**Recent Developments Affecting Estate Planning**

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# I. 2015 Texas Legislative Changes

**A. New rules governing disclaimers.** The Estate Code provisions governing disclaimers were replaced by a new Chapter 240 of the Texas Property Code, adapted from the Uniform Disposition of Property Interests Act.

1. **Statute “unbundled” from federal tax law; no longer a nine-month time limit on making a disclaimer**. For many years, a primary motivation for considering a disclaimer was to avoid transfer taxes. If, for example, already-wealthy daughter Donna received a substantial inheritance (aggravating her estate tax and income tax picture) and then made gifts to her children, there would be federal gift tax consequences. By making a disclaimer, the disclaimed interest would pass to Donna’s children (i) with no gift tax consequences, and (ii) with the benefit of utilizing her parent’s otherwise-unused GST exemption.

a. With a $5.43 million estate and gift tax exemption, any tax motivation for making a disclaimer has virtually disappeared (except for estate plans based on a disclaimer-funded spousal bypass trust). Instead, the likely motivation for making a disclaimer would be to avoid creditors’ claims.

b. To be valid for federal tax purposes, a disclaimer must be made within nine months after the transfer is made. Under the statute as amended, the disclaimer can be made at any time before the heir or beneficiary has accepted the interest.

2. **Simplified delivery and filing requirements**. Under the former law, a disclaimer instrument had to be delivered to the personal representative and filed with the probate court, with distinctive delivery rules applicable to nonprobate transfers. The new rules, applicable to probate and noprobate transfers alike, greatly simplify the rule governing delivery, which can be in person, by mail, by fax, by email, or by any other method likely to result in receipt.

3. **Fiduciary’s power to disclaim**. Fiduciaries may disclaim (1) powers granted to the fiduciary, (2) interests in property, or (3) powers over property otherwise passing to a trust for the benefit of a ward, estate or beneficiary. Court approval is required for disclaimers by a dependent administrator, guardian, or trustee of a court-created trust that benefits a minor or disabled person, or if the disclaimed interest would pass to the disclaiming fiduciary individually.

**B. Wills may be reformed for mistake.** It has long been held that, under trust law, a trust can be reformed to correct a mistake. The courts consistently held, however, that a will could not be reformed after the testator’s death. “While courts have jurisdiction to construe wills, they have none to reform or correct them.” Jackson v. Templin, 66 S.W.2d 666 (Tex. Comm. App. 1933). That rule has been changed by Estates Code §§ 255.451-255.456, authorizing judicial modification or reformation of wills to address administrative issues, achieve the testator’s tax objectives, qualify a beneficiary for governmental benefits, or (if supported by clear and convincing evidence) correct a scrivener’s error.

**C. Transfer on Death deed as a means of avoiding probate**. New Estates Code Chapter 114 enacts the Texas Real Property Transfer on Death Act, which allows the owner of real property to designate a beneficiary to receive title to the property on the owner’s death without the necessity of probate. The TOD deed does not affect the transferor’s ownership right, and the owner retains the power to transfer or encumber the property or revoke the deed. The TOD deed, which may not be created by the exercise of a power of attorney, must be recorded in the county in which the property is located. The statute sets out an optional TOD deed form, which no doubt will soon appear on the Internet.

**D. Directed Trusts—trust protectors and trust advisors**. A new Property Code § 114.0031, which was proposed by Texas Bankers Association and applies only to noncharitable trusts, provides that a person who is given authority to direct, consent to, or disapprove a trustee’s investment, distribution or other decisions is considered a fiduciary in exercising that authority except to the extent the trust provides otherwise. A trustee who acts in accordance with those directions is not liable for doing so, except in cases of willful misconduct or gross negligence. The trustee has no duty to monitor the advisor’s conduct, provide advice to or consult with the advisor, or communicate with or warn any beneficiary or third party just because the trustee might have exercised its discretion differently.

# II. Legislation Relating to Estate and Gift Tax

**A. Repeal of the Estate Tax?** Proposed repeal of the federal estate and gift tax and the generation-skipping transfer tax is back in the news.On February 26, 2015,Representative Kevin Brady (R. Texas) introduced the Death Tax Repeal Act of 2015 (H.R. 1105). The bill is rather short and to the point:

SECTION 1. **Short title**.

This Act may be cited as the “Death Tax Repeal Act”.

SEC. 2. **Repeal of estate and gift taxes**.

(a) **In general**.—Subtitle B of the Internal Revenue Code of 1986 (relating to estate, gift, and generation-skipping taxes) is hereby repealed.

(b) **Effective date**.—The repeal made by subsection (a) shall apply to estates of decedents dying, gifts made, and generation-skipping transfers made after the date of the enactment of this Act.

1. While we have heard this song before, the bill is being taken seriously—at least by Congress. On April 16, the Death Tax Repeal Act was passed by the House of Representatives on a 240-179 vote, and was sent to the Senate. Well… as noted below, President Obama’s Fiscal Year 2016 Budget Proposal proposed *expansion* of the estate tax and disallowance of stepped-up basis. It is fair to say that the administration is not enthused about repeal of the estate tax.

**B. Obama administration’s Fiscal Year 2016 Budget Proposal.** In On February 2, 2015, the Treasury Department published its Fiscal Year 2016 Budget Proposal (“the Greenbook”), explaining the president’s budget proposals for 2016. Several of the proposals relating to transfer taxes were golden oldies, carried over from earlier Budget Proposals, but one of them—repeal of the §1014 stepped-up basis rule—is a stunner … or a joke. (Take your pick.)

1. **Lower the exemption to $3.5 million and increase tax rate to 45 percent—in 2016.** This proposal, which would restore the estate, gift and GST tax parameters to their 2009 levels, first appeared in last year’s Greenbook—except that last year’s edition would have applied to decedents dying on or after January 1, 2018. This year’s proposal would apply to estates of decedents dying on or after January1, 2016. It would raise the transfer tax rate to 45 percent, and would lower the estate tax exemption and the GST exemption to $3,500,000, and the gift tax exemption to $1,000,000, with no indexing for inflation. If it means anything—and it doesn’t—Sen. Bernie Sanders (I-Vt.) has introduced a bill that would enact these changes.

a. With more than a few Congressmen working on repeal of the estate tax—as if it hasn’t already been repealed for 99.9 percent of the population as a practical matter—this provision is dead ***before*** arrival.

2. **GRATS and installment sales to defective grantor trusts would be killed off**. Two proposals from the 2015 Greenbook were combined into one.

a. **Grantor Retained Annuity Trusts—remainder must be valued at greater of 25 percent of the value of the transferred assets or $500,000.** For the third year, the Budget Proposal includes a provision that would kill off short-term grantor retained annuity trusts by requiring a 10-year minimum GRAT term [*cf.* Walton v. Commissioner, 115 T.C. 589 (2000)], providing that the amount of the annuity payout could not be decreased during the GRAT term, and imposing a maximum term on GRATs—the grantor’s life expectancy plus ten years. However, the 2016 edition goes further, by requiring that the GRAT interest must have a value equal to the greater of 25 percent of the transferred assets or $500,000, “but not more than the value of the assets contributed.”

b. **DIGITS**. Installment sales to “defective” grantor trusts also would no longer be tax-effective. If a deemed owner under a grantor trust “engages in a transaction with that trust that constitutes a sale, exchange, or comparable transaction that is disregarded for income tax purposes … the portion of the trust attributable to the property received by the trust in that transaction (including all retained income therefrom, appreciation thereon, and reinvestments thereof, net of the amount of the consideration received by the person in that transaction) would be includible in the deemed owner’s gross estate, would be subject to gift tax if during the deemed owner’s life the grantor trust treatment is terminated, and would be treated as a gift by the deemed owner as to any distribution to another person during the deemed owner’s lifetime. The transfer tax imposed by this proposal would be payable from the trust.”

3. **Limit GST-exempt trusts to 90 years**. Carried over from earlier proposals is a provision under which the GST exemption would expire after 90 years. The 90-year period is inspired by the Uniform Statutory Rule Against Perpetuities (USTRAP), which has been enacted in about a dozen states.

4. **Extend duration of lien in Section 6166 deferral**. Under current law,if a §6166 election is made to defer taxes relating to a closely held business, the §6324(a)(1) lien continues for ten years. However, the deferral of payment of the tax can continue for up to fifteen years and three months after the decedent’s death. The proposal would extend the lien throughout the §6166 deferral period.

5. **Health and Education Exclusion Trusts (HEETS) would be subject to GST**. Section 2503(e) provides for an unlimited gift tax exclusion for tuition and medical payments made directly to the service-provider. For purposes of the GST, §2611(b)(1) excludes “any transfer which, if made during the donors life would not be treated as a taxable gift by reason of section 2503(e).” This has invited the use of HEETs, which provide for payment from the trust of medical expenses and tuition to multiple generations of descendants. (The trust must include a non-skip person—a charity—that has a substantial interest in the trust.) As with last year’s edition, the Budget Proposal would kill off HEETs by providing that §2611(b)(1) applies only to a payment by a donor directly to the service-provider, and not to trust distributions.

6. **Restriction on use of *Crummey* withdrawal powers**. It would be an understatement to say that the Commissioner does not like the use of *Crummey* withdrawal powers. Again this year, the Budget Proposal would (i) eliminate the present interest requirement for gifts that qualify for the annual exclusion, and (ii) impose an annual limit of $50,000 per-donor with respect to a “new category” of transfers of property that give the donee a *Crummey* withdrawal power, as well as transfers to passthrough entities, transfers of interests subject to a restriction on sale, and transfers that cannot be immediately liquidated by the donee.

a. I don’t know how this “new category” of gift transfers would work in terms of eliminating the requirement that a gift must be of a present interest—but I’m not going to worry about it because it ain’t going to happen.

7. **Expand definition of “executor” to encompass all tax issues**. Here is a proposal that isn’t controversial, and is not D.O.A. The Code currently defines “executor” for purposes of the estate tax, but not for purposes of tax matters that arose prior to the decedent’s death. The proposal would expand the definition, making the Code’s definition of executor applicable for all tax purposes, enabling the executor (for example) to agree to a compromise or assessment, claim a refund, and file an action regarding tax liability.

8. **Inherited retirement benefits: Five-year payout limit for beneficiaries other than spouses, minor children**. Under the proposal (also included in the 2014 and 2015 Budget Proposals), except for spouses (who could continue to make spousal rollovers) and minor children, disabled or chronically ill beneficiaries, and beneficiaries not more than ten years younger than the participant, beneficiaries could no longer stretch out required minimum distributions over their life expectancy. Instead, payouts would be limited to five years after the decedent’s death. Roth IRAs would be subject to the same five-year rule.

9. **What isn’t there: valuation discounts—but are we going to have regulations?** The Obama administration’s 2013 Budget Proposal recommended amending §2704 (the “disappearing rights and restrictions” special valuation rule). Under the proposal, the statute would be amended to a new category of “disregarded restrictions.” These restrictions would be ignored for transfer tax valuation purposes in valuing an interest in a family-controlled entity (*e.g*., a family limited partnership or an LLC) that is transferred to a member of the family if, after the transfer, the restriction could be removed by the transferor or the transferor’s family. Interestingly, this proposal did not resurface in the 2014 Greenbook and has not appeared since.

a. **Can we expect to see regulations, then?** Section 2704(b)(4) gives the Secretary authority to issue regulations regarding a restriction that has “the effect of reducing the value of the transferred interest for purposes of this subtitle, but does not ultimately reduce the value of such interest to the transferee.” For over a decade, Treasury’s Priority Guidance Plan included “guidance under §2704 regarding restrictions on the liquidation of an interest in a corporation or partnership.” At an ABA meeting in September 2009, Cathy Hughes, of Treasury’s Office of Tax Policy, indicated that the regulations were ready to be published, but were being held back pending possible Congressional action.

b. Well, Congress has not taken any action, and the current Congress is not at all likely to do so. At the ABA Section of Taxation meeting in May, Hughes noted that Congress had not enacted the proposed changes to §2704, “so now we are going to issue the regs.”

**C. Repeal of the “new basis at death” rule?** In his State of the Union address, President Obama announced that the Budget Proposal would repeal §1014, the “new basis at death” rule. Prior to his speech, a White House Fact Sheet referred to the stepped-up basis rule as “perhaps the largest single loophole in the entire individual income tax code.” The proposal also would raise the capital gain tax rate to 28 percent—“the rate at which capital gains were taxed under President Reagan.” All of this would be effective after December 31, 2015.

1. From the Greenbook: “The proposal “would end stepped-up basis by treating bequests ***and gifts*** [emphasis added] as realization events that would trigger tax liability for capital gains. To ensure the proposal creates neither tax nor compliance burdens for middle class families, decedents would be allowed a $200,000 per cou­ple ($100,000 per individual) exclusion for capital gains income, along with a $500,000 per couple ($250,000 per individual) exclusion for personal residences. Tangible personal property other than art and similar collectibles (e.g., bequests or gifts of furniture or other household items) would also be excluded. In addition, family members that inherited small, family-owned and operated businesses would not owe tax on the gains unless and until the asset were sold, and closely-held businesses would have the option to pay tax on gains over 15 years.” A deduction would be allowed for the cost of appraisals of appreciated assets, and an estate tax deduction would be allowed for the tax on gains deemed realized at death. The tax could be avoided by donating appreciated assets to charity.

2. **Déjà vu all over again?** Haven’t we heard something like this before? The Tax Reform Act of 1976 adopted a carryover basis rule, which (after attempted fixes and technical corrections) was deemed so unworkable that even the Treasury Department was behind repeal of carryover basis in 1979. The TRA ’76 model provided for various adjustments to basis, prorating such death costs as administration expenses, state and federal estate taxes, etc., etc. with respect to each appreciated asset. No mention of such adjustments is made in the Budget Proposal.

3. **Provide reporting on a consistent basis between estate tax valuation and income tax basis in the heir’s hands.** Curiously, the Greenbook included a proposal from earlier editions, based on the premise that §1014 would still be with us. As noted in the Greenbook, the value of property as reported on an estate tax return raises a rebuttable presumption of the property’s basis in the hands of the heir—but in more than a few cases in the past, the heirs have successfully rebutted that presumption. Treasury’s concern is that the executor may report a low valuation to reduce estate taxes, yet the heirs would argue that the reported value was low-balled to save transfer taxes. The proposal would provide that the basis for income tax would be the same as values “as determined for gift or estate tax purposes.”

a. Is inclusion of this provision just bad editing of the 2016 Budget Proposal, or is it rather a tacit realization that a statute repealing the stepped-up basis rule won’t even come before Congress?

**D. Do you want an estate tax closing letter? You will have to ask for one—after four months.** In a June 16, 2015 update to its frequently asked questions and answers on the IRS website, the Service announced that for estate tax returns filed after June 1, 2015, closing letters will be issued only on request of the taxpayer. The reason given for the change was that “[t]he volume of estate tax returns filed solely to make the portability election continues to increase tying up limited resources.” The announcement advised that practitioners should wait at least four month after filing the return to request a closing letter.

1. The premise of the change of procedure is that the IRS believes it will issue fewer closing letters if taxpayers have to ask for one. This is questionable, as nearly all executors will want to have a closing letter before terminating the administration and distributing the estate. The June 23, 2015 issue of Daily Tax Reports advised, at p. G-4, that the AICPA is considering asking the IRS to add a check-the-box to the Form 706, which would allow the executor to request a closing letter at the time the return is filed.

# III. Section 401—Qualified Plans and IRAs

**A. “No tax due” must have meant “no estate tax due.”** In Morris v. Commissioner, T.C. Memo 2015-82, Morris received a $95,484 distribution from an IRA owned by his father. Morris told the Tax Court that he checked the box to not have federal income tax withheld from the distribution because the paralegal who settled father’s estate advised him that there would be no tax due on the distribution. After receiving the distribution, Morris distributed $37,000 to his two siblings based on what he believed were his father’s wishes. Judge Lauber noted that the paralegal “evidently meant that there would be no Federal estate tax or Michigan inheritance tax due. But petitioner understood her to mean that no tax of any kind would be due.” Needless to say, that’s not how it works, and the court affirmed a $27,000 deficiency. Although Morris “acted honorably in executing what he believed to be his father’s wishes, his good conduct has no bearing on whether the IRA distributions were includible in his gross income.” The judge added that the advice Morris thought he received from the law firm “might have affected his liability for the accuracy-related penalty.”

**B. What to do when participant’s “estate” (or a trust) is named as beneficiary.** As a general rule, a surviving spouse can make a rollover to his own IRA only if the decedent’s qualified plan or IRA designated the spouse as beneficiary. When assets in a decedent’s plan or IRA pass to a trust or the decedent’s estate, which then distributes the assets to the surviving spouse, the spouse is treated as having received the IRA assets from a third party and not the decedent, precluding a spousal rollover.

1. **If will or trust benefits spouse and gives broad distribution powers, there's an escape hatch**. A number of rulings have approved rollovers where the surviving spouse had the unrestricted power to distribute P’s IRA or plan benefits to herself. Recent entries: Ltr. Rul. 201445031 (spouse was personal representative and sole beneficiary of the estate) and Ltr. Rul.201423043 (spouse was sole trustee of the marital trust, which allowed distributions as trustee deemed desirable for her “support, comfort and welfare in her accustomed manner of living” or “for any other purpose the trustee believes to be for the taxpayer’s best interest”).

# IV. Section 671—Grantor Trust Rules

**A. Yes, this irrevocable trust is a grantor trust**. In Ltr. Rul. 201507008, an irrevocable trust gave a Distribution Advisor the power to direct an independent trustee to make distributions of income or principal to Grantor, and to make distributions to Grantor’s issue with Grantor’s written consent. Grantor would exercise this consent power in a non-fiduciary capacity and in her sole discretion. Grantor had the power to borrow from the trust at a reasonable rate of interest with or without security. Grantor retained a special inter vivos and testamentary power of appointment that could be exercised during her lifetime or by will, but only with the written consent of a Trust Protector. The Distribution Advisor was not a “related or subordinate” party, and any successor Distribution Advisor could not be “related or subordinate” to Grantor.

1. The Service ruled that this was a grantor trust for federal income tax purposes, and that any transfer of property to the trust would not be a completed gift.

**B. Assets of wife’s revocable trust were not assets of husband’s bankruptcy estate**. In In re Reuter, 499 B.R. 655 (W.D. Mo. 2013), H and W established revocable trusts in 2005. H was a trustee and beneficiary, along with W, of both trusts. The bankruptcy trustee sought a declaratory judgment that H’s powers over and interests in W’s revocable trust caused the property to be included in his bankruptcy estate. Not so, said the court. First, H was a discretionary beneficiary of the trust, and discretionary interests are not subject to the claims of a bankruptcy trustee. Second, H did not hold the power to revoke the trust; only W could revoke her trust. Third, the trust contained a valid spendthrift clause.

**C. GRAT reformed to make trust remainder interest irrevocable.** Under the facts of Ltr. Rul. 201442042, T retained an attorney to prepare two GRATs, under which the remainder interests would pass to a trust for the benefit of T’s children. The attorney drafted the children’s trust as a revocable trust, over which T retained a right to amend, modify or revoke. (Ouch!) In addition, T was the trustee. An accountant preparing the gift tax return noted that the trust receiving the remainder interests would be includible in T’s estate, but was assured by the attorney that there was no tax problem (!). Gift tax returns were filed showing the transfers as completed gifts. Some years later, another attorney reviewed T’s estate plan and the GRATs, and advised T as to the problem.

1. The Service approved reformation of the trusts. Affidavits made by the taxpayer, attorneys, accountant and financial advisors established by clear and convincing evidence that T intended the transfers to the GRATs to be completed gifts.

# V. Section 2031—Definition of Gross Estate—Valuation Issues

**A. Ninth Circuit says—again—that Tax Court does not know how to handle valuation cases**. In recent years, in estate tax valuation cases the Court of Appeals for the Ninth Circuit has been decidedly hostile territory as far as the Tax Court is concerned. In several high-profile cases, Tax Court decisions have been reversed and remanded (or reversed and rendered judgment) with dismissive and sometimes sarcastic language strongly intimating that, in the Ninth Circuit’s view, certain judges on the Tax Court couldn’t tell their … er, don’t know what they are doing when it comes to valuation issues. See Morrissey v. Commissioner, 243 F.3d 1145 (9th Cir. 2001); Estate of Simplot v. Commissioner, 249 F.3d 1191 (9th Cir. 2001); Estate of Mitchell v. Commissioner, 250 F.3d 696 (9th Cir. 2001). The most recent entry in this interesting saga is Estate of Giustina v. Commissioner, 2014-2 USTC ¶60,684 (9th Cir. 2014), involving valuation of decedent’s interest in a limited partnership.

1. Guistina held a 41.1 percent limited partnership interest in a timberland company. The Tax Court had concluded that although the owner of an LP interest could not unilaterally force liquidation, the owner of that interest could form a two-thirds voting bloc with other limited partners to do so, and assigned a 25 percent probability to this occurrence. As there was a 25 percent likelihood that the partnership would be liquidated, the Tax Court assigned a 25 percent weight to an asset-based valuation and a 75 percent weight to valuation of the partnership as a going concern.

2. You are dead wrong again, said the Ninth Circuit. “This conclusion is contrary to the evidence in the record. In order for liquidation to occur, we must assume that (1) a hypothetical buyer would somehow obtain admission as a limited partner from the general partners; (2) the buyer would then turn around and seek dissolution of the partnership or removal of the general partners who just approved his admission to the partnership; and (3) the buyer would manage to convince at least two (or possibly more) other limited partners to go along, despite the fact that ‘no limited partner ever asked or ever discussed the sale of an interest.’ Alternatively, we must assume that the existing limited partners, or their heirs or assigns, owning two-thirds of the partnership, would seek dissolution. We conclude that it was clear error to assign a 25% likelihood to these hypothetical events. As in Estate of Simplot v. Commissioner, 249 F.3d 1191, 1195 (9th Cir. 2001), the Tax Court engaged in ‘imaginary scenarios as to who a purchaser might be, how long the purchaser would be willing to wait without any return on his investment, and what combinations the purchaser might be able to effect’ with the existing partners.” The case was remanded to the Tax Court for recalculation of the value of G’s interest in the partnership.

a. However, the court concluded, “the Tax Court did not clearly err by using the Commissioner’s proposed 25% marketability discount rather than the Estate’s proffered 35% discount, especially considering that the Estate’s expert acknowledged that such discounts typically range between 25% and 35%.”

# VI. Section 2032—Alternate Valuation

**A. The alternate valuation election is apparently not dead yet**. The election to utilize the §2032 alternate valuation date (six months after the date of decedent’s death), and even the opportunity to consider the election, is rarely encountered in today’s world. The election can be made only if the effect will be to (i) reduce the value of the decedent’s gross estate and (ii) reduce the total amount of estate tax and generation-skipping transfer tax that otherwise would be due. Needless to say, a lower valuation of the estate’s assets would produce a lower basis under the “new basis at death” rule. And yet…

1. **Extension to make election granted**. In Ltr. Rul. 201503003, the Service granted a 120-day extension to make the alternate valuation election, although the executor failed to timely file the estate tax return—and did not consult with an attorney until after the return’s due date (including extensions). An attorney advised the executor of the estate’s filing requirement and filed a return within one year after the due date (including extensions)—but no alternate valuation was made on the late-filed return. Nonetheless, the Service ruled that the executor had acted reasonably and in good faith, and granted an extension.
2. **Extension to make election denied**. Section 2032(d)(1) and Reg. § 20.2032-1(b)(3) provide that the alternate valuation date election may not be made if the return is filed more than one year after the due date, including extensions. In Ltr. Rul. 201441001, an estate’s request for an extension to make an alternate valuation date election was denied because the estate tax return was filed more than one year after the return’s due date.

# VII. Sections 2036 and 2038—Retained Interests or Powers

**A. Family Trust not includible in decedent’s gross estate even though its assets weren’t segregated** **back when his wife died**. In Ltr. Rul. 201429009, D and his wife W had created a joint revocable trust. When W died, the trust estate was to be divided into a Survivor’s Trust that would hold D’s share of property, and a Family Trust that would hold W’s property. The Family Trust gave D a $5,000 or five percent lapsing withdrawal right over principal. After W’s death, a law firm advised that it was not necessary to segregate the assets of the two trusts, and the assets were administered as a single trust.

1. The Service ruled that except for assets subject to the “5 or 5” withdrawal power, the value of the Family Trust was not includible in D’s gross estate. Corrective measures had been taken to properly allocate assets between the trusts once the error was discovered, and D’s estate was able to ascertain and track the assets that should have been allocated to the Family Trust.

# VIII. Section 2041—General Powers of Appointment

**A. Power to appoint to grantor’s descendants did not include beneficiary**. This drafting error has occurred more than a few times, when a trust grantor wants to give the trust beneficiary a special power of appointment. Under the facts of Ltr. Ruls. 201446001 thru 201446011 (trusts for 11 grandchildren), Grandfather established a trust for the benefit of grandchild G. The trust gave G a testamentary power to appoint the trust property to the grantor’s “issue.” Oops! Grandchild G was one of the grantor’s issue! The Service ruled that this was not a general power of appointment. Because the power of appointment was a testamentary power, G could not appoint to himself or to any of his creditors. Also, as the permissible appointees were Grandfather’s issue, G by his will could not appoint to his estate or the creditors of his estate.

1. Also see Ltr. Rul. 201444002, involving the same issue and the same result.

# IX. Section 2042—Life Insurance

**A. “Transfer for value” rule did not apply because grantor trusts and spouses were involved.** Under §101(a)(1), gross income does not include amounts received under a life insurance contract paid by reason of the death of the insured. Section 101(a)(2) provides, however, that this exclusion from gross income is lost if a life insurance contract is transferred for a valuable consideration. In that situation, the exclusion from gross income is limited to the amount of the consideration received (and any subsequent premiums paid) by the transferee.

In Ltr. Ruls. 201423009 and 201426005, Trust 1, a grantor trust as to both H and W, owned several joint life policies on H and W, and a single life policy on H. Trust 2, a grantor trust as to W only, was substantially funded. It was proposed that Trust 2 would purchase the life insurance policies from Trust 1, to ensure the funding of premiums on the life insurance contracts. In concluding that the proposed transfers would not trigger the transfer for value rule, the Service analyzed the transaction as having two aspects.

1. As for the joint lives policies, to the extent the transfer was attributable to W, this was a transaction between W as a grantor of Trust 1, transferring the policy to W as grantor of Trust 2. This did not involve a sale or exchange because W was treated as the income tax owner of both the seller trust and the purchaser trust.

2. The second aspect of the transaction involved the joint lives policies attributable to H and the single life policy of which H was the insured. W as grantor of Trust 2 gave consideration to H as grantor of Trust 1 in exchange for the policies. Under §1041(a), there is no gain or loss on transactions between spouses. “This action has the result, under §1041(a), as being treated as a gift to her husband.”

**B. Exculpatory clause no help to trustee where insurance policies lapsed**. In Rafert v. Meyer, 290 Neb. 219 (2015), Rafert established an irrevocable insurance trust to own three insurance policies whose death benefits totaled $8.5 million. The beneficiaries were to be Rafert’s daughters. Rafert’s attorney (Meyer) drafted the trust and was the trustee. Meyer completed the policy applications and used a false address (in South Dakota!) for his contact information. (Why the false address? No explanation is given in the court’s opinion.) The trust instrument provided that “[t]he Trustee shall be under no obligation to pay the premiums which may become due and payable under the provisions of such policy of insurance, or to make certain that such premiums are paid by the Grantor or others, or to notify any persons of the non-payment of such premiums, and the Trustee shall be under no responsibility or liability of any kind in the event such premiums are not paid as required.” However, the trustee had an obligation to furnish annual reports to trust beneficiaries.

1. Rafert made the initial premium payments totaling $262,000. She made a second set of premium payments, which “were paid directly to an insurance agent by issuing checks to a corporation owned by the agent. However, the premiums were never forwarded to the insurers by the agent or his company, and Appellants do not know what happened to the premiums.” The notices of nonpayment were sent to the South Dakota address and were never received by Meyer. As a result, Rafert and her daughters were unaware that the policies lapsed. Rafert and her daughters sued for breach of fiduciary duty, but the trial court held that Meyer wasn’t liable by reason of the trust’s exculpatory provision.

2. The Nebraska Supreme Court reversed, and remanded the case for trial. Under the Nebraska statutes, the terms of a trust do not prevail over a trustee’s duty to act in good faith and in the interests of the beneficiaries, and the duty to keep qualified beneficiaries reasonably informed about facts necessary to protect their interests. Further, even if such terms were exculpatory and could prevail over the statute, the court held that they wouldn’t prevail in this case because Meyer didn’t adequately explain the exculpatory clause and its consequences to his client.

3. Moral: If an instrument you draft contains an exculpatory clause, make sure that you explain its implications to the client—and memorialize that you gave that explanation.

# X. Section 2053—Administration Expense Deduction

**A. No “hazards of litigation” valuation discount.** In Estate of Foster v. Commissioner, 2014-1 U.S.T.C. ¶60,675 (9th Cir. 2014), at the time of her death F was the defendant in several lawsuits in her capacity as trustee of three marital trusts established under her husband’s estate plan. The estate’s appraisal of the marital trusts reflected a 29 percent discount based on the hazards of litigation presented by the lawsuits. When the Service denied the “hazards of litigation” discount, in anticipation of a Tax Court trial the estate obtained a second appraisal, which applied a discount of 12.9 percent to 17.2 percent. The difference in value between the two appraisals was $8.1 million. Pointing to this discrepancy, the Tax Court upheld the Service’s denial of the “hazards of litigation” discount and the Court of Appeals for the Ninth Circuit affirmed, because the litigation was not “ascertainable with reasonable certainty” at the time of F’s death.

1. **The case arose prior to 2009 changes in the Section 2053 regulations**. Under the former regulations, in order to deduct the estimated amount of a claim, the estate had to show that the amount of the claim was ascertainable with reasonable certainty, and the estimated amount was deductible only if the amount will be paid. Under current Reg. § 20.2053-4(d)(1), no estate tax deduction can be taken for potential or unmatured claims. If a claim is later paid or matures, it can be deducted under a timely refund claim.

# XI. Section 2055—Charitable Deduction

**A. No charitable income tax deduction because amount wasn’t “permanently set aside” due to pending litigation**. In Estate of Belmont v. Commissioner, 144 T.C. No. 6 (2015), B died in 2007, owning a primary residence in Ohio, a condominium in Santa Monica, and a pension retirement account. B’s will bequeathed $50,000 to her brother David and her residuary estate to the Columbus Jewish Foundation. In 2006, B had permitted David to move into the condominium, and he had been living there for about nine months when B died. David, who wanted to continue to reside in the condominium, asked the Foundation if he could exchange his $50,000 bequest for a life estate in the condo, but the Foundation said no. David filed a creditor’s claim, which was denied. He then filed a Petition to Confirm Interest in Real Property on which he ultimately prevailed.

1. The accountant who filed the estate’s fiduciary income tax return was not aware of David’s claim regarding the condominium. The return reported a charitable deduction based on the value of the residuary estate passing to the Foundation. The funds thought to be payable to the Foundation were not segregated or otherwise set apart from the general funds used by the estate to pay its expenses.

2. The Tax Court held that the estate was not entitled to a charitable income tax deduction under §642(c). For funds to be considered “permanently set aside” under the Treasury regulations, the possibility that the amount set aside will not ultimately be devoted to such charitable purpose must be “so remote as to be negligible.” Here, there was more than a negligible risk that the costs of defending David’s claims could dissipate the estate, which contained no other income-producing assets and had other expenses that could deplete the residuary estate.

# XII. Section 2056—Marital Deduction

**A. No problem in dividing QTIP trust into three trusts and terminating one of them.** In Ltr. Rul. 201426016, D and his wife S had six children. S and two of the children served as trustees of a trust for which a QTIP election had been made. The trustees proposed to (1) divide the trust into three separate trusts, (2) leave one of the new trusts as is, (3) convert a second trust into a total return trust, and (4) petition a state court to terminate the third trust and distribute the assets to the six children, subject to the children paying any resulting gift taxes.

1. You can do that, said the Service. First, dividing the trust into three trusts would not affect the trusts’ QTIP status. Second, termination of the third trust would not have any impact on the other two trusts. Under §§2511 and 2519, S would be deemed to make a gift of the entire value of the third trust, reduced by the amount of gift tax paid by the children. However, this would not cause S to be treated as having made a gift or a transfer with respect to the other two trusts, and thus the special valuation rule of §2702 would not be invoked. Third, conversion of the second trust to a unitrust pursuant to state law would not be deemed a gift or other disposition of any interest in the trust to the remainder beneficiaries. Finally, the transactions would not cause the marital trust to recognize gain or loss under §1001. Prior revenue rulings have established that a partition of jointly owned property is not a sale or other disposition because the owners do not acquire any new or additional interests.

2. Also see Ltr. Rul. 201419001, involving division of a QTIP trust into two separate trusts.

# XIII. Section 2503—Taxable Gifts; Annual Exclusions

**A. Crummey provisions qualified for annual exclusions notwithstanding trust’s no-contest and arbitration provisions.** Chief Counsel’s Advice201208026, published in 2012, caused a lot of consternation (and heartburn) regarding the use of Crummey withdrawal provisions. The CCA advised that gifts to a trust with Crummey provisions did not qualify for annual exclusions because the trust included an arbitration provision and contained a no-contest (“*in terrorem*”) clause which, if triggered by a beneficiary’s challenge, would remove the beneficiary from the trust. The CCA apparently was issued in relation to the pending litigation in Mikel v. Commissioner, T.C. Memo. 2015-64, in which the Tax Court rejected the Service’s position in a case involving 60 (!) Crummey beneficiaries.

1. **The trust provisions**. The Mikels jointly transferred their residence, a condominium and other real property, at a reported value of $3.262 million, to an irrevocable trust for the benefit of family members. The trustee was given discretion to make distributions of income and principal among the grantors’ children, descendants, and their spouses for a beneficiary's health, education, maintenance, support, wedding costs, purchase of a primary residence or business, or for entering a trade or profession.

a. **Crummey withdrawal power**. The trustee was required to give beneficiaries notice of their Crummey withdrawal right within a reasonable time after a contribution was made to the trust. The withdrawal power would lapse if not exercised within 30 days after receipt of the notice. A savings clause provided that the withdrawal provision should be construed so as to qualify for the federal gift tax annual exclusion. The transfer was made on June 15, 2007, and the trustee gave notice to the beneficiaries almost four months later, on October 9, 2007.

b. **The arbitration provision**. The trust provided that if a dispute were to arise concerning the trust, the dispute “shall be submitted to a panel consisting of three persons of the Orthodox Jewish faith.” The Tax Court opinion advises that “[s]uch a panel in Hebrew is called a *beth din*.”

c. ***In terrorem* provision**. Under the trust, if a beneficiary were to “take part in or aid in any proceeding to oppose the distribution of the Trust Estate, … or challenges an distribution set forth in this Trust,” any provision in favor of the beneficiary would be revoked and the beneficiary “shall be excluded from any participation in the Trust estate.”

d. **The gift tax return—filed late**. The Mikels did not file timely gift tax returns reporting the gifts. In December 2011, “after being contacted by the IRS, the Mikels each filed gift tax returns.” (The opinion does indicate how the Service learned about the 2007 gifts.) Each return reported a transfer of assets worth $1.6 million, and each return took 60 annual exclusions. With an annual exclusion of $12,000 in 2007, exclusions totaled $720,000 and reduced the taxable gift to $911,000, fully covered by each taxpayer’s gift tax exemption equivalent—meaning that no gift tax was due.

2. **Partial summary judgment granted to taxpayers**. Before the Tax Court, the government made the arguments set out in the 2012 CCA. The government conceded that each beneficiary was given an unconditional right of withdrawal, that the notices were timely received, and that the trustee could not properly refuse a demand. However, it was contended, the beneficiaries were not given present interests because a right of withdrawal would be legally enforceable only if the beneficiary could go before a state court to enforce that right. That is something a beneficiary would be reluctant to do because of the *in terrorem* provision. Therefore, said the government, the withdrawal rights were “illusory,” as any attempt to seek legal enforcement of that right “would result in adverse consequences to its holder.”

a. As to the first contention, that the withdrawal right would be legally enforceable only if the beneficiary could go to court, the Tax Court responded: “[I]t is not obvious why the beneficiary must be able to ‘go before a state court to enforce that right.’ Here, if the trustees were to breach their fiduciary duties by refusing a timely withdrawal demand, the beneficiary could seek justice from a beth din, which is directed to ‘enforce the provisions of this Declaration … and give any party the rights he is entitled to under New York law.’ A beneficiary would suffer no adverse consequences from submitting his claim to a beth din, and respondent has not explained why this is not enforcement enough.”

b. ***In terrorem* clause not triggered by challenge to withdrawal provision**. Moreover, said the court, the *in terrorem* clause was to be triggered if a beneficiary were to “take part in or aid in any proceeding to oppose the *distribution* of the Trust Estate, … or challenges a *distribution* set forth in this Trust.” [Emphasis added.] The purpose, said the court, was to deter challenges to the trustee’s discretionary power to make distributions, and did not speak to challenges to the exercise or non-exercise of the withdrawal right.

3. **Other issues—number of Crummey beneficiaries and asset valuations—not resolved.** The cross-motions for partial summary judgment addressed only the issue of whether the beneficiaries had been given present interests for annual exclusion purposes, and the case was remanded to the Tax Court. A footnote notes that there are factual disputes, yet to be resolved, as to the number of beneficiaries who were give withdrawal rights, and as to the asset values reported on the gift tax returns.

4. **What about the “retained special power of appointment” issue?** Under the facts of CCA 201208026, the grantors had retained special testamentary powers of appointment. The CCA concluded that this made the transfers “incomplete” for gift tax purposes, but only as to the remainder interests. And this, said the CCA, triggered the special valuation rule of Int. Rev. Code § 2702: because the grantors had retained interests that were not qualified annuity trust or unitrust interests. Thus, their retained interests were valued at zero, and annual exclusions did not apply to the transfer. The Tax Court decision in Mikel v. Commissioner sets out only the dispositive provisions mentioned above, and does say anything about any retained special power of appointment.

# XIV. Section 2511—Transfers in General

**A. Should a durable power of attorney grant the power to make gifts?** In drafting durable powers of attorney, for clients with more-than-modest estates it has been a common (and desirable) practice to grant the attorney-in-fact the power to make gifts, with the objective being to minimize or eliminate estate taxes in the principal’s estate. Under the Texas Statutory DPOA, by initialing a box the attorney-in-fact can be given the authority to make gifts not to exceed annual exclusions (and “Special Instructions” can be added to authorize larger gifts). Tex. Est. Code Ann. §752.051.

1. **… when the estate tax exemption is $5.43 million?** I should say, it *used to be* a common (and desirable) practice to give the DPOA agent the power to make gifts. This made sense back when the estate tax exemption was $175,625, or $600,000, or $1,000,000 (or even today, in jurisdictions that have a state estate tax with modest exemptions). But with a $5.43 million estate tax exemption—destined to increase annually with CPI adjustments—for the vast majority of clients (even those who are “mere millionaires”), potential estate taxes are not a planning concern. Instead, the power to make gifts may open the door to what has become an increasing concern: the use—the exploitation—of DPOAs as instruments of financial abuse of the elderly.

2. **Gifts to qualify for Medicaid and other governmental programs.** While estate planning attorneys have, in the past, recommended the DPOA authorization to make gifts as a means of reducing estate taxes, in today’s world the gift-making authority is likely to be of greater importance to clients at the other end of the economic spectrum, where qualification for Medicaid long-term care benefits or some other governmental program may be a concern. The bottom line is that, except for mega-wealthy clients for whom potential estate taxes are an issue (or clients in a jurisdiction with a state estate tax), DPOAs should *not* grant the authority to make gifts unless qualification for a government benefit may be a potential objective and the gift-making authority should be limited to that purpose.

**B. No home (or client) should be without a durable power of attorney—right?** A Google searchfor information on the Florida Durable Power of Attorney Act, enacted in 2010, produced this observation from ElderLaw Answers: “A Durable Power of Attorney should be a part of every [Florida resident's estate plan.](http://www.karplaw.com/page/florida-estate-planning)” Many professionals in the estate planning community would be inclined to agree, and tend to favor rules that enhance the usefulness of durable powers. In contrast, more than a few members of the Elder Law section of the Bar have seen more than a few cases in which durable powers have been employed as instruments of financial abuse of the elderly. “Once a financial durable power of attorney is validly executed, it can be an extremely powerful document, authorizing an agent to perform virtually any act with respect to the principal property that the principal could perform. This breadth of power coupled with few required execution formalities creates a fear of overreaching by unscrupulous agents.” Dessin, Acting as Agent Under a Financial Durable Power of Attorney: An Unscripted Role, 75 Neb. L. Rev. 574, 582 (1996). A disturbing and increasing number of cases have involved overreaching or misappropriation by the attorney-in-fact, invariably a relative or friend of the principal. The very lack of oversight and convenience of that make powers of attorney attractive in planning for incapacity, in contract to cumbrous and costly guardianship or conservatorship administrations, also make DPOAs easy to abuse.

1. **Where did that mortgage come from?** One ploy (reported to me by *two* El Paso attorneys) goes something like this: When Aunt Annie dies, it is discovered that there is a mortgage on the family home, even though the mortgage was paid off years ago. What’s up? Nephew Norman (the attorney-in-fact) secured an equity loan; the loan balance is $92,000, the money is nowhere to be found (Norman having expended all the funds on Aunt Annie’s behalf, he tells us, although he has no records), and Norman is judgment-proof.

But wait a minute! The DPOA statute explicitly requires that the attorney-in-fact keep records! Tex. Est. Code Ann. §751.103. Are you telling me that Norman broke the law?

2. **Headline in Wall Street Journal**, Nov. 28, 2007: **How to Ensure Relatives Don’t Rip You Off**. The article begins with this sentence: “Sadly, Brooke Astor is making headlines again. But there may be a lesson in the indictment of the late philanthropist’s son and a lawyer close to the family’s affairs: It can be risky to hand off financial responsibilities even to someone you think you can trust.” The article gives further details of the Astor case (and several others), involving alleged abuse of a durable power of attorney, and outlines “some steps you can take to help safeguard your financial power of attorney document.” These include (i) requirement that agent provide family members or a third party with regular accountings, (ii) name co-agents, or an overseer with a removal power, or (iii) create a revocable trust instead.

**C. Case study**. At the time Larry Lawyer prepared a will for Margaret Brown (then a widow in her 70s) four years ago, Lawyer also prepared a durable power of attorney, health care power of attorney, living will, and anatomical gift statement, all of which Mrs. Brown signed. The will leaves Margaret’s entire estate in equal shares to her two children: Carol, who lives in Austin; and David, who lives in Los Angeles. The will names Carol as independent executor, and David as alternate. Ms. Brown was disabled by a stroke two years ago, and Carol has been transacting on her behalf pursuant to the DPOA. Ms. Brown is now in a rest home. Because of the DPOA, it has not been necessary to appoint a guardian.

1. **David Brown has retained you**. Flying in from Los Angeles, David tells you that he is very concerned that Carol is abusing her authority under the power of attorney, is expending their mother’s funds for her personal benefit, and has appropriated some of their mother’s assets for her personal use. David wants to know: Does he have standing to bring an action against Carol, demanding an accounting of her actions under the durable power of attorney and (if appropriate) recovery of Mrs. Brown’s assets that Carol has appropriated or expended for her personal use?

2. **Forget the facts of (1). *You are Larry Lawyer***. It develops that David, represented by another attorney, has indeed established that Carol had abused the power of attorney, to the tune of about $650,000. Of the missing $650,000, only $230,000 can be traced—to Carol’s unsuccessful investment in soy bean futures contracts on the Chicago Commodities Exchange. David has been appointed as his mother’s guardian. David’s lawyer thought about suing Carol to recover the missing funds, but decided against it because she is judgment-proof. Instead, David has filed suit against ***you***.

a. David’s attorney is confident that, after discovery, he will be able to establish that virtually every client for whom you have drafted wills in the past several years leaves with a “package deal” that includes a durable power of attorney, living will, health care power of attorney, etc., and that the gist of what you have told your clients about durable powers (spending on average 4 minutes—with 2 minutes on who to name as attorney-in-fact and alternate) is that “these are very useful; they solve a lot of problems, and this will reduce if not eliminate the need for a guardianship if you are disabled.”

b. David’s attorney is also confident that he can establish that, as a young adult, Carol had a severe drug problem, to the point of having had to go to a dry-out farm; and that, more recently, Carol has had a drinking problem. You have told your lawyer—actually, the malpractice carrier’s lawyer—that you didn’t know anything about this because you never asked Mrs. Brown, except to learn that she had two adult children named Carol who lives in Austin and David who lives in Los Angeles.

You are scheduled to be deposed next Friday. Are you ready?

c. Let’s go back to when Larry Lawyer drafted Mrs. Brown’s will and, in the course of the client interview, recommended that Mrs. Brown give someone a durable power of attorney. How close does the following come to what would happen at your firm?

LL: “This Financial Power of Attorney that I have drafted will be real helpful if you lose the capacity to handle your affairs. That way, we can avoid the complications and expenses of a guardianship. Who would you like to name as your power-holder to act on your behalf?”

MB: “Well, my daughter Carol lives here in town and sometimes I have her write checks for me, but my son David lives in Los Angeles.”

LL: “Good. How do you spell Carol’s last name?”

End of this portion of attorney-client conference; rest of time spent in discussing Mrs. Brown’s will and revocable trust. Is Larry Lawyer in trouble?

3. **What steps do you take in explaining to the client the benefits—and the potential risks—of a durable power of attorney?** Especially if the client is older (and perhaps in the process of diminishing capacity, but with sufficient capacity to make a will, etc.), what steps do you take in guiding the client through the process of selecting a suitable, trustworthy person as attorney-in-fact? What factors or indicators do you look for in satisfying yourself that the client has made a sensible choice?

4. **What steps do you take in explaining the broad scope of the powers granted by the DPOA?** To make this point, I will use North Carolina as the example, as that state, like Texas, has a Statutory Short Form DPOA. However, my observations also apply to other states as well, whether the powers are set out in the statute except to the extent they are expanded or limited (as in Florida), or whether the powers are hand-crafted by attorneys who choose not to rely on or incorporate statutory powers. The North Carolina Statutory Short Form lists 17 powers that are either granted by initialing the line, or denied either by striking the item or not initialing the line. Item (3) is captioned “Bond, Share, Stock, Securities and Commodity Transactions.” The Texas statutory form also has a box that includes “commodity transactions” in its caption—commodity transactions!

I recommend that the client be given a xerographic copy of the powers set out in the statute at the initial client interview, when the possible use of a financial power of attorney is first discussed. I also recommend a disclosure statement along the following lines, acknowledging that the client has been furnished a copy of the scope of the agent’s powers and has been given an opportunity to read them.

**THE POWERS GRANTED BY THIS DOCUMENT ARE BROAD AND SWEEPING**. You are authorizing the person named as your agent (attorney‑in‑fact) full legal power and authority to act on your behalf, without any court approval or supervision, by taking any and all actions relating to your property. **YOU SHOULD NOT APPOINT A PERSON AS YOUR AGENT UNLESS YOU HAVE COMPLETE AND TOTAL TRUST AND CONFIDENCE IN THE PERSON**. A copy of the relevant [North Carolina; Florida] statute is attached hereto. **YOU SHOULD READ THESE STATUTORY PROVISIONS**. If you have any questions about this document, or about any of your agent’s powers, you should address these questions to a member of the [ ... ] law firm, or to some other attorney of your choice. **YOU MAY REVOKE THIS POWER OF ATTORNEY AT ANY TIME IF YOU WISH TO DO SO**.

This document does not authorize anyone to make medical or health care decisions for you. Such decisions can be made pursuant to a Health Care Power of Attorney, if you have executed one.

Sign below to acknowledge your receipt of this disclosure statement prior to your execution of this Durable Power of Attorney, to affirm that **YOU HAVE BEEN GIVEN THE OPPORTUNITY (1) TO READ THE ATTACHED STATUTORY POWERS** and (2) **TO ASK ABOUT THE SCOPE OF ANY POWERS THAT YOU DO NOT FULLY UNDERSTAND**.

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Mary Q. Client

Date: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**D. Fiduciary duties arose as soon as attorney-in-fact knew that she had been named in durable power of attorney (!)**. 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 had 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.) We now have another case that follows Vogt v. Warnock. In Jordan v. Lyles, 455 S.W.3d 785 (Tex. App.—Tyler, 2015), the court upheld a jury verdict that an agent breached her fiduciary duties of fairness and full disclosure notwithstanding the agent’s contention that there was no evidence that, in the transactions in dispute, her actions were pursuant to the power of attorney.

1. A bill introduced at the 2015 legislative session, sponsored by the Real Estate, Probate and Trust Law section of the State Bar, would have overruled these cases by providing that only an agent who accepts appointment is a fiduciary. However, the bill was not enacted.

2. In light of these rather troublesome decisions, unless and until the issue is clarified it may be appropriate for attorneys to recommend “springing” durable powers of attorney that become effective on the principal’s incapacity. Alternatively, for a durable power that is presently operative, in a paper presented at the June 2015 Advanced Estate Planning & Probate course, Dallas attorney Donald Totusek suggested the following provision (giving attribution for its drafting to Dallas attorney William McRae):

**Fiduciary relationship**. I intend that a fiduciary relationship is not created between my Agent and me unless and until my Agent acts under this power of attorney, and then only with respect to those matters on which my Agent acts in accordance with this power of attorney.

# XV. Section 6166—Extension of Time to Pay Tax—Closely Held Business

**A. No refund as to non-deferred estate tax if the estate has made a §6166 election.** In Estate of McNeely v. United States, 2014-1 U.S.T.C. ¶60,679 (D. Minn. 2014), the estate filed for an extension of the filing deadline and made an estimated estate tax payment of $2.5 million. A cover letter noted that the estate expected to make a §6166 election. When the estate tax return was filed making a §6166 election, the estate tax due was $9.13 million, of which only $512,000 was not subject to deferral under §6166. The estate sought a refund of $1,988,000 (the difference between its estimated payment of $2.5 million and the non-deferred estate tax of $512,000).

1. The Service denied the request for a refund, stating that the “overpayment” would be applied to the installments due under §6166, the first of which wasn’t due for five years. The court agreed, and upheld denial of a refund. At the time the estate made the tax payment, it had a net tax liability (the amount of the deferred portion of estate tax). Thus, there was no balance to refund. The Service had the discretion to credit the overpayment to the outstanding tax liability, regardless of the taxpayer’s instructions.

**B. Pro rata transfer of assets from a partnership to LLCs did not unwind §6166 election**. Ltr. Rul. 201403012 involved the pro rata distribution of business assets of a partnership to D’s estate (for which a §6166 election had been made) and another partner, followed by contribution of the assets to separate limited liability companies. After the restructuring, each LLC was owned pro rata by the partner and the estate, and continued the same business activities as before. Because the transaction did not materially alter the business and no withdrawal of money or property occurred, the deferral of tax under §6166 was not affected.

# XVI. Section 6651—Failure To File Return or To Pay Tax

**A.** **Reliance on over-the-hill estate planning attorney results in $1.2 million in late-filing penalties.** While “the factual circumstances are complex and sad,” and “this Court finds it difficult to hold that Plaintiffs are ultimately responsible for Ms. Backsman's malpractice, that is what binding precedent requires.” So said the court in Specht v. United States, 2015-1 U.S.T.C. ¶60,686 (S.D. Ohio 2015). The result was a $1.2 million failure-to-file penalty and $210,600 in interest, along with an estate tax of $3.9 million.

1. T died at age 92 on December 30, 2009, leaving a $12.5 million estate and a will that named T’s cousin, Specht, as executor. Specht, then 73, was a homemaker with a high school education who had never served as an executor, did not own any stock, and had never been in an attorney's office. Specht retained attorney Backsman, who had drafted T’s will, to represent her in administering the estate. Backsman “had over 50 years of experience in estate planning, but unbeknownst to Mrs. Specht, was privately battling brain cancer. Ms. Backsman deceived Mrs. Specht (whether intentionally or unintentionally), as to the status of an extension regarding the filing of the estate's tax returns. That deception eventually led to malpractice claims and the voluntary relinquishment of Ms. Backsman's law license.” A footnote in the opinion notes that Ms. Backsman had since been declared incapacitated and was subject to a guardianship over her person and estate.

a. Backsman discussed with Specht the deadline for filing an estate tax return, and advised Specht that UPS stock would have to be sold to pay estate taxes. Backsman had Specht sign a blank paper that would authorize the sale, but the stock was not sold. Prior to the return deadline, Sprecht received four notices from the Ohio probate court warning her that the estate had missed probate deadlines. When Specht asked Backsman about this, Backsman advised that she would take care of the matter. Notices were received from the Ohio Department of Taxation warning that a state estate tax return had not been filed. Another family that had retained Backsman as attorney for their estate called Specht, warning her that Backsman was incompetent. After receiving these calls, Specht contacted Backsman, who assured her that things were going fine. Bottom line: Specht received several warnings but took no action until November 1, 2010, when she terminated Backsman and hired another attorney. The estate tax return was filed on January 26, 2011—15 months and 26 days after T’s death. The estate brought a malpractice action against Backsman, which was settled.

2. Assessment of the late-filing penalty was affirmed. Specht argued that she lacked the sophistication to single-handedly complete and file the estate tax return, but the court responded that “there is no evidence to suggest that she lacks the sophistication to understand the importance of the estate tax deadline or to ensure that deadline was met.” Under United States v. Boyle, 469 U.S. 241 (1985), "[t]he failure to make a timely filing of a tax return is not excused by the taxpayer's reliance on an agent, and such reliance is not 'reasonable cause' for a late filing under Section 6651(a)(1)…. One does not have to be a tax expert to know that tax returns have fixed filing dates and that taxes must be paid when they are due."

a. The court noted that “in light of Ms. Backman's malpractice, the State of Ohio refunded the late filing and payment penalties for Ohio estate taxes without the Estate filing a refund suit. It is truly unfortunate that the United States did not follow the State of Ohio's lead.”

# XVII. Section 6901—Transferee Liability

**A. Estate of J. Howard Marshall still fomenting litigation, but this time not involving Anna Nicole Smith.** Topless dancer Anna Nicole Smith’s dalliance with and marriage to wheelchair-bound octogenarian J. Howard Marshall, a Texas billionaire, engendered much litigation and problems for J. Howard’s family members in the 1990s. And the litigation isn’t over, as a result of some of J. Howard’s transactions. United States v. Marshall, 771 F.3d 854 (2014), involved three issues: (1) whether donees of gifts had to pay interest on their transferee liability, (2) whether the donee of a gift to a grantor retained income trust was the income beneficiary or the remainderman, and (3) whether a trustee and an executor were personally liable for distributions made prior to the government’s assessment of transferee liability.

Shortly before his death in 1995, J. Howard sold all of his stock in Marshall Petroleum Inc. (“MPI”) back to MPI at below-market value. Extended litigation between J. Howard’s estate and the IRS resulted in three unreported Tax Court decisions that (among other issues) concluded that the bargain sale to MPI resulted in indirect gifts to the other MPI shareholders—J. Howard’s ex-wife Stevens, his son Pierce, Pierce’s wife, and trusts for two grandchildren. (It must *really* have been a bargain sale, because the gifts totaled $83 million!) When J. Howard’s estate refused to pay the resulting gift tax, the government assessed transferee liability against the donees.

1. **Donees must pay interest on amount of unpaid transferee liability**. The parties agreed that the donees were liable for interest attributable to the donor “at least up to the amount of each individual gift.” They disagreed as to whether the government was entitled to interest on the unpaid donee liability. After an extended analysis of the relevant statutes and their legislative history, the court affirmed the district court ruling in favor of the government. Because §6901 imposed personal liability upon transferees, it was appropriate for the government to impose interest with respect to that personal liability. The court chose to follow [Baptiste v. Commissioner, 29 F.3d 1533 (11th Cir. 1994)](http://web2.westlaw.com/find/default.wl?mt=208&db=506&tc=-1&rp=%2ffind%2fdefault.wl&findtype=Y&ordoc=2027868110&serialnum=1994169600&vr=2.0&fn=_top&sv=Split&tf=-1&pbc=5AABA43B&rs=WLW12.04), and not Poinier v. Commissioner, 858 F.2d 917 (3rd Cir. 1988).

2. **Transferee liability imposed on GRIT income beneficiary.** J. Howard’s ex-wife Stevens had received 47,623 shares of MPI stock as part of a divorce settlement. In 1989, Stevens transferred 22,798 shares of those shares to a ten-year grantor retained income trust, with the remainder to pass to her son Pierce. When the government imposed transferee liability against Stevens’ estate (Stevens died in 2007), her estate contended that the tax attributable to the GRIT should be charged against the Pierce’s estate, because Pierce had received the trust corpus when the GRIT terminated in 1999. After an extended analysis, the court concluded that the income beneficiary was the donee for gift tax purposes, and that the remainderman did not share responsibility for the unpaid gift tax.

3. **Executor and trustee personally liable for distributions from the estate and for charitable set-aside after receiving notice of government claim**. Finally, the court held that Pierce as executor of Stevens’ estate and Finley Hilliard as trustee of the Stevens Living Trust were personally liable for distributions that had been made after the Service had given notice that it intended to impose transferee liability on the estate and the trust. The action was based on [31 U.S.C. § 3713](http://web2.westlaw.com/find/default.wl?mt=208&db=1000546&docname=31USCAS3713&rp=%2ffind%2fdefault.wl&findtype=L&ordoc=2027984499&tc=-1&vr=2.0&fn=_top&sv=Split&tf=-1&pbc=A9D9E8BB&rs=WLW12.04), known as the Federal Priority Statute, for distributions by a fiduciary to lower-priority creditors and failure to preserve sufficient funds to pay taxes. The court affirmed the district court’s finding that Pierce and Hilliard should have been aware of the potential liability to the government when the various distributions were made. The court held, however, that Pierce did not breach any fiduciary duty because under Texas law an executor does not owe a fiduciary duty to the estate’s creditors.

**B. Transferee cannot collaterally attack tax assessment against estate**. In United States v. Cowles-Reed, 2014-2 U.S.T.C. ¶60,682 (9th Cir. 2014), D’s gross estate included the entire value of Proctor & Gamble stock held in joint tenancy with his children. When the estate tax was not paid when due, the Service asserted transferee liability. The children collaterally attacked the assessment made against D’s estate, contending that the estate tax should be reduced because of unclaimed administration expense deductions, and that the estate should be excused from late-payment penalties because the failure to pay was due to reasonable cause. No go, said the court. The estate was not a party to this action, and the children were suing in their individual capacities and not in any representative capacity. Third parties may not contest the merits of a tax assessment.

1. One of the children contended that she is not personally liable for the unpaid estate tax because the Service had not made an assessment against her as a transferee under §6901. That is a losing argument, said the court. In an action to impose transferee liability under §6324(a)(2), the Service may rely on the assessment of tax against the estate, and is not required to make an individual assessment under §6901.

**C. Summary judgment: Transferee personally liable without regard to his third-party claim for contribution from estate’s co-beneficiaries**. In United States v. Whisenhunt, 2014 WL 3610792, (N.D. Tex. 2014), the court ruled that there was no reason to delay entry of judgment against an estate beneficiary who was personally liable for the estate’s unpaid penalties and interest. The transferee had filed an action against co-beneficiaries to contribute their pro rata share of the assessed penalties. However, said the court, this was a separate issue, and did not affect the transferee’s personal liability to the extent of distributions he had received from the estate. The facts necessary to determine the co-beneficiaries’ duty to share in the unpaid penalties were separate from the facts necessary to conclude that the transferee was personally liable. The court also noted that the transferee failed to timely raise the issue of whether the executor’s alleged disability may have raised a reasonable cause defense.

# XVIII. Section 7502—Timely Mailing Treated as Timely Filing and Paying

A. **Always use registered or certified mail; OK?** Ltr. Rul. 201442015 involved a request for an extension of time to file Form 8939, making a §1022 election to allocate basis with respect to carryover basis property. (The decedent died in 2010.) The executor contended (with supporting affidavits) that the Form 8939, which had been mailed by regular mail by the estate’s accountant, was lost by the U.S. Postal Service. Sorry, said the Service; no extension. If the accountant had mailed the Form 8939 by registered or certified mail or other designated delivery service, under §7502 the mailing would have constituted prima facie evidence of the filing. Not so with regular mail, however. Because the executor could have easily avoided the problem, failure to make the election was not the result of intervening events beyond the executor’s control.