts to include the value of interests in the decedent’s gross estate.

d. **Discount planning has been turned on its head.** Planning techniques that reduced value by way of discounts—fractional interest, minority interest, restrictions on transferability, lack of marketability—no longer project benefits but are a matter of concern because of their potential effect on the “new basis at death” rule.

4. “But I have all of those sophisticated estate planning tools that I won’t be using anymore! And I spend so much time learning all of those things! Should I consider shifting my practice to another area?”

**Au contraire!** These “mere millionaire” clients are still going to need wills (with those wills invariably containing at least some trust provisions), and will continue to have concerns about retirement planning, planning for disability and incapacity, creditor protection, second spouse protection, business succession planning, planning for descendants with disabilities, planning for clients who own real property in another state—and that’s just a partial list.

a. January 2017 article from The Onion (“America’s Finest News Source”): “GENEVA, SWITZERLAND—World Health Organization officials expressed disappointment Monday at the group’s finding that, despite the enormous efforts of doctors, rescue workers and other medical professionals worldwide, the global death rate remains constant at 100 percent.”
b. **Don’t hit the word processor “delete” button on those sophisticated planning forms.** They may come back into play if and when the exemption is replaced by a more modest exemption.

5. **Communicating with existing clients.** The TCJA has had a profound effect on the estate plans for more than a few of your clients. This will be particularly true for **wills that include one or more formula clauses** that are triggered by exemption amounts as of the date of death—e.g., a formula gift to a QTIPable marital trust, with the residue to pass to a credit shelter trust; or a formula allocation of assets between a GST-exempt trust and a GST-nonexempt trust. If these trusts have different beneficiaries, the increased exemption will have the effect of dramatically shifting beneficial interests.

a. When ERTA introduced the unlimited marital deduction in 1981 (replacing the quantitative “one-half of my adjusted gross estate” limitation on the deduction), many existing wills made formula gifts of “the maximum allowable marital deduction available to my estate.” To avoid having an act of Congress change the amount of testamentary gifts—to the entire estate, ERTA 1981 included a transition rule, under which formula clauses in wills executed before a certain date were to be construed in accordance with the former law.

b. **There is no transition rule under the TCJA.** Unless wills or other planning documents with formula provisions are revised, Congress through the higher exemption will have made substantive changes in the client’s estate plan.

c. **Send a letter along the following lines?**

“Dear ____

“Our records show that you signed your estate planning documents in ____. As you know, Congress recently enacted a comprehensive tax bill that made major changes in our income tax, estate tax, and gift tax laws. These changes may have affected your estate plan. Also, the Texas legislature recently made significant changes relating to powers of attorney and other estate planning instruments. Finally, revisions may be appropriate due to changes in the family, as by the birth of a new family member, the death of a family member, marriages or divorces within the family, changes in financial circumstances, or by other factors such as changes in your goals and desires.

“This may be a good time for you to review your estate plan, to be sure that it is still consistent with your planning objectives. If you would like my assistance in reviewing your estate plan and related documents, please give me a call.

“With best regards,”

**B. Trusts remain the linchpin of any good estate plan.** The Dukeminier & Johanson Wills, Trusts & Estates casebook began with a letter from prototypical client Howard Brown: “Wendy and I now have very simple wills giving our property to each other in case of death and then to our children when the survivor of us dies…. We think our main objectives should be to avoid probate and eliminate as many inheritance taxes as possible.” We have always been able to tell Howard and Wendy that if they live in Texas, avoiding probate is not a concern because of our independent administration procedures. And now we can tell the Browns that they have absolutely no concern about estate taxes. Does that mean we can tell the Browns that they can and should stay with their current two two-page wills? Absolutely not! For Howard and Wendy—and for virtually all clients—trusts will continue to be an integral part of a good estate plan.
1. **A history lesson.** Prior to the 1970s, when your parents and grandparents could buy a nice three-bedroom house for $20,000 to $30,000, the $60,000 exemption eliminated all estate tax concerns for many clients. Two-page (“I love you, you love me”) wills were common, and were seen as doing the job reasonably well—or at least adequately. In Texas (and in most of the states outside the East Coast), inter vivos and testamentary trusts were rarely employed, and then only for wealthy clients. The Trust Code component of Johanson’s Texas Estates Code Annotated (2017 ed.) cites just 24 cases involving Texas trusts decided before 1950. (That doesn’t count cases involving constructive trusts or resulting trusts, which aren’t really trusts.) The cases that made modern Trust law cases came from states like Massachusetts and New York, not Texas.

   a. By the mid-1970s, though, that same house was worth $60,000 to $80,000—meaning that one asset in the client’s estate would “use up” the $60,000 exemption. If the client had a couple of life insurance policies and a pension plan, eliminating or at least tamping down the estate tax became a concern. Although the exemption was increased to $175,625 and then to $600,000, for many clients a planning objective was to reduce if not wholly eliminate taxes on the death of the client and his or her spouse.

   b. The initial or primary motivation for the use of bypass trusts was to provide economic benefits to the spouse or child without estate tax cost. However, clients and their counselors came to realize, and appreciate, the myriad non-tax benefits of a trust settlement, including creditor protection through the use of spendthrift provisions, avoidance of guardianship of the beneficiary lost her capacity, control over the scope of the beneficiary’s interest, and control of the remainder interest by giving the beneficiary (at most) a special or limited testamentary power of appointment. A trust that benefited children could also provide substantial non-tax benefits.

2. **Bypass trusts for spouses.** For a couple in their 40s (or 50s, or 60s, or 70s), bypass trusts—that give the spouse a life income interest and limited invasion powers over trust principal—continue to be important even if there are never going to be any estate taxes to bypass. A trust settlement is superior to an outright disposition to the spouse for a number of reasons.

   a. A major concern is that **if the surviving spouse later becomes incapacitated,** the result will be a costly and cumbersome guardianship administration. If instead the estate was left in trust—with the spouse serving as trustee (or co-trustee) for as long as her or she is able and so inclined—a guardianship administration will be avoided.

   b. A trust gives **spendthrift protection** against creditors’ claims. Yes, but are potential creditors’ claims a real concern for a 75-year-old retiree who has a modest lifestyle and doesn’t drive motorcycles? How likely is it that there will be any creditors’ claims to be concerned about? Mr. Murphy (of Murphy’s Law fame) provides the answer to those who would eschew spendthrift protection: “If anything can go wrong it will, and in the worst possible way.”

   c. A trust settlement assures that **on the spouse’s death the remainder interest will pass to the children,** rather than to that dreaded “personal trainer” second husband, that trophy second wife, or that too-solicitous caretaker.

   d. A trust can and should give the spouse a **special testamentary power of appointment**—the power to appoint the trust property (e.g.,) “outright or in further trust to such one or
more of my descendants as survive me.” Professor Ed Halbach (University of California) has noted that a power to appoint also give the power to disappoint, and tend to insure filial devotion: If an elderly mother or grandmother has a special testamentary power to appoint $2 million in assets, how likely is it that she will be alone at Thanksgiving?

2. **Bypass trusts for the children.** Another problem with that two-page will: If the children will succeed to more than a modest amount, there are very real advantages in creating trusts for the children's benefit rather than giving them outright ownership (i.e., ownership free of a trust). And, each child can be the trustee of his or her own trust, giving the child the power to make management and investment decisions (just as an outright owner would make) while also giving various advantages.

   a. **Covering the contingency of divorce.** In today’s world, more marriages are terminated by divorce than by death. If property is bequeathed outright to a child, it is the child's separate property and theoretically is not “on the table” for purposes of division upon divorce. However, all property on hand at the time of divorce (or death) is presumptively community property. To keep its separate property status, the property cannot be commingled with community property, and good records must be kept; otherwise it may not be possible to establish separate ownership so as to overcome the community presumption by the required “clear and convincing” evidence. A trust (even one with the child as trustee) is a useful vehicle for segregating and managing separate property separately.

   b. **Creditor protection.** If the child is in a profession or line of work in which malpractice suits are a concern (and, in today's litigious society, that includes just about everybody!), property left to a child in a trust can be given spendthrift protection, meaning that no creditors can reach the child's interest in the trust—even if the child declares bankruptcy.

   c. **In-law protection.** Even if the child’s marriage is solid and the likelihood of divorce is remote, parents may be concerned that the child’s spouse might take some action that puts the child’s inheritance at risk.

   d. **Avoids guardianship** should the child, years from now, lose her capacity.

   e. **Bypasses child’s estate for tax purposes** if the child’s estate exceeds her exemption equivalent in the year of her death.

3. **Contingent trusts.** All wills should include a contingent trust, to cover the contingency that an outright distribution may be made to a minor beneficiary (avoiding guardianship—and avoiding the beneficiary’s succeeding to outright ownership at age 18); to a beneficiary who, it turns out, has filed for bankruptcy; or to a beneficiary who, it turns out, that has special needs. Here is a useful contingent trust clause, developed by Clyde Farrell, an Elderlaw attorney in Austin.:

   B-2. **Contingent Trusts.** Any portion of my residuary estate, or of the Howard Brown Family Trust or a Contingent Trust upon the trust's termination, which would be distributable to a beneficiary (i) who is under age 23, (ii) who (in the determination of my executor or the trustee) lacks the mental capacity to manage his or her own financial affairs, (iii) who has filed a petition for protection under the Bankruptcy Code within 180 days before my death, or (iv) who has a disability as defined by the Social Security Administration and who (in the determination of my executor or the trustee) needs benefits for which he or she might qualify if distribution is
to a trust, instead shall be distributed to the trustee of a Contingent Trust. Each beneficiary's portion so distributed shall be held and administered as a separate trust for the beneficiary.

a. **Distributions.** The trustee may distribute to the beneficiary, from time to time, so much or all of the trust income and principal as the trustee, in its discretion, deems appropriate for the beneficiary's best interest. Any income not so distributed shall be added to the principal of the trust.

b. **Termination.** The trust shall terminate when the beneficiary attains age 25 or dies before that age; or, in the case of a beneficiary who lacks the capacity to manage his or her own financial affairs, when the beneficiary regains that capacity; or, in the case of a beneficiary who has filed a bankruptcy petition or has a disability, when the beneficiary dies or the trustee in its discretion determines that termination of the trust would be in the beneficiary’s best interest. Upon termination, the trust principal and accumulated income shall be distributed:

   1. To the beneficiary.
   2. If the beneficiary is not living, to the beneficiary's descendants.
   3. If none of the beneficiary's descendants is then living, to my descendants.
   4. If none of my descendants is then living, to [“atom bomb” beneficiaries].

_____________________

a. **Bankruptcy concern.** Under §541(a)(5) of the Bankruptcy Code, if a person acquires or becomes entitled to acquire an inheritance within 180 days after filing for bankruptcy, the inherited property is included in the bankruptcy estate. This cannot be avoided by a disclaimer of the inheritance. It is the date of the decedent’s death, and not when the property is received, that controls. The Contingent Trust will cause the beneficiary’s share to pass into a trust protected from creditors. This assumes that (a) the will contains a spendthrift clause, and (b) the person has elected state law exemptions.

b. **Special Needs concern.** An outright bequest of property may cause the beneficiary to lose eligibility for SSI or Medicaid benefits. The Contingent Trust establishes a very basic Special Needs trust, as the trustee is given unlimited discretion to make distributions (not governed by a support standard of any other standard). Under this simple format for a special needs trust, distributions can be made to cover the beneficiary’s supplemental needs.

C. **Clayton trust?** Where spouses are involved, consideration should be given to the “second look” provided by a so-called Clayton trust, based on *Estate of Clayton v. Commissioner*, 976 F.2d 1486 (5th Cir. 1992). The will leaves the residuary estate to a QTIPable trust which provides that, to the extent a timely QTIP election is not made, the residue will pass to a bypass trust that contains more flexible terms.

1. When the first spouse dies, the executor can (if appropriate) file a Form 706 that makes a QTIP election (or partial election) and that elects DSUE portability. The **good news** is that on the spouse’s death (i) her estate will have a larger exemption, and (ii) the trust assets will receive a new basis for income tax purposes by reason of the §2044 gross estate inclusion. The **bad news** is that the spouse may have been lucky enough to live to see either the sunset of the TCJA’s increased exemption or Congress’s lowering of the exemption, resulting in estate tax.
2. As for the portability election, if a spouse dies while the higher TCJA exemption is in place, the surviving will have the benefit of the deceased spouse’s $111-plus million exemption even if the second spouse dies after the exemption has dropped to a lower amount.

II. Section 671—Grantor Trust Rules

A. Colorado decision: Exchange of promissory note for trust corpus was a request for a loan, not a substitution of property of equivalent value. In In re Condiotti, 14CA0969 (Colo. App. 2015) (unpub. op.), the court held that the trustees of an intentionally defective grantor trust properly ruled that the settlor’s attempt to exchange a promissory note for the trust corpus was a request for a loan and not a substitution of property of equivalent value. “As a result … we affirm the probate court’s order that instructed the trustees that they could ‘properly reject’ the settlor’s proposed transaction.”

1. In 2000, Condiotti established an irrevocable trust for his minor son in 2000, naming his wife as trustee. MidFirst Bank was later appointed as co-trustee. The trust gave Condiotti the power to substitute property of equivalent value for the trust corpus. The trust also provided, however, that no person could borrow trust principal or income without adequate interest or security. In 2011 Condiotti advised the trustees that he had decided to exercise the substitution power by substituting a promissory note for the full $9,500,000 value of the trust’s corpus. The trustees replied, first, that the settlor was not actually invoking the substitution power but instead was attempting to invoke the loan power that the trust instrument expressly denied him; and second, that the promissory note was not of “equivalent value” to the trust’s corpus.

a. The probate court agreed with both of the trustees’ contentions. This court affirmed the probate court’s ruling that the proposed transaction was an attempt to exercise the loan power, not the substitution power, so the trustees could properly reject it. “We therefore do not address the order’s alternative holding that, even if the proposed transaction were an exercise of the substitution power, the promissory note was not of ‘equivalent value, ...

2. Noting that the determination of whether a transaction is a loan is a question of fact, the court concluded that the transaction constituted a loan. “The record contains evidence that (1) the settlor would have become the trust’s debtor, and the trust would have become the settlor’s creditor; (2) the settlor offered a promissory note in exchange for the entire trust corpus; (3) the trust corpus was valued at about $9,500,000; (4) the promissory note bore an interest rate of 1.27%; and (5) the promissory note stated that the settlor would repay the amount received in exchange for the promissory note.”

a. “This case is similar to one that the Internal Revenue Service considered in Rev. Rul. 85-13, 1985-7 I.R.B. 28. This ruling held that a grantor’s ‘receipt of the entire corpus of the trust in exchange for [the grantor’s] unsecured promissory note constituted an indirect borrowing of the trust corpus.’”

B. Federal district court (E.D. Louisiana): Exchange of secured promissory notes for trust corpus did constitute a substitution of property of equivalent value. However, Estate of Benson v. Rosenthal, 2016 WL 2855456 (E.D. La. 2016) (unpub. op.), reached a contrary result, distinguishing In re Condiotti.

1. Estate of Benson involved several intentionally defective grantor trusts established by Benson, naming Rosenthal as trustee. “[T]hese trusts hold ownership interests in various entities that in turn own valuable property, including the New Orleans Saints and Pelicans franchises, the New Orleans Fox television affiliate, automobile dealerships, and the Benson Tower and Champions Square development.” The trusts’ substitution powers were exercisable by Benson without the approval of the trustee. Loans to Benson could be made “upon the terms and conditions as are
deemed appropriate by the trustee.” As in Trust of Candiotii, the settlor advised the trustees that he was exercising the substitution power by substituting promissory notes (with valuation adjustment clauses that would be triggered by appraisals), several parcels of real estate, and the forgiveness of $100 million of indebtedness owed to Benson by several of the trusts. The trustees refused to enter into the transaction on the ground that unsecured promissory notes were not a proper trust investment, and that he had to make his own verification that the assets to be exchanged were of equivalent value before the exchange could occur. Benson supplemented his exchange request with additional documents, including collateral assignments giving the trusts security interests. When the trustee again said no, Benson brought this action, supplementing the Notice of Exchange with a valuation of the assets by a valuation consultant firm.

2. Condiotti and Rev. Rul. 85-13, involving unsecured notes, were distinguishable, said the court. “Here, Plaintiff has tendered fully-secured promissory notes based on qualified appraisals bearing adequate interest rates. In addition, Plaintiff has offered tangible property and other assets to form equivalent value in the attempted substitution. This Court finds these distinctions significant. Accordingly, [Condiotti and Rev. Rul. 85-13] provide this Court with little assistance because they are both distinguishable and non-binding.”

III. Section 1014—Basis of Property Acquired From a Decedent

A. New focus: Income tax planning. For the vast majority of our clients, any concern about taxes will focus on income tax planning—and, in particular, planning to secure a step-up in basis for the client’s successors who acquire property from the decedent. While the ink is not yet dry on suggested planning steps that might be taken to secure a step-up in basis, here is a brief list of techniques that are being discussed.

1. Give the trustee (not a beneficiary-trustee) a discretionary power to distribute assets out of the trust to the beneficiary. It would be appropriate to use precatory language as to the settlor’s intent. E.g., “I suggest that the Trustee consider exercising the power so that, upon the beneficiary’s death, his or her estate may utilize the basis increase allowed under Internal Revenue Code Section 1014.”

   a. For an existing bypass trust, this would be appropriate (ii) if the distribution of principal is authorized and will not breach the trustee’s fiduciary duty to the remaindermen, and (ii) loss of divorce protection and creditor protection is not a concern.

2. Give an independent party the power to grant a “limited” general power of appointment to the beneficiary. Jason Flaherty (Brink Bennett Flaherty, Austin) has suggested this clause:

   “The Independent Trustee may grant the beneficiary of a trust a testamentary power to appoint all or part of the trust or trust share to the creditors of the beneficiary’s estate. Any testamentary power of appointment granted by the Independent Trustee must be in writing and may be revoked at any time during the lifetime of the beneficiary to whom the power was given. I suggest that the Independent Trustee consider exercising this authority when it may reduce generation-skipping transfer taxes or so that, upon the beneficiary’s death, his or her estate may utilize the basis increase allowed under Internal Revenue Code Section 1014.”

3. The Delaware Tax Trap, leading to a gross estate inclusion if the holder of a special testamentary power of appointment exercises the power by giving the appointee a presently exercisable general power of appointment.
4. **Give a remainderman an inter vivos special power of appointment to appoint assets to the income beneficiary.** The bypass is drafted so as to give Mom a mandatory or discretionary income interest for life. On Mom’s death the trust is to continue, but is to be divided into stirpital shares for the three children (and their descendants). The trust gives son John a special inter vivos power to appoint trust assets to Mom (and a backup special inter vivos power of appointment to daughter Donna if John predeceases Mom). Mom is now in her 80s and in poor health. The trust includes assets that have appreciated substantially since Dad’s death ten years ago. John exercises the power of appointment by appointing those assets outright to Mom. When Mom dies, the assets will receive a new basis.

   a. Will John have made a taxable gift by exercising the power of appointment—when he has a remainder beneficial interest in the trust? (Is it a contingent remainder or a vested remainder subject to total divestment? Without reading the trust language I don’t know—and I don’t care.) I do not believe that John will have made a taxable gift; that will be my reporting position. And if that is my “reporting” position, John will not file a Form 709 gift tax return. And even if John has made a taxable gift, he has that $11.18 million exemption.

   b. **Is §1014(e) a concern if Mom (the donee) dies within one year?** Under §1014(e)(1), if appreciated property is acquired by the decedent by gift within one year of death and passes from the decedent to the donor or the donor’s spouse, “the basis of such property in the hands of such donor (or spouse) shall be the adjusted basis of such property in the hands of the decedent immediately before the death of the decedent.” That should not be a concern, because even if Mom’s will puts the property back into the same trust, it will not have passed “to the donor or the donor’s spouse.”

5. **If the client wants to secure a basis step-up for his own assets, give elderly family member a “circumscribed” general power of appointment.** In “The ‘Hook’ of Increased Tax Basis,” Trusts & Estates 10 (April 2018), Turney Berry (an ACTEC member in Louisville) has an article in which he discusses the following plan. (I see Berry’s article as a “think about it” piece—I’m not sure whether Berry is recommending the plan as distinguished from putting it out for discussion.) Client’s estate is (and is likely to remain) less than the exemption amount, and he has assets that have appreciated substantially in value. Client transfers the appreciated assets to an irrevocable inter vivos trust for the benefit of Client’s spouse and descendants (and Client can serve as trustee). This will result in a taxable gift—but in today’s $11.18 million exemption world, who cares? The trust gives an elderly family member, who (i) does not have and is not likely to have creditor concerns and (ii) is likely to die before Client, a “circumscribed” general testamentary power of appointment exercisable only in favor of the power-holder’s estate, with the power extending only to assets having a value greater than their income tax basis. Power-holder dies, and—voila! The trust assets, includible in the decedent’s gross estate, get a new basis for income tax purposes.

   a. “This transaction isn’t for everyone but, then again, can we say that any estate-planning idea is right for absolutely everyone? Of course not!”

IV. **Sections 2036 and 2038—Retained Interests or Powers**

   A. **FLP assets includible in gross estate under §2036(a)(2) even though decedent grantor held only limited partnership interests.** It has often been said that “hard cases make bad law.” Of Estate of Powell v. Commissioner, 148 T.C. No. 18 (2017), it can be said that bad cases (here, involving what the concurring opinion called “aggressive deathbed tax planning”) can make really bad law. Powell’s son, acting under a power of attorney, contributed $10 million of cash and marketable securities to a
family limited partnership, in return for a 99% LP interest. Her two sons contributed unsecured promissory notes in return for the 1% general partner interest. On the same day, the son, acting as agent under the power of attorney, transferred Powell’s 99% LP interest to a charitable lead annuity trust under which an annuity was paid to charity for Powell’s life with the remainder passing to the two sons. The remainder interest was valued by assuming a 25% discount for lack of control and lack of marketability of the 99% LP interest. (Slight problem—among many: the durable power of attorney only authorized gifts with annual exclusions.) Powell died seven days later.

1. Bad facts? Excuse me! The partnership entity was: funded only by assets of the soon-to-be decedent … with only cash and marketable securities … seven days before death (although we are told that Powell died unexpectedly) … a transfer to a CLAT of a charitable annuity for the life of the soon-to-die grantor, and a discounted remainder interest to pass to the two sons … with all of this having been accomplished under a power of attorney, meaning that the son was essentially negotiating with himself. Las Vegas wouldn’t even make book on whether the taxpayer had a chance of winning.

   a. And the estate’s argument before the Tax Court was—how to put it as genteely as possible—of the same … quality.

2. The Service assessed a deficiency on the ground that the $10 million of assets contributed to the FLP were includible in Powell’s gross estate (without discount) under one of four theories—actually, all four theories: (i) §2036(a)(1)—retained possession and enjoyment or right to income, (ii) §2036(a)(2)—right in conjunction with any other person to designate who could possess and enjoy the property or its income, (iii) §2038—power to revoke, alter, amend or terminate the transfer, and (iv) §2035(a)—transfer of property within three years of death that otherwise would have been included in the gross estate under §§2036-2038 if the transfer had not been made.

   a. The estate did not contest the application of §2036(a)(2) (!!), and did not raise the exception to §2036 for a bona fide sale for full consideration (!!). The only argument made by the estate was that §§2036 and 2038 could not apply because the decedent no longer owned the LP interest at her death—despite the fact that the LP interest had been transferred within three years of death, bringing §2035(a) into play.

3. This was a “reviewed” Tax Court decision, which means that it was considered by the full Tax Court. The majority and concurring opinions both agreed that §2036(a)(2) applied. The majority opinion (Judge Halpern, joined by seven judges) reasoned that Powell, in conjunction with the general partners, could dissolve the partnership; and that Powell, through her son as general partner and as her agent, could control the amount and timing of the distributions. Six judges joined in Judge Lauber’s opinion that §2036(a)(2) applied (without giving any discussion of the basis for its application), but rejected the majority opinion’s discussion of a “double inclusion” issue. This means that fifteen out of seventeen judges saw merit in the application of §2036(a)(2) to an FLP case—the first case to apply §2036(a)(2) where the decedent owned only a limited partnership interest.

   a. It would be nice, and comforting, if the decision could be dismissed on the ground that this was essentially a sham partnership whose sole purpose was to produce valuation discounts, and that the taxpayer didn’t deserve to win. Bad facts, yes; but still … fifteen out of seventeen judge found merit in apply §2036(a)(2) where the decedent owned only a limited partnership interest? The case is appealable to the Ninth Circuit.
V. Section 2041—Powers of Appointment

A. Why HEMS ascertainable standard powers should continue to be employed. A beneficiary’s power to invade trust principal is not a general power of appointment if the power is limited by an ascertainable standard relating to health, education, maintenance or support. For years, HEMS invasion powers have been employed in drafting trusts, to insure that beneficiaries have access to trust principal without causing the property to be included in the beneficiaries’ gross estate. With an $11.18 million estate tax exemption, concern about a gross estate inclusion has disappeared except for very large estates. Instead, it might be advantageous for a beneficiary to hold a general power of appointment, resulting in a stepped-up basis for the trust assets.

1. In Estate of Vissering v. Commissioner, 990 F.2d 578 (10th Cir. 1993), V was the beneficiary and co-trustee (along with a bank) of a trust that gave the trustees a discretionary power to distribute principal “as may be required for the continued comfort, support, maintenance, or education of said beneficiary.” The government argued that because the distribution power was tied to “comfort,” V held at death a general power of appointment, resulting in a gross estate inclusion. The court (generously) held that the quoted phrase satisfied the HEMS standard because the distribution power was required for the continued comfort of the beneficiary. The result was reversal of a $708,000 deficiency.

2. If the Vissering case had arisen today, it is likely that the parties’ arguments would be reversed. The estate would likely argue that V held a general power of appointment, resulting in a basis step-up for the trust assets; the government would argue no; this indeed met the ascertainable standard test.

B. Does this suggest that beneficiaries should be given a power to invade for “comfort”? There are two reasons why the answer is NO. First, the creditor protection given by the trust’s spendthrift clause would be lost. Property Code §112.035, which authorizes the use of spendthrift provisions in Texas trusts, states, in subsection (d), that “[i]f the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary of the settlor’s beneficial interest does not prevent the settlor’s creditors from satisfying claims from the settlor’s interest in the trust estate.” However, subsection (f) provides that “[a] beneficiary of the trust may not be considered to be a settlor … merely because the beneficiary, in any capacity, holds or exercises a presently exercisable power to … consume, appropriate, or distribute property to or for the benefit of the beneficiary if the power is … limited by an ascertainable standard, including health, education, support, or maintenance of the beneficiary.”

Second, there is a Family Law reason relating to divorce. This could enable the attorney for the soon-to-be ex-spouse to argue that a portion of the beneficiary’s trust interest is “on the table” for a just and right division in a divorce action. Three principles of Texas law are in play. (i) In Texas, only community property is subject to just and right division in a divorce proceeding. The divorce court cannot award one spouse’s separate property to the other spouse. (ii) Property acquired by gift, will or inheritance is separate property. (iii) The income from separate property is community property.

1. In Wilmington Trust Co. v. United States, 4 Cl. Ct. 6, 14 (1983), aff’d, 753 F.2d 1055 (Fed.Cir.1985), a tax law case, the court held that the income from trusts, the corpus over which the income beneficiary had no right or control, constituted the beneficiary’s separate property—the bequest received by the beneficiary was the income interests themselves, and not the underlying assets that produced the income.
2. In *Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.-Texarkana 1976, no writ), H was the income beneficiary of a trust which provided that, upon reaching age 40, H could withdraw all or any portion of the trust assets. If H did not exercise the withdrawal power, the trust continued for H’s life. H did not exercise the age-40 withdrawal power. The court held that the trust income interest and accumulated income were community property. H had a possessory right to the trust corpus, and even though he had chosen not to exercise that right, he was effectively the owner of the trust property—triggering the rule that the income from separate property is community property.

3. In *Sharma v. Routh*, 302 S.W.3 353 (Tex. App.—Houston [14th Dist.] 2009, no writ). H was the beneficiary and trustee of a QTIP trust and a credit shelter trust (created by his first wife) that gave H HEMS ascertainable standard distribution powers. H, who never exercised the distribution power, married W—and several months later H filed for divorce. In the first draft of its opinion, the court wrote that H’s income interests in the two trusts (and thus a substantial amount of accumulated income) were community property. As to both trusts (said the court in its draft opinion), H’s power to make distributions to himself triggered the *Marriage of Long* result—H owned the trust corpus. Additionally, as to the QTIP trust, it was clear that H owned the trust because upon his death the trust property’s value would be includible in his gross estate for estate tax purposes. (!)

   a. The attorney representing H sent me a copy of the draft opinion, and I almost immediately (the clock was ticking) wrote an amicus brief in which I pointed out (as tactfully as possible) OOPS! (i) The HEMS distribution power was limited, and did not give H an interest in the trust corpus. Because distributions were to take into account other available recourses, H had not taken (and could not have taken) distributions for his support and maintenance. (ii) The §2044 inclusion in H’s gross estate was the result of the QTIP election, and not because H owned the trust property.

   b. In its published opinion, the court ruled that H did not “own” the QTIP trust, and that the H would have a present possessory right to receive principal distributions from the trusts only if he determined that such distributions were necessary for his maintenance under the support provision. The record showed no evidence that H was ever entitled to receive distributions of trust corpus.

VI. Section 2056—Marital Deduction


1. **Background.** In Rev. Proc. 2014-18, 2014-7 I.R.B. 513, the Service authorized a procedure for obtaining an extension that eliminated the need to apply for a private letter ruling. However, the simplified procedure expired on December 31, 2014. Rev. Proc. 2017-34 notes that “the considerable number of ruling requests for an extension of time to elect portability received since December 31, 2014, indicates a need for continuing relief…. Further, the considerable number of ruling requests received has placed a significant burden on the Service.”

2. The procedure is available only for estates under the filing threshold for which no estate tax return has been filed. The estate must file a Form 706 within two years after the decedent’s death or by January 2, 2018, whichever date is later. Making this procedure available through
January 2, 2018, “provides additional relief to the estates of decedents with a date of death in the first years after the enactment of the portability election provisions because the executors of those estates and their advisors may not have been aware of the opportunity.” The two-year limitation period should not unduly compromise the ability of the taxpayer or the Service to compute and verify the DSUE amount because the necessary records are likely to be available during that period. The Form 706 must state, at the top, “FILED PURSUANT TO REV. PROC 2017-34 TO ELECT PORTABILITY UNDER §2010(c)(5)(A).”

a. If the above requirements are not satisfied, an extension must be sought by requesting a private letter ruling.

B. **Personal representative ordered to make portability election notwithstanding general waiver in premarital agreement.** *Estate of Vose v. Lee*, 390 P.3d 238 (Okla. 2017), is a case of first impression as to the duty of a personal representative to make a portability election. Decedent died intestate in 2016, and her surviving spouse (Vose, who married decedent in 2006) was initially appointed administrator of the estate. A premarital agreement was discovered under which Vose had waived his right to be appointed personal representative, and decedent’s son by her first marriage (Lee) was appointed administrator. Although the size of the estate is not mentioned in the court’s opinion, it was less than $5.45 million (the estate tax exemption in 2016), meaning that no federal estate tax return was required to be filed. Vose filed a petition to compel the administrator to file an estate tax return for purposes of making a portability election, agreeing to pay any costs associated with preparing the return. The administrator contested the petition on the ground that the premarital agreement waived “all claims and rights, actual, inchoate, vested, or contingent” in the estate. The Oklahoma Supreme Court affirmed the lower court’s order that the administrator must timely file an estate tax return for purposes of electing portability.

1. The court concluded that Voss’s standing to assert his interest in the DSUE was not barred by the prenuptial agreement. Int. Rev. Code §2010 “grants Vose a potential interest as the surviving spouse in the portability of the DSUE, independent of his ability to take as an heir…. The determinative question, then, is not whether the antenuptial agreement between Vose and Decedent bars him from being a legal heir, but whether the agreement bars him from having any interest in the portability of the DSUE.”

2. The court noted that a waiver of rights is not binding unless made with full knowledge of the rights intended to be waived. The premarital agreement was made in 2006; the law allowing a portability election was enacted in 2010. Although the parties clearly intended a comprehensive waiver of their marital rights under the law as they existed at the time, the agreement was silent as to portability because the change in law was unforeseeable to the parties when the contract was made.

3. “An administrator of an estate occupies a fiduciary relationship toward all parties having an interest in the estate.” The court rejected the administrator’s contention that because the DSUE was valuable only to Vose, he should be allowed to demand consideration from Vose in exchange for making the election.

C. **Service acted properly in examining estate tax return of predeceased spouse to determine correct DSUE amount.** In *Estate of Sower v. Commissioner*, 149 T.C. No. 11 (2017), H died in 2012, survived by his spouse S. The estate tax return for H’s estate, which reported no estate tax liability, elected portability of the deceased spousal unused exclusion (DSUE) in the amount of $1,256,033. The return reported no taxable gifts, but it listed $945,420 in taxable gifts on the worksheet provided to calculate taxable gifts to be reported on the return. (Oops!) On November 1,
2013, the Service issue a Letter 627, Estate Tax Closing Document, which stated that the return had been accepted as filed, and that the Service would not reopen or examine the return unless there was evidence of fraud etc., a substantial error based on an established IRS position, or a serious administrative error.

1. S died in August 7, 2013, and the estate tax return for S’s estate claimed a DSUE of $1,256,033 from H’s estate. (As with the return for H’s estate, the return did not report a taxable gift of $997,921, but did not include a worksheet showing such a gift.) In the examination of the return for S’s estate, the Service noted the problem with her unreported gifts. The Service also opened an examination of the return for H’s estate to determine the proper DSUE amount, and uncovered the same problem of unreported taxable gifts. This did not cause any tax to be paid from H’s estate, but the Service concluded that the DSUE amount should be reduced to $282,690—and the Tax Court agreed.

2. The court noted that §2010(c)(5)(B) expressly authorizes the Service to look at the predeceased spouse’s return. Moreover, §7602 gives the Service broad discretion to examine a range of materials to ascertain the correctness of any return. Thus, the Service properly exercised the power conferred by these statutes to determine the proper DSUE amount.

3. The estate argued that the Letter 627, which accepted H’s estate tax return as filed, constituted a closing agreement under §7121, which estopped the Service from making changes to the DSUE amount flowing from that return. The court responded that the regulations specifically limit closing agreements to agreements using the prescribed forms Form 866 (Agreement as to Final Determination of Tax Liability) and Form 906 (Closing Agreement on Final Determination Covering Specific Matters).

4. The estate also contended that this was an improper second examination. Not so, said the court. There was no examination because an examination contemplates a report for additional facts. Here, the Service did not request any further facts from H’s estate, but merely reviewed a return that was already in the Service’s possession.

VII. Durable Powers of Attorney—Texas Legislative Changes

In enacting a Texified version of the Uniform Power of Attorney Act, effective September 1, 2017, the legislature made several beneficial changes in the statutes governing durable powers of attorney. The Act adopts most of the Uniform Act’s provisions promulgated by the Commissioners on Uniform State Laws in 2006 (and modified several times since then)—with some Texas twists. [I have paraphrased the relevant statutes—unless the provision is in quotation marks, in which case the statutory language has been reproduced.]

§ 751.00201. Meaning of Disabled or Incapacitated Person for Purposes of Durable Power of Attorney

“Unless otherwise defined by a durable power of attorney, a person is considered disabled or incapacitated for purposes of the durable power of attorney if a physician certifies in writing at a date later than the date the durable power of attorney is executed that, based on the physician’s medical examination of the person, the person is determined to be mentally incapable of managing the person’s financial affairs.”

§ 751.0021. Definition of Durable Power of Attorney

An instrument is a durable power of attorney for if the instrument:
(1) is in a writing that designates another person as agent and grants authority to the agent to act in place of the principal;
(2) is signed by the principal;
(3) states that "This power of attorney is not affected by subsequent disability or incapacity of the principal"; or "This power of attorney becomes effective on the disability or incapacity of the principal; and
(4) is notarized by a notary public.

§ 751.0023. Validity of Power of Attorney
A photocopy or electronically transmitted copy of a durable power of attorney has the same effect as the original instrument and may be relied on without liability by a person who is asked to accept the power of attorney to the same extent as the original.

§ 751.004. Duration of Durable Power of Attorney
“A durable power of attorney does not lapse because of the passage of time unless the instrument creating the power of attorney specifically states a time limitation.”

§ 751.021. Co–Agents
Two or more persons may be designated as co-agents. Unless otherwise indicated (and the Statutory DPOA has boxes to be initialed), each co-agent may exercise authority independently of the other co-agent.

§ 751.024. Reimbursement and Compensation of Agent
Absent contrary provision, an agent is entitled to “compensation that is reasonable under the circumstances.”

1. This in an important topic to discuss with the client. (The former statute made no mention of compensation—or for reimbursement of expenses, for that matter.) Under the Statutory DPOA, the principal is to initial one of two alternatives:
   My agent is entitled to reimbursement of reasonable expenses incurred on my behalf and to compensation that is reasonable under the circumstances.
   My agent is entitled to reimbursement of reasonable expenses incurred on my behalf but shall receive no compensation for serving as my agent.
   “[i]f no selection is made, each agent will be entitled to compensation that is reasonable under the circumstances.”

2. Some clients will contemplate that (e.g.,) daughter Donna will serve without compensation—in a sense, satisfying a familial obligation. On the other hand, activities in exercising powers as an agent may be substantial. If the client’s will names Donna as independent executor, Donna would be entitled to compensation—why not as agent under the DPOA? On the other hand, if there is friction among family members, Donna’s entitlement to compensation could lead to hard feelings. The statute does not specify who is to determine “reasonable compensation.”

§ 751.031. Grants of Authority in General and Certain Limitations—[hot powers]
What are referred to in the practice as “hot powers” can be exercised only if expressly authorized by the power of attorney:
“(1) create, amend, revoke, or terminate an inter vivos trust;
“(2) make a gift;
“(3) create or change rights of survivorship;
“(4) create or change a beneficiary designation; or
“(5) delegate authority granted under the power of attorney.”
Notwithstanding a grant of the above authority, absent contrary provision “an agent who is not an
ancestor, spouse, or descendant of the principal may not exercise authority under the power of
attorney to create in the agent, or in an individual to whom the agent owes a legal obligation of
support, an interest in the principal’s property, whether by gift, right of survivorship, beneficiary
designation, disclaimer, or otherwise.”

§ 751.032. Gift Authority
If the agent is authorized to make gifts, absent contrary provision such gifts are limited to the $15,000
annual exclusion amount.

§ 751.033. Authority to Create or Change Certain Beneficiary Designations
If the agent is granted authority under 751.031 to change a beneficiary, such change can be made in
a life insurance policy or a retirement plan, and in a bank account including survivorship accounts.

§ 751.051. Effects of Acts Performed by Agent
“An act performed by an agent under a durable power of attorney has the same effect, and inures to
the benefit of and binds the principal and the principal’s successors in interest, as if the principal had
performed the act.”

§ 751.054. Knowledge of Termination of Power; Good-Faith Acts
A third person dealing with the agent is fully protected even if the durable power has been revoked
or the principal has died if the person acted in good faith and did not know that the power has been
revoked or that the principal has died.

§ 751.101. Fiduciary Duties
When does fiduciary duty arise? In Vogt v. Warnock, 107 S.W.3d 778 (Tex. App.—El Paso 2003,
writ denied), the court held that a party who knew she had been named under a durable power of
attorney stood in a fiduciary relationship with the principal even though she never exercised her
authority under the power. (The court ruled, however, that the evidence did not support a jury verdict
that gifts and business transactions were unfair to the principal.) The concerns raised by the Vogt case
are resolved by §751.101, which provides that an agent who accepts appointment under a power of
attorney becomes a fiduciary as to the principal only when acting as agent under the power.

§ 751.103. Maintenance of Records
The agent must maintain records of each action taken or decision made by the agent.

§ 751.132. Termination of Agent’s Authority
Divorce terminates a power of attorney that names the spouse—now an ex-spouse—as agent.

§ 751.133. Relation of Attorney in Fact or Agent to Court-appointed Guardian of Estate
Appointment of a guardian of the principal’s estate terminates the power of attorney.

§ 751.201. Acceptance of Durable Power of Attorney Required; Exceptions
In the past, some financial institutions have refused to accept a power of attorney for some reason—
e.g., “this power of attorney is more than two years old.” This is no longer a permissible response.
Unless there are grounds for refusal (listed in the statute), a person who is presented with and asked
to act pursuant to the agent’s request of action must either accept the power of attorney or request an
attorney’s opinion that the power of attorney is valid and has not been revoked. A broad list of
grounds for refusal to act (ten of them!) include knowledge that the power of attorney has been
revoked, or that validity of the power is in litigation.
§ 751.251. Judicial Relief—[oversight by third parties]

“(a) The following may bring an action requesting a court to construe, or determine the validity or enforceability of, a durable power of attorney, or to review an agent’s conduct under a durable power of attorney and grant appropriate relief:

“(1) the principal or the agent;
“(2) a guardian, conservator, or other fiduciary acting for the principal;
“(3) a person named as a beneficiary to receive property, a benefit, or a contractual right on the principal’s death;
“(4) a governmental agency with regulatory authority to protect the principal’s welfare; and
“(5) a person who demonstrates to the court sufficient interest in the principal’s welfare or estate.”

Suppose that Mother has given a durable power of attorney to trusted Daughter (who lives in the same city). Son, who lives in California, consults you. He is concerned that Daughter is abusing the power of attorney, and is appropriating Mother’s assets for her personal benefit. Does Son have standing to take any action to determine whether Daughter is acting improperly?

a. Under former Texas law, the answer was No. During Mother’s lifetime, Son has no interest in Mother’s property. Only Mother herself, or the holder of her durable power or her duly appointed guardian had standing to challenge any transaction concerning Mother’s property. In order to have standing, Son would have to be appointed guardian of Mother’s estate—and if Mother had named Daughter in a Designation of Guardian Before Need Arises, Son will have a further obstacle to overcome.

b. New § 751.251 changes the answer to Yes. The statute addresses this problem by permitting actions to construe a power of attorney or review the agent’s conduct brought by (iii) a person named as beneficiary to receive the property on the principal’s death, or (v) any other person who demonstrates to the court sufficient interest in the principal’s welfare or estate.

Statutory Durable Powers of Attorney. Several modifications were made in the statutory durable power of attorney form. The notice at the beginning of the form advises that if the principal wants the agent to have authority to execute home equity loan documents, the power must be signed in the office of the lender, an attorney or a title company. The notice also advises the principal that he or she may appoint co-agents who, unless otherwise provided, may act independently of each other. The statutory form contains optional provisions regarding compensation and reimbursement of agents, and whether co-agents should act jointly or independently. The “hot” powers mentioned above are not part of the statutory form, but may be added.

VIII. Other 2017 Legislative Changes

A. Digital assets. New Estates Code Chapter 2001 enacts the Texas Revised Uniform Fiduciary Access to Digital Assets Act, which addresses the management and disposition of digital assets (email accounts, social networking accounts, online photos and videos, airline rewards, bitcoins, etc.). These assets are important in today’s world, and should not be ignored in the estate planning process. You should attend a CLE course addressing these issues at your earliest opportunity (if you haven’t already done so), ideally a program in which Gerry Beyer (Texas Tech) makes the presentation. Beyer was the Chair of the committee that pushed for the enactment of TRUFADAA.
B. **Small estate administration by affidavit—$75,000.** Under an amendment to Estates Code § 205.001, a small estate administration by affidavit is available for intestate estates with nonexempt property not exceeding $75,000 (increased from $50,000).

C. **Publication of notice to creditors—an “oops” is corrected.** For quite some time, Estates Code § 308.051 (and its predecessor in the Probate Code) has called for publication of notice of administration in a newspaper printed in the county in which letters are issued. Oops! The Austin American-Statesman is now printed in San Antonio, and the Austin Business Journal is printed in Dallas. That leaves Travis County with the Austin Chronicle. Most small counties have no newspaper printed in the county. As amended, the statute calls for publication in a newspaper of general circulation in the county, regardless of where the newspaper is printed.

D. **Partition of tenancy in common—Uniform Partition of Heirs Property Act.** As we learned in first-year Property in our law school years, any cotenant has a right to bring an action to partition the common property, either in kind or (more typically) by judicial sale. While that all sounds straightforward, a partition suit involves a court action, with its attendant costs and (in some cases) complications. This can raises issues for family members who inherit real property as tenants in common and cannot agree on a proper resolution of their ownership interests. New Property Code § 23A.101 authorizes a procedure under which the fair market value of the property is determined, a cotenant is given the option to buy out the other cotenants and, if the buyout right is not exercised, the property is either partitioned in kind or sold in open market.

E. **Cotenant heir can acquire title by adverse possession.** As we also learned in first-year Property, it is very difficult to acquire title by adverse possession as against a cotenant. Sole possession by one cotenant is not hostile or adverse as long as the cotenant does not exclude the other cotenants’ coequal right of possession. In order for the statute limitations to start to run, there must be an “ouster”—a frontal and visible assertion of exclusive ownership. This creates a problem where some ancestor died intestate two or more generations ago, and there is no reasonable way of knowing where his heirs might be.

1. Civil Practice & Remedies Code § 16.0625, enacted in 2017, changes the situation with respect to tenancies created by intestate succession. Under the statute, a cotenant heir may acquire the interest of other cotenant heirs who simultaneously acquired their interests by intestacy (and their successors). The possessing cotenant must have held the property in peaceable and exclusive possession for an uninterrupted 10-year period and paid property taxes, and the nonpossessing cotenants must not have contributed to the property’s maintenance and taxes or challenged the possessing cotenant’s exclusive possession.

2. After the 10-year period has elapsed, the possessing cotenant must file a § 203.002 affidavit of heirship and an affidavit of adverse possession, must publish notice in a newspaper in the county in which the land is located, and must provide written notice by certified mail to the last known addresses of the other cotenant heirs. If after five years no controverting affidavit has been filed by other cotenants, title vests in the cotenant in possession.

3. Title by adverse possession under this procedure is limited to the greater of 160 acres or the number of acres actually enclosed.