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48th Annual Midwest Estate, Tax & Business Planning Institute

June 3-4, 2021

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48TH ANNUAL MIDWEST ESTATE TAX & BUSINESS PLANNING INSTITUTE™

Agenda – Day 1

8:30 A.M. **Registration & Coffee**

8:55 A.M. Welcome & Introduction
- *MaryEllen K. Bishop & Jeffrey B. Kolb,* Institute Co-Chairs

9:00 A.M. Recent Developments of Interest to Estate Planners
- *Turney P. Berry & Charles A. Redd*

10:00 A.M. **Coffee Break**

10:15 A.M. Recent Developments of Interest to Estate Planners (continued)
- *Turney P. Berry & Charles A. Redd*

11:15 A.M. Ethics for Estate Planners
- *Margaret M. Christensen*

12:15 P.M. **Lunch Break**

1:15 P.M. Income Tax Issues You Will be Stuck Dealing with (or love) After You Structure Your Estate Plan (The Good, the Bad, and the, You'll Wish You Hadn't Done That)
- *Richard L. Bartholomew*

2:15 P.M. **Break**

2:25 P.M. Anticipating Will Contests and How to Avoid Them
An estate planner must always be on guard when drafting instruments which may supply incentive for someone to contest a will. Anytime an individual would take more through intestacy or under a prior will, the potential for a will contest exists, especially if the estate is large. Although will contests are relatively rare, the prudent attorney must recognize situations which are likely to inspire a will contest and take steps during the drafting stage to reduce the probability of a will contest action and the chances of its success. Prof. Beyer will alert you to the situations increasing the likelihood of a will contest and discuss eighteen prevention techniques.
- *Dr. Gerry W. Beyer*

3:25 P.M. **Break**

3:25 P.M. eWills
Electronic wills are no longer a technique that is futuristic in character – they have arrived! Five states, including Indiana, have e-will statutes in place and the Uniform Electronic Wills Act received approval in July 2019. This presentation will provide you with what you need to know to get ready for e-wills including historical development, workings of the Uniform Electronic Wills Act, existing state variations, and recommendations.
- *Dr. Gerry W. Beyer*

4:35 P.M. **Adjournment**

June 3 - 4, 2021

48TH ANNUAL MIDWEST ESTATE TAX & BUSINESS PLANNING INSTITUTE™

Agenda – Day 2

8:35 A.M. **Welcome & Introduction**
- *MaryEllen K. Bishop & Jeffrey B. Kolb,* Institute Co-Chairs

8:45 A.M. The SECURE ("Setting Every Community Up for Retirement Enhancement" or "Sending Everyone Cowering Under Reduced Expectations") ACT and Other Recent Developments in Estate Planning for Retirement Assets
- *Robert K. Kirkland*

10:15 A.M. Coffee Break

10:30 A.M. Special Needs Trust Update
- *Robert W. Fechtman*

11:30 A.M. Legislative & Case Law Update
- *MaryEllen K. Bishop*

12:15 P.M. Lunch Break

1:15 P.M. Available and Flexible Methods for Signing, Witnessing or Notarizing Indiana Wills, POAs, and Health Care Advance Directives
- *Jeffrey S. Dible*

2:15 P.M. Coffee Break

2:25 P.M. What the Cool Kids are Doing in Estate Planning - The hot techniques planners are talking about with clients these days, including SLATs, long-term GRATs, and using charitable trusts as retirement plan beneficiaries
- *Professor Samuel A. Donaldson*

3:25 P.M. Coffee Break

3:35 P.M. Dealing with Uncle Sam: Everyone's Least Favorite Relative in the Family Business - Income and Estate Tax Planning for Clients with Closely-held Businesses
- *Professor Samuel A. Donaldson*

4:35 P.M. Adjournment

June 3 - 4, 2021

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With nearly four decades of experience in law, MaryEllen represents her clients with focused estate planning, probate, litigation and tax services. She is a Board Certified Indiana Trust and Estate Lawyer.

She is very actively involved in the legal community and holds multiple professional leadership positions. She has also written several professional papers and presented many lectures focusing on the areas of probate, probate and trust litigation and estate planning.

With her passion for meeting new people and learning about their families, MaryEllen helps clients plan for the future and maneuver very difficult times in life.

In her free time, she enjoys spending time with family, gardening, and traveling.

Practice Areas

- Board Certified Indiana Trust and Estate Lawyer (Certified by TESB)
- Business Planning
- Estate and Probate Administration
- Estate Planning
- Individual and Fiduciary Taxation
- Trust Litigation

Education

- Indiana University Robert H. McKinney School of Law, JD- 1982
- Indiana University, Marketing, BS- 1979

Bar Admissions

- Indiana, 1983
- U.S. District Court Northern District of Indiana, 1983
- U.S. District Court Southern District of Indiana, 1983
- U.S. Supreme Court, 1989
- U.S. Tax Court, 1983

Published Works

- •Co-Chair Midwest Estate Tax & Business Planning Institute
- •Indiana Law Survey, 2013-present
- •Recent Legislation and Cases in Estate Planning & Probate, 2004-present
- •What's New in Estate Planning and Administration, 2002-present
- •Basic Will and Trust Drafting
- •The Long and Winding Road to Probate Court

Honors / Awards

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- •Board of Trustees, Indiana University
- •Indiana Super Lawyer in Practice Area of Estate Planning/Trusts
- •Best Lawyers in America in Practice Area of Estates and Trusts and Trust and Estate Litigation
- •Best in Client Satisfaction Wealth Manager, Five Star
- •Master Fellow, Indiana Bar Foundation
- •Distinguished Fellow, Indianapolis Bar Foundation

Professional Affiliations

- •Indiana University Alumni Association, Past International Chair
- •Indiana University Robert H. McKinney School of Law, Past Secretary to the Board of Visitors
- •Indiana University School of Medicine, Past Co-Chair of Planned Giving Committee
- •Indiana University Women's Philanthropy Leadership Counsel
- •Indianapolis Bar Association, Past Chair for Estate Planning and Administration Section
- •Indianapolis Bar Association, Past Vice President to Board of Managers
- •Indiana State Bar Association, Written Publications Committee of Res Gestae, Past Co-Chair
- •Indiana State Bar Association, Probate Review Committee, 2005-present
- •Estate Planning Council of Indianapolis
- •American College of Trust and Estate Council, Fellow

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Richard L. Bartholomew graduated from Indiana University with a BS in Business in 1978 and a JD from Indiana University School of Law in 1981. He joined the firm in 1991 and became a shareholder in 1996. His specialty areas include all areas of tax, estate planning, mergers, acquisitions and spin-off tax consulting, succession planning, continuing education presenter to the AICPA Federal Tax Conference, Indiana Continuing Legal Education Seminars, Annual Tax Symposiums in Minnesota, North Carolina, Ohio and North Dakota and Bisk Continuing Education DVD's distributed nationwide.

Richard has been actively involved in various organizations in the Lafayette community including Community Foundation of Greater Lafayette, Lafayette Rotary Club Foundation, Indiana CPA Society Litigation Services, Westminister Village Foundation, Lafayette Rotary Club,and East Tipp Summer Rec.

Richard has many interests outside of the firm including woodworking (he built all of the cabinets in his house as well as various pieces of furniture), snow skiing, fishing, golf, creating Power Point presentations for weddings and birthdays, drawing and playing with his dog, Zoe.

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Turney Berry is the leader of the Firm's Trusts, Estates & Personal Planning Service Team, he also serves on the Firm's Executive Committee. He concentrates his practice in the areas of estate and business planning, estate and trust administration, and charitable giving and tax-exempt organizations.

Professional Activities and Memberships:

- American College of Trust and Estate Counsel Past Regent
- Past President, ACTEC Foundation
- Member and Past Chair, Charitable and Tax Exempt Organizations Committee; Member and Vice Chair, Estate and Gift Tax Committee; State Laws Committee
- State Chair for Kentucky

National Conference of Commissioners on Uniform State Laws:

- Member, Probate Code Revisions (2008); Principal and Income Act Update (2008); Real Property Transfer on Death Act (2009); Insurable Interests Amendment to the Uniform Trust Code (2010); Premarital and Marital Agreements (2012); Drafting Committee on Trust Decanting (2013); Chair, Drafting Committee on Revised Principal and Income Act (in progress); Chair, Power of Appointment Act (in progress);
Chair, Study Committee on Trust Protectors (in progress); Vice-Chair, Drafting Committee on Divided Trusteeship (in progress)

Member, Advisory Council of the Heckerling Institute on Estate Planning:

- Trustee, Southern Federal Tax Institute
- Fellow, American College of Tax Counsel
- American Bar Association (Taxation and Real Property, Probate & Trust Law Sections) Vice Chair, Charitable Planning

Member, National Association of Estate Planners and Councils

Member, Joint Editorial Board for Trusts and Estates

Member, Advisory Board of Trusts and Estates Monthly

Co-Chair, Midwest/Midsouth Estate Planning Seminar (University of Kentucky)

Adjunct Professor, Vanderbilt University School of Law:

- Estate Planning and Drafting Seminar
- Representing the Family Business, Tax and Non-Tax Aspects
- Estate, Gift and Generation-Skipping Transfer Tax

Adjunct Professor, University of Louisville Brandeis School of Law:

- Estate Planning and Drafting (Non-Tax)

Adjunct Professor, University of Missouri School of Law:

- Representing the Family Business

Legal Advisory Subcommittee, Council on Foundations

Former Articles Editor, The Tax Lawyer

National Committee on Planned Giving (Kentucky Chapter)

Louisville Estate Planning Council

Associate Member, American Association of Life Underwriters

Louisville Bar Association (Sections of Estate Planning and Probate and Taxation)

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EDUCATION

B.A., Summa Cum Laude, Eastern Michigan University (1976)
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LL.M., University of Illinois (1983)
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SELECTED PROFESSIONAL ACTIVITIES

Bar memberships: United States Supreme Court, Texas, Ohio (inactive status), Illinois (inactive status)
Member: American Law Institute; American College of Trust and Estate Counsel (Regent and Academic Fellow); American Bar Foundation; Texas Bar Foundation; Texas State Bar Association
Editor-in-Chief, REPTL Reporter, State Bar of Texas (2013-present)
Keeping Current Probate Editor, *Probate and Property* magazine (1992-present)

CAREER HISTORY

Private Practice, Columbus, Ohio (1980)
Instructor of Law, University of Illinois (1980-81)
Professor, St. Mary's University School of Law (1981-2005)
Governor Preston E. Smith Regent's Professor of Law, Texas Tech University School of Law (2005 – present)
Visiting Professor, Boston College Law School (1992-93)
Visiting Professor, University of New Mexico School of Law (1995)
Visiting Professor, Southern Methodist University School of Law (1997)
Visiting Professor, Santa Clara University School of Law (1999-2000)
Visiting Professor, La Trobe University School of Law (Melbourne, Australia) (2008 & 2010)
Visiting Professor, The Ohio State University Moritz College of Law (2012)
Visiting Professor (virtual), Boston University School of Law (2014 & 2016)
Visiting Professor (virtual), University of Illinois College of Law (2017)

SELECTED HONORS

Order of the Coif
Estate Planning Hall of Fame, National Association of Estate Planners & Councils (2015)
ABA Journal Blawg 100 Hall of Fame (2015)
Outstanding Professor Award – Phi Alpha Delta (Texas Tech Univ.) (2016) (2015) (2013) (2010) (2009) (2007) (2006)
Excellence in Writing Awards, American Bar Association, Probate & Property (2012, 2001, & 1993)
President's Academic Achievement Award, Texas Tech University (2015)
Outstanding Researcher from the School of Law, Texas Tech University (2017 & 2013)
Chancellor's Council Distinguished Teaching Award (Texas Tech University) (2010)
President's Excellence in Teaching Award (Texas Tech University) (2007)
Professor of the Year – Phi Delta Phi (St. Mary's University chapter) (1988) (2005)
Student Bar Association Professor of the Year Award – St. Mary's University (2001-2002) (2002-2003)
Russell W. Galloway Professor of the Year Award – Santa Clara University (2000)
Distinguished Faculty Award – St. Mary's University Alumni Association (1988)
Most Outstanding Third Year Class Professor – St. Mary's University (1982)
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SELECTED PUBLICATIONS

WILLS, TRUSTS, AND ESTATES: EXAMPLES AND EXPLANATIONS (7th ed. 2019); FAT CATS AND LUCKY DOGS – HOW TO LEAVE (SOME OF) YOUR ESTATE TO YOUR PET (2010); TEACHING MATERIALS ON ESTATE PLANNING (4th ed. 2013); 9 & 10 TEXAS LAW OF WILLS (Texas Practice 2020); TEXAS WILLS, TRUSTS, AND ESTATES (2018); 12, 12A, & 12B WEST'S TEXAS FORMS — ADMINISTRATION OF DECEDENTS' ESTATES AND GUARDIAN-SHIPS (4th ed. 2019); *When You Pass on, Don't Leave the Passwords Behind: Planning for Digital Assets*, PROB. & PROP., Jan./Feb. 2012, at 40; *Wills Contests – Prediction and Prevention*, 4 EST. PLAN. & COMM. PROP. L.J. 1 (2011); *Digital Wills: Has the Time Come for Wills to Join the Digital Revolution?*, 33 OHIO N.U.L. REV. 865 (2007); *Pet Animals: What Happens When Their Humans Die?*, 40 SANTA CLARA L. REV. 617 (2000); *Ante-Mortem Probate: A Viable Alternative*, 43 ARK. L. REV. 131 (1990).

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Meg Christensen concentrates her practice on three main areas of law: lawyer ethics, appeals and business litigation. Since 2017, she has served as co-chair for Dentons Bingham Greenebaum's Recruiting Committee.

Her focus includes:
- Ethics – Meg has represented lawyers in all stages of the disciplinary process pending before the Indiana Supreme Court. Additionally, she has represented other professionals in front of various state licensing boards, and the IRS Office of Professional Responsibility.
- Appellate – Meg brings a fresh perspective to identifying and analyzing issues on appeal. Meg's experience includes representing clients in the appellate phase of complex business disputes, contract and insurance coverage disputes, and shareholder liability.
- Business Litigation – Meg assists clients in litigation in both state and federal courts in claims involving multi-million dollar contract disputes, shareholder liability, enforcement of employee restrictive covenants, inter-governmental disputes, unfair competition claims, dissolutions, administrative enforcement and licensing. She is experienced in media law issues including defamation defense, reputation management, and social media harms. Meg also represents the media in pursuing access to public records and enforcing open door laws.
- Meg's clients are primarily concerned about the impact their legal disputes will have on their business or personal lives. Recognizing that litigation introduces uncertainty into her client's plans, Meg prides herself in clearly communicating with clients about the practical effect of various strategies. Meg's goal is to help busy clients focus on what they do best while she works to present their strongest arguments in pursuit of the best possible result.
- Between the Indiana State Bar Association (ISBA), the Indiana Continuing Legal Education Forum (ICLEF) and Association of Professional Responsibility Lawyers (APRL), Meg presents on ethics at over a dozen continuing legal education seminars each year. As part of ISBA's Ethics Committee, she considers and issues advisory opinions, recommends rule changes and facilitates lawyer education events. Meg is an active member of the APRL and devotes her time to researching trends in disciplinary enforcement and lawyer ethics.
- In her free time, Meg enjoys cooking, hosting dinner parties, and attending yoga or barre class. She's an avid NPR listener, loves old homes and house rehabs and attending camp with her two children. She has a vested interest in voting advocacy and once served as a member of the United Nations Election Protection Delegation, monitoring the polls in El Salvador's National Election.

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Jeffrey S. Dible

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Jeff has frequently testified before legislative committees of the Indiana General Assembly regarding trust and estate law reform legislation and (in 2011 and 2012) inheritance tax repeal. In 2017 and early 2018, he was the chairperson of an ISBA Task Force that drafted the "electronic wills, trusts and POAs" legislation, which the General Assembly enacted in 2018 as P.L. 40-2018 (House Enrolled Act 1303). He also participated extensively in the drafting of 2021 Indiana legislation enacted to update signing and witnessing requirements for wills (House Enrolled Act 1255) and to overhaul Indiana's health care advance directive statutes (Senate Enrolled Act 204), and he testified in favor of both bills before their passage.

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Biography:
Before joining the Georgia State Law faculty in 2012, Samuel A. Donaldson, professor of law was at the University of Washington School of Law for 13 years. During his tenure at the University of Washington, he was a five-time recipient of the Philip A. Trautman Professor of the Year award from the law school's Student Bar Association. He served for two years as an associate dean for academic administration and six years as the director of the law school's graduate program in taxation.

Donaldson teaches a number of tax and estate planning courses, as well as courses in the areas of property, commercial law and professional responsibility.

Donaldson is an academic fellow of the American College of Trust and Estate Counsel and a member of the Bar in Washington, Oregon, and Arizona. Among his scholarly works, Donaldson is a co-author of the popular West casebook, Federal Income Tax: A Contemporary Approach, and a co-author of the Price on Contemporary Estate Planning treatise published by Wolters Kluwer.

He has served as the Harry R. Horrow Visiting Professor of International Law at Northwestern University and a visiting assistant professor at the University of Florida Levin College of Law.

Donaldson, an amateur crossword constructor's puzzles have been published in The New York Times, The Los Angeles Times, The Washington Post, The Wall Street Journal and other outlets.

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ROBERT W. FECHTMAN, JD, CELA

Robert Fechtman is a life-long resident of Indiana. He graduated from Northwestern University with a degree in music and a major in economics, and he received his JD from Rutgers School of Law. He also attended the University of San Diego's Institute on International and Comparative Law at Magdalen College, Oxford University. In 6th and 7th grade, Mr. Fechtman went away to school to sing with the American Boychoir in Princeton, New Jersey.

Mr. Fechtman focuses his practice on the problems of older and disabled persons, particularly special needs trusts, estate planning and trusts, health law, Medicaid planning, guardianships and decedents' estates. He is a frequent writer and speaker on a variety of estate planning, disability and elder law topics. He has been certified as an elder law attorney by the National Elder Law Foundation.

Mr. Fechtman is a member of the National Academy of Elder Law Attorneys, and he is a two-time Past President of the Indiana Chapter of the National Academy of Elder Law Attorneys. He is a member and a Past President of the Special Needs Alliance, which is a national, non-profit, invitation-only network of lawyers dedicated to disability and public benefits law. He is also a member of the Elder Law Section and the Probate, Real Property and Trusts Section of the Indiana State Bar Association, and a member of the Indianapolis Bar Association. Mr. Fechtman is a sustaining member of the Indiana Trial Lawyers Association. He is currently serving on the Boards of Directors of the National Elder Law Foundation, which is the accrediting organization for elder law attorneys, and of the Indianapolis Bar Association Estate Planning and Administration Section Executive Council, and the current President of the Board of The Indianapolis Children's Choir.

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Bob Kirkland is Managing Partner of the law firm of Kirkland Woods & Martinsen LLP, which has offices in Liberty, Missouri, Springfield, Missouri and Overland Park, Kansas. He is licensed to practice law in Missouri and Kansas. He works with a variety of individual clients, handling the preparation of Wills, Living Trusts, Durable Powers of Attorney, Irrevocable Trusts, Charitable Trusts and Minorâ€™s Trusts, and counseling clients in the areas of gifting techniques, asset protection, charitable planning and business succession planning. He also advises fiduciaries in estate, conservatorship and trust administration matters.

Mr. Kirkland is a Fellow of the American College of Trust and Estate Counsel ("ACTEC"), is a past Missouri State Chair of ACTEC, and a past member of the ACTEC Board of Regents and ACTEC Executive Committee. He is also a member of the Employee Benefits Committee, Sponsorship Advisory Committee (Chair), Digital Property Task Force, Membership Selection Committee, Long Range Planning Committee, and Communications Committee of ACTEC. He is listed in the last twenty (20) editions of The Best Lawyers in America and the most recent additions of Super Lawyers. Mr. Kirkland has successfully completed the Effective Probate Mediation Training course sponsored by ACTEC, and frequently serves as a mediator of trust and estate disputes.

Bob also served as the ACTEC Observer to the Uniform Law Commission Drafting Committee on Fiduciary Access to Digital Assets, is serving as the ACTEC Observer to the Uniform Law Commission Drafting Committee on Electronic Wills.

Among several professional and civic activities, Mr. Kirkland serves as a Vice Chair of the Missouri Bar Probate and Trust Committee, and a member of the editorial board of Trusts and Estates magazine.

Mr. Kirkland is a frequent author and lecturer in the estate planning and charitable giving areas. He has lectured on a variety of topics at seminars sponsored by ACTEC, The Heckerling Institute, ALI-CLE, Society of Trust and Estate Practitioners, The Missouri Bar, The Kansas Bar Association, The Oklahoma Bar Association, the Hawaii Tax Institute, the Southern Federal Tax Institute, the Notre Dame Estate Planning Institute, the Duke University Estate Planning Conference, the Florida Fellows Institute, the UCLA Institute on Estate Planning, The MO-KAN Trust Conference, the American Heart Association, and the Estate Planning Councils of Greenville, New York City, Baltimore, Louisville, Philadelphia and St. Louis.

Mr. Kirkland holds a B.S. in accounting from William Jewell College (1980), a J.D. from the University of Missouri-Kansas City School of Law (1983), and an L.L.M. in estate planning from the University of Miami, Florida School of Law (1985). During his tenure at the UMKC School of Law, he served as Managing Editor of the UMKC Law Review.

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CHARLES A. REDD

Charles A. Redd is a partner in the St. Louis, Missouri, office of the law firm of STINSON LLP. Mr. Redd concentrates his practice in estate planning, estate and trust administration and estate and trust-related litigation. Prior to joining Stinson, Mr. Redd was a partner in and Vice Chairman of the Trusts & Estates Practice Group at the law firm of SNR Denton US LLP (now Dentons US LLP). Mr. Redd was also previously a partner in the law firm of Armstrong, Teasdale, Schlafly & Davis (now Armstrong Teasdale LLP) and was Chairman of that firm's Trusts & Estates Department. He was previously employed as a Trust Administrator by First Wisconsin Trust Company (now U.S. Bank, N.A.), Milwaukee, Wisconsin, and as an Assistant Counsel by Centerre Trust Company of St. Louis (now Bank of America Private Bank).

Mr. Redd has extensive experience and expertise in: (a) the drafting of wills, trust instruments, durable powers of attorney, marital agreements and other estate planning documents; (b) pre- and post-death tax planning for individuals, trusts and estates; (c) preparation and filing of estate tax returns, gift tax returns and fiduciary income tax returns; (d) representation and filing of estate tax returns, gift tax returns and fiduciary income tax returns; (e) representation of individual and corporate fiduciaries and (f) litigation in the Probate Division and other equity divisions of the Circuit Court. Mr. Redd has worked on estates and estate planning projects, some involving assets valued at over a billion dollars, and has successfully handled numerous estate tax, gift tax and generation-skipping transfer tax matters, will and trust construction cases, will contests, contests of trust agreements, alleged breach of fiduciary duty cases and other types of cases involving estates and trusts.

Mr. Redd is a member of the State Bar of Wisconsin, The Missouri Bar, the Illinois State Bar Association, The Bar Association of Metropolitan St. Louis and the Estate Planning Council of St. Louis.

Mr. Redd was Chairman of the Missouri Bar's Health Care Durable Power of Attorney Subcommittee, and he played a significant role in the drafting and enactment of the Missouri Durable Power of Attorney for Health Care Act. In 1991, Mr. Redd received The Missouri Bar President's Award. Mr. Redd was the principal draftsman of the Missouri Family Trust Company Act.

Mr. Redd is an elected member of The American Law Institute and a Fellow of The American College of Trust and Estate Counsel (Past Missouri State Chair; Past Regent; Past Chair of Communications Committee; Estate and Gift Tax Committee; and Fiduciary Litigation Committee). He was an adjunct professor of law (Estate Planning) at Northwestern University School of Law for fifteen years. He serves as Co-Chair of the Editorial Advisory Board of, and writes a regular column in, TRUSTS & ESTATES magazine. In 2018, he was inducted into the Estate Planning Hall of Fame® by the National Association of Estate Planners and Councils. Mr. Redd is listed in The Best Lawyers in America and is "Band 1" ranked by Chambers and Partners in their High Net Worth guide. He frequently writes and lectures nationally on topics in the trusts and estates field.

* * * * * * * * *

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Section One

NOTABLE DEVELOPMENTS OF INTEREST TO ESTATE PLANNERS

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Section One

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NOTABLE DEVELOPMENTS OF INTEREST TO ESTATE PLANNERS

PART 1 – TAX REFORM PROVIDES SIGNIFICANT CHANGES FOR ESTATE PLANNERS

On December 22, 2017 was enacted "An Act To Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," Pub. L. No. 115-97, ("2017 Tax Act"). The 2017 Tax Act makes significant income tax changes, the effects of which will not really be understood for some time, particularly after regulations are issued. The major transfer tax change is the doubling of the wealth transfer exclusion.

A. Effective Date and Sunset

Most provisions in the 2017 Tax Act became effective January 1, 2018. Except with respect to the change in the calculation of inflation adjustments, many of the changes to business taxes and other changes, discussed below, many of the provisions of the 2017 Tax Act will sunset on January 1, 2026 and the law in effect on December 31, 2017 will become effective again, unless legislation is enacted altering this sunset.

B. New Basic Exclusion Amounts for Estate and Gift Taxes and New Generation-Skipping Transfer Exemption and Clawback

For estate and gift tax purposes, the 2017 Tax Act increased the basic exclusion amount under section 2010(c)(3) to $10 million as adjusted for inflation with a 2010 base year (the same base year as under prior law). Thus, the basic exclusion amount for 2021 for gift and estate tax purposes, and the generation-skipping transfer ("GST") exemption amount under section 2631(c), is $11,700,000. Under the current applicable exclusion amount, the number of decedent's estates subject to federal estate tax may only reach a few thousand, and taxpayers have the ability to make larger gifts during their lives free of gift tax. Just as important, taxpayers with less than the exclusion amount may transfer assets among themselves in order to include assets in the estate of a taxpayer most likely to die soonest. This creates enormous basis planning opportunities.

On November 26, 2019, final clawback regulations were issued (§20.2010-1(c)). T.D. 9884. In a nutshell, the regulations take the positions that (1) donors who paid gift tax on gifts prior to 2017 in excess of the original basic exclusion amount can make up to $5 million of gifts in 2018-2025 which will be protected from tax by the additional basic exclusion amount and (2) donors who die after 2025 and who made gifts in 2018-2025 that were protected from gift tax by the additional basic exclusion amount will be able to preserve the additional basic exclusion amount used against those gifts when their estate taxes are determined. So there is no "clawback" but in order to preserve the additional basic exclusion amount, a gift will have to be made. In other words, a donor who makes only a $5 million gifts before 2025 and dies after 2025 will not benefit from the additional exclusion.

Suppose the first spouse dies before 2026 and portability is elected. The surviving spouse may use the full unused exclusion amount of the first spouse, even after January 1, 2026. Examples 3 and 4 of the final regulations state:

(iii) Example 3. Individual B's predeceased spouse, C, died before 2026, at a time when the basic exclusion amount was $11.4 million. C had made no taxable gifts and had no taxable estate. C's executor elected, pursuant to §20.2010-2, to allow B to take into account C's $11.4 million DSUE amount. B made no taxable gifts and did not remarry. The basic exclusion amount on B's date of death is $6.8 million. Because the total of the amounts allowable as a credit in computing the gift tax payable on B's post-1976 gifts attributable to the basic exclusion amount (zero) is less than the credit based on the basic exclusion amount allowable on B's date of death, this paragraph (c) does not apply. The credit to be applied for purposes of computing B's estate tax is based on B's $18.2 million applicable exclusion amount, consisting of the $6.8 million basic exclusion amount on B's date of death plus the $11.4 million DSUE amount, subject to the limitation of section 2010(d).

(iv) Example 4. Assume the facts are the same as in Example 3 of paragraph (c)(2)(iii) of this section except that, after C's death and before 2026, B makes taxable gifts of $14 million in a year when the basic exclusion amount is $12 million. B is considered to apply the DSUE amount to the gifts before applying B's basic exclusion amount. The amount allowable as a credit in computing the gift tax payable on B's post-1976 gifts for that year ($5,545,800) is the tax on $14 million, consisting of $11.4 million in DSUE amount and $2.6 million in basic exclusion amount. This basic exclusion amount is 18.6 percent of the $14 million exclusion amount allocable to those gifts, with the result that $1,031,519 (0.186 x $5,545,800) of the amount allowable as a credit for that year in computing gift tax payable is based solely on the basic exclusion amount. The amount allowable as a credit based solely on the basic exclusion amount for purposes of computing B's estate tax ($2,665,800) is the tax on the $6.8 million basic exclusion amount on B's date of death. Because the portion of the credit allowable in computing the gift tax payable on B's post-1976 gifts based solely on the basic exclusion amount ($1,031,519) is less than the credit based solely on the basic exclusion amount ($2,665,800) allowable on B's date of death, this paragraph (c) does not apply. The credit to be applied for purposes of computing B's estate tax is based on B's $18.2 million applicable exclusion amount, consisting of the $6.8 million basic exclusion amount on B's date of death plus the $11.4 million DSUE amount, subject to the limitation of section 2010(d).

The Preamble also has an odd "warning" styled an Anti-abuse Rule which states:

6. Anti-abuse Rule

A commenter recommended consideration of an anti-abuse provision to prevent the application of the special rule to transfers made during the increased BEA period that are not true inter vivos transfers, but rather are treated as testamentary transfers for transfer tax purposes. Examples include transfers subject to a retained life estate or other retained powers or interests, and certain transfers within the purview of chapter 14 of subtitle B of the Code. The purpose of the special rule is to ensure that bona fide inter vivos transfers are not subject to inconsistent treatment for estate tax purposes. Arguably, the possibility of inconsistent treatment does not arise with regard to transfers that are treated as part of the gross estate for estate tax purposes, rather than as adjusted taxable gifts. An anti-abuse

> provision could except from the application of the special rule transfers where value is included in the donor's gross estate at death. Although the Treasury Department and the IRS agree that such a provision is within the scope of the regulatory authority granted in section 2001(g)(2), such an anti-abuse provision would benefit from prior notice and comment. Accordingly, this issue will be reserved to allow further consideration of this comment.

Chapter 14 has certain deemed valuation rules for preferred partnerships that could fall within the scope of this reservation. Other areas of concern would be gifts with retained income interests – those use current exclusion as completed gifts but require subsequent estate income so that the donor gets a basis step-up at death; consider a common-law GRIT for instance.

The 2017 Tax Act did not change the transfer tax rates. The regulations dealing with clawback do not mention GST because, the Preamble states, GST is beyond the scope of the project. However, the Preamble also notes that nothing in the statute indicates that sunset would affect allocation of GST exemption when available.. The Blue Book stated that during 2018-2025 additional GST exemption was available. Presumably Treasury does not believe that exemption disappears once allocated.

C. Inflation Adjustments

All provisions in the Code that provide amounts subject to indexing for inflation will use the chained consumer price index for all urban consumers ("C-CPI-U" or "Chained Consumer Price Index"). Section 1(f)(6); 2017 Tax Act § 11002. This inflation adjustment method is a permanent change to the Code. The use of the Chained Consumer Price Index will result in slower growth of inflation and a slower increase in basic exclusion amount than the prior method, the Consumer Price Index for all Urban Consumers, or CPI-U. It will also cause more taxpayers to be in higher tax brackets over time which is a partial undoing of the effects of ERTA from 1981.

D. Miscellaneous Itemized Deductions.

Miscellaneous itemized deductions subject to the 2% floor under Section 67(a)-(b) are suspended. Section 67(g).

Because many states base their income tax calculation on federal taxable income, the elimination of many itemized deductions due to Section 67(g) will increase state income taxes for many individuals, trusts and estates as well. Some states have attempted to recast those deductions as charitable contributions. To date, those efforts have failed. In fact, those efforts have done affirmative harm. Previously, the IRS took the position that a state tax credit received for a charitable contribution would not reduce the donor's income tax deduction. See CCA201105010. But the IRS has a new position now: a tax credit is a quid pro quo. TD 9864 (June 11, 2019). The Preamble explains:

> The new limitation, and the resulting efforts by states and taxpayers to devise alternate means for deducting the disallowed portion of their state and local taxes, has generated increased interest in the question of whether a state or local tax

> credit should be treated as a return benefit – a quid pro quo – when received in return for making a payment or transfer to an entity described in section 170(c). The Treasury Department and the IRS did not publish formal guidance on this question before the enactment of the limitation under section 164(b)(6). In 2010, however, the IRS Chief Counsel advised that, under certain circumstances, a taxpayer may take a deduction under section 170 for the full amount of a contribution made in exchange for a state tax credit, without subtracting the value of the credit received in return. See CCA 201105010 (Oct. 27, 2010) ("the 2010 CCA"). IRS Chief Counsel has also taken the position in Tax Court litigation that the amount of a state or local tax credit that reduces a tax liability is not an accession to wealth includible in income under section 61 or an amount realized for purposes of section 1001. In these cases, the Tax Court agreed with the Chief Counsel's position. See, for example, Maines v. Commissioner, 144 T.C. 123, 134 (2015); Tempel v. Commissioner, 136 T.C. 341, 351-54 (2011); aff'd sub nom. Esgar Corp. v. Commissioner, 744 F.3d 648 (10th Cir. 2014).
>
> Upon reviewing the authorities under section 170, the Treasury Department and the IRS questioned the reasoning of the 2010 CCA. On June 11, 2018, the Treasury Department and the IRS issued Notice 2018-54, 2018-24 I.R.B. 750, announcing the intention to propose regulations addressing the federal income tax treatment of contributions pursuant to state and local tax credit programs. On August 27, 2018, the proposed regulations (REG-112176-18) were published in the **Federal Register** (83 FR 43563).
>
> The proposed regulations generally stated that if a taxpayer makes a payment or transfers property to or for the use of an entity listed in section 170(c), and the taxpayer receives or expects to receive a state or local tax credit in return for such payment, the tax credit constitutes a return benefit, or quid pro quo, to the taxpayer and reduces the taxpayer's charitable contribution deduction. The proposed regulations included a separate rule for state and local tax deductions, providing that they do not constitute a quid pro quo unless they exceed the amount of the donor's payment or transfer. The proposed regulations also included an exception under which a state or local tax credit is not treated as a quid pro quo if the credit does not exceed 15 percent of the taxpayer's payment or 15 percent of the fair market value of the property transferred by the taxpayer. Finally, the proposed regulations would amend §1.642(c)-3 to provide similar rules for payments made for a purpose specified in section 170(c) by a trust or decedent's estate.
>
> The Treasury Department and the IRS received over 7,700 comments responding to the proposed regulations and 25 requests to speak at the public hearing, which was held on November 5, 2018. Copies of written comments received and the list of speakers at the public hearing are available for public inspection at www.regulations.gov or upon request. The comments and revisions are discussed generally in this preamble. After considering the comments received and the concerns expressed at the public hearing, the Treasury Department and the IRS adopt the proposed regulations with certain revisions explained subsequently.

Suppose Congress repeals the SALT cap. Will Treasury reverse its position, again?

Note that the cap does not include expenses of an estate or trust not subject to the 2% floor under section 67(e). Expenses of an estate or trust are not subject to the 2% floor if such expenses would not have been incurred if the property were not held in a trust or estate. Thus, executor and trustee fees and attorney's fees related to trust and estate administration should continue to be deductible.

The income tax deduction for estate tax attributable to income in respect of a decedent under section 691(c) was not altered by the 2017 Tax Act.

Section 642(h)(2) states that on termination of an estate or trust any deductions (other than the estate or trust exemption and other than the charitable deduction) for the estate or trust in excess of gross income are allowable as deductions to the beneficiaries. This deduction is eliminated due the suspension of miscellaneous itemized deductions for individuals under section 67(g). Beneficiaries may still claim a trust or estate's net operating losses or capital loss carryovers upon trust or estate termination under section 642(h)(1). The IRS and Treasury have issued generally taxpayer-friendly regulations dealing with section 67(g). T.D. 9918. The summary states:

> This document contains final regulations clarifying that the following deductions allowed to an estate or non-grantor trust are not miscellaneous itemized deductions: Costs paid or incurred in connection with the administration of an estate or non-grantor trust that would not have been incurred if the property were not held in the estate or trust, the personal exemption of an estate or non-grantor trust, the distribution deduction for trusts distributing current income, and the distribution deduction for estates and trusts accumulating income. Therefore, these deductions are not affected by the suspension of the deductibility of miscellaneous itemized deductions for taxable years beginning after December 31, 2017, and before January 1, 2026. The final regulations also provide guidance on determining the character, amount, and allocation of deductions in excess of gross income succeeded to by a beneficiary on the termination of an estate or non-grantor trust. The final regulations affect estates, non-grantor trusts (including the S portion of an electing small business trust), and their beneficiaries.

The final regulations amend Treas. Reg. §1.67-4(a), <u>Costs paid or incurred by estates or non-grantor trusts</u> to read as follows:

> (a) Deductions — (1) Section 67(e) deductions — (i) In general. An estate or trust (including the S portion of an electing small business trust) not described in § 1.67-2T(g)(1)(i) (a non-grantor trust) must compute its adjusted gross income in the same manner as an individual, except that the following deductions (section 67(e) deductions) are allowed in arriving at adjusted gross income:
>
> (A) Costs that are paid or incurred in connection with the administration of the estate or trust that would not have been incurred if the property were not held in such estate or trust; and
>
> (B) Deductions allowable under section 642(b) (relating to the personal exemption) and sections 651 and 661 (relating to distributions).
>
> (ii) Not disallowed under section 67(g). Section 67(e) deductions are not itemized deductions under section 63(d) and are not miscellaneous itemized deductions under section 67(b). Therefore, section 67(e) deductions are not disallowed under section 67(g).
>
> (2) Deductions subject to 2-percent floor. A cost is not a section 67(e) deduction and thus is subject to both the 2-percent floor in section 67(a) and section 67(g) to the extent that it is included in the definition of miscellaneous itemized deductions under section 67(b), is incurred by an estate or non-grantor trust (including the S

portion of an electing small business trust), and commonly or customarily would be incurred by a hypothetical individual holding the same property.

The most interesting aspect of the final regulations is the ability to pass out unused deductions when an estate or trust terminates. The Summary to the final regulations stated as follows:

1. In General

Section 642(h) provides that if, on the termination of an estate or trust, the estate or trust has: (1) A net operating loss carryover under section 172 or a capital loss carryover under section 1212, or (2) for the last taxable year of the estate or trust, deductions (other than the deductions allowed under section 642(b) (relating to the personal exemption) or section 642(c) (relating to charitable contributions)) in excess of gross income for such year, then such carryover or excess will be allowed as a deduction, in accordance with the regulations prescribed by the Secretary of the Treasury or his delegate (Secretary), to the beneficiaries succeeding to the property of the estate or trust.

Section 1.642(h)-2(a), as articulated in the proposed regulations and these final regulations, provides that if, on termination of an estate or trust, the estate or trust has for its last taxable year deductions (other than the deductions allowed under section 642(b) or section 642(c)) in excess of gross income, the excess deductions are allowed under section 642(h)(2) as items of deduction to the beneficiaries succeeding to the property of the terminated estate or trust.

2. Character and Amount of Excess Deductions

Section 1.642(h)-2(b)(1) of the proposed regulations provides that each deduction comprising the excess deductions under section 642(h)(2) retains, in the hands of the beneficiary, its character (specifically, as allowable in arriving at adjusted gross income, as a non-miscellaneous itemized deduction, or as a miscellaneous itemized deduction) while in the estate or trust. The character of these deductions does not change when succeeded to by a beneficiary on termination of the estate or trust. Furthermore, an item of deduction succeeded to by a beneficiary remains subject to any limitation applicable under the Code in the computation of the beneficiary's tax liability.

The final regulations contain two examples explaining the operation of these rules:

§ 1.642(h)-5 Examples.

Paragraphs (a) and (b) of this section (Examples 1 and 2) illustrate the application of section 642(h).

(a) Example 1: Computations under section 642(h) when an estate has a net operating loss—(1) Facts. On January 31, 2020, A dies leaving a will that provides for the distribution of all of A's estate equally to B and an existing trust for C. The period of administration of the estate terminates on December 31, 2020, at which time all the property of the estate is distributed to B and the trust. For tax purposes, B and the trust report income on a calendar year basis. During the period of administration, the estate has the following items of income and deductions:

Table 1 to Paragraph (a)(1)

Income:		
Taxable interest	$2,500	
Business income	3,000	
Total income		5,500

Table 2 to Paragraph (a)(1)

Deductions:		
Business expenses (including administrative expense allocable to business income)	5,000	
Administrative expenses not allocable to business income that would not have been incurred if property had not been held in a trust or estate (section 67(e) deductions)	9,800	
Total deductions		14,800

(2) Computation of net operating loss. (i) The amount of the net operating loss carryover is computed as follows:

Table 3 to Paragraph (a)(2)(i)

Gross income		$5,500	
Total deductions	14,800		
Less adjustment under section 172(d)(4) (allowable non-business expenses ($9,800) Limited to non-business income ($2,500))	7,300		
Deductions as adjusted		7,500	
Net operating loss			2,000

(ii) Under section 642(h)(1), B and the trust are each allocated $1,000 of the $2,000 unused net operating loss carryover of the terminated estate in 2020, with the allowance of any net operating loss carryover to B and the trust determined under section 172. Neither B nor the trust can carry back any of the net operating loss of A's estate made available to them under section 642(h)(1). See § 1.642(h)-1(b).

(3) Section 642(h)(2) excess deductions. The $7,300 of non-business deductions not taken into account in determining the net operating loss of the estate are excess deductions on termination of the estate under section 642(h)(2). Under § 1.642(h)-2(b)(1), such deductions retain their character as section 67(e) deductions. Under § 1.642(h)-4, B and the trust each are allocated $3,650 of excess deductions based on B's and the trust's respective shares of the burden of each cost.

(4) Consequences for C. The net operating loss carryover and excess deductions are not allowable directly to C, the trust beneficiary. To the extent the distributable net income of the trust is reduced by the net operating loss carryover and excess deductions, however, C may receive an indirect benefit from the carryover and excess deductions.

(b) Example 2: Computations under section 642(h)(2)—(1) Facts. D dies in 2019 leaving an estate of which the residuary legatees are E (75%) and F (25%). The estate's income and deductions in its final year are as follows:

Table 4 to Paragraph (b)(1)

Income:			
Dividends		$3,000	
Taxable Interest		500	
Rent		2,000	
Capital Gain		1,000	
Total Income			6,500

Table 5 to Paragraph (b)(1)

Deductions:			
Section 62(a)(4) deductions:			
Rental real estate expenses		2,000	
Section 67(e) deductions:			
Probate fees	1,500		
Estate tax preparation fees	8,000		
Legal fees	2,500		
Total Section 67(e) deductions		12,000	
Non-miscellaneous itemized deductions:			
Personal property taxes		3,500	
Total deductions			17,500

(2) Determination of character. Pursuant to § 1.642(h)-2(b)(2), the character and amount of the excess deductions is determined by allocating the deductions among the estate's items of income as provided under § 1.652(b)-3. Under § 1.652(b)-3(a), the $2,000 of rental real estate expenses is allocated to the $2,000 of rental income. In the exercise of the executor's discretion pursuant to § 1.652(b)-3(b), D's executor allocates $3,500 of personal property taxes and $1,000 of section 67(e) deductions to the remaining income. As a result, the excess deductions on termination of the estate are $11,000, all consisting of section 67(e) deductions.

(3) Allocations among beneficiaries. Pursuant to § 1.642(h)-4, the excess deductions are allocated in accordance with E's (75 percent) and F's (25 percent) interests in the residuary estate. E's share of the excess deductions is $8,250, all consisting of section 67(e) deductions. F's share of the excess deductions is $2,750, also all consisting of section 67(e) deductions.

(4) Separate statement. If the executor instead allocated $4,500 of section 67(e) deductions to the remaining income of the estate, the excess deductions on termination of the estate would be $11,000, consisting of $7,500 of section 67(e) deductions and $3,500 of personal property taxes. The non-miscellaneous itemized deduction for personal property taxes may be subject to limitation on the returns of both B and C's trust under section 164(b)(6)(B) and would have to be separately stated as provided in § 1.642(h)-2(b)(1).

Example 2 above was criticized as it appeared in the proposed regulations which resulted in the modification:

> Section § 1.642(h)-5(b), Example 2, of the proposed regulations (Example 2) demonstrates computations under section 642(h)(2). The expenses in Example 2 include rental real estate taxes in an attempt to illustrate a deduction subject to limitation under section 164(b)(6) to the beneficiary that must be separately stated as provided in § 1.642(h)-2(b)(1).
>
> Multiple commenters noted that Example 2 raises several issues that could be potentially relevant to that example, such as whether the decedent was in a trade or business and the application of section 469 to estates and trusts. To avoid these issues, which are extraneous to the point being illustrated, one commenter suggested that the example be revised so that the entire amount of real estate expenses on rental property equals the amount of rental income. The Treasury Department and the IRS did not intend to raise such issues in the example and consider both issues to be outside the scope of these regulations. Accordingly, the Treasury Department and the IRS adopt the suggestion by the commenter and modify Example 2 to avoid these issues by having rental real estate expenses entirely offset rental income with no unused deduction.
>
> Commenters also noted that Example 2 does not properly allocate rental real estate expenses because the example characterizes the rental real estate taxes as itemized deductions. These commenters asserted that real estate taxes on property held for the production of rental income are not itemized deductions but instead are allowed in computing gross income and cited to section 62(a)(4) as providing that ordinary and necessary expenses paid or incurred during the taxable year for the management, conservation, or maintenance of property held for the production of income under section 212(2) that are attributable to property held for the production of rents are deductible as above-the-line deductions in arriving at adjusted gross income. One commenter suggested that, if the goal of Example 2 is to illustrate state and local taxes passing through to the beneficiary, then the example should include state income taxes rather than real estate taxes on rental real estate. The Treasury Department and the IRS have revised this example in the final regulations to include personal property tax paid by the trust rather than taxes attributable to rental real estate.
>
> Lastly, commenters noted that Example 2 does not demonstrate the broad range of trustee discretion in § 1.652(b)-3(b) and (d) for deductions that are not directly attributable to a class of income, or deductions that are, but which exceed such class of income, respectively. In response to these comments, the Treasury Department and the IRS have modified Example 2 to illustrate the application of trustee discretion as found in § 1.652(b)-3(b) and (d).

Section 643(f) provides that, for purposes of subchapter J of the Code (§§ 641-685), pursuant to regulations, two or more trusts shall be treated as one trust if: (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries and (2) a principal purpose of such trust is the avoidance of the income tax. For purposes of section 643(f), spouses shall be treated as one person. No regulations have been issued under this subsection.

E. **Divorce – Income Tax**.

The 2017 Tax Act repealed section 682, which provided that if one spouse created a grantor trust for the benefit of the other spouse and the spouses divorced, thereafter the trust income would not be taxed to the grantor spouse to the extent of any income that the donee-spouse is entitled to receive. These changes are effective for divorce decrees and separation agreements entered into after 2018. Thus, taxpayers seeking a divorce during 2018 will likely benefit if the divorce is finalized before the end of the calendar year. Modifications entered into after 2018 are subject to the 2017 Tax Act if the modification expressly states that this provision of 2017 Tax Act applies. 2017 Tax Act § 11051(c)(2). No sunset applies to the repeal of the above provisions regarding alimony and separate maintenance payments and section 682. The IRS intends to issue regulations regarding the application of section 682 before its repeal is effective. Notice 2018-37. In the Notice, the IRS requested comments on whether guidance is needed regarding the application of sections 672(e)(1)(A), 674(d), and 677 following a divorce or separation in light of the repeal of section 682.

In light of the repeal of section 682, sections 672(e)(1)(A), 674(a) and 677(a) may have the effect of triggering grantor trust status due to the non-grantor spouse's powers over a trust even after the spouses divorce. Section 672(e)(1)(A) provides that the grantor of a trust shall be treated as holding any power or interest in such trust held by any individual who was the spouse of the grantor at the time of the creation of such power or interest. Section 674(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the trust assets is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party. However, section 674(d) provides that section 674(a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a Trustee or Trustees, none of whom is the grantor or spouse living with the grantor, to distribute, apportion or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, if such power is limited by a reasonably definite external standard that is set forth in the trust instrument. Section 677(a) provides that the grantor of a trust shall be treated as the owner of any portion of a trust, whether or not the grantor is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor or the grantor's spouse, or held or accumulated for future distribution to the grantor or the grantor's spouse.

F. **Basis of Life Insurance Policies.**

For purposes of life settlements of life insurance policies, the 2017 Tax Act provides that a taxpayer's basis in a life insurance policy is not reduced by the cost of insurance. This provision reverses the IRS's position, stated in Rev. Rul. 2009-13 that a taxpayer's basis does include such charges. Accordingly, the IRS has issued Rev. Rul. 2020-05 which revises the examples to reflect the change.

New reporting requirements are imposed for life settlements. Section 6050Y. The transfer for value rules are excluded from life settlements. Section 101(a)(2). These provisions do not sunset after 2025.

PART 2 – IS MORE TAX REFORM ON THE WAY?

On March 1, 2021, the Senate has a majority derived from the Vice-President's power to break tie votes. The existing filibuster rules remain because a majority of current senators dread minority status more than they enjoy majority status; that is, by nature they prefer to block what they perceive as awful more than they hope to enact what they think is likely to improve things a little. For purposes of "hammering the rich" this suggests no retroactivity and small rather than grand steps, on wealth transfer taxes. Might the applicable exclusion be reduced sooner than January 1, 2026? Sure, although that would be a largely cosmetic step; the increase is already in budget projections so the additional revenue would be that from 2022-2025, a mere four years. Might it be reduced below the "sunset" level? Perhaps – it was $3.5 million not very long ago (2009). The Tax Policy Center (www.taxpolicycenter.org) projects that a restoration of the 2009 estate tax ($3.5 million, no indexing, 45% rate) would subject 0.65% of estates taxable by 2030 and raise $67.2 billion, versus making the current rules permanent which would tax 0.10% of estates and raise $22.3 billion. One could imagine a principle that we would not have a generally applicable tax unless it applied to at least 1% of taxpayers. Congress is not in the principles business but such in this instance would lead to an interesting discussion: apply the estate tax more broadly or repeal it?

What of other suggestions. Wealth taxes are the current rage – a rare instance of US political figures who generally admire European leadership not liking what they have done, which is reject wealth taxes – because it would generate "instant" revenue. Some supporters of such taxes are in the Biden administration. Over the long expanse of history wealth taxes generally are imposed when a country stares in the face of war. Accordingly other approaches may be more likely.

Ending the step-up in basis seems like an obvious move if it contains provisions to "protect" those who do not pay estate tax now. A benefit of reducing the applicable exclusion is that it would reduce the number of taxpayers who feel entitled to both no estate tax and a step-up, so that the step-up could then be eliminated with less cost. At least theoretically. Other proposals such as imposing the estate tax on assets held in grantor trusts (a Sanders proposal) seem like long-shots. What about having capital gains realized at death? That perhaps is not quite as long a long-shot but at this point the proposals are hardly thought through enough to consider in any detail.

Lawyers in high-cost areas like New York and Washington have long proclaimed that at low enough tax rates taxpayers will pay taxes rather than tax lawyers. In most of the country the cost of tax planning is so inexpensive that rates are irrelevant to the planning decision. A rate of 40% or 45% is not foreordained for the estate tax; within the last generation the marginal rate was as high as 60%. A return to graduated rates, perhaps steeply, could be perceived as striking a blow against "the rich." Similarly, on the income tax side steeply graduated rates could yield interesting results – both budget and sociological – if Congress were willing. Suppose there were no step-up in basis but there were a lower capital gains rate if assets were sold within two years of a decedent's death. Such innovation would require creativity and where creativity might come from is unclear.

An increase in the capital gains rate seems likely. Accordingly, selling before the increase is desirable if a sale is to occur anyway. For assets in trust there is an easy solution. Suppose the assets are in trust 1. Trust 2 is created, that is not a grantor trust with respect to trust 1 but that has similar beneficiaries, albeit not identical terms with trust 1.. A distribution is made from trust 1 to trust 2 "on behalf of" the beneficiaries. This may require an amendment of trust 1. Under section 643(e) an election may be made AFTER the end of 2021 (when we know whether the capital gains rates went up in 2021 or not). Section 643(e) provides:

(e) TREATMENT OF PROPERTY DISTRIBUTED IN KIND

(1) BASIS OF BENEFICIARY. The basis of any property received by a beneficiary in a distribution from an estate or trust shall be—

(A) the adjusted basis of such property in the hands of the estate or trust immediately before the distribution, adjusted for

(B) any gain or loss recognized to the estate or trust on the distribution.

(2) AMOUNT OF DISTRIBUTION. In the case of any distribution of property (other than cash), the amount taken into account under sections 661(a)(2) and 662(a)(2) shall be the lesser of—

(A) the basis of such property in the hands of the beneficiary (as determined under paragraph (1)), or

(B) the fair market value of such property.

(3) ELECTION TO RECOGNIZE GAIN

(A) In general. In the case of any distribution of property (other than cash) to which an election under this paragraph applies—

(i) paragraph (2) shall not apply,

(ii) gain or loss shall be recognized by the estate or trust in the same manner as if such property had been sold to the distributee at its fair market value, and

(iii) the amount taken into account under sections 661(a)(2) and 662(a)(2) shall be the fair market value of such property.

(B) Election. Any election under this paragraph shall apply to all distributions made by the estate or trust during a taxable year and shall be made on the return of such estate or trust for such taxable year.

Any such election, once made, may be revoked only with the consent of the Secretary.

(4) EXCEPTION FOR DISTRIBUTIONS DESCRIBED IN SECTION 663(a). This subsection shall not apply to any distribution described in section 663(a).

The following chart describes the major features of the proposals thusfar (as of May 15, 2021).

POSSIBLE 2021 FEDERAL TAX LEGISLATION OF INTEREST TO ESTATE PLANNERS

	STEP Act[1] (Discussion Draft) Sen. Van Hollen, et al.[2] March 29, 2021	For the 99.5% Act S. 994 Sen. Sanders, et al.[3] March 25, 2021	H.R. 2286 Rep. Pascrell March 29, 2021	American Families Plan President Biden April 28, 2021
Transfer Tax Rates		45% up to $10 million 50% up to $50 million 55% up to $1 billion 65% at and over $1 billion		45% (informally floated during campaign and NOT part of American Families Plan)
Transfer Tax Exemptions		$3.5 million for estate tax and GST tax $1 million for gift tax		$3.5 million for estate tax (informally floated during campaign and NOT part of American Families Plan)
Income Tax Rates				39.6% ordinary income top rate; 39.6% LTCG rate if household income $1 million or more
Valuation		No discounts for non-business assets inside entity; no entity-level discounts if transferor, transferee and family have control or majority ownership unless entity is actively traded		
Basis Adjustment At Death		Not for assets held in decedent's grantor trust that's not included in decedent's gross estate		Not for gains of over $1 million (single) or $2.5 million (spouses); exemptions for family-owned businesses and farms if family continues to operate
Deemed Sale Rules	Gifted assets deemed sold for FMV; assets held at death deemed sold for FMV (LTCG tax deductible for estate tax purposes);		Gifted assets deemed sold for FMV; assets held at death deemed sold for FMV; above rules don't apply to "ordinary" TPP or to	

[1] The "Sensible Taxation and Equity Promotion Act."

[2] In addition to Senator Van Hollen, Senators Booker, Sanders, Whitehouse and Warren signed on to the STEP discussion draft.

[3] In addition to Senator Sanders, Senators Gillibrand, Whitehouse, Van Hollen and Reed signed on to the For the 99.5% Act.

	STEP Act[1] (Discussion Draft) Sen. Van Hollen, et al.[2] March 29, 2021	For the 99.5% Act S. 994 Sen. Sanders, et al.[3] March 25, 2021	H.R. 2286 Rep. Pascrell March 29, 2021	American Families Plan President Biden April 28, 2021
	above rules don't apply to "ordinary" TPP or to assets passing to spouse, QTIP trust, charity, trust for charity or grantor trust includable in gross estate; all assets held in trust (other than in an excepted trust) deemed sold for FMV every 21 years (or on 12/31/26 if trust created before 2006); assets in grantor trust deemed sold for FMV – **if**: • Assets are distributed; • Grantor trust status ceases; or • Includability in gross estate ceases Appraisal costs income tax deductible; no underpayment of estimated tax penalties for tax arising from deemed sales at death; 6166-type deferral possible for up to 15 years; $100,000 indexed) lifetime exclusion of gain; $1 million (indexed) exclusion of gain at death (reduced by amount of lifetime exclusion used)		assets passing to spouse, QDOT trust the entirety of which spouse can appoint, charity or grantor trust includable in gross estate; certain trust modifications and decantings would be deemed sales for FMV; assets held 30 years in trust (other than in an excepted trust) deemed sold for FMV every 30 years (or on 01/01/22 if then already held 30 years); assets in grantor trust deemed sold for FMV – **if**: • Assets are distributed; • Grantor trust status ceases; or • Includability in gross estate ceases 6166-type deferral possible for up to 7 years; $1 million (indexed after 2022) exclusion of net capital gain; annual exclusion gifts also excluded	
GRATs		Minimum term 10 years; maximum term 10 years plus life expectancy; $500,000 or 25% minimum remainder interest at outset; no decrease in annuity payment amount during term		

	STEP Act[1] (Discussion Draft) Sen. Van Hollen, et al.[2] March 29, 2021	For the 99.5% Act S. 994 Sen. Sanders, et al.[3] March 25, 2021	H.R. 2286 Rep. Pascrell March 29, 2021	American Families Plan President Biden April 28, 2021
Treatment of Grantor Trusts		Included in gross estate; distributions are gifts; cessation of grantor trust status is gift – **if**: • Grantor is deemed owner; or • Non-grantor is deemed owner and engages in sale or exchange with trust		
GST Exemption		Allocation to trust lasts for 50 years from date of trust creation or date of statute's enactment		
Annual Exclusion Gifts		**Per donor** limit of double annual exclusion amount – **if**: • Gift in trust; • Gift of pass-through entity interest; or • Gifted asset can't be sold or liquidated immediately		
Reporting to IRS	Annual full accounting; names, addresses and EINs of grantor, Trustee and all beneficiaries – **if** trust: • Is over $1 million; **or** • Has over $20,000 in gross income		Name and EIN of transferee of asset(s) along with asset description(s), basis and FMV; basis and FMV also to be reported to recipient	
Effective Date(s)	Deaths and transfers after 12/31/**20**	Various	Deaths and transfers after 12/31/21	

PART 3 – ESTATE PLANNING PRACTICE IN 2018 AND BEYOND

I. WHERE WE ARE TODAY

A. New Planning Approaches

1. Given the large Applicable Exclusion Amount, it becomes clear that for many even traditional clients the estate tax has disappeared as an issue. This could change depending on political developments and is to change anyway on January 1, 2026; many clients are under $24 million but above $12 million.

2. As 2026 approaches, absent change, we will be faced with enormous pressure to enable clients to make gifts to use the soon to exercise basis exemption amount. Laying the groundwork today for such a possibility seems wise.

3. Estate planners will focus more of the tax planning for clients on the income tax, rather than the transfer taxes. In particular, it is likely estate planning will focus on tax basis planning and maximizing the "step-up" in basis at death.

4. Because the "step-up" in basis may come at little or no transfer tax cost, estate planners will seek to force estate tax inclusion in the future.

5. The state of residence of the client and his or her beneficiaries will greatly affect the estate plan. In other words, if a client is domiciled in California, and his or her beneficiaries living in California, then dying with the assets may be the extent of the tax planning. On the other hand, if the beneficiaries live in a state like Texas that has no state income tax, then transferring the assets out of the estate during the lifetime of the client may be warranted. As a result, estate planners will need to ask clients two questions that, in the past, did not significantly matter: (a) Where are you likely to be domiciled at your death? and (b) Naturally, at your death, your children, grandchildren, and other beneficiaries will be lovingly at your bedside, but where are they likely to be domiciled then?

Another example of the importance of domicile can be seen in Shaffer v. Commissioner of Revenue, 148 N.E.3d 1197 (Ma. 2020), in which the first spouse to die did so domiciled in New York leaving a QTIP trust for the survivor who later died domiciled in Massachusetts in 2011. Massachusetts had an estate tax based on the size of the federal estate, which included the QTIP assets. The estate argued no Massachusetts QTIP election had been made but the court determined that was not relevant here. The estate also argued that the estate tax was unconstitutional when applied in this manner. The court concluded that the state could tax transfers of property rights and that the decedent's right in the QTIP transferred to the remainder beneficiaries at her death. The US Supreme Court declined to hear the case.

B. **Portability Planning**

1. Portability, at least in theory, can provide additional capacity for the surviving spouse's estate to benefit from a "step-up" in basis with little or no transfer tax costs. The extent to which portability is being used is uncertain. The 2017 IRS statistical data showed only 681 nontaxable portability returns filed.

2. In traditional by-pass trust planning, upon the death an individual who has a surviving spouse, assets of the estate equal in value to the decedent's unused Applicable Exclusion Amount fund a trust (typically for the benefit of the surviving spouse and, perhaps, descendants). The trust is structured to avoid estate tax inclusion at the surviving spouse's estate. The marital deduction portion is funded with any assets in excess of the unused Applicable Exclusion Amount. The by-pass trust avoids estate tax inclusion at the surviving spouse's estate. From an income tax standpoint, however, the assets in the by-pass trust do not receive a "step-up" in basis upon the death of the surviving spouse. Furthermore, while the assets remain in the by-pass trust, any undistributed taxable income above minimal amounts will be subject to the highest income tax rates at the trust level.

3. In portability planning, the decedent's estate would typically pass to the surviving spouse under the marital deduction, and the DSUE Amount would be added to the surviving spouse's Applicable Exclusion Amount. Because all of the assets passing from the decedent to the surviving spouse in addition to the spouse's own asset will be subject to estate taxes at his or her death, the assets will receive a "step-up" in basis. Additional income tax benefits might be achieved if the assets that would otherwise have funded the by-pass trust are taxed to the surviving spouse, possibly benefiting from being taxed a lower marginal income tax bracket. In addition, if the by-pass trust would have been subject to a high state income tax burden, having the assets taxed to a surviving spouse who moves to a low or no income tax state would provide additional income tax savings over traditional by-pass trust planning.

4. Of course, there are other considerations, including creditor protection, "next spouse" issues and potential "Medicaid" planning, which would favor by-pass trust planning. From a tax standpoint, the trade-off is the potential estate tax savings of traditional by-pass trust planning against the potential income tax savings of portability planning. Because the DSUE Amount does not grow with the cost-of-living index, very large estates will benefit more with traditional by-pass trust planning because all of the assets, including any appreciation after the decedent's death, will pass free of transfer taxes. On the other hand, smaller but still significant estates should consider portability as an option because the combined exclusions -- the DSUE Amount frozen but the surviving spouse's Applicable Exclusion Amount growing with the cost-of-living index -- is likely to allow the assets to pass at the surviving spouse's death with a full step-up in basis with little or no transfer tax costs (unless the assets are subject to significant state death taxes at that time).

Estates where a surviving spouse may need to qualify for government assistance should consider a modified by-pass trust type planning; the trust for the surviving spouse is designed specifically with governmental assistance in mind. For example, perhaps a child or other person should be allowed to terminate the spouse's interest in the trust

(or otherwise modify it). Consider a trust "for" the surviving spouse in which the descendants are beneficiaries. A trusted child or other person could have a lifetime special power of appointment in favor of anyone; that power would be exercised every month, quarter, or year in favor of the spouse until that was inappropriate. The spouse would say accurately that no trusts were for his or her benefit. For Medicaid purposes, trusts under Will are favored over trust agreements.

5. In evaluating the income tax savings of portability planning, planners will want to consider that even for very large estates, the surviving spouse has the option of using the DSUE Amount by making a taxable gift to a grantor trust. The DSUE Amount is applied against a surviving spouse's taxable gift first before reducing the surviving spouse's Applicable Exclusion Amount (referred to as the basic exclusion amount). The grantor trust would provide the same estate tax benefits as the by-pass trust, but the assets would be taxed to the surviving spouse as a grantor trust thus allowing the trust assets to appreciate out of the surviving spouse's estate without being burdened by income taxes. If the assets appreciate, then this essentially solves the problem of the DSUE Amount being frozen in value. Moreover, the grantor trust likely provides for a power to exchange assets of equivalent value with the surviving spouse who can exchange high basis assets for low basis assets of the grantor trust prior to death and essentially effectuate a "step-up" in basis for the assets in the grantor trust.

6. Although a "step-up" in basis is great in theory, no tax will be saved if there is a loss at the time of death resulting in a "step-down" in basis or the asset is income in respect of a decedent (IRD). Furthermore, even if the assets receive a "step-up" in basis, will anyone benefit? Many assets, like family-owned businesses, may never be sold or may be sold so far in the future that the benefit of a step-up is attenuated. On the other hand, if the asset that receives a "step-up" in basis is either depreciable or depletable under the Code, the deductions that arise do result in tax benefits to the owners of that asset. Similarly, an increase in the tax basis of an interest in a partnership or in S corporation shares may not provide immediate tax benefits, but they do allow additional capacity of the partner or shareholder to receive tax free distributions from the entity. These concepts and how certain assets benefit or don't benefit from the basis adjustment at death are discussed in more detail below.

7. Portability planning is slightly less appealing to couples in community property states because, as discussed below, all community property gets a "step-up" in basis on the first spouse's death. Thus, the need for additional transfer tax exclusion in order to benefit from a subsequent "step-up" in basis is less crucial. This is not true, however, for assets that are depreciable (commercial real property) or depletable (mineral interests). As discussed below, these types of assets will receive a "step-up" in basis but over time, the basis of the asset will be reduced by the ongoing depreciation deductions. As such, even in community property states, if there are significant depreciable or depletable assets, portability should be considered.

II. OBTAINING AND RETAINING BASIS

A. Generally

1. As discussed above, estate planning will increasingly focus on the income tax savings resulting from the "step-up" in basis. Estate planners will seek to maximizing the "step-up" up in basis by ensuring that the assets that are includible in the estate of a decedent are the type of assets that will:

a. Benefit from a "step-up" (avoiding the inclusion cash or property that has a basis greater than fair market value)

b. Benefit the most from the "step-up" (for example, very low basis assets, collectibles, and "negative basis" assets); and

c. Provide significant income tax benefits to the beneficiaries (assets are likely to be sold in a taxable transaction after "step-up" or depreciable/depletable assets giving rise to ongoing income tax deductions).

2. In addition to the foregoing, estate planners will increasingly seek to:

a. Maximize the value of certain assets because the step-up" in basis is based on fair market value (rather than trying to reduce the value for transfer tax purposes); and

b. Intentionally create estate tax inclusion, especially if the decedent lives in a state with no state death tax and if the decedent has significant unused Available Exclusion Amount above his or her assets.

B. Swapping Assets with Existing Grantor Trusts

1. Many individuals have made significant taxable gifts, using all or a significant portion of their Available Exclusion Amounts. Many of those gifts were made to grantor trusts.

2. A common power used to achieve grantor trust status for the grantor trust is one described under section 675(4)(C), namely giving the grantor, the power, in a non-fiduciary capacity, to reacquire the trust corpus by substituting other property of an equivalent value. For income tax purposes, transactions between the grantor and the grantor trust will be disregarded. As such, grantors may exercise the power to swap high basis assets for low basis assets without jeopardizing the estate tax includibility of the assets and without having a taxable transaction for income tax purposes.

3. To maximize the benefits of the swap power, it must be exercised as assets appreciate or are sold over time. When exercised properly, this can ensure that only those assets that benefit the most from the step-up will be subject to estate inclusion.

a. If grantor does not have sufficient other assets, repurchase will be difficult - although the donor could borrow cash from a third party. What are the results if cash is borrowed by the grantor, the grantor buys assets from the trust, the trust loans the cash back to the grantor, the grantor pays back the third party lender and, at death, the grantor's estate satisfies the note to the trust with assets having fair market value basis?

b. The income tax consequences if a note is used to repurchase property are uncertain because the trust's basis in note may equal grantor's original carryover basis in the asset given to the trust and now reacquired so paying off the note may generate gain). In other words, if grantor trust status terminates because the grantor dies, and the trust owns a note from the grantor – now the grantor's estate – the note likely does not receive a step-up in basis so when the estate pays it off the trust will have gain.

c. Because the sudden or unexpected death of the grantor may make a repurchase difficult or impossible, estate planners may want to consider drafting "standby" purchase instruments to facilitate fast implementation of repurchase.

C. Should Valuation Discounts Be Undone?

1. Where assets have been divided among generations to create discounts, consideration should be given to undoing those arrangements if the effect is to depress the value of an estate below the amount of Available Exemption Amount in order to increase the income tax basis of the assets.

2. Discount entities could be dissolved or restated to allow the parties to the entity to withdraw.

a. An option could be given to a parent allowing the sale of the parent's interest to a child or children for undiscounted fair market value at death. Giving such an option to a parent would be a gift unless accompanied by adequate and full consideration.

b. If undivided interests in property are owned, agreements could be entered into that require all generations to consent to the sale of the property as one tract if any one owner wanted to sell. Quite obviously such agreements may be contrary to other estate planning or ownership goals of the family.

c. The ability of the IRS to ignore provisions of an agreement that increase the value of assets in the hands of a parent, but not in the hands of a child, is uncertain. By its literal terms, section 2703 of the Code applies only to provisions that reduce value and to restrictions on the right to sell or use property. To illustrate, in Estate of James A. Elkins, Jr., et al. v. Commissioner, 140 T.C. No. 5 (2013), the Tax Court applied section 2703 to ignore a family co-tenancy agreement requiring all owners of fractional interests in art to agree before the art could be sold. The purpose of that agreement was to limit the marketability of a fractional interest.

But what might the effect on value be of an agreement which provided, instead, that any fractional owner could compel the sale of the entire asset? Similarly, a provision that allowed a shareholder in business to put stock to the business at death for fair market value would seem to be outside the scope of the section. In many instances, amending old agreements to include such provisions will be more likely to create gift from the younger owners to the older than would terminating an old agreement and creating a new one.

D. Powers of Appointment For Basis Purposes

1. Generally

a. Consideration should be given to using a "circumscribed general power" that has the following characteristics: (1) a testamentary power, (2) in favor of the creditor of the powerholder's estate, (3) with the consent of a non-adverse party, (4) only over assets with a fair market value in excess of basis, and (5) capped such that the amount subject to the power when added to the other assets of the powerholder produces a total that is $1,000 less than the powerholder's Basic Exclusion Amount.

b. The rights of creditors to property over which a powerholder has a testamentary general power is worth considering. The majority view at common law is that the powerholder of a power, conferred on the powerholder by another, is treated as the beneficial owner of the appointive property for purposes of creditors' rights only if (1) the power is general *and* (2) the powerholder exercises the power. No distinction is made between a testamentary and a presently exercisable power. Creditors of a powerholder of a *non*general power, on the other hand, cannot reach the appointive assets even if the power was effectively exercised. The theory is that the donor who creates a nongeneral power did not intend to benefit the powerholder.

When the powerholder of a general power exercises the power by will, the view that the appointed property is treated as if it were owned by the powerholder means that the creditors of the powerholder's estate can reach the appointed property for the payment of their claims. See, e.g., Clapp v. Ingraham, 126 Mass. 200 (1879). The rule prevails even if this is contrary to the expressed wishes of the donor of the power. See, e.g., State Street Trust Co. v. Kissel, 19 N.E.2d 25 (Mass. 1939).

The exercise of the power by will does not confer actual beneficial ownership of the appointive assets on the powerholder for all purposes. The assets do not ordinarily become part of the powerholder's probate estate. Thus, in terms of priority, the powerholder's own estate assets are ordinarily used first to pay estate debts, so that the appointive assets are used only to the extent the powerholder's probate estate is insufficient.

Under the majority view at common law, the powerholder's creditors can reach the appointive assets only to the extent the powerholder's exercise was an *effective* exercise. A few states, however, follow the view that even an ineffective exercise entitles the powerholder's creditors to reach the appointive assets. See, e.g., Estate of Breault, 211 N.E.2d 424 (Ill. App. Ct. 1965). Moreover, even in states adhering to the majority view, an ineffective exercise can

sometimes "capture" the appointive assets for the powerholder's estate, in which case the appointive assets become part of the powerholder's probate estate for all purposes, including creditors' rights.

When the powerholder of a general power makes an inter vivos appointment, treating the appointed assets as if they were owned by the powerholder does not automatically mean that the powerholder's creditors can subject the appointed assets to the payment of their claims. If the appointment is in favor of a *creditor*, the powerholder's other, unsatisfied creditors can reach the appointed assets only by having the appointment avoided as a "preference" in bankruptcy proceedings. Apart from bankruptcy, the powerholder can choose to pay one creditor rather than another with his or her owned assets, and the same is true with respect to appointive assets. If the appointment is in favor of a *volunteer* (i.e., the appointment is gratuitous), the powerholder's creditors can reach the appointed assets only if the transfer is the equivalent of a fraudulent transfer under applicable state law.

In a minority of jurisdictions, the powerholder of a general power, conferred on him or her by another, is *not* treated as the owner of the appointive property even if the power is exercised. See, e.g., St. Matthews Bank v. DeCharette, 83 S.W.2d 471 (Ky. 1935). Of course, if the powerholder exercises the power in favor of himself or herself or his or her estate, the appointed property becomes owned in the technical sense, and creditors even in states adhering to the minority view would be able to subject the assets to the payment of their claims to the same extent as other property owned beneficially by the powerholder. A few states have enacted legislation that affect the rights of the powerholder's creditors. The legislation is not uniform. Some of the legislation expands the rights of the powerholder's creditors and some contracts them.

The Uniform Powers of Appointment Act takes the following position. If the power is conferred by another, the rights of the powerholder's creditors depend on whether the power is general or nongeneral. If the power is general, the appointive property is subject to a claim of (1) a creditor of the powerholder, to the extent the powerholder's property is insufficient, if the power is presently exercisable (whether or not actually exercised), and (2) a creditor of the powerholder's estate, to the extent the estate is insufficient, subject to the right of a decedent to direct the source from which liabilities are paid. See Uniform Act §502. If the power is nongeneral, the general rule is that creditors have no rights in the appointive property. See Uniform Act §504(a). Some states (including Kentucky) have reversed this rule when adopting the act.

2. Power of Appointment Not Subject to Fiduciary Standard. In In re Estate of Zucker, 2015 WL 5254061 (Pa. Superior Ct. 2015), decedent's wife, Syma, exercised a power of appointment in favor of two of three children. The third, Wendy, objected claiming:

> Wendy alleged that Syma's appointment was not a proper exercise of the power as it was done "in bad faith, based on hate and malice toward Wendy, contrary to [the Decedent's] intent to benefit his issue equally (absent a good faith reason to the contrary) and the duty imposed on Syma to act in good faith when exercising a testamentary power imposed by Pennsylvania law."

The court disagreed, declining even to impose a good faith standard. The opinion states:

> We have reviewed the language contained in Decedent's will and in the codicil to Syma's will in which she directed that the principal contained in the marital trust be divided into two trusts for the benefit of Scott and Karyn and their issue. We have also reviewed the case law provided by the parties and the orphans' court. We conclude that none of the cases, in which challenges to the exercise of the power of appointment were raised, direct that the appointments must be made in good faith. Rather, we state again that a donee's duty is to the donor and the donee must exercise that power within the donor's established conditions. Moreover, the donee has the right to select some of the potential appointees to the exclusion of others. See Estate of Kohler, 344 A.2d at 472. No duty of good faith has been established. Therefore, we conclude that the orphans' court's grant of Scott and Karyn's motion for judgment on the pleadings was proper. The orphans' court did not commit an error of law.

The court notes that Syma was not the trustee. Does that matter? Suppose she had been; her exercise of a testamentary power of appointment would seem to occur after service as trustee ended. May a trustee exercise an inter vivos power without following a fiduciary standard?

The California Court of Appeals held in Tubbs v. Berkowitz, 47 Cal.App.5th 548 (Cal.App. 2020), that where a surviving spouse is named both as trustee of a marital trust and is given a lifetime general power of appointment over the marital trust assets, the surviving spouse could exercise the nonfiduciary power of appointment even while serving as trustee. The opinion states:

> A trustee "has a duty to administer the trust according to the trust instrument ...." (§ 16000.) A trustee also only has the powers conferred by the trust instrument and the powers conferred by statute, unless limited by the trust instrument. (§ 16200.) Here, the very language of the Marital Trust allowed Berkowitz to act in his capacity as the surviving spouse (not the trustee) and designate himself as the recipient of the Trust assets. The Marital Trust then required the trustee to distribute the assets to any person designated by the surviving spouse, including the surviving spouse himself. Thus, under the plain terms of the Marital Trust, Berkowitz (acting as the trustee) was required to transfer the assets once he exercised the power of appointment in his favor. He could not possibly have breached any fiduciary duties by doing something that was expressly authorized and required under the terms of the Marital Trust. (*Hearst v. Ganzi* (2006) 145 Cal.App.4th 1195, 1207-1208, 52 Cal.Rptr.3d 473 [trustees did not breach their fiduciary duties where their actions were explicitly authorized by the trust].)
>
> Finally, we note that Berkowitz's exercise of his power of appointment would have been unobjectionable if he had resigned as trustee before exercising the power. In that scenario, the successor trustee (Tubbs) would have been required to transfer the assets to Berkowitz once he exercised the power of appointment in his favor. Tubbs claims "those are not the facts before this Court," but we see no reason why the result should be different where Berkowitz was both the donee and the trustee who had no discretion but to follow the terms of the power of appointment.

No authority is cited on the point (either way).

To the contrary is Peterson v. Peterson, 835 S.E.2d 651 (Ga. App. 2019), a much litigated matter whose facts were described as follows:

> Charles Hugh Peterson died testate in 1994 and was survived by his wife, Mary, and their three sons Alex, David, and Calhoun. Mr. Peterson's will, which was probated in 1995, created two testamentary trusts: a marital trust for the primary benefit of Mary, and a residual "by-pass" trust for the benefit of Mary and the couple's three sons. Mary and her three sons were each designated a co-executor of the will and a co-trustee of both the marital and by-pass trusts. Item 5 of Mr. Peterson's will created a marital trust for Mary, while Item 6 created a by-pass trust for Mary and their three sons. The relevant portion of the will creating the terms of the by-pass trust reads as follows:
>
>> Trustees shall hold and manage the property in this trust and ... may encroach on such part of the principal thereof as the Trustees may deem necessary to provide for the support in reasonable comfort of my wife and to provide for the proper support and education of my descendants[.] To the extent practicable, however, I request the Trustees in making encroachment for the benefit of my wife to encroach first on any trust created for my wife ... before encroaching on this trust for my wife[.]
>>
>> My primary desire is that my wife be supported in reasonable comfort during her lifetime and that my children be supported in reasonable comfort during their lives; my secondary desire is that the principal of this trust be preserved as well as possible consonant with the consummation of my primary objective[.]
>>
>> [My wife] shall have no power to appoint [trust] property to herself, to her estate, to her creditors, or to the creditors of her estate.
>
> * * *
>
> Sometime after the will was probated, a dispute arose between the co-executors and co-trustees over the administration of the estate and the by-pass trust, pitting Mary and Calhoun against Alex and David. Alex and David filed petitions for accounting and damages for breach of duties as executors and trustees against Mary and Calhoun, and sought the removal of Mary and Calhoun as executors and trustees in probate court. Mary and Calhoun each moved for summary judgment on all claims, and the superior court granted their motions. Alex and David appealed those rulings.
>
> In the first appearance of this case before this Court, we reversed the trial court's grant of summary judgment to Calhoun in an unpublished opinion. See *Peterson I*. One month later, the Supreme Court of Georgia in *Peterson II* reversed the trial court's grant of summary judgment to Mary for similar reasons. Both cases held that material issues of fact remained with respect to Appellees' failure to fully fund the trusts at issue in the case and whether Appellees wasted assets. See *Peterson I*, slip op. at pp. 7-8, 10; *Peterson II*, 303 Ga. at 215-217 (3), 811 S.E.2d 309.

The trial court had held that Mary did not owe the other beneficiaries a fiduciary duty when exercising the power of appointment. Mary cited a Connecticut case, <u>Connecticut Bank & Trust Co. v. Lyman</u>, 170 A.2d 130 (Conn. 1961) but the Georgia court noted in <u>Lyman</u> the powerholder was not a trustee. The Georgia Court of Appeals went the other way, deciding Mary <u>did</u> have a fiduciary duty:

> In the present case, the potentiality of conflicts of interests with respect to Mary's requests for conveyance of all property in the by-pass trust to Calhoun is well

> documented in the litany of litigation that has transcended decades among the co-trustees and co-beneficiaries. As we find no law which could excuse Mary from her fiduciary duty under the trust, even if acting solely as a beneficiary under the trust, we find that the trial court erred in concluding that Mary could act exclusively in her capacity as a beneficiary of both trusts in exercising her appointment power to convey trust assets.

Having a power exercised when the powerholder is a trustee (or perhaps an advisor) is perilous.

Because the holder of a power of appointment is not a fiduciary, the holder of a lifetime power may have his or her actions attributed to a grantor or beneficiary. In the 1970s two cases dealing with the Goodwyn family established the principle that if a trust agreement prohibited the grantor from acting as de facto trustee the mere fact that the grantor did in fact act as de facto trustee would not established a retained interest under section 2036, Estate of Goodwyn, T. C. Memo. 1973-153, nor a power for the grantor trust provisions of sections 671ff, Estate of Goodwyn v. Commissioner, T.C. Memo. 1976-238.

> Under the terms of the deeds creating these trusts, the trustees were granted broad discretionary powers with respect to both the distribution of income to the beneficiaries and the investment and management of the corpus of the trusts. Notwithstanding the designation of Richards and Russell as trustees, it further appears that at all times from the establishment of the trusts until his last illness, the decedent exercised complete control with respect to the purchase and sale of trust assets, investment of any proceeds, and the determination of the amounts, if any, to be distributed to the respective beneficiaries.
>
> The assets of the various trusts, together with other trusts, as well as property owned by the decedent, were accounted for by a single set of records maintained in the offices of the decedent. Except for the Federal income tax returns prepared and filed by the decedent on behalf of the various trusts, no separate records were maintained showing the assets and income of any of these trusts.
>
> The respondent argues that the decedent should be treated as trustee, in fact, possessing such rights and powers as to cause the inclusion of the assets thereof in his gross estate, relying on sections 2033, 2036 (a)(2), and 2038. Section 2033 requires a finding that the decedent had an interest in the assets of the trusts at the time of his death. There is no basis for such a finding. Section 2038(a)(1) relates to "a power" exercisable by the decedent "to alter, amend, revoke, or terminate," the trusts. No such power was reserved by the decedent. Accordingly, in the final analysis the respondent's position is predicated on the determination that by reason of the de facto control exercised by the decedent the trusts are includable in his estate pursuant to section 2036(a)(2).[5] It is clear that the powers granted to the trustees would, if reserved by the decedent, be such as to require the inclusion of the assets of the trusts in the estate of the decedent. *United States v. O'Malley* [66-1 USTC ¶ 12,388], 383 U.S. 627 (1966). Does the fact that the decedent was able to exercise such powers through the cooperation of unrelated trustees require a different result? The question thus presented for decision is whether the value of such trusts is includable in the estate of the decedent by reason of the de facto control over the trusts exercised by the decedent, notwithstanding that no power to exercise such control was reserved to or by the decedent once he resigned his duties as trustee of certain of these trusts.

[footnotes omitted]

The Goodwyn rationales appear to be based on a trustee having authority; if an advisor who is not a fiduciary can direct a trustee, and the trustee must follow the direction, then will Goodwyn protect the grantor whose advisor follows the grantor's advice regularly. Similarly, where a grantor gives an inter vivos power of appointment to someone during the grantor's lifetime the Goodwyn rationale is inapplicable.

PART 4 – FEDERAL RULINGS, CASES AND OTHER DEVELOPMENTS

A. INCOME TAX MATTERS

1. **Consistent Basis Reporting**. [WE AWAIT FINAL REGULATIONS] The IRS has issued Proposed Regulations under new sections 1014(F) and 6035. REG-127923-15. Treasury did not identify these Proposed Regulations as ones which impose an undue financial burden on taxpayers, add undue complexity to the Federal tax laws, or exceed the statutory authority of the IRS Notice 2017-38. The second quarter update to 2017-2018 Priority Guidance Plan puts regulations under section 1014(f) and 6045 in the "Near-Term Burden Reduction" category.

Prop. Reg. § 1.1014-10 deals with basis consistency. The summary to the Proposed Regulations states in part:

> A. Section 1014(f)
>
> Section 1014(f) imposes an obligation of consistency between the basis of certain inherited property and the value of that property for Federal estate tax purposes.
>
> Section 1014(f)(1) provides that the basis of property acquired from a decedent cannot exceed that property's final value for purposes of the Federal estate tax imposed on the estate of the decedent, or, if the final value has not been determined, the value reported on a statement required by section 6035(a).
>
> Section 1014(f)(2) provides that section 1014(f)(1) only applies to property the inclusion of which in the decedent's gross estate increased the estate's liability for the Federal estate tax (reduced by credits allowable against the tax).
>
> Section 1014(f)(3) provides that, for purposes of section 1014(f)(1), the basis of property has been determined for Federal estate tax purposes if (A) the value of the property is shown on a return under section 6018 and that value is not contested by the Secretary before the expiration of the time for assessing the estate tax; (B) in a case not described in (A), the value is specified by the Secretary and that value is not timely contested by the executor of the estate; or (C) the value is determined by a court or pursuant to a settlement agreement with the Secretary.

With respect to § 1014(f)(2), and property that is both subject to and excluded from the requirements, Prop. Reg. §1.1014-10(b) states:

> (b) Property subject to consistency requirement—(1) In general. Property subject to the consistency requirement in paragraph (a)(1) of this section is any property that is includable in the decedent's gross estate under section 2031,any property subject to tax under section 2106, and any other property the basis of which is

> determined in whole or in part by reference to the basis of such property (for example as the result of a like-kind exchange or involuntary conversion) that generates a tax liability under chapter 11 of subtitle B of the Code (chapter 11) on the decedent's estate in excess of allowable credits, except the credit for prepayment of tax under chapter 11.
>
> (2) Exclusions. For purposes of paragraph (b)(1) of this section, property that qualifies for an estate tax charitable or marital deduction under section 2055, 2056, or 2056A, respectively, does not generate a tax liability under chapter 11 and therefore is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section. For purposes of paragraph (b)(1) of this section, tangible personal property for which an appraisal is not required under § 20.2031-6(b) is deemed not to generate a tax liability under chapter 11 and therefore also is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section.
>
> (3) Application. For purposes of paragraph (b)(1) of this section, if a liability under chapter 11 is payable after the application of all available credits (other than a credit for a prepayment of estate tax), the consistency requirement in paragraph (a)(1) of this section applies to the entire gross estate (other than property excluded under paragraph (b)(2) of this section) because all such property contributes to the liability under chapter 11 and therefore is treated as generating a tax liability under chapter 11. If, however, after the application of all such available credits, no tax under chapter 11 is payable, the entire gross estate is excluded from the application of the consistency requirement.

In other words, gross estates under the Applicable Exclusion Amount are outside the consistency requirement (but note that the <u>reporting</u> requirements are separate). Property for which a marital or charitable deduction is allowed is not subject to the consistency rules either, nor is tangible personal property worth $3,000 or less (no appraisal required per Treas. Reg. § 20.2031-6(b)). IRD and cash are likewise excluded but not if the value is as a numismatic.

A taxpayer's initial basis may not exceed the final value of the property which the summary explains this way:

> Proposed § 1.1014-10(a)(1) provides that a taxpayer's initial basis in certain property acquired from a decedent may not exceed the final value of the property as that term is defined in § 1.1014-10(c). This limitation applies to the property whenever the taxpayer reports to the IRS a taxable event with respect to the property (for example, depreciation or amortization) and continues to apply until the property is sold, exchanged, or otherwise disposed of in one or more transactions that result in the recognition of gain or loss for Federal income tax purposes. The property for this purpose includes any other property the basis of which is determined in whole or in part by reference to the basis of the property acquired from the estate or as a result of the death of the decedent (for example as the result of a like-kind exchange or involuntary conversion).
>
> ***
>
> Section 1014(f)(3) provides that, for purposes of section 1014(f)(1), the final value of property has been determined for Federal estate tax purposes if: (A) The value is reported on a Federal estate tax return filed with the IRS and is not contested by the IRS before the period of limitation on assessment expires; (B) the value is specified by the IRS and is not timely contested by the executor of the

> estate; or (C) the value is determined by a court or pursuant to a settlement agreement with the IRS.
>
> Proposed § 1.1014-10(c)(1) defines the final value of property that is reported on a Federal estate tax return filed with the IRS. That value is the value reported on the Federal estate tax return once the period of limitations on assessment for adjusting or contesting that value has expired. The IRS may specify a value for the property by determining a value in the course of carrying out its responsibilities under section 7803(a)(2). If the IRS determines a value different from the value reported, the final value is the value determined by the IRS once that value can no longer be contested by the estate. If the value determined or specified by the IRS is timely contested by the estate, the final value is the value determined in an agreement that is binding on all parties, or the value determined by a court once the court's determination is final.
>
> Proposed § 1.1014-10(c)(2) provides that the recipient of property to which the consistency requirement applies may not claim a basis in excess of the value reported on the statement required to be furnished under section 6035(a) (the value shown on the Federal estate tax return) if the taxpayer's basis in the property is relevant for any purpose under the Internal Revenue Code before the final value of that property has been determined under proposed § 1.1014-10(c)(1). However, under section 1014(f)(1), basis cannot exceed the property's final value. Therefore, proposed § 1.1014-10(c)(2) provides that, if the final value is determined before the period of limitation on assessment expires for any Federal income tax return of the recipient on which the taxpayer's basis is relevant and the final value differs from the initial basis claimed with respect to that return, a deficiency and an underpayment may result.

These requirements may create problems for personal representatives who "horse trade" with the IRS during estate tax audits. Not only does the amount of estate tax matter, but the valuation of specific assets does as well.

Suppose a beneficiary disagrees with a personal representative. That is a state law actionable item except that a beneficiary who wins may have no federal recourse. Suggestions that a beneficiary should be able to file a protective claim have been made.

What if property is omitted from the Form 706 or discovered later after the Form 706 has been filed? Prop. Reg. §1.1014-10(c)(3) provides:

> (3) After-discovered or omitted property—(i) Return under section 6018 filed. In the event property described in paragraph (b)(1) of this section is discovered after the estate tax return under section 6018 has been filed or otherwise is omitted from that return (after-discovered or omitted property), the final value of that property is determined under section (c)(3)(i)(A) or (B) of this section.
>
> (A) Reporting prior to expiration of period of limitation on assessment. The final value of the after-discovered or omitted property is determined in accordance with paragraph (c)(1) or (2) of this section if the executor, prior to the expiration of the period of limitation on assessment of the tax imposed on the estate by chapter 11, files with the IRS an initial or supplemental estate tax return under section 6018 reporting the property.

> (B) No reporting prior to expiration of period of limitation on assessment. If the executor does not report the after-discovered or omitted property on an initial or supplemental Federal estate tax return filed prior to the expiration of the period of limitation on assessment of the tax imposed on the estate by chapter 11, the final value of that unreported property is zero. See Example 3 of paragraph (e) of this section.
>
> (ii) No return under section 6018 filed. If no return described in section 6018 has been filed, and if the inclusion in the decedent's gross estate of the after-discovered or omitted property would have generated or increased the estate's tax liability under chapter 11, the final value, for purposes of section 1014(f), of all property described in paragraph (b) of this section is zero until the final value is determined under paragraph (c)(1) or (2) of this section. Specifically, if the executor files a return pursuant to section 6018(a) or (b) that includes this property or the IRS determines a value for the property, the final value of all property described in paragraph (b) of this section includible in the gross estate then is determined under paragraph (c)(1) or (2) of this section.

Section 6035 creates separate notification requirements. Those requirements are burdensome. The basic requirements are described by the summary as follows:

> 7. Requirement To Provide Information Return and Statement(s) Under Section 6035
>
> The proposed regulations define the term Information Return as the Form 8971, Information Regarding Beneficiaries Acquiring Property from a Decedent, which includes a copy of a Schedule A (Statement) for each person who has received or will receive property from the estate or by reason of the decedent's death.
>
> Proposed § 1.6035-1(a)(1) provides that an executor who is required to file a Federal estate tax return also is required to file an Information Return with the IRS to report the final value of certain property, the recipient of that property, and other information prescribed by the Information Return and the related instructions. The executor also is required to furnish a Statement to each beneficiary who has acquired (or will acquire) property from the decedent or by reason of the death of the decedent to report the property the beneficiary has acquired (or will acquire) and the final value of that property.
>
> 8. Circumstances Under Which No Information Return or Statement(s) Is Required Under Section 6035
>
> Commenters expressed concern that the section 6035 filing requirements might extend to a return filed by an estate solely to make the portability election under section 2010(c)(5), or a generation-skipping transfer tax election or exemption allocation. The proposed regulations provide that the filing requirements of section 6035 do not apply to such returns because these returns are not required by section 6018.
>
> 9. Property To Be Reported on an Information Return and Statement(s)
>
> Commenters requested that the regulations clarify the types of property to be reported on the Information Return and one or more Statements. In response, proposed § 1.6035-1(b) defines the property to be reported on an Information Return and Statement(s) as all property included in the gross estate for Federal

> estate tax purposes with four exceptions: Cash (other than coins or paper bills with numismatic value); income in respect of a decedent; those items of tangible personal property for which an appraisal is not required under § 20.2031-6(b); and property that is sold or otherwise disposed of by the estate (and therefore not distributed to a beneficiary) in a transaction in which capital gain or loss is recognized.
>
> 10. Beneficiaries
>
> Proposed § 1.6035-1(c)(1) provides that each beneficiary (including a beneficiary who is also the executor of the estate) who receives property to be reported on the estate's Information Return must receive a copy of the Statement reporting the property distributable to that beneficiary. Proposed § 1.6035-1(c)(2) provides that, if the beneficiary is a trust, estate, or business entity instead of an individual, the executor is to furnish the entity's Statement to the trustee, executor, or to the business entity itself, and not to the beneficiaries of the trust or estate or to the owners of the business entity.
>
> ***
>
> Proposed § 1.6035-1(c)(4) provides that, if the executor is unable to locate a beneficiary by the due date of the Information Return, the executor is required to report that on that Information Return and explain the efforts taken to locate the beneficiary. If the executor subsequently locates the beneficiary, the executor is required to furnish the beneficiary with a Statement and file a supplemental Information Return with the IRS within 30 days of locating the beneficiary. If the executor is unable to locate a beneficiary and distributes the property to a different beneficiary who was not identified in the Information Return as the recipient of that property, the executor is required to file a supplemental Information Return with the IRS and furnish the successor beneficiary with a Statement within 30 days after distributing the property.

In most estates, assets may be divided among multiple beneficiaries. Every beneficiary must receive a report of every asset the beneficiary could receive. Estates that pour into a trust will be simpler to deal with, however, the executor must report regarding the trust assets too.

Controversially, the IRS expanded reporting to subsequent transfers. The summary states:

> As discussed earlier in this preamble, section 6035(a)(2) imposes a reporting requirement on the executor of the decedent's estate and on any other person required to file a return under section 6018. The purpose of this reporting is to enable the IRS to monitor whether the basis claimed by an owner of the property is properly based on the final value of that property for estate tax purposes. The Treasury Department and the IRS are concerned, however, that opportunities may exist in some circumstances for the recipient of such reporting to circumvent the purpose of the statute (for example, by making a gift of the property to a complex trust for the benefit of the transferor's family).
>
> Accordingly, pursuant to the regulatory authority granted in section 6035(b)(2), the proposed regulations require additional information reporting by certain subsequent transferors in limited circumstances. Specifically, proposed § 1.6035-1(f) provides that, with regard to property that previously was reported or is required to be reported on a Statement furnished to a recipient, when the recipient distributes or transfers (by gift or otherwise) all or any portion of that property to

> a related transferee, whether directly or indirectly, in a transaction in which the transferee's basis for Federal income tax purposes is determined in whole or in part with reference to the transferor's basis, the transferor is required to file and furnish with the IRS and the transferee, respectively, a supplemental Statement documenting the new ownership of this property. This proposed reporting requirement is imposed on each such recipient of the property. For purposes of this provision, a related transferee means any member of the transferor's family as defined in section 2704(c)(2), any controlled entity (a corporation or any other entity in which the transferor and members of the transferor's family, whether directly or indirectly, have control within the meaning of section 2701(b)(2)(A) or (B)), and any trust of which the transferor is a deemed owner for income tax purposes.
>
> In the event such transfer occurs before a final value is determined within the meaning of proposed § 1.1014-10(c), the transferor must provide the executor with a copy of the supplemental Statement filed with the IRS and furnished to the transferee reporting the new ownership of the property. When a final value is determined, the executor will then provide a supplemental Statement to the new transferee instead of to the transferor. The supplemental Statements are due no later than 30 days after the transferor distributes or transfers all or a portion of the property to the transferee.

The effective date is when Final Regulations are published. Reporting has been extended until June 30, 2016 for estates of decedents dying after July 31, 2015.

Treasury personnel believe they have clear regulatory authority to impose subsequent reporting. Reporting requirements terminate upon the determination of basis by a sale. Suppose immediately after death an estate sold property to the decedent's revocable trust which is the recipient of the property. The sale would be for fair market value plus a nominal amount such as $3,000 and would be for a note. The estate would recognize gain on $1,000 and would thereafter be outside the system. The note would be distributed to the revocable trust.

After June 30, 2016 (Notice 2016-27), the due dates of the Form 8971 will be "(i) The date that is 30 days after the due date of the estate tax return required by section 6018 (including extensions, if any), or (ii) The date that is 30 days after the date on which that return is filed with the IRS." Under certain circumstances the information must be supplemented:

> (e) Duty to supplement.—(1) In general. In the event of any adjustment to the information required to be reported on the Information Return or any Statement as described in paragraph (e)(2) of this section, the executor must file a supplemental Information Return with the IRS including all supplemental Statements and furnish a corresponding supplemental Statement to each affected beneficiary by the due date described in paragraph (e)(4) of this section.
>
> (2) Adjustments requiring supplement. Except as provided in paragraph (e)(3) of this section, an adjustment to which the duty to supplement applies is any change to the information required to be reported on the Information Return or Statement that causes the information as reported to be incorrect or incomplete. Such changes include, for example, the discovery of property that should have been (but was not) reported on an estate tax return described in section 6018, a change in the value of property pursuant to an examination or litigation, or a change in

> the identity of the beneficiary to whom the property is to be distributed (pursuant to a death, disclaimer, bankruptcy, or otherwise). Such changes also include the executor's disposition of property acquired from the decedent or as a result of the death of the decedent in a transaction in which the basis of new property received by the estate is determined in whole or in part by reference to the property acquired from the decedent or as a result of the death of the decedent (for example as the result of a like-kind exchange or involuntary conversion). Changes requiring supplement pursuant to this paragraph (e)(2) are not inconsequential errors or omissions within the meaning of § 301.6722-1(b) of this chapter.
>
> (3) Adjustments not requiring supplement—(i) In general. A supplemental Information Return and Statement may but they are not required to be filed or furnished
>
> (A) To correct an inconsequential error or omission within the meaning of § 301.6722-1(b) of this chapter, or
>
> (B) To specify the actual distribution of property previously reported as being available to satisfy the interests of multiple beneficiaries in the situation described in paragraph (c)(3) of this section.

The timing requirements of supplemental reporting is strict:

> Due date of supplemental reporting—(i) In general. Except as provided in paragraph (e)(4)(ii) of this section, the supplemental Information Return must be filed and each supplemental Statement must be furnished on or before 30 days after—
>
> (A) The final value within the meaning of § 1.1014-10(c)(1) is determined;
>
> (B) The executor discovers that the information reported on the Information Return or Statement is otherwise incorrect or incomplete, except to the extent described in paragraph (e)(3)(i) of this section; or
>
> (C) A supplemental estate tax return under section 6018 is filed reporting property not reported on a previously filed estate tax return pursuant to § 1.1014-10(c)(3)(i). In this case, a copy of the supplemental Statement provided to each beneficiary of an interest in this property must be attached to the supplemental Information Return.
>
> (ii) Probate property or property from decedent's revocable trust. With respect to property in the probate estate or held by a revocable trust at the decedent's death, if an event described in paragraph (e)(4)(i)(A), (B), or (C) of this section occurs after the decedent's date of death but before or on the date the property is distributed to the beneficiary, the due date for the supplemental Information Return and corresponding supplemental Statement is the date that is 30 days after the date the property is distributed to the beneficiary. If the executor chooses to furnish to the beneficiary on the Statement information regarding any changes to the basis of the reported property as described in § 1.1014-10(a)(2) that occurred after the date of death but before or on the date of distribution, that basis adjustment information (which is not part of the requirement under section 6035) must be shown separately from the final value required to be reported on that Statement.

> (f) Subsequent transfers. If all or any portion of property that previously was reported or is required to be reported on an Information Return (and thus on the recipient's Statement or supplemental Statement) is distributed or transferred (by gift or otherwise) by the recipient in a transaction in which a related transferee determines its basis, in whole or in part, by reference to the recipient/transferor's basis, the recipient/transferor must, no later than 30 days after the date of the distribution or other transfer, file with the IRS a supplemental Statement and furnish a copy of the same supplemental Statement to the transferee. The requirement to file a supplemental Statement and furnish a copy to the transferee similarly applies to the distribution or transfer of any other property the basis of which is determined in whole or in part by reference to that property (for example as the result of a like-kind exchange or involuntary conversion). In the case of a supplemental Statement filed by the recipient/transferor before the recipient/transferor's receipt of the Statement described in paragraph (a) of this section, the supplemental Statement will report the change in the ownership of the property and need not provide the value information that would otherwise be required on the supplemental Statement. In the event the transfer occurs before the final value is determined within the meaning of proposed § 1.1014-10(c), the transferor must provide the executor with a copy of the supplemental Statement filed with the IRS and furnished to the transferee in order to notify the executor of the change in ownership of the property. When the executor subsequently files any Return and issues any Statement required by paragraphs (a) or (e) of this section, the executor must provide the Statement (or supplemental Statement) to the new transferee instead of to the transferor. For purposes of this provision, a related transferee means any member of the transferor's family as defined in section 2704(c)(2), any controlled entity (a corporation or any other entity in which the transferor and members of the transferor's family (as defined in section 2704(c)(2)), whether directly or indirectly, have control within the meaning of section 2701(b)(2)(A) or (B)), and any trust of which the transferor is a deemed owner for income tax purposes. If the transferor chooses to include on the supplemental Statement provided to the transferee information regarding any changes to the basis of the reported property as described in § 1.1014-10(a)(2) that occurred during the transferor's ownership of the property, that basis adjustment information (which is not part of the requirement under section 6035) must be shown separately from the final value required to be reported on that Statement.

There are penalty provisions as well described by the summary:

> Section 2004(c) of the Act added a new accuracy-related penalty for underpayments attributable to an inconsistent estate basis. See section 6662(b)(8).
>
> Section 6662(k) provides that there is an inconsistent estate basis if the basis of property claimed on a return exceeds the basis as determined under section 1014(f).
>
> Section 2004(c) of the Act adds statements under section 6035 to the list of information returns and payee statements subject to the penalties under section 6721 and section 6722, respectively. Specifically, the Act adds new paragraph (D) to section 6724(d)(1) to provide that the term information return means any statement required to be filed with the Secretary under section 6035. The Act also adds new paragraph (II) to section 6724(d)(2) to provide that the term payee statement means any statement required to be furnished under section 6035 (other than a statement described in section 6724(d)(1)(D)).

2. **Termination of Trust Results In Capital Gains**. In PLR 201932001 the IRS considered the termination of a trust along actuarial lines. The facts presented were:

> On Date 1, a date prior to September 25, 1985, Settlor created an irrevocable trust, Trust, for the benefit of Son. The material purpose of Trust was to ensure that Son receive an income stream for his support. Under the terms of the Trust agreement, the trustees are required to distribute all of the net income of Trust to Son, and, upon his death, distribute the remainder to his issue, per stirpes. The Trust agreement does not authorize any distributions of principal during Son's life. Son has four living adult children (Current Remaindermen) and eight living grandchildren, four of whom are adults (Successor Remaindermen). None of Son's descendants has a predeceased child with living issue. Son and Bank are currently serving as co-trustees of Trust.
>
> State Statute provides, in relevant part, that matters that may be resolved by a nonjudicial settlement include termination of the trust, provided that court approval of such termination is obtained in accordance with this section, and the court must conclude that continuance of the trust is not necessary to achieve any material purpose of the trust. State Statute further provides that upon such termination, the court may order the trust property distributed as agreed by the parties to the agreement or otherwise as the court determines is equitably consistent with the purposes of the trust.
>
> On Date 2, Son, the Current Remaindermen and the Successor Remaindermen entered into Agreement. Agreement states that the continuance of Trust "is no longer necessary to achieve any clear material purpose of such trust because [[Son]'s net worth has grown significantly, such that he does not need income from [Trust] for his support." Agreement further provides for the termination of Trust and the distribution of Trust's assets among Son, the Current Remaindermen and the Successor Remaindermen in accordance with the actuarial value of each beneficiary's share (Proposed Distribution).,

The IRS concluded that the transaction was in substance a sale. The ruling states:

> Rev. Rul. 72-243, 1972-1 C.B. 233, provides that the proceeds received by the life tenant of a trust, in consideration for the transfer of the life tenant's entire interest in the trust to the holder of the remainder interest, are treated as an amount realized from the sale or exchange of a capital asset under § 1222. The right to income for life from a trust estate is a right in the estate itself. See McAllister v. Commissioner, 157 F.2d 235 (2d Cir. 1946), cert. denied, 330 U.S. 826 (1947).
>
> In Rev. Rul. 69-486, 1969-2 C.B. 159, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to a make a non-pro rata distribution of property in kind. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries, an exchange that required recognition of gain under § 1001.
>
> Although the proposed transaction takes the form of a distribution of the present values of the respective interests of Son, the Current Remaindermen, and the

> Successor Remaindermen, in substance it is a sale of Son's and the Successor Remaindermen's interests to the Current Remaindermen. Rev. Rul. 69-486.
>
> The amounts received by Son as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. Rev. Rul. 72-243. Because Son's basis in the income interest of Trust is a portion of the entire basis of the property under § 1015(b), and because the disposition of Son's term interests is not part of a transaction in which the entire interest in Trust is transferred to a third party, Son's adjusted basis in Son's interest in Trust is disregarded under § 1001(e). Son's holding period in the life interests in Trust exceeds one year. Accordingly, based on the facts submitted and representations made, the entire amount realized by Son as a result of the early termination of Trust will be long-term capital gain under § 1222(3).
>
> Similarly, the amounts received by the Successor Remaindermen as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. Cf. Helvering v. Gambrill, 313 U.S. 11, 15 (1941), 1941-1 C.B. 364 (The phrase "property held by the taxpayer" under a prior law holding period rule relating to capital gains and losses includes not only full ownership, but also any interest owned whether vested, contingent, or conditional). The Successor Remaindermen's holding period in their interests in Trust also exceeds one year. Accordingly, under § 1222(3), the gain determined under § 1001(a) by the Successor Remaindermen as a result of the early termination of Trust will be long-term capital gain.
>
> In addition, to the extent that a Current Remainderman exchanges property, including property deemed received from Trust, for the interests of Son and the Successor Remaindermen, the Current Remainderman will recognize gain or loss on the property exchanged. Accordingly, based on the facts submitted and representations made, for purposes of determining gain or loss, the amount realized by each Current Remainderman on the exchange of property for Trust interests held by Son and the Successor Remaindermen will be equal to amount of cash and fair market value of the trust interests received in exchange for the transferred assets. Section 1.1001-1(a) and Rev. Rul. 69-486.

Interestingly, the taxpayer asked for the "sale" ruling, perhaps to ensure it was "at least" a capital transaction. Suppose the parties had amended the trust to add principal distribution provisions. Would that have been a gift by the consenting parties, even prior to an actual distribution? Would that have altered the result of the ruling?

As discussed elsewhere in these materials, another potential strategy would be to cause the trust to terminate by operation of law. That could occur if all of the beneficial interests in the trust were contributed to an LLC (and if the LLC or the managers of the LLC were also trustees of the trust).

3. No Income Tax Benefit From Revocable Trust, Even Indirectly.. In Heiting v. United States, 2020 WL 374468 (W.D. Wis. 2020) the taxpayer's revocable trust held some stock which the trustee sold. The trust provided that stock was not to be sold, so the trustee bought it back. The taxpayers had paid income tax on the gain so now wanted a credit on their next year's income tax return under the claim of right doctrine. The court denied the credit because the trust was revocable and thus the prohibition on sale and the repurchase were not mandatory. The opinion states:

> The Heitings argue that the trustee was not authorized to sell the stock in the first place, so the trustee had a legal obligation to use the proceeds of the sale to repurchase the stock. The trustee's legal obligation, the argument goes, should be imputed to the Heitings because tax law treats the Heitings, not the trust, as the owner of the trust's assets. Dkt. 20, at 7. Furthermore, according to the Heitings, they could not ignore a breach of the trust agreement and profit from it. The basic principle of the Heitings' argument is that, for IRS purposes, a grantor trust is disregarded and the Heitings and their trust are, essentially, one in the same.
>
> The Heitings are correct that a grantor trust is disregarded for purposes of income tax. But the Heitings' argument is fundamentally unsound as a matter of trust law.
>
> Neither the trustee nor the Heitings were actually obligated to repurchase the BMO and Fidelity shares. Under the Wisconsin Trust Code, "[w]hile a trust is revocable, the trustee may follow a direction of the settlor that is contrary to the terms of the trust." Wis. Stat. § 701.0808(1). So the Heitings, without amending the trust, could have instructed the trustee to do anything with the proceeds of the stock sale. Under the trust agreement itself, the trustee had to follow the Heitings' directions in taking any action regarding BMO and Fidelity stock—not only in selling it, but in buying it back as well. See Dkt. 11, Article IX, Article X. And, by the terms of the trust agreement, the Heitings could have amended or revoked the trust at any time, as they did in 2016.

B. <u>CHARITABLE AND TAX-EXEMPT MATTERS - Sections 170, 642, 664, 501, 509, 2055, 2522, and 4940-4947</u>

1. <u>Charitable Distributions From Trusts</u>. Suppose a trust does not provide for distribution to charity but the beneficiaries desire such distributions to occur. If the trust is modified validly under state law to allow charitable distributions, will that allow the trust to take a section 642(c) deduction? In CCA 201651013 the IRS concluded no because the trust <u>after modification</u> was not the "governing instrument." The ruling states:

> In <u>Old Colony Trust Company v. Commissioner</u>, 57 S.Ct. 813 (1937), the Supreme Court reversed a decision of the First Circuit (87 F. 2d 131). A trust document authorized but did not require the trustees to make current charitable payments if they could do so without jeopardizing the payment of annuities from the trust to non-charitable beneficiaries. The Board of Tax Appeals denied most of the income tax charitable deduction under the predecessor of § 642(c)(1) because it found that the taxpayer had not met its burden of proof regarding whether most of the payments were actually made from trust income during the year made. The First Circuit denied the entire deduction because the charitable payments were "not imperatively directed" by the trust. If the trustee exercised discretion in making the payments, they were not "pursuant to" the terms of the trust. The Supreme Court referred to the plain dictionary meaning of "pursuant to" as "acting or done in consequence or in prosecution (of anything), hence, agreeable; conformable; following; according," which standard was met by the authorization in the trust instrument.
>
> In <u>Crown Income Charitable Fund v. Commissioner</u>, 8 F.3d 571, 573 (7th Cir. 1993), *aff'g* 98 T.C. 327 (1992), the Seventh Circuit addressed the issue of commutation. The trust at issue in <u>Crown</u> contained a provision permitting the trustees to commute the charitable interest only if, as a matter of law, it was clear that doing so would not adversely affect the maximum charitable deduction otherwise available. The trustees of the Crown Income Charitable Fund

distributed trust assets in excess of the annuity amount to the charitable beneficiary over a number of years and deducted, under § 642(c), the full amount distributed to the charitable beneficiaries. Both the Seventh Circuit and the Tax Court held that the excess distributions were not deductible under § 642(c) because those instruments were not made pursuant to the terms of the governing instrument.

In Brownstone v. United States, 465 F.3d 525 (2nd Cir. 2006), a deceased husband's will created a marital deduction trust, which granted the husband's surviving wife a general testamentary power of appointment. When the wife died, she exercised her power in favor of her estate, the residue of which passed to charitable organizations. The trustee of the marital deduction trust distributed $1 million to the wife's estate and claimed a charitable contribution deduction under § 642(c), because the $1 million distribution passed entirely to the charitable beneficiaries under the wife's will.

The Second Circuit in Brownstone held that the distribution to the charities was made pursuant to the wife's power of appointment and not pursuant to the governing instrument, the deceased husband's will. The Second Circuit interpreted the definition of governing instrument narrowly, stating that an instrument subject to the creating instrument (the wife's will) could not combine with the creating instrument (the husband's will) and qualify as the governing instrument. The sole governing instrument in Brownstone was the husband's original will; therefore, the marital deduction trust was not entitled to a deduction under § 642(c) since the distribution was made pursuant to the wife's will.

* * *

In Emanuelson v. United States, 159 F.Supp. 34 (D.C. Conn. 1958), decedent left two conflicting wills -- one which left 2/3 of the residue of decedent's estate to certain charities, and another which left the entire residue to non-charitable legatees. After decedent's death, a controversy arose among the beneficiaries of the two wills. The controversy was resolved in a written compromise agreement between the two sets of beneficiaries, under which 52/480 of the residue passed to the charities named in one of the wills. Payments made to the charities under the written compromise agreement were held to be made pursuant to the will. Rev. Rul. 59-15, 1959-1 C.B. 164, citing Emanuelson, held that a settlement agreement arising from a will contest qualifies as a governing instrument.

In the current case, the taxpayer makes a summary argument that the payments qualify under § 642(c) because they are pursuant to the governing instrument, citing to Old Colony. They do not address the authorities concerning deductions under modified trust instruments. Here there was no conflict with respect to Trust B subsequent to the division of Parent Trust. The trust terms were unambiguous. The purpose of the court order was not to resolve a conflict in Trust B but to obtain the economic benefits which the parties believe they will receive from the modification of the Parent Trust. Neither Rev. Rul. 59-15 nor Emanuelson hold that a modification to a governing instrument will be construed to be the governing instrument in situations where the modification does not stem from a conflict of some sort. Additionally, both Crown and Brownstone have a narrow interpretation of what qualifies as pursuant to a governing instrument. Therefore, any payments to Foundation 1 and Foundation 2 after the modification of Trust B would not be considered to be made pursuant to the governing instrument, and Trust B is not entitled to a deduction for such payments under § 642(c).

The IRS also held that a 661, DNI, deduction would not be available. This result is controversial as the ruling notes. Commentators are divided, for instance:

> One standard treatise supports them on two policy grounds: "All of the courts but one [U.S. Trust District Court] that have considered this issue have sustained these regulations, even though they substantially exceed the scope of the statutory language . . . The cases supporting the regulations take the appropriate view because a contrary rule has the effect of giving both an estate tax deduction (for the charitable disposition) and an income tax deduction (for the item distributed to charity) for the same payment. "Also, as a result of deducting distributions of corpus to charity, the non-charitable legatees in effect receive the estate's income tax-free. The benefit of the income tax deduction inures to the noncharitable legatees, rather than to the charity, so the court decisions favoring the regulation seem fundamentally sound." [citations omitted] Danforth, Robert T., et al., Federal Income Taxation of Estates and Trusts [current through 2016], at 4.07[1]
>
> However, at least as many secondary sources in this area disagree with the disallowance under § 661(a), at least under some facts. Another standard treatise, Ferguson, M. Carr, et al, Federal Income Taxation of Estates, Trusts, & Beneficiaries (current through 2016), states at § 6.10: "The analysis [explaining why a single payment should not allow double deduction under §§ 642(c) and § 661(a)] does not, however, answer the question whether amounts that pass to charity in such a way as not to qualify for the deduction under § 642(c), such as amounts that pass to nonqualified quasi-charitable organizations or are used for purposes that are not exclusively charitable, escape the proscription of § 663(a)(2). Obviously, such amounts do *not* qualify 'for the deduction provided in § 642(c).' Are they therefore deductible as distributions under § 661? A literal reading of the statute strongly suggests that many such amounts should be. Even an undisputedly charitable beneficiary would be treated the same as any other beneficiary under the distribution rules, if it were not for §§ 642(c) and 663(a)(2). When no deduction is available under § 642(c), § 663(a)(2) seems to plainly not apply."

The taxpayer attempted to inspire the IRS to accept a bona fide state court modification to the trust instrument as being the "governing instrument" but the IRS rejected inspiration in CCA 201747005. The taxpayer and the IRS settled the case but the IRS did not concede the point.

There is no evidence that this is part of a larger exercise to limit the tax effect of prospective state court modifications (for instance, adding general power for basis). If a trust cannot be effectively amended, what can be done to obtain a charitable deduction for trust income? The assets of the trust could be contributed to an S corp. and the trust could become an ESBT (see discussion of the 2017 Tax Act). Or, distributions could be made to a 501(c)(4) organization, for which a section 661 deduction is allowable. A third way is that Rev. Ruling 2004-05 may help.

Gifts by partnerships or LLCs are deductible proportionately by the partners or members. IRC § 702(a)(4). Rev. Rul. 96-11 holds that when a partnership makes a charitable contribution of property, the basis of each partner's interest in the partnership should be decreased, but not below zero, by the partner's share of the partnership's basis in the property contributed. Similarly, a partner's charitable deduction for the contribution of appreciated property by the partnership does not seem to be limited to her share of the partnership's basis in the assets. See Private Letter

Ruling 8405084. Thus, contributions of appreciated property by partnerships preserve the tax benefit of receiving a deduction at fair market value for the contribution of appreciated property; the unrealized appreciation is not transferred to the partner's interest in the partnership.

Rev. Rul. 2004-05 provides that a trust which is a partner will benefit from a charitable contribution made by the partnership even if the trust itself has no charitable beneficiaries. The Ruling does not state how the trust came to be a partner. May a trust with no charitable beneficiaries become a partner in a partnership which allows charitable contributions without the consent of the trust partner? Presumably the answer is yes so long as the beneficiaries are agreeable. See also Private Letter Ruling 200208019, in which the IRS considered whether the members of a partnership were entitled to a charitable deduction on account of the partnership's grant of a conservation easement to a charitable organization. The IRS concluded that each partner was entitled to a charitable deduction equal to each partner's distributive share of the gift. A trust could not benefit from that deduction because §642(c) allows only deductions for income.

PLR 201225004 involved a trust claiming the section 642(c) deduction for income distributed to charity and the requirement that the income be distributed "pursuant to the terms of the governing instrument." Here, the distribution was directed by a beneficiary's exercise of a lifetime special power of appointment and the IRS determined that satisfied the "pursuant to" requirement even though the governing instrument did not specify a charitable bequest. It only authorized exercise of the power in favor of charity. In PLR 9821029, an individual exercised a lifetime nongeneral power of appointment over a trust to create a charitable remainder trust for a term of years with the trust as the unitrust beneficiary. The IRS allowed the trust to be the beneficiary and allowed the charitable remainder trust to be created by the exercise of the power.

If a charity is given the right to withdraw a portion of the income and gains from a trust then the charity is the owner of that portion under section 678 which avoids the need for a section 642(c) deduction. This is a "BDOT solution".

2. Use of Section 501(c)(4) Organizations to Facilitate Business Interest Ownership. Under the Protecting Americans from Tax Hikes Act of 2015, Section 2501(a) was amended to specifically exclude from federal gift tax "transfers of money or other property to an organization described in paragraph (4), (5), or (6) of section 501(c) and exempt from tax under section 501(a), for the use of such organization." This exclusion from federal gift tax is applicable to lifetime gifts to section 501(c)(4), (5), and (6) organizations, but does not apply to transfers at death. Accordingly testamentary transfers to section 501(c)(4), (5), and (6) organizations still would be taxable for estate tax purposes. Moreover, lifetime transfers to these organizations also could be subject to IRC § 2036. No private inurement is permitted for a section 501(c)(4) organization. Effective July 19, 2019, are final regulations under section 506 dealing with the requirement that an organization notify the IRS within 60 days of its intent to operate under section 501(c)(4). TD 9873.

Section 501(c)(4) Organizations include "civic leagues" and "social welfare organizations," which must be nonprofit and organized for the promotion of the common good and general welfare of the community as a whole, and "local associations of employees," in which membership is limited to employees of a particular person or particular person in a designated locality, and the earnings of which must be used for charitable, educational or recreational activities. Specific examples of section 501(c)(4) organizations would be homeowners associations, veterans groups, community centers and community programs, volunteer fire departments, parks associations, public recreational facilities, and service organizations.

A section 501(c)(4) organization does not appear to fit within the definition of "disqualified person," because it is:

- Not a substantial contributor or foundation manager;
- Not an individual
- Not a "35 percent" corporation, partnership, trust or estate; and
- Not a private foundation.

No cases or rulings appear to establish that a section 501(c)(4) organization would be a disqualified person. This may create a useful opportunity to use section 501(c)(4) organizations to avoid excess business holdings and self-dealing issues that could arise from transfers of closely-held business interests to a private foundation.

Section 4943 would preclude a private foundation from long-term ownership of more than 20 percent of the voting stock of a corporation or other business enterprise in combination with all disqualified persons. However, if a section 501(c)(4) organization is not a disqualified person, it could own a "business enterprise" with one or more private foundations in a manner that would avoid violating the prohibition against excess business holdings under section 4943. If an owner transferred interests in a closely-owned business to a private foundation in conjunction with a transfer to a section 501(c)(4) organization, it may be possible to avoid excess business holdings.

To illustrate,

- Donor could recapitalize her closely-held business enterprise from 1 million shares of common stock to 100,000 shares of voting stock and 900,000 shares of nonvoting stock.

- Donor then could contribute 80,000 shares of voting stock to a new section 501(c)(4) organization that Donor's family controls, without incurring gift tax.

- At death, Donor could contribute 20 percent of voting stock and all nonvoting stock to a private foundation, and the section 501(c)(4) organization would own 80 percent of the voting stock.

If a section 501(c)(4) organization is not a disqualified person (even if it is controlled by one or more disqualified persons) it would be permissible for a private foundation and the section 501(c)(4) organization to enter into transactions that ordinarily would be treated as self-dealing. For example a section 501(c)(4) organization could:

- Purchase or borrow assets from a related private foundation.
- Lease real estate to a related private foundation.
- Co-own and co-invest with a related private foundation.

3. Estate Income Tax Deduction. Where a decedent lacks a taxable estate, but wants to make a charitable bequest, consideration should be given to providing that the first dollars of income of the estate go to charity in an amount equal to the amount of the bequest. The estate will receive an income tax deduction if the estate has sufficient income.

4. Conservation Easement Controversy. In addition to the cases noted in these CLE materials, the Tax Court has handed down more than two-dozen government victories along the same grounds. On June 25, 2020, in IR-2020-130 the IRS announced a "time-limited settlement offer" to taxpayers with cases pending in Tax Court. The IRS position is that it will not negotiate syndicated easements so promoters pay full penalties (40%) but taxpayers may make themselves eligible for a 10% - 20% penalty if they settle cooperatively, but the benefits of the deduction will be lost (a taxpayer may deduct acquisition cost of the land). Taxpayers who are not in syndicates but whose easements are defective on technical grounds are in a bit of a no-man's land. By way of background, the IRS has been very grumpy with syndicated easements for several years. Notice 2017-10 states:

> The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) are aware that some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to obtain charitable contribution deductions in amounts that significantly exceed the amount invested. This notice alerts taxpayers and their representatives that the transaction described in section 2 of this notice is a tax avoidance transaction and identifies this transaction, and substantially similar transactions, as listed transactions for purposes of §1.6011-4(b)(2) of the Income Tax Regulations (Regulations) and §§6111 and 6112 of the Internal Revenue Code (Code).

The specific transaction covered by the Notice is described as follows:

> An investor receives promotional materials that offer prospective investors in a pass-through entity the possibility of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment. The promotional materials may be oral or written. For purposes of this notice, promotional materials include, but are not limited to, documents described in §301.6112-1(b)(3)(iii)(B) of the Regulations. The investor purchases an interest, directly or indirectly (through one or more tiers of pass-through entities), in the pass-through entity that holds real property. The pass-through entity that holds the real property contributes a conservation easement encumbering the property to a tax-exempt entity and allocates, directly or through one or more tiers of pass-through entities, a charitable contribution deduction to the investor. Following that contribution, the investor reports on his

> or her federal income tax return a charitable contribution deduction with respect to the conservation easement.

The effect of the Notice is retroactive:

> Transactions entered into on or after January 1, 2010, that are the same as, or substantially similar to, the transaction described in section 2 of this notice are identified as "listed transactions" for purposes of §1.6011-4(b)(2) and §§6111 and 6112 effective December 23, 2016. Persons entering into these transactions on or after January 1, 2010, [emphasis added] must disclose the transactions as described in §1.6011-4 for each taxable year in which the taxpayer participated in the transactions, provided that the period of limitations for assessment of tax has not ended on or before December 23, 2016.
>
> Material advisors, including appraisers, who make a tax statement on or after January 1, 2010, with respect to transactions entered into on or after January 1, 2010, have disclosure and list maintenance obligations under §§6111 and 6112. See §§301.61113, 301.6112-1.
>
> For rules regarding the time for providing disclosure of a transaction described in this notice, see §§1.6011-4(e) and 301.6111-3(e). However, if, under §1.6011-4(e)(1), a taxpayer is required to file a disclosure statement with respect to a transaction described in this notice after December 23, 2016, and prior to May 1, 2017, that disclosure statement will be considered to be timely filed if the taxpayer alternatively files the disclosure with the Office of Tax Shelter Analysis by May 1 (because April 30 is a Sunday). In addition, for purposes of disclosure of transactions described in this notice, the 90-day period provided in §1.6011-4(e)(2)(i) is extended to 180 days. Further, if under §301.6111-3(e), a material advisor is required to file a disclosure statement with respect to the listed transaction described in this notice by January 31, 2017, that disclosure statement will be considered to be timely filed if the taxpayer files the disclosure with the Office of Tax Shelter Analysis by May 1, 2017 (because April 30 is a Sunday).

On June 27, 2019, the Congressional Research Service issued a white paper titled Charitable Conservation Contributions Potential for Abuse? Easements declined in 2009–13 but substantially increased in 2014-15.

Independently, a committee of the American Bar Association has issued a report, the ABA RPTE Conservation Easement Task Force: Recommendations Regarding Conservation Easements and Federal Tax Law. (Available via SSRN at https://ssrn.com/abstract=3385453 or 53 Real Property, Trust and Estate Law Journal, Fall 2018/Winter 2019).

In a July 31, 2019 letter to a taxpayer who had written to Senators Isakson and Perdue, Chief Counsel Michael Desmond stated:

> Your letter accurately notes that the IRS believes that significant abuse of the conservation easement deduction continues to exist, particularly overvaluation of easements. Overvaluations pose a vexing and persistent problem, which the IRS addresses in Treasury Regulation section 1.170A-17 and in the syndicated conservation easement listing notice, Notice 2017-10.

> The IRS has made overvalued easements an enforcement priority. IRS examiners are trained to look for overvaluation indicators, which are nearly always the primary reason for commencing a conservation easement deduction audit.
>
> Easement donors who rely on appraisers with extensive professional qualifications and experience may in good faith believe that the appraisals they prepare contain correct conclusions of value and comport with statutory and regulatory requirements. At times, however, the reliance is misplaced. When appraisals look too good to be true, taxpayers who rely on them are taking a risk.

There are four general issues to keep an eye, two general and two specific to easements. The general issues are defective appraisals – those that don't meet the requirements – and the failure to give income tax basis information to the IRS as required. The specific issues are the "granted in perpetuity" requirement and the "protected in perpetuity" requirement. From the perspective of policy, the IRS appears to lack confidence in appraisers, which affects its willingness to accept valuations, and in some, perhaps many, easement holders, which affects its willingness to accept a broad interpretation of the regulatory limits.

5. Granted In Perpetuity and Protected In Perpetuity Requirements. In Pine Mountain Preserve LLLP et al. v. Commissioner, 151 T.C. No. 14 (2018), the primary issue was whether the ability to construct residences in various building areas invalidated a conservation easement. The taxpayer (Pine Mountain Preserve LLLP) conveyed to the North American Land Trust (NALT) in 2005, 2006, and 2007, easements covering relatively small portions of land in Alabama. Each easement defined a conservation area that was to be restricted in perpetuity from commercial and residential development, with a carve-out in the 2005 and 2006 easements for 16 reserved "building areas," within each of which the taxpayer could construct a single-family residence. The 2006 easement did not specify the location of the building areas, and the 2005 easement permitted the taxpayer, with the consent of the land trust, to move the building areas from their initially designated locations to any other location within the conservation area.

The opinion states:

> We begin with the 2006 easement because it presents a somewhat novel pattern. The 2006 easement permits Pine Mountain to establish within the 2006 Conservation Area six Building Areas, each as large as one acre. Each Building Area may include a single-family dwelling plus "a shed, garage, gazebo, and pool," and the owner of each Building Area may construct a 5,000-square-foot barn within 1,000 feet of its perimeter. However, the 2006 easement does not specify, either in the deed itself or in an attached plat, the locations of the six Building Areas. And it places no limitations on where within the 2006 Conservation Area such Building Areas may be located, except to say that these locations must be "approved in advance" by NALT.
>
> It seems clear to us that the 2006 easement does not embody "a restriction (granted in perpetuity) on the use which may be made of the real property." See sec. 170(h)(2)(C). Although the restriction placed by the easement is perpetual, "the restriction on 'the real property' is not." Belk III, 774 F.3d at 226 (quoting section 170(h)(2)(C)). Pine Mountain remained free to build a six-acre residential development within the 2006 Conservation Area, thus converting to commercial use land that was supposed to be protected in perpetuity from development. Indeed, it was impossible to define, when the 2006 easement was granted, what

"real property" would actually be restricted from development, because the residential lots could literally be placed anywhere within the 2006 Conservation Area. As a result, the perpetual use restriction did not attach at the outset "to a defined parcel of real property" or to "a single, immutable parcel" of land. Id. at 225, 227.

NALT had to approve the precise location of the six residences within the 2006 Conservation Area. By so doing, NALT might minimize the derogation of conservation values that the subdivision caused and perhaps ensure that "the conservation purpose [wa]s protected in perpetuity." Sec. 170(h)(5)(A). But this does not change the fact that the easement, when granted, did not create a perpetual use restriction on a defined parcel of land, as required by section 170(h)(2)(C). Because the 2006 easement does not constitute a "qualified real property interest," Pine Mountain could not claim for the donation of this interest a charitable contribution deduction under section 170(f)(3)(B)(iii) and (h)(1).

2. 2005 Easement

Most of the 2005 Conservation Area consists of ridgelines and higher elevation land in the northwest portion of Parcel 2. The balance consists of lower lying land around a man-made lake near the center of Parcel 2. Overall the easement covers about 47% of the acreage of Parcel 2.

Apart from the acreages involved, the 2005 easement is substantially similar to the easements involved in Bosque Canyon. It reserves to Pine Mountain or individual homeowners the rights to construct one single-family dwelling and appurtenant structures within each of ten "Building Areas" inside the 2005 Conservation Area. Although the deed itself does not limit the size or location of these ten Building Areas, an attached plat shows each Building Area as a one-acre lot situated around the man-made lake.

Article 3.16, however, provides that the "boundaries of the Building Areas may be modified by mutual agreement" of Pine Mountain and NALT. Such modification is subject to the proviso that "the areas of a Building Area shall not be increased" and that the boundary modifications shall not, in NALT's "reasonable judgment," adversely affect conservation purposes. Article 3.16 thus permits the Building Areas to be relocated (with NALT's consent) to higher elevation zones or to other locations within the 2005 Conservation Area.

Besides permitting the relocation of homesites, the easement permits Pine Mountain to build within the 2005 Conservation Area other structures and facilities appurtenant to the residential development. These include:

• at least ten barns, each of which may include "an apartment for occupancy by a caretaker and such caretaker's family";

• two scenic overlooks, one of which "may include a guest bedroom," occupying up to six acres in the aggregate;

• at least one riding stable and indoor riding ring, occupying up to ten acres in the aggregate;

• up to 14 piers and boat launches, which may include four "common boat launch facilit[ies] with associated boat storage building[s]";

> • up to five ponds, occupying up to 25 acres in the aggregate, which may apparently be encumbered by piers and boat launch facilities; and
>
> • a reasonable (but otherwise unlimited) number of wildlife hunting stands or blinds to facilitate hunting and shooting by homeowners and their guests.
>
> The easement does not specify the location of any of these facilities, and their location could change if the location of the Building Areas changed. Although NALT's approval is generally required, its approval for certain facilities (such as the man-made ponds) "shall not be unreasonably withheld." For other facilities, such as the piers, boat launches, boat storage buildings, and hunting blinds, no approval or prior review by NALT is needed.
>
> We conclude that the rights reserved to Pine Mountain, considered in their entirety, prevent the 2005 easement from constituting a "qualified real property interest." See sec. 170(h)(2). As in Bosque Canyon, the easement deed allows all ten residences to be moved from the man-made lake to other, possibly more desirable, locations within the 2005 Conservation Area. And as in Bosque Canyon, the easement places no limits on how many homesites can be moved, how often this can be done, or how far into the future such relocations can occur.
>
> The 2005 easement also permits Pine Mountain to construct, anywhere within the 2005 Conservation Area, a variety of other buildings. At least 11 of these buildings may include additional living quarters. All of these facilities are intended for the recreational use of the homeowners and their guests. Collectively, they have the effect of expanding the residential development well beyond the ten acres consumed by the Building Areas alone.

A dissent would have been less restrictive but attracted only one vote.

The Eleventh Circuit reversed in part, affirmed in part, and remanded in part, upon appeal; Pine Mountain Preserve, LLLP v. Commissioner, ______________ (11th Cir. 2020). The court first held that the easements satisfy the granted-in-perpetuity requirement of section 170(h)(2)(C). The court concluded the Tax Court misunderstood the statute. The opinion states:

> On its face, § 170(b)(2)(C) doesn't require much—only that a grant embody "a restriction (granted in perpetuity) on the uses which may be made of the real property." It seems to us clear that a conservation easement of the sort at issue here qualifies. It constitutes "a restriction" on "the use . . . of the real property" because it burdens what would otherwise be the landowner's fee-simple enjoyment of—and absolute discretion over—the use of its property. And it does so "in perpetuity" because nothing in the grant envisions a reversion of the easement interest to the landowner, its heirs, or assigns. A broad limitation on the use of the property that applies to the parcel as a whole satisfies the statutory test, even if within that parcel there exist certain narrow exceptions to that limitation. I.R.C. § 170(h)(2)(C).
>
> The Commissioner contends, by contrast, that an aggregate restriction on the use of the land isn't enough; rather, he asserts, every inch of land must be subject to the restriction in perpetuity—such that, his argument goes, even a limited reservation of development rights violates the granted-in-perpetuity requirement. "[T]he whole point of § 170(h)(2)(C)," the Commissioner argues, "is to ensure that a conservation easement's restriction on the use that may be made of the real

> property is *perpetual*, meaning that the restriction cannot be subsequently removed, weakened, or diminished . . . ." Br. of Appellee at 45–46 (emphasis original). But the Commissioner misunderstands both the plain language of the statute and the common-law provenance of the term "perpetuity." As for the language, the word that precedes the term "restriction" is "a," and it seems to us indisputable that the 2005 and 2006 easements impose "a restriction"—singular—on the uses to which the subject parcels may be put because they broadly restrict Pine Mountain's preexisting development rights. And they impose that restriction "in perpetuity," as that term is understood in the common law, because Pine Mountain, its heirs, or assigns remain indefinitely subject to the restriction and because nothing in the grants will cause the easements, either automatically or upon the happening of some event, to revert back to the Pine Mountain or its successors.
>
> * * *
>
> The Tax Court constructed a "Swiss cheese" analogy—the entire conservation area serving as the slice and the development zones the holes. As the Tax Court saw it, § 170(h)(2)(C) demands that the entire slice (the conservation area) be protected from development in perpetuity, such that the landowner cannot under any circumstances relocate any of the holes (reserved rights).
>
> But whether exceptions to restrictions in a conservation easement poke holes in the slice runs, we think, to whether the easement adequately *protects* the conservation purposes, which is a question to be answered by reference to § 170(h)(5)(A), not § 170(h)(2)(C). Using the Tax Court's own cheese metaphor, all that § 170(h)(2)(C)'s granted-in-perpetuity condition requires is that the landowner grant a slice (*i.e.*, a restrictive easement) in the first place, which here Pine Mountain plainly did. We agree with Pine Mountain that the better cheese analogy is to Pepper Jack. Here, the reserved rights don't introduce holes into the conservation-easement slice, because the entire slice remains subject to "a restriction"—*i.e.*, the conservation easement. Instead, the reserved rights are embedded pepper flakes, and, so long as they don't alter the actual boundaries of the easement, § 170(h)(2)(C) is satisfied.

Importantly, the opinion distinguished the easements here from those considered by the Fourth Circuit in Belk:

> In rejecting the deductions for the 2005 and 2006 easements, the Tax Court relied heavily on a series of its own previous decisions that the Fourth Circuit subsequently affirmed in *Belk v. C.I.R.*, 774 F.3d 221 (4th Cir. 2014). *Belk* concerned a conservation easement in which the landowner had reserved a right, subject to the donee organization's approval, to "substitute an area of land . . . contiguous to the Conservation Area for an equal or lesser area of land comprising a portion of the Conservation Area." *Belk v. C.I.R.*, 140 T.C. 1, 3 (2013), *aff'd*, 774 F.3d 221 (4th Cir. 2014). The reviewing courts held that this provision disqualified the property interest under § 170(h)(2)(C) "because the real property contributed to the Trust is not subject to a use restriction in perpetuity." *Belk*, 774 F.3d at 226. As the Fourth Circuit interpreted that provision, "[t]he placement of the article 'the' before 'real property' makes clear that a perpetual use restriction must attach to a defined parcel of real property rather than simply *some* or *any* (or interchangeable parcels of) real property." *Id*. at 225 (emphasis in original). It held that if the grant permits land from outside the easement to be swapped for easement land—thus freeing the easement land from the attendant restrictions—

> then "the restriction on 'the real property' is not" perpetual because the boundaries of the restricted property have shifted. *Id*. at 226.
>
> The 2005 and 2006 easements here bear no resemblance to the one at issue in the *Belk* litigation. The easements that Pine Mountain granted only allow building areas to be moved around *within the fixed boundaries of the easement*— they don't permit outside-territory swapping. Pine Mountain's easements more closely resemble those in *BC Ranch II v. C.I.R.*, 867 F.3d 547 (5th Cir. 2017). In that case, landowners had deeded perpetual conservation easements to a land trust but reserved rights to build homesites on select five-acre plots, subject to the trust's consent. The Fifth Circuit held that the easements satisfied § 170(h)(2)(C)'s granted-in-perpetuity requirement because "[o]nly discrete five-acre residential parcels, entirely within the exterior boundaries of the easement property," could be moved within the conservation area. *Id.* at 553. In so holding, the court distinguished *Belk* on grounds that apply equally here. The Fifth Circuit explained that the problem in *Belk* arose "because the donor of the easement could develop the same land that it had promised to protect, simply by lifting the easement and moving it elsewhere," even to "tracts of land entirely different and remote from the property originally covered by that easement"—*that*, the court recognized, is what violated the granted-in-perpetuity requirement. *Id*. at 553. The Fifth Circuit also observed that parcel-swapping would complicate valuations because an appraiser would have to value a moving target. *Id*.
>
> By contrast, there are no such dangers where, as in *BC Ranch*—and here— an easement only permits the relocation of building areas within the conservation area without changings the easement's boundaries. *Id.* at 552. First, such an arrangement can't be used to release the real property from the easement in a wholesale manner. And second, so long as "the unencumbered homesite parcels have roughly the same per-acre value as the rest of the" easement territory, then appraisal is feasible because "changing the boundaries of some of the homesite parcels would not return any value to the easement donors." *Id*. at 553.

Then the court turned to the protected-in-perpetuity requirement, which the Tax Court had upheld. The court agreed with the Tax Court:

> Each easement's amendment clause "recognize[s] that circumstances could arise which would justify the modification of certain restrictions" in the grant. The clause thus states that NALT, as the "Holder," and Pine Mountain, as the "legal owner," "shall mutually have the right, in their sole discretion, to agree to amendments to this Conservation Easement, which are not inconsistent with the Conservation Purposes." The Commissioner asserts that the amendment provision gives so much discretion to the parties that it causes the 2007 easement—and again, by extension the others as well—to violate the "double-perpetuity requirement" of § 170(h)(2)(C) and § 170(h)(5)(A). We disagree. For starters, to the extent that the Commissioner's position equates "perpetuity" with inalienability, unreleasability, or unamendability, we reject it. As we have explained, "perpetuity"—as used in connection with conservation easements—draws on the term's common-law meaning and denotes only that the granted property won't automatically revert to the grantor, his heirs, or assigns. *See supra* at 12–13.
>
> Separately, it seems to us that the Commissioner's position proves entirely too much. Parties to a bilateral contract—which is all a conservation easement is—can *always* agree after the fact to amend their agreement, whether or not they expressly reserve that right to themselves in writing. If the possibility of

> amendment were a deal-killer, then there could be no such thing as a tax deductible conservation easement.
>
> As the Tax Court correctly observed, the easements at issue here are conveyances with respect to which Pine Mountain and NALT contracted. It is (literally) hornbook contract law that contracting parties are free to amend their agreements after the fact. *See* 28 Williston on Contracts § 70:154 (4th ed.) ("A promise modifying a duty under an executory contract is binding if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made."); *see also* Restatement (Second) of Contracts § 89 (1981) (similar). More particularly, traditional servitude doctrine has long allowed for the amendment of easements. *See* Restatement (Third) of Property (Servitudes) § 7.1 (2000) (observing that a property servitude "may be modified or terminated by agreement of the parties, pursuant to its terms"). 5 And indeed, even the Uniform Conservation Easement Act—the act that enabled landowners to grant perpetual easements to conservation trusts—provides for the possibility of bilateral amendments. *See* UCEA § 2(a) ("Except as otherwise provided . . . , a conservation easement may be created, conveyed, recorded, assigned, released, *modified*, terminated, or otherwise *altered* or affected in the same manner as other easements." (emphasis added)).

The essence of the Eleventh Circuit's policy determination – if court's make policy determinations – is in footnote 4, to which the careful listener can almost hear the IRS replying "no, no, no, are you crazy?"

> 4 Lest anyone worry that our interpretation of § 170(h)(2)(C) gives the Pine Mountains of the world a free pass, we make two observations in closing our discussion of the 2005 and 2006 easements. First, we have dealt only with § 170(h)(2)(C). Even after passing through the granted-in-perpetuity gateway, a conservation easement must still satisfy § 170(h)(5)(A)'s protected-in-perpetuity requirement; that, it seems to us, is likely where Congress envisioned the heavy lifting—the more rigorous analysis of the degree to which the grant protects conservation purposes—should occur. Second, recall that NALT has extensive advance-approval rights under these easement contracts. NALT is a sophisticated land-conservation organization, and we have little doubt that when it comes to negotiating conservation easements, it is well positioned and equipped to look after conservation interests.

Finally, the court remanded for a "better" determination of value from the Tax Court. The court thought the original decision just "split the baby" which was inappropriate.

6. Judicial Extinguishment. Woodland Property Holdings v. Commissioner, T.C. Memo. 2020-55, denied a charitable deduction for a conservation easement because the easement could be extinguished by judicial action. The opinion states:

> For an easement of the sort involved here, a charitable contribution deduction is allowable only if the underlying conservation purpose is "protected in perpetuity." Sec. 170(h)(5)(A); see Coal Prop. Holdings, 153 T.C. at 135. The regulations set forth detailed rules for determining whether this "protected in perpetuity" requirement is met. See sec. 1.170A-14(g), Income Tax Regs.
>
> The rules governing "judicial extinguishment" appear in section 1.170A-14(g)(6), Income Tax Regs. It provides that the donor must agree that the easement gives

> rise to a property right in the donee having a FMV "that is at least equal to the proportionate value that the * * * [easement] at the time of the gift, bears to the value of the property as whole at that time." Id. subdiv. (ii) (emphasis added). In the event of a sale following judicial extinguishment of the easement, the donee "must be entitled to a portion of the proceeds at least equal to that proportionate value." Ibid. "In effect, the 'perpetuity' requirement is deemed satisfied because the sale proceeds replace the easement as an asset deployed by the donee 'exclusively for conservation purposes.' " Coal Prop. Holdings, 153 T.C. at 136(quoting section 170(h)(5)(A)).
>
> The regulation requires, in short, that the donee receive a proportionate share of the sale proceeds, as determined by the fraction set forth in the regulation.[3] The easement deed in this case does not satisfy this requirement. The deed defines the donee's share of the sale proceeds as the FMV of the easement, determined "as of the date of this Conservation Easement." The donee's share is thus restricted to "a date-of-gift value that would exclude subsequent appreciation." R.R. Holdings, at *13. The donee would accordingly "watch its proportion of potential extinguishment proceeds shrink over the years if the underlying property appreciates." Ibid. This shrinking value does not equal the "proportionate value" of the sale proceeds that the regulation mandates that the donee receive.

The court notes other similar cases:

> As petitioner acknowledges, the question presented by respondent's motion is identical, "with similar conservation easement language," to the question decided adversely to the taxpayer in R.R. Holdings, LLC v. Commissioner, T.C. Memo. 2020-22, and Oakbrook Land Holdings, LLC v. Commissioner, T.C. Memo. 2020-54. This question is substantially similar to that decided adversely to the taxpayer in PBBM-Rose Hill, Ltd. v. Commissioner, 900 F.3d 193 (5th Cir. 2018), and Coal Prop. Holdings, LLC v. Commissioner, 153 T.C. 126 (2019).

See also Railroad Holdings v. Commissioner, T.C. Memo. 2020-22; and Rock Creek Property Holdings v. Commissioner, Tax Court Order, Docket No. 5599-17 (February 10, 2020).

In Sells v. Commissioner, T.C. Memo. 2021-12, the court concluded the taxpayer had reasonable cause when using a "defective" extinguishment clause because of PLR 200836014 which had approved a similar clause and because the court found similar clauses were in widespread use, including by the easement holder.

In a separate, reviewed, opinion to the one cited above, Oakbrook Land Holdings v. Commissioner, 154 T.C. No. 10 (2020), the Tax Court upheld the "protected in perpetuity" regulation. In 1983 the IRS issued a proposed regulation with a "perpetuity" requirement, and received more than 700 pages of comments. With respect to the procedural aspects of the regulation, the opinion states:

> The two aspects of the "judicial extinguishment" rule to which petitioner objects are the requirement that the donee receive a proportional share of the proceeds and the fact that the "proportionate share" formula does not account for the possibility of donor improvements. Treasury clearly considered the comments it received on the first point because it substantially revised the text of section 1.170A-14(g)(6)(ii), Income Tax Regs., in response to those comments. See supra pp. 14-15.

Only one of the 90 commenters mentioned donor improvements, and it devoted exactly one paragraph to this subject. That commenter, NYLC, was concerned about facade easements on historic structures, as opposed to "perpetual open space easements," with which Treasury was chiefly concerned. See 48 Fed. Reg. at 22940. And NYLC mentioned this point to support its belief that donors of facade easements "are likely to be discouraged from making a donation," a supposition that Treasury may reasonably have discounted.

In any event, "[t]he administrative record reflects that no substantive alternatives to the final rules were presented for Treasury's consideration." SIH Partners, 150 T.C. at 44; see dissenting op. p. 102 ("A comment is * * * more likely to be significant if the commenter suggests a remedy for the purported problem it identifies."). NYLC offered no suggestion about how the subject of donor improvements might be handled; it simply recommended "deletion of the entire extinguishment provision." Only one other commenter of the 13 mentioning judicial extinguishment voiced that recommendation.

Footnote 3, relevant to the dissent, states:

Our dissenting colleague errs in relying on United States v. Nova Scotia Food Prods. Corp., 568 F.2d 240 (2d Cir. 1977), to support his position. See dissenting op. pp. 110-113. That case involved a Food and Drug Administration (FDA) regulation establishing minimum "time, temperature, and salinity" requirements for processing fish. The Second Circuit invalidated the regulation as applied to one category of fish product, "non-vacuum-packed hot-smoked white-fish." Nova Scotia Food Prods. Corp., 568 F.2d at 253. The court first held that the FDA had "failed to disclose to interested parties the scientific data and the methodology upon which it relied." Id. at 250. "When the basis for a proposed rule is a scientific decision, the scientific material which is believed to support the rule should be exposed to the view of interested parties for their comment." Id. at 252. The court also held that the agency had failed to consider: (1) evidence that heating "certain types of fish to high temperatures will completely destroy the product," (2) the suggestion that using "nitrite and salt as additives could safely lower the high temperature otherwise required," and (3) the suggestion that different processing requirements should be established for different species of fish. Id. at 245. Here, the basis for the proposed regulation was not "a scientific decision"; Treasury relied on no undisclosed data when proposing its regulation; the two commenters who opposed the judicial extinguishment rule offered no concrete alternative suggestions; and the concerns they expressed lacked the significance of concerns about destroying the commercial viability of a product, which the Second Circuit aptly described as "vital questions" in Nova Scotia Food Prods. Corp., 568 F.2d at 252.

***

The broad statements of purpose contained in the preambles to the final and proposed regulations, coupled with obvious inferences drawn from the regulations themselves, are more than adequate to enable us to perform judicial review. We find that Treasury's rationale for the judicial extinguishment rule "can reasonably be discerned and * * * coincides with the agency's authority and obligations under the relevant statute." SIH Partners, 150 T.C. at 47. We accordingly hold that Treasury satisfied all applicable APA requirements when promulgating this rule.

The court then turned to the substance, analyzed under Chevron as explained by the court:

> Having concluded that the regulation was properly promulgated, we turn to petitioner's contention that the regulation is substantively invalid. When considering a challenge to the substantive validity of a regulation, we generally employ the two-part test established by Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984). The first prong of that test asks "whether Congress has directly spoken to the precise question at issue." Id. at 842. "If the intent of Congress is clear, that is the end of the matter." Ibid.
>
> Section 170(h)(5)(A) sets forth a general requirement that the conservation purpose be "protected in perpetuity." Congress does not appear to have considered the possibility that an easement might be judicially extinguished, and the statute does not address how that possibility would affect a taxpayer's ability to satisfy the "perpetuity" requirement. Congress therefore did not speak directly to the question at issue.
>
> We accordingly proceed to Chevron step two, which requires us to consider whether the regulation "is based on a permissible construction of the statute." Chevron, 467 U.S. at 843. If the statute is silent, we must give deference to the interpretation embodied in the agency's regulation unless it is "arbitrary, capricious, or manifestly contrary to the statute." Id. at 844; see United States v. MeadCorp., 533 U.S. 218, 227 (2001). In other words we must sustain the regulation so long as it represents a "reasonable interpretation" of the law Congress enacted. Chevron, 467 U.S. at 844; see SIH Partners, 150 T.C. at 50.

The court determined that the regulation was valid under Chevron:

> We cannot say that the regulation's "proportionate value" approach is "arbitrary, capricious, or manifestly contrary to the statute." Chevron, 467 U.S. at 844. Under the regulation the donee acquires "a property right, immediately vested in the donee organization," in a share of any future proceeds. Sec. 1.170A-14(g)(6)(ii), Income Tax Regs. Needless to say, the easement might be extinguished many years after it was granted, and considerable inflation in property values might occur in the interim. If the donee's share were limited to the easement's historical FMV, its property right could be eviscerated in real dollar terms. This would allow the donor or its successors to "reap[ ] a windfall if the property is destroyed or condemned." Carroll, 146 T.C. at 214 (quoting Kaufman, 687 F.3d at 26). That outcome would be at odds with the regulation's central purpose: to ensure satisfaction of the statute's "protected in perpetuity" requirement by supplying the donee with an asset that replaces, in real terms, the easement that has been lost.
>
> ***
>
> Second, petitioner contends that the regulation is invalid because it does not permit the donee's share of the proceeds to be reduced by the value of improvements (if any) made by the donor. The regulation as proposed did not address donor improvements, and only one of 90 commenters mentioned the point. See supra pp. 21-22. Once again, we cannot say that the absence of a provision addressing donor improvements renders the regulation "arbitrary, capricious, or manifestly contrary to the statute." Chevron, 467 U.S. at 844.
>
> Treasury's goal in prescribing this regulation was to ensure satisfaction of the statute's "protected in perpetuity" requirement. In effect this requirement is deemed satisfied because the sale proceeds replace the easement as an asset

deployed by the donee "exclusively for conservation purposes." Sec. 170(h)(5)(A). In certain factual scenarios, reducing the donee's proceeds on account of donor improvements could frustrate this goal, especially if local land values should decline.

For example, assume that a taxpayer donates an easement valued at $1 million on property valued at $2 million without the easement. The taxpayer thereafter spends $1 million improving the property. Many years later, there is an economic downturn, the easement is extinguished, and the property is sold for $2 million. Under the regulation the donee would be entitled to $1 million (half of the proceeds) and the conservation purpose would be deemed "protected in perpetuity." Sec. 170(h)(5)(A). But if improvements were carved out, the donee's share would be reduced to $500,000 or zero, depending on whether the carve-out was applied to the entire proceeds or to the donee's 50% share.

NYLC, the only commenter to mention donor improvements, notably did not suggest any text to address this problem. And addressing it would have raised a host of questions: Would the donee's proceeds be reduced by improvements the donor had made before granting the easement, after granting it, or both? Would the donor get credit for improvements to the land itself (such as grading) or only for erecting structures? Would the donee's proceeds be reduced by the donor's cost for the improvements or by their FMV at the time the easement was extinguished? And how would the problem mentioned in the previous paragraph be solved, to prevent the donee's share from being severely reduced or even eliminated? It is conceivable that Treasury could have drafted a regulation that addressed the possibility of donor improvements, dealing with these ancillary questions in some rational way. But that was a policy decision for Treasury, not this Court, to make.

The court thought it significant that the regulation was finalized long ago in 1986:

> The regulation petitioner challenges was promulgated in January 1986. It has never been amended. In the past 34 years Congress has amended section 170 more than 30 times, but these amendments have never suggested any disagreement with the construction of the statute that Treasury adopted in section 1.170A-14(g)(6), Income Tax Regs. This "strongly suggests that * * * [Congress] did not view Treasury's construction * * * as unreasonable or contrary to the law's purpose." SIH Partners, 150 T.C. at 53-54 (sustaining under Chevron step two a regulation that had persisted substantially unchanged for nearly 50 years).
>
> [footnote omitted]

Twelve judges signed on to the majority opinion. There was a concurrence and a dissent. The concurrence in result only by Judge Toro would have flunked the regulation under Chevron but disallowed the deduction because the charity did not receive all the state law property rights in the land. That opinion states:

> Oakbrook maintains that the requirement of section 170(h)(5)(A) is met so long as the donee, upon a sale or other disposition after extinguishment by judicial proceeding, would obtain an amount equal to the fair market value of the easement at the time the easement was established, subject to reduction for subsequent improvements funded exclusively by the donor.[3] But Oakbrook's position ignores the fact that, to be eligible for a deduction under section 170(h) in the first place, a donor must grant to a donee an "interest[ ] in real property." Sec. 170(h)(2). One of the rights inherent in a real property interest (and presumably required to be

> transferred to the donee in order to satisfy section 170(h)(2)(C)) is the property holder's right to be compensated at fair market value upon a subsequent transfer or taking.
>
> ***
>
> The formula set out in the Deed exposes the fundamental problem for Oakbrook-under the terms of the Deed, the donee never received the type of "interest[ ] in real property" contemplated by section 170(h)(2)(C) and further protected by section 170(h)(5)(A). Put another way, by failing to convey to the donee the unrestricted right to be compensated at fair market value upon a future transfer or taking, the Deed so restricted the donee's interest as to cause it to fall outside the purview of section 170(h)(2)(C).
>
> The shortcoming inherent in the Deed also affects Oakbrook's compliance with section 170(h)(5)(A). The payment of a predetermined fixed amount would be insufficient as compensation for a right "protected in perpetuity" if the fair market value of the property had appreciated since the date the easement was granted. When a transfer of money to the donee is intended to satisfy the "perpetuity of purpose" requirement of section 170(h)(5)(A), no reasonable reading of the statute would bless the donee receiving an amount that is less than the fair market value of its "interest[ ] in real property" as of the time of the conversion of its interest into cash.

On the other hand, Judge Toro would have invalidated the donor improvement portion of the regulation:

> I begin at the same starting place--the statutory text. The statute provides a deduction for a contribution to a qualified organization of a "qualified real property interest" made "exclusively for conservation purposes." Although the statute makes clear that there can be no deduction unless the conservation purposes are "protected in perpetuity," one cannot lose track of the fact that the deduction is predicated on a "qualified real property interest" being contributed to a qualified organization. Thus, the most that a qualified organization can be entitled to receive if its "qualified real property interest" is extinguished in the future is the full value of that interest. Whatever the purpose of a contribution, that purpose may not be invoked to require the donor to give the donee, as a precondition to receiving a deduction for his contribution, a right to receive compensation properly attributed to the real property interest that the Code permits the donor to retain. A regulation interpreted to require otherwise cannot be a permissible interpretation of the statutory text before us. Under that text, the interest the donee organization must obtain in connection with a contribution is the "qualified real property interest" transferred to it. Requiring the donor to promise to turn over to the donee proceeds in excess of the fair market value of that interest is inconsistent with the statutory framework, and nothing in the "statutory purposes" compels a different conclusion. Goldstein, 451 F.3d at 881 (quoting Abbott Labs., 920 F.2d at 988).
>
> The opinion of the Court admits that "[i]t is conceivable that Treasury could have drafted a regulation that addressed the possibility of donor improvements, dealing with [the types of questions noted above] in some rational way." See op. Ct. p. 30. But the opinion of the Court overlooks the lack of a "rational" solution to those problems, by noting that "that was a policy decision for Treasury, not this Court, to make." See id. In the Court's view, "Treasury's overarching goal [in prescribing the regulation] was to guarantee that the donee, upon judicial extinguishment of the easement, would receive the full share of proceeds to which

> it was entitled. * * * Treasury exercised reasoned judgment by adhering to a simple rule that splits sale proceeds in a direct proportional manner." See id. p. 31.
>
> I agree with the opinion of the Court that the donee should "receive the full share of proceeds to which it was entitled." See id.(emphasis added). But a rule interpreted to require the deed to allocate to the donee not only the proceeds attributable to its own real property interest but also a share of the proceeds attributable to the interest the Code permits the donor to retain does not " ' "fit" ' with the statutory language" and is unreasonable. Good Fortune Shipping SA v. Commissioner, 897 F.3d at 262 (quoting Goldstein, 451 F.3d at 881). Calling it a "policy decision" does not change the fact that the rule, as interpreted by the Commissioner, yields in certain circumstances a result that is entirely unreasonable and without any basis in the statute. Under Chevron, Treasury is entitled to draw lines on the page provided by Congress; Chevron does not give Treasury legislative authority to substitute a different page for the one Congress enacted into law.

Judge Toro also found the procedural part of the rulemaking defective:

> In response to the notice, Treasury received more than 700 pages of comments during the extended comment period and at least another 130 pages after the comment period had closed. A hearing on the proposed regulation was requested and was held on September 15, 1983. Thirty-seven members of the public were originally scheduled to speak at the hearing, and 30 actually spoke. The hearing lasted more than five hours, and the transcript exceeds 200 pages.
>
> A Treasury Decision adopting final regulations was published in the Federal Register on January 14, 1986. See T.D. 8069, 1986-1 C.B. 89, 51 Fed. Reg. 1496 (Jan. 14, 1986). The Treasury Decision spanned roughly 12 pages, of which approximately 10 contained the actual text of the regulations. That left just over two pages for Treasury's responses to comments and other administrative matters (for example, the Paperwork Reduction Act notice and drafting information). Put another way, Treasury used six columns of the Federal Register to address more than 700 pages of timely comments and more than 200 pages of public testimony. Those six columns were intended to cover comments on a "regulation project consisting of 10 paragraphs, 23 subparagraphs, 30 subdivisions, and 21 examples." See op. Ct. p. 24.
>
> One might wonder how an agency familiar with the D.C. Circuit's decision in Home Box Office, which by 1986 had been on the books for more than eight years, could have thought that six columns in the Federal Register sufficed to "respond[ ] to significant points raised by the public" in more than 700 pages, or how that response constituted a "dialogue" between the agency and the public contemplated by the APA as interpreted by Home Box Office and the authorities on which it relied. Home Box Office, 567 F.2d at 35-36 (fn. ref. omitted); see also PPG Indus., 630 F.2d at 466 (reiterating that the APA requires agencies "to give reasoned responses to all significant comments in a rulemaking proceeding"). Even for an agency determined to be exceedingly "concise," six columns in the Federal Register would be a tight amount of space to show "what major issues of policy were ventilated ... and why the agency reacted to them as it did." Carlson, 938 F.3d at 344 (alteration in original) (quoting Del. Dep't of Nat. Res. & Envtl. Control v. EPA, 785 F.3d 1, 17 (D.C. Cir. 2015)).

> But, in my view, Treasury did not think it confronted such a Herculean task. It is more likely that Treasury was simply following its historical position that the APA's procedural requirements did not apply to these types of regulations.[15] As the Treasury Decision explains, Treasury took the view that "[a]lthough a notice of proposed rulemaking which solicited public comments was issued, the * * * [IRS] concluded when the notice was issued that the regulations are interpretative and that the notice and public comment procedure requirement of 5 U.S.C. 553 did not apply." T.D. 8069, 1986-1 C.B. at 92. When an agency engaged in a particular rulemaking exercise believes the APA does not require it to provide notice and receive comments at all, it is not difficult to see why that agency might think that a rather brief explanation, offered as it were out of its own generosity, should be good enough.[17]
>
> The problem with this position, however, is that Treasury's conclusion that the regulation at issue here did not require notice and comment was mistaken, as the opinion of the Court correctly makes clear
>
> ***
>
> The NYLC Comment Letter in effect countered that the proposed rule on future donor improvements was contrary to those policy decisions, would lead to inequitable results that were inconsistent with the statute, and would deter future contributions. In short, the NYLC Comment Letter offered comments that, "if adopted, would require a change in an agency's proposed rule." Home Box Office, 567 F.2d at 35 n.58. Those comments were both "relevant and significant," requiring a response. Grand Canyon, 154 F.3d at 468; accord Carlson, 938 F.3d at 343-344.
>
> Unfortunately, however, the Treasury Decision finalizing the regulations contains no such response. The Treasury Decision changed the sentence on which the Commissioner relies with respect to donor improvements as follows (with the relevant change underscored):
>
>> (1) Proposed Regulation: "For purposes of this paragraph (g)(5)(ii), that original minimum proportionate value of the donee's property rights shall remain constant." 48 Fed. Reg. 22946.
>>
>> (2) Final Regulation: "For purposes of this paragraph (g)(6)(ii), that proportionate value of the donee's property rights shall remain constant." T.D. 8069, 1986-1 C.B. at 99.
>
> But Treasury gave no explanation as to how the change addressed the concerns expressed in the NYLC Comment Letter. In short, Treasury's actions did not provide "an explanation [that] is clear enough that its 'path may reasonably be discerned.' " Encino Motorcars, 579 U.S. at ___, 136 S. Ct. at 2125 (quoting Bowman Transp., 419 U.S. at 286).[18] Nor does Treasury's action provide any insight on "what major issues of policy were ventilated ... and why the agency reacted to them as it did" on this point. Carlson, 938 F.3d at 344 (quoting Del. Dep't of Nat. Res. & Envtl. Control, 785 F.3d at 17).

Three judges agreed with portions of Judge Toro's opinion.

The dissent reviewed multiple comments to Treasury's proposed regulation and then turned to Treasury's response:

> What we hear is the chirping of crickets.
>
> The Final Rule's statement of basis and purpose shows absolutely no mention of the extinguishment-proceeds clause at all, much less any mention of the proportionate-share or improvements problems--and no reasoned response to any of the public's comments on those provisions.[9] The majority doesn't deny this, see op. Ct. pp. 23-25, and we aren't even the first court to notice: In Kaufman v. Shulman, 687 F.3d 21, 26 (1st Cir. 2012), the First Circuit was forced to guess at the apparent purpose of the section 1.170A-14(g)(6)(ii), Income Tax Regs., after noting that it "was unexplained when first promulgated."
>
> This makes the defining characteristic of section 1.170A-14(g)(6)(ii), Income Tax Regs., its utter lack of any contemporaneous explanation of its key choices--to require that donees get a fraction, rather than an absolute amount, of extinguishment proceeds and to require that they get a share of any proceeds from a donor's improvements to the property. There is no prefiguring of these choices in the legislative history or the notice of proposed rulemaking, and no explanation of them in the Final Rule. Had Treasury responded in any meaningful way to the comments that it received, such as those from the NYLC, neither donors and donees, nor courts, see, e.g., Oakbrook, T.C. Memo. 2020-54, at *20-*28 (highlighting the confusing nature of section 1.170A-14(g)(6), Income Tax Regs., and attempting to discern its meaning), nor the IRS, compare Priv. Ltr. Rul. 200836014 (Sept. 5, 2008) (stating that the regulation isn't violated by a conservation easement in which a donee receives only proceeds less any amount attributable to an improvement), with Oakbrook, T.C. Memo. 2020-54, at *36 (addressing the IRS's argument that a conservation easement in which a donee receives only proceeds less any amount attributable to an improvement is a violation of the regulation), would have to grapple with whether "proportionate value" establishes a fraction or a fixed value, or whether a donee is entitled to any extinguishment proceeds attributable to the value of improvements or rising land values. Such widespread industry confusion is precisely what APA section 553 is intended to avoid. So while we don't demand a perfect explanation for Treasury's decision making, see Bowman Transp., 419 U.S. at 286, we should demand some, see Encino Motorcars, 579 U.S. at __, 136 S. Ct. at 2125. And here, there wasn't any.

With respect to the substance, the dissent notes that Chevron can be applied in different ways – which is right is uncertain at the moment – and that Treasury now justifies the regulation on grounds different from what it did when it issued the regulation. As to this point, the dissent states:

> These seem like perfectly plausible reasons. But they are not the ones that Treasury itself offered at the time it issued the regulation. This raises another problem for the Commissioner in his defense--the Chenery rule. The Chenery rule prevents an agency from relying on *post hoc* rationalizations to defend its decision making. SEC v. Chenery Corp., 318 U.S. 80, 87 (1943) ("The grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based."); see also State Farm, 463 U.S. at 50 (courts may not accept post hoc rationalizations). And Chevron step 2 is limited by Chenery. Bank of Am., N.A. v. FDIC, 244 F.3d 1309, 1319 (11th Cir. 2001) (stating that Chenery must be considered at step 2 of Chevron); see also Council for Urological Interests

> v. Burwell, 790 F.3d 212, 222 (D.C. Cir. 2015); America's Cmty. Bankers v. FDIC, 200 F.3d 822, 835 (D.C. Cir. 2000). We shouldn't be coming up with our own *post hoc* justifications for the reasonableness of the rule if the Commissioner's lawyers wouldn't be able to.
>
> The same problem affects our analysis of the substantive validity of this regulation under State Farm. The Sixth Circuit has warned agencies that its arguments in favor of a regulation not being "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" is likewise limited by the Chenery rule. See Atrium, 766 F.3d at 567-68 ("[T]he ground upon which an administrative order must be judged are those upon which the record discloses that its action was based." (quoting Chenery, 318 U.S. at 87)).
>
> The majority today comes up with as good a set of arguments as possible to justify the reasonableness of the regulatory choices that Treasury made when it was drafting this regulation. But Treasury didn't make them. Or at least it didn't make them in the administrative record of this regulation.

7. Golf Course Does Not Automatically Invalidate Conservation Easement Deduction. The Eleventh Circuit in Champions Retreat Golf Founders v. Commissioner, 2020 WL 2462534 (11th Cir. 2020) summarized the case as follows:

> The appellant taxpayer claimed a charitable deduction for donating a conservation easement over property that included a private golf course and undeveloped land. The Commissioner of Internal Revenue disallowed the deduction, and the Tax Court upheld the decision. The deduction was proper if the donation was made for "the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem," or was made for "the preservation of open space . . . for the scenic enjoyment of the general public." I.R.C. § 170(h)(4)(A)(ii) & (iii)(I).
>
> Without the golf course, this easement would easily meet these criteria. Because the Code does not disqualify an easement just because it includes a golf course, we reverse the Tax Court's decision and remand for determination of the proper amount of the deduction.

One of the issues addressed by the court was whether the land was required to be natural, or was the habitat required to be natural. The opinion states:

> The Commissioner's expert takes no issue with the proposition that many birds use the property including some that are worthy of protection. He says, though, that the habitat itself is not relatively natural. For this he focuses on the fairways and greens — they consist of non-native bermuda and bent grass — not the undeveloped portion of the easement, which is, at least for the most part, quite natural.
>
> What matters under the Code and regulation is not so much whether all the *land* is natural, but whether the *habitat* is natural. Indeed, the regulation says it is not disqualifying that the land has been altered, so long as "the fish, wildlife, or plants continue to exist there in a relatively natural state." 26 C.F.R. § 1.170A-14(d)(3)(i). The Commissioner's expert noted nothing unnatural about these birds' existence; they apparently find the habitat quite suitable.

> Champions also cites the property's population of southern fox squirrels — a species for which the habitat, including the golf course, is hospitable. The species is not threatened but has suffered declines caused by diminishing habitat, due in part to forest-management practices. The Commissioner discounts the importance of the species, noting that Georgia has a six-month season in which hunters may take up to 12 squirrels per day. But that is not dispositive of the question whether providing the squirrels a habitat is a conservation purpose. That Georgia chooses not to protect the species hardly seems a reason to deny whatever protection is available under *federal* law. Protecting fox squirrels would not alone be sufficient to establish a conservation purpose, but they add to the weight on Champions' side of the scale.
>
> Finally, while the golf course itself is comprised primarily of non-native grasses, the remainder of the easement property is natural and includes a rare species of plant, the denseflower knotweed. The Commissioner has offered no theory under which protecting the denseflower knotweed is not an appropriate conservation purpose.
>
> It is true, as the Commissioner notes, that the knotweed exists on only a limited proportion of the easement — perhaps 7%, with the capacity to occupy up to 17%. But the knotweed that exists, whatever its proportion, is worthy of protection.

A discussion of the Tax Court's approach to birds cannot be read without a smile:

> Despite the abundant bird species, including many of conservation concern, the declining southern fox squirrels, and the rare denseflower knotweed, the Tax Court said Champions had not established the required conservation purpose. To reach this result, the court considered, or at least discussed in its opinion, only birds seen by both Champions experts — ignoring any bird seen by only one Champions expert, even if the bird was also seen by the Commissioner's expert. The court did this despite explicitly crediting the testimony of both Champions experts. The court offered no explanation for this approach, and we can conceive of none.
>
> The court also ignored a bird that was heard but not seen. The court did not explain how a bird could be heard if not present on or at least near the property.
>
> The Tax Court's implicit finding that the only birds on the property were those seen by both Champions experts is clearly erroneous. More importantly, the Tax Court's conclusion that Champions did not contribute this easement "for the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem" — a conclusion based in part on the clearly erroneous finding of fact — is wrong as a matter of law.
>
> Were it not for the presence of a golf course on part of this property, the assertion that contributing an easement over property with this array of species does not qualify as a conservation purpose would be a nonstarter.

The concerned land is also scenic, notes the court:

> The record establishes without dispute that members of the public can and do canoe and kayak on the Savannah River alongside the easement and on the Little River as it runs through the easement. The view from the rivers includes the easement's natural areas as well as the golf course. The record includes a video

illustrating the stark difference in the views of the easement property, on the one hand, and the property farther down the Savannah River, on the other. The downriver property includes considerable development — development that few canoers or kayakers would find scenic.

One could perhaps debate whether a golf course provides scenic enjoyment. But the natural areas covered by this easement surely do. And the golf course, whose most prominent feature visible from a canoe or kayak on the river is the trees, detracts only a little, if at all. When compared to a condominium building or even private homes, the easement property qualifies as open space providing scenic enjoyment. And preserving relatively natural views along these two rivers — views free of development on the other side as well because of the national forest — serves a public interest.

In asserting the contrary, the Commissioner says the rivers' banks are from three to ten feet high, as if this somehow eliminates the opportunity for scenic enjoyment. The Tax Court took the same approach. But trees, on the one hand, and condos or other buildings, on the other hand, can be seen from a canoe or kayak, even when a river's banks are ten feet high. Indeed, if a ten-foot bank obscures anything, it is the fairways and greens and other non-natural features of a golf course, not the trees. From a kayak on a river with a ten-foot bank, the flat parts of a golf course look just like open land. The notion that the banks somehow prevent scenic enjoyment is a makeweight.

Were it not for the presence of a golf course on part of this property, the assertion that preserving open space alongside rivers with three- to ten-foot banks cannot be "for the scenic enjoyment of the general public" and provide a public benefit would be a nonstarter.

A dissent thought that the property was scenic but was dubious about the other conservation values:

Second, in my view, Champions' easement might not be a "relatively natural habitat." I.R.C. § 170(h)(4)(A)(ii). The man-made golf course takes up more than 80 percent of the easement. In making the course, Champions used non-native grasses, one of which requires the use of large fans to keep it cool in the hot Georgia sun. And to maintain the course, Champions pumps anywhere from 70,000 to 600,000 gallons of water a day out of the Little River.

Champions also coats its golf course with chemicals — including fungicide, herbicide, insecticide, algaecide, and fertilizer. To apply these potent chemicals, Champions' staff members sometimes need gloves and respirators. The chemicals not only artificially change the habitat, but do so in ways that pose what the tax court called "environmental hazards." In fact, Champions designed the golf course to drain into nearby ponds, creeks, and otherwise undisturbed wetlands. The golf course drains toward the knotweed (a rare plant that Champions says is protected by the easement), and as the majority itself recognizes, "the knotweed thus may suffer harm from the chemicals used on the course." Maj. Op. at 14. Although the majority finds comfort in Champions' pledge to follow the golf industry's best environmental practices, we have little information about what those practices are, or how they stack up to other standards. And those standards, whatever they are, hardly define the boundary between easements that can and cannot qualify for a deduction under federal law.

Ultimately, the majority is willing to look past the easement's unnatural features because of the birds and squirrels living there. The argument has some force,

especially because it does appear that the tax court overlooked evidence about the prevalence of these species. But the presence of animals cannot hide that a lot of the easement is highly developed and at least somewhat hazardous to certain species. And no matter how many animals live on the Champions easement, the reality remains the same: with the chemicals, imported grasses, large fans, artificial drainage, and water pumping, it is not at all clear that the easement amounts to a "relatively natural habitat." I do not mean to say that a golf course could never qualify; it's simply not clear that this one does.

8. **Perpetuity Requirement in Façade Easement**. The Sixth Circuit has strictly construed the perpetuity requirement for conservation easements in Hoffman Properties v. Commissioner, 956 F.3d 832 (6th Cir. 2020). The opinion states:

> The parties agree on the general legal framework. To satisfy the "perpetuity" requirement, the donation must be "[e]nforceable in perpetuity," meaning that it includes "legally enforceable restrictions" that will prevent the donor from using its retained interest in the property in a way "inconsistent with the [donation's] conservation purposes." Treas. Reg. § 1.170A-14(g)(1); *see Glass v. Comm'r*, 471 F.3d 698, 713 (6th Cir. 2006). The parties simply disagree about whether Hoffman's donation included adequate restrictions.
>
> ***
>
> The key language in this agreement is in Paragraph 3. That Paragraph describes certain "[c]onditional [r]ights"—actions that Hoffman could take so long as AAHP approved. JA 107. For instance, Hoffman reserved the right to "[a]lter, reconstruct or change the appearance [of the façade] . . . contrary to the Secretary's Standards" or to "[a]lter or change the appearance of the Air Space in a manner contrary to the Secretary's Standards." JA 107–08. (For reference, the "Secretary's Standards" are regulations issued by the Secretary of the Interior on the rehabilitation of historic buildings. 36 C.F.R. § 67.7.) Paragraph 3 also directs Hoffman to submit these proposed changes to AAHP, which would review the changes based on the Secretary's Standards and either approve or reject them. Finally, the Paragraph makes clear that AAHP's "failure . . . to act within forty-five (45) days of receipt [of a proposed change] shall be deemed to constitute approval [of the change] and to permit [Hoffman] to undertake the proposed activity." JA 108.
>
> Simply put, Paragraph 3 gives AAHP a 45-day window in which to prevent certain changes to the façade or airspace. And if the organization misses that window—for whatever reason—it loses the ability to stop the change. It almost goes without saying that this provision violates the "perpetuity" requirement. After all, there's a world of difference between restrictions that are enforceable "in perpetuity" and those that are enforceable for only 45 days. *See The American Heritage Dictionary* 977 (1976) (defining "perpetuity" as "[t]ime without end; eternity"); *Black's Law Dictionary* 711 (5th ed. 1979) (defining "in perpetuity" as "[e]ndless duration; forever"); *Webster's Third New International Dictionary* 1685 (1986) (defining "perpetuity" as "endless time" and a "duration without limitations as to time"). You can't even really compare the two.
>
> What's more, it seems that most (if not all) of the rights reserved in Paragraph 3 could be inconsistent with the conservation purposes of the donation. We know this not only because of the sheer breadth of the reserved rights—for instance, the power to "[a]lter, reconstruct, or change" the façade—but also because many of

> the rights are expressly defined as "contrary to the Secretary's Standards." JA 107. Recall that these standards concern the rehabilitation of historic buildings; they're designed to ensure that any changes are "consistent with the historic character of the property." 36 C.F.R. § 67.7(e). And the donation agreement itself tells AAHP to use these standards when it evaluates whether a proposed change would conflict with the purposes of the donation. So it's not hard to imagine how these changes would be inconsistent with the conservation purposes of the donation. By all appearances, then, the agreement fails to protect these purposes "in perpetuity."
>
> ***
>
> *The Donation Agreement*. Hoffman also insists that other provisions in the agreement protect the conservation purposes "in perpetuity." But this argument misses the point: whatever else the agreement says, Paragraph 3 prevents AAHP from enforcing these provisions if the organization fails to act on the proposed change within 45 days. And again, this brief window falls far short of the statutory requirement that the conservation purposes of the donation be "protected in perpetuity." I.R.C. § 170(h)(5)(A).
>
> For similar reasons, Paragraph 10 doesn't do Hoffman any good even though it provides that the agreement "shall be interpreted broadly to effect its purposes and the transfer of rights and the restrictions on use." JA 118. This provision tells us to construe the agreement, not rewrite it. *Cf. Keen v. Helson*, 930 F.3d 799, 805 (6th Cir. 2019). But there's no way Hoffman could prevail unless we rewrote some of the terms in Paragraph 3.1.

Footnote 1 addresses savings clauses:

> Curiously, Hoffman doesn't point to the one provision in the agreement that might support this result. Paragraph 10 includes what appears to be a saving clause: "Notwithstanding anything to the contrary herein, [the parties] agree that [AAHP] shall hold this [donation] 'exclusively for conservation purposes' as that term is defined in the Code and [its] implementing regulations[.]" JA 118. Hoffman might have argued that this clause negates any other provision in the agreement that would render the donation not "exclusively for conservation purposes"—such as the 45-day provision. But perhaps it didn't make this argument because other courts have found saving clauses unenforceable in this context. *See, e.g., Belk v. Comm'r*, 774 F.3d 221, 228–30 (4th Cir. 2014); *R.R. Holdings, LLC v. Comm'r*, 119 T.C.M. (CCH) 1136, 2020 WL 569926, at *6–7 (2020). Since Hoffman hasn't raised the issue, we'll leave it for another day.

The taxpayer argued that it had amended the original agreement to correct the problem but that amendment had not been recorded, as the original required, and the taxpayer presented no evidence that the chances the 45-day clause would be implicated were so remote as to be negligible.

Suppose the 45-day clause were the reverse: if no response from the charitable organization then no change could be made. Chief Counsel Memorandum 202002011 approved such a clause stating:

> **Constructive Denial.** For activities or uses that are expressly permitted by the terms of the easement only with the easement holder's approval, the property owner's request for approval shall be in writing and shall describe the nature, scope, design, location, timetable, and any other material aspect of the proposed

> activity or use in sufficient detail to permit the easement holder to make an informed determination regarding approval or denial of the request. Such a request shall be delivered to the easement holder at least sixty (60) days prior to the anticipated start date of such activity or use.
>
> The easement holder agrees to use reasonable diligence to respond to such a request within the sixty (60) days of delivery. The easement holder's failure to respond to such a request within the sixty (60) day period shall be deemed a constructive denial.
>
> Because a constructive denial is not a decision by the easement holder based on the merits of the property owner's request, it is not final or binding on the easement holder, and the property owner can resubmit the same or a similar request for approval.
>
> Section 170(h)(1) allows a deduction for a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. Section 170(h)(2)(C) states that a qualified real property interest is a restriction (granted in perpetuity) on the use of the real property. Section 170(h)(5)(A) further provides that in order for a contribution to be treated as exclusively for conservation purposes, the conservation purpose must be protected in perpetuity.
>
> CONCLUSION
>
> No, a constructive denial clause is not inconsistent with the perpetuity requirements of section 170(h).

9. No Self-Dealing Where Marital Trust and Charitable Trust Divided Assets. A series of complicated transactions "cashing the spouse out" of various trusts were summarized by the IRS in PLR 202016002 as follows:

> The transaction pursuant to the Settlement Agreement, in which Spouse will receive the present value of her life income interests in Irrevocable Trust and Marital Trust, and Charitable Trust will receive the remaining trust assets, may be regarded in substance as an indirect exchange between Spouse and Charitable Trust similar to the one described in Rev. Rul. 72-243. Charitable Trust was not funded upon Decedent's death by Decedent, and no deduction has been or will be allowed under § 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522 with respect to Charitable Trust prior to the contemplated exchange. Therefore, prior to the exchange, Charitable Trust is not a trust described in § 4947(a)(1).
>
> As discussed above, Spouse will receive a gift tax deduction under § 2522 of more than $5,000 for the property deemed transferred by her to Charitable Trust (which will exceed 2 percent of all contributions to Charitable Trust), causing Charitable Trust to be subject to § 4947(a)(1) at that time. Spouse will be a disqualified person with respect to Charitable Trust when the Settlement Agreement is executed, as a substantial contributor to Charitable Trust and as a family member of the creator of Charitable Trust. Section 53.4941(d)-1(a) provides, however, that the term "self-dealing" does not include a transaction between a private foundation and a disqualified person where the disqualified person status arises only as a result of such transaction. Accordingly, §4941 will not apply to the indirect exchange between Spouse and Charitable Trust pursuant to the Settlement Agreement in which Spouse will receive the present value of her life income

> interest in Irrevocable Trust, GST Exempt Marital Trust, and GST Non-Exempt Marital Trust, and Charitable Trust will receive the remaining trust assets.
>
> Based on the facts submitted and the representations made, we conclude that the indirect exchange between Spouse and Charitable Trust pursuant to the Settlement Agreement will not be treated as an act of self-dealing under § 4941.

That the trust was not yet funded was key.

10. Eyewear Contribution Flunks Appraisal Requirements. Campbell v. Commissioner, T.C. Memo. 2020-41, deals with a fascinating charitable contribution strategy summarized by the court as follows:

> This eyewear charitable contribution program involved ZD Products, Inc. (ZD Products), consolidating over 170,000 designer eyeglass frames it possessed into units of approximately 3,432 frames each and selling these units to 50 buyers for $50,000 per unit; each buyer would then purportedly be eligible to donate his or her frames after a minimum one-year holding period to Lions in Sight, a section 501(c)(3) nonprofit organization[4] (or to a different qualified charitable organization of the buyer's choosing), and claim a charitable contribution deduction at the appraised fair market value at the time of donation.

The appraisal was fascinating:

> The initial written appraisal prepared by Marshall & Stevens and dated November 27, 2006 (2006 Marshall & Stevens appraisal), was included with the offering memorandum. The 2006 Marshall & Stevens appraisal described the **[*6]** property that ZD Products requested it value and the property's physical condition as follows:
>
> > **1.3 Description of the Donated Property**
> >
> > The property to be contributed consists of new (unused) Designer Eyewear Products ("Designer Eyewear Products" or "donated property"). The subject property list with description, count and wholesale price originated from Eyewear Designs LTD. Located in Syosset NY. The subject property consists of various styles and designer brand names. These designer brand names include Bill Blass, Elizabeth Arden, Perry Ellis, and Pierre Cardin. The total quantity is 171,600. A sampling of the various brand names and models show that the eyewear brands are still active in the marketplace. These particular designer eyewear product brand names are some of the most well known and long standing eyewear products in the designer eyewear marketplace. They have however have [sic] been discounted over time and are no longer the most current popular styles and brands.
> >
> > **1.4 Physical Condition of the Property**
> >
> > We have not made a personal viewing of the subject property. It is our understanding that the subject property analyzed is in new (unused) condition and that the amount of property or "count" is correct. The current location of the subject property is not known.

> The referenced "subject property list" (which was attached to the 2006 Marshall & Stevens appraisal) stated that the "donated property" consisted of 31,950 Bill Blass frames, 23,150 Elizabeth Arden frames, 13,200 Elizabeth Arden "Petites" frames, 33,150 Pierre Cardin frames, 54,350 Perry Ellis frames, and 15,800 Perry Ellis America frames. This list also showed various models within each eyewear brand of varying quantities and wholesale prices. The wholesale price per model **[*7]** ranged from $37 to $80. Using the market approach[7] and on the basis of the wholesale prices with a markup of 35%, Marshall & Stevens opined that the fair market value of the "donated property" as of November 27, 2006, was $11,266,115.
>
> ***
>
> Pursuant to the offering memorandum Marshall & Stevens prepared a followup written appraisal for ZD Products; this appraisal was dated December 26, 2007, and certified by Senior Manager Shane Park at Marshall & Stevens (2007 Marshall & Stevens appraisal). The 2007 Marshall & Stevens appraisal contained the same description and physical condition of the "donated property" as the 2006 Marshall & Stevens appraisal except that the total quantity of eyeglass frames had increased to 349,629 (from 171,600) and included the following additional brand names — Laura Ashley, Eddie Bauer, HSM, Nicole Miller, Dakota Smith, and Bebe.
>
> The inventory list attached to the 2007 Marshall & Stevens appraisal stated that the "donated property" consisted of the same quantity and frame models as the inventory list attached to the 2006 Marshall & Stevens appraisal plus 84,847 Laura Ashley frames, 38,923 Eddie Bauer frames, 583 HSM frames, 6,044 Nicole Miller frames, 1,047 Signature Collection frames,[8] 43,411 Dakota Smith frames, and 3,174 Bebe frames. This list also showed various models within each eyewear brand of varying quantities and wholesale prices. Like the inventory list attached to the 2006 Marshall & Stevens appraisal, the wholesale price per model ranged from $37 to $80. Using the market approach and on the basis of the wholesale prices with a markup of 35%, Marshall & Stevens opined that the fair market value of the "donated property" as of December 26, 2007, was $24,019,826.
>
> On April 9, 2008, Marshall & Stevens sent petitioners a letter stating that it had "made an analysis and valuation of the Fair Market Value of Designer Eyewear Products" and that "as a result of our analysis, we have determined that the Fair Market Value of the Designer Eyewear Products you hold is $225,596 based on" the 2007 Marshall & Stevens appraisal. The 2007 Marshall & Stevens appraisal was attached to the letter.

The court agreed with the IRS that whatever the appraisal was of, it was not of what the taxpayer donated. Indeed, it was impossible to ascertain what the taxpayer donated:

> Although the 2007 Marshall & Stevens appraisal included Mr. Campbell's 3,432 eyeglass frames, we (and the IRS) have no way to determine whether what he alone contributed is overvalued. This is the type of situation that Congress intended to prevent when it codified more than 15 years ago the requirement that a taxpayer claiming a charitable contribution deduction for the donation of property worth more than $5,000 obtain a qualified appraisal for the property contributed. Sec. 170(f)(11)(C) (as amended by the American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 883(a), 118 Stat. at 1631).

> Tellingly, the 349,629 eyeglass frames that Marshall & Stevens valued varied in price between $37 and $80, yet petitioners could not discern whether Mr. Campbell's 3,432 frames are from the low end of the price spectrum, the high end, or some varying combination. Indeed, the 2012 Miles appraisal highlights the primary defect of the 2007 Marshall & Stevens appraisal. In the 2012 Miles appraisal, 39,709 of the 349,629 eyeglass frames were assigned a value of zero as of December 2007. Might Mr. Campbell's 3,432 frames been a part of the 39,709 frames?
>
> On brief petitioners argue (via requesting that the Court find as fact) that Mr. Campbell purchased and donated a fractional interest, i.e., an undivided 3,432d interest, in the 349,629 frames. The record unmistakably belies this. As an initial matter, petitioners have stipulated that Mr. Campbell purchased a single allotment of 3,432 eyeglass frames from ZD Products.

Oddly, the taxpayers also did not receive an appropriate contemporaneous written acknowledgment which is somewhat bizarre. The opinion notes:

> Respondent contends that Lions in Sight's December 28, 2007, letter to Mr. Campbell was not a proper CWA because it did not address the “goods or services” question. We agree (although we recognize that petitioners claim, and it can be inferred from the record, that Mr. Campbell's Lions in Sight donation was not made with the expectation of a quid pro quo). The letter merely acknowledged his “generous gift of prescription eyeware [sic]” and how his contribution would assist Lions in Sight; it made no mention of whether Lions in Sight provided any goods or services in consideration for Mr. Campbell's contribution. As we have stated many times, the CWA must affirmatively state that no consideration was provided for the contributed property regardless of whether a taxpayer actually received any consideration; this is a mandatory requirement and no deduction will be allowed if the CWA does not include such a statement.

Ironically, the taxpayers avoided penalties because the IRS notice of penalties was defective:

> On the basis of the record before us, we hold that respondent has failed to carry his initial burden of production under section 7491(c) to show that he complied with the procedural requirements of section 6751(b). The Civil Penalty Approval Form, although properly signed and dated before the issuance of the notice of deficiency (the first formal communication of penalties to petitioners), does not show separate approval for the section 6662(a) and (h) penalties. The one-page form fails to state with any degree of specificity which penalties should be asserted (and are approved); indeed, all that the form states is that a “[p]enalty will be asserted with the 2008 [y]ear.” Section 6751(b)(1) would be meaningless **[*33]** if written supervisory approval of an unspecified penalty was sufficient; examining agents would be free to assert any type of penalty after written supervisory approval was given, an action that section 6751(b)(1) was designed to prevent. Consequently, since respondent has not proffered any other evidence that he complied with the procedural requirements of section 6751(b), petitioners are not liable for the section 6662(a) and (h) accuracy-related penalties.

11. **<u>Donation Disallowed Because Appraisal Summary Omitted Basis Information</u>**. Loube v. Commissioner, T.C. Memo. 2020-3, involved the contribution of a house for deconstruction to a charitable

organization. The taxpayer attached the appraisal to the taxpayer's income tax return but the appraisal summary did not set forth basis which the court held was fatal. The opinion states:

> We have recently held that a taxpayer who fails to disclose "cost or adjusted basis" on its appraisal summary has failed to substantially comply with section 1.170A-13, Income Tax Regs. RERI Holdings I, LLC v. Commissioner, 149 T.C. 1. We decided so because Congress specifically enacted DEFRA's heightened reporting requirements in order to combat inflated charitable deductions by requiring, where reasonably obtainable, the disclosure of "cost or adjusted basis" to "facilitate the Commissioner's efficient identification of overvalued property." Belair Woods, LLC v. Commissioner, at *17. Thus, a taxpayer's failure to provide the "cost or adjusted basis" on an appraisal summary is a failure to substantially comply with DEFRA sec. 155 because it is a failure to "provide[ ] sufficient information to permit * * * [the Commissioner] to evaluate the[ ] reported contributions, as intended by Congress." Smith v. Commissioner, 2007 WL 4410771, at *20; see also Belair Woods, LLC v. Commissioner, at *15-*20.
>
> In RERI Holdings I, LLC v. Commissioner, 149 T.C. at 2-3, a partnership acquired and donated a future interest in commercial property to a university. The partnership claimed a $33,019,000 charitable contribution deduction on its informational return. Id. The partnership attached to its return a complete appraisal as well as an appraisal summary. Id. at 7. However, the appraisal summary left blank the space for the donor's cost or adjusted basis and provided no explanation for the omission. Id. We held in RERI that the omission of basis from an appraisal summary prevents the appraisal summary from achieving its intended purposes and cannot be excused by substantial compliance. Id. at 16-17.
>
> In Belair Woods, LLC v. Commissioner, at *3-*5, a limited liability company (Belair) entered into a deed of conservation easement with a land trust. The easement covered 141.15 acres of land. Id. Belair claimed a resulting charitable contribution deduction of $4,778,000 on its tax return. Id. at *5-*6. Belair attached an appraisal summary which did not state the cost or the adjusted basis of the property contributed. Id. at *6-*7. Belair also attached a letter indicating that it did not state the basis because "the basis of the property is not taken into consideration when computing the amount of the deduction." Id. at *7. The Court found that Belair did not strictly comply with the regulatory requirement because the appraisal summary did not report the basis and the attached letter failed to provide a sufficient explanation showing why Belair was unable to provide that information. Id. at *11-*12.
>
> Belair's tax matters partner argued that the disclosure in the return had substantially complied because Belair's cost basis in the conservation easement could be effectively derived from several attachments to its partnership tax return: (1) a Schedule L, Balance Sheets per Books; (2) a Schedule M-1, Reconciliation of Income (Loss) Per Books With Income (Loss) Per Return; (3) a section 743(b) election and calculation sheet; and (4) the attached appraisal. Id. at *19. We rejected the tax matters partner's argument because supplying the cost or adjusted basis on the appraisal summary goes directly to the essence of statute. Id. at *15-*16 (citing Bond v. Commissioner, 100 T.C. at 41).
>
> Petitioners contend that attaching the full appraisal to their return provided the necessary information such that they substantially complied. We are not swayed. While it may have been possible for the Commissioner to glean sufficient information from the purchase price and tax information listed in the appraisal, that does nothing to change the fact that Congress specifically passed DEFRA's

> heightened substantiation requirements so that the Commissioner could efficiently flag properties for overvaluation from the face of appraisal summaries. In so doing, Congress wanted precisely to prevent the Commissioner from having to sleuth through the footnotes of millions of returns. "The IRS reviews millions of returns each year for audit potential, and the disclosure of cost basis on the Form 8283 itself is necessary to make this process manageable. Revenue agents cannot be required to sift through dozens or hundreds of pages of complex returns looking for clues about what the taxpayer's cost basis might be." Belair Woods, LLC v. Commissioner, at *20. "If cost basis is not explicitly disclosed where it is required to be disclosed, the Commissioner will be handicapped in identifying suspicious charitable deductions and deterring taxpayers from 'continu[ing] to play the "audit lottery." ' " Id.(quoting S. Prt. No. 98-169 (Vol. 1), at 444 (1984)). That is why we ruled as we did in RERI and Belair Woods and why we rule as we do now.

The charity itself was interesting:

> Petitioners resided in Maryland when they filed their petition. On or about July 1, 2013, petitioners purchased real property in Potomac, Maryland. The property was purchased for $795,000 and consisted of 0.38 acres of land and a single-family house. Petitioners desired to demolish the house and construct in its place a new residence of their own design.
>
> Second Chance, Inc. (Second Chance), is incorporated under the laws of Maryland and qualifies as a charitable organization under section 501(c)(3). Second Chance performs deconstruction, which is something less than demolition. Where demolition typically results in annihilation of a structure, deconstruction might involve only the removal of furniture, appliances, fixtures, lumber, and other materials. Second Chance sells salvageable material from deconstruction on the open market through its warehouse. But Second Chance's raison d'être is to use the deconstruction process to teach marketable skills to persons facing barriers to employment ranging from limited education to criminal records while environmentally reusing materials that would otherwise end up as landfill debris.
>
> Typically, at the stage where the decision has been made to demolish a structure, the owner will enter into an agreement with Second Chance to allow Second Chance to use the structure for deconstruction. The owner will also make a cash contribution to Second Chance, which covers the upfront costs of Second Chance's deconstruction. Once Second Chance has finished its training and removed salvageable materials, the owner will engage a third party to demolish the structure.
>
> Second Chance contacted petitioners via email on May 3, 2013, explaining its deconstruction program. The email noted that a contribution would generate a tax deduction and included a "Tax Strategy Planning Worksheet". It further noted that a demolition company would still have to be engaged and that the demolition company's cost would be constant in the project.

Footnote 2 states:

> The parties in this case appear to agree that Second Chance's deconstruction did not appreciably reduce petitioners' demolition costs.

The IRS had other issues with the way the appraisal was done – appraising the house versus items in the house – and the IRS also advanced the interesting argument that the gift was a partial interest. The court did not address those arguments. See also Oakhill Woods v. Commissioner, T.C. Memo. 2020-24, with the same issue and result. The Tax Court also rejected a challenge to the regulation's validity:

> This argument is unpersuasive for at least three reasons. First, a taxpayer's "return" for a particular year includes all IRS forms and schedules required to be filed as part of the return. See sec. 1.6011-1, Income Tax Regs. The Form 8283, comprising the appraisal summary, was an essential component of petitioner's return for 2010. By requiring inclusion of information concerning cost basis and acquisition date on the Form 8283, the Secretary complied with Congress' mandate that such data be "include[d] on such return." DEFRA sec. 155(a)(1)(C).
>
> Second, even if Congress were thought to have intended "appraisal summary" and "return" to be mutually exclusive terms, there is nothing in DEFRA section 155 that prohibits the Secretary from requiring that information concerning cost basis and acquisition date be included both on the appraisal summary and elsewhere on the return. Petitioner reads into DEFRA section 155(a)(1)(C) a negative pregnant that is wholly unjustified by the text.
>
> Third, DEFRA section 155(a)(3), which petitioner fails to cite, wholly undermines its argument. That paragraph, captioned "Appraisal summary," provides that, "[f]or purposes of this subsection, the appraisal summary shall be in such form and include such information as the Secretary prescribes by regulations." (Emphasis added.) Congress thus left the Secretary with discretion to require inclusion on Form 8283 of whatever information the Secretary reasonably deemed relevant. See Blau, 924 F.3d at 1270 ("Though the Congress left it to the discretion of the Secretary * * * to impose additional reporting requirements, the Congress specifically identified the basis and the date of acquisition as the bare mini-mum that a taxpayer must provide."). The Code provision governing appraisals makes the depth of the Secretary's discretion plain. See sec. 170(f)(11)(C) (requiring that taxpayers obtain a qualified appraisal and "attach[ ] to the return * * * such information regarding such property and such appraisal as the Secretary may require"). For these reasons we reject petitioner's contention that the regulation violates Chevron step one on the theory that it contravenes "the unambiguous language of the statute."
>
> It seems equally obvious that the regulation satisfies Chevron step two, which requires that the regulation be "based on a permissible construction of the statute." Chevron, 467 U.S. at 843, 104 S.Ct. 2778. When enacting DEFRA Congress decided that the IRS needed disclosure of information--specifically including information concerning cost basis and acquisition date of donated property--in order to combat claims of "excessive charitable deductions" by taxpayers seeking to "play 'the audit lottery.' " S. Prt. No. 98-169 (Vol. 1), supra at 444. Congress accordingly directed the Secretary to issue regulations requiring that taxpayers claiming certain types of charitable deductions attach to their returns an appraisal summary, which "shall be in such form and include such information as the Secretary prescribes by regulations." DEFRA sec. 155(a)(3).
>
> The Secretary reasonably concluded that the information the IRS needed would be most accessible to its examining agents if all of the required information appeared in the same place, namely, on the appraisal summary. The Secretary [*27] therefore issued regulations requiring that information concerning cost basis and acquisition date (as well as nine other types of information) be included in the

> appraisal summary included with the return. See sec. 1.170A-13(c)(4)(ii), Income Tax Regs. We have no difficulty concluding that the Secretary's requirement to this effect was "based on a permissible construction of the statute." Chevron, 467 U.S. at 843, 104 S.Ct. 2778. We will accordingly deny petitioner's cross-motion for summary judgment insofar as it contends that the regulation is invalid.

12. **Judicial Ethics, Oklahoma**. A judge may not serve as a trustee of a charitable foundation under Oklahoma law. Oklahoma Judicial Ethics Opinion 2020-1, 2020 WL 7863327. A friend died and created a charitable foundation; the judge was to be one of three trustees. A duty of the trustees was to select charitable distributees. The Ethics Commission reasoned that "[t]he trustees of the newly created charitable foundation could put themselves in conflicting situations with other charities based on their decisions of granting or denying the other charities' requests for funding." Rule 3.7 of the Code of Judicial Conduct provides:

> **RULE 3.7 Participation in Educational, Religious, Charitable, Fraternal, or Civic Organizations and Activities**
>
> (A) Subject to the requirements of Rule 3.1, a judge may participate in activities sponsored by organizations or governmental entities concerned with the law, the legal system, or the administration of justice, and those sponsored by or on behalf of educational, religious, charitable, fraternal, or civic organizations not conducted for profit, including but not limited to the following activities:
>
> (1) assisting such an organization or entity in planning related to fund-raising, and participating in the management and investment of the organization's or entity's funds;
>
> (2) soliciting contributions for such an organization or entity, but only from members of the judge's family, members of the judge's household or from judges over whom the judge does not exercise supervisory or appellate authority;
>
> (3) soliciting membership for such an organization or entity, even though the membership dues or fees generated may be used to support the objectives of the organization or entity, but only if the organization or entity is concerned with the law, the legal system, or the administration of justice;
>
> (4) appearing or speaking at, receiving an award or other recognition at, being featured on the program of, and permitting his or her title to be used in connection with an event of such an organization or entity, but if the event serves a fund-raising purpose, the judge may participate only if the event concerns the law, the legal system, or the administration of justice;
>
> (5) making recommendations to such a public or private fund-granting organization or entity in connection with its programs and activities, but only if the organization or entity is concerned with the law, the legal system, or the administration of justice; and
>
> (6) serving as an officer, director, trustee, or nonlegal advisor of such an organization or entity, unless it is likely that the organization or entity:
>
>> (a) will be engaged in proceedings that would ordinarily come before the judge; or

(b) will frequently be engaged in adversary proceedings in the court of which the judge is a member, or in any court subject to the appellate jurisdiction of the court of which the judge is a member.

> COMMENT
>
> [1] The activities permitted by paragraph (A) generally include those sponsored by or undertaken on behalf of public or private not-for-profit educational institutions, and other not-for-profit organizations, including law-related, charitable, and other organizations.
>
> [2] Even for law-related organizations, a judge should consider whether the membership and purposes of the organization, or the nature of the judge's participation in or association with the organization, would conflict with the judge's obligation to refrain from activities that reflect adversely upon a judge's independence, integrity, and impartiality.
>
> [3] Mere attendance at an event, whether or not the event serves a fund-raising purpose, does not constitute a violation of paragraph 4(A). It is also generally permissible for a judge to serve as an usher or a food server or preparer, or to perform similar functions, at fund-raising events sponsored by educational, religious, charitable, fraternal, or civic organizations. Such activities are not solicitation and do not present an element of coercion or abuse the prestige of judicial office.
>
> [4] Identification of a judge's position in educational, religious, charitable, fraternal, or civic organizations on letterhead used for fund-raising or membership solicitation does not violate this Rule. The letterhead may list the judge's title or judicial office if comparable designations are used for other persons.

Presumably the concern was that the judiciary could be seen as favoring or disfavoring certain charities.

13. **<u>No Self-Dealing Due To Tax Reimbursement Provision After Spouses' Deaths</u>**. In PLR 202042007 husband had created Trust A, wife had created Trust B, each a revocable trust that had become irrevocable when each died. Husband's estate is subject to estate tax because Trust B became a QTIP for husband at wife's death and Trust B contains a tax reimbursement provision in favor of husband's estate. The reimbursement would be in the form of closely-held stock and husband's estate would seek to pay the estate tax using section 6166. Meanwhile, the assets in Trust A would pay to the couple's private foundation, generating no estate tax.

The issue was that at husband's death half of the QTIP, Trust B, passed to the foundation, so would the payment of estate tax be indirect self-dealing? The IRS concluded it would not:

> H's estate will pay an estate tax that results from the inclusion of the assets of Trust B in H's estate for tax purposes. Trust B, pursuant to the Trust B trust agreement and the order of the probate court, is reimbursing H's estate, in kind, with Corporation stock having a fair market value equal to the estate tax resulting from the inclusion of the Trust B assets in H's estate.
>
> Trust B requires the trustee of Trust B to reimburse H's estate for the estate taxes resulting from the inclusion of the assets of Trust B in H's estate before making any distributions to beneficiaries. Thus, the reimbursement by Trust B to H's estate in the form of Corporation shares pursuant to Trust B trust agreement is payment of a necessary expense associated with the administration of Trust B. Taxpayer's only interest in Trust B is as a residuary beneficiary. Thus, while under *Reis*, supra, Taxpayer has an interest in the Trust B residuary assets, Taxpayer has

no interest in the stock transferred to H's estate to satisfy Trust B's reimbursement obligation because, by definition, it is not part of the Trust B residuary.

The reference to Reis is to Estate of Reis v. Commissioner, 87 T.C. 1016 (1986) in which the Tax Court held that where an estate passed to a foundation the assets of the estate are akin to assets of the foundation and actions affecting them are subject to the self-dealing rules.

14. Pre-Arranged Sales. Under the anticipatory assignment of income doctrine, a taxpayer who earns or otherwise creates a right to receive income will be taxed on any gain realized from that right if, based on the realities and substance of events, the receipt of income is practically certain to occur, even if the taxpayer transfers the right before receiving the income (see Ferguson v. Commissioner, 174 F.3d 997 (9th Cir. 1999); Lucas v. Earl, 281 U.S. 111 (1930)). The related step transaction doctrine similarly prevents a taxpayer from escaping taxation by collapsing a series of substantially linked steps into a single overall transaction (see Penrod v. Commissioner, 88 T.C. 1415, 1428 (1987)).

In Palmer v. Commissioner (62 T.C. 684 (1974), aff'd on other grounds, 523 F.2d 1308 (8th Cir. 1975), acq, 1978-1 C.B. 2), the Tax Court held that a taxpayer's gift of stock in a closely-held corporation to a private foundation, followed by a redemption, would not be characterized as a sale or redemption between the taxpayer and the corporation followed by a gift of the redemption proceeds to the foundation, because the foundation was not legally obligated to redeem the stock at the time it received the shares. In Revenue Ruling 78-197 (1978-1 C.B. 83), the Service announced that it would treat the proceeds of a stock redemption under facts similar to those in the Palmer case as income to the donor only if the donee is legally bound or can be compelled by the corporation to surrender the shares for redemption. The “bright line” test of Palmer and Revenue Ruling 78-197 is not haze free.

In Blake v. Commissioner, 42 T.C.M. 1336 (1981), aff’d, 697 F.2d 473 (2d. Cir. 1982), the donor contributed stock to a charity with the understanding that the charity would permit the corporation to redeem the stock and the charity would then use the proceeds to buy the donor’s yacht at an inflated price. The yacht was sold shortly thereafter by the charity for less than 50 percent of the price it had paid the donor. The Second Circuit Court of Appeals found the “understanding” enough to re-characterize the transaction as a sale of stock by the donor, followed by a contribution of the yacht to charity. Note that, unlike in other situations, there was a quid pro quo required by the donor in order for the donor to make the stock gift.

In Ferguson v. Commissioner, 108 T.C. 244, (1997), aff’d, 174 F.3d 997 (9th Cir. 1999), there was a gift of stock followed by a redemption pursuant to the terms of a merger agreement. The donors were directors and minority shareholders of Company A. On day 1, Company A entered into an agreement and plan of merger with Company B. Company A’s board of directors (the donors abstaining) approved the merger and recommended it to the shareholders. On day 6, Company B made its tender offer. By day 34, more than 50 percent of the shareholders had tendered their shares. On day 43, the donors donated some of their Company A stock to a charity, which in turn immediately tendered the stock to Company B. On day 46, Company B announced its acceptance of all the tendered shares and purchased all of the shares on day 47. The Tax Court found that the donors were taxable on the gain from the stock transferred

to charity because by the date of the gift the donors' interest had been converted from an interest in a viable corporation to a fixed right to receive cash. The Ninth Circuit Court of Appeals affirmed, holding that the transaction had "ripened" into a right to receive sale proceeds once 50 percent shareholder approval for the merger had been reached.

The application of Revenue Ruling 78-197 again arose in Gerald A. Rauenhorst, et al. v. Commissioner, 119 T.C. No. 9 (2002). In that case, Arbeit (a partnership) owned warrants enabling it to purchase NMG stock. On September 28, 1993, WCP (a corporation) offered to purchase all NMG stock. On November 9, 1993 the partnership assigned some warrants to four charities. On November 19 Arbeit sold its remaining warrant to WCP, and the charities sold their warrants to WCP. On November 22, 1993, WCP and NMG agreed on a sale of all the NMG stock. The government argued that the bright-line test of Revenue Ruling 78-197 was not controlling. The court held that, based on the facts of the case and the "no legal obligation" test of Palmer and Revenue Ruling 78-197, there was no prearranged sale, and in the process took a very dim view of the government's urging to ignore the ruling:

> While this Court may not be bound by the Commissioner's revenue rulings, and in the appropriate case we could disregard a ruling or rulings as inconsistent with our interpretation of the law, see Stark v. Commissioner, 86 T.C. 243, 251 (1986), in this case it is respondent who argues against the principles stated in his ruling and in favor of our previous pronouncements on this issue. The Commissioner's revenue ruling has been in existence for nearly 25 years, and it has not been revoked or modified. No doubt taxpayers have referred to that ruling in planning their charitable contributions, and, indeed, petitioners submit that they relied upon that ruling in planning the charitable contributions at issue. Under the circumstances of this case, we treat the Commissioner's position in Rev. Rul. 78-197, 1978-1 C.B. 83, as a concession. Accordingly, our decision is limited to the question whether the charitable donees were legally obligated or could be compelled to sell the stock warrants at the time of the assignments.

A footnote to the opinion states as follows:

> The record indicates that no agreement was entered into by the donees before Nov. 19, 1993, the date they signed the warrant purchase and sale agreement. On Nov. 16, 1993, NMG's legal counsel sent letters to each of the donees enclosing a warrant purchase and sale agreement. Those letters state that pursuant to the warrant purchase and sale agreement, the donees would agree to sell their reissued warrants to WCP and "to abstain from either exercising its Warrant or selling or otherwise transferring it to any other party through Dec. 31, 1993." Certainly, the formality of having the donees enter into the warrant purchase and sale agreements suggests that they had not entered into any binding agreements before Nov. 19, 1993.

Subsequent to Rauenhorst, the government reiterated its intention, generally, to follow its own rulings in litigation. In PLR 200230004, a husband and wife proposed to transfer 495 of 500 shares of a C corporation to a charitable remainder unitrust and asked whether the redemption would be treated as an assignment of income. The ruling first describes Palmer and Revenue Ruling 78-197 and then states as follows:

> In the present case, at the time X shares are transferred to Trust, X will be under no legal obligation to redeem the contributed stock. There is no agreement among the parties under which X would be obligated to redeem, or Trust would be

> obligated to surrender for redemption, the stock. Trust is not legally obligated to accept any offer of redemption made by X. Accordingly, any redemption by X of the stock contributed by Grantors to Trust will be respected.
>
> Based on the representations submitted and information described above, we conclude that a purchase by X of the stock transferred by Grantors to Trust will be treated as a redemption of the stock from Trust, and will not be treated as a redemption of stock from Grantors or a distribution by X to Grantors. Therefore, the sale or redemption by Trust of its X stock will not result in the capital gain in such sale or the redemption price being attributed for tax purposes to Grantors.

In PLR 200321010, a retired officer of a corporation intended to give shares of the corporation to a charitable remainder unitrust. The transfer would trigger an option under a shareholder agreement, giving the company the right to purchase the stock for a formula price. The ruling described the "bright-line" test of Palmer, cited Rauenhorst, and concluded as follows:

> Consequently, the test for purposes of this ruling request, is whether the CRUT will be legally bound or can be compelled by Company to surrender the stock for redemption at the time of the donation. Here, X proposes to transfer the Company stock to the CRUT. Under the restrictions contained in each year's stock restriction agreement, the CRUT must first offer the stock to Company at a set formula price should the CRUT propose to dispose of the shares. This provision amounts to a right of first refusal. However, it does not mean that the CRUT is legally bound or can be compelled by Company to surrender the stock to Company at the time of the donation. The information submitted contains no indication that the CRUT will be legally bound, or could be compelled by Company, to redeem or sell the gifted stock. That all or a portion of the gifted stock was subject to restrictions upon transfer to a third party by X, and thus by the CRUT following the transfer, does not give Company the ability to compel its redemption or sale from the CRUT. The CRUT is free to retain title to and ownership of the stock indefinitely.
>
> Because the CRUT is not legally bound and cannot be compelled by Company to redeem or sell the stock, we conclude that the transfer of the Company stock by X to the CRUT, followed by any subsequent redemption of the stock by Company, will not be recharacterized for federal income tax purposes as a redemption of the stock by Company from X followed by a contribution of the redemption proceeds to the CRUT. See Palmer v. Commissioner, supra, and Rev. Rul. 78-197, supra. The same principles apply if the stock is sold by the CRUT rather than redeemed by Company. Thus, provided there is no prearranged sale contract whereby the CRUT is legally bound to sell the stock upon the contribution, we conclude that any subsequent sale will not be recharacterized for federal income tax purposes as a sale of the stock by X, followed by a contribution of the sale proceeds to the CRUT. Accordingly, any redemption proceeds or sales proceeds received by the CRUT for the stock will not be treated as taxable income received by X.

See also PLR 200821024 to the same effect.

In Dickinson v. Commissioner, T.C. Memo. 2020-128, Judge Greaves reached the right result but the litigation itself is disturbing. The CFO of a private company donated shares to a donor advised fund (DAF) when allowed to transfer shares by the board, on three occasions. The board was comfortable allowing the transfers because

the DAF had a policy of trying to sell closely-held shares quickly which meant, as a practical matter, offering the shares back to the company. In fact, after each donation the company redeemed the shares.

The IRS treated the donation and redemption as an integrated whole to claim the taxpayers in effect sold the stock and contributed the proceeds. Why is puzzling. One would have thought that Rev. Rul. 78-197 would have been dispositive for the taxpayers but apparently not. The opinion discusses that ruling as follows:

> The parties point us to Rev. Rul. 78-197, 1978-1 C.B. 83, a "bright-line" rule the IRS applies in cases like Palmer, which focuses on the donee's control over the disposition of the appreciated property. See Rauenhorst v. Commissioner, 119 T.C. at 165. This Court has not adopted Rev. Rul. 78-197, supra, as the test for resolving anticipatory assignment of income issues, see Rauenhorst v. Commissioner, 119 T.C. at 166, and does not do so today. The ultimate question, as noted in Palmer, is whether the redemption and the shareholder's corresponding right to income had already crystallized at the time of the gift. See Palmer v. Commissioner, 62 T.C. at 694-695. Regardless of whether the donee's obligation to redeem the stock may suggest the donor had a fixed right to redemption income at the time of donation, See Rauenhorst v. Commissioner, 119 T.C. at 166-167, respondent does not allege that petitioner husband had any such right in this case. Accordingly, respondent's resort to Rev. Rul. 78-197, supra, is unavailing.

The opinion relies on a two-prong approach set forth in Humacid Co. v. Commissioner, 42 T.C. 894 (1964), which respected the form of the transaction if the taxpayer (1) gives the property away absolutely and parts with title thereto (2) before the property gives rise to income by way of a sale.

The court determined both prongs were easily met. Even a "preexisting understanding among the parties that the donee would redeem donated stock does not convert a postdonation redemption into a predonation redemption."

The opinion notes:

> Furthermore, neither a pattern of stock donations followed by donee redemptions, a stock donation closely followed by a donee redemption, nor selection of a donee on the basis of the donee's internal policy of redeeming donated stock suggests that the donor failed to transfer all his rights in the donated stock. See, e.g., Grove v. Commissioner, 490 F.2d at 242–245 (respecting form of transaction where donee needed to fundraise to support its operations, and over a decade consistently redeemed annual donations of stock for which donor remained entitled to dividends); Carrington v. Commissioner, 476 F.2d at 705–706 (respecting form of transaction where donee redeemed stock eight days after it was donated); Palmer v. Commissioner, 62 T.C. 684, 692–693 (1974), (respecting form of transaction where, pursuant to a single plan, the taxpayer donated stock to a foundation and then caused the corporation to redeem the stock from the foundation the day after the donation), aff'd, 523 F.2d 1308 (8th Cir. 1975). Petitioners' contemporaneous documentary evidence of an absolute gift, and respondent's failure to assert facts indicating any genuine controversy on this point, lead us to conclude that petitioner husband's donations satisfy the first Humacid requirement.

With respect to second prong, the court follows a "practically certain" analysis which is squishier that the bright-line test of Rev. Rul. 78-197:

> Where a donee redeems shares shortly after a donation, the assignment of income doctrine applies only if the redemption was practically certain to occur at the time of the gift, and would have occurred whether the shareholder made the gift or not. See Palmer v. Commissioner, 62 T.C. at 694–695; see also Ferguson v. Commissioner, 174 F.3d 997, 1003–1004 (9th Cir. 1999) (finding that the shareholder recognizes income from a stock sale where acquisition is "practically certain to occur", rather than the subject of "a mere anticipation or expectation", before the shareholder donates stock), aff'g 108 T.C. 244 (1997). In Hudspeth v. United States, 471 F.2d 275, 276 (8th Cir. 1972), for example, the court recast a stock donation as a taxable stock sale and donation of the sale proceeds where the taxpayer donated stock after the issuing corporation's directors and shareholders had adopted a plan of complete liquidation. See also Jones v. United States, 531 F.2d 1343, 1343–1344 (6th Cir. 1976); Allen v. Commissioner, 66 T.C. 340, 347 (1976).2 By contrast, there was no assignment of income in Palmer v. Commissioner, 62 T.C. at 687–688, 695, even though all parties were related and anticipated the redemption before the donation, because "no vote for the redemption had yet been taken" when the shareholder donated the stock. As in Palmer, the redemption in this case was not a fait accompli at the time of the gift.

15. Another Favorable Note to CLT Via Non-Voting LLC Interests Ruling. Many individuals sell assets during lifetime to family trusts in exchange for notes. A foundation or entity like a CLT that is similarly subject to the self-dealing rules of section 4941 may not hold those notes, because the obligor trust will be a disqualified person with respect to the CLT. The solution to this problem is to drop the note into an LLC and transfer non-voting interests to the CLT. Such was allowed most recently in PLR 202037009 which states:

> CLT proposes that Revocable Trust form LLC and contribute cash and the Note to LLC in exchange for 100% of LLC's ownership interests, 99% of which are nonvoting interests and 1% of which are voting interests. Revocable Trust will satisfy its distribution obligations by distributing to CLT an amount of nonvoting interests in LLC with a value equal to CLT's full distribution entitlement. The remaining undistributed nonvoting interests and all voting interests in LLC will be distributed to the other Revocable Trust beneficiaries, A, B, and C in their individual capacities, and not as trustees of CLT.
>
> Pursuant to the LLC operating agreement, LLC will be managed by a single manager (Manager) who is selected and may be removed by a vote of the members holding a majority of the voting interests. The holders of the nonvoting interests will possess no management rights or rights to vote on the appointment or removal of Manager. An amendment to the LLC operating agreement or dissolution of the LLC requires the approval of all members, whether holding voting or nonvoting interests.
>
> LLC will hold and administer the Note and receive payments of interest and principal on the Note. Aside from the cash initially contributed to LLC by Revocable Trust, LLC's PLR-133620-18 3 sole asset and source of income will be the Note. CLT will engage only in passive investment activities, and not in the operation of any business enterprise. At least 95% of CLT's gross income will be from passive investments including interest and dividends.

* * *

CLT will not "control" LLC within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5) due to a lack of voting power. As holder of the nonvoting interests, CLT will have no management rights or right to vote on the manager of LLC. The other beneficiaries of Revocable Trust will own all of the voting interests, giving them the right to select and remove the manager LLC. As a holder of nonvoting interests, CLT will have a right to receive distributions only if LLC dissolves or chooses to make current distributions, but the timing and amount of such distributions will be uncertain and cannot be compelled by CLT. Only the other beneficiaries of Revocable Trust, as the holders of the voting interests, may elect or remove the Manager, who will have the sole power to manage the affairs of LLC and determine the timing and amount of distributions. Thus, CLT and CLT's trustees (acting only in such capacity) will not have sufficient votes or positions of authority to cause LLC to engage in a transaction.

Additionally, CLT will not have the power to compel dissolution of LLC since LLC may only be dissolved with written approval of all members, including the holders of the voting interests. The power associated with the nonvoting interests of LLC as a necessary party to vote on the liquidation of LLC is not considered equivalent to a "veto power" within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5) because the power cannot be exercised over an action relevant to any potential act of self-dealing. Consequently, CLT will not "control" LLC within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5)

Accordingly, CLT's receipt of nonvoting interests in LLC from Revocable Trust will not constitute a loan or extension of credit between a "private foundation" and a "disqualified person" within the meaning of section 4941(d)(1)(B) and Treas. Reg. §53.4941(d)-2(c) because CLT will not acquire an interest in the promissory note; instead, CLT will acquire nonvoting interests in LLC, with respect to which it will not have any management rights or control over distributions.

Thus, CLT's receipt and continued ownership of nonvoting interests in LLC will not constitute an act of self-dealing described in section 4941.

* * *

Under Treas. Reg. § 53.4941(d)-1(b)(4), a transaction between a private foundation and an organization does not result in an act of self-dealing where the organization is neither controlled by the foundation nor does it have a disqualified person owning at least a 35% beneficial interest in the organization. Here, as explained above, CLT does not control LLC because CLT only holds nonvoting interests, with the only voting interests in LLC held by the other Revocable Trust beneficiaries. Although the other Revocable Trust beneficiaries may be trustees of CLT and thus disqualified persons, they own the voting interests in LLC in their individual capacities and not as foundation managers of CLT. Further, the other Revocable Trust beneficiaries only own an approximately 1% beneficial interest in LLC, below the 35% threshold.

* * *

LLC's sole asset will be the Note, which will generate passive income in the form of interest, as described in sections 4943(d)(3) and 512(b)(1). As such, LLC will not be considered a "business enterprise" for purposes of section 4943(d)(3) because at least 95 percent of its gross income will derive from passive sources.

> See also Treas. Reg. § 53.4943-10(c)(1). Because LLC will not be considered a "business enterprise," the restrictions on excess business holdings under section 4943 will not apply. Thus, CLT's receipt and continued ownership of nonvoting interests in LLC will not result in excess business holdings under section 4943.

See also PLR 2021002, involving the sale during lifetime to a joint revocable trust followed by the note contribution.

16. Termination of a CRAT. In PLR 202047005 spouses were annuity beneficiaries of a charitable remainder annuity trust. The spouses assigned their annuity interests to the remainder charity which became the only beneficiary of the trust. The trust would then be dissolved by court order. The annuitant spouses were also trustees of the CRAT. The IRS determined there would be no self-dealing nor income tax at termination. The spouses would receive no income tax deduction for the contribution because they have no basis in the annuity interest. The ruling notes:

> In Rev. Rul. 86-60, 1986-1 C.B. 302, Situation 1, in 1980, A created a charitable remainder annuity trust described in section 664(d)(1). A retained the annuity interest in the trust for life. The remainder beneficiary was X, a charitable organization described in sections 170(c) and 2522(a). In 1984, A transferred the entire annuity interest in the trust to X. The Service ruled that, although A had previously divided the interest A held in the property, the division was not to avoid section 170(f)(2)(A). Thus, under section 1.170A-7(a)(2)(i), A's transfer of A's entire life annuity interest qualified for an income tax charitable deduction.
>
> * * *
>
> Generally, section 170(a)(1) would permit an income tax charitable contribution deduction for the present value of an annuity interest assigned to a charitable organization; such assignment would be treated as a gift for Federal income tax purposes.
>
> Analogous to the taxpayer in Situation 1 in Rev. Rul. 86-60, Taxpayer and Spouse desire to transfer their undivided annuity interest to Foundation, a charitable organization described in sections 170(c) and 2522(a). Pursuant to section 170(e)(1)(B)(ii), Taxpayer's and Spouse's income tax charitable contribution deduction will be reduced by the total amount of the gain that would have been realized if the contributed property had been sold at its fair market value. Pursuant to section 1001 et. seq., as described above, Taxpayer's and Spouse's basis in the annuity interest will be zero, thus resulting in a gain equal to their entire interest transferred, and no income tax charitable contribution deduction will be allowed for the assignment of their annuity interest.
>
> Despite the fact that Taxpayer and Spouse will not be eligible for an income tax charitable contribution deduction for the assignment of their undivided annuity interest, Rev. Rul. 86-60 provides that the assignment of an annuity interest is treated as a gift under section 1.170A-1(h), and not as a sale or exchange of a capital asset that would result in taxable income to Taxpayer and Spouse.
>
> Section 170(a)(1) allows as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. Special rules apply for contributions to private foundations. Pursuant to section 170(e)(B)(ii), the amount of any charitable contribution of property otherwise taken into account

> under section 170 is reduced by the sum of, in the case of a charitable contribution to or for the use of a private foundation (as defined in section 509(a)), other than a private foundation described in subsection (b)(1)(F), the amount of gain which would have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution). As a result, the charitable contribution deduction for appreciated property to private foundations is generally limited to the donor's basis in the property, which in this case, is zero.

C. SECTION 408 — IRAs AND RETIREMENT PLANS

1. SECURE Act Changes. Sections 114 and 401 of the Setting Every Community Up for Retirement Enhancement ("SECURE") Act of 2019 contain a number of provisions important to estate planners primarily in connection with distributions from defined contribution plans ("plans") and individual retirement accounts.

a. Required Beginning Date Change

The term required beginning date ("RBD") refers to the date when the plan participant or IRA owner (the "employee") begins receiving required minimum distributions ("RMDs") from the plan or IRA. Before the SECURE Act, the RBD was April 1 of the year following the year in which the employee reached age 70½ or, if not a 5% owner, retired, whichever was later. Section 114 of the SECURE Act, amending sections 401(a)(9)(B) & (C) and 408(b), changes the RBD for employees who reach age 70½ after December 31, 2019 to April 1 of the year following the year in which the employee reaches age 72 or, if not a 5% owner, retires, whichever is later. One result of this change is that no one will have an RBD in 2021.

This is a small positive development for taxpayers because, while there is no prohibition against or penalty for starting to receive distributions a year or two earlier than one's RBD, those who can afford to defer starting to receive distributions until the new RBD may have as much as an extra year of tax-deferred earnings on the amount of their initial RMD.

b. Introduction of "Eligible Designated Beneficiary" Concept

Section 401 of the SECURE Act, amending section 401(a)(9)(E), introduces the term "eligible designated beneficiary" ("EDB"). An EDB includes an employee's surviving spouse, an employee's child who has not reached majority (an employee's child who has not completed a "specified course of education" is a minor but what such a course is, is uncertain; similarly, a child who has not attained age 26 appears to be a minor for these purposes), a "disabled" individual (within the meaning of section 72(m)(7)), a chronically ill individual (within the meaning of section 7702B(c)(2)) and an individual not more than ten years younger than the employee. An employee's child who has reached majority is no longer an EDB. EDB status is determined as of the employee's date of death.

c. Minimum Required Distribution Rules Under SECURE Act

Before the SECURE Act, if the beneficiary of a defined contribution plan or IRA was a designated beneficiary ("DB") (very simply, an individual who is designated as a beneficiary under the plan (or IRA)), RMDs

could generally be made to the DB over his or her life expectancy. The opportunity to spread RMDs over a beneficiary's life expectancy was (and is) generally considered to be a positive attribute because it usually enables accumulation and compounding of tax-deferred earnings within the plan or IRA for a relatively long period.

The SECURE Act left the defined contribution plan and IRA distribution options pertaining to a surviving spouse largely unchanged. As before, a surviving spouse may elect to treat a predeceased spouse's IRA as her or his own, implement a spousal rollover or take plan or IRA distributions over her or his life expectancy as annually recalculated. A surviving spouse may delay the start of distributions until the predeceased spouse would have reached age 72.

Also left undisturbed by the SECURE Act are the RMD rules applicable when there is no DB. In that case, if the employee dies before reaching his or her RBD, all plan or IRA proceeds must be distributed by the end of the fifth year after the year of the employee's death, and, if the employee dies on or after reaching his or her RBD, all plan or IRA proceeds must be distributed over the employee's then remaining life expectancy without annual recalculation.

However, under the SECURE Act, if and only if a plan or IRA beneficiary is an EDB, he or she may receive plan or IRA proceeds over his or her life expectancy (but, unless such beneficiary is the employee's surviving spouse, without annual recalculation). If a plan or IRA beneficiary is a DB but not an EDB, that DB must take all plan or IRA proceeds by the end of the tenth year after the year of the employee's death. These provisions are effective with respect to plans and IRAs where the employee died or dies after December 31, 2019.

d. Summary of Trust Planning Under SECURE Act

A so-called "conduit trust" is a trust whose terms mandate that any and all distributions the trust receives from a plan or IRA pursuant to the applicable beneficiary designation shall be immediately paid over to the current beneficiary. A conduit trust is the ultimate "see-through trust" because, when determining the amounts of RMDs distributable from a plan or IRA to the trust, one simply looks to the identity and age of the current beneficiary.

If plan or IRA benefits are payable to a conduit trust for the benefit of the employee's surviving spouse, those benefits may be paid over the annually recalculated life expectancy of the surviving spouse. Following the death of the surviving spouse, any remaining benefits will have to be paid no later than the end of the tenth year after the year of death of the surviving spouse.

If plan or IRA benefits are payable to a conduit trust for the benefit of a non-spousal EDB, those benefits may be paid over the life expectancy of the EDB without recalculation. Following the death of the non-spousal EDB, any remaining benefits will have to be paid no later than the end of the tenth year after the year of such death. The major exception to these rules, however, is that, if the non-spousal EDB is a minor child of the employee, the plan or IRA benefits payable to the conduit trust can no longer be paid over the EDB's life expectancy (without recalculation) from and after the point when that child has reached majority. From and after that time, any remaining benefits will

have to be paid no later than the end of the tenth year after the year in which the child reached majority. If plan or IRA benefits are payable to a conduit trust for the benefit of a DB who is not an EDB, those benefits will have to be paid no later than the end of the tenth year after the year of the employee's death.

A so-called "accumulation trust" is a "see-through trust" whose terms do not require that any and all distributions the trust receives from a plan or IRA pursuant to the applicable beneficiary designation shall be paid over to any trust beneficiary at any particular time. A see-through trust is one that is valid under state law, irrevocable, has identifiable, human beneficiaries and as to which certain documentation is provided to the plan or IRA custodian or trustee by October 31 of the year after the employee's death. See Treas. Reg. Section 1.401(a)(9)-4, A-5(b).

In general, if plan or IRA benefits are payable to an accumulation trust, those benefits will have to be paid no later than the end of the tenth year after the year of the employee's death. The exceptions to this general rule are as follows:

- If the accumulation trust is for the benefit of a disabled individual or a chronically ill individual, (two categories of EDB as defined in amended section 401(a)(9)(E)) and has multiple beneficiaries, it is an "applicable multi-beneficiary trust" ("AMBT"). Plan or IRA benefits payable to an AMBT may be paid using the life expectancy method, but it is not entirely clear whether the measuring life is that of the disabled or chronically ill individual or another beneficiary.
- If one or more beneficiaries of the accumulation trust are non-DBs:
  - If the employee dies before his or her RBD, plan or IRA benefits will have to be paid no later than the end of the fifth year after the year of the employee's death.
  - If the employee dies on or after his or her RBD, plan or IRA benefits may be paid over the employee's then remaining life expectancy without recalculation.

2. Waiver of 2020 Required Minimum Distributions. The CARES Act (the "Coronavirus Aid, Relief and Economic Security Act"), signed by the President on March 27, 2020, includes a provision (Section 2203, amending sections 401(a)(9) & 402(c)(4)) granting a waiver of any and all defined contribution plan and IRA RMDs that, in the absence of the waiver, would have been required in 2020. Thus, amounts that would have been mandated RMDs for 2020 (even for those who reached age 70½ in 2019 and so would have been required to take two RMDs in 2020) were permitted instead to remain inside the plan or IRA in 2020 and continue to generate tax-deferred investment return.

On June 23, 2020, the IRS issued Notice 2020-51. Notice 2020-51 explicitly allows a recipient of a RMD in 2020 to roll it over – essentially reversing the transaction and its otherwise applicable tax consequences.

The timing of enactment of the CARES Act in relation to the 2020 RMD waiver it granted, however, created a dilemma for those employees who wanted to take advantage of the waiver but at the time of enactment or shortly thereafter had already taken their 2020 RMD and allowed sixty days to pass. To alleviate this problem, Notice 2020-

51 also expanded the usual sixty-day rollover period so that any RMD received in 2020, regardless of when received in 2020, could be rolled over until August 31, 2020, at the earliest.

Other important provisions of the CARES Act include Section 2202, amending section 72, which allowed the following:

- A "qualified individual" could receive in-service "coronavirus-related distributions" from a plan or IRA of up to $100,000.00 from January 1, 2020 through December 30, 2020 without being subject to the 10% early distribution penalty if the recipient was under age 59½ and with the options to elect ratable income taxation of the amount distributed over a three-year period or to repay to the plan or IRA within three years the amount distributed as if the repayment were validly rolled-over in a trustee-to-trustee transfer within sixty days of the distribution. Qualified individuals are those who is diagnosed with SARS-CoV-2 or COVID-19, whose spouse or a dependent diagnosed with SARS-CoV-2 or COVID-19 or who experiences adverse financial consequences from being quarantined, furloughed or laid off, having work hours reduced, being unable to work due to lack of child care or closing or reducing the hours of a business owned or operated by such individual. This was an expansive group.

- A qualified individual could receive loans from a qualified plan of up to $100,000.00 or the employee's nonforfeitable, accrued benefit (an increase in the loan limit from $50,000 or one-half of the employee's nonforfeitable, accrued benefit) through September 22, 2020. See IRS Notice 2020-50. A plan sponsor may delay a qualified individual's loan repayment obligation for one year. Subsequent repayments with respect to any such loan are required to be adjusted to reflect that delay and any interest accruing during that delay.

D. SECTIONS 671-678 -- GRANTOR TRUST RULES

1. Section 678 and a Presently Exercisable General Power of Appointment As A Planning Device.

Section 678 provides:

> (a) General Rule. —A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:
>
> > (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or
> >
> > (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.
>
> (b) Exception Where Grantor Is Taxable. Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom section 679 applies) is otherwise treated as the owner under the provisions of this subpart other than this section.
>
> [emphasis added]

Section 678(a)(2) has long been the basis for estate tax planning: a parent contributes $5000 to a trust that gives the child a 30 day withdrawal right and gives the child other powers that would have made the trust a grantor trust if the child had contributed the $5000 to the trust. The child would appear to be the owner of the entire trust

(assuming that parent has no rights in the trust that would make the parent the grantor) and thus Rev. Rul. 85-13 would treat the child and the trust as the same taxpayer. Such trusts are often referred to as BDITs – Beneficiary Deemed Inheritor's Trusts – and have been the subject of wide discussion and controversy. See, e.g., Jerome M. Hesch, Lawrence Brody, Richard A. Oshins & Susan P. Rounds, *A Gift From Above: Estate Planning on a Higher Plane — The Unique Design of a BDIT Minimizes — Even Eliminates — Many Tax and Non-Tax Problems*, 150 Tr. & Est. 17 (Nov. 2011); but also Rev. Proc. 2021-3, Section 4 (42) which provides:

> (42) Section 678.—Person Other than Grantor Treated as Substantial Owner.— Whether a person will be treated as the owner of any portion of a trust over which that person has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner of the trust under § 671 if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041. if the trust purchases the property from that person with a note and the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

Section 678(a)(1) has given rise to a different kind of planning. Suppose a beneficiary may withdraw an amount equal to all of the trust's taxable income in any given year (from all of the trust assets) but not the entire trust assets. Ed Morrow refers to this as the BDOT; IRC 678(a)(1) the "*Beneficiary Deemed Owner Trust*" (BDOT), LEIMBERG ESTATE PLANNING NEWSLETTER #2516 (Sept. 5, 2017). The BDOT appears clearly effective for income shifting, but it is not quite as clear whether it makes the person with the right to withdraw the owner of the entire trust for Rev. Rul. 85-13 purposes.

The regulations governing the grantor trust rules (sections 671-679) clearly provide that the reference to "income "unless specifically limited, refers to income determined for tax purposes and not to income for trust accounting purposes. Treas. Reg. §1.671-2(b). In order for the beneficiary to be treated as the owner of the entire trust for income tax purposes under section 678(a)(1), the withdrawal power must apply to all net taxable income during the year, including capital gains. If a beneficiary may withdraw "income" then under applicable state law the concern would be that the trust means income determined for trust accounting purposes which would not typically include extraordinary dividends or capital gains.

To cause the taxable income attributable to the corpus portion of the trust also to be treated as owned by the beneficiary, the withdrawal power must apply with respect to an amount equal to all of the net taxable income. Having the corpus portion of the trust being treated as owned by the beneficiary for income tax purposes is extremely important if the beneficiary wishes to sell assets to the trust and have the transfer treated as a non-recognition event under the reasoning of Rev. Rul. 85-13. In Campbell v. Commissioner, T.C. Memo 1979-495, beneficiaries had the power to cause the trustee to distribute capital gains; beneficiaries did not request and the trustee did not distribute the capital gains income to the beneficiaries, but they were deemed to be the owners of the capital gains income under section 678(a)(1). PLR 201633021 also supports this result.

Income is taxable to a powerholder under section 678(a)(1) whether or not the amount is actually withdrawn. If it is withdrawn, such withdrawal is generally a non-taxable event because it is not a distribution that is reported under the distribution rules for non-grantor trusts. Rev. Rul. 67-241. For instance, section 678(a)(1) applies if the powerholder is a minor for whom a guardian who could exercise the power has not been appointed. Rev. Rul. 81-6 (child could withdraw all income until age 25; minority status irrelevant); Trust No. 3 v. Commissioner, 285 F.2d 102 (7th Cir. 1960)(minor beneficiaries could terminate a trust; that no guardians had been appointed was irrelevant).

What happens if the power is not exercised, as will often be the case? The trust agreement may provide that failure to withdraw the taxable income amount in a particular year would lapse and could not be exercised in a later year. If so, and if the lapsed power exceeds the greater of "(A) $5,000, or (B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied," the power holder will be treated as having made a gift of the excess amount (unless it is an incomplete gift because of retained powers over the trust), which will mean the property will be included in the powerholder's estate. Note that if the person with the withdrawal right is not an individual the "5 x 5 exception" may not apply; section 2514(e), which creates the exception, applies by its term to an "individual."

Generally, the net taxable income of a trust will be less than 5% of the trust value. To use the full trust value to measure the 5% amount, the beneficiary ought to be able to withdraw the net taxable income amount from all of the trust assets. In Rev. Rul. 66-87 the beneficiary had the power to withdraw accounting income and the 5% element was calculated based just on the accounting income, not all trust assets. Fish v. U.S., 432 F.2d 1278 (9th Cir. 1970), held that the 5% amount, when applied to a power to withdraw "all or part of the net income of the trust for that year" was only 5% of the income, not 5% of the trust assets. The taxpayer argued that because the income payable to the decedent would have been payable either from corpus or income, the entire trust represents "assets out of which, or the proceeds out of which, the exercise of lapsed powers could be satisfied." The court disagreed because for federal tax purposes the distribution would have been a distribution of income.

The IRS cited Fish in Rev. Rul. 85-88 to hold that where a power of appointment is limited to annual trust income the 5 percent test is based on annual trust income, not the amount of trust corpus. Neither Fish nor the Ruling considered the result if the withdrawal right could be from any trust assets. Prudence suggests that a beneficiary should be authorized to withdraw the greater of the net taxable income or 5% of the trust corpus from any of the income or out of the entire corpus of the trust. The right to withdraw may also hang.

Other issues to consider are the rights of creditors of the powerholder and the presence of a true grantor under sections 671-677 which trump section 678.

If the Fish problem can be solved, almost any trust may be taxed to a designated person, for example a person in a state without an income tax. That may not mean the trust is a wholly grantor trust with the benefits of Rev. Rul. 85-13. Does the grantor have rights over corpus? Treas. Reg. § 1.671-3(a)(1) indicates one person can own "income" but not own corpus. Put another way, what does the term "portion" mean in section 678? It could mean the "income"

portion as opposed to the "corpus" portion or it could mean the undivided interest portion of the trust that a person with a right of withdrawal could withdraw, whether income or corpus. Treas. Reg. § 1.671-3 provides as follows:

> **(a)** When a grantor or another person is treated under subpart E (section 671 and following) as the owner of any portion of a trust, there are included in computing his tax liability those items of income, deduction, and credit against tax attributable to or included in that portion. For example:
>
>> **(1)** If a grantor or another person is treated as the owner of an entire trust (corpus as well as ordinary income), he takes into account in computing his income tax liability all items of income, deduction, and credit (including capital gains and losses) to which he would have been entitled had the trust not been in existence during the period he is treated as owner.
>>
>> **(2)** If the portion treated as owned consists of specific trust property and its income, all items directly related to that property are attributable to the portion. Items directly related to trust property not included in the portion treated as owned by the grantor or other person are governed by the provisions of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Items that relate both to the portion treated as owned by the grantor and to the balance of the trust must be apportioned in a manner that is reasonable in the light of all the circumstances of each case, including the terms of the governing instrument, local law, and the practice of the trustee if it is reasonable and consistent.
>>
>> **(3)** If the portion of a trust treated as owned by a grantor or another person consists of an undivided fractional interest in the trust, or of an interest represented by a dollar amount, a pro rata share of each item of income, deduction, and credit is normally allocated to the portion. Thus, where the portion owned consists of an interest in or a right to an amount of corpus only, a fraction of each item (including items allocated to corpus, such as capital gains) is attributed to the portion. The numerator of this fraction is the amount which is subject to the control of the grantor or other person and the denominator is normally the fair market value of the trust corpus at the beginning of the taxable year in question. The share not treated as owned by the grantor or other person is governed by the provisions of subparts A through D. See the last three sentences of paragraph (c) of this section for the principles applicable if the portion treated as owned consists of an interest in part of the ordinary income in contrast to an interest in corpus alone.
>
> **(b)** If a grantor or another person is treated as the owner of a portion of a trust, that portion may or may not include both ordinary income and other income allocable to corpus. For example:
>
>> **(1)** Only ordinary income is included by reason of an interest in or a power over ordinary income alone. Thus, if a grantor is treated under section 673 as an owner by reason of a reversionary interest in ordinary income only, items of income allocable to corpus will not be included in the portion he is treated as owning. Similarly, if a grantor or another person is treated under sections 674-678 as an owner of a portion by reason of a power over ordinary income only, items of income allocable to corpus are not included in that portion. (See paragraph (c) of this

section to determine the treatment of deductions and credits when only ordinary income is included in the portion.)

(2) Only income allocable to corpus is included by reason of an interest in or a power over corpus alone, if satisfaction of the interest or an exercise of the power will not result in an interest in or the exercise of a power over ordinary income which would itself cause that income to be included. For example, if a grantor has a reversionary interest in a trust which is not such as to require that he be treated as an owner under section 673, he may nevertheless be treated as an owner under section 677(a)(2) since any income allocable to corpus is accumulated for future distribution to him, but items of income included in determining ordinary income are not included in the portion he is treated as owning. Similarly, he may have a power over corpus which is such that he is treated as an owner under section 674 or 676 (a), but ordinary income will not be included in the portion he owns, if his power can only affect income received after a period of time such that he would not be treated as an owner of the income if the power were a reversionary interest. (See paragraph (c) of this section to determine the treatment of deductions and credits when only income allocated to corpus is included in the portion.)

(3) Both ordinary income and other income allocable to corpus are included by reason of an interest in or a power over both ordinary income and corpus, or an interest in or a power over corpus alone which does not come within the provisions of subparagraph (2) of this paragraph. For example, if a grantor is treated under section 673 as the owner of a portion of a trust by reason of a reversionary interest in corpus, both ordinary income and other income allocable to corpus are included in the portion. Further, a grantor includes both ordinary income and other income allocable to corpus in the portion he is treated as owning if he is treated under section 674 or 676 as an owner because of a power over corpus which can affect income received within a period such that he would be treated as an owner under section 673 if the power were a reversionary interest. Similarly, a grantor or another person includes both ordinary income and other income allocable to corpus in the portion he is treated as owning if he is treated as an owner under section 675 or 678 because of a power over corpus.

(c) If only income allocable to corpus is included in computing a grantor's tax liability, he will take into account in that computation only those items of income, deductions, and credit which would not be included under subparts A through D in the computation of the tax liability of the current income beneficiaries if all distributable net income had actually been distributed to those beneficiaries. On the other hand, if the grantor or another person is treated as an owner solely because of his interest in or power over ordinary income alone, he will take into account in computing his tax liability those items which would be included in computing the tax liability of a current income beneficiary, including expenses allocable to corpus which enter into the computation of distributable net income. If the grantor or other person is treated as an owner because of his power over or right to a dollar amount of ordinary income, he will first take into account a portion of those items of income and expense entering into the computation of ordinary income under the trust instrument or local law sufficient to produce income of the dollar amount required. There will then be attributable to him a pro rata portion of other items entering into the computation of distributable net income under subparts A through D, such as expenses allocable to corpus, and a

pro rata portion of credits of the trust. For examples of computations under this paragraph, see paragraph (g) of § 1.677(a)-1.

Where one trust can withdraw all of the assets of the other trust, the trust with the withdrawal right seems clearly the owner of the whole trust for income tax purposes. But with a more limited withdrawal right the result is uncertain. An example of a power to vest "the income therefrom" is described in Private Letter Ruling 201633021. The ruling involved Trust 1 and Trust 2 which were non-grantor trusts because the grantor had died. The assets of Trust 1 and Trust 2 are held for the benefit of the same beneficiaries. The governing document of Trust 2 provides that Trust 1 retains the power, solely exercisable by Trust 1, to revest the net income of Trust 2 in Trust 1; provided, however, that such power shall lapse on the last day of such calendar year. Trust 2 further provides that income includes (i) any dividends, interest, fees and other amounts characterized as income under section 643(b) of the Code, (ii) any net capital gains realized with respect to assets held less than twelve months, and (iii) any net capital gains realized with respect to assets held longer than twelve months. The ruling provides that the trustee "proposes to transfer funds from Trust 1 to Trust 2."

The IRS concluded, "Trust 1 will be treated as the owner of the portion of Trust 2 over which they have the power to withdraw under § 678(a). Accordingly, Trust 1 will take into account in computing their tax liability those items which would be included in computing the tax liability of a current income beneficiary, including expenses allocable to which enter into the computation of distributable net income. Additionally, Trust 1 will also take into account the net capital gains of Trust 2." The ruling unfortunately does not provide any insight on what the income tax consequences would be when Trust 1 "transfers funds" to Trust 2. The language of the ruling implies the Trust 1 will be treated as a beneficiary of Trust 2 but also "as the owner of the portion of Trust 2 over which they have the power to withdraw under § 678(a)."

The language doesn't necessarily (but it could) mean that Trust 1 is the deemed owner entirely of Trust 2 and all of its assets. If Trust 1 is treated as the owner entirely of Trust 2, then theoretically Trust 1 could engage in a sale of the assets of Trust 1 to Trust 2 in exchange for an installment note, and the transaction would be disregarded for income tax purposes under Revenue Ruling 85-13. This would be the result if Trust one could withdraw all the assets of Trust 2 at any time.

If, however, Trust 1 is merely an entity that must report the income, capital gain, expenses, and other items used to compute DNI, then such a transaction could, in part, be considered a taxable event. Even if the latter interpretation is correct, if Trust 1 is a non-GST exempt trust and Trust 2 is a GST exempt trust, the tax liability borne by Trust 1 from all of Trust 2's income and capital gain could significantly increase Trust 2's trust assets over time and decrease the assets in Trust 1.

In a more recent ruling, PLR 202022002, the trust agreement of a Trust 1 prohibited the distribution of Shares (perhaps of a closely-held company) to the beneficiaries, but allowed for the distribution of the proceeds from the sale of Shares. Trust 1 contributed all of its Shares to LLC, a newly formed entity classified as partnership for Federal tax purposes, in exchange for membership interest in LLC. The same restrictions on the Shares were placed on the

membership interests of LLC. Trust 1 then transferred a portion of its LLC interest to a Subtrust for the sole benefit of A. After A reached the age of 40, A exercised a withdrawal right to take all of the Subtrust's assets, except the LLC interests. The Subtrust agreed to sell a portion of its LLC interests to Trust 2 in exchange for cash and a promissory note. Trust 2 is a grantor trust with respect to A. A also had the authority to withdraw the cash and promissory note from Subtrust after the sale. The IRS concluded, "because A has a power exercisable by herself to vest the proceeds of Subtrust's LLC interest in herself and that those proceeds are Subtrust's only asset, A will be treated as the owner of Subtrust under § 678. Consequently, the transfer of the LLC interests to Trust 2 is not recognized as a sale for federal income tax purposes because Trust 2 and Subtrust are both wholly owned by A."

2. **Grantor Trusts and Spouses**. PLR 201927003 is helpful. Each spouse created a grantor trust. Then spouse one sold a partnership interest to spouse two's trust, and Trust One sold interests to Trust Two. The ruling provides:

> Section 1041(a)(1) of the Code provides that no gain or loss shall be recognized on a transfer of property from an individual to a spouse. Section 1041(b) of the Code provides that, in the case of any transfer described in subsection (a), (1) the property shall be treated as acquired by the transferee by gift, and (2) the basis of the transferee in the property shall be the adjusted basis of the transferor. Because Trust 1 is a grantor trust, assets sold by Trust 1 will be treated for federal tax purposes as sold by Spouse 1. In addition, because Trust 2 is a grantor trust, assets purchased from Taxpayer and Trust 1 will be treated for federal tax purposes as purchased by Spouse 2. Accordingly, based on the information submitted, we rule as follows: (1) Spouse 1 will recognize no gain or loss on the sale by Spouse 1 of a x percent limited partnership interest in Partnership to Trust 2 (§ 1041(a)(1) and Rev. Rul. 85-13). (2) Spouse 1 will recognize no gain or loss on the sale by Trust 1 of a x percent limited partnership interest in Partnership to Trust 2 (§ 1041(a)(1) and Rev. Rul. 85-13). (3) The basis of property acquired from Spouse 1 by Trust 2 will be the same as the adjusted basis in the property in the hands of Spouse 1 (§ 1041(b)(2)). (4) The basis of property acquired from Trust 1 by Trust 2 will be the same as the adjusted basis in the property in the hands of Trust 1 (§ 1041(b)(2)).

3. **DING Trusts**. State income tax may be avoided if assets may be transferred into a non-grantor trust in such a way as to avoid the transferor making a gift. The typical acronym for such trusts is a DING Trust, for Delaware Incomplete Non-Grantor Trusts, but there is nothing magical about Delaware as the state in which the trust ought be created.

Typically, the grantor of the trust wants to be a beneficiary. Thus, in order to avoid grantor trust status the grantor may receive distributions only at the direction of adverse parties. Generally, some of the grantor's descendants are beneficiaries of the trust and are thus thought to be adverse for income tax purposes, and thus are empowered to make distributions to the grantor.

The grantor also wants the transfer to be incomplete for gift tax purposes. In a string of rulings beginning in 2001 the IRS determined that a testamentary power of appointment in the grantor made the gift incomplete. See e.g. 200148028, 200715005, and others in between. In CCA 201208026 the IRS reversed that position, concluding

that the testamentary power of appointment would only affect the remainder interest not the income or present interest. So, the trick is to give the grantor some power that will make the gift incomplete but that will not cause the trust to be a grantor trust for income tax purposes.

One such power is the grantor's power to make distributions in a non-fiduciary capacity pursuant to a fixed and ascertainable standard under Reg. §2511-2 so long as retention of such power does not cause the assets of the trust to be subject to the grantor's creditors (because that would cause the trust to be a grantor trust for income tax purposes, per Rev. Rul. 54-516). Delaware, Ohio, Nevada and Wyoming protect trusts where the donor retains this power.

Another potential power would be to require the grantor's consent before distributions were made to others. This power would pass muster in many of the asset protection states, including Delaware.

In IR-2007-127 (July 9, 2007) the IRS announced it was reconsidering its position on the gift tax consequences to the beneficiaries on the distribution committees. The IRS was likely spooked by comments from a professional group about the tax consequences of DINGs and the government's arguably incoherent ruling position. However, without comment on what learning has been achieved, the IRS began issuing rulings in this area, in March 2013.

New York has enacted legislation providing that DINGs are subject to New York income tax if created by a New York domiciliary even if not a grantor trust for federal income tax purposes. Other states may adopt similar legislation.

PLR 201832008 is typical of current ING trust creation. The distribution of authority is carefully divided and distributed:

> Grantor is the only donor and all property contributed to Trust will be Grantor's separate property under State 1 law. The trustee, Trustee, is a trust company with its headquarter in State 2. Trust is governed by the laws of State 2. Currently, Grantor and Spouse have two minor children, Child 1 and Child 2.
>
> During Grantor's lifetime, at any time or times, Trustee, pursuant to an appointment of the Committee or Grantor, while the Committee is in existence, shall distribute to the Beneficiaries such amounts of net income or principal of Trust as the Committee or Grantor determines. Any appointment, determination, or action by the Committee requires either (i) The unanimous written consent of the then serving members of the Committee, other than Grantor (Unanimous Member Power), or (ii) The written consent of Grantor and a majority of the other then serving members of the Committee (Grantor's Consent Power). In addition, Grantor, in a non-fiduciary capacity, may appoint such amounts of principal to one or more persons in the group consisting of Grantor's descendants, Father, Mother, and Individual, as Grantor deems advisable to provide for such person's health, support, and education. (Grantor's Sole Power). Such power may not be exercised to discharge or satisfy Grantor's legal obligations. Any net income not distributed shall be accumulated and added to the principal of Trust.

If at any time a Committee member fails or ceases to serve then the position of such Committee member shall remain vacant; subject to exception for the appointment of representatives with legal authority to act on behalf of another Committee member.

The Trust agreement provides that if there is no Committee, the trustee (other than a beneficiary-trustee) may pay any one or more of the beneficiaries such amount or amounts of the net income and principal for any purpose, even to the extent of all or none, at any time and from time to time, as the trustee determines in his discretion and only with Grantor's written consent, and in making such determinations, the trustee may consider or ignore, in the trustee's discretion, the beneficiaries' other financial resources of any kind.

Initially, Committee consists of Grantor, Representative 1, Representative 2, Father, and Mother. Representatives 1 and 2 act on behalf of Child 1 and Child 2, respectively, until each child reaches majority age. As each of the minor children, Child 1 and Child 2, reaches majority age, that child will become a member of the Committee, replacing his representative. Trust provides that, at any time, members of the Committee, may by unanimous vote add one or more members to the Committee (other than Spouse) provided that such members are beneficiaries of Trust. The Trust agreement, as amended, states that Committee shall be deemed not to exist at any time there are fewer than two members other than Grantor. The Committee shall also be dissolved and cease to exist upon Grantor's death.

Upon Grantor's death, the trustee shall distribute such amounts of trust property as Grantor appoint to or in favor of any one person or more persons or entities, other than Grantor, Grantor's estate, the creditors of Grantor, or the creditors of Grantor's estate, as Grantor may appoint by will (Grantor's Testamentary Power). Such power may not be exercised to discharge or satisfy Grantor's legal obligations.

Upon Grantor's death, the trustee shall divide the then remaining trust property into as many separate shares of equal value as necessary to dispose of the property. Any balance which is not distributed pursuant to Grantor's Testamentary Power shall be distributed as follows: (1) one such equal share to Father, if he is then living; (2) one such equal share to Mother, if she is then living; (3) one such equal share to Individual, if he is then living, and (4) seven such equal shares to Grantor's then living descendants, by right of representation, to be held in further trust for such descendants. If none of the remainder beneficiaries is living upon Grantor's death, any balance which is not distributed pursuant to Grantor's Testamentary Power shall be distributed in equal shares in further trust for the benefit of individuals named in Trust.

The grantor’s contribution to the trust was an incomplete gift:

In this case, Grantor retained the Grantor's Consent Power over the net income and principal of Trust. Under § 25.2511-2(e), a donor is considered as himself having a power if it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. The Committee members are not takers in default for purposes of § 25.2514-3(b)(2). They are merely co-holders of the power. Under § 25.2514-3(b)(2), a co-holder of a power is only considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate. In this case, the Committee ceases to exist upon the death of Grantor.

Accordingly, the Committee members do not have interests adverse to Grantor under § 25.2514-3(b)(2) and for purposes of § 25.2511-2(e). Therefore, Grantor is considered as possessing the power to distribute net income and principal to any beneficiary himself because he retained the Grantor's Consent Power.

If the Committee ceases to exist, the Trustee has the power to distribute net income to a beneficiary. However, the Trustee's power is not a condition precedent to each Grantor's Consent Power. Each Grantor's Consent Power over income is presently exercisable and not subject to a condition precedent. Thus, the Trustee's power to distribute net income does not cause the transfer of property to be complete with respect to the income interest in Trust for federal gift tax purposes. Therefore, each Grantor is considered as possessing the power to distribute income to any beneficiary himself or herself because he or she retained the Grantor's Consent Power.

Grantor also retained the Grantor's Sole Power over the principal of Trust. Under § 25.2511-2(c), a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. In this case, the Grantor's Sole Power gives Grantor the power to change the interests of the beneficiaries. Even though Grantor's power is limited by an ascertainable standard, i.e., health, education, and support, Grantor's power is not a fiduciary power. Accordingly, the retention of the Grantor's Consent Power and the Grantor's Sole Power causes the transfer of property to Trust to be incomplete for federal gift tax purposes.

If the Committee ceases to exist, the Trustee, in its fiduciary capacity, also has the power to distribute principal to one or more beneficiaries. The powers of the Trustee are not conditions precedent to the Grantor's powers. Grantor's Sole Power over principal is presently exercisable and not subject to a condition precedent. Accordingly, Grantor retains dominion and control over the principal of Trust until the Trustee exercises his or her power to appoint principal. *See* *Goldstein v. Commissioner*, 37 T.C. 897 (1962). Thus, the Trustee's powers to distribute principal do not cause the transfer of property to be complete with respect to the remainder in Trust for federal gift tax purposes. Accordingly, the retention of Grantor's Consent Power and Grantor's Sole Power causes the transfer of property to Trust to be wholly incomplete for federal gift tax purposes.

Further, Grantor retained the Grantor's Testamentary Power to appoint the property in Trust to any persons, other than to the Grantor's estate, Grantor's creditors, or the creditors of Grantor's estate. Under § 25.2511-2(b), the retention of a testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder. Accordingly, the retention of this power causes the transfer of property to Trust to be incomplete with respect to the remainder for federal tax purposes.

Finally, the Committee members possess the Unanimous Member Power over net income and principal. This power is not a condition precedent to Grantor's powers. Grantor's powers over the net income and principal are presently exercisable and not subject to a condition precedent. Grantor retains dominion and control over the net income and principal of Trust until the Committee members exercise their Unanimous Member Power. Accordingly, the Unanimous Member Power does not cause the transfer of property to be complete with respect to the income interest for federal gift tax purposes. *See* *Goldstein v. Commissioner*, 37 T.C. 897 (1962); *Estate of Goelet v. Commissioner*, 51 T.C. 352 (1968).

Nonetheless the grantor's powers did not make the trust taxable to the grantor for income tax purposes.

A distribution from the trust to other than the grantor would be a gift by the grantor. See also PLR 202006002, dealing with community property (one of a series), and PLR 202014001, also part of a series. See also PLR 202017018.

PLR 201908008 is a recent incomplete gift, non-grantor trust ruling, with a charitable feature. The facts presented were otherwise typical:

> On Date, Settlor created Trust, an irrevocable trust, for the benefit of Individual A, Individual B, and Foundation (Eligible Beneficiaries). Trust has an Independent Trustee and an Administrative Trustee. The situs of Trust is State.
>
> Article I(1) of Trust provides that during the life of Settlor, the trustees shall pay so much, if any, of the net income from such trust to or for the benefit of any one or more of the Eligible Beneficiaries, in such equal or unequal shares and to the exclusion of any one or more of the other Eligible Beneficiaries, as the Distribution Committee shall, at any time or from time to time by written instrument delivered to the trustees, direct; provided, however, that the trustees shall not distribute any amount to any of the Eligible Beneficiaries pursuant to any direction of the Distribution Committee unless and until Settlor shall, acting individually and solely in a nonfiduciary capacity, first consent in writing to such direction (Settlor's Consent Power).
>
> Article I(2) provides that the trustees shall be authorized to distribute all or any part of the net income not so paid pursuant to Article I(1) to any one or more of the Eligible Beneficiaries, in such equal or unequal shares and to the exclusion of any one or more of the other Eligible Beneficiaries, as the Independent Trustee shall, at any time or from time to time in the absolute discretion of the Independent Trustee, determine for any purpose.
>
> Article I(3) provides that the trustees shall pay so much, if any, of the principal of such trust to or for the benefit of any one or more charitable organizations, and in such equal or unequal shares, as Settlor shall, at any time or from time to time by written instrument, direct and appoint; provided, however, that this power of appointment shall be a limited power, which shall not be exercisable to any extent in favor of Settlor, Settlor's estate, the creditors of Settlor, or the creditors of Settlor's estate (Settlor's Inter Vivos Limited Power of Appointment).
>
> Any net income not so paid pursuant to Article I shall be accumulated and added to principal.
>
> Article II provides that following Settlor's death, the trustees shall distribute the trust estate to one or more charitable organizations, and in such equal or unequal shares, as Settlor shall direct and appoint; provided, however, that this power of appointment shall be a limited power, which shall not be exercisable to any extent in favor of Settlor, Settlor's estate, creditors of Settlor, or creditors of Settlor's estate (Settlor's Testamentary Limited Power of Appointment). To the extent Trust property is not effectively appointed, the trustees shall distribute such whole or part to such one or more charitable organizations, and in such equal or unequal shares, as the Independent Trustee shall determine in the absolute discretion of the Independent Trustee.

> Article III(A) provides that during the life of Settlor, the Distribution Committee shall have the power to direct the trustees as provided in Article I. Following Settlor's death, the PLR-113144-18 3 Distribution Committee shall cease to exist and the person or persons who shall, immediately prior to the death of Settlor, be in office as members of the Distribution Committee shall cease to have any authority, either individually or collectively, to direct the trustees or to exercise any other right or power under Trust.
>
> Under Article III(B), the initial members of the Distribution Committee are Independent Trustee, Individual A and Individual B. Article III(C) provides that Settlor, or if Settlor at any time is not able to act, the members of the Distribution Committee may appoint successor members to the committee. The Independent Trust also has the power under Article III(D) to appoint members to the committee.
>
> Article III(F) provides that (i) there shall be at least one member of the Distribution Committee in office at all times during Settlor's life and (ii) a majority of the members of the committee shall, at all times during Settlor's life, consist of Eligible Beneficiaries.
>
> Article III(G) provides that if and so long as there shall be more than one member on the Distribution Committee, the committee shall act by majority vote of such members.
>
> Article V(G) provides that there shall not be more than three individuals, or more than two individuals and one corporation in office as trustees of Trust, and none of Settlor, Settlor's husband, and any individual or corporation who is related or subordinate to Settlor or Settlor's husband (within the meaning of § 672(c)) is eligible to serve as trustee of Trust.
>
> Article XII(B)(6) defines the term "charitable organization" to mean and include only an organization (a) that is described in §§ 170(c), 2055(a), and 2522(a); and (b) that shall not, by any action or course of conduct, have so disqualified itself that any charitable deduction that would otherwise be available for federal income, estate or gift tax purposes, in respect of property passing to such organization, would be disallowed.
>
> Settlor has made the following representations. Settlor has not claimed nor will she claim an income tax or gift tax charitable deduction under § 170(c) or 2522(a) for any property transferred by Settlor to Trust at any time, unless and until Trust makes a payment to one or more charitable organizations. No person (including any corporation or trust) other than Settlor is presently expected to make any transfer of property to Trust at any time, so no other charitable deduction will be claimed or available for contributions of property to Trust. Trust will not set aside any amounts for charitable purposes and claim a deduction under § 642(c)(2).

The charitable provisions are not typical. The ruling states that the trust may receive a section 643(c) deduction and that the settlor will not be a disqualified person with respect to the trust because no income tax deduction was claimed. With respect to this point, the ruling states:

> The basic purpose of § 4947 is to prevent these trusts from being used to avoid the requirements and restrictions applicable to private foundations. For purposes of this section, a trust shall be presumed (in the absence of proof to the contrary)

to have amounts in trust for which a charitable deduction was allowed if a deduction would have been allowable under one of these sections.

Section 53.4947-1(c)(1)(i) provides that a trust is one which has amounts in trust for which a deduction was allowed under § 642(c) within the meaning of § 4947(a)(2) once a deduction is allowed under § 642(c) to the trust for any amount permanently set aside.

In Virginian Hotel Corp. v. Helvering, 319 U.S. 523 (1943), the Supreme Court held that "allowed" meant that the taxpayer had taken the deduction and the Commissioner had not challenged it. Id. at 527. Noting that there was "no machinery for formal allowances of deductions from gross income," a deduction being claimed and going unchallenged is the only way in which a deduction could be "allowed."

Trust has both charitable and non-charitable beneficiaries and is not exempt from tax under § 501(a). One of the requirements to qualify as a split-interest trust described in § 4947(a)(2) is that the trust has amounts in trust for which a charitable deduction was allowed to some person (including the trust itself for a charitable set-aside). Settlor has represented that, for the duration of Trust, Trust will not hold any amounts for which a person claimed a charitable deduction for a transfer to Trust, or for which Trust claimed a charitable deduction under § 642(c)(2) for a set-aside. Thus, for Settlor's life, Trust will not qualify as a split-interest trust under § 4947(a)(2). The fact that Settlor may claim a gift tax deduction under § 2522 (or that Trust may claim an income tax deduction under § 642(c)(1) when a charitable distribution from Trust is made is not material, because such amount is not held in Trust when the charitable deduction arises.

Based upon the facts submitted and representations made, we conclude that Settlor will not be a disqualified person with respect to Trust because Trust will not be treated as a split-interest trust within the meaning of §§ 4947(a)(2) and 53.4947-1(c)(1)(i) and, accordingly, the provisions of §§ 507, 508(e), 4941, 4943, 4944, and 4945 shall not apply to Trust during Settlor's life.

In PLR 202017018 – the only ING ruling issued in 2020 – a settlor established an irrevocable trust to benefit himself, his spouse, his descendants, his parents and his parents' descendants (in addition to himself and his own descendants). A corporate fiduciary was the sole Trustee and there was a distribution committee consisting of at least two individuals other than the settlor and the settlor's spouse but could also include the settlor. The distribution committee was initially the settlor, the settlor's parents and the settlor's sister. An elaborate mechanism was set forth in the trust instrument to ensure that, throughout the settlor's life, the distribution committee remained intact. At the settlor's death, the distribution committee was to cease operations, and all powers previously held by the distribution committee were thereafter to be held and exercised by the Trustee. Distributions from the trust could be made as follows:

- Income or principal could be distributed to or for any beneficiary (other than the settlor's spouse) as determined by a majority of the distribution committee, other than the settlor or the settlor's spouse, acting in a non-fiduciary capacity, with the written consent of the settlor;
- Income or principal could be distributed to or for any beneficiary as determined unanimously by the distribution committee, other than the settlor or the settlor's spouse, acting in a non-fiduciary capacity; and

- Principal could be distributed to or for any beneficiary (other than the settlor or the settlor's spouse) as determined by the settlor, acting in a non-fiduciary capacity, for the health, education or support of any one or more of such beneficiaries.

Consistent with the above rules, distributions could be made in equal or unequal amounts among concurrent beneficiaries. During the settlor's life, the Trustee was not permitted to make any distributions except as directed in accordance with the above rules. In addition, the settlor held a testamentary power of appointment that could be exercised in favor the settlors' parents' descendants (except the settlor, his estate, his creditors or his estate's creditors), the settlor's spouse or any one or more charitable organizations.

The IRS ruled as follows:

- Neither the settlor nor any member of the distribution committee will be considered the grantor or owner of the trust for income tax purposes;
- The settlor's transfer of property to the trust will be considered not to be a completed gift for gift tax purposes;
- Discretionary distributions won't be considered gifts for gift tax purposes by any distribution committee member; and
- A distribution committee member's gross estate for estate tax purposes won't include the value of any trust property.

Last year, the IRS indicated it wouldn't issue ING trust rulings with respect to ING trusts with somewhat narrow characteristics in Revenue Procedure 2020-3. Even more recently, the IRS completely put the brakes on all ING trust rulings in Rev. Proc. 2021-3 (Section 5.01(9) & (17)). Quite obviously, for an ING trust to be effective the state in which the trust is resident must either not have an income tax or must have an income tax rate much lower than the rate being avoided.

E. SECTION 1361 – S CORPORATIONS

F. SECTIONS 2031 and 2512 – VALUATION

1. Valuation of LLCs. At issue in Grieve v. Commissioner, T.C. Memo. 2020-28, was the valuation of non-voting interests in two LLCs, Rabbit and Angus, each holding securities. Interests in one were given to a 2 year GRAT, and in the other interests were transferred in exchange for a private annuity. The LLCs were controlled by the transferor's daughter, Margaret. The IRS argued that the voting and non-voting should be valued together, which the court rejected.

> When a gift of property is made, its value at the date of the gift shall be considered the amount of the gift. Sec. 25.2512-1, Gift Tax Regs. We do not engage in imaginary scenarios as to who a purchaser might be. Estate of Giustina v. Commissioner, 586 F. App'x 417, 418 (9th Cir. 2014), rev'g and remanding T.C. Memo. 2011-141. In Olson v. United States, 292 U.S. 246, 257 (1934), the Supreme Court explained:
>
> > Elements affecting value that depend upon events or combinations of occurrences which, while within the realm of possibility, are not fairly shown to be reasonably probable should be excluded from consideration

> for that would be to allow mere speculation and conjecture to become a guide for the ascertainment of value--a thing to be condemned in business transactions as well as in judicial ascertainment of truth. * * *

> Respondent's expert relies upon an additional action, the purchase of the class A units. Mr. Mitchell contends that the economic realities have to be taken into consideration and that the economic stake of the holder of a 99.8% interest of the class B units "dwarfs" that of the holder of the class A units. However, Margaret, the sole owner of the class A units, testified that she had no intention of selling the units. She further testified that if she ever sold the units she would demand a premium much higher than what was estimated in the Mitchell reports. If the class B units were ever sold outside the family, Margaret explained that she would require that she be paid a management fee.
>
> We are looking at the value of the class B units on the date of the gifts and not the value of the class B units on the basis of subsequent events that, while within the realm of possibilities, are not reasonably probable, nor the value of the class A units. See id. In Succession of McCord v. Commissioner, 461 F.3d 614, 629 (5th Cir. 2006), rev'g and remanding McCord v. Commissioner, 120 T.C. 358 (2003), the Court of Appeals for the Fifth Circuit reasoned that there are three types of conditions along the "speculative" continuum: (1) a future event that is absolutely certain to occur; (2) a future event "that is not absolutely certain to occur, but nevertheless may be a 'more . . . certain prophec[y]'"; and (3) "a possible, but low-odds, future event" which is "undeniably a 'less . . . certain prophec[y]'".
>
> Mr. Mitchell's valuations relied on an additional action. He concluded that to determine the value of what a willing buyer would pay and what a willing seller would seek for the class B units, a premium to purchase the class A units has to be taken into account. Elements affecting the value that depend upon events within the realm of possibility should not be considered if the events are not shown to be reasonably probable. Olson, 292 U.S. at 257. The facts do not show that it is reasonably probable that a willing seller or a willing buyer of the class B units would also buy the class A units and that the class A units would be available to purchase. To determine the fair market values of the class B units we look at the willing buyer and willing seller of the class B units, and not the willing buyer and willing seller of the class A units.

It is unclear from the opinion what inspired the IRS to audit these transactions.

2. **Valuation of LLCs Holding Leased Property For Gift, Estate, and Charitable Purposes**. Judge Buch has decided for the Tax Court a straightforward valuation case in Estate of Warne v. Commissioner, T.C. Memo. 2021-17. There were five LLCs at issue with various percentages owned by a family trust included in the decedent's estate.

The easiest issue to deal with was the estate tax charitable deduction. At the decedent's death she left 75% of Royal Gardens, LLC to the family foundation and 25% to St. John's Lutheran Church. The estate argued that 100% went to charity but the IRS argued Ahmanson Foundation v. United States, (9th Cir. 1981) and the Tax Court agreed with the IRS. An estate receives a charitable deduction only for what the charities receive, which the court held was a 4% discount for the 75% and a 27.385% discount for the 25% (each stipulated by the parties). The discounts could have been avoided by leaving 100% to the Foundation and having it distribute 25% to the church.

The family trust held fractions of the other LLCs as follows:

> At the time of Miriam Warne's death, the LLCs had the following ownership structure: WRW was held 78% by the Family Trust and 22% by William Warne; VJK was held 86.3% by the Family Trust, 0.5% by Tom Warne, and 4.4% by each of the three granddaughters; Warne Ranch was held 72.5% by the Family Trust, 26% by Tom Warne, and 0.5% by each granddaughter; Warne Investments was held 87.432% by the Family Trust and 12.568% by Trust "H"; and Royal Gardens was held 100% by the Family Trust. William Warne and Tom Warne were cotrustees of the Family Trust. They are also coexecutors of Miriam Warne's estate.

The experts valued the leased real estate using a sales comparison approach to value the land. With respect to the effect of discounts at the entity level, the opinion states:

> The discount for lack of control for the majority interests held by the Family Trust should be low. The LLCs' operating agreements grant significant power to the majority interest holder, such as the ability to unilaterally dissolve the LLCs and appoint and remove managers. The Family Trust held the majority interest in every LLC at issue. When a majority interest holder exerts control similar to that which the Family Trust can exercise in the LLCs, we have held that no discount for lack of control applies.31 Because the parties agree to a discount for lack of control, we will find one; however, given the control retained by the Family Trust, the discount should be slight.

The IRS's expert argued for a 2% lack of control discount based on closed-end mutual funds, which the court rejected. The taxpayer's expert argued based on data from minority interest sales for a 5% - 8% discount. However the taxpayer's expert also assumed that if the majority tried to liquidate the minority would sue which the court concluded was an unwarranted assumption. So the court applied a 4% lack of control discount. The court much preferred the taxpayer's expert on lack of marketability, stating:

> The parties' experts used the same general method to calculate their discounts for lack of marketability. Both experts calculated the LLCs' restricted stock equivalent discounts and adjusted that calculation to account for the LLCs' characteristics to reach the final discount for lack of marketability. However, Mr. Schwab's analysis was more credible. His report considered additional metrics and provided a more thorough explanation of his process. In calculating the restricted stock equivalent discount, he determined the most important factors--such as the market-to-book ratio and market risk volatility--and he gave them more significant weight in his analysis. Mr. Schwab concluded a 10% to 12% restricted stock equivalent discount and decreased it by 25% as a holding period adjustment. He opined that a 5% to 10% discount for lack of marketability should apply.
>
> In contrast, Mr. Robak concluded a 2% discount for lack of marketability, providing little information to support this conclusion. In calculating the restricted stock equivalent discount, Mr. Robak weighted every factor equally and reached a 14.5% restricted stock equivalent discount. He then calculated a 2% discount for lack of marketability without justifying the substantial decrease in the discount. When an expert does not provide enough evidence to support his opinion, we decline to adopt that opinion. Without justification for his conclusion, it appears Mr. Robak made a visceral reduction of the discount rate data instead

> of a statistical one. We therefore decline to adopt the Commissioner's discount for lack of marketability analysis.
>
> We adopt Mr. Schwab's lack of marketability discount but believe it should remain at the lower end of the 5% to 10% range. Therefore, the discount for lack of marketability for the LLCs is 5%.

Each of the parties used different experts to value the underlying properties then the entities.

The taxpayers had not filed a timely gift tax return and the court upheld a penalty because the estate presented no evidence of reasonable cause.

G. SECTION 2032 — ALTERNATE VALUATION AND SECTION 2032A — SPECIAL USE VALUATION

1. New Proposed Alternate Valuation Regulations. [WAITING ON FINAL REGULATIONS.] REG-112196-07. An estate may elect alternate valuation and value its assets as of six months after death for estate tax purposes. If the alternate valuation date is elected, property disposed of before six months after death is valued on the date of the disposition. §2032 was originally enacted in 1935, after the stock market crash of 1929. On April 25, 2008, Treasury issued proposed Regulations to restrict the application of section 2032 by preventing post-death events other than market conditions from being taken into account when valuing the property. Those Proposed Regulations defined market conditions as events outside the control of the decedent, the decedent's executor or trustee, or any other person whose property being valued affected the fair market value of the property. The government's defeat in Kohler v. Commissioner, T.C. Memo. 2006-152, inspired the Proposed Regulations. The Tax Court ruled in Kohler that stock received by an estate in a post-death reorganization should be the property valued on the alternate valuation date and that the restrictions placed on the stock should be taken into account. In its action on decision stating non-acquiescence, the IRS took the view that the court incorrectly applied the regulations by allowing a post-death change in the character of the property to be taken into account when determining the property's value. The IRS thought that the court misapplied Treas. Reg. § 20.2032-1(c)(1), which provides that a tax-free reorganization is not a disposition under section 2032.

The Background portion of the Supplementary Information to the 2011 Proposed Regulations discussed them as follows:

> Generally, paragraph (c)(1)(i) identifies transactions that constitute distributions, sales, exchanges, or dispositions of property. If an estate's (or other holder's) property is subject to such a transaction during the alternate valuation period, the estate must value that property on the transaction date. The value included in the gross estate is the fair market value of that property on the date of and immediately prior to the transaction. The term "property" refers to the property includible in the decedent's gross estate under section 2033.
>
> Sections 20.2032-1(c)(1)(ii) and (c)(1)(iii)(A) identify two exceptions to the rule in § 20.2032-1(c)(1)(i). If either exception applies, the estate may use the 6-month date and value the property held on that date. The exception in § 20.2032-1(c)(1)(ii) applies only to transactions in which an interest in a corporation,

partnership, or other entity (entity) includible in the decedent's gross estate is exchanged for one or more different interests (for example, a different class of stock) in the same entity or in an acquiring or resulting entity or entities during the alternate valuation period. Such transactions may include, without limitation, reorganizations, recapitalizations, mergers, or similar transactions. This exception substitutes a fair market value test for the corporate provisions in the current regulations. Specifically, this paragraph proposes that, if, during the alternate valuation period, the interest in an entity includible in the gross estate is exchanged for a different interest in the same entity, or in an acquiring or resulting entity or entities, and if the fair market value of the interest on the date of the exchange equals the fair market value of the property for which it was exchanged, then the transaction will not be treated as an exchange for purposes of section 2032(a)(1). As a result, the estate may use the 6-month date to value the interest in the same entity or in the acquiring or resulting entity or entities received in the exchange. For this purpose, the fair market values of the surrendered property and received interest are deemed to be equal if the difference between the fair market values of the surrendered property and the received interest does not exceed 5 percent of the fair market value of the surrendered property as of the transaction date. This section has no effect on any other provision of the Code that is applicable to the transaction. For example, the provisions of chapter 14 may apply even if the transaction does not result in a deemed exchange for section 2032 purposes as a result of satisfying the provisions of § 20.2032-1(c)(1)(ii).

Section 20.2032-1(c)(1)(iii)(A) proposes that, if, during the alternate valuation period, an estate (or other holder) receives a distribution from a business entity, bank account, or retirement trust (entity) and an interest in that entity is includible in the decedent's gross estate, the estate may use the 6-month date to value the property held in the estate if the following requirement is satisfied. The fair market value of the interest in the entity includible in the gross estate immediately before the distribution must equal the sum of the fair market value of the distributed property on the date of the distribution and the fair market value of the interest in the entity includible in the gross estate immediately after the distribution. If this requirement is not satisfied, the estate must use the fair market value as of the distribution date and immediately prior to the distribution of the entire interest in the entity includible in the gross estate. For purposes of this section, any distribution is deemed to consist first of excluded property (as defined in § 20.2032-1(d)), if any, and then of included property.

The Proposed Regulations contain a large number of examples. Examples 1 and 3 illustrate the basic position:

Example 1. At D's death, D owned property with a fair market value of $100X. Two months after D's death (Date 1), D's executor and D's family members formed a limited partnership. D's executor contributed all of the property to the partnership and received an interest in the partnership in exchange. The investment of the property in the partnership is a transaction described in paragraph (c)(1)(i)(F) and/or (G) of this section. As a result, the alternate valuation date of the property is the date of its contribution and the value to be included in D's gross estate is the fair market value of the property immediately prior to its contribution to the partnership. The result would be the same if D's estate instead had contributed property to a limited partnership formed prior to D's death by D and/or other parties, related or unrelated to D. Further, the result would be the same if D's estate had contributed the property to a corporation, publicly traded or otherwise, or other entity after D's death and prior to the 6-month date.

***

> Example 3. D's gross estate includes a controlling interest in Y, a corporation. During the alternate valuation period, Y issued additional shares of stock and awarded them to certain key employees. D's interest in Y was diluted to a non-controlling interest by Y's issuance of the additional stock. Y's issuance of the stock is a transaction described in paragraph (c)(1)(i)(I) of this section. The value to be included in D's gross estate is the fair market value of D's stock immediately prior to Y's issuance of the additional stock. The result would be the same if D's estate included a minority interest in Y on the date of death and that interest became a controlling interest during the alternate valuation period as the result of Y's redemption of the shares of another shareholder.

The IRS realizes that any recapitalization may result in small value changes. Example 5 illustrates a 5% de minimis rule for reorganizations or recapitalizations, the upshot of which could be an incentive to recapitalize entities automatically if 4.99% is a substantial value savings.

> Example 5. (i) At D's death, D owned common stock in Y, a corporation. Two months after D's death (Date 1), there was a reorganization of Y. In the reorganization, D's estate exchanged all of its stock for a new class of stock in X. On the date of the reorganization, the difference between the fair market value of the stock D's estate received and the fair market value on that date of the stock includible in D's gross estate at death was greater than 5% of the fair market value, as of the date of the reorganization, of the stock D held at death. The reorganization is a transaction described in paragraph (c)(1)(i)(H) of this section and does not satisfy the exception described in paragraph (c)(1)(ii) of this section. Thus, the alternate valuation date is the date of the reorganization and the value to be included in D's gross estate is the fair market value of the stock immediately prior to the reorganization. This result is not affected by whether or not the reorganization is a tax-free reorganization for Federal income tax purposes. The result would be the same if the stock had been held, for example, in an IRA with designated beneficiaries. See paragraph (c)(3)(i)(C) of this section.
>
> (ii) If, instead, the difference between the two fair market values as of the date of the reorganization was equal to or less than 5% of the fair market value, as of the date of the reorganization, of the stock D held at death, the reorganization would satisfy the exception provided in paragraph (c)(1)(ii) of this section. Thus, the alternate valuation date would be the 6-month date. The value to be included in D's gross estate would be the fair market value, determined as of the 6-month date, of the new class of stock in Y that D's estate received in the reorganization.

Conservation easements granted during estate administration are an exception to the general rule. As a result, for purposes of determining both the estate's eligibility to make an election under §2032 and the value of the property on the alternate valuation date, the fair market value of the property as of the date of death must be compared to the fair market value of that property as of the alternate valuation date, in each case as that value is adjusted by reason of the existence of the conservation easement.

Retirement plans are specifically discussed. Alternate valuation is available. The Proposed Regulations provide:

(iii) Distributions from an account or entity in which the decedent held an interest at death.

(A) In general. If during the alternate valuation period, an estate (or other holder of the decedent's interest) receives a distribution or disbursement (to the extent the distribution or disbursement consists of included property, as defined in paragraph (d) of this section) (payment) from a partnership, corporation, trust (including an IRA, Roth IRA, 403(b), 401(k), Thrift Savings Plan, etc.), bank account or similar asset, or other entity (entity), and an interest in that entity is includible in the gross estate, the payment does not result in a distribution under paragraph (c)(1)(i)(I) of this section. However, this rule applies only if, on the date of the payment, the fair market value of the decedent's interest in the entity before the payment equals the sum of the fair market value of the payment made to the estate (or other holder of the decedent's interest in the entity) and the fair market value of the decedent's interest in the entity, not including any excluded property, after the payment. In this case, the alternate valuation date of the payment is the date of the payment, and the alternate valuation date of the decedent's remaining interest in the entity, if any, is the 6-month date (or the transaction date, if any, subsequent to this payment). If this requirement is not met, the payment is a distribution under paragraph (c)(1)(i) of this section, and the alternate valuation date of the decedent's entire interest in the entity is the date of the payment. For purposes of this section, a distribution or disbursement is deemed to consist first of excluded property, if any, and then of included property, as those terms are defined in paragraph (d) of this section.

With respect to the sale of an asset or division of an account, Examples 9-12 are as follows:

Example 9. Husband died owning an interest in a brokerage account titled in the names of Husband and Wife with rights of survivorship. On Husband's death, the account held marketable securities, corporate bonds, municipal bonds, certificates of deposit, and cash. During the alternate valuation period, Wife's stockbroker advised her that the account could not be held under the social security number of a deceased individual. Accordingly, approximately one month after Husband's death, Wife directed the stockbroker to transfer the account into an account titled in Wife's sole name. Because title to the joint account passes to Wife at the moment of Husband's death by operation of law, the transfer of the joint account into an account in Wife's sole name is not a transaction described in paragraph (c)(1)(i) of this section. Accordingly, the value of the assets held in Wife's solely owned account will be includible in Husband's gross estate at their fair market value on the 6-month date. The result would be the same if the brokerage firm automatically transferred title to the account into Wife's name, or if Wife changed the beneficiary designation for the account. Finally, the result would be the same if, instead of an account with a brokerage firm, the assets were held in Husband's retirement account (IRA or similar trust such as a Roth IRA, 403(b) plan, or 401(k) plan) or Wife's ownership of the account was the result of a contract (a beneficiary designation form) rather than operation of law.

Example 10. Assume the same facts as in Example 9 except that, during the alternate valuation period, Wife directed the stockbroker to sell a bond in the account. The sale is a transaction described in paragraph (c)(1)(i)(I)(4) of this section. Wife is an individual described in paragraph (c)(3)(i)(D) of this section. Thus, the alternate valuation date of the bond is the date of its sale. The values to be included in D's gross estate are the fair market value of the bond on date of its sale, and the fair market value of the balance of the account on the 6-month date. The result would be the same if the bond had matured and was retired during the

alternate valuation period. The result also would be the same if the bond was held within a retirement account (IRA or similar trust such as a Roth IRA, 403(b) plan, or 401(k) plan).

Example 11. Assume the same facts as in Example 9 except that, during the alternate valuation period, Wife withdrew cash from the account or otherwise received income or other disbursements from the account. Each such withdrawal or disbursement from the account (to the extent it consists of included property as defined in paragraph (d) of this section) is a distribution described in paragraph (c)(1)(i)(I)(4) of this section. Provided that, on the date of each distribution, the fair market value of the account before the distribution (not including excluded property) equals the sum of the included property distributed and the fair market value of the included property in the account immediately after the distribution in accordance with paragraph (c)(1)(iii)(A) of this section, the alternate valuation date for each distribution is the date of the distribution and the alternate valuation date for the account is the 6-month date. The value to be included in the gross estate is the fair market value of each distribution of included property (determined as of the date of distribution) and the fair market value of the account on the 6-month date. The result would be the same if the assets were held in an IRA or similar trust, such as a Roth IRA, 403(b) plan, or 401(k) plan.

Example 12. Husband died with a retirement account, having named his three children, in specified shares totaling 100%, as the designated beneficiaries of that account. During the alternate valuation period, the account was divided into three separate retirement accounts, each in the name of a different child and funded with that child's designated share. The division of the retirement account is not a transaction described in paragraph (c)(1)(i) of this section by reason of paragraph (c)(2) of this section, so the alternate valuation date for each of the new accounts is the 6-month date.

H. SECTION 2033 – GROSS ESTATE

I. SECTIONS 2035-2038 – RETAINED INTERESTS

1. Tax Court Strikes A Blow Against Discount Planning. Estate of Powell v. Commissioner of Internal Revenue, 148 T.C. No. 18 (2017) is a reviewed opinion with eight judges on the majority opinion, two concurring in result only, and seven joining a concurring opinion. What's going on here? The case involved three elements – state law and the actions of an attorney in fact; section 2043; and section 2036(a)(2). The latter is the most significant aspect of the opinion. The opinion reads as if the Tax Court, despairing of Congress or the IRS "doing anything about" discount planning, decided to strike a blow on its own.

The facts were simple. On August 6, 2008, Mrs. Powell's son, as attorney in fact, created a Delaware partnership, NHP Enterprises. On August 8, 2008, again as attorney in fact, the son contributed $10,000,752 to NHP in exchange for a 99% limited partnership interest. Son, as general partner had full control of the partnership which could be dissolved with written consent of all partners. Immediately thereafter, the son assigned the 99% to a CLAT using his power of attorney. By all accounts, Mrs. Powell was incapacitated all this time, and she died on August 15, 2008.

The Court ignored the application of section 2036(a)(1) using the "implied agreement" argument advanced by the IRS. Instead the Court looked to apply section 2036(a)(2).

The taxpayer conceded that funding NHP was not a "bona fide sale for adequate and full consideration." Section 2036(a) states:

> (a) General Rule.—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), * * * under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—
>
> (1) the possession or enjoyment of, or the right to the income from, the property, or
>
> (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

May the decedent have the right at death for section 2036 to apply? The Court says no. That the decedent had the power as a limited partner to dissolve the partnership with someone else – the general partner – for a moment prior to the transfer to the CLAT was sufficient to invoke section 2036(a)(2). The transfer would have needed to be more than three years before death to be effective given section 2035.

The Court was worried about 2036(a)(2) workarounds. Footnote 4 to the opinion states:

> Because we express no view on whether the transfer of decedent's cash and securities to NHP was subject to a right described in sec. 2036(a)(1) (or whether enjoyment of those assets was subject to change on the date of decedent's death through the exercise of a power described in sec. 2038(a)), it does not follow that, had NHP's limited partnership agreement been drafted in a way that prevented the application of sec. 2036(a)(2), decedent's gross estate would have been reduced by any discount applicable in valuing the limited partner interest issued in exchange for those assets.

The Court also determined that the transfer to the CLAT was invalid under applicable state law – California – because the power of attorney did not specifically authorize gifts (beyond the annual exclusion) which is required in California to confer a broad gift power. Thus the NHP units were also included in the decedent's estate.

Concurring that there was no double inclusion led the majority to expound upon section 2043 with the minority writing that the court should have applied a simple "recycling of value" theory. The concurring opinion states:

> The Court correctly concludes that section 2036(a)(2) applies here. See op. Ct. pp. 14–21 (relying on Estate of Strangi v. Commissioner, T.C. Memo. 2003–145, 85 T.C.M. (CCH) 1331, aff'd on other grounds, 417 F.3d 468 (5th Cir. 2005)). The decedent clearly "made a transfer" of the $10 million in cash and securities.

And she clearly retained the proverbial "string" that pulls these assets back into her estate.

But the Court concludes, see op. Ct. p. 22, that section 2036(a) does not require "the inclusion in the value of decedent's gross estate of the full date-of-death value of the cash and securities," while admitting that the statute, "read in isolation, would require that result." See Estate of Thompson v. Commissioner, T.C. Memo. 2002–246, 84 T.C.M. (CCH) 374, 386 ("Section 2036(a) effectively includes in the gross estate the full fair market value * * * of all property transferred in which the decedent had retained an interest." (Emphasis added.)). Instead, the Court holds that section 2036(a)(2) brings into the gross estate a much smaller sum: the value of the cash and securities ($10 million) minus the value of the limited partnership interest that the decedent got in exchange. Otherwise, the Court says, the $10 million would be included in her estate twice: first via section 2036(a)(2) and again via her partnership interest, which would be separately includible as property of the estate under section 2033.

This is where I part company with the Court, because I do not see any "double inclusion" problem. The decedent's supposed partnership interest obviously had no value apart from the cash and securities that she allegedly contributed to the partnership. The partnership was an empty box into which the $10 million was notionally placed. Once that $10 million is included in her gross estate under section 2036(a)(2), it seems perfectly reasonable to regard the partnership interest as having no distinct value because it was an alter ego for the $10 million of cash and securities.

This is the approach that we have previously taken to this problem. See Estate of Thompson, 84 T.C.M. (CCH) at 391 (concluding that the decedent's interest in the partnership had no value apart from the assets he contributed to the partnership); Estate of Harper v. Commissioner, T.C. Memo. 2002–121, 83 T.C.M. (CCH) 1641, 1654; cf. Estate of Gregory v. Commissioner, 39 T.C. 1012, 1020 (1963) (holding that a decedent's retained interest in her own property cannot constitute consideration under section 2043(a)). And this is the approach that I would take here. There is no double-counting problem if we read section 2036(a)(2), as it always has been read, to disregard a "transfer with a string" and include in the decedent's estate what she held before the purported transfer—the $10 million in cash and securities.

Rather than take this straightforward path to the correct result, the Court ad-opts as the linchpin of its analysis section 2043(a). Neither party in this case advanced any argument based on section 2043(a); indeed, that section is not cited in either party's briefs. And as the Court recognizes, see op. Ct. p. 28, we have not previously applied section 2043(a), as the Court does here, to limit the amount includible in a decedent's gross estate under section 2036(a). See, e.g., Estate of Harper, 83 T.C.M. (CCH) at 1654 (ruling that section 2043(a) "is inapplicable where, as here, there has been only a recycling of value and not a transfer for consideration").

Invoking section 2043(a), the Court divides the $10 million into a "doughnut" and a "doughnut hole." The "doughnut" consists of the limited partnership interest allegedly received by the decedent; on the Court's theory, this is pulled back into the gross estate via section 2035 or 2038, and its value then included under section 2033. As a result, section 2036(a), paired with section 2043(a), has the much-reduced function of bringing back into the gross estate, not the full value of the $10 million as that section by its terms requires, but only "the amount of any discounts (that is, the doughnut holes) allowed in valuing the partnership interest."

> See op. Ct. pp. 26–27. This theory seemingly validates the estate's claimed discount for lack of marketability, which seems highly suspect on the facts presented.
>
> The Court's exploration of section 2043(a) seems to me a solution in search of a problem. It is not necessary; the parties did not think it was necessary; and our prior cases show that it is unnecessary. And even if the section 2043(a) issue were properly presented, I am not sure that the Court's application of that provision is correct. It is far from clear to me that the decedent's partnership interest—a consequence of the now-disregarded transfer—can constitute "consideration in money or money's worth" within the meaning of section 2043(a).

If there is no persuasive non-tax reason for the entity, and ownership is surrendered within three years of death, then avoiding section 2036(a)(2) is difficult. One approach is to limit the decedent's rights over the entity in the first place. For example, the client could add assets to a trust that lacks any current beneficiaries. The client would retain a testamentary power of appointment thus making the gift incomplete but the assets would be includable in the client's estate. The trustee would engage in the discount planning, presumably under specific authority in the trust. The decedent would never have had any liquidation right or other section 2036(a)(2) right unless such were somehow imputed through the trust to the grantor.

Another approach is to sell the decedent's interest in the entity. The issue there is whether if the sale is for less than would be included in the decedent/seller's estate did the decedent/seller receive full consideration. In United States v. Allen, 293 F.2d 916 (10th Cir. 1961) the decedent created a trust reserving 3/5ths of the income for life; many years later she sold the income interest for far less than the value of 3/5ths of the trust. The court held that was an inappropriate loophole because – under the 1939 Code – a taxpayer could keep income for most of the taxpayer's life and then sell close to death for a fraction of what otherwise would be included.

In trying to understand the implications of Powell, the case of Estate of Frank D. Streightoff, T.C. Memo. 2018-178, should be considered. Ultimately an 18% lack of marketability discount was allowed, and the section 2036 issue which might have been dispositive was not. The argument by the estate was that the transfer was an assignee interest, which was rejected. The opinion states:

> The parties disagree as to the type of interest that must be valued and included in the value of decedent's gross estate. [footnote omitted]
>
> The estate contends that the agreement created an assignee interest in decedent's limited partnership interest under Texas State law and the partnership agreement. It contends that it valued and reported decedent's interest in the revocable trust correctly as an assignee interest on Schedule G of its tax return. Respondent contends that the agreement did not create an assignee interest held by the revocable trust. Respondent argues that decedent transferred his 88.99% limited partnership interest to the revocable trust and the value to be included in the value of the gross estate should be that of a limited partnership interest.
>
> We need to determine whether the interest decedent transferred to the revocable trust was a limited partnership interest or an assignee interest. Generally, State law determines the property interest that has been transferred for Federal estate

tax purposes. See McCord v. Commissioner, 120 T.C. 358, 370 (2003), rev'd and remanded on other grounds, 461 F.3d 614 (5th Cir. 2006). TRLPA (as in effect for the relevant period) provides that a partnership interest is personal property and is assignable, in whole or in part, unless the partnership agreement provides otherwise. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, secs. 7.01 and 7.02(a)(1) (West). An assignee of a partnership interest is entitled to receive, to the extent assigned, allocations of income, gain, loss, deduction, credit, or similar items, and to receive distributions to which the assignor is entitled, but an assignment does not entitle the assignee "to become, or to exercise rights or powers of, a partner". Id. sec. 7.02(a)(2) and (3). The assignee may become a limited partner, with all rights and powers of a limited partner under a partnership agreement, in the manner that the partnership agreement provides or if all partners consent. Id. sec. 7.04(a) and (b).

Although we consult State law to determine what property interests were transferred, our inquiry may not end there. See McCord v. Commissioner, 120 T.C. at 371. The Federal tax effect of a particular transaction is governed by the substance of the transaction rather than its form. Frank Lyon Co. v. United States, 435 U.S. 561, 573 (1978). The doctrine that the substance of a transaction will prevail over its form has been applied in Federal estate and gift tax cases. See Heyen v. United States, 945 F.2d 359, 363 (10th Cir. 1991); Estate of Murphy v. Commissioner, T.C. Memo. 1990-472. In particular, we have indicated a willingness to look beyond the formalities of intrafamily partnership transfers to determine what, in substance, was transferred. See Kerr v. Commissioner, 113 T.C. 449, 464-468 (1999), aff'd, 292 F.3d 490 (5th Cir. 2002). We will consider both the form and the substance of decedent's transfer to the revocable trust to determine whether the property interest transferred was an assignee interest or a limited partnership interest.

***

We conclude that the form of the agreement establishes that decedent transferred to the revocable trust a limited partnership interest and not an assignee interest. The economic realities underlying the transfer of decedent's interest also support our conclusion that the transferred interest should be treated as a limited partnership interest for Federal estate tax purposes. This is because we conclude that regardless of whether an assignee or a limited partnership interest had been transferred, there would have been no substantial difference before and after the transfer to the revocable trust. See Kerr v. Commissioner, 113 T.C. at 467-468. Pursuant to Streightoff Investments' partnership agreement only the general partner had the right to direct the partnership's business; neither limited partners nor assignees had managerial rights. The partnership agreement provided that assignees had no rights to any information regarding the business of the partnership or to inspection of the books or records of the partnership. However, this distinction made no difference in this case because Ms. Streightoff was both a partner entitled to information regarding Streightoff Investments and the trustee of the revocable trust.

The partnership agreement provided that an "unadmitted assignee" did not have the right to vote as a limited partner. In Kerr v. Commissioner, 113 T.C. at 467, we determined that the only real difference between the rights of a limited partner and those of an assignee was the right to vote on partnership matters, and we concluded that this difference was not significant. We held that under such circumstances the transferred interest should be valued as a limited partnership interest rather than as an assignee interest. Id. Here, we conclude similarly that

> whether the revocable trust held the voting rights associated with a limited partnership interest would have been of no practical significance. There were no votes by limited partners following the execution of the agreement. Additionally, during his life decedent held the power to revoke the transfer to the revocable trust. If he had revoked the transfer, he would have held all the rights of a limited partner in Streightoff Investments, including the right to vote on partnership matters. Also, Streightoff Management as the general partner could have treated the holder of an assignee interest as a substitute limited partner. Under the facts and circumstances of this case, there was no difference in substance between the transfer of a limited partnership interest in Streightoff Investments and the transfer of an assignee interest in that limited partnership interest. See id.; Astleford v. Commissioner, T.C. Memo. 2008-128, slip op. at 16. Accordingly, as a matter of both form and substance, the interest to be valued for estate tax purposes is an 88.99% limited partnership interest in Streightoff Investments.

The Fifth Circuit affirmed, noting that even if an assignee interest had been transferred the valuation would have been the same. Streighthoff v. Commissioner, 954 F.3d 713 (5th Cir. 2020). The Fifth Circuit held:

> *Economic Substance*. From an economic reality standpoint, we also agree with the tax court's alternative substance over form rationale. Estate of Streightoff, 2018 WL 5305054, at *7 ("[R]egardless of whether an assignee or a limited partnership interest had been transferred, there would have been no substantial difference before and after the transfer to the revocable trust."). Assuming we were to accept the Estate's argument that the Assignment conveyed an unadmitted assignee interest as a matter of form, the substance of the transaction will nonetheless prevail. The substance over form doctrine permits a court to determine a transaction's characterization according to its "underlying substance of the transaction rather than its legal form." Southgate Master Fund, 659 F.3d at 480. Here, looking beyond the formalities of this intrafamily transfer, the Assignment lacks economic substance outside of tax avoidance. Griffin v. United States, 42 F. Supp. 2d 700, 703 (W.D. Tex. 1998) ("[E]ven if a transaction falls within the literal requirements of the tax statute, the transaction will be disregarded . . . if it has no business purpose or economic effect other than the creation of tax deductions, or if its only purpose is tax avoidance."). While SILP limited partners appear to enjoy several managerial and oversight powers that unadmitted assignees do not6, there were no practical differences after the Assignment was executed. Other than Elizabeth, there is no record of SILP's limited partners, the decedent's children, exercising their partnership rights or responsibilities. For example, this partnership held no meetings or votes, nor was there any attempt to remove Streightoff Management as SILP's general partner. Without genuine nontax circumstances present, the Assignment is the functional equivalent of a transfer of limited partnership interest. See Kerr, 113 T.C. at 467 (Under similar facts, the court held that "[t]he objective economic realities underlying the transfers" support that "there were no significant differences . . . between the rights of limited partners and assignees."); see also Streightoff, 2018 WL 5305054, at *7.

2. Application of Section 2043 to Defective FLP Transfer. The 30,000 foot view of Moore v. Commissioner, T.C. Memo. 2020-40, is set out by Judge Holmes of the Tax Court as follows:

> Howard Moore was born into rural poverty but over a long life built a thriving and very lucrative farm in Arizona. In September 2004 he began negotiating its sale, but his health went bad. He was released from the hospital and entered hospice care by the end of that year.

> Then he began to plan his estate.
>
> What his lawyer came up with was quite complex--a combination of five trusts and a partnership--and it required him to contribute most of his farm to the partnership. His stated reason was to protect the farm from various business risks and bring his sometimes fractious family together to learn to manage the business without him. But five days after the partnership received part ownership of the farm, Moore sold it. And even after the sale, Moore stayed on the farm and directed its operations until he died.
>
> The key question we have to answer is whether Moore's plan works to reduce the size of his taxable estate. We also have to figure out whether Moore's efforts to reduce the size of his taxable estate resulted in taxable gifts.

In a nutshell, the court concluded that the taxpayer retained control of the farm, and had no bona fide, non-tax reasons for the FLP or transfer, and included it in his estate. But then the court went on to discuss section 2043 in the most detailed way yet by the Tax Court. That discussion is worth consideration for planning purposes:

> a. The Problem of Section 2043(a)
>
> The root of this problem is that section 2043 prohibits the Commissioner from just adding the proceeds from the sale of Moore's farm to his gross estate. It requires instead a more complicated set of calculations when there are transactions--like the transfer of four-fifths of the farm from the Living Trust to the FLP--that fall within section 2036. Section 2043(a) says (with the key word italicized)
>
>> If any one of the transfers * * * described in sections 2035 to 2038, inclusive, and section 2041 is made, created, exercised, or relinquished for a consideration in money or money's worth, but is not a bona fide sale for an adequate and full consideration in money or money's worth, there shall be included in the gross estate *only* the excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent.
>
> The number that needs to be included in the gross estate can be expressed in an equation: $V_{included} = C_d + FMV_d - C_t$, where
>
> $V_{included}$ = value that must be added to the gross estate;
>
> C_d = date-of-death value of the consideration received by the decedent from the transaction that remains in his estate, see sec. 2033;
>
> FMV_d = fair market value at date of death of property transferred by the decedent whose value is included in the gross estate under section 2036; and
>
> C_t = consideration received by the decedent at the time of the transfer, which has to be subtracted under section 2043(a).
>
> To see how this works, let's look at a few examples. We'll start with the simplest and work toward one that echoes what we have here.

Example 1: Constant Values. Imagine a parcel of land worth $1000. Its aging owner transfers its ownership to a FLP in which his partnership interest is worth $500, but he keeps a life estate. What's included in his gross estate is $1000, computed as the partnership interest valued at $500 when he died (and thus included in his estate under section 2033), plus $1000 (the value of the land as of the date of death), minus $500 (the value of the partnership interest when he received it). If the decedent hadn't done the transaction the $1000 parcel would be in his estate; the Code essentially nullifies the bargain sale's effect on the value of the gross estate.

This was more or less the situation in Estate of Powell. The result seems sensible. As we pointed out in that case, however, problems can arise when the value of the transferred asset fluctuates between the time of transfer and the time of death. Estate of Powell v. Commissioner, 148 T.C. at 408 n.7.

Let's turn to those.

Example 2: Inflating Values. Now consider the same facts as in the first example, but the value of the land and the FLP share doubles between the time of transfer and the date of death. The now $1000 FLP interest stays in the estate under section 2033; but one must add another $2000 to the estate because the fair market value of the land is also measured as of the date of death. The result is the inclusion of $2500 in the estate: $1000 + $2000 - $500. This might be thought to be less sensible: If the decedent had kept the land, only $2000 would be in his gross estate.

Example 3: Declining Values. Again, the same facts but the land and the FLP share halve in value. The FLP interest is worth only $250 at the date of death and the land is worth only $500. What's included in the gross estate? $250 + $500 - $500 = $250, instead of $500. This makes the decedent who does the transaction better off than one who doesn't.

And now we can introduce discounted FLP interests.

Example 4: Discounted Interest, But Simple. This example will have slightly different facts. There is still a piece of land worth $1,000 and the aging owner transfers it to a FLP. However, this time, the aging owner's son contributes a peppercorn to the FLP as well. Under the partnership agreement the son is the general partner and the aging land owner is the limited partner. Father and son agree that this triggers a 25% discount for lack of control, and the value of the father's partnership interest sinks to $750. Under the formula, the estate would include $750 for the FLP interest (under section 2033), $1000 for the transferred land (under section 2036), but with $750 subtracted (under section 2043).

Example 5: Discounted Interest, But Not Simple. Now assume the same facts as example 4 except this time the FLP sells the land for $1000. Then, the FLP makes a distribution of $400 back to the aging father. Under the formula this produces a strange result. Included in the estate is $400 cash (section 2033), $450 for the FLP interest (section 2033), $1000 for the transferred land (section 2036), less $750 (section 2043)--in all the estate now has a value of $1100. Had the aging man just sold the land he would have only $1000 in his estate.

Some of these examples thus lead to what may seem odd results, but we must nevertheless apply the Code as it is written and interpreted in a Division Opinion. See Sec. State Bank v. Commissioner, 111 T.C. 210, 213 (1998), aff'd, 214 F.3d 1254 (10th Cir. 2000); Hesselink v. Commissioner, 97 T.C. 94, 99-100 (1991);

Nihiser v. Commissioner, T.C. Memo 2008-135, 95 T.C.M. (CCH) 1531, 1534 (2008).

And there's one last thing to note--the variable C_d is not limited by tracing rules. This means that whatever is left of the original consideration in an estate is included, but so are any proceeds from its later sale because section 2033 includes all property that a decedent owns in his gross estate. This also means that any property that leaves an estate after a transfer governed by section 2036 but before a decedent's death is *not* generally included in the gross estate.

ii. Application of Section 2043(a)

We can now begin to customize the equation to fit these cases. (We'll do this with verbal descriptions and leave the actual math to the parties under Rule 155.)

FMV_d. The fair market value of the farm was established by the sale to the Mellons. This was an arms-length sale to a third party, and neither the estate nor the Commissioner disputes that it sets the fair market value of the farm on both the date the price was agreed to and the date of sale. The transfer of four-fifths of the farm from the Living Trust to the FLP occurred at very nearly the same time as this sale. Moore then died less than two months later. We find it more likely than not that the fair market value of the farm did not change in so short a time. See, e.g., Cave Buttes, L.L.C. v. Commissioner, 147 T.C. 338, 355 (2016); Dunlap v. Commissioner, T.C. Memo 2012-126, 103 T.C.M. (CCH) 1689, 1709 (2012).

C_t. Section 2043 tells us to subtract from this value of the farm the value of the consideration that Moore received. We value this consideration on the date it was received. One-fifth of the value of the farm went directly to the Living Trust and is a matter of multiplication. But what of the remaining four-fifths? This is the portion that went from the Living Trust to the FLP in exchange for an interest in the FLP. Here the parties' estimations diverge. The estate says that Moore got an interest in the FLP worth about \$5.3 million; the Commissioner argues that it was worth about \$8.5 million. Because of the brief time between the challenged transfer and Moore's death, we find it more likely than not that this value--whether it was \$5.3 million or \$8.5 million--did not change between the time Moore received it and the time he died. On the facts of these cases, then, we don't think this dispute matters because we would add back either figure after subtracting it.

With the value of the consideration that Moore received measured at the time he received it equal to the value of the consideration that remained in his estate at the time of his death, the equation thus far is:

(Either \$5.3 million or \$8.5 million + (.2 * value of farm at date of death)) + ((value of farm at date of death) - ((either \$5.3 million or \$8.5 million) + (.2 * value of farm at date of death))).

C_d. This variable, however, is not simply the value of the consideration from the challenged transaction. Section 2033 tells us to include only the value of that consideration that remains in the estate as of the date of Moore's death. To get to this number we have to look for any money that left that estate after the farm's sale and before that date. There were three of these adjustments to the C_d variable that the parties identified and argued about:

• unpaid attorney's fees,

• transfers to Moore's children, and

• $2 million dollar purported loan.

The court concluded the transfers and loans were gifts.

The upshot of the section 2043 analysis is that taxpayers need to avoid section 2036 if at all possible. Disposition of all interests in entities three years prior to death is helpful, as could be use of an incomplete gift trust to facilitate the gift or sale of non-voting units. If assets appreciate between the time of transfer and the time of inclusion there may be double inclusion. Alternatively, before death the transaction needs to be unwound with some assets "in" and others "out" of the soon-to-be decedent's estate.

The decedent's revocable trust had a charitable allocation clause to a CLAT that stated:

> [T]he smallest amount which, when transferred to the Howard V. Moore Charitable Lead Annuity Trust as provided in Section 2 of the Article will result in the least possible federal estate tax being payable as a result of my death after allowing for the applicable exclusion amount (after taking into account adjusted taxable gifts, if any) as finally determined for federal estate tax purposes, and the credit for state death taxes (but only to the extent that the use of this credit does not require an increase in the state death taxes paid).
>
> The denominator is the value of the Living Trust as determined for federal estate-tax purposes.

The court whiffed on its interpretation of that clause. First it found that it did not apply to zero-out the estate tax because the farm was not included in the trust so the clause could not direct it to charity. That is partially correct. Then it stated:

> There is also a second, much more general problem here. Charitable deductions are allowed only for the value of property in a decedent's gross estate if transferred to a charitable donee "by the decedent during his lifetime or by will." Sec. 20.2055-1(a), Estate Tax Regs. We have repeatedly denied charitable deductions where the donation turned upon the actions of the decedent's beneficiary or an estate's executor or administrator. See, e.g., Estate of Engelman v. Commissioner, 121 T.C. 54, 70-71 (2003); Estate of Marine v. Commissioner, 97 T.C. 368, 378-79 (1991), aff'd, 990 F.2d 136 (4th Cir. 1993).
>
> Charitable deductions must be ascertainable at a decedent's date of death. Ithaca Tr. Co. v. United States, 279 U.S. 151, 154 (1929)(transfers to a charity must be "fixed in fact and capable of being stated in definite terms of money"); Estate of Marine, 97 T.C. at 375. Section 20.2055-2(b)(1), Estate Tax Regs., states:
>
> If, as of the date of a decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.

> Whether the Living Trust would get additional funds from the Irrevocable Trust to transfer to the Charitable Trust was not ascertainable at Moore's death but only after an audit by the Commissioner, followed by a determination that additional property should be included in Moore's estate, followed by either the successful defense of that position or the estate's acquiescence to his determinations. For the exception to apply, it would have to have been almost certain that the Commissioner would not only challenge, but also successfully challenge the value of the estate. We do not think that's a reasonable conclusion.
>
> The estate likens its facts to those of Estate of Christiansen v. Commissioner, 586 F.3d 1061 (8th Cir. 2009), aff'g 130 T.C. 1 (2008), and Estate of Petter v. Commissioner, 653 F.3d 1012 (9th Cir. 2011), aff'g T.C. Memo. 2009-280. In Estate of Christiansen v. Commissioner, 586 F.3d at 1062-63, even though the amount of the property to be transferred was subject to change based on a formula clause, we allowed a charitable deduction because the transfer itself was not contingent on the happening of some event.
>
> In Estate of Petter, a FLP was to distribute LLC units to the trusts that Ms. Petter had set up for each of her children. The trusts were to receive a specific number of units up to a set dollar amount, with any units over that set value going to charity. Estate of Petter, 653 F.3d at 1020. Since the value of these units was unknown (because it was based on the FMV of stock held by the FLP), id., if a subsequent audit by the Commissioner led to a revaluation of the units then some of those units that had already been transferred to trusts had to be retransferred to the charitable donee in accordance with the trust provisions, id. at 1019. As in Estate of Christiansen, value was at issue, but not whether there would be a transfer to the donee at all. Estate of Petter, 653 F.3d at 1018.
>
> Article 5, section 2 of Moore's Irrevocable Trust does not say that the Living Trust will receive a transfer of assets of unknown value. It says that whether the Living Trust will even receive a transfer of assets is unknown-contingent on an examination by the Commissioner. This is unlike Estate of Christiansen, where we *knew* the charity would get a transfer of assets, just not the value, or Estate of Petter, where we *knew* the charity would get some transfer of value, just not how much. Here, we *don't know* if the charity would get any additional assets at all.

That is simply wrong. The allocation of assets between, say, a marital deduction and bypass trust works the same way as this clause. Judge Holmes also authored Christiansen and Petter. Why the different readings is unclear.

J. SECTIONS 2041 AND 2514 — GENERAL POWERS OF APPOINTMENT

1. Effect of Change of State Law on General Power in Trustee. A decedent was sole trustee and a beneficiary in PLR 202020008, with discretion to distribute assets as follows:

> Article Sixth of Mother's will and Article Seventh of Father's will provide that if the trustee deems the net income of the respective trusts not sufficient to provide for the proper support, maintenance, comfort, education and recreation of any income beneficiary, taking into consideration other income and financial resources of such beneficiary, so far as known to the trustee, the trustee may as often as it deems necessary pay to or apply for the use and benefit of such beneficiary such additional part of the corpus of the trust estate (including the whole thereof) as the trustee in its sole and absolute discretion believes will be in the best interest of and tend to promote the welfare of such beneficiary.

No governing law for the trust was specified and the decedent/trustee moved from one state to another. The IRS notes the applicable state law:

> In Year 1, while Decedent was residing in State A, State A enacted Statute 1, which provides in part that unless a settlor or a testator clearly indicates that a broader power is intended by express reference to Statute 1, a person who is a beneficiary of a trust that permits the person, as trustee or co-trustee, to make discretionary distributions of income or principal to or for the benefit of himself or herself may exercise that power in his or her favor only for his or her health, education, support, or maintenance within the meaning of § 2041 and § 2514 of the Internal Revenue Code (Code). Statute 1 applies to any irrevocable trust created under a document executed in or before Year 1, unless all parties in interest elect affirmatively not to be subject to the provision. Such election was not made with respect to Trust 1 and Trust 2.
>
> In Year 2, Decedent became a resident of State B and remained a State B resident until his death on Date 3. Statute 2, effective in State B at the time of Decedent's death, provides in part that unless the terms of the trust expressly indicate that Statute 2 does not apply, a person who is a beneficiary and a trustee may not make discretionary distributions of either principal or income to or for the benefit of that trustee, except to provide for that trustee's health, education, maintenance, or support as described under § 2041 and § 2514 of the Code.

The IRS concluded that the decedent did not have a general power nor did the enactment of the statute in State A or the move to State B affect the GST grandfathered status of the trusts:

> In Ruling 1 of the present case, we conclude that the enactment of Statute 1 did not constitute a release of a general power of appointment by Decedent. In Ruling 2 of the present case, we conclude that Decedent did not have a general power of appointment at the time of his death and that the lapse of Decedent's fiduciary powers as trustee at his death did not constitute a release of a general power of appointment. Therefore, we conclude neither the enactment of Statute 1 nor the lapse of Decedent's fiduciary powers at his death constitute a constructive addition to the trust for purposes of § 26.2601-1(b)(1)(v)(A).
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> The enactment of Statute 1 did not change the standard for which distributions can be made to Decedent under the terms of Trust 1 or Trust 2. The enactment of Statute 1 changed who may exercise certain fiduciary powers. Any successor trustee or co-trustee of Trust 1 or Trust 2 appointed pursuant to Article Eighth of Mother's will or Article Ninth of Father's will would have had the power to make the broader distributions to Decedent from Trust 1 and Trust 2 as are allowable under Article Sixth of Mother's will and Article Seventh of Father's will, respectively. The state law restriction on Decedent's ability to exercise the fiduciary powers himself, as trustee of Trust 1 and Trust 2, does not change his interest in the trust for the purposes of § 26.2601-1(b)(4)(i)(D)(2).
>
> In the present case, we conclude that the enactment of Statute 1 will not be considered a modification or trustee action that: (1) results in a shift of a beneficial interest in Trust 1 or Trust 2 to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification; or (2) extends the time for vesting of any beneficial interest in Trust 1 or Trust 2 beyond the period provided for in the original trust terms. Accordingly, we conclude that the enactment of Statute 1 did not affect the exempt status of Trust 1 or Trust 2. Additionally, we conclude that because Statute 2 imposes substantially the same

changes as Statute 1, Decedent becoming a resident of State B and becoming subject to Statute 2 did not affect the exempt status of Trust 1 or Trust 2.

The ruling is one of a series.

K. SECTIONS 61, 83, 409A, 2042 AND 7872 - LIFE INSURANCE

1. **Analysis of Split Dollar Plan**. Estate of Clara M. Morrissette v. Commissioner, 146 T.C. No. 11 (2016) confronts directly the gift tax consequences of split-dollar life insurance plans. Before turning to the specific arrangement before the court, it is instructive to read the court's understanding of split-dollar insurance and the 2003 final regulations. The opinion states:

> The IRS issued final regulations in September 2003 that govern all split-dollar life insurance arrangements entered into or materially modified after September 17, 2003 (final regulations). The final regulations define a split-dollar life insurance arrangement as an arrangement between an owner and a nonowner of a life insurance contract in which: (i) either party to the arrangement pays, directly or indirectly, all or a portion of the premiums on the life insurance contract; and (ii) the party paying for the premiums is entitled to recover all or any portion of those premiums, and such recovery is to be made from, or is secured by, the proceeds of the life insurance contract. Id. para. (b)(1).
>
> ***
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> The final regulations provide two mutually exclusive regimes for taxing split-dollar life insurance arrangements entered into (or materially modified) after September 17, 2003, either the economic benefit regime or the loan regime. Id. subpara. (3)(i); see Our Country Home Enters., Inc. v. Commissioner, 145 T.C. __, __ (slip op. at 29) (July 13, 2015).
>
> The determination of which regime applies to a split-dollar life insurance arrangement depends on which party owns, or is deemed to own, the life insurance policy subject to the arrangement. Generally, the person named as the owner in the insurance contract is treated as the owner of the contract. Sec. 1.61-22(c)(1), Income Tax Regs. A nonowner is any person other than the owner who has any direct or indirect interest in the contract. Id. subpara. (2).
>
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> As an exception to the general rule, the final regulations include a special ownership rule that provides that if the only economic benefit provided under the split-dollar life insurance arrangement to the donee is current life insurance protection, then the donor will be the deemed owner of the life insurance contract, irrespective of actual policy ownership, and the economic benefit regime will apply. Id. subpara. (1)(ii)(A)(2). If, on the other hand, the donee receives any additional economic benefit, other than current life insurance protection, then the donee will be considered the owner and the loan regime will apply. Id.
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> ***
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> For a split-dollar life insurance arrangement to be taxed under the economic benefit regime, the owner or deemed owner will be treated as providing an annual benefit to the nonowner in an amount equal to the value of the economic benefits

> provided under the arrangement, reduced by any consideration the nonowner pays for the benefits. Sec. 1.61-22(d)(1), Income Tax Regs. The value of the economic benefits provided to the nonowner for a taxable year under the arrangement is equal to the sum of (i) the cost of current life insurance protection, (ii) the amount of cash value to which the nonowner has current access during the year, and (iii) any economic benefits not otherwise described that are provided to the nonowner. Id. subpara. (2).
>
> The cost of the current life insurance protection takes into account the life insurance premium factors that the Commissioner publishes for this purpose. See id. subpara. (3)(ii). The amount of the current life insurance protection is the death benefit of the life insurance contract (including paid-up additions) reduced by the sum of the amount payable to the owner plus the portion of the cash value taxable to (or paid for by) the nonowner. See id. subdiv. (i). The amount of the insurance policy cash value is determined disregarding surrender charges or other similar charges or reductions and including insurance policy cash value attributable to paid-up additions. See id. subpara. (4)(i).
>
> ***
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> The final regulations provide that the nonowner has current access to any portion of the policy cash value to which the nonowner (i) has a current or future right and (ii) that currently is directly or indirectly accessible by the nonowner, inaccessible to the owner, or inaccessible to the owner's general creditors. Id. subdiv. (ii).

Here, Clara M. Morrissette established a revocable trust, the Clara M. Morrissette Trust (CM Trust), and contributed her shares in the Interstate Group (a family corporation) to the trust. In 2006 the CMM Trust entered split-dollar insurance arrangements with three Dynasty Trusts established, one for each of her three sons. The CMM Trust contributed $29.9 million to the three trusts to purchase universal life insurance policies for the sons.

> To provide the Dynasty Trusts with the resources to purchase the Interstate Group stock held by or on behalf of a decedent, each Dynasty Trust purchased two universal life insurance policies, one on the life of each other brother. On October 4, 2006, (i) the Arthur Dynasty Trust purchased two universal life insurance policies, one on the life of Donald and one on the life of Kenneth; (ii) the Donald Dynasty Trust purchased two universal life insurance policies, one on the life of Arthur and one on the life of Kenneth; and (iii) the Kenneth Dynasty Trust purchased two universal life insurance policies, one on the life of Arthur and one on the life of Donald.

The opinion described the split-dollar terms as follows:

> To fund the purchase of the policies, each Dynasty Trust and the CMM Trust entered into two split-dollar life insurance arrangements (each a split-dollar life insurance arrangement, and collectively, split-dollar life insurance arrangements) on October 31, 2006, to set forth the rights of the respective parties with respect to the policies. The CMM Trust contributed (i) $9.96 million to the Arthur Dynasty Trust, (ii) $9.98 million to the Donald Dynasty Trust, and (iii) $9.96 million to the Kenneth Dynasty Trust. The Dynasty Trusts then used that money to pay a lump-sum premium on each policy to maintain that policy for the insured's projected life expectancy.

> Under the split-dollar life insurance arrangements, upon the death of the insured the CMM Trust would receive a portion of the death benefit from the respective policy insuring the life of the deceased equal to the greater of (i) the cash surrender value (CSV) of that policy, or (ii) the aggregate premium payments on that policy (each a receivable, and collectively, receivables). Each Dynasty Trust would receive the balance of the death benefit under the policy it owns on the life of the deceased, which would be available to fund the purchase of the stock owned by or for the benefit of the deceased. If a split-dollar life insurance arrangement terminates for any reason during the lifetime of the insured, the CMM Trust would have the unqualified right to receive the greater of (i) the total amount of the premiums paid or (ii) the CSV of the policy, and the Dynasty Trust would not receive anything from the policy.
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> Each split-dollar life insurance arrangement includes the following recital: "WHEREAS, the parties intend that this Agreement be taxed under the economic benefit regime of the Split-Dollar Final Regulations, and that the only economic benefit provided to the [Dynasty] Trust[s] under this arrangement is current life insurance protection."
>
> Additionally, the Dynasty Trusts executed collateral assignments of the policies to the CMM Trust to secure payment of the amounts owed to the CMM Trust. Neither the Dynasty Trusts nor the CMM Trust retained the right to borrow against a policy.

The court noted that the Preamble to the final regulations contained an example like this transaction:

> As a threshold matter, the preamble to the final regulations includes an example that is structured identically to the split-dollar life insurance arrangements at issue. The preamble distinguishes between a donor, or the donor's estate, who is entitled to receive an amount equal to the <u>greater</u> of the aggregate premiums paid by the donor or the CSV of the contract and a donor, or the donor's estate, who is entitled to receive the <u>lesser</u> of those two values. T.D. 9092, sec. 5, Gift Tax Treatment of Split-Dollar Life Insurance Arrangements, 2003-2 C.B. 1055, 1062. In the former situation, the donor makes a gift to the donee equal to the cost of the current life insurance protection provided less any premium amount paid by the donee. <u>Id.</u> In the latter situation, the value of the donor's gift of economic benefits equals the cost of current life insurance protection provided, the amount of policy cash value to which the trust has current access, and the value of any other economic benefits, less the amount of premiums paid by the donee. <u>Id.</u> Thus, it follows that where a donor is to receive the greater of the aggregate premiums paid or the CSV of the contract, the possibility of the donee receiving an additional economic benefit is foreclosed.
>
> We are aware that the Court has previously been unpersuaded by a preamble to regulations. <u>See Allen v. Commissioner</u>, 118 T.C. 1, 17 n.12 (2002) ("In addition to the obvious fact that these documents also are not items of legislative history, these documents are afforded little weight in this Court." (citing <u>Dobin v. Commissioner</u>, 73 T.C. 1121, 1127 n.9 (1980))). We are not bound by the preamble, but because it is an agency's interpretation of its statute, we apply the standard enunciated by the Supreme Court in <u>Skidmore v. Swift & Co.</u>, 323 U.S. 134, 140 (1944). Therefore, the Commissioner is entitled to at least the lowest level of deference in interpreting his own regulations and their statutes. <u>See United States v. Mead Corp.</u>, 533 U.S. 218, 221 (2001); <u>ADVO, Inc. v. Commissioner</u>, 141 T.C. 298, 322 (2013); <u>Armco, Inc. v. Commissioner</u>, 87 T.C. 865, 868 (1986) (explaining how a preamble is drafted and that it is a statement of intent that

> represents the institutional viewpoint). Here, however, the preamble is consistent with the estate's interpretation of the statute and contrary to respondent's position. While we find the logic of the preamble sound, to be thorough we will articulate why, under the final regulations, the economic benefit regime applies.

Here, the court found the special ownership rule would apply because the Dynasty Trusts had no access to cash value:

> For the Dynasty Trusts to have current access under the final regulations, the Dynasty Trusts must first have a current or future right to any portion of the policy cash value. The split-dollar life insurance arrangements are structured so that upon the termination of a split-dollar life insurance arrangement during the lifetime of the insured, 100% of the CSV (including CSV attributable to premiums paid by the Dynasty Trusts) would be paid to the CMM Trust. Additionally, if a split-dollar life insurance arrangement were to terminate as a result of the death of the insured, the Dynasty Trusts would be entitled to receive only that portion of the death benefit of the policy in excess of the receivable payable to the CMM Trust. Accordingly, under the split-dollar life insurance arrangements the Dynasty Trusts had no current or future right to any portion of the policy cash value, and thus, no current access under the regulations.
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> Respondent argues that the Dynasty Trusts had a direct or indirect right in the cash values of the insurance policies by virtue of the terms of the 2006 Amendment to the CMM Trust. Under that amendment, the CMM Trust's interest in the cash values of the policies would pass to the Dynasty Trusts or directly to Mrs. Morrissette's sons or their heirs upon her death. However, because the CMM Trust was a revocable trust with respect to Mrs. Morrissette, she retained an absolute right to alter the CMM Trust throughout her lifetime. Accordingly, the Dynasty Trusts did not have a legally enforceable right to the cash values of the policies during the lifetime of the grantor. Furthermore, the split-dollar life insurance arrangements did not require the CMM Trust to distribute the receivables to the Dynasty Trusts. Rather, Mrs. Morrissette retained the right to receipt of the receivables.

The IRS also argued this plan was analogous to reverse-split dollar plans:

> Respondent argues that the circumstances referenced in Notice 2002-59, 2002-2 C.B. 481, apply to the split-dollar life insurance arrangements at issue prohibiting the use of the economic benefit regime. Notice 2002-59, sec. 3.01, 2002-2 C.B. at 482, states:
>
>> Treasury and the Service understand that, under certain split-dollar life insurance arrangements (some of which are referred to as "reverse" split-dollar), one party holding a right to current life insurance protection uses inappropriately high current term insurance rates, prepayment of premiums, or other techniques to confer policy benefits other than current life insurance protection on another party. The use of such techniques by any party to understate the value of these other policy benefits distorts the income, employment, or gift tax consequences of the arrangement and does not conform to, and is not permitted by, any published guidance.
>
> Notice 2002-59, supra, is mainly focused on reverse split-dollar life insurance arrangements. Under a typical reverse split-dollar life insurance arrangement, an

> irrevocable life insurance trust (ILIT) purchases a large life insurance policy, and the insured and the ILIT enters into a split-dollar life insurance arrangement. Under this arrangement, the insured is entitled to the policy's death benefit and in return pays the ILIT the greater of the actual cost of one-year term insurance or the P.S. 58 rate.[6] This arrangement is the opposite of the typical split-dollar life insurance arrangement and thus is referred to as "reverse split-dollar". Because life insurance costs have decreased substantially since the P.S. 58 rates were set by the IRS, the insured's payment of economic benefits using the P.S. 58 rates would be substantially greater than the actual mortality charges incurred by the ILIT. With a large policy, the insured could transfer significant sums to the ILIT and, on the basis of older IRS rulings, incur little or no gift tax costs. In the most abusive cases, the insured would prepay the P.S. 58 economic benefit amounts for several years. After a few years, the parties usually terminate the arrangement. The ILIT, flush with cash from the excess payments from the insured, either maintains the policy or cashes it out.
>
> ***
>
> The split-dollar life insurance arrangements between the CMM Trust and the Dynasty Trusts bear no resemblance to the transactions Notice 2002-59, supra, is prohibiting. Mrs. Morrissette, who was 94 at the time she set into motion these arrangements, wanted the Interstate Group to remain in her family. To that end, she caused the CMM Trust to pay a lump-sum premium, through the Dynasty Trusts, on the life insurance policies held on the lives of her sons, the proceeds of which would be employed to purchase the stock held by each of her sons upon his death. Unlike the reverse split-dollar life insurance arrangements described in the notice, the receivables the CMM Trust obtained in exchange for its advances provided the CMM Trust sole access to the CSV of the policies.
>
> Additionally, respondent argues that the "prepaid premiums" pay not only for current insurance protection, but also for future protection, which is a benefit other than current life insurance protection and requires that the arrangement be taxed under the loan regime. This position relies on Notice 2002-59, supra, for the proposition that prepayment of future premiums (by paying a single premium) confers policy benefits other than current life insurance protection. This assertion, however, assumes that the Dynasty Trusts would otherwise be required to pay the premiums. Under the split-dollar life insurance arrangements, the Dynasty Trusts are not required, but are permitted, to pay any portion of the policies' premiums. The split-dollar life insurance arrangements were structured such that the CMM Trust was obligated to pay all the premiums. Thus, under the split-dollar life insurance arrangements, regardless of how the CMM Trust elected to pay the premiums (whether in one lump sum or over any number of installments), the CMM Trust would not relieve the Dynasty Trusts of any obligation to pay premiums because the Dynasty Trusts were not required to pay any premiums.

The risk to the taxpayer in these transactions is that the IRS will succeed on a claim that the prepaid premiums are a gift. The risk may be mitigated if a net gift is made. In Estate of Levine, T.C. No. 9345-15 (2016), the court followed Morrissette because all parties agreed it controlled.

The Tax Court denied the taxpayer's motions for summary judgement on the application of section 2036, 2038, and 2703 to split-dollar policies in Cahill v. Commissioner, T.C. Memo. 2018-84. The court reviewed its understanding of the facts as follows:

> In exchange for decedent's payment of $10 million as premiums on the policies for MB Trust's benefit, decedent[5] received (and continued to own until he died) the right to terminate the split-dollar agreements in conjunction with the trustee of MB Trust. Each split-dollar agreement states that, upon termination, one of two things could happen: (1) MB Trust could opt to retain the policy, in which case decedent would immediately receive the greater of premiums paid or cash surrender value with respect to the related policy, or (2) MB Trust could decline its option to retain the policy, in which case the policy would be transferred to Northern Trust, N.A., in full or partial satisfaction of decedent's liability to Northern Trust, N.A. (We will refer to these as the termination rights.)
>
> Additionally, each split-dollar agreement states that upon the death of the insured, decedent would receive the greatest of the remaining loan balance, premiums paid, or cash surrender value. (We will refer to these as decedent's death benefit rights.) MB Trust would receive any excess of the death benefits over the amount required to be paid to decedent. (We will refer to these as MB Trust's death benefit rights.)
>
> On its estate tax return, the estate claimed that the aggregate value of all the rights decedent held under the split-dollar agreements, including the termination rights, was $183,700. The estate contends that (1) because decedent's right to terminate the split-dollar agreements was held in conjunction with the trustee of MB Trust and (2) because it would allegedly never make economic sense for MB Trust to allow termination of the split-dollar agreements, termination was so unlikely that the termination rights had no value as of decedent's date of death. On this basis, the estate contends that the value of decedent's interests in the split-dollar agreements is limited to the value of decedent's death benefit rights. The estate further contends that on decedent's date of death these rights were worth only $183,700, because Patrick and Shannon Cahill, the insured persons, were then projected to live for many years, with the result that decedent's rights had only a relatively small present value.
>
> In the notice of deficiency respondent adjusted the total value of decedent's rights in the split-dollar agreements from $183,700 to $9,611,624; i.e., to the aggregate cash surrender value of the policies as of decedent's date of death. In support of this adjustment, respondent presents alternative theories applying sections 2036(a)(2), 2038(a)(1), and 2703(a)(1) and (2). The estate seeks summary judgment that sections 2036, 2038, and 2703 are inapplicable; it looks for support for its position in section 1.61–22, Income Tax Regs.

The court concluded that those may, or may not, have been a bona find sale for full and adequate consideration:

> There are many unresolved factual questions with respect to whether this transfer had a legitimate business purpose. For instance: (1) Were these arrangements actually intended to provide liquidity decades from now, or were they intended merely to eliminate the cash surrender value from decedent's estate? (2) The guaranteed return (3%) on the investment in the policies appears to be lower than the interest rate on the loan decedent used to purchase the policies (one month LIBOR plus 1.14%); taking into account all of the economic facts and circumstances, would this arrangement actually be capable of providing liquidity decades from now? How much liquidity, in present valued terms (i.e. valued to the date of execution)? At what cost, in present valued terms? And (3) why was an arrangement intended to provide liquidity potentially decades from now funded with a loan that required a balloon payment of the entire principal amount after

only five years? That is, if decedent was acting as a prudent business person, why did he fund a long-term obligation with a short-term loan? Because such questions remain, summary judgment is inappropriate with respect to whether decedent's transfer of $10 million was part of a bona fide sale.

***

According to the estate, at decedent's date of death MB Trust's ability to veto decedent's termination of the agreements rendered the termination rights valueless. Additionally, the estate alleges that decedent's death benefit rights are worth less than 2% of the cash surrender value (i.e., $183,700 ÷> $9,611,624 < 2%). But MB Trust's veto power existed from the moment decedent entered into these split-dollar agreements, and nothing in the undisputed facts presently before us suggests that the terms of the split-dollar agreements were altered between execution of the agreements and decedent's date of death; consequently, this alleged 98% discount must have been present from the execution of these agreements. Therefore, according to the estate's valuation theory, the initial transfer of $10 million in value cannot have been in exchange for property worth that amount; i.e., under the estate's argument, what decedent received was necessarily worth at least 98% less than what he transferred (even without taking into account the amounts used to pay commissions and fees to the insurance company). Consequently, at least according to the estate's valuation theory, the value of what decedent received (allegedly, something close to $183,700) was not even roughly equal to the $10 million decedent paid.

The court believes that section 2703 may apply on a simple reading of the statute:

On the basis of the undisputed facts, we conclude that under section 2703(a)(1) the split-dollar agreements, and specifically the provisions that prevent decedent from immediately withdrawing his investment, are agreements to acquire or use property at a price less than fair market value. The estate claims that decedent paid $10 million to the insurance companies for the benefit of MB Trust and in return received certain rights, namely, the termination rights (which the estate claims are worthless) and decedent's death benefit rights (which, according to the estate's valuation theory, are worth less than 2% of the cash surrender value). MB Trust, meanwhile, paid nothing into this arrangement and received MB Trust's death benefit rights. As best we understand the estate's valuation theory, MB Trust's death benefit rights are allegedly worth at least the cash surrender value minus the value of decedent's death benefit rights (i.e., $9,611,624—(allegedly) $183,700 = $9,427,924). Nothing in the parties' filings suggests that MB Trust ever paid, or was obligated to pay, any interest or other amount to compensate decedent for MB Trust's acquisition and use of this amount.

The court rejected an analogy of a split-dollar agreement to notes or partnership and held that 2703 may apply:

We note that most of the estate's arguments with respect to section 2703(a) are generally to the effect that, if section 2703(a) applies in this case, it would also apply to all sorts of other options, agreements, rights, and restrictions. For example, the estate argues that "almost every two-party agreement has a restriction that one party cannot just unilaterally terminate the agreement." The estate's implicit claim would appear to be that its hypothetical restriction is so obviously legitimate that Congress could not have meant for section 2703(a) to apply. But section 2703(b) provides the exceptions to application of section

> 2703(a); in particular, section 2703(b)(3) specifically provides for comparison of the terms of the option, agreement, right, or restriction to "similar arrangements entered into by persons in an arms' length transaction." The estate's vague and general arguments by way of comparison are therefore more appropriate as part of a section 2703(b)(3) analysis. And because the parties have yet to address whether section 2703(b) applies in this case, we decline to consider it.

The case of Machacek v. Commissioner of the Internal Revenue, 906 F.3d 429 (6th Cir. 2018), dealt with an interesting split-dollar income tax question. The opinion summarizes the issue as follows:

> Petitioners-appellants John J. Machacek, Jr. (John Machacek) and Marianne Machacek (together, the Machaceks), a married couple, were the sole shareholders of John J. Machacek, Jr., Inc. (Machacek, Inc.), a corporation organized under Subchapter S of the Internal Revenue Code (an S corporation). John Machacek was also an employee of Machacek, Inc. The Machaceks appeal the Tax Court's ruling requiring them to treat as income the economic benefits resulting from Machacek, Inc.'s payment of a premium on John Machacek's life insurance policy under a compensatory split-dollar arrangement. Relying on the compensatory nature of the arrangement, the Tax Court rejected the Machaceks' argument that the economic benefits should be treated as a shareholder distribution.
>
> Because the Tax Court did not consider the impact of a provision of the tax regulations specifically requiring that such economic benefits be treated as shareholder distributions, we reverse the Tax Court's decision and remand for further proceedings consistent with this opinion.
>
> **I. Background**
>
> In 2002, Machacek, Inc. adopted the Sterling Benefit Plan in order to provide certain benefits to its employees. Pursuant to the plan, Machacek, Inc. provided John Machacek with a life insurance policy and paid the $100,000 annual premium in the 2005 tax year; both Machacek, Inc. and the Machaceks filed timely tax returns for that year. Because Machacek, Inc. is an S corporation, its income, losses, deductions, and credits are "passed through" to shareholders for tax purposes. Machacek Inc. deducted the $100,000 premium, and that amount was thus not included in the Machaceks' individual income. The Machaceks also did not include as individual income the economic benefits flowing from the increase in value of the life insurance policy.
>
> The Tax Court determined that Machacek, Inc. was not entitled to deduct the $100,000 premium payment. Because the $100,000 premium payment was not deductible, Machacek, Inc. underreported its income for that year and, due to the pass-through nature of S corporations, the increased income was passed through to the Machaceks, who were then required to pay income tax on that amount. The non-deductibility of the premium payment is not disputed, and the Machaceks concede that they must report the amount of the premium payment as pass-through income.
>
> The dispute here concerns the tax treatment of the economic benefits flowing to John Machacek as a result of Machacek, Inc.'s payment of the premium. The parties dispute whether the Machaceks are required to report as taxable income—in addition to the pass-through amount of the premium—the economic benefits flowing from the increase in value of the life insurance policy caused by the payment of the premium.[1]

The opinion is fascinating because the Court ultimately relied on a regulation uncited by either party. The taxpayer argued for a four step analysis:

> At the first step, the Machaceks argue that notwithstanding that the economic benefits here flowed from a compensatory split-dollar arrangement, the regulations require that the economic benefits "be treated as a 'distribution of property' from the corporate-owner (Machacek, Inc.) to the non-owner (Mr. Machacek)." (Appellants' Br. at 17.) This step of the argument relies on 26 C.F.R. § 1.301-1(q)(1)(i), which states that the provision of economic benefits "by a corporation to its shareholder pursuant to a split-dollar life insurance arrangement ... is treated as a distribution of property." Neither the Machaceks nor the Commissioner addressed this regulation before the Tax Court, and the Tax Court made no mention of this regulation.
>
> At the second step, the Machaceks point to the fact that "distributions of property" to a shareholder are ordinarily governed by 26 U.S.C. § 301(c). *See* 26 U.S.C. § 301(a) ("[A] distribution of property ... made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in [§ 301(c)].").
>
> At the third step, the Machaceks argue that Subchapter S—rather than § 301(c)—governs the treatment of the distribution here because Machacek, Inc. is an S corporation. *See* 26 U.S.C. § 1368(a) ("distribution of property made by an S corporation with respect to its stock to which (but for this subsection) section 301(c) would apply shall be treated in the manner provided" by Subchapter S).
>
> At the fourth step, the Machaceks argue that Subchapter S mandates that any shareholder distribution "taxable under the Subchapter S provisions ... would escape taxation under the split-dollar regulations." (Appellants' Br. at 17.)

The IRS thought that the mere fact that the arrangement was a compensatory split-dollar arrangement was determinative:

> The Commissioner correctly notes that such treatment would be uncontroversial if the recipient of the economic benefits were an ordinary employee, rather than an S corporation's shareholder-employee. The distinction between John Machacek's different roles—employee and shareholder—is therefore key to the Commissioner's position.
>
> In response to the Machaceks' reliance on § 1.301-1(q)(1)(i), the Commissioner points only to the distinction between compensatory and shareholder arrangements. The Commissioner recognizes that § 1.301-1(q)(1)(i) applies to both compensatory and shareholder arrangements but concludes that it "does not mean that in any situation where a compensatory arrangement covers a shareholder, the taxpayer's status as a shareholder trumps his status as an employee, causing the economic benefit to be treated as a distribution to a shareholder," because "[s]uch an interpretation of the regulation would make no sense, as it would defeat the reason for distinguishing between a compensatory arrangement and a shareholder arrangement." (Appellee's Br. at 37.)
>
> ***
>
> Finally, the Commissioner notes that "Machacek, Inc. will be entitled to a deduction in a future tax year," pursuant to 26 C.F.R. § 1.83-6(a)(5), "when it

> actually transfers ownership of the policy to John Machacek." (Appellee's Br. at 41; *see also id.* at 26.) The Commissioner appears to rely on a possible future deduction as a way to counter the Tax Court's acknowledgement that the result below "may seem aberrational." The Commissioner argues that "it is [the Machaceks], not the Commissioner, who are arguing for an inequitable result under which they would escape taxation on the accumulation value of the policy, and realize an additional tax advantage when their corporation deducts the cost of the policy in the future." (Appellee's Br. at 41.) However, the Machaceks will also have personal tax consequences when the policy is transferred.

Finally, the Court reaches what it concludes is the dispositive regulation:

> In finding for the Commissioner, the Tax Court did not address 26 C.F.R. § 1.301-1(q)(1)(i). Neither party cited or relied on this regulation below, and we are aware of no case discussing the regulation in any context. But given its importance in this scenario, we cannot simply ignore it. If the economic benefits to John Machacek are properly treated as a distribution of property to a shareholder—rather than as compensation to an employee—then the Tax Court erred.
>
> Section 1.301-1(q)(1)(i) is dispositive and renders irrelevant whether John Machacek received the economic benefits through a compensatory or shareholder split-dollar arrangement. Section 1.301-1(q)(1)(i) treats economic benefits provided to a shareholder pursuant to *any* split-dollar arrangement as a distribution of property within the ambit of § 301. And, although another sub-section of that regulation, 26 C.F.R. § 1.301-1(c), states that the regulation as a whole "is not applicable to an amount paid by a corporation to a shareholder unless the amount is paid to the shareholder in his capacity as such," the explicit inclusion in § 1.301-1(q)(1)(i) of all arrangements described in § 1.61-22(b)(2)—which includes compensatory arrangements—makes clear that when a shareholder-employee receives economic benefits pursuant to a compensatory split-dollar arrangement, those benefits are treated as a distribution of property and are thus deemed to have been paid to the shareholder in his capacity as a shareholder. The Commissioner offers no alternative interpretation that gives meaning to the inclusion of compensatory arrangements in § 1.301-1(q)(1)(i). Our interpretation is further supported by the fact that § 1.61-22(d) states that the tax treatment of the economic benefits depends on the "relationship between the owner and the non-owner." The Commissioner argues that this language shows that the tax treatment depends on the nature of the split-dollar arrangement—compensatory or shareholder—but if that were the controlling factor, the regulation could have said so. It does not.

The Tax Court issued another opinion dealing with various issues in Morrisette on May 13, 2021. Estate of Morrissette v. Comm'r, T. C. Memo. 2021-60 (hereinafter referred to as Morrissette II). In general the opinon was favorable to the taxpayer. The court held that sections 2036 and 238 did not pull the policy proceeds into the grantor's estate because the arrangement was based on a sale for full and adequate consideration, that section 2703 did not apply which would have included the underlying cash surrender value of the policies in the decedent's estate, and that the fair market value could be calculated using discounted cash-flow. Nonetheless the court found the 40% gross valuation misstatement penalty (section 6662(h) was appropriate. With the generous permission of Howard Zaritsky, his discussion and comment on Morrissette II is as follows:

The Tax Court ruled in *Morrissette II* that: (a) the policy proceeds are not includible in the gross estate of the deceased grantor of the revocable trust under Sections 2036 or 2038, because they were made in a *bona fide* sale for adequate and full consideration; (b) the special valuation rules of Section 2703 do not require inclusion of the cash surrender value of the policies in the decedent's gross estate; (c) the fair market values of the decedent's split-dollar rights could be calculated using the discounted cash value methodology; and (d) a 40% gross valuation misstatement penalty under Section 6662(h) was appropriate.

The Tax Court (Judge Goeke) reviewed the facts in even greater detail that he had in the earlier opinion of the court and noted that, while the petitioners agree that the fair market values of the split-dollar rights are includible in Mrs. Morrissette's gross estate because they were held by her revocable trust, the IRS sought to include the $30 million in premium payments or the $32.6 million in cash surrender value in the decedent's gross estate under Sections 2036 and 2038. The IRS argued, as it had in *Cahill*, that the revocable trust, through the split-dollar agreement, had retained the possession, enjoyment, or right to income in the transferred funds under Section 2036(a)(1), a power to designate the beneficial enjoyment of the transferred funds under Section 2036(a)(2), or a power to alter the transferred funds under Section 2038(a). As the Tax Court in *Cahill* had already stated that the rights retained in an intergenerational split-dollar life insurance agreement fell under Section 2036(a)(2) or 2038(a) (the application of Section 2036(a)(1) was not considered in that case), the court did not need to re-evaluate that issue here, but instead focused on the bona fide sale exception to both Sections 2036 and 2038.

The IRS also contended that the transfer was not a bona fide sale for adequate and full consideration, but the Tax Court disagreed. The Tax Court applied the same analysis in *Morrissette II* that it had applied in *Estate of Powell at* 411 (2017), that the bona fide sale exception requires both (1) a legitimate and significant nontax purpose and (2) adequate and full consideration for money or money's worth. The court rejected the IRS argument that the transfers between the revocable trust and the dynasty trusts were not a "sale" as that term is ordinarily defined, because the dynasty trusts paid no consideration. The court pointed out that Section 2036 and 2038 adopt a broader definition of "sale," that includes transactions that are not commonly categorized as sales. Basically, they require only a voluntary act of transferring property in exchange for something. *Estate of Bongard v. Comm'r*, 124 T.C. 95, 113 (2005). *Estate of Stone v. Comm'r*, T.C. Memo. 2003-309 (treating a contribution of assets to a business entity in exchange for an interest in the entity as a sale for purposes of section 2036(a)). In *Morrissette II*, the revocable trust voluntarily and in good faith transferred money to the dynasty trusts in exchange for a right to repayment. Thus, the split-dollar agreement between the revocable trust and the dynasty trusts was a sale for this limited purpose.
The court then held that Clara had a legitimate and significant nontax motive for advancing the funds to pay the premiums under the split-dollar agreement. The court explained that the nontax purpose must be a genuine purpose that motivates the transaction, rather than a theoretical purpose or justification. *Estate of Bongard*, 124 T.C. at 118. The existence of additional testamentary objectives, however, does not negate the existence of a legitimate nontax purpose, as such purposes are often inextricably interwoven. *Estate of Bongard*, 124 T.C. at 121; *Estate of Black v. Comm'r*, 133 T.C. 340, 362-363 (2009).

The evidence established that Clara sought to maintain control over the company and to pass that control on to her sons and future generations. The split-dollar agreements were instrumental in accomplishing these objectives and assuring the control and succession of an active closely-held business is a legitimate nontax purpose for the *bona fide* sale exception. to ensuring that Interstate's ownership remained in her family after her sons died. Citing *Estate of Bigelow v. Comm'r*, 503 F.3d 955, 972 (9th Cir. 2007), *aff'g* T.C. Memo. 2005-65; *Estate of Strangi v. Comm'r*, 417 F.3d at 481; *Estate of Reynolds v. Comm'r*, 55 T.C. 172, 194 (1970). The court explained that:

> *The brothers wanted to honor their parents' wish that the three brothers inherit Interstate equally and pass the company on to their children. However, they were also realistic about the need to pay estate tax and the possibility that they would need to sell part of Interstate to pay it. They believed that there was a significant chance that the family would lose control of Interstate if their families were not given this option . . . . The split-dollar agreements provided each brother's children with the option to exit the business and cash out their interests after the brother's death and at the same time allowed the remaining brothers and their families to purchase the interests by funding the buyout. The buy-sell provision also prevented the brothers from selling their Interstate stock to outsiders as a means to retaliate against one another for past disputes.* T.C. Memo. 2021-60 at *76.

The court also held that the split-dollar agreements served a second legitimate, nontax purpose, a smooth transition in Interstate's management. The agreements helped assure that those sons who had long worked for the company could remain with the company for their professional futures, preserving both their expertise and institutional knowledge. The court found testimony from these sons about their succession concerns to be credible.

The court acknowledged that the split-dollar agreements were also part of an estate tax saving strategy. Nonetheless, the existence of a tax motivation does not negate the existence of a legitimate nontax motive. As the court explained, "caselaw requires the presence of a legitimate, nontax purpose; it does not require the absence of a tax saving motivation." T.C. Memo. 2021-60 at *78. One son "who made most decisions relating to the split-dollar agreements, credibly testified that he would have engaged in the split-dollar agreements even if they had not provided any estate tax saving because of the nontax financial benefits that they provided." *Id.* Furthermore, the court found that the record showed the sons concerns about the correct inheritance of the company and that these were not merely theoretical justifications for the agreements.

The court rejected the argument that if the sons "stood on both sides of the split-dollar agreements," there could be no legitimate nontax purpose. A taxpayer's standing on both sides of a transaction can indicate there is no legitimate, nontax purpose for the transfer, but it is not conclusive. *Estate of Thompson v. Comm'r*, 382 F.3d 367, 382 (3rd Cir. 2004), *aff'g* T.C. Memo. 2002-246. This is particularly true when the relationship of sons, as here, was occasionally hostile. See *Estate of Stone* (resolving intrafamily disputes that had led to litigation in the past is a legitimate, nontax purpose).

The IRS also argued that the sons had complete control over the policies and could cancel them at any, because the dynasty trusts would inherit the split-dollar rights. The court rejected this argument because, while the sons, as co-trustees, had the discretion to distribute each split-dollar agreement, such distribution was not guaranteed. Moreover, the effects of the possible distribution of the split-dollar agreements after Clara's death were more relevant to the determination of the fair market value of the split-dollar rights then to whether the transfers qualified as bona fide sales. The parties to the buy-sell agreement understood their future obligations and there was credible testimony that there was no prearranged plan to terminate the split-dollar agreements upon Clara's death.

The court rejected the government's argument that purchasing life insurance policies with high initial cash values and modest death benefits proved that tax motivations were primary. The court noted that the sons had credibly testified that they choose those policies to ensure that the revocable trust would be adequately compensated for financing the premiums and that it would earn interest for funding the premiums through inside buildup in the value of the policies.

The court also rejected the IRS argument that the fact that the sons retained their father's stock after his death and the equal distribution of the insurance proceeds among the dynasty trusts showed that the buy-sell provision was not a legitimate reason for the transfer of the premiums. The court stated that it made sense that two of the sons would retain their father's voting stock as they worked for the company and they wanted to protect their careers.

The court also held that the revocable trust had received adequate and full consideration in money or money's worth for its premium payments. The court rejected the estate's argument that the fact that the transaction complied with the requirements of the economic benefit regime should mean that there was adequate and full consideration, because the regulations expressly do not apply for estate tax purposes. The economic benefit regime does not require a comparison of the amount of the premium payment with the value of the rights that the revocable trust received in exchange.

The court noted that, unlike the question of fair market value, the adequacy of consideration is not defined on the basis of a willing buyer and willing seller and is not judged from the perspective of hypothetical persons. *Kimbell v. United States*, 371 F.3d 257, 266 (5th Cir. 2004). The bona fide sale exception does not require an arm's-length transaction and an intrafamily transfer, though requiring heightened scrutiny, can constitute a *bona fide* sale. *Estate of Bongard*, 124 T.C. at 122-123; *Estate of Thompson*, 382 F.3d at 382-383. The question of adequacy of consideration requires that the consideration be similar to that which two unrelated persons would provide after negotiating at arm's length. *Estate of Bongard*, 124 T.C. at 122-123. In *Kimbell*, 371 F.3d at 265-266, the Court of Appeals for the Fifth Circuit acknowledged that an investor received a partnership interest for adequate and full consideration even though the partnership interest had a substantially lower fair market value than the assets contributed to the partnership. The key is whether the exchange is an informed trade, and investors may desire an asset for features other than its fair market

value, such as "management expertise, security or preservation of assets, and capital appreciation." *Estate of Thompson*, 382 F.3d at 381. Here, the split-dollar agreements provided financial benefits other than the ability to sell or collect immediately on the split-dollar rights, including repayment plus inside buildup in the value of the policies, management succession, and efficiency and capital accumulation. The court noted that the intervening events between the transfer date, when one determines adequate and full consideration, and the valuation date, when one determines fair market value, which were significant. Clara had been in relatively good health on the transfer date, and one of the sons had been diagnosed with terminal cancer and was no longer even insurable. Clara could have outlived any one of her sons, and the split-dollar agreements were a safe investment with an adequate interest rate.

The court held that the revocable trust received adequate and full consideration on the basis of the split-dollar agreements' repayment terms that included interest earned in the form of inside buildup of the insurance policies. The minimum interest rates and the actual appreciation in the policies' cash values were higher than the interest rates that the CMM trust had been earning on the money. Respondent does not argue that the repayment terms were inadequate. The split-dollar agreements also provide the additional benefit of deferral of tax on the policies' inside buildup and the tax-exempt payout of the death benefits to the beneficiaries.

The court distinguished the facts in *Cahill*, noting that the decedent in *Cahill* was 90 years of age, while the decedent in *Morrissette II* was 75 years old, and the decedent in *Estate of Cahill* borrowed the entire $10 million premium payments from a bank while Clara had sufficient assets to pay almost 90% of the premiums herself, as well as other sources of income to repay the small loan she did obtain from the company. Perhaps more importantly, *Cahill,* unlike *Morrissette II,* did not involve active business operations and such financial considerations as management efficiency and succession, capital accumulation and family dynamics that put those financial considerations at risk. The split-dollar agreements in *Estate of Morrissette II* provided financial benefits similar to those in *Kimbell* and unlike those in *Cahill*.

The court noted that in this case, the estate tax saving was achieved not through execution of the split-dollar agreements alone, but rather through the undervaluation of the split-dollar rights. In exchange for $30 million, the dynasty trusts agreed to buy life insurance and repay the revocable trust and Clara still held the contract rights at the time of her death. However, she no longer had use of or access to the $30 million. Thus, the split-dollar agreements changed the nature of the revocable trust's relationship with the funds that it had transferred.

The court also held that Section 2703(a) did not apply to this arrangement, in a very rare victory for the taxpayer under this section. The court held that the split-dollar agreements were part of a *bona fide* business arrangement, not a device to transfer property at less than adequate and full consideration, and that its terms were comparable to similar arrangements entered into at arm's length.

The court explained that, for this purpose, a bona fide business agreement must further some business purpose. *Amlie v. Comm'r*, T.C. Memo. 2006-76. Such a purpose was established by the estate, as discussed above.

Regarding whether the agreement was a device to transfer property for less than adequate and full consideration, the court agreed with the government that some facts indicated a testamentary purpose for the split-dollar agreements, but that the mutual termination restriction was not itself a device. Device status depends in part on the fairness of the consideration received by the transferor. See *Estate of True v. Comm'r*, T.C. Memo. 2001-167, aff'd, 390 F.3d 1210 (10th Cir. 2004). Here, split-dollar agreements contained reasonable repayment terms, including an inside buildup at a guaranteed interest rate of 3% (and an actual rate of between 4.75% and 5.4%), which was comparable to long-term bonds and actually higher than the revocable trust had been earning on the transferred funds. In light of these and the other intangible benefits discussed above, the court held that the mutual termination restriction was not a device.

On whether the mutual termination restriction was comparable to split-dollar agreements between or among unrelated persons in an arm's-length transaction, the court rejected the analysis of the IRS expert, who compared the Morrissette split-dollar agreements with those entered into by publicly-traded corporations to compensate executives. The court rejected these as having "little relevance to ascertaining whether a closely held corporation or its majority shareholder would include a mutual termination restriction in a split-dollar agreement." T.C. Memo 2021-60 at *104. Also, the government instructed its expert to consider only policies owned by corporate employers, which were not applicable in this case where the corporation had no interest in the policies; the policies were owned by the dynasty trusts. The court noted that the government could not justify this limitation on the policies considered by its expert.

Additionally, the split-dollar agreements reviewed by the government's expert included some type of restriction on the employer's right to terminate the agreement unilaterally, such as vesting for years of service. Here, the senior executives had worked for the company for over 40 years and the court stated that:

> [l]ong-term senior executives would likely demand a mutual termination restriction comparable to the one at issue, and the reviewed agreements provide vesting provisions. The mutual termination restriction would ensure the executives' rights to the net death benefits similar to vesting in employment compensation packages on the basis of years of service. In total, approximately 30% of the public agreements imposed some restriction on the employer's termination rights. The termination rights of another 13% are not as clear as respondent argues. T.C. Memo 2021-60 at *105.

The taxpayer was less successful in sustaining a $7.5 million valuation for the decedent's rights under the split-dollar agreements. The court explained that there were two differences between the analyses of the estate's experts and the government's expert: (a) computation of the probability-adjusted expected values of the policies; and (b) the applicable discount rates to determine the present value of those expected returns. The experts differed on both issues, but far more significantly on the second than on the first.

Each expert determined a probability-adjusted expected value for each year of the brothers' life expectancies by estimating an expected cash surrender value for each year and multiplying that value by the brothers' probabilities of mortality that year. On the expected value of the policies, one of the estate's experts valued the split-dollar rights at $7,808,314. The court rejected this valuation because the estate's expert used a blended yield rate that placed too much weight on anticipated decreases in the actual policy yields, and thereby inappropriately decreased the expected cash surrender values. The court also rejected this valuation because the expert used policy illustrations that were not issued close to the valuation date, which the court noted involve subsequent events that were not foreseeable on the valuation date are not, therefore, generally helpful. Citing *Messing v. Comm'r*, 48 T.C. 502, 509 (1967).

Both of the estate's experts used the IRS mortality table for to determine the probability of each insured dying in each year. Actually, the government's expert used tables that provided a lower valuation for the estate, which the court treated as a concession.

The court accepted the discount rates of 8.85% and 6.4% (different rates for different insurers) proposed by the government's expert, finding that they more accurately reflected the risk that the insurers would default on their payment obligations under the policies. That expert used yields that were lower than the average historic yields for both insurers, because interest rates for U.S. Treasury bonds were at a 50-year low. The court held that considering the spot yields on U.S. Treasury bonds more accurately captured the market conditions on the valuation date. The court also held that the actuarial tables negated the argument that it was difficult to determine the timing of the repayments (although a standard actuarial table does little to predict when one of the insured Morrissette sons would actually die).

The estate's experts used life settlement yields as the discount rate, producing a range of yields from 15% to 18% (one expert) or from 9.3% to 23.2% (the other expert). The court rejected these yields because life settlement yields require information regarding the varying sizes of the underlying policies, the financial strength of the insurance companies, the insureds' medical histories, mortality assumptions, and continued obligations to pay premiums. Most of this information was not available to the court. The court stated that, "[w]ithout more information, it is not possible to place the split-dollar agreements accurately within that range." T.C. Memo 2021-60 at *115.

More importantly, the court agreed with the government that the sons likely intended to terminate the split-dollar agreements on December 31, 2013 (when the statute of limitations on estate tax deficiencies regarding Clara's estate return expired), and that this should be deemed to be the maturity date of the policies, producing a fair market value of $27,857,709. The court noted that the revocable trust agreement provided that the split-dollar rights would be allocated to the respective dynasty trusts that owned the underlying policies, which would give the dynasty trusts full control over the policies and allow them to terminate the agreements on December 31, 2013.

The court also sustained a 40% gross valuation misstatement penalty with respect to the valuation of the split-dollar agreement rights held by Clara's estate. It rejected claims that the penalties were never approved by the agent's supervisors, as required under Section 6751(b). While the approval had been done without great formality, such formality is not required and the court found adequate evidence to sustain the penalty as having been approved.

The court also held that the estate had not reasonably relied on the opinions of its valuation experts. Reliance on professional advice may provide a reasonable cause defense if, under all the circumstances, the reliance was reasonable and in good faith. *Neonatology Assocs., P.A. v. Comm'r*, 115 T.C. 43, 98-99 (2000), *aff'd*, 299 F.3d 221 (3d Cir. 2002). The court stated that the estate's $7.5 million appraisal was not reasonable and the sons should have realized it. Despite the business and other nontax purposes for entering into the split-dollar agreements, the sons knew that these arrangements were being marketed as an estate tax saving strategy, and that the tax benefits would be obtained through the low valuation of the split-dollar agreements. The only purpose for valuing the split-dollar rights at $7.4 million rather than the $30 million that the revocable trust actually paid was estate tax saving.

Morrissette II suggests that intergenerational split-dollar life insurance arrangements may work, though only in certain specific situations. First, there must be a bona fide nontax purpose for the arrangement. There was none in *Cahill*, but the business succession issues in *Morrissette II* provided a clear and substantial nontax purpose. Once such a purpose exists, the co-existence of tax motivations may not be a problem.

Second, the planned disposition of the decedent's rights under the split-dollar agreement to the trusts for the insureds and their descendants proved problematic in *Morrissette II*. This was the basis by which the Tax Court valued the retained rights under the split-dollar agreements at a figure far in excess of the actuarial value that the taxpayer reported on the decedent's estate tax return. Had these rights be left to, for example, a separate common trust fund for the descendants of the deceased, rather than to the specific dynasty trusts that owned the policies themselves, a different and more favorable result might have been achieved.

This aspect of the Morrissette II opinion is questionable. Clara's rights under the split-dollar agreements should be valued as of the date of her death based on the price a hypothetical unrelated person would pay for those rights. Instead, the court determined the value of those rights taking into account (a) the specific rights in the split-dollar agreements which the dynasty trusts received from the revocable trust as a result of Clara's death, and (b) the specific rights the dynasty trusts acquired when they entered into the split-dollar agreements. Under that analysis, the split-dollar agreements terminated, and each dynasty trust acquired complete control of the underlying policies which insured the life of the other two Morrissette sons pursuant to the cross-purchase arrangements. A hypothetical unrelated person who purchased the Receivables would not have had the right to terminate the split-dollar arrangements. Moreover, since the court found that one of the insured Morrissette sons was diagnosed with terminal cancer before the estate filed its estate tax return, and a second son died of brain cancer shortly thereafter, it is unlikely that the independent trustees of the dynasty trusts would have agreed to terminate the policies to obtain the cash surrender values.

Third, Section 2703, while devastating in *Cahill*, was surmounted by the taxpayer in Morrissette II principally because of the existence of a clear and substantial nontax business purpose for the agreements. One would, of course, still would have to establish that the terms of the agreement are comparable to similar arrangements entered into by persons in an arms' length transaction, but it seems likely that this will be relatively easy to overcome if there is a substantial nontax business purpose for the agreements.

Fourth, the decedent's arguments in *Cahill* were weakened because the transaction was negotiated between the trustee of the revocable trust (the decedent's son and attorney-in-fact) and his cousin (the trustee of the MB Trust). The transaction would have had far more credibility were the trustees independent and unrelated to each other. Obviously, this increases the cost of the transaction, but it is a small price to pay to give the arrangement a far more bona fide appearance.

Fifth, the use of a third-party loan to pay the life insurance premiums is not inherently inappropriate or disqualifying, but the existence of sufficient personal assets to make these payments was cited favorably by the court in *Morrissette II*. Also, it is likely that the lender required that the decedent in *Cahill* have the right to terminate the agreement, at a minimum with the consent of the trustee of the MB Trust. Also, the existence of the loan raises the presumption that the donor anticipates getting the cash out of the policy not later than when the loan becomes due. Thus, it is better if

the premiums are paid from assets already held by the expected decedent, or from money borrowed against assets other than the policy.

Another approach would be to eliminate entirely the right to terminate the agreement that was deemed a power under Section 2036(a)(2) and 2038. In both *Cahill* and *Morrissette*, this power was expressly provided by the split-dollar agreement. A court has reason to be skeptical about any power of the donor to require that the policy be cashed-in, either alone or together with the donee, because the donor no longer owns the policy. The right to cash-in the policy ought to rest with the policy owner. Where a donor borrows to pay the premiums and must use the policy as security for the loan, it is likely that the lender will require that the donor have the ability to reach the cash values. Otherwise, however, such a provision is really not essential to the validity of the split-dollar agreement or the effectiveness of the arrangement. The agreement should provide what happens when the insured dies (that the premiums or cash value are repaid), and it should provide what happens if the policy is cancelled (repayment of the cash value), but it need not provide what happens if the agreement itself is terminated. Generally, contracts presume that they will be implemented, rather than terminated.

The split-dollar agreement could, instead, be silent on termination and assume that the payments by the decedent will be repaid when the insured dies or the policy is cancelled. Moreover, it could grant the right to terminate the policy and the agreement solely to the donee—the irrevocable trust. This seems both reasonable from a business standpoint, because it vests the right to terminate in the policy's actual owner, and prudent from an estate tax standpoint, because it deprives the donor of any power that could be classified as a right to control beneficial enjoyment under Section 2036(a)(2) or a right to alter or amend beneficial enjoyment under Section 2038.

Clients may object because they fear that circumstances may change and they may need to recover cash from the policy. This is not a serious problem, however, because general contract law provides that all of the parties to a contract can agree to terminate it by mutual consent. See, e.g., 29 Williston on Contracts § 73—Elements of Rescission (4th ed.). Thus, the provision in *Cahill* did not really give the donor anything that he did not already have. A right afforded by state law, however, is not a retained right to alter, amend, revoke, or terminate or to control beneficial enjoyment for estate tax purposes. *Helvering v. Helmholz*, 296 U.S. 93 (1935).

In light of the current low applicable federal rates (AFR), one could also consider replacing an economic benefit split-dollar agreement with a simple promissory note, providing for annual payments of interest at the relevant AFR, until the death of the insured, and for repayment of the entire principal at that time. The Tax Court in *Cahill* recognized that Sections 2036 and 2038 did not apply to a simple promissory note and took pains to distinguish a split-dollar agreement from a promissory note. The taxpayer may thus accept this analysis and, instead, lend the irrevocable trust an amount sufficient to pay the premiums on the insurance policies. The parties should also comply with the safe harbor under Reg. § 1.7872-15, by filing the IRS statement for each nonrecourse loan that a reasonable person would expect repayment in full.

Of course, arrangements would have to be made for paying the interest on the loan currently. Such arrangements could involve additional gifts, withdrawals from the policy cash values, or annual deemed gifts of the unpaid interest. The discount for the promissory note is likely to be less than comparable to that for a split-dollar agreement, but it should still be significant because (a) the term of the note is both uncertain (the death of the insured) and far into the future, and (b) the AFR rates are currently substantially below market interest rates. This approach also has the double benefit of simplicity and clarity. It is far less complex to draft than an intergenerational split-dollar agreement, and the parties are far more likely to understand its terms than they are those of an intergenerational split-dollar agreement.

L. SECTION 2053 and 2054 - DEBTS AND ADMINISTRATION EXPENSES

M. SECTIONS 2056, 2056A AND 2519- MARITAL DEDUCTION

1. Termination of QTIP Trust Creates Double Gifts. CCA 202118008 involved simple facts and a most unfortunate result. Suriviving spouse was the beneficiary of a QTIP trust, received all the income of course, could receive principal for health, maintenance, and support in the spouse's accustomed standard of living if the income were insufficient, and had a testamentary power of appointment among descendants. Apparently for planning

purposes, the spouse and descendants decided to terminate the trust and give all of the trust assets back to the spouse who then disposed of the assets in what appear to be sales and perhaps other estate planning transactions. The National Office determined that spouse made a gift of the value of the QTIP assets when the trust was terminated, and that the descendants made a gift of the value of their remainder interests. There was no offset for the respective gifts, and the transaction was not treated as a sale. The termination was done via a commutation agreement that the CCA describes this way:

> On Date 3, Spouse, as the current beneficiary and as the trustee of Trust 1, and Child 1 and Child 2, as remainder beneficiaries and virtual representatives of the contingent and unborn beneficiaries of Trust 1, entered into Agreement. Under the terms of Agreement, Trust 1 was commuted1 and all of its property was distributed to Spouse. Recital H of Agreement provides that Spouse and Children agree that "Trust assets could be more effectively utilized if [Spouse] held such assets outright and free of trust." In Recital F of Agreement, the parties acknowledge that Spouse's testamentary limited power of appointment is "not operative." Paragraph 3 of Agreement provides:
>
>> By signing this Agreement and by virtue of the QTIP election for the Trust, the commutation of the Trust results in a deemed gift, for federal gift tax purposes, of the remainder interest in the Trust assets from [Spouse] to [Children] under Section 2519 of the Code. By virtue of the distribution of all of the Trust assets to [Spouse], the commutation of the Trust does not result in a deemed gift of [Spouse's] income interest in the Trust under Section 2511 of the Code. Additionally, by signing this Agreement and by virtue of the distribution of all of the Trust asset [sic] to [Spouse], the commutation of the Trust results in a gift, for federal gift tax purposes, of the remainder interest in the Trust from [Children] to [Spouse]. The deemed gift of the remainder interest from [Spouse] to [Children] and the gift from [Children] to [Spouse] results in a reciprocal gift transfer.

First up to be considered were the tax consequences to the spouse. The CCA states:

> In this case, Spouse, as personal representative of Decedent's estate, made an election under § 2056(b)(7) to treat Trust 1 as QTIP and claimed a marital deduction on Decedent's Form 706 for the value of Trust 1. Years later, on Date 3, Spouse and Children entered into Agreement. By its terms, Agreement effected the commutation of Trust 1.
>
> In a commutation, the trustee makes terminating distributions to the holders of the beneficial interests in the trust equal to the actuarial value of the interests. Each beneficiary gives up his or her respective beneficial interest in exchange for a lumpsum payment, in what is essentially a sale transaction. The commutation terminates any relationship between the beneficiary and the trust, and if all interests are commuted, the trust terminates.
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> Based on the above, the commutation of Trust 1 effected by Agreement constitutes a disposition by Spouse of Spouse's qualifying income interest within the meaning of § 2519(a). Section 25.2519-1(a) and (f); *Estate of Novotny*. Accordingly, for gift tax purposes, Spouse is treated as transferring by gift all interests in Trust 1 other than the qualifying income interest.3

Footnote 3 states:

> Note that the commutation does not constitute a gift of Spouse's qualifying income interest under § 2511 because Spouse received adequate and full consideration for Spouse's qualifying income interest based on the distribution of all trust property to Spouse. *See* § 25.2519-1(g), *Example 2*.

The CCA summarized the Estate of Novotny, 93 T.C. 12 (1989) like this: the surviving spouse and remainderman divided the sale proceeds of QTIP proportionately on the basis of the respective values of their interests; the court indicated that the ommutation constituted a disposition by the spouse of the income interest for purposes of § 2519 and was thus subject to gift tax.

So, the QTIP was terminated, the spouse received all the QTIP assets, and the spouse made a gift of the value of those assets to the descendants. Now let's look at the what the descendants did. Before the termination they would have received the assets when the spouse died. The CCA provides as follows:

> In this case, Child 1, Child 2, and Spouse entered into Agreement, which legally bound all persons interested in Trust 1. The effect of Agreement was to extinguish Spouse's testamentary limited power of appointment, commute Trust 1, and terminate Trust 1. As a result, Agreement vested a valuable property interest (the value of the remainder) in Children, the then remaindermen. Rather than accept a terminating distribution of the value of their beneficial interest, Child 1 and Child 2 agreed that the trust property "could be more effectively utilized" by Spouse holding the property outright. The outright distribution of all trust property to Spouse pursuant to the terms of Agreement constitutes a transfer of the value of Children's remainder interests without receipt of adequate and full consideration.4 Accordingly, Child 1 and Child 2 each made a gift under § 2511 of the value of their respective remainder interest in Trust 1 to Spouse. Section 2512(b).

Footnote 4 is omitted and deals with spouses subsequent transfers.

The children argued that there had to be some offset here, otherwise the property was being taxed twice. The National Office rejected that position stating:

> In *Commissioner v. Wemyss*, 324 U.S. 303 (1945) and its companion case *Merrill v. Fahs*, 324 U.S. 308 (1945), the Supreme Court considered the gift tax meaning of the term "adequate and full consideration in money or money's worth" in the context of antenuptial contracts.
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> In *Wemyss*, the donor transferred assets to his fiancé to compensate her for the loss of an income interest that would terminate upon her marriage to him. There was no dispute that both a promise of marriage and detriment to a contracting party constituted valuable consideration for purposes of the law of contracts. The Tax Court had held that if the promise of marriage was the consideration, it was not one reducible to a money value and, if the fiancé's loss of the income interest was the consideration, it did not constitute consideration in the hands of the donor. The Supreme Court stated:

If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct. . . . The section taxing as gifts transfers that are not made for "adequate and full (money) consideration" aims to reach those transfers which are withdrawn from the donor's estate.

Wemyss, 324 U.S. at 307-08. In other words, valuable contractual consideration in the hands of the donor is not sufficient; adequate and full consideration is that which replenishes, or augments, the donor's taxable estate.

In *Merrill,* the donor transferred property to donor's then spouse in exchange for spouse's relinquishment of marital rights in donor's remaining property. The Court held that spouse's relinquishment of the marital rights did not constitute adequate and full consideration for donor's transfer because the assets subject to the marital rights were already includible in donor's gross estate. *Id*. at 312-13.

Rev. Rul. 69-505, 1969-2 C.B. 179, involves a transfer to a trust of joint-tenancy property that is treated as a reciprocal exchange for consideration in money or money's worth. A and B owned the property as joint tenants and could each unilaterally sever the joint tenancy, and if not severed, the property would pass to the survivor upon the death of the other joint tenant. A and B transferred the property to a trust, reserving the right to receive one-half of the income therefrom for their joint lives and all to the survivor for life with remainder to C. Citing § 25.2511-1(e) and *U.S. v. Estate of Grace*, 395 U.S. 316 (1969), the revenue ruling holds that the transfers between A and B are treated as a reciprocal exchange for consideration in money or money's worth. Thus, neither A nor B made a gift to the other to the extent that the transfers were of equal value. The revenue ruling concludes that since the value of the gift by B is less than the value of the gift by A, A is deemed to have made a gift to B of the difference in value of A's and B's transfer.

***

Agreement characterized the transaction as a commutation of Trust 1 followed by a distribution of all trust property to Spouse. Thus, Spouse agrees to the extinguishment of Spouse's lifetime interest in Trust 1 and Children agree to the extinguishment of their remainder interest in Trust 1 in exchange for receipt of their respective proportionate share of trust property. Also pursuant to Agreement, Children transfer their proportionate share of trust property received in the commutation to Spouse and receive no consideration from Spouse in exchange for the transfer. Absent entering into Agreement, Spouse had no right to the remainder under the terms of Trust 1 or otherwise. Therefore, from an economic perspective, the transaction resulted in a one-sided gift transfer from Children to Spouse.

It is the deemed gift transfer arising by application of § 2519(a) that is the crux of Spouse and Children's position, as stated in Agreement, that the transfers are reciprocal gift transfers. However, unlike in Rev. Rul. 69-505, Spouse's deemed transfer under § 2519(a) and Children's transfers of their remainder interests under § 2511 do not constitute offsetting exchanges of consideration. Spouse received no consideration for the deemed transfer to Children under § 2519(a). That is, because the entire value of Trust 1 was subject to inclusion in Spouse's gross estate under § 2044, the transfer of the remainder by Children to Spouse does not augment Spouse's estate and, thus, cannot constitute the receipt of

adequate and full consideration for gift tax purposes. *See Commissioner v. Wemyss; Merrill v. Fahs.*

The fact that Spouse can receive no consideration for the deemed transfer resulting from the application of § 2519(a) does not nullify Children's transfers of their remainder interests in Trust 1. When Trust 1 was commuted, the remainder interest vested outright, equally in Children, the then remaindermen. Children then transferred their valuable property interest to Spouse and received nothing in exchange. Under § 2512(b) and *Wemyss*, these transfers by Children for no consideration constitute a gift. If Children were to transfer their remainder interests to a third party other than Spouse, the transfers would clearly be a gift. The result is the same if the donee is the surviving spouse beneficiary of a QTIP trust.5 Thus, the transaction cannot be considered involving offsetting transfers for consideration within the meaning of Rev. Rul. 69-505.

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In Rev. Rul. 98-8, 1998-1 C.B. 541, the surviving spouse purchased from the trust remainderman the remainder interest in a QTIP trust by issuing a promissory note equal to the actuarial value of the remainder interest to the remainderman. As a result of the purchase, the trust terminated under its terms and the entire corpus was transferred to the surviving spouse. The surviving spouse then used the proceeds to pay the remainderman the value of the remainder interest. The revenue ruling concludes that the purchase of the remainder interest, which is analogous to a commutation of the QTIP trust, is treated as a taxable disposition by the surviving spouse of the qualifying income interest, resulting in a gift of the value of the remainder interest under § 2519. Citing to *Wemyss*, the revenue ruling explains that the receipt of the remainder interest cannot increase the donor's taxable estate because it is already subject to inclusion in the surviving spouse's taxable estate under § 2044. Accordingly, the surviving spouse's receipt of the remainder interest cannot constitute adequate and full consideration under § 2512 for the promissory note transferred. The revenue ruling notes that any other result would subvert the legislative intent and statutory scheme underlying § 2056(b)(7).

In *Estate of Kite v. Commissioner*, T.C. Memo. 2013-43, the surviving spouse was the beneficiary of two QTIP trusts. According to a prearranged plan, the QTIP trusts were terminated and all assets were distributed to the surviving spouse. Two days later, the surviving spouse sold the assets to her three children in exchange for three deferred private annuity agreements under which payments would commence ten years thereafter. In the event that the surviving spouse died within the ten-year period, her annuity interest would terminate and nothing would be payable to her estate. Based on the facts and circumstances, the court found the sale of the assets of the QTIP trusts to the children in exchange for deferred annuities constituted a bona fide sale for adequate and full consideration and treated the annuity transaction as a single integrated transaction for purposes of § 2519. Moreover, the sale of the assets of the QTIP trusts, followed by the payment to the surviving spouse of the proceeds equal to the value of her income interest, was a disposition of her qualifying income interest for purposes of § 2519. In response to petitioner's post-opinion argument that there was no gift tax deficiency for the § 2519 disposition of the surviving spouse's qualifying income interest based on the receipt of full and adequate consideration, the court stated,

> [S]ection 2519(a) treats the disposition of a qualifying income interest as a deemed transfer of the remainder interest. In other words, "the donee spouse is treated as making a gift under section 2519 of the entire trust less the qualifying income interest" (emphasis added). Sec. 25.2519-

> 1(a), Gift Tax Regs. The term "gift" is not an accident. The remainder interest is a future interest held by the remainderman and not the donee spouse. Accordingly, the donee spouse cannot receive full and adequate consideration, or indeed any consideration, in exchange for the remainder interest. This result is supported by the intent of the marital deduction and the QTIP regime.

> *Estate of Kite v. Commissioner*, No. 6772-08 (T.C. Oct. 25, 2013) (order and decision under Tax Court Rule 155). The court ruled that the decedent owed gift tax on the value of the deemed § 2519 gift. *Id*.

> Here, the QTIP statutory scheme and legislative history support the view that Rev. Rul. 69-505 has no application and the separate transfers by Spouse and Children cannot be offset by consideration for gift tax purposes. Decedent's estate received the benefit of deferral of the estate tax liability allocable to the property of Trust 1 as a result of electing QTIP for such property under § 2056(b)(7). Because the commutation effected by Agreement constitutes a taxable disposition by Spouse within the meaning of § 2519(a) (see Issue 1), it marks the end of the deferral of the tax.

> Rev. Rul. 98-8 and *Estate of Kite* illustrate that a disposition under § 2519(a) has significant tax consequences, which are appropriate in view of the QTIP statutory scheme and legislative history. Here, because the commutation of Trust 1 results in a disposition of Spouse's qualifying income interest within the meaning of § 2519(a), Spouse is treated as effectively transferring the remainder interest even though under state property law precepts the remainder interest is held by Children, not Spouse. The taxable transfer by Spouse resulting from the application of § 2519 marks the end of the deferral of estate tax on the Trust 1 property that passed untaxed from Decedent's estate, and is no longer subject to inclusion in Spouse's gross estate under § 2044(b)(2). Eliminating the taxable transfer by Spouse based on a deemed reciprocal gift transfer by the remaindermen would allow the value of the remainder of Trust 1 to escape transfer tax under both §§ 2519 and 2044, which would be contrary to the QTIP statutory scheme and legislative history.

Finally, the National Office got around to valuing the two gifts. The spouse's gift – recall that the spouse received all the property – was valued by subtracting the spouse's income interest from the full value of the trust property. The children's gifts were valued based on standard actuarial methods. The CCA states:

> Section 25.2519-1(c)(4) provides that the amount treated as a transfer under § 25.2519-1(c)(1) is further reduced by the amount the surviving spouse is entitled to recover under § 2207A(b) (relating to the right to recover gift tax attributable to the remainder interest). Under § 25.2519-1(c)(4), if the donee spouse is entitled to recover gift tax under § 2207A(b), the amount of the gift tax recoverable and the value of the interest treated as transferred under § 2519 are determined by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability. The gift tax consequences of failing to exercise the right of recovery are determined separately under § 25.2207A-1(b).

> Under § 2207A(b) and § 25.2207A-1(a), a surviving spouse treated as transferring an interest in property by reason of § 2519 is entitled to recover from the "person receiving the property" the amount of gift tax attributable to that property. The right of recovery arises at the time the gift tax is actually paid by the surviving spouse subject to § 2519.

> In this case, the amount of Spouse's gift under § 2519 is determined by subtracting the value of Spouse's qualifying income interest from the fair market value of the trust property as of Date 3, the date of Agreement. Section 2519(a); § 25.2519-1(a). Discretionary principal distributions and the testamentary limited power of appointment are not taken into account. A standard § 7520 income factor can be used to value the qualifying income interest, and thus, the value of Spouse's qualifying income interest is determined by multiplying the value of the trust property by the income factor of
>
> 0.09172.6 Section 25.2512-5(d)(2)(iii); § 25.7520-1. Based on a value of the trust property of $b, the value of Spouse's qualifying income interest is $e. The amount of Spouse's gift under § 2519, therefore, is $f (i.e., $b – $e = $f).
>
> To the extent Spouse is entitled to recover gift tax attributable to the remainder interest under § 2207A(b), this amount is reduced, using an interrelated calculation. Note that, under § 25.2207A-1(b), if Spouse waives or otherwise fails to exercise Spouse's right of recovery, Spouse will be treated as making an additional gift in the amount of the unrecovered tax.7
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> ***
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> Based on the available facts, it is appropriate to value each of Children's interests as one-half of the actuarial present value of the remainder interest, adjusting as necessary for the restrictions on the beneficial interests. The determination takes into account that the possibility of principal invasion was so remote as to be negligible, given that the combined value of the property held by Trust 1 was $b at the time of commutation and, thus, annual income of Trust 1 would have been substantial and likely sufficient for Spouse's health, maintenance, and support, even if Spouse's accustomed manner of living were extravagant.8 Further, the determination takes into account, based on all the facts and circumstances, that the testamentary limited power of appointment would be appropriately treated as having no measurable effect on the values of these interests.
>
> Accordingly, based on the available facts, we conclude that the actuarial value of Children's proportionate shares of the remainder interest is properly determined under § 7520, using a standard remainder factor. Thus, the value of each child's remainder interest under § 7520 is determined by multiplying the value of the trust property by the remainder factor of 0.908289 then dividing the product by 2. Section 25.2512-5(d)(2)(ii); § 25.7520-1. Based on a value of the trust property of $b, the fair market value of each child's gift, therefore, is $g (i.e., ($b x 0.90828) ÷ 2 = $g).

Footnote 8 notes that the spouse must not have needed principal distributions because the spouse sold most of the assets received "immediately after Spouse received it in exchange for promissory notes that did not provide for the payment of principal until a date after Spouse's probable life expectancy."

In PLR 202116001 a QTIP ("Qualified Trust") was divided and the spouse released an income right over part of the trust. The ruling describes what happened as follows:

> On Date 1, Trustee divided Qualified Trust into two trusts, Qualified Trust-A and Continuing Qualified Trust, both with terms and provisions identical to those set forth in Qualified Trust. Trustee placed $x in cash and marketable securities into Qualified Trust-A and retained all other assets in Continuing Qualified Trust. The

> assets retained in Continuing Trust are income producing such that Spouse retains the enjoyment of the assets. On Date 2, Trustee and the beneficiaries of Qualified Trust-A petitioned Court for entry of an order with respect to Qualified Trust-A. On Date 3, finding that a continuation of Qualified Trust-A unchanged would defeat or substantially impair its purposes, Court entered Order. Order modifies the terms and provisions of Qualified Trust-A.
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> Article V of Qualified Trust-A, as modified by Order, provides that Qualified Trust-A shall terminate upon the death of the last surviving income beneficiary. However, at any time, including prior to Spouse's death, Qualified Trust-A may be terminated as to a beneficiary's interest and any part of the trust property representing her interest may be distributed to that beneficiary if the trustee considers such distribution to be in the best interests of the beneficiary, considering the demonstrated ability of the beneficiary to handle money and property wisely, her judgment, prudence and discretion, and any other factors the trustee may consider relevant. The trustee may exercise the power of termination even if the beneficiary is restrained from alienating her interest.
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> Article III, section 3.1, as modified by Order, provides that the original and principal beneficiaries of Qualified Trust-A shall become the income beneficiaries in proportion to their interests in the principal. Section 7.2, allowing the trustee to make distributions to Spouse for her health, education, maintenance and support, is deleted in its entirety. Order further provides that, the terms and conditions of Qualified Trust-A shall be interpreted and applied as if Spouse had died on the date Order is entered, and that Trustees shall continue to be the trustee of Qualified Trust-A and Continuing Qualified Trust. Although Order is effective on Date 3, it is expressly conditioned on receipt of favorable rulings from the Internal Revenue Service prior to Date 4.

Because the trust continued even after the income interest was given up, there was no gift form the remainder beneficiaries. However, the gift by the spouse was described like this:

> In the present case, following the division of Qualified Trust on Date 1, the trusts resulting from the division, Qualified Trust-A and Continuing Qualified Trust, had terms and provisions identical to those set forth in Qualified Trust. Thus, the division of Qualified Trust did not change the beneficial interests of Spouse, Daughter 1 or Daughter 2 in the property originally held in Qualified Trust. Accordingly, based on the facts submitted and representations made, we rule that the division of Qualified Trust on Date 1 did not cause the assets remaining in Qualified Trust after the division (referred to as Continuing Qualified Trust) to be subject to the United States Gift Tax pursuant to § 2519 or 2511.
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> Order, however, modifies the terms of Qualified Trust-A to change the beneficial interests of Spouse, Daughter 1, and Daughter 2 in the property of Qualified Trust-A. Article V of Qualified Trust-A, which continues to provide that Qualified Trust-A shall terminate upon the death of the last surviving income beneficiary, is modified to provide that at any time, including prior to Spouse's death, Qualified Trust-A may be terminated as to a beneficiary's interest. In other words, Order terminates Spouse's income interest as of Date 3. The term "disposition" as used in § 2519, applies broadly to circumstances in which the surviving spouse's right to receive the income is relinquished or otherwise terminated, by whatever means. See H. Rep. No. 97-201, at 161 (1981). The property in Qualified Trust-A is a portion of the property originally held by Qualified Trust with respect to which Decedent's estate was allowed a deduction under § 2056(b)(7). Thus, for

> purposes of § 2519, the entry of Order on Date 3 resulted in a disposition of a qualifying income interest for life in Qualified Trust-A.
>
> Accordingly, based on the facts submitted and representations made, we rule that Spouse is deemed to have made a transfer of all of the property in Qualified Trust-A under § 2519, other than the value of her qualifying income interest, and Spouse is deemed to have made a transfer of her qualifying income interest in Qualified Trust-A under § 2511, on Date 3 upon entry of Order approving modifications by which the income interest of Spouse in Qualified Trust-A is terminated and distributions from Qualified Trust-A are permitted to be made prior to death of Spouse.

A QTIP election is at root a "deal" between the surviving spouse and the government. The government allows a marital deduction and the surviving spouse agrees that all of the enjoyment and value of the property as to which the election is made will flow through the hands of the surviving spouse. The "deal" is necessary because a QTIP trust often is designed without any other power in the surviving spouse which would cause estate tax inclusion. Accordingly, if the surviving spouse gives up any of the income interest in QTIP property, the surviving spouse is deemed to have made a gift of the entire value of that QTIP property (that would not have had to be the rule; the surviving spouse could have been deemed to have made a gift of that portion of the income, but such a determination is complicated and uncertain, thus a strict "penalty" rule was imposed by statute). Concluding that a "transfer" of a remainder by the children has occurred and is a gift creates double-taxation of the same QTIP property. Had their been no QTIP election the government's approach would have been more sensible: the spouse had an income interest, the children a remainder interest, the children allowed all the trust property to be distributed to the spouse which must have been a gift. However, the QTIP deal should not be allowed to change half the equation and impose a total gift on the spouse but yet impose non-QTIP consequences on the children.

N. SECTIONS 2501 TO 2524 – GIFTS

1. Unusual Assignment Clause Produced A Gift. Nelson v. Commissioner, T.C. Memo. 2020-81, involved the transfer of units in a limited partnership, Longspar, to a trust in 2008. One transfer was a gift, the other a sale for a note. The transfers were by assignment as follows:

> Mrs. Nelson made two transfers of limited partner interests in Longspar to the Trust. The first transfer was a gift on December 31, 2008. The Memorandum of Gift and Assignment of Limited Partner Interest (memorandum of gift) provides:
>
>> [Mrs. Nelson] desires to make a gift and to assign to * * * [the Trust] her right, title, and interest in a limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS ($2,096,000.00) as of December 31, 2008 * * *, as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment.
>
> Petitioners structured the second transfer, on January 2, 2009, as a sale. The Memorandum of Sale and Assignment of Limited Partner Interest (memorandum of sale) provides:

> [Mrs. Nelson] desires to sell and assign to * * * [the Trust] her right, title, and interest in a limited partner interest having a fair market value of TWENTY MILLION AND NO/100THS DOLLARS ($20,000,000.00) as of January 2, 2009 * * *, as determined by a qualified appraiser within one hundred eighty (180) days of the effective date of this Assignment * * *.

> Neither the memorandum of gift nor the memorandum of sale (collectively transfer instruments) contains clauses defining fair market value or subjecting the limited partner interests to reallocation after the valuation date. In connection with the second transfer, the Trust executed a promissory note for $20 million (note). Mr. Nelson, as trustee, signed the note on behalf of the Trust. The note provides for 2.06% interest on unpaid principal and 10% interest on matured, unpaid amounts, compounded annually, and is secured by the limited partner interest that was sold. Annual interest payments on the note were due to Mrs. Nelson through the end of 2017.

Appraisals were completed and 6.14% and 58.65% of the Longspar units were transferred. Upon audit, the IRS increased the values of the units transferred. The question for the court was what was transferred:

> The parties agree that the transfers were complete once Mrs. Nelson executed the transfer instruments parting with dominion and control over the interests. See Burnet v. Guggenheim, 288 U.S. 280, 286 (1933); Carrington v. Commissioner, 476 F.2d 704 (5th Cir. 1973), aff'g T.C. Memo. 1971-222; Estate of Metzger v. Commissioner, 100 T.C. 204, 208 (1993), aff'd, 38 F.3d 118 (4th Cir. 1994); sec. 25.2511-2(b), Gift Tax Regs. But they disagree over whether Mrs. Nelson transferred Longspar limited partner interests of $2,096,000 and $20 million, as petitioners contend, or percentage interests of 6.14% and 58.65%, as respondent contends.

> We look to the transfer documents rather than subsequent events to decide the amount of property given away by a taxpayer in a completed gift. See Estate of Petter v. Commissioner, T.C. Memo. 2009-280, 2009 WL 4598137, at *12 (citing Succession of McCord v. Commissioner, 461 F.3d 614, 627 (5th Cir. 2006), rev'g and remanding 120 T.C. 358 (2003)), aff'd, 653 F.3d 1012 (9th Cir. 2011); see also Commissioner v. Procter, 142 F.2d 824 (4th Cir. 1944) (disregarding the subsequent reallocation of property to the donor via a saving clause as contrary to public policy), rev'g and remanding a Memorandum Opinion of this Court. Petitioners argue that the transfer instruments show that Mrs. Nelson transferred specific dollar amounts, not fixed percentages, citing a series of cases that have respected formula clauses as transferring fixed dollar amounts of ownership interests. In each of those cases we respected the terms of the formula, even though the percentage amount was not known until fair market value was subsequently determined, because the dollar amount was known. Wandry v. Commissioner, T.C. Memo. 2012-88, 2012 WL 998483, at *4; Hendrix v. Commissioner, T.C. Memo. 2011-133, 2011 WL 2457401, at *5-*9; Estate of Petter v. Commissioner, 2009 WL 4598137, at *11-*16.

> Saving clauses have been treated differently. As we explained in Estate of Petter and Wandry, courts have rejected saving clauses because they relied on conditions subsequent to adjust the gifts or transfers so the size of the transfer (as measured either in dollar amount or percentage) could not be known. Thus, for example, in Commissioner v. Procter, 142 F.2d at 827, the Court of Appeals for the Fourth Circuit rejected a clause adjusting part of a gift to "automatically be deemed not to be included in the conveyance in trust hereunder and shall remain the sole

property of * * * [the taxpayer]" because the adjustment would be triggered only by a "final judgment or order of a competent federal court of last resort that any part of the transfer * * * is subject to gift tax."

In Succession of McCord v. Commissioner, 461 F.3d at 618, the Court of Appeals for the Fifth Circuit upheld a gift of an interest in a partnership expressed as "a dollar amount of fair market value in interest" reduced by a transfer tax obligation rather than a percentage interest that was determined in agreements subsequent to the gift. It held that "a gift is valued as of the date that it is complete; the flip side of that maxim is that subsequent occurrences are off limits." Id. at 626. The formula clause in the initial transfer document did not include qualifying language that fair market value was to be "as finally determined for [Federal gift] tax purposes," but the court did not find that omission fatal because the value of the gift was ascertainable as of the date it was complete. Id. at 627.

Petitioners argue that we should construe the transfer clauses here as more akin to the formula clauses that were upheld in Succession of McCord, Estate of Petter, and Wandry, that is, read them as transferring dollar amounts rather than percentages. However, as part of their argument, they cite evidence of their intent, which includes their settlement discussions with IRS Appeals and subsequent adjustments to reflect changes in valuation to reflect those discussions. Of course, as in Succession of McCord, we look to the terms of the transfer instruments and not to the parties' later actions except to the extent that we conclude the terms are ambiguous and their actions reveal their understanding of those terms. Id. at 627-628.

Therefore, to decide whether the transfers were of fixed dollar amounts or fixed percentages, we start with the clauses themselves, rather than the parties' subsequent actions. The gift is expressed in the memorandum of gift as a "limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS ($2,096,000.00) as of December 31, 2008 * * *, as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment." Similarly, the sale is expressed in the memorandum of sale as a "limited partner interest having a fair market value of TWENTY MILLION AND NO/100THS DOLLARS ($20,000,000.00) as of January 2, 2009 * * *, as determined by a qualified appraiser within one hundred eighty (180) days of the effective date of this Assignment."

The transferred interests thus are expressed in the transfer instruments as an interest having a fair market value of a specified amount as determined by an appraiser within a fixed period. The clauses hang on the determination by an appraiser within a fixed period; value is not qualified further, for example, as that determined for Federal estate tax purposes. See, e.g., Estate of Christiansen v. Commissioner, 130 T.C. 1, 14-18 (2008) (upholding gift clause providing fair market value "as such value is finally determined for federal estate tax purposes"), aff'd, 586 F.3d 1061 (8th Cir. 2009); Estate of Petter v. Commissioner, 2009 WL 4598137, at *11-*16 (upholding gift clause transferring the number of units of a limited liability company "that equals one-half the minimum * * * dollar amount that can pass free of federal gift tax by reason of Transferor's applicable exclusion amount" along with a clause providing for an adjustment to the number of units if the value "is finally determined for federal gift tax purposes to exceed the amount described" in the first clause).

Unlike the clause in Succession of McCord, "fair market value" here already is expressly qualified. By urging us to interpret the operative terms in the transfer instruments as transferring dollar values of the limited partner interests on the

> bases of fair market value as later determined for Federal gift and estate tax purposes, petitioners ask us, in effect, to ignore "qualified appraiser * * * [here, Mr. Shrode] within * * * [a fixed period]" and replace it with "for federal gift and estate tax purposes." While they may have intended this, they did not write this. They are bound by what they wrote at the time. As the texts of the clauses required the determination of an appraiser within a fixed period to ascertain the interests being transferred, we conclude that Mrs. Nelson transferred 6.14% and 58.35% of limited partner interests in Longspar to the Trust as was determined by Mr. Shrode within a fixed period.

Longspar itself owned interests in a closely-held company, "Stacked" discounts were allowed, summarized by the court as follows:

> First, Mrs. Nelson transferred 6.14% and 58.65% Longspar limited partner interests to the Trust. Next, discounts of 15% for lack of control and 30% for lack of marketability should apply to the valuation of WEC common stock, resulting in a fair market value of $912 per share. Therefore, the controlling, marketable value of Longspar is $60,729,361. Discounts of 5% for lack of control and 28% for lack of marketability should apply to calculate the fair market value of a Longspar limited partnership interest. As a result, a 1% Longspar limited partner interest has a fair market value of $411,235 and the 6.14% and 58.65% Longspar limited partner interests Mrs. Nelson transferred to the Trust have fair market values of $2,524,983 and $24,118,933, respectively.

2. Gifts vs. Loans vs. Loans Incapable of Repayment. At issue in Estate of Bolles, T.C. Memo. 2020-71, was whether various transfers, mother to son, were gifts, loans, or, as it turns out, loans that couldn't be repaid. The case suggests that taxpayers should argue with the IRS if they can prove a change in circumstances between the time of an unpaid loan and the time of the lender's death. The court's conclusion is as follows:

> Finally, we address the issue of whether the advances were loans or gifts. Both parties rely on the analysis of Miller v. Commissioner, T.C. Memo. 1996-3, aff'd, 113 F.3d 1241 (9th Cir. 1997), for the traditional factors used to decide whether an advance is a loan or a gift. Those factors are explained as follows: (1) there was a promissory note or other evidence of indebtedness, (2) interest was charged, (3) there was security or collateral, (4) there was a fixed maturity date, (5) a demand for repayment was made, (6) actual repayment was made, (7) the transferee had the ability to repay, (8) records maintained by the transferor and/or the transferee reflect the transaction as a loan, and (9) the manner in which the transaction was reported for Federal tax purposes is consistent with a loan.
>
> These factors are not exclusive. See, e.g., Estate of Maxwell v. Commissioner, 98 T.C. 594 (1992), aff'd, 3 F.3d 591 (2d Cir. 1993). In the case of a family loan, it is a longstanding principle that an actual expectation of repayment and an intent to enforce the debt are critical to sustaining the tax characterization of the transaction as a loan. Estate of Van Anda v. Commissioner, 12 T.C. 1158, 1162 (1949), aff'd per curiam, 192 F.2d 391 (2d Cir. 1951).
>
> While Mary recorded the advances to Peter as loans and kept track of interest, there were no loan agreements or attempts to force repayment. Respondent focuses on the lack of security for the loans to Peter. We agree that the reasonable possibility of repayment is an objective measure of Mary's intent. The estate maintains that during her life Mary always considered these advances as loans. We cannot reconcile this argument with the deterioration of Peter's financial

> situation and the ultimate failure of his practice in San Francisco and later in Las Vegas.
>
> Peter's creativity as an architect and his ability to attract clients likely impressed Mary. We find she expected him to make a success of the practice as his father had, and she was slow to lose that expectation. However, it is clear she realized he was very unlikely to repay her loans by October 27, 1989, when her trust provided for a specific block of Peter's receipt of assets at the time of her death. Accordingly, in 1990 the "loans" lost that characterization for tax purposes and became advances on Peter's inheritance from Mary. In conclusion, we find the advances to Peter were loans through 1989 but after that were gifts. We have considered whether she forgave any of the prior loans in 1989, but we find that she did not forgive the loans but rather accepted they could not be repaid on the basis of Peter's financial distress.

For the opinion to be helpful requires close attention to the facts:

> A loving mother of her five children, Mary was determined to provide her assets to her children equally. Her practice was to keep a personal record of her advances and occasional repayments for each child. On the basis of her original intent and the advice of her tax counsel, she treated the advances as loans. She forgave the "debt" account of each child every year on the basis of the gift tax exemption amount. Her practice would have been noncontroversial but for the substantial funds she advanced to Peter.
>
> ***
>
> Peter was the oldest of their five children. He graduated from college with a degree in architecture in 1965. On the basis of his academic achievements and his father's reputation as an architect in San Francisco, Peter's professional career showed great promise. He began his career in Boston. He took over his father's architecture practice in San Francisco in the early 1970s and enjoyed some early success in attracting clients. Peter expanded the practice through the 1970s into the early 1980s; but despite his salesmanship he began to have financial difficulties largely because his expectations exceeded realistic results. By 1983 Peter's practice was not current on its bills. In July 1983 Peter, as president of Bolles Associates and Peter B. Bolles, P.A., entered into an agreement with the Bolles Trust to use trust property as security for $600,000 in bank loans. The agreement also reflects that the Bolles Trust was owed $159,828 in back rent by Peter's practice. Within a year Peter had failed to meet the obligations of the agreement, and the Trust was ultimately held liable for the $600,000. Mary had contemporaneous knowledge of these events.

Between 1985 and 2007 Mary transferred $1,063,333 to or for Peter's benefit (directly to him, to his accounts, paying other of his debts). Peter made no payments after 1988. In Mary's estate plan, she adjusted for the transfers, with interest (using the AFR). The IRS argument was that either Mary made gifts or a note should be in her estate:

> The calculations found in article five of the First Amendment describe the manner in which advances, described as loans, are to be taken into account in dividing the trust assets among decedent's children upon her death. In essence, under subparagraph (b), the value of the trust assets after allowance for expenses such as estate tax is divided equally; however, each child's share is reduced, and that amount redistributed pro rata among the other beneficiaries, by the amount of the child's outstanding loans, if any, plus accrued interest.

> The explanation of adjustments to the notice of deficiency states:
>
> I. Schedule C, Items 2 and 3
>
> It is determined that the fair market value of the Promissory Note and receivable due from Peter P. Bolles under IRC section 2031 is $1,063,333 instead of zero as reported and that interest on the Promissory Note and receivable is includible in the gross estate under IRC section 2033 in the amount of $1,165,778. Therefore, the value of the gross estate is increased by $2,229,111.
>
> II. Adjusted Taxable Gifts
>
> In the event it is determined that the fair market value under IRC section 2031 of the Promissory Note and receivable from Peter Bolles and interest on the Promissory Note and receivables is zero then it is determined that Mary P. Bolles transferred property to Peter Bolles during her life such that "adjusted taxable gifts" in the amount of $1,063,333 is included in computing taxpayer's estate tax liability under IRC section 2001(b).

This is an interesting situation but one that is difficult but not impossible to replicate for planning purposes. Suppose a parent loans money to a child to pay the child's expenses during, say medical school; then the child goes into a line of medical work that cannot support repayment. Perhaps in such instance a no gift, no loan position could be sustained, but most families would not plan for such.

O. SECTION 2518 – DISCLAIMERS

P. SECTIONS 2601-2654 - GENERATION-SKIPPING TRANSFER TAX

1. Modification of GST Grandfathered Trust Allowed Where Property Vested in Same Generation As Before Modification. PLR 202011001 states:

> In this case, Trust A was irrevocable prior to September 25, 1985. The amended trust agreement provides for outright distribution to the beneficiaries upon the termination of Trust A and the Trust A Successor Trusts, 21 years after the death of Son. Under the proposed modification of the trust agreement, any share upon the termination of Trust A and the Trust A Successor Trusts distributable to a beneficiary who is under the age of b, will be held in a continuing trust for that continuing beneficiary. Each continuing beneficiary will have a testamentary general power of appointment with respect to the property. Under § 2041(a)(2), the continuing beneficiary's trust property will be includible in his or her estate at his or her death. Further, each continuing beneficiary will be treated as the transferor of the trust corpus for GST tax purposes under § 2652(a)(1). The proposed modification will not result in a shift of any beneficial interest in any beneficiary who occupies a generation lower than the persons holding the beneficial interests. Further, the proposed modification in further trust will not extend the time for vesting of any beneficial interest in any trust. Accordingly, based on the facts presented and the representations made, we rule that the proposed modification will not cause Trust A or the Trust A Successor Trusts to lose their exemption from the GST tax of chapter 13.

The modifications appeared to have the purpose of affecting distribution to son. The ruling is one of a series.

Q. SECTIONS 2701-2704 - SPECIAL VALUATION RULES

1. How Might The Doctrine Of Merger Be Used With A GRAT? Because a trust is created by separating legal and equitable title to property, merging legal and equitable title to property in one person will, in general, cause the trust to terminate. The doctrine of merger is incorporated in section 402(a)(5) of the UTC, the comment to which states:

> Subsection (a)(5) addresses the doctrine of merger, which, as traditionally stated, provides that a trust is not created if the settlor is the sole trustee and sole beneficiary of all beneficial interests. The doctrine of merger has been inappropriately applied by the courts in some jurisdictions to invalidate self-declarations of trust in which the settlor is the sole life beneficiary but other persons are designated as beneficiaries of the remainder. The doctrine of merger is properly applicable only if all beneficial interests, both life interests and remainders, are vested in the same person, whether in the settlor or someone else. An example of a trust to which the doctrine of merger would apply is a trust of which the settlor is sole trustee, sole beneficiary for life, and with the remainder payable to the settlor's probate estate.

The Restatement (Third) of Trusts § 69, Comment b, states that "[i]f, by operation of law, the legal title to the trust property passes to the beneficiary who has the entire beneficial interest, merger occurs, the trust terminates, and the beneficiary holds the property free of trust. Where the life interest and remainder interest is held by two beneficiaries who are also the only co-trustees, whether merger occurs in favor of the two beneficiaries is uncertain. See Scott and Ascher on Trusts § 11.2.5.

Suppose the grantor and the remainder beneficiaries contribute their respective interests to an LLC in exchange for membership interests that are proportionate to the interests of each such that the grantor receives an interest equal in value to the amount that would be included in the grantor estate if she died at that moment. The LLC would have all the beneficial interests in the GRAT property. If the LLC could become trustee of the GRAT then the doctrine of merger ought to apply. May an LLC serve as trustee? Under the UTC, for example, there is no definition of trustee but there are broad references to "persons" serving as trustee and the definition of person includes entities like an LLC. Some states may impose other limitations. In PLR 201928005, dealing with merger in the context of a GRAT, the IRS notes a state law requirement that a trustee may terminate a CLAT where the annuity and remainder are held by one beneficiary (and concludes the trustee doing so will not cause gain or loss recognition).

Where an LLC cannot serve as trustee, if the LLC managers serve as trustees is that sufficient? The answer is uncertain. The LLC managers are not the LLC.

Would a merger into an LLC be a taxable event for income tax purposes? The answer would seem to be no. Similarly, because the grantor receives an LLC interest having a value equal to what would be in the grantor's estate if the grantor died at that moment concerns like those raised in CCA 201745012 arguably are avoided.

2. **GRAT Inclusion**. Treas. Reg. §20.2036-1(c)(2)(i) applies section 2036 to a GRAT. When the grantor dies during the GRAT term, an amount of the GRAT is included in the grantor's estate which is sufficient to produce the annuity using the section 720 rate then in effect (with special rules for annuities, that change during the term). As a practical matter, absent a substantial increase in the section 7520 rate between the date of the GRAT and the grantor's death, an extraordinary appreciation, all of a GRAT is included in the Grantor's estate at death. An exception is for GRATs with long terms, perhaps as long as 99 years, because the annuity required to zero out over such a long-term is very low, as discussed below.

In Badgley v. United States, 121 A.F.T.R.2d 2018-1816 (N.D. Ca. 2018) the taxpayer challenged the regulation where the GRAT term was 15 years. The taxpayer lost. The opinion states:

> Plaintiff contends that the Court should disregard the Regulation as an unreasonable interpretation of section 2036 as applied to Patricia's GRAT. *See* Pl. Mot. at 24 (citing *Prof'l Equities v. Commissioner*, 89 T.C. 165 (1987)). Defendant argues that the Regulation is a reasonable interpretation of section 2036 and valid under *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). Plaintiff does not expressly dispute that *Chevron* applies; instead, Plaintiff claims that the Regulation is interpretive and thus given less deference as compared to a legislative rule. See Pl. Opp. at 19.
>
> The Court applies *Chevron*'s two-step framework. *See Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 52 (2011). At *Chevron* step one, the Court asks "whether Congress has directly addressed the precise question at issue." *Id*. (quotation omitted). The parties agree that section 2036 does not expressly address whether annuity payments constitute some possession, enjoyment, or right to income from the transferred property. Def. Mot. at 14; Pl. Mot. at 19. So the Court proceeds to step two. At that step, the Court "may not disturb an agency rule unless it is arbitrary or capricious in substance, or manifestly contrary to the statute." *Mayo Found. for Med. Educ.*, 562 U.S.at 53 (quotation omitted).
>
> The Court concludes that the Regulation is reasonable, and valid under *Chevron*. In drafting the Regulation, the IRS and Treasury Department relied principally on the above discussed binding authorities, including *Church's, Hallock, and Spiegel's*. *See* Grantor Retained Interest Trusts—Application of Sections 2036 and 2039, T.D. 9414, 73 Fed. Reg. 40173-01 (July 14, 2008) at 40174. Those cases support Defendant's view of section 2036, which parallels the Regulation's interpretation of that section. The IRS and Treasury Department also drew on section 2036's legislative history to devise the Regulation, observing that Congress amended section 811(c) to include interests retained for a term of years. *Id*. (citing H.R. Rep. no. 81-1412 at 9 (1949)). Though Plaintiff cites legislative history for the opposite conclusion, Plaintiff does not explain why that history supports the Regulation. *See* Pl. Opp. at 20.

Overturning a final regulation is difficult. Here the regulation was designed to be anti-taxpayer. Inclusion with one payment to go is calculated the same as on day 2 of the GRAT. The taxpayer appealed arguing that an annuity is not a retained right to income or use, and the valuation approach of the regulations should be thrown out, but the appeal was denied by the Ninth Circuit. Badgley v. United States, 957 F.3d 969 (9th Cir. 2020). The opinion states:

The fact that § 2036(a)(1) does not include the term "annuity" does not exclude annuities from its ambit. This is consistent with the decisions of the Supreme Court and our sibling circuits, which have concluded that interests such as reversionary interests, the power of appointment, and rent— also not expressly listed in § 2036(a)—nevertheless fall into one of the three categories. *See, e.g., Estate of Spiegel v. Comm'r*, 335 U.S. 701, 705 (1949) (potential reversionary interest in property is possession or enjoyment); *Fid.-Phila. Tr. Co. v. Rothensies*, 324 U.S. 108, 111 (1945) (beneficiaries' estates "took effect in enjoyment" only at transferor's death because she held power of appointment); *Estate of McNichol*, 265 F.2d at 671 (rent from property is enjoyment). As far back as the 1940s, the Supreme Court rejected the proposition that taxpayers could "escape the force of this section by hiding behind the legal niceties contained in devices and forms created by conveyances." *Church's Estate*, 335 U.S. at 646 (quotation omitted); *see also Fid.- Phila.*, 324 U.S. at 111 ("The application of this tax does not depend upon elusive and subtle casuistries." (quotation omitted)). We reject Badgley's argument that because § 2036(a)(1) does not expressly mention annuities, the full value of Decedent's GRAT cannot be included in the gross estate.

***

In *Commissioner v. Clise*, 122 F.2d 998 (9th Cir. 1941), involving annuity contracts outside of the trust context, we concluded that when a grantor retained the "economic benefit" of annuity payments, she retained enjoyment of the property. *Id.* at 999, 1003–04. Because the annuities went to Clise for her lifetime and to a designated second annuitant upon her death, "[t]he practical effect of the annuity contracts was to reserve to [her] the enjoyment of the property transferred and to postpone the fruition of the economic benefits thereof to the second annuitants until her death." *Id.* at 1004; *see also Forster v. Sauber*, 249 F.2d 379, 380 (7th Cir. 1957) (holding retained annuity includable in gross estate because "grantor has retained the economic enjoyment of the contracts for life"); *Mearkle's Estate v. Comm'r*, 129 F.2d 386, 388 (3d Cir. 1942) (holding annuity contracts includable because their practical effect was "to reserve to the annuitant the enjoyment of the property transferred and to postpone the fruition of the economic benefits to the second annuitant until after the death of the first"). We conclude that when a grantor derives substantial present economic benefit from property, she retains the enjoyment of the property for purposes of § 2036(a)(1).5 As in *Clise*, Decedent's annuity was a "substantial present economic benefit," requiring inclusion of the GRAT's date of death value in her estate. She received $302,259 per year for fifteen years through the annuity. Moreover, because the partnership was the only property placed in the GRAT, the annuity stemmed from that property interest. As "something of value enjoyed by her," *Bayliss v. United States*, 326 F.2d 458, 461 (4th Cir. 1964), the annuity reserved to Decedent the enjoyment of the partnership interest during her lifetime. And because Decedent died before the termination of the GRAT, the property was not transferred to its beneficiaries before her death—and remained tied to her by the string she created.

***

Badgley also challenges 26 C.F.R. § 20.2036-1(c)(2), which includes the formula the IRS uses to calculate the portion of the property includable under § 2036(a). The regulation interprets § 2036(a) to provide that GRATs are includable in a grantor's gross estate because they are sufficiently tied to the grantor.7 Badgley's argument regarding the formula is limited to two sentences and two footnotes, without a single citation to legal authority. As we have previously held, arguments presented in such a cursory manner are waived. Federal Rule of Appellate

> Procedure 28(a)(8)(A) requires an appellant's opening brief to contain the "appellant's contentions and the reasons for them, with citations to the authorities and parts of the record on which the appellant relies." *Id*. "Arguments made in passing and not supported by citations to the record or to case authority are generally deemed waived." *United States v. Graf*, 610 F.3d 1148, 1166 (9th Cir. 2010).

Suppose the grantor of the GRAT is unlikely to survive the term. A remainder interest purchase strategy was tried in CCA 201745012 which the IRS described as follows:

> <u>ISSUES</u>
>
> (1) Whether the remainder interest in transferred property in which the donor has retained an annuity replenishes the donor's taxable estate so as to constitute adequate and full consideration in money or money's worth for gift tax purposes where the purchase of the remainder occurs on the donor's deathbed during the term of the annuity.
>
> (2) Whether a note given in exchange for property that does not constitute adequate and full consideration in money or money's worth for gift tax purposes is deductible as a claim against the estate.
>
> <u>CONCLUSIONS</u>
>
> (1) Where the purchase of the remainder occurs on the donor's deathbed during the term of the annuity, the remainder does not replenish the donor's taxable estate. Accordingly, the remainder does not constitute adequate and full consideration in money or money's worth for gift tax purposes. Merrill v. Fahs, 324 U.S. 308 (1945).
>
> (2) A note given in exchange for property that does not constitute adequate and full consideration in money or money's worth for gift tax purposes is not deductible as a claim against the estate.

The purchase occurred the day before the grantor died. The essence of the replenishment argument was outlined by the IRS:

> In <u>Commissioner v. Wemyss</u>, 324 U.S. 303 (1945), the Supreme Court considered the meaning of the term "adequate and full consideration in money or money's worth" for gift tax purposes. There, the donor transferred assets to his fiancé to compensate her for the loss of an income interest that would terminate upon her marriage to him. There was no dispute that both a promise of marriage and detriment to a contracting party constituted valuable consideration for purposes of the law of contracts. The Tax Court had held that if the promise of marriage was the consideration, it was not one reducible to a money value and if the fiancé's loss of the income interest was the consideration, it did not constitute consideration in the hands of the donor.
>
>> If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct. . . . The section taxing as gifts transfers that are not made for 'adequate and full (money) consideration' aims to reach those transfers which are withdrawn

> from the donor's estate. To allow detriment to the donee to satisfy the requirement of 'adequate and full consideration' would violate the purpose of the statute and open wide the door for evasion of the gift tax.

> Wemyss, 324 U.S. at 307-08. In other words, valuable contractual consideration in the hands of the donor is not sufficient; adequate and full consideration is that which replenishes, or augments, the donor's taxable estate.
>
> Wemyss had a companion case, Merrill v. Fahs, 324 U.S. 308 (1945), which was also a gift tax case. Merrill and its predecessors likewise involved situations where A transferred property to B, A's fiancé or spouse, in exchange for B's relinquishment of marital rights in A's remaining property. Both Wemyss and Merrill have come to stand for the general proposition that "adequate and full consideration in money or money's worth" for gift tax purposes is that which replenishes, or augments, the donor's taxable estate. See Steinberg v. Commissioner, 141 T.C. 258, 266 (2013) (noting that under the estate depletion theory, a donor receives consideration in money or money's worth only to the extent that the donor's estate has been replenished), citing Wemyss, at 307-08, and Randolph E. Paul, Federal Estate and Gift Taxation, para. 16.14, at 1114-15 (1942).1 See also I.R.C. § 2043(b)(1) ("Transfers for Insufficient Consideration"). Thus, B's relinquishment of marital rights in A's property will have no effect on the includible value of that property in A's gross estate. Accordingly, the relinquishment of marital rights cannot replenish a donor's gross estate for estate tax purposes, and thus cannot constitute adequate and full consideration for gift tax purposes. See also Commissioner v. Bristol, 121 F.2d 129, 136 (1st Cir. 1941).
>
> It is important to keep in mind that in each of the above cases, the relinquishment of the marital rights in the donor's remaining assets did constitute valuable contractual consideration in the hands of the donor, and did benefit the donor. It enabled the donor to dispose of that property free of the spousal claims of the second marriage. See Merrill v. Fahs, 324 U.S. at 309. For instance, Bristol involved the waiver of spousal claims against a family business that the donor wished to bequeath to the children of his first marriage. Bristol, 121 F.2d at 131. Indeed, in each of these cases, it was the prospective husband's desire to dispose of his property as he chose that was the basis of the ante-nuptial agreement. This freedom did not constitute adequate and full consideration, however, because it did not augment the husband's taxable estate.
>
> Here, it cannot be disputed that Donor's liability on the promissory notes depleted Donor's taxable estate. However, in the context of a deathbed purchase of a remainder interest in transferred property in which a donor has retained a § 2036 "string," the receipt of the remainder does not increase the value of the donor's taxable estate, because the value of the entire property, including that of the remainder, will be includible in the donor's gross estate pursuant to § 2036(a)(1). Thus, Donor's receipt of the remainder interests cannot constitute adequate and full consideration within the meaning of § 2512(b). Commissioner v. Wemyss, 324 U.S., at 307-08. Cf. Rev. Rul. 98-8, 1998-1 C.B. 541 (reaching a similar conclusion for gift tax purposes in the context of §§ 2519 and 2044.) Accordingly, Donor has made a completed gift to the beneficiaries of Trust 1 in the amount of the value of the promissory notes transferred to Trust 1.

The CCA repeatedly notes the "deathbed" nature of the transaction. It is unclear if an earlier purchase would have mattered, if at such time the entire GRAT would have been included in the grantor's estate.

When the section 7520 rate is extremely low, a very long-term GRAT will require extremely low annuity payments to zero-out. For example, a 99 year term GRAT when the 7520 rate is 0.6% requires an annuity of 1.342568% to zero-out. If the 7520 rate thereafter increases to 3% (the April 2019 rate) only 44.75239% of the GRAT assets would be included in the grantor/annuitant's estate. Suppose a GRAT were terminated at such time by the doctrine of merger; the "replenishment" standard suggested by Wemyss would seem to be satisfied.

3. Grandfathered Buy-Sell Status Unaffected By Changes and Recapitalization. In PLR 202014006 the issue was whether various transactions would terminate the grandfathered status under section 2703 of a buy-sell agreement in effect on October 8, 1990. Various transfers of shares to trusts were discussed and two corporate changes described as follows:

> Ruling #2
>
> On Date 7, a date after October 8, 1990, Company amended the Articles to change its name to the current name. On Date 8, Company amended and restated the Articles. Also on Date 8, Company amended and restated the Bylaws that included administrative changes such as name change, indemnification, and number of members constituting the Board of Directors.
>
> Based upon the facts submitted and representations made, we conclude that none of the amendments to the Articles on Date 7, the amendments and restatement of the Articles on Date 8, and the amendment and restatement of the Bylaws on Date 8 constitute substantial modifications of any right or restriction in the Articles, the Bylaws, or the Agreement within the meaning of § 25.2703-1(c). Consequently, we conclude that the Articles, the Bylaws, and the Agreement continue to be grandfathered for purposes of chapter 14.
>
> Ruling #3
>
> The proposed Plan of Recapitalization includes a stock split of one share of Company common stock into one share of Class A voting common stock and x shares of Class B nonvoting common stock. The Articles and Agreement will be amended to reflect the stock split and the addition of Class B nonvoting common stock to the capital structure. The issuance of the Class B nonvoting common stock does not change the terms and conditions to which the shareholders are already subject. In addition, the beneficial interest in the Company will not be affected by the stock split because each shareholder of common stock will receive x shares of Class B nonvoting common stock for every share of common stock held prior to the recapitalization. Accordingly, we conclude that the recapitalization does not affect the quality, value, or timing of any rights of the parties to the Agreement.
>
> Based upon the facts submitted and representations made, we conclude that the proposed Plan of Recapitalization, the proposed amendments to the Articles and Agreement to reflect the stock split and the addition of Class B nonvoting common stock to the capital structure, and the issuance of Class B nonvoting common stock, will not constitute substantial modifications of the Agreement or the Articles within the meaning of § 25.2703-1(c). Further, we conclude that the proposed Plan of Recapitalization and the proposed amendments, described above, will not cause § 2703 to apply to transfers of shares of Company stock subject to the Agreement, as amended.

The ruling was one of a series. See also PLR 202015004, one of a series; and PLR 202017012.

R. SECTION 6166 — EXTENSION OF TIME TO PAY TAX

S. TAX ADMINISTRATION

1. **Priority Guidance Plan**. 2020-2021 (November 17, 2020).

PART 1. IMPLEMENTATION OF TAX CUTS AND JOBS ACT (TCJA)

4. Regulations clarifying the deductibility of certain expenses described in §67(b) and (e) that are incurred by estates and non-grantor trusts. Notice 2018-61 was published on July 30, 2018 and proposed regulations were published on May 11, 2020.

* * *

PART 3. BURDEN REDUCTION

4. Regulations under §§ 1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. Proposed and temporary regulations were published on March 4, 2016.

* * * *

18. Final regulations under § 2642(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption.

PART 6. GENERAL GUIDANCE

* * *

EMPLOYEE BENEFITS

A. Retirement Benefits

3. Guidance implementing changes made by the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), Division O of the Further Consolidated Appropriations Act, 2020, Pub. L. No. 116-94 (133 Stat. 2534) and section 104 of Division M of the Further Consolidated Appropriations Act, 2020, known as the Bipartisan American Miners Act of 2019 (Miners Act).

- PUBLISHED 08/24/20 in IRB 2020-35 as NOT. 2020-62 (RELEASED 08/06/20).
- PUBLISHED 08/31/20 in IRB 2020-36 as NOT. 2020-60 (RELEASED 08/13/20).
- PUBLISHED 09/14/20 in IRB 2020-38 as REV. PROC. 2020-40 (RELEASED 09/02/20).
- PUBLISHED 09/14/20 in IRB 2020-38 as NOT. 2020-68 (RELEASED 09/02/20).

* * *

6. Regulations under § 401(a)(9) updating life expectancy and distribution tables for purposes of the required minimum distribution rules and addressing certain other issues under section 401(a)(9). Note: Proposed Regulations Issued November 8, 2019.

7. Regulations relating to SECURE Act modifications to certain rules governing §401(k) plans.

* * *

EXEMPT ORGANIZATIONS

2. Guidance on circumstances under which an LLC can qualify for recognition under §501(c)(3).

* * *

4. Final regulations on §509(a)(3) supporting organizations. Proposed regulations were published on February 19, 2016.

5. Guidance under §4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.

6. Regulations regarding the excise taxes on donor advised funds and fund management.

* * *

GIFTS AND ESTATES AND TRUSTS

1. Guidance on basis of grantor trust assets at death under § 1014.

2. Guidance on user fee for estate tax closing letters under §2001.

3. Final regulations under § 2032(a) regarding imposition of restrictions on estate assets during the six month alternate valuation period. Proposed regulations were published on November 18, 2011.

4. Regulations under § 2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against the estate.

5. Regulations under § 7520 regarding the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests.

INSURANCE COMPANIES AND PRODUCTS

1. Final regulations under § 72 on the exchange of property for an annuity contract. Proposed regulations were published on October 18, 2006.

2. **No Ruling Positions**. In Rev. Proc. 2021-3 the IRS provided issues on which it will not rule. Among those are:

> (38) Section 170.—Charitable. Etc., Contributions and Gifts.—Whether a charitable contribution deduction under § 170 is allowed for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 170(c).
>
> (39) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsement on the note.
>
> (81) Sections 507, 664, 4941, and 4945.—Termination of Private Foundation Status; Charitable Remainder Trusts; Taxes on Self-Dealing; Taxes on Taxable Expenditures.—Issues pertaining to the tax consequences of the termination of a charitable remainder trust (as defined in § 664) before the end of the trust term as defined in the trust's governing instrument in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets.
>
> (87) Section 641. —Imposition of Tax. —Whether the period of administration or settlement of an estate or a trust (other than a trust described in §664) is reasonable or unduly prolonged.
>
> (88) Section 642(c). —Deduction for Amounts Paid or Permanently Set Aside for a Charitable Purpose. —Allowance of an unlimited deduction for amounts set aside by a trust or estate for charitable purposes when there is a possibility that the corpus of the trust or estate may be invaded.
>
> (89) Section 643(f).—Treatment of multiple trusts.—Whether two or more trusts shall be treated as one trust for purposes of subchapter J of chapter 1.
>
> (90) Section 664. —Charitable Remainder Trusts. —Whether the settlement of a charitable remainder trust upon the termination of the noncharitable interest is made within a reasonable period of time.
>
> (92) Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a trust when (i) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (iv) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.
>
> (97) Section 1001.—Determination of Amount of and Recognition of Gain or Loss.—Whether the termination of a charitable remainder trust before the end of the trust term as defined in the trust's governing instrument, in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust

assets, is treated as a sale or other disposition by the beneficiaries of their interests in the trust.

(111) Section 2055.—Transfers for Public, Charitable, and Religious Uses.—Whether a charitable contribution deduction under § 2055 is allowed for the transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2055(a).

(113) Section 2522.—Charitable and Similar Gifts.—Whether a charitable contribution deduction under § 2522 is allowable for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2522(a).

(114) Section 2601.—Tax Imposed.— Whether a trust exempt from generation-skipping transfer (GST) tax under § 26.260l — l(b)(1), (2), or (3) of the Generation-Skipping Transfer Tax Regulations will retain its GST exempt status when there is a modification of a trust, change in the administration of a trust, or a distribution from a trust in a factual scenario that is similar to a factual scenario set forth in one or more of the examples contained in § 26.2601-1 (b)(4)(i)(E).

(122) Section 4941.—Taxes on Self- Dealing.—Whether transactions during the administration of an estate or trust meet the requirements of the exception to § 4941 set forth in § 53.4941(d)-1(b)(3) of the Private Foundation Excise Tax Regulations, in cases in which a disqualified person issues a promissory note in exchange for property of an estate or trust.

In addition, rulings will "not ordinarily" be issued on the issues below. "Not ordinarily" means that unique and compelling reasons must be demonstrated in order for a ruling to be issued.

(18) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property may deduct the fair market value of the property transferred and leased back as a charitable contribution.

(39) Section 664.—Charitable Remainder Trusts.—Whether a trust that will calculate the unitrust amount under § 664(d)(3) qualifies as a § 664 charitable remainder trust when a grantor, a trustee, a beneficiary, or a person related or subordinate to a grantor, a trustee, or a beneficiary can control the timing of the trust's receipt of trust income from a partnership or a deferred annuity contract to take advantage of the difference between trust income under § 643(b) and income for Federal income tax purposes for the benefit of the unitrust recipient.

(42) Section 678.—Person Other than Grantor Treated as Substantial Owner.—Whether a person will be treated as the owner of any portion of a trust over which that person has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner of the trust under § 671 if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041. if the trust purchases the property from that person with a note and the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(49) Sections 2035, 2036, 2037, 2038, and 2042.—Adjustments for Certain Gifts Made Within Three Years of Decedent's Death; Transfers with Retained Life

Estate; Transfers Taking Effect at Death; Revocable Transfers; Proceeds of Life Insurance.—Whether trust assets are includible in a trust beneficiary's gross estate under § 2035, 2036. 2037, 2038, or 2042 if the beneficiary sells property (including insurance policies) to the trust or dies within 3 years of selling such property to the trust, and (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(52) Section 2501.—Imposition of Tax.—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary will be treated as a gift for purposes of § 2501 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(53) Section 2503.—Taxable Gifts.— Whether the transfer of property to a trust will be a gift of a present interest in property when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(54) Section 2514.—Powers of Appointment.—If the beneficiaries of a trust permit a power of withdrawal to lapse, whether § 2514(e) will be applicable to each beneficiary in regard to the power when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(57) Section 2601.—Tax Imposed.— Whether a trust that is exempt from the application of the generation-skipping transfer tax because it was irrevocable on September 25, 1985, will lose its exempt status if the situs of the trust is changed from the United States to a situs outside of the United States.

(58) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether annuity interests are qualified annuity interests under § 2702 if the amount of the annuity payable annually is more than 50 percent of the initial net fair market value of the property transferred to the trust, or if the value of the

> remainder interest is less than 10 percent of the initial net fair market value of the property transferred to the trust. For purposes of the 10 percent test, the value of the remainder interest is the present value determined under § 7520 of the right to receive the trust corpus at the expiration of the term of the trust. The possibility that the grantor may die prior to the expiration of the specified term is not taken into account, nor is the value of any reversion retained by the grantor or the grantor's estate.
>
> (59) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether a trust with one term holder satisfies the requirements of § 2702(a)(3)(A) and § 25.2702-5(c) to be a qualified personal residence trust.
>
> (60) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary is subject to § 2702 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

Finally, rulings related to private trust companies, decanting, or the basis adjustment, if any, of assets owned by a grantor trust, will not be issued until the IRS resolves the issue through publication of a revenue ruling, revenue procedure, or regulations. In addition, ING trusts have been moved to the “to be resolved” list from the “no ruling” list; INGs are described like this:

> (9) Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a transfer in trust under §§ 673 to 677 that is purported to be an incomplete gift under § 2511, specifically including, but not limited to, a transfer to a trust providing for distributions at the direction of a committee to the donor and the committee members either by unanimous consent of the committee members or a majority of the committee members with the consent of the donor.
>
> * * *
>
> (17) Section 2511.—Transfers in General.—Whether a transfer in trust that is purported not to be considered owned by the grantor under § 671 is an incomplete gift, specifically including, but not limited to, a transfer to a trust providing for distributions at the direction of a committee to the donor and the committee members either by unanimous consent of the committee members or a majority of the committee members with the consent of the donor.

3. Alleged Failure to Advise About Basis. A complaint styled Raia v. Lowenstein Sandler has been filed in the Superior Court of New Jersey Law Division: Civil Part, Bergen County (BER-L-000921-19). The essence of the action is the supposed failure of counsel to advise clients that assets given to dynasty trusts retain carryover basis and potential particular problems that could result from depreciation recapture upon the trusts ceasing to be grantor trusts when the grantor died. Regardless of the merits – if any – of the action, it is a reminder for estate planners.

4. Where Estate Tax Paid In Full, Late Return Not Cause For Penalty. Skeba v. United States, 2020 WL 70962 (D. NJ. 2020) involved a situation where estate tax was overpaid but the actual estate tax return was not filed until June 30, 2015, past the extension date of September 10, 2014. The IRS asserted a penalty because the tax was paid eight days past the original due date but an extension of time to pay, until September 10, 2014, had also been granted. The opinion states:

> In the Court's view, the resolution of this matter hinges on an interpretation of a section of the IRS Code (26 C.F.R.§ 6651) called "Failure to file tax return or to pay tax." This provision has several sections, and each shall be addressed.
>
> Generally, § 6651 addresses the assessment of penalties for late filing of a return, and late payment of taxes due. More specifically, the penalty under § 6651(a)(1) addresses the failure to file a timely return:
>
>> In case of failure (1) to file any return on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate ....
>
> 26 U.S.C. § 6651(a)(1).
>
> On the other hand, the penalty for failure to timely pay the tax is set forth in § 6651(a)(2). This section reads:
>
>> In case of failure ... (2) to pay the amount shown as tax on any return specified in paragraph (1) on or before the date prescribed for payment of such tax (determined with regard to any extension of time for payment), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount shown as tax on such return 0.5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate ...
>
> § 6651(a)(2).
>
> The calculation of the penalty imposed for failure to timely file a return (subsection (a)(1)) and failure to timely pay the tax (subsection (a)(2)) is clarified in § 6651(b). It declares:
>
>> (b) Penalty imposed on net amount due. For purposes of--
>>
>>> (1) subsection (a)(1), the amount of tax required to be shown on the return shall be reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax and by the amount of any credit against the tax which may be claimed on the return,

> (2) subsection (a)(2), the amount of tax shown on the return shall, for purposes of computing the addition for any month, be reduced by the amount of any part of the tax which is paid on or before the beginning of such month and by the amount of any credit against the tax which may be claimed on the return[.]

§ 6651(b).

The parties disagree on how to construe these provisions. Plaintiff proffers two arguments in support of its position. First, Plaintiff argues that § 6651(a)(1) should be read together (*in pari materia*) with § 6651(b)(1). In reading these subsections together, Plaintiff concludes that the late filing penalty is calculated by using the formula set forth in subsection (a)(1), incorporating the "net amount due" on the "the date prescribed for payment" as set forth in subsection (b)(1). Since the estate tax was overpaid on March 18, 2014 and the extension ran until September 10, 2014, there was no net amount due on the September deadline; and hence, no penalty may be imposed.

Secondly, and in the alternative, Plaintiff argues that the phrase "such failure is due to reasonable cause not due to willful neglect" in subsection (a)(1) protects the taxpayer from a penalty if the return was filed late due to a reasonable cause.

The Government disagrees with the taxpayer's arguments. The Government proffers that the requirements of § 6651(a)(1) and (b) must be construed with another statute (26 U.S.C. § 6151) entitled "Time and place for paying taxes shown on returns." § 6151states: "[T]he date filed for payment of such tax shall be deemed a reference to the last day fixed for such payment (determined without regard to any extension of time for paying the tax)." More specifically, § 6151 reads in pertinent part:

> (a) General rule. Except as otherwise provided in this subchapter [26 USCS § 6151 *et seq.*] when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary, pay such tax to the internal revenue officer with whom the return is filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).
>
> * * *
>
> (c) Date fixed for payment of tax. In any case in which a tax is required to be paid on or before a certain date, or within a certain period, any reference in this title to the date fixed for payment of such tax shall be deemed a reference to the last day fixed for such payment (determined without regard to any extension of time for paying the tax).

Id. Based on § 6151, the Government cleverly reasons that the last day for payment was nine months after the death of Agnes **Skeba**—March 10, 2014; because no return was filed by that date a penalty may be assessed. Applying the rationale to the facts, the Government contends only $750,000 was paid on or before March 10, 2014, when $2,528,838 was due on that date. Referring back to § 6651(a)(1), a 25% penalty on the difference may therefore be assessed because it was not paid by March 10, 2014. As such, the full payment of the estate tax on March 18, 2014 is of no avail because the "last date fixed" was March 10, 2014. Accordingly, the Government argues that the imposition of a penalty in the amount of $450,959.00 is appropriate.

> The IRS's arguments miss the mark. First, both §§ 6651(a)(1) and (a)(2) designate the specific day on which penalties will be assessed for both late filing and payment of the estate tax return. Both paragraphs specify that the "date prescribed" is to "be determined with regard to any extension of time for filing." The language of the statute in dispute is the one which is given precedence over a more generic statute like § 6151. *See La Vallee Northside Civic Asso. v. V.I. Coastal Zone Mgmt. Com.*, 866 F.2d 616, 621 (3d Cir. 1989); *see also Meyers v. Heffernan*, No. 12-2434 (MLC), 2014 WL 3343803, at *8 (D.N.J. July 8, 2014).
>
> The Government puts forth a valid point that there is an administrative need to complete and close tax matters. Here, the Estate had nine months to file the return, the extension added six months, and Defendant unilaterally added another nine months to file the return. Although there was the timely payment of the estate taxes, the matter, in the Government's view, lingered and the administrative objective to timely close the file was not met. *See generally Boyle*, 469 U.S. at 251, 105 S.Ct. 687. There may be a need for some other penalty for failure to timely file a return, but Congress must enact same.

The opinion noted that the lawyer and CPA for the estate had been repeatedly assured that there would be no penalty, and then that the assessment was a mistake. The case shows the peril of relying on such assurances.

Rev. Rul. 81-237 appears to require always a minimum penalty of $100. There was no mention of that ruling in the opinion. The United States has appealed to the Third Circuit.

5. <u>Trustee of Revocable Trust Discharged From Personal Liability for Estate Tax</u>. The facts of <u>United States v. Paulson</u>, 2020 WL 1821022 (S.D. Cal. 2020), were simple:

> 6. On July 19, 2000, Mr. Allen E. Paulson died. (*Id.*)
>
> 7. Mr. Allen E. Paulson's Will was filed with the Probate Court. (*Id.*) Michael Paulson and Edward White were appointed and served as Co-Executors of the Estate until Edward White's resignation effective October 8, 2001. (*Id.*) Thereafter, Michael Paulson served as a court appointed Executor until January 15, 2013 and ceased performing those duties as part of the 2013 Settlement Agreement with the Co-Trustees. (*Id.*) The Court determined that because there was no executor appointed by the probate court after Michael Paulson's attempted resignation in 2013, Michael Paulson is still the statutory executor, but not personally liable for any estate tax in that capacity. (*Id.* at 3–4.)
>
> 8. At the time of Mr. Allen E. Paulson's death, the Living Trust held all of Mr. Allen E. Paulson's assets except for 100% of the shares in the Gold River Hotel & Casino Corporation (hereafter "Gold River shares"), which were valued at $0.[1] (*Id.* at 4.) The Living Trust's assets included real estate, stocks, bonds, cash, receivables and miscellaneous assets valued on the date of Mr. Allen E. Paulson's death at $193,434,344. (*Id.*) According to Form 706, the deductions[2] totaled $178,495,454. (*Id.*)
>
> 9. Following Mr. Allen E. Paulson's death, Michael Paulson and Edward White became co-trustees of the Living Trust until White's resignation effective October 8, 2001. (*Id.*)

> 10. On October 11, 2001, Nicholas V. Diaco, M.D. consented to act as co-trustee of the Living Trust with Michael Paulson. (*Id.*) Michael Paulson only served as trustee of the Living Trust until March 24, 2009, when he was removed. (*Id.*)
>
> 11. After an extension of time to file the return, on October 23, 2001, the IRS received the Estate's Form 706 Estate Tax Return. (*Id.* at 5.) The return was signed by Michael Paulson as Co-Executor. (*Id.*) The Estate paid $706,296 concurrently with its filing of the Estate Tax Return. (*Id.*) The Estate elected to defer the payment of the balance of its estate taxes under Section 6166 of the Internal Revenue Code over the next 15 years. (*Id.*) Although the original amount of estate tax shown due by the Estate Tax Return has been paid, the additional assessment of estate tax made by the IRS in 2006 remains unpaid. (*Id.*)
>
> 12. At the same time he filed the Estate Tax Return with the IRS, Michael Paulson filed a cover letter with the Return and also filed a letter dated October 19, 2001 requesting a discharge under 26 U.S.C. § 2204. (*Id.*)
>
> [emphasis added]

The issue was whether in the letter Paulson asked for discharge only as executor or as trustee too. The court found the request for discharge covered both:

> As Michael Paulson points out, in contrast to Plaintiff's arguments that none of the procedures were followed, the letter sent to the IRS tells a different story. First, the title of the letter is "Request for discharge of fiduciaries from personal liability." (Doc. No. 189-1 at 8.) The plural form of fiduciary may indicate that Michael Paulson sought to be discharged as a trustee and executor. Second, the letter enclosed (1) a copy of Federal Form 4768; (2) co-executor's Section 6166 election for deferral of federal estate tax; and (3) co-executor's request for discharge from personal liability pursuant to I.R.C. Section 2204. (Doc. No. 172 at 21.) As to the request for discharge, the letter is not specific as to whether Michael Paulson was requesting discharge under parts (a) or (b) or both of Section 2204. (*Id.*) Further, requesting the longer time frame of nine months was likely appropriate as it encompassed both the time frame to be discharged as a fiduciary and as an executor.
>
> 226 U.S.C. § 2204 does not specify how Michael Paulson was to sign the letter. Plaintiff produces no case law to support its position that the way in which Michael Paulson signed the letter only exhibits that he signed it only as an executor. Michael Paulson argues that he signed using the term "Co-Executor" as a way to identify Michael Paulson's title in a manner consistent with his title appearing on the federal estate tax return. (Doc. No. 189-1 at 11.) Currently, there is no authority that requires specific format, form or wording to make an application for discharge. *See United States v. Johnson*, 224 F. Supp. 3d 1220, 1237 (D. Utah 2016) ("*Johnson II*"), *reversed on other grounds United States v. Johnson*, 920 F.3d 639 (10th Cir. 2019). However, Plaintiff argues that Michael Paulson signed various documents in different capacities and sometimes would sign the same document multiple times in his differing capacities. (Doc. No. 191-1 at 19–21.) There is no such requirement, however, how to sign the letter nor is there a requirement that Michael Paulson was supposed to provide two letters to the IRS.

The court appeared offended that the IRS took 12 years to raise the issue:

> Further, the IRS never contacted Michael Paulson regarding any confusion over the letter. In fact, the IRS never responded to the letter. The IRS is "to notify the fiduciary (1) of the amount of such tax for which it has been determined the fiduciary is liable, or (2) that it has been determined that the fiduciary is not liable for any such tax." 26 U.S.C. § 2204. If there was any confusion, Plaintiff argues that the IRS should have alerted the fiduciary that he remained liable for the full amount of "any estate tax for which the fiduciary may be personally liable." The Court agrees. Plaintiff should not have waited twelve years to raise this issue in litigation.

6. Reminder That Private Postage Meter Yields To Official Post Office Time Stamp. In Thomas v. Commissioner, T.C. Memo. 2020-33, the taxpayer's Tax Court petition was required to be filed by March 5, 2018 (90 days after the issuance of the Notice of Deficiency). The opinion states:

> Petitioners assert that petitioner husband took the petition to the Fernley [Nevada] USPS office on March 5, 2018, and placed it in the mailbox before 5 p.m., the last mail pickup time at that office. The Fernley USPS office, however, postmarked the envelope on March 6, 2018. Respondent speculates that the USPS office may have already been closed by the time petitioner husband placed the petition in the mailbox, which may be why the envelope was postmarked the day after the alleged mailing date. Respondent also notes that had petitioner husband taken the petition to the Reno USPS office the envelope would have been postmarked on that same day because that office postmarks mail pieces until 11:59 p.m.
>
> We follow the guidelines the regulations provide us. In this instance the regulations instruct us that where the envelope containing the petition bears a legible USPS postmark, the postmark must bear a date on or before the last date prescribed for filing for it to be considered timely filed. See sec. 301.7502 - 1(c)(1)(iii)(A), Proced. & Admin. Regs. Accordingly, even if we were to credit petitioners' assertions that they timely deposited the petition in the mail, the petition is still considered not timely filed because the USPS postmark on the envelope does not bear a date on or before March 5, 2018. See id. Further, because petitioners mailed the petition using postage printed through a private postage meter with no request that a certified mail receipt be postmarked by a USPS employee, they are not entitled to any relief under section 301.7502-1(c)(2), Proced. & Admin. Regs. Accordingly, the Court lacks jurisdiction under sections 6213(a) and 7502 to redetermine the deficiency, and we are obliged to grant respondent's motion to dismiss.

The administrative regulation is clear:

> Section 301.7502-1(c)(1)(iii)(B)(3), Proced. & Admin. Regs., provides for situations in which a mailpiece has both a USPS postmark and a non-USPS mark. That section provides as follows:
>
> If the envelope has a postmark made by the U.S. Postal Service in addition to a postmark not so made, the postmark that was not made by the U.S. Postal Service is disregarded, and whether the envelope was mailed in accordance with this paragraph (c)(1)(iii)(B) will be determined solely by applying the rule of paragraph (c)(1)(iii)(A) of this section.

7. **Executor Personally Liable For Estate Tax**. In United States v. Kohls, ____________________ (S.D. Ohio 2020) the executor didn't pay the estate tax owed, transferred the estate assets, and closed the estate. At issue was the statute of limitations on the IRS. The opinion states:

> Corwin J. Kohls died testate on September 10, 2001. On September 12, 2001, Douglas M. Kohls, his son, opened an estate in the Common Pleas Court of Montgomery County, Ohio, Probate Division ("Probate Court") and was named the executor.
>
> ***
>
> The IRS audit of the 706 Return was completed and, on or about May 27, 2005, the executor signed a Form 890, Waiver of Restriction on Assessment and Collection of Deficiency and Acceptance of Overassessment - Estate Gift and Generation Skipping Transfer Tax ("Assessment Waiver"). In the Assessment Waiver, the executor consented to the immediate assessment and the collection of a $199,077 estate tax deficiency. On that same date, the executor also signed a Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation Skipping Transfer) -Taxes" ("Application for Extension"). Pursuant to 26 U.S.C. § 6161(b)(2). The IRS granted the Estate a one-year extension for payment so that the federal estate tax of $199,077, plus interest, was now due on or before May 27, 2006.
>
> Pursuant to 26 U.S.C. § 6203, on July 4, 2005, the IRS made an assessment against the Estate of the $199,077 estate tax deficiency. Doc. #7-2, PAGEID##49-50; Doc. #7-1, PAGEID#35.
>
> On August 12, 2005, and October 12, 2005, the Estate, through the executor, transferred two properties for no consideration. Specifically, on August 12, 2005, the Estate transferred property located at 8305-8311 Woodgrove Drive in Centerville, Ohio, ("Woodgrove Drive Property") to Defendant's sister, Cynthia L. Rogers. On October 12, 2005, property in the Estate located at 4627-4629 Far Hills Avenue, Kettering, Ohio, ("Far Hills Avenue Property") was transferred to Defendant individually. Using the date of death values and subtracting the mortgages, the net equity of the Woodgrove Drive Property was $53,439 and the net equity of the Far Hills Avenue Property was $571,001. Doc. #7-1, PAGE ID #37.
>
> On May 27, 2006, the executor signed a second Application for Extension seeking another one-year extension to pay the Estate's taxes. This extension was also granted and payment of the tax deficiency was extended until May 27, 2007.
>
> Although the federal tax deficiency was unpaid, the Estate was closed in February 2007. On May 27, 2007, the third and final Application for Extension was signed by the executor and granted by the IRS. As a result, payment of the Estate's tax and interest was due on May 27, 2008.
>
> As of May 8, 2018, the amount of the Estate's federal estate tax liabilities, "taking into account the assessments of taxes, penalties and interest, and all payments, credits, abatements, and accruals" totaled $322,875.43. Doc. #7-5, PAGEID#166.

The IRS had 13 years to sue, but starting when?

> In addition to the ten years to file suit, Defendant concedes that because of the three one-year extensions that were granted by the IRS in the Applications for Extension, Form 4768, 26 U.S.C. § 6161(b)(2) extends the ten-year statute of limitations for an additional three years. According to Defendant, because he signed the Assessment Waiver, also known as the Form 890, on May 27, 2005, the thirteen-year time period begins to run from this date. As such, the statute of limitations ran on May 27, 2018, and Defendant's Motion should be sustained. Doc. #8, PAGEID183.
>
> Alternatively, Defendant argues that the latest period of time to start the running of the ten-year statute of limitations under 26 U.S.C. § 6502 is the date when the IRS received the signed May 27, 2005, Assessment Waiver. Defendant asserts that the IRS's date of receipt of the Assessment Waiver was June 2, 2005. Based on this argument, Defendant asserts that under § 6502(d) and the three one-year extensions, the "alternate collection statute expiration date" is June 2, 2018, which is thirty days before the Complaint was filed. Doc. #8, PAGEID#183.
>
> In response to Defendant's statute of limitations defense, although Plaintiff agrees that it had 13 years to file its Complaint, it disputes that the May 27, 2005, Assessment Waiver is the starting point. Specifically, the United States argues that the "assessment" referred to in 26 U.S.C. § 6502 is not the Assessment Waiver Defendant signed on May 27, 2005. According to Plaintiff, "[A]n assessment is made 'by recording the liability of the taxpayer in the office of the Secretary in accordance with rules and regulations prescribed by the Secretary.'" 26 U.S.C. § 6203. *Laing v. United States*, 423 U.S. 161, 170 n.13 (1976) ("The assessment is essentially a bookkeeping notation that is made when the Secretary or his delegate establishes an account against the taxpayer on the tax rolls."). As such, Plaintiff argues that its Complaint was timely filed.
>
> The Court finds that Defendant's reliance on the Assessment Waiver, Form 890, as the "assessment" referred to in 26 U.S.C. § 6502 is misplaced. A "Form 890 is a waiver of restriction on assessment and collection of the deficiency. It is not an assessment." *Singleton v. C.I.R.*, 71 T.C.M. (CCH) 3127, *3, n. 3 (T.C. 1996).
>
>> An assessment is made by recording the liability of a taxpayer in the office of the Secretary in accordance with prescribed rules or regulations. Sec. 6203. The date of assessment is the date the summary record of assessment is signed by the assessment officer. Sec. 301.6203-1, Proced. & Admin.
>
> *Id*.

8. **Meaning of Tax Reimbursement Clause**. At issue in Karimipour v. Karimipour (In re Davidson Magnifying Glass Non-Exempt Trust, _______________ (Mich. Ct. App. 2021), was whether the tax reimbursement clause in a trust required the trustee to pay out the amount of the "unified credits" used. The opinion states:

> Under Article IV(4)(e) of the trust agreements, if Marla or Ethan "exercises a power of appointment and Transfer Taxes are imposed" as a result of the transfer of trust property, the trustees are required to pay those "Transfer Taxes as provided in the Paragraph entitled Payment of Taxes." In relevant part, Article X of the trust agreements provides the following:
>
>> 1. Payment of Taxes. Following any transfer of Trust Property which results in any Transfer Taxes to the beneficiary of any trust created under this trust

> instrument, the Trustee shall reimburse such beneficiary or distribute trust property to such beneficiary in accordance with the following:
>
> a. If so directed by the beneficiary or the Personal Representative of the beneficiary's estate, the Trustee shall pay from the remaining property held in a trust for the beneficiary, directly to the appropriate governmental authority, to the beneficiary or to the Personal Representative of the beneficiary's estate, as the Trustee deems advisable, without seeking reimbursement or recovery from any Person, the amount by which the Transfer Taxes payable in any jurisdiction by reason of the transfer are increased.
>
> * * *
>
> "Transfer Taxes" are defined in Article XVI of the trust agreements to "mean[] . . . any gift taxes, including taxes arising pursuant to , and any gift, transfer or other similar succession taxes imposed by any state resulting from a transfer subject to federal gift tax[.]" Although the definition of "Transfer Taxes" includes "any gift taxes," under Article X, paragraph (1)(a) of the trust agreements, the taxes must also be "payable."

Does gift taxes "payable" mean the total gift tax or the net, after the application of the donor's unified credit? The court held that payable means the amounts actually paid:

> The sums of money that were required to be paid—and that were actually paid—to the Internal Revenue Service ("IRS") by Marla and Ethan were their respective gift taxes, which were calculated after the application of the unified credits. Marla and Ethan did not actually pay a sum of money with respect to the unified credits because a unified credit is not a tax that must be paid to the IRS. See e.g., 26 USC 2505. Rather, as evidenced by the facts of this case, a unified credit is used to calculate the gift taxes that must be paid to the IRS, and the credits function to decrease the amount of money owed to the IRS. Accordingly, under the terms of the trust agreements, the amount of gift taxes payable means the amount of gift taxes calculated after the application of the unified credits. Consequently, because the use of the unified credits does not constitute payment of a gift tax, the trustees were not required to reimburse Marla and Ethan for the value of the unified credits.

Although unusual, the case is a good illustration generally of the importance of carefully drafted tax clauses. Who ought to benefit from unified credits/exemption/applicable exclusion is not obvious in every case.

9. <u>User Fee For Closing Letter</u>. On December 31, 2020 Treasury issued a proposed regulation allowing but requiring an estate to pay $67 to obtain an estate tax closing letter. REG-114615-16. In June, 2015 the IRS stopped issuing closing letters automatically, which had been the previous, long-time practice. Because closing letters were regularly issued, state revenue authorities, probate courts, and others were accustomed to receiving them as evidence that " almost certainly" — in colloquial language — the IRS exam of the estate was finished and the taxes paid. With the change the IRS proposed a new system that allowed an estate to request a closing letter or for the taxpayer estate to receive a transcript of the audit. The procedure never worked very well from the practitioner point of view and got much worse in the spring of 2020 during the pandemic. Interestingly, the stated rationale for the

change was the enormous increase in DSUE/portability returns; in 2016, 12,000 regular estate tax returns but 20,000 DSUE returns.

Payment of $67 to restore the former custom is an improvement (unless you are a taxpayer who thinks your taxes are already paying for a closing letter, described by the proposed regs as a "customer service convenience"). However, the IRS has not simply added the fee as an option on the Form 706 but rather has a different procedure in mind:

Guidance on the procedure for requesting an estate tax closing letter and paying the associated user fee is not provided in these proposed regulations. The Treasury Department and the IRS expect to implement a procedure that will improve convenience and reduce burden for authorized persons requesting estate tax closing letters by initiating a one-step, web-based procedure to accomplish the request of the estate tax closing letter as well as the payment of the user fee. As presently contemplated, a Federal payment website, such as http://www.pay.gov, will be used and multiple requests will not be necessary. The Treasury Department and the IRS believe implementing such a one-step procedure will reduce the current administrative burden on authorized persons in requesting estate tax closing letters and will limit the burden associated with the establishment of a user fee for providing such service.

The AICPA suggested payment with the 706 in a comment dated February 25, 2021, with a box to check on the 706 and until then the executor handwriting the request at the top of the return. One hopes such common sense practices are adopted.

T. MISCELLANEOUS

PART 4 – STATE DEVELOPMENTS

U. STATE DEVELOPMENTS

1. Choice of Law Between Filial Support Statutes. An adult son was in a Pennsylvania care facility and his parents were in New Jersey in the case of Melmark v. Schutt, 206 A. 3d 1096 (Pa. 2019). The essence of the issue was set forth by the court as follows:

> Melmark suggests Pennsylvania's filial-support law should be applied instead of New Jersey's, given the Commonwealth's interest in ensuring that facilities which care for indigent persons in Pennsylvania are able to look to designated family members to obtain compensation for the provision of essential services. Melmark indicates this interest is especially pronounced here because Alex's "wealthy parents" "knowingly abandon[ed]" their indigent son "in Pennsylvania with no form of support." Brief for Appellant at 25, 31. Further, Melmark proffers that all relevant events occurred in Pennsylvania and, as a Pennsylvania non-profit institution, Melmark was entitled to rely on Pennsylvania law when it provided care to Alex. Thus, Melmark argues, even if New Jersey law would otherwise give more protection to Parents than Pennsylvania's filial support statute for actions occurring in New Jersey, Pennsylvania has a stronger interest in the matter under the present facts.

Melmark also emphasizes that Parents could have moved Alex to a New Jersey facility, where NJ-DDD would have resumed paying for Alex's care and residence, or continued with their efforts to compel NJ-DDD to pay Melmark. Instead, Melmark argues, Parents took steps, including manipulating the legal systems of both states, to keep Alex in Pennsylvania. According to Melmark, Parents did this because they wanted Melmark to be Alex's lifelong home where he could live free of charge. Under this scenario, Melmark offers that Pennsylvania's policy favoring family-supplied compensation for the care of indigent persons should predominate. See *id*. at 30-42.

Parents counter that New Jersey has the basic responsibility for establishing and regulating the support obligations of its citizens. They suggest that the choice-of-law question should be viewed as solely involving the relationships among family members. See Brief for Appellees at 19-22 (citing *McSwain v. McSwain*, 420 Pa. 86, 215 A.2d 677 (1966) (where an automobile accident involving Pennsylvania citizens occurred in Colorado, applying Pennsylvania law generally precluding interspousal lawsuits, although the suit would have been permitted under Colorado law)). Employing traditional choice-of-law factors, such as which state has the most significant contacts or relation to the action and the protection of justified expectations, Parents emphasize that Parents and Alex were New Jersey citizens at all times and that Parents reasonably expected to be relieved of any obligation to support Alex inasmuch as he was no longer a minor and they were over 55 years old. By contrast, Parents characterize Pennsylvania's interest in this litigation as less weighty as it solely involves the ability of a private institution to be paid for services rendered.

Parents assert, as well, that requiring them to make support payments under Pennsylvania law, when New Jersey exempts its citizens over the age of 55 from such liability, would violate their equal protection rights. For support, they reference *Pennsylvania, Department of Public Assistance v. Mong*, 117 N.E.2d 32 (Ohio 1954), a dispute in which an indigent father living in Pennsylvania sought support from a son whom he had abandoned while the son was under 16 years old, and who was living in Ohio at the time of the litigation. Ohio's statute relieved the son of obligations toward his father due to the abandonment, whereas Pennsylvania's did not. The court applied Ohio law on the grounds that it would violate equal protection not to allow him to avail himself of Ohio's protections solely because the father was from Pennsylvania. Parents interpret Mong as indicating that the law of the state where the alleged obligor lives – here, New Jersey – should control. See Brief for Appellees at 26.

The court determined that Pennsylvania law should apply. The opinion states:

We do not deny that New Jersey has a substantial competing interest in fulfilling its policy of exempting parents over 55 years old from support obligations relative to their adult children. In relation to this specific dispute, however, the force of that interest is diminished for two reasons. First, NJ-DDD took steps to ensure that Parents would not have to pay for Alex's support, as it offered to place Alex in a New Jersey facility at public expense. New Jersey thus acted pursuant to its public policy, and that policy could have been effectuated had Parents accepted NJ-DDD's offer.

Second, and more important, the course of conduct in which Parents engaged would, by their admission, result in an unrelated private party (Melmark) bearing the cost of providing for their indigent son's care for the remainder of his life. In this respect, although New Jersey's welfare laws apparently provide for Alex's

> support at public expense, there is no reason to suppose that New Jersey has adopted a public policy favoring imposition of the ongoing cost of care for indigent adults on an *unwilling private third party*. By contrast, Pennsylvania plainly has a strong interest in ensuring that relatives do not leave their disabled family members at private Pennsylvania facilities in such a way that those facilities are forced to incur substantial uncompensated expenses on an indefinite basis – an interest which is reflected in 23 Pa.C.S. §4603. Under such a scenario, the exemption in New Jersey's statutory filial support law for parents over 55 years of age cannot justifiably override Pennsylvania's governing statute – at least for the period from April 1, 2012 to May 15, 2013 – so that the financial burden for Alex's care falls upon Melmark.
>
> In light of the foregoing, we conclude that Pennsylvania has the stronger interest in applying its law within the framework of this controversy. Accordingly, we will reverse the judgment of the Superior Court insofar as it directed to the contrary, and remand for application of Pennsylvania law as to Count III of the complaint.

2. Premarital Agreement A Fraudulent Transfer In Community Property State. In 2005, Robert Sturm got a judgment against Todd Moyer, who had no assets. Periodically, Strum investigated Moyer's assets. In 2014 Moyer married and signed a prenuptial agreement. The effect of the premarital agreement was at issue in Sturm v. Moyer, 32 Cal. App. 5th 299 (Ca. App. 2019). The opinion describes the agreement as follows:

> The premarital agreement provided that each party's earnings and income, and any property acquired during the marriage by each spouse, would be that spouse's separate property; each party acknowledged that these earnings, income, and property otherwise would be community property. The agreement attached as exhibits lists of each party's significant real and personal property and liabilities in which that party currently held an interest; Moyer's list (Exhibit A) included Sturm's judgment against him, as well as several liens and pending lawsuits. The agreement also included a kind of sunset provision (paragraph 5.15), which provided that in the event the judgments and liens against Moyer listed in Exhibit A, and any money judgment entered against him during marriage, lapse or otherwise become unenforceable for any reason, the parties' earnings and income, and any assets purchased with those earnings and income, from the date of the marriage will be treated as community property, with certain exceptions. Finally, the premarital agreement included a provision allowing the parties to open a jointly owned checking account to meet their reasonable present and future living expenses, but providing that any property acquired with funds from the account will be owned in the ratio of the respective contributions of each party's separate property into the account; it also expressly stated that the account will not create any community property interest.

The application of the Uniform Fraudulent Transfers Act (UFTA) was discussed as follows

> Having set forth the relevant statutory provisions, we consider whether the UFTA applies to premarital agreements (such as the one at issue here) that make each spouse's earnings, income, and other assets acquired during marriage that spouse's separate property. Resolution turns on two key questions. First, does such an agreement effect a "transfer" under the UFTA? Second, was the agreement intended to "hinder, delay, or defraud any creditor" of the debtor-spouse? The first question is one of law, and can be resolved in this appeal from a demurrer judgment. The second question is one of fact, which cannot be determined on a

demurrer or an appeal from a demurrer. We simply note that the complaint alleges sufficient facts to meet the requirement of fraudulent intent, but proof of those facts awaits trial.

Considering the first question, as noted, "transfer" under the UFTA has a broad meaning. It includes "every mode, direct or indirect, absolute or conditional, . . . of disposing of or parting with an asset or an interest in an asset." (Civ. Code, former § 3439.01, subd. (i); currently, Civ. Code, § 3439.01, subd. (m).) Under this definition, there is no doubt that an agreement made *during marriage* in which a debtor-spouse agrees that the non-debtor-spouse's future earnings, income, or assets would be the non-debtor-spouse's separate property constitutes a transfer because the debtor-spouse is parting with an interest in an asset — the community property represented by the other spouse's earnings — in which he or she has a "present [and] existing . . . interest[]" (Fam. Code, § 751) during continuance of the marriage. (See *State Bd. of Equalization v. Woo* (2000) 82 Cal.App.4th 481.)

But what if this same agreement is made in a premarital agreement? Because the parties are not married when the agreement is entered into, the debtor-spouse has no present and existing interest in the community property represented by the non-debtor-spouse's future earnings, income, and assets. Thus, it can be argued (as defendants do here) that no transfer takes place because, by the premarital agreement, the spouses altered the applicability of the community property laws such that neither spouse obtains any interest in community property upon marriage. On the other hand, it can be argued (as Sturm does here) that by law the premarital agreement does not become effective until marriage (Fam. Code, § 1613), at which point two things happen — each spouse obtains a present interest in community property by operation of law (Fam. Code, § 751) and then, by agreement, each spouse transfers to the other his or her community interest in the other's earnings, income, or other property acquired during the marriage.

***

It might be argued that applying the UFTA to a premarital agreement in which the parties agree that each party's earnings, income, and assets acquired during marriage would be that party's separate property would discourage marriage in cases, such as the present one, in which one of the parties has significant debts while the other party has substantial income. But the Legislature already has provided protection for the couple in such a case, by enacting Family Code section 911. As noted, under that statute, the non-debtor-spouse's earnings are sheltered from liability for the debtor-spouse's premarital debts, so long as those earnings are kept by the non-debtor-spouse in a separate account (to which the debtor-spouse does not have a right of withdrawal) and are not commingled with other property in the community estate. This provision demonstrates, not only an intent to protect the non-debtor-spouse's earnings, but also a policy judgment — an intent to prevent the debtor-spouse from taking advantage of that protection at the expense of his or her creditors by being allowed access to the protected funds.

3. **Child Support vs. Special Needs**. Alexander v. Harris, 2019 WL 2147281 (Fl. App. 2019) dealt with a fascinating policy issue. A father was the beneficiary of a special needs trust established when he was injured in a car accident. He owed about $92,000 in child support. The special needs trust received more monthly than the father's expenses and thus had accumulated about $142,000. Could the $92,000 be paid from the trust. The court held yes stating:

> The father argues that using the trust's funds to satisfy his support obligations would jeopardize his eligibility for public assistance under federal law; however, he cannot identify any legal basis for this conclusion. We can find no federal law or regulation expressly addressing the garnishment of a special needs trust to satisfy a support obligation. To the extent that 42 U.S.C. § 1396p discusses support payments and eligibility, subsection (c)(2)(B)(iii) states that "[a]n individual shall not be ineligible for medical assistance by reason of paragraph (1) to the extent that . . . the assets . . . were transferred to . . . the individual's child." Furthermore, federal law gives great deference to state courts in family law proceedings, and the Supreme Court has explained that "[s]tate family and family-property law must do 'major damage' to 'clear and substantial' federal interests before the Supremacy Clause will demand that state law be overridden." *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 581 (1979) (quoting *United States v. Yazell*, 382 U.S. 341, 352 (1966)). In *Rose v. Rose*, 481 U.S. 619, 630 (1987), the Supreme Court recognized that payment of child support is in the parent's best interest, explaining that federal "benefits are not provided to support [the beneficiary] alone." There is no indication in the federal statutes that Congress has expressed any intention to preempt state statutes, like section 736.0503, that permit garnishment of spendthrift trusts to satisfy the child support obligations of the beneficiary. Id. at 628 ("Given the traditional authority of state courts over the issue of child support, their unparalleled familiarity with local economic factors affecting divorced parents and children, and their experience in applying state statutes . . . that do contain detailed support guidelines and established procedures for allocating resources following divorce, we conclude that Congress would surely have been more explicit had it intended the Administrator's apportionment power to displace a state court's power to enforce an order of child support.").
>
> Resolution of this case requires consideration of the equities between these particular parties and resolution of competing public policies related to the enforceability of spendthrift provisions and the payment of support.
>
> > On the one hand, there is the long held policy of this state that recognizes the validity of spendthrift trusts. On the other hand, there is the even longer held policy of this state that requires a former spouse or a parent to pay alimony or child support in accordance with court orders.
>
> *Bacardi*, 463 So. 2d at 221. Where the two conflict, this court has held that Florida's public policy favoring enforcement of support orders takes precedence. *Berlinger*, 133 - 6 - So. 3d at 966 ("Florida has a public policy favoring spendthrift provisions in trusts and protecting a beneficiary's trust income; however it gives way to Florida's strong public policy favoring enforcement of alimony and support orders."). Thus, although the trial court correctly recognized the compelling equitable interests of the parties in this case, we must nevertheless reverse. The special needs trust does not protect the father from his legal obligation to support his child. A continuing writ of garnishment is appropriate in this case, and the court may limit the award to such relief as is appropriate under the circumstances. *See* § 736.0503(3).

4. **<u>Suicide a Breach of Marital Settlement</u>**. Timothy Woytas was divorced and agreed to maintain certain life insurance policies payable to his former wife and children. The policies contained a two year suicide exclusion. Mr. Woytas committed suicide within two years. The court held that he breached his settlement agreement. Because of the dollars involved, the remedy was to award all of the estate assets to the former spouse and children. <u>Woytas v. Greenwood Tree Experts, Inc.</u>, 206 A.3d 386 (N.J. 2019).

5. Meaning of Charitable Beneficiary Being in Existence at Death. In Sibley v. Estate of Sibley, 2019 WL 1461325 (Fla. App. 3d, 2019), a trust provided as follows:

> All remaining trust estate to the Settlor's charitable foundation, the CURTISS F. SIBLEY CHARITABLE FOUNDATION. If the [Foundation] **is no longer in existence upon the Settlor's death**, then the Trustee shall distribute all of the remaining trust estate to the FELLOWSHIP HOUSE FOUNDATION of South Miami, Florida.

(Emphasis added)

At the decedent's death, the Sibling Charitable Foundation had been administratively dissolved. Of course, as the court notes, an administration dissolution can be easily corrected. What effect does that have? The opinion states:

> Additionally, Charles contends that because the Foundation was reinstated ten months after it was administratively dissolved (and seven months after Curtiss' death), the trial court erred in not relating back the reinstatement to the date of the administrative dissolution, thereby treating the Foundation as if it had never been administratively dissolved. Charles relies for this proposition on section 607.1422, Florida Statutes (2011), which provides in pertinent part:
>
>> (1) A corporation administratively dissolved under s. 607.1421 may apply to the Department of State for reinstatement at any time after the effective date of dissolution. The corporation must submit a reinstatement form prescribed and furnished by the Department of State or a current uniform business report signed by the registered agent and an officer or director and all fees then owed by the corporation, computed at the rate provided by law at the time the corporation applies for reinstatement.
>>
>> (2) If the Department of State determines that the application contains the information required by subsection (1) and that the information is correct, it shall reinstate the corporation.
>>
>> (3) When the reinstatement is effective, it relates back to and takes effect as of the effective date of the administrative dissolution and the corporation resumes carrying on its business as if the administrative dissolution had never occurred.
>
> (Emphasis added.)
>
> However, we hold that this statutory provision does not apply to the issue presented here: a determination of whether, at a fixed point in time (the date of Curtiss' death), the Foundation "was no longer in existence" as instructed by the Trust's time-certain testamentary provision.
>
> Were we to apply the relation-back provision of section 607.1422 to the instant circumstance, as urged by Charles, the administration of an estate might never achieve finality, because an administratively dissolved beneficiary might (at some unknown point in the future) be reinstated and seek application of the relation-back provision to establish its nunc pro tunc existence. As Fellowship House aptly noted in its brief: "To assume the ability to perpetually reinstate the Foundation

> by [Charles] (or anyone else for that matter) after the death of Curtiss renders meaningless the testamentary instruction, as the Foundation could, quite possibly, always be in existence as long [as] someone prospectively filed the necessary annual reports and paid the delinquent fees."

6. **South Dakota Refuses To Enforce California Child Support Order**. In Matter Cleopatra Cameron Gift Trust, Dated May 26, 1998, 931 N.W.2d 244 (SD. 2019), the South Dakota Supreme Court held that a California order directing a trustee to pay child support for a beneficiary's children was not entitled to full faith and credit in South Dakota because it was a method of enforcement only. The opinion states:

> The Full Faith and Credit Clause of the United States Constitution provides that, "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State." U.S. Const. art. IV, § 1. The command to afford the judgments of foreign states full faith and credit is further codified at 28 U.S.C. § 1738 (2013), which provides that authenticated records and judicial proceedings "shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State[.]"
>
> The United States Supreme Court has recognized that providing full faith and credit to the judgments of foreign states serves the salutary purpose of limiting the opportunity to relitigate issues that have been resolved previously through the judicial process. *Riley v. New York Trust Co.*, 315 U.S. 343, 348-49, 62 S. Ct. 608, 612, 86 L. Ed. 885 (1942). As a result, the Full Faith and Credit Clause "alter[s] the status of the several states as independent foreign sovereignties, each free to ignore obligations created under the laws or by the judicial proceedings of the others, and ... make[s] them integral parts of a single nation." *V.L. v. E.L.*, —— U.S. ——, 136 S. Ct. 1017, 1020, 194 L. Ed. 2d 92 (2016) (per curiam) (quoting *Milwaukee County v. M.E. White Co.*, 296 U.S. 268, 277, 56 S. Ct. 229, 234, 80 L. Ed. 220 (1935)); *see also Wooster v. Wooster*, 399 N.W.2d 330, 334 (S.D. 1987) (recognizing that valid foreign judgments are given effect in the interests of comity).
>
> Generally, if the judgment was "rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment, [it] qualifies for recognition throughout the land." *Id.* Furthermore, "[a] State may not disregard the judgment of a sister State because it disagrees with the reasoning underlying the judgment or deems it to be wrong on the merits." *Id.*; *see also Milliken v. Meyer*, 311 U.S. 457, 462, 61 S. Ct. 339, 342, 85 L. Ed. 278 (1940) ("[T]he full faith and credit clause of the Constitution precludes any inquiry into the merits of the cause of action, the logic or consistency of the decision, or the validity of the legal principles on which the judgment is based.").
>
> There are, however, certain limitations upon the requirements of the Full Faith and Credit Clause. Providing full faith and credit to a foreign state's judgment "does not mean that States must adopt the practices of other States regarding the time, manner, and mechanisms for enforcing judgments. Enforcement measures do not travel with the sister state judgment as preclusive effects do; such measures remain subject to the evenhanded control of forum law." *Baker by Thomas v. Gen. Motors Corp.*, 522 U.S. 222, 235, 118 S. Ct. 657, 665, 139 L. Ed. 2d 580 (1998); *see also* Restatement (Second) of Conflict of Laws § 99 (1971) ("The local law of the forum determines the methods by which a judgment of another state is enforced."). " 'Evenhanded' means only that the state executes a sister state

judgment in the same way that it would execute judgments in the forum court." *Adar v. Smith*, 639 F.3d 146, 159 (5th Cir. 2011).

Justice Scalia, in his concurring opinion in *Baker*, noted that the power of the Full Faith and Credit Clause is to make the judgment of "one State[ ] conclusive evidence in the courts of another State[.]" 522 U.S. at 242, 118 S. Ct. at 668 (Scalia, J. concurring) (quoting *Wisconsin v. Pelican Ins. Co.*, 127 U.S. 265, 291-92, 8 S. Ct. 1370, 1375, 32 L. Ed. 239 (1888)). Yet despite the preclusive power of one state's judgment, it "can only be executed in [the forum state] as its laws may permit." *Id.* (quoting *Lynde v. Lynde*, 181 U.S. 183, 187, 21 S. Ct. 555, 556, 45 L. Ed. 810 (1901)); *see also Adar*, 639 F.3d at 161 (holding there was no violation of the Full Faith and Credit Clause where a Louisiana registrar recognized the validity of a New York adoption decree, but only allowed one unmarried parent's name on the Louisiana birth certificate because under Louisiana law, only married couples could jointly adopt).

Here, an examination of the statute upon which the family court relied to order direct Trust payments to Christopher reveals it to be a conspicuous method of enforcing a support obligation where an obligor is the beneficiary of a trust protected by a spendthrift provision:

(c) Whether or not the beneficiary has the right under the trust to compel the trustee to pay income or principal or both to or for the benefit of the beneficiary, the court may, to the extent that the court determines it is equitable and reasonable under the circumstances of the particular case, *order the trustee to satisfy all or part of the support judgment* out of all or part of future payments that the trustee, pursuant to the exercise of the trustee's discretion, determines to make to or for the benefit of the beneficiary.

(d) This section applies to a support judgment notwithstanding any provision in the trust instrument.

Cal. Prob. Code § 15305 (emphasis added.)

It is equally clear that the *Ventura County* court also perceived Cal. Prob. Code § 15305 to be an enforcement provision. The *Ventura County* court broadened the enforcement authority of California trial courts to order direct trust payments, notwithstanding a spendthrift provision, upon a finding the trustee acted in bad faith by not authorizing a distribution. The court described Cal. Prob. Code § 15305 as a means of enforcing the support order, observing, "A spendthrift provision 'is not effective to exempt the trust from *enforcement of a judgment for support of a minor child* ....' " *Ventura Cty.*, 11 Cal. Rptr. 3d at 495 (emphasis added) (quoting Cal. Prob. Code § 15305, cmt.).

Viewed in this context, the family court's order compelling the direct payment of child support from the Trust was an unmistakable means of enforcing Cleopatra's obligation. Christopher's counsel acknowledged at oral argument that the direct payment order was, in truth, an enforcement method. In our view, the trustee was not the child support obligor and was only nominally joined in the divorce action to enforce Cleopatra's obligation. Because the means of enforcing judgments does not implicate full faith and credit considerations, the circuit court here was not required to submit to the California order compelling direct payments from the Trust if this method of self-executing enforcement is not authorized by South Dakota law. Based upon a review of our relevant statutes, it is not authorized and is, in fact, expressly prohibited.

> Our Legislature has placed formidable barriers between creditor claims and trust funds protected by a spendthrift provision. *See* SDCL 55-1-41 ("If the trust contains a spendthrift provision, no creditor may reach present or future mandatory distributions from the trust at the trust level."); SDCL 55-1-35 ("No trustee is liable to any creditor for paying the expenses of a spendthrift trust."). More to the point, the Legislature has emphatically rejected even the specter of an argument that would allow a child support creditor to reach trust funds protected by a spendthrift provision. Indeed, this precise legal theory is identified in § 59 of the Restatement (Third) Trusts (2003) which states that "[t]he interest of a beneficiary in a valid spendthrift trust can be reached in satisfaction of an enforceable claim against the beneficiary for ... support of a child ...." However, the Legislature anticipated such an argument in South Dakota courts and definitively foreclosed it with its 2007 enactment of SDCL 55-1-25 which provides in part:
>
> In the area of creditor rights, the Restatement of Trusts (Third) and the Uniform Trust Code create many new positions of law as well as adopts many minority positions of law. The provisions of §§ 55-1-24 to 55-1-43, inclusive, affirmatively reject many of these positions. *Therefore, the Legislature does not intend the courts to consult the Restatement (Third) of the Law of Trusts ... § 59 ... with respect to subject matters addressed by the provisions of §§ 55-1-24 to 55-1-43, inclusive.*
>
> (Emphasis added); *see also Richardson v. Richardson*, 2017 S.D. 92, ¶ 16, 906 N.W.2d 369, 374 (stating that courts "must be mindful of the Legislature's public policy determinations ....").

The trust had been subject to various courts in California during the divorce of a beneficiary, Cleopatra. Cleopatra was at that time a co-trustee with a corporate fiduciary. Ultimately Cleopatra changed situs to South Dakota, with positive results (assuming she didn't want to pay continuing child support).

7. Failure to Discuss Basis Planning. Stevenson v. Stanyer, 2019 WL 2895378 (Wa. Ct. App., Div.3)(unreported).

Income tax basis planning is increasingly a part of estate planning and became the subject of a malpractice claim in Spokane, Washington. Many years ago, Dr. and Mrs. Richard Stevenson transferred a lake house in Idaho into a trust to avoid estate tax on the property. Dr. Stevenson died in 1989 and the trust worked as intended with the property remaining in the trust for Mrs. Stevenson's benefit until her death in 2016. Mrs. Stevenson's children decided to sell the lake house and learned they would owe capital gains taxes whereupon Mrs. Stevenson's son, as executor, sued the lawyer who had updated Mrs. Stevenson's will, power of attorney, and health care directive some six months before she died. The opinion states that the "essence of the complaint" was that the lawyer should have advised Mrs. Stevenson to have entered into an agreement with the trust beneficiaries to dissolve the trust, take the lake house into her personal name, and receive increased basis, none of which would cause any estate tax to be owed because of the increased estate exemption. The damages were $159,000 in capital gains taxes.

The lawyer defended on the grounds that he was not asked to do any tax work on behalf of the beneficiaries. The decedent's son remembered his mother's "clear intention" that her death not result in a taxable event to her estate

or her beneficiaries but the court found that there was no evidence such intent was ever expressed to the lawyer. The opinion notes that "[t]here is simply no indication that her desire to avoid tax consequences for the children was ever communicated to Mr. Stanyer. Similarly, the e-mail communications between Stanyer and Stevenson, offered into the record by both parties, do not mention the issue of tax advice." The court concluded that it "is difficult to see how any general duty to provide tax advice for her estate would encompass tax advice for the beneficiaries of the trust she controlled."

Many lawyers make more expansive claims for the sort of advice we are providing to a client, and in many instances actually represent both the parents and children or at least some of the children. Arguably the successful defense made by the lawyer here would be more difficult in such instances.

8. **Trust Protector As Fiduciary With A Duty To Whom?** Ron v. Ron, __________________ (S.D. Tx. 2020), deals with the alleged dissipation of assets in connection with a divorce. Directly pertinent to estate planners is a question addressed by the court regarding a trust protector in a children's trust, the recipient of some of the alleged dissipation. The relevant language of the children's trust was:

> The Trust states: "The purpose of a Trust Protector is to direct my1 Trustee in certain matters concerning the trust, and to assist, if needed, in achieving my objectives as expressed by the other provisions of my estate plan hereunder." Id. at 17. The Trust explicitly empowers the Trust Protector to carry out several duties. Relevant here, the Trust provides:
>
> > The Trust Protector may add as a beneficiary of any trust established hereunder (i) any descendant of my husband's parents; (ii) any spouse or surviving spouse of any such descendant (other than me); and (iii) any charity, subject to any limitations the Trust Protector determine appropriate. The Trust Protector may also remove any beneficiary who was added under this subsection.

The wife was upset because the trust protector added husband as a beneficiary of a trust she had created (to which husband had transferred assets). Wife, Suzanne, claimed the trust protector, Stein, had a fiduciary duty to her. The court held that neither the trust nor Texas law created such a fiduciary relationship:

> In my view, nothing in Section 4.01 of the Trust creates a fiduciary relationship between Stein and Suzanne. If anything, the provision strongly suggests that the fiduciary relationship is between Stein and the Trustee—who Stein is to "direct" and "assist"—or perhaps, between Stein and the Trust—which contains Suzanne's memorialized objectives. *Id*. The mere fact that Section 4.01 references Suzanne's objectives means nothing when the Trust explicitly states that "[a]ll provisions of this agreement are to be construed to accomplish these objectives." *Id*. at 10. Given this reality, literally every provision in the Trust is expressly intended to achieve Suzanne's objectives. Surely, this does not mean that every individual implicated by a given provision has entered a fiduciary relationship with Suzanne.

***

> Though not argued by the parties, I also considered the provision of the Texas Trust Code that mentions trust protectors and their fiduciary duty. Section 114.0031(a)(1) of the Texas Trust Code states: "'Advisor' includes protector." TEX. PROP. CODE § 114.0031(a)(1). Section 114.0031(e) then provides:
>
> If the terms of a trust give a person the authority to direct, consent to, or disapprove a trustee's actual or proposed investment decisions, distribution decisions, or other decisions, the person is an advisor. An advisor is a fiduciary regardless of trust terms to the contrary except that the trust terms may provide that an advisor acts in a nonfiduciary capacity if:
>
>> (1) the advisor's only power is to remove and appoint trustees, advisors, trust committee members, or other protectors; and
>>
>> (2) the advisor does not exercise that power to appoint the advisor's self to a position described by Subdivision.
>
> *See* TEX. PROP. CODE § 114.0031(e). This seems to be the only provision in the Texas Trust Code that discusses the fiduciary duty owed by a trust protector. Notably, the section discusses the trust protector in his role as advisor to the trustee. This suggests that the fiduciary relationship is between Stein (Trust Protector) and Avi (Trustee)— again, or perhaps, between Stein (Trust Protector) and the Trust itself. In other words, Texas law does not create a formal fiduciary relationship between Stein and Suzanne.

9. Restrictions On Marriage. Parents do not always approve of a child's choice of spouse. Such was the case in In re Estate of Connolly, 2019 WL 1643856 (Va. Cir. Ct. April 16, 2019) where:

> Mr. Connolly, predeceased by Mrs. Connolly, executed his Last Will and Testament on September 29, 1998 ("the Will"), Mr. Connolly owned and resided in a house located in Alexandria and devised this house to his daughter Susan "for as long as she desires to live there" and further provided:
>
>> Upon [Susan's] death or upon her cessation of living on the premises or any time she chooses to sell the house, the house shall be sold and the net proceeds of such sale shall be divided equally among my surviving children, except that the share which I bequeath to my son, Kevin Brian Connolly, shall not be distributed to him if he is married to the same person he is married to on the date of the execution of this will. Said share shall be divided equally among my surviving children.

The court had no trouble ascertaining the intent of the provision:

> The language of the Will conclusively shows Mr. Connolly's intent for Kevin to divorce Francine. First, Mr. Connolly clearly refers to Francine when he writes: "if [Kevin] is married to the same person he is married to on the date of the execution of this will" because Kevin was married to Francine at the time Mr. Connolly signed the Will and the evidence presented showed that Mr. Connolly was aware of their marriage at this time. Second, "no longer married" clearly expresses his intent for them to divorce. Further, the depositions of Kevin and Father Donahue, the family's priest, show that Mr. Connolly adamantly opposed Kevin's marriage to Francine because he did not attend their wedding and repeatedly expressed his contempt for Francine after they married. Therefore,

> under the facts of this case, I find that Mr. Connolly, through his Will, explicitly encouraged Kevin to divorce his wife.

Accordingly, the provision was invalid:

> While there is no Virginia common law addressing the validity of will provisions that encourage divorce, there exists strong precedent against wills containing absolute prohibitions of marriage. *See, e.g.*, *Meek v.* Fox, 88 S.E. 161, 163 (Va. 1916) ("It has, by numerous decisions of this court, been held that any contract or provision in general or total restraint of marriage is against the policy of the laws of this state, and this view, it appears, has been uniformly taken wherever the question has arisen."); *Maddox v. Maddox*, 52 Va. (11 Gratt.) 804, 807 (1854) ("[N]ot only should all positive prohibitions of marriage be rendered nugatory, but all unjust and improper restrictions upon it should be removed, and all undue influences in determining the choice of the parties should be carefully suppressed."). Further, Virginia courts have long held that provisions in contracts that encourage divorce are prohibited as against public policy. *See, e.g.*, *Capps v. Capps*, 216 Va. 378 (1975); *Shelton v. Stewart*, 193 Va. 162 (1951). Courts in other states have also deemed that absent a testator's intent to protect the beneficiary, a provision in a will encouraging divorce violates public policy. *See, e.g.*, *Hall v. Eaton*, 259 Ill. App. 3d 319 (4th Dist. 1994). Taking the next logical step, this Court finds that a stipulation in a will that encourages a devisee to divorce his or her spouse, absent an intent to financially protect the devisee, is as loathsome as an absolute prohibition on marriage and therefore violates public policy.

In Rotert v. Stiles, 159 N.E.3d 46 (In. App. 2020), mom left the share to her son, Roger Rotert, outright if he were unmarried at her death, but in trust if her were married. He was married. The court held that the provision was void as a condition restraining marriage.

Interestingly, the opinion suggests another formulation might have altered the result. Suppose mom's share for Rotert went in trust but distributions would only be made to him when he was unmarried. Perhaps that would be a limitation, not a condition. The opinion notes:

> However, Indiana's jurisprudence has distinguished a "condition" restraining marriage from a "limitation" of a bequest or devise on the basis of the recipient's marriage status. *Id.* at 777. In *Hibbits v. Jack*, 97 Ind. 570, 577 (Ind. 1884), our supreme court held that a devise of land to the testator's wife "so long as she shall remain my widow" did not contain a condition in restraint of marriage, but rather a mere limitation. Prior to arriving at this conclusion, the court discussed the differences between conditions in restraint of marriage, which are void, and mere limitations, which are not void:
>
>> The only general rule, perhaps, in determining whether words are words of condition or of limitation, is that, where they circumscribe the continuance of the estate, and mark the period which is to determine it, they are words of limitation; when they render the estate liable to be defeated, in case the event expressed should arise before the determination of the estate, they are words of condition.
>
> Id. at 575.

> In *Summit*, 9 N.E. at 583-84, the supreme court concluded that a devise in which the husband willed to his wife "all [his] estate, both real and personal, as long as she remain[ed] [his] widow," involved words of limitation, not words of condition which would have been treated as a void restraint of marriage. In arriving at this conclusion, the court considered the following:
>
>> Words of limitation mark the period which is to determine the estate; but words of condition render the estate liable to be defeated in the intermediate time, if the event expressed in the condition arises before the determination of the estate, or completion of the period described by the limitation. The one specifies the utmost time of continuance, and the other makes some event, which, if it takes place in the course of that time, will defeat the estate.
>
> *Id*. at 583. In reliance on *Hibbits* and Summit, the court held in *Thompson v. Patten*, 70 Ind.App. 490, 123 N.E. 705, 705-06 (1919), that, the provision, stating with respect to a devise of land to the testator's wife "to be and remain her absolute property as long as she remains my widow," was a limitation, not a condition in restraint of marriage.
>
> Subsequently, in *Stauffer v. Kessler*, 81 Ind.App. 436, 130 N.E. 651, 652 (1921), the court again addressed the validity of a provision which stated that the defendant was to receive "real estate for and during the term of natural life; provided, however, that if the said [defendant], who is now a widower, shall marry, then such marriage shall terminate this estate." Although the court found the provision was valid upon the apparent basis that the condition was contained in a deed of conveyance rather than in a will, all parties in the case conceded that the relevant provision was a condition rather than a limitation. *Id*. at 652.

The dissent would have gone the other way because either son was married, or not, when mom died, so the Will provision could not have restrained his behavior:

> By the very terms of that devise, any action Rotert might take with regard to his marriage after the opening of the estate would be inconsequential to the form of his inheritance. Thus, the provision cannot be said to encourage or discourage any behavior from Rotert in a manner that could violate public policy regarding marriage. *See* Restatement (Second) of Property, Don. Trans. § 6.1 (1983) (Oct. 2020 Update) ("A devise conditioned on the devisee being unmarried at the time of the testator's death is not an illegal restraint on marriage."). *And cf. Estate of Owen*, 855 N.E.2d at 611-12 (invalidating as condition encouraging divorce a perpetual rental restriction conditioned on daughter not being married to her husband at whatever time in the future that she wished to rent). I, therefore, cannot agree with the Majority that this Trust provision "simply cannot be interpreted as anything other than an encouragement for Rotert to divorce his wife of almost twenty years upon the opening of the estate ...."

10. **<u>Former Beneficiary Has Standing To Challenge a Revocable Trust Under California Law</u>**. If amendments to a revocable trust made shortly before the settlor dies disinherit a beneficiary, does that individual, as one who is not named in the trust's final iteration, have standing to challenge the validity of the disinheriting amendments in probate court on grounds such as incompetence, undue influence, or fraud? That was the question before the court in <u>Barefoot v. Jennings</u>,456 P.3d 447 (Ca. 2020). The California appellate court had concluded that only a currently named beneficiary could petition a court regarding the existence or "internal affairs" of a trust but the Supreme Court disagreed:

> Our review concerns whether plaintiff has standing to assert the invalidity of the Trust amendments that left her without an interest in her mother's trust estate. In concluding that plaintiff does not have standing to challenge the amendments to the Trust, the Court of Appeal suggested that plaintiff relied exclusively on section 17200, subdivision (a), which provides: "Except as provided in Section 15800, a trustee or beneficiary of a trust may petition the court under this chapter concerning the internal affairs of the trust or to determine the existence of the trust." Section 15800 generally provides that so long as the trust remains revocable (that is, as long as the settlor is alive) and the settlor is competent, the settlor, "and not the beneficiary, has the rights afforded beneficiaries under this division." (*Id*., subd. (a); see *Estate of Giraldin*, *supra*, 55 Cal.4th at p. 1066, 150 Cal.Rptr.3d 205, 290 P.3d 199.) Here, the settlor (Maynord) has died, so section 15800 is no longer relevant.
>
> ***
>
> The applicable Probate Code provisions support plaintiff's standing to challenge the merits of the Trust amendments on the grounds of incompetence, undue influence, or fraud. Section 17200, subdivision (a), authorizes a beneficiary to petition the court concerning the trust's affairs "or to determine [its] existence." Section 17200, subdivision (b)(3) contemplates the court's determination of "the validity of a trust provision." Plainly, the term "trust provision" incorporates any amendments to a trust. Section 24, subdivision (c) defines a "beneficiary" for trust purposes, as "a person who has any present or future interest, vested or contingent." Assuming plaintiff's allegations are true, she has a present or future interest, making her a beneficiary permitted to petition the probate court under section 17200.
>
> ***
>
> Reading the Probate Code section consistent with the statutory scheme as a whole, and examining the statutory language to give it commonsense meaning, we conclude that claims that trust provisions or amendments are the product of incompetence, undue influence, or fraud, as is alleged here, should be decided by the probate court, if the invalidity of those provisions or amendments would render the challenger a beneficiary of the trust. (See *Coalition of Concerned Communities, Inc. v. City of Los Angeles* (2004) 34 Cal.4th 733, 737, 21 Cal.Rptr.3d 676, 101 P.3d 563 [courts should not examine statutory language in isolation].) So when a plaintiff claims to be a rightful beneficiary of a trust if challenged amendments are deemed invalid, she has standing to petition the probate court under section 17200.
>
> Defendants argue that interpreting section 17200 to permit purported beneficiaries to challenge a trust or its amendments would "invite chaos" because it would permit individuals with no present interest in the trust to "meddle" with its administration. We think defendants overstate the matter. Our holding does not allow individuals with no interest in a trust to bring a claim against the trust. Instead, we permit those whose well-pleaded allegations show that they have an interest in a trust — because the amendments purporting to disinherit them are invalid — to petition the probate court.

11. **<u>Charitable Trust Beneficiary Standing</u>**. The Maine version of the Uniform Trust Code grants standing to a charitable beneficiary that is a "qualified beneficiary." A charity is a designated beneficiary if it is "expressly designated to receive distributions" under the trust and, on the relevant date is a distributee or permissible

distributee of income or principal. At issue in Attorney General v. Sanford, 225 A.3d 1026 (Me. 2020), was whether this permissive language made the charity "expressly designated":

> All or any part of the net income and principal may be paid for the charitable purposes of 1) providing educational and scientific study of ant[iq]ue automobiles, whether owned by the trust or any other charitable organization, and other methods of transportation, 2) providing for the display to the public of antique automobiles, whether owned by the trust or any other charitable organization, and 3) maintaining in suitable condition for public display and study any antique automobiles owned by the trust or any other charitable organization.
>
> In furtherance of the foregoing purposes the Trustee may, without limitation, sell such automobiles as he from time to time deems necessary or advisable, whether to provide a suitable endowment to maintain the Collection or to permit the continued display of antique automobiles by Seal Cove Auto Museum or by any other museum[;] ... loan all or any part of the Collection to museums, including without limitation Seal Cove Auto Museum, or other charitable organizations ... for public display or study; permit access to the Collection for educational purposes by scholars or students; and generally do all such acts as may be necessary or appropriate to educate the public with respect to antique automobiles and to make the Collection available for public viewing.

Holding that "expressly designated" does not mean "mandatory," the opinion states:

> We now consider whether Seal Cove is "expressly designated to receive distributions under the terms of" the Trust. *Id.* § 110(1). In particular, we must determine whether a charitable organization satisfies this requirement by showing that it is expressly *permitted* to receive distributions from the trust or whether a charitable organization must show that it is expressly *mandated* to receive distributions from the trust. Because the Declaration of Trust expressly authorizes the Trustees to make distributions to Seal Cove, but does not require them to do so, the resolution of this appeal turns on the meaning of the word "designated."
>
> In statutory interpretation, we first examine "the plain meaning of the statutory language in the context of the whole statutory scheme." *Sunshine v. Brett*, 2014 ME 146, ¶ 13, 106 A.3d 1123. "Only if the statutory language is ambiguous—that is, reasonably susceptible to more than one interpretation—will we consider other indicia of legislative intent." *Id.*
>
> The meaning of 18-B M.R.S. § 110(1) is established when it is compared to section 103(12), which articulates the definition of a qualified beneficiary of a private trust. Title 18-B M.R.S. § 103(12) states:
>
>> "Qualified beneficiary" means a living beneficiary who on the date the beneficiary's qualification is being determined:
>>
>> **A.** Is a distributee or permissible distributee of trust income or principal;
>>
>> **B.** Would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in paragraph A

terminated on that date, but the termination of those interests would not cause the trust to terminate; or

C. Would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

Title 18-B M.R.S. § 110(1) similarly provides:

A charitable organization expressly designated to receive distributions under the terms of a charitable trust has the rights of a qualified beneficiary under this Code if the charitable organization, on the date the charitable organization's qualification is being determined:

A. Is a distributee or permissible distributee of trust income or principal;

B. Would be a distributee or a permissible distributee of trust income or principal upon the termination of the interests of other distributees or permissible distributees then receiving or eligible to receive distributions; or

C. Would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

The Legislature's use of nearly identical language in sections 103(12)(A)-(C) and 110(1)(A)-(C) demonstrates its intent that a charitable organization may assert the rights of a qualified beneficiary only if it has a beneficial interest in a charitable trust *equal* to that of a qualified beneficiary of a private trust. *Cf. Great N. Nekoosa Corp. v. State Tax Assessor*, 675 A.2d 963, 967-68 (Me. 1996)(Clifford, J., dissenting) (citing *Sullivan v. Stroop*, 496 U.S. 478, 484, 110 S.Ct. 2499, 110 L.Ed.2d 438 (1990)) ("Identical words in different parts of the same statute are presumed to have the same meaning." (emphasis omitted)). Thus, a charitable organization does not need to show that the terms of the trust make it a mandatory distributee in order to satisfy the "expressly designated" requirement.

Our reading of section 110(1) comports with the canon of statutory interpretation that "[w]ords in a statute ... be given meaning and not treated as meaningless and superfluous." *Wong v. Hawk*, 2012 ME 125, ¶ 8, 55 A.3d 425. Reading the word "designated" as "mandated" would eviscerate the phrase "or permissible distributee" as it is used in section 110(1)(A) because a charitable organization that is expressly mandated to receive distributions under the terms of the trust would not be a "permissible distributee," but simply a "distributee." We will not interpret a statute in such a way as to render some words meaningless. *See id.*

The Commentary to the UTC suggests the opposite result but the court expressly ignored it:

The Trustees argue that Uniform Trust Code commentary to section 110 supports their interpretation of the word "designated." That commentary states that to have the rights of a qualified beneficiary, a charitable organization "must be named in the terms of the trust and must be designated to receive distributions," and therefore "excluded are organizations who may receive distributions only in the trustee's discretion ...." 18-B M.R.S.A. § 110 Unif. Trust Code cmt. (2012). The Trustees argue that this shows that the word "designated" must be read to mean "mandated."

> This argument fails because the plain language of section 110(1), as adopted by the Legislature, unambiguously provides a different directive. The language used by the Legislature gives Seal Cove the rights of a qualified beneficiary. The commentary to the UTC is not part of the statute and cannot create an ambiguity where none exists. *See* Sunshine, 2014 ME 146, ¶ 13, 106 A.3d 1123.

In Hadassah v. Melcer, 268 So.3d 759 (Fl. App. 2019), the court found that Hadassah was a qualified beneficiary where the trust provided:

> The trust was created in 1989 by Sylvia Gelt. The trust instrument provided that upon her death, a portion of the trust fund was to be placed in a Credit Shelter Trust for her husband, Samuel. Upon his death, the balance of the Credit Shelter Trust was to be divided into three separate trusts for the benefit of their daughters.
>
> During their lifetimes, the daughters have the right to receive income and principal distributions from their respective trusts. They do not have general or testamentary powers of appointment over any portion of the principal or undistributed income of their respective trusts.
>
> The trust instrument provides that upon the death of each daughter, her trust terminates and the balance of the principal and any undistributed income is redistributed to the trust(s) of the remaining living daughter(s). When the last daughter dies, the trust terminates and the trustee is instructed to distribute the remaining principal and undistributed income to three named charities.

12. Trustee Liable For Delay In Distributing Trust Proceeds Under South Carolina Law. In Deborah Dereede Living Trust dated December 18, 2013 v. Karp, 831 S.E.2d 435 (SC. App. 2019), the court held "as soon as practicable" meant just that. The clause in question provided:

> As soon as practicable following my death, my Trustee shall sell the house and lot located at 131 WHISPERING PINES DR., LAKE WYLIE, SC 29710. The sales proceeds shall be used first to pay off any mortgage against the property, and second to pay off that certain promissory note given by me to TYRE DEALER NETWORK CONSULTANTS, INC. Said promissory note, at the time of the execution of my Trust, is in the amount of $250,000.00, but in no event shall the amount due exceed one-half of the sales price of the property. After payoff of said mortgage and said note, my Trustee shall then distribute one-half of the remaining net sales proceeds to HUGH DEREEDE, outright and free of trust. The other one-half of the remaining net sales proceeds shall be distributed in accordance with the Articles that follow.

So the house sold but the executor and trustee wanted to wait until the creditor's claims period expired because under South Carolina assets in a revocable trust could be reached by probate creditors. The court held no:

> We agree with the trial court that the trust's directive that Karp sell the house "as soon as practicable" and distribute the proceeds to Tyre and Hugh did not permit Karp to wait until she could ascertain the liquidity of the estate and the extent of any creditors' claims. Such a delay is common and often required in the probate of a person's estate, but as Medlin [beneficiary's expert] testified, the unique trust provision here required expedited distribution to Tyre and Hugh. Medlin acknowledged Karp's position was understandable and not one of bad faith, for §

> 62-3-505(a)(3) makes revocable trust assets subject to probate claims if the probate estate is insufficient to pay its creditors. But, as Medlin emphasized, Karp risked no personal liability by following Deborah's intent to expedite distribution***343** of the house sale proceeds, as the Trust Code insulated her and allowed creditors to follow the money and recover against the distributee. *See* S.C. Code Ann. § 62-7-604(b) (Supp. 2018). Medlin also noted in his affidavit that a personal representative or trustee is only liable to non-beneficiaries if they are personally at fault. *See* S.C. Code Ann. § 62-3-808 (Supp. 2018); S.C. Code Ann. § 62-7-1010(b) (Supp. 2018); *see also* S.C. Code Ann. § 62-7-1002 (Supp. 2018) (stating trustee only liable to beneficiaries for breach of fiduciary duty). He also testified the trust provision at issue was an expression of Deborah's intent that the distributions to Tyre and Hugh be given priority and expedited.

13. **Declaratory Judgment Action Does Not Trigger No Contest Clause**. At issue in Hunter v. Hunter, 838 S.E.2d 721 (Va. 2020), was whether Chip, a beneficiary of a trust known as Theresa's Trust, triggered a no contest clause by filing an action questioning the inform and report provisions of the trust. Eleanor, the trustee, argued yes. The complaint that Chip filed had two counts the court described as follows:

> Chip filed this declaratory judgment action, seeking a favorable interpretation of the trust that would require Eleanor to provide Chip with information and documents related to the trust. Aware of the no-contest provision in the Theresa Trust, Chip divided his declaratory judgment complaint into two carefully worded counts. Count II acknowledged the ultimate goal of the litigation by asserting that Chip sought the "determination of the rights of Chip and Eleanor" under the terms of the Theresa Trust to require the trustee to inform and report under Code § 64.2-775, other various provisions of the Virginia Uniform Trust Code, or stand-alone principles of common law and equity jurisprudence. The rationale behind Count II, as Chip explained to the circuit court in a subsequent brief, was that he interpreted the language of the inform-and-report waiver provision to only apply to the duty to inform and report under former Code § 55-548.13 and to have no effect on what he interpreted as freestanding inform-and-report duties arising under other sources of law. *See* R. at 177-85. Based upon prior communications with Eleanor's counsel, Chip understood Eleanor's position to be that the waiver provision relieved her of any and all inform-and-report duties.
>
> The complaint expressly sought to create a firewall protecting Count I from any uninvited, premature consideration of Count II. Prior to the complaint's allusion to the competing interpretations of the inform-and-report waiver provision, Count I requested that the circuit court "initially determine" whether determining Chip's and Eleanor's rights and duties under the trust "would constitute a 'contest' " under the no-contest provision, thereby triggering the forfeiture of Chip's beneficial interest in the trust. J.A. at 3. Count I stated that the court should consider the request in Count II "if, and only if," the court interpreted the no-contest provision to be inapplicable. *Id.* Relying on our decision in *Virginia Foundation of Independent Colleges v. Goodrich*, 246 Va. 435, 436 S.E.2d 418 (1993), the complaint insisted that it sought "no further relief than that which has been held by the Virginia Supreme Court ... to permit a beneficiary to file a declaratory judgment action seeking an interpretation ... without such conduct being held to fall within the scope of a no contest clause and/or actuating a no contest clause." J.A. at 3. In Count I, Chip contended that he "merely [sought] an interpretation of the language of the Trusts with respect to the rights and duties of Chip and Eleanor," and thus, Count II did not trigger the application of the no-contest clause. *Id.* at 11.

The no contest clause and the reasoning of the lower court, the opinion summarized this way:

> The circuit court held that Count II of the complaint had triggered the no-contest provision and, on this basis, ordered the forfeiture of Chip's interest in the Theresa Trust. Even if it were true that Count II had violated the no-contest provision, the court erred by disregarding the if-and-only-if proviso of Count I and ordering a forfeiture based upon Count II. Instead, in such a scenario, the circuit court should have entered judgment on Count I in Eleanor's favor and dismissed Count II as moot.
>
> That said, we do not accept the first premise of the circuit court's reasoning that Count II violated the no-contest provision. Whether such a violation has occurred "depends upon the wording of the 'no contest' provision and the facts and circumstances of each particular case." *Womble*, 198 Va. at 529, 95 S.E.2d 213; *see also Goodrich*, 246 Va. at 439, 436 S.E.2d 418. In the first paragraph of the self-styled "IN TERROREM PROVISION" of the trust, Theresa provided background context explaining her intent:
>
>> I have from time to time made gifts and provided financial support to each of my children and to my grandchild as I wished, and as my husband and I determined to be necessary to their circumstances. Except as otherwise expressly set forth in this document, the share for any beneficiary hereunder shall not be affected by any gifts or loans to any beneficiary hereunder.
>
> J.A. at 254. The next paragraph of the no-contest provision begins: "I desire that my children and grandchild not expend resources *disputing loans, gifts or bequests that I have made*." *Id.* (emphasis added). Theresa then sought to enforce that desire by declaring:
>
>> Therefore, if any beneficiary under this Trust Agreement takes any one or more actions described in this paragraph, then the interest of such beneficiary under this Trust Agreement shall be revoked, and such beneficiary shall be deemed to have predeceased me without surviving descendants for all purposes under this Trust Agreement, effective as of the date such action is taken.
>
> *Id.* One of the "actions" triggering the forfeiture was "[c]ontest[ing] any provision of this Trust Agreement." *Id.*
>
> The no-contest provision provided a specific definition for a prohibited "contest" of the trust: "For purposes of this Article, a person shall be deemed to contest an instrument or action, if he or she takes any action seeking to invalidate, nullify, set aside, render unenforceable, or otherwise avoid the effect of such instrument, action or transaction." *Id.* at 255. A caveat, however, followed this definition:
>
>> The preceding paragraph shall take effect regardless of whether such contest is made in good faith or is ultimately successful, provided, however that a petition made in good faith and not objected to by my Trustee hereunder, seeking an interpretation of this or any other instrument, shall not be considered a contest of such instrument.
>
> *Id.*

> Focusing on the sentence defining "contest," Chip asserts that Count II never sought to "invalidate, nullify, set aside, render unenforceable, or otherwise avoid" any provision of the Theresa Trust. *Id.* Nor did he violate his mother's "desire" that no beneficiary should "expend resources disputing loans, gifts or bequests" that she had previously made. *Id.* at 254. Instead, when properly construed, Count II merely sought an interpretation of the trustee's inform-and-report duties under other sources of law that would be wholly unaffected by the waiver provision. The circuit court disagreed with Chip and ordered the forfeiture of his interest in the trust. We believe the court erred in doing so.

Eleanor, the trustee, argued that the no contest cause was triggered because she did not agree to the petition. The court flatly rejected that argument stating:

> Eleanor acknowledges this general rule but argues that the no-contest provision in the Theresa Trust required forfeiture even if Chip sought only a judicial interpretation of its provisions. Skipping over the sentence defining "contest," Eleanor lays emphasis on the proviso that follows. That proviso, broken out below for clarity, purports to recognize an exception to the no-contest provision:
>
> - *provided*, however that a petition
>   - made in *good faith* and
>   - *not objected to by my Trustee* hereunder,
>   - seeking an *interpretation* of this or any other instrument,
> - shall not be considered a contest of such instrument.
>
> *See* J.A. at 255 (emphases added). Eleanor argues that this proviso extends the no-contest provision to a beneficiary's good faith petition for a judicial interpretation of the trust if she, as trustee, objects to the request. To her, the meaning of the provision is quite clear: A request for a judicial interpretation of the trust constitutes a contest triggering forfeiture so long as she says so. We have several concerns about this argument.
>
> To begin, we have never addressed (much less approved) a no-contest provision seeking to seal the courthouse doors to a litigant seeking an interpretation (rather than an invalidation) of a trust or will provision. Several courts have criticized such an effort as an impermissible overreach inconsistent with the traditional boundaries of no-contest provisions. Leading commentators have taken a similar view.[11] We need not resolve that question in this case, however, because the proviso Eleanor relies upon merely implies, but does not expressly state, that her mother intended to include a request for judicial interpretation within the definition of a contest, thus warranting a forfeiture. In this area of legal draftsmanship, mere implications will not suffice.
>
> As we noted earlier, forfeiture provisions are "strictly construed," *Rafalko*, 290 Va. at 395, 777 S.E.2d 870, because "equity abhors forfeitures," *Jones*, 101 U.S. at 628, and because "provisions that require forfeiture are not favored in the law and will not be enforced except according to their clear terms," *Rafalko*, 290 Va. at 402, 777 S.E.2d 870. To be effective, the provision must "precisely express" an intent to cause a forfeiture. *Keener*, 278 Va. at 443, 682 S.E.2d 545. "The instrument must give the right of forfeiture in terms so clear and explicit as to

> leave no room for any other construction." *Davis*, 205 Va. at 169, 135 S.E.2d 812. These canons of construction have great weight in the context of a no-contest provision in a trust instrument since a trust's very identity as a creature of equity presupposes the possibility of oversight of the trustee by a chancellor jealous of safeguarding the rights of all parties with an interest in the trust.
>
> Strictly construed, the proviso in the no-contest provision of the Theresa Trust does not equate a request for an *interpretation* of the trust's provisions with a *contest* of the trust. Instead, the no-contest provision enumerates the actions constituting a "contest" as "any action seeking to invalidate, nullify, set aside, render unenforceable, or otherwise avoid the effect of such instrument, action or transaction." J.A. at 255. These verbs — invalidate, nullify, set aside, render unenforceable, and avoid the effect of — are not synonyms for interpret.
>
> The proviso purports to remove an action (a request for judicial interpretation) from a list in which the action never appeared in the first place. The proviso states that Eleanor, as trustee, can agree that a request for an interpretation is not a contest. The proviso thus assumes that a request for an interpretation has already been defined as a "contest" by the no-contest clause — thus creating the need for a proviso that excises "interpretation" from that definition in certain circumstances. By doing so, the proviso makes a tautological assertion "in which the point to be proved is implicitly taken for granted," Black's Law Dictionary 189 (11th ed. 2019), a classic example of begging the question. One does not need an exception to a rule to do something the rule does not prohibit.
>
> For these reasons, the principles of strict construction dictate that neither the definition of "contest" nor the proviso's attempted exception from that definition clearly and unmistakably states that either count of Chip's declaratory judgment action violates the no-contest provision by seeking an interpretation of the trust and, based thereon, a declaration of the trustee's duties. The circuit court erred in concluding otherwise.

14. Settlement Agreement Among Trust Beneficiaries Void. Roth v. Jelley, 45 Cal.App.5th 655 (Ca.App. 2020), involved a settlement among some, but, crucially, not all of the trust beneficiaries. The opinion reviews the factual background:

> Petitioner Mark Roth (Mark) petitioned the probate court to be recognized as the beneficiary of a trust created by his grandfather pursuant to the default distribution provision of his grandfather' will. The probate court rejected the petition on the ground that an order made in the probate of the grandfather's estate in 1991 (which we refer to as the "1991 Decree") eliminated Mark's interest in the trust and was binding on him, even though he received no notice of the court proceeding that resulted in the 1991 Decree. This appeal presents the question whether Mark had a property interest in the testamentary trust created by his grandfather such that he had a due process right to notice and an opportunity to be heard before the probate court could enter the 1991 Decree that eliminated his interest in the trust.
>
> Mark's grandfather, McKie Roth Sr. (McKie Sr.) created a trust in his will for the benefit of his wife Yvonne Roth (Yvonne) during her life and granted her a testamentary power of appointment over the remainder. The will provided a default distribution scheme in case Yvonne did not exercise her appointment power, under which McKie Sr.'s three adult children from a prior marriage and the Yvonne's one adult son from a prior marriage would each take a one-quarter share of the remainder of the trust, with the proviso that, if an adult child did not

> survive Yvonne, then that child's surviving issue would take that child's share per stirpes. Thus, under the will, the issue of each of the four adult children had a contingent remainder interest in the trust, subject to divestment by Yvonne's exercise of her appointment power.
>
> When McKie Sr. died in 1988, his three adult children raised claims against their father McKie Sr.'s estate unrelated to the trust; they eventually settled their claims with McKie Sr.'s estate, Yvonne (his surviving wife), and the estate executor. One of the terms of the settlement was that the McKie Sr.'s three adult children disclaimed any interest in the trust.
>
> In 1991, the probate court issued a decree of final distribution of the McKie Sr.'s estate—the 1991 Decree—which included language changing the default distribution of the trust upon Yvonne's death, ostensibly based on the terms of the settlement. The 1991 Decree specified that the remainder of the trust was to be distributed solely to Yvonne's son or his surviving issue in case of default (i.e., failure of Yvonne to exercise her testamentary power of appointment). But McKie Sr.'s grandchildren (specifically, Mark and the other then-living issue of McKie Sr.'s three adult children) were not given prior notice of the 1991 decree, even though the decree *eliminated* their contingent interests in the remainder of the trust. Yvonne died in 2016 without having exercised her testamentary power of appointment.
>
> Mark's father McKie Roth Jr. (McKie Jr.) predeceased Yvonne. Mark petitioned the probate court to be recognized as a beneficiary of the trust pursuant to the default distribution provision of McKie Sr.'s will. He asserted the 1991 Decree was void because he never received notice of the proceeding that culminated in the 1991 decree.
>
> At the parties' agreement, the probate court decided the following dispositive issue in a bifurcated proceeding: was the 1991 Decree binding on the parties? The court determined the 1991 Decree was binding even though Mark received no prior notice because, in the court's view, Mark had no cognizable property interest in the trust.
>
> We conclude, however, that Mark did have a property interest in the trust in 1991 and that the 1991 Decree adversely affected his interest. Since it is not contested that Mark's existence and address were reasonably ascertainable at the time, due process required that Mark be given notice of the proceeding that resulted in the 1991 Decree and an opportunity to object. Because Mark was not given such notice, the 1991 Decree is void. Accordingly, we reverse.

[emphasis in original]

Why did the probate court believe Mark was not required to receive notice? Because Mark would not take unless at least two contingencies were met. The Court of Appeals summarizes Mark's interest as follows:

> Mark's property interest in the FYR Trust was contingent, not vested, because Mark would only take a share of the remainder if certain conditions precedent occurred: McKie Jr. had to predecease Yvonne ("not be then living" upon Yvonne's death) and Mark had to survive McKie Jr. ("leave issue surviving them"). Further, there had to be some balance left in the trust at its termination and Yvonne had to refrain from using her testamentary power of appointment.

> Mark's interest was future, not present, because he could only take a share of the remainder upon Yvonne's death in the future.

But reaches the opposite conclusion from the probate court:

> But we reject the probate court's determination that Mark "had no more than a unilateral expectation to a share of the [FYR] Trust." Mark had an actual property interest in the trust as set forth in the MWR Will. Mark's property interest was contingent and subject to divestiture if Yvonne exercised her testamentary power of appointment, but it was more than a "mere unilateral expectation" as claimed by respondents. First, "[t]he law has long recognized that a contingent future interest is property [citation] no matter how improbable the contingency" (*In re Marriage of Brown* (1976) 15 Cal.3d 838, 846, fn. 8, 126 Cal.Rptr. 633, 544 P.2d 561), and "a contingent remainder is an estate and not a mere expectancy" (*Estate of Zuber* (1956) 146 Cal.App.2d 584, 591, 304 P.2d 247). Second, takers in default (i.e., persons specified by a donor of a power of appointment to take property in default of the appointment) hold property interests even though "their interests are subject to complete divestment" through exercise of a power of appointment. (*Ammco Ornamental Iron, Inc. v. Wing* (1994) 26 Cal.App.4th 409, 418-419, 31 Cal.Rptr.2d 564 ["persons in existence, who are specifically designated in a trust instrument to take in default of the exercise of a power of appointment by the holder of the preceding estate, are beneficiaries of that trust and acquire vested remainder interests, although their interests are subject to complete divestment"]; see § 672, subd (a) ["if the powerholder of a discretionary power of appointment fails to appoint the property, releases the entire power, or makes an ineffective appointment, in whole or in part, the appointive property not effectively appointed passes to the person named by the donor as taker in default"].) Thus, Mark's contingent future interest in the remainder of the FYR Trust created by the MWR Will upon McKie Sr.'s death was a cognizable property interest, not a mere expectancy, and this property interest did not disappear simply because it was subject to complete divestment if Yvonne chose to exercise her testamentary power of appointment.

The existence of a property interest required notice be given to Mark. The opinion states:

> 1. Due Process Requires Reasonable Notice of Any Proceeding Adversely Affecting a Property Interest
>
> In 1950, the United States Supreme Court in *Mullane v. Central Hanover Bank & Trust Co*. (1950) 339 U.S. 306, 314, 70 S.Ct. 652, 94 L.Ed. 865 (*Mullane*) "recognized that prior to an action which will affect an interest in life, liberty, or property protected by the Due Process Clause of the Fourteenth Amendment, a State must provide 'notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.' ... [T]he Court held that published notice of an action to settle the accounts of a common trust fund was not sufficient to inform beneficiaries of the trust whose names and addresses were known. The Court explained that notice by publication was not reasonably calculated to provide actual notice of the pending proceeding and was therefore inadequate to inform those who could be notified by more effective means such as personal service or mailed notice." (*Mennonite Bd. of Missions v. Adams* (1983) 462 U.S. 791, 795, 103 S.Ct. 2706, 77 L.Ed.2d 180 (*Mennonite*).)
>
> In *Mennonite*, the United States Supreme Court succinctly stated the rule, "Notice by mail or other means as certain to ensure actual notice is a minimum

> constitutional precondition to a proceeding which will adversely affect the liberty or property interests of *any* party ... if [that party's] name and address are reasonably ascertainable." (*Mennonite*, *supra*, 462 U.S. at p. 800, 103 S.Ct. 2706.)
>
> ***
>
> Because the 1991 Decree adversely affected Mark's property interest in the FYR Trust, he was entitled to notice by mail and an opportunity to be heard if his name and address were reasonably ascertainable. (*Mennonite*, *supra*, 462 U.S. at pp. 795, 800, 103 S.Ct. 2706.)
>
> At the time the 1991 Decree was adopted, Mark was McKie Jr.'s adult son and McKie Sr.'s grandson, and Jelley had apparently been dealing with disputes with McKie Jr. (and his siblings) for some years. It appears Jelley only had to ask McKie Jr. for the names and addresses of his existing children in order to provide Mark mailed notice. Mark has maintained below and on appeal that his existence and whereabouts were either known or reasonably ascertainable, and respondents do not contest this point. Under these circumstances, we conclude due process required that Mark be given mailed notice of the probate hearing that resulted in the 1991 Decree and an opportunity to object.
>
> Respondents claim that even if Mark had a property interest in the FYR Trust, *Mullane* does not require actual notice "given the remoteness of his interest." They rely on the *Mullane* court's observation, "Nor do we consider it unreasonable for the State to dispense with more certain notice to those beneficiaries whose interests are *either conjectural or future* or, although they could be discovered upon investigation, do not in due course of business come to knowledge of the common trustee." (*Mullane*, *supra*, 339 U.S. at p. 317, 70 S.Ct. 652, italics added.) They argue this observation shows Mark was not entitled to mailed notice. We are not persuaded.
>
> First, Mark's property interest in the FYR Trust was not conjectural. The MWR Will created a contingent future remainder interest in the trust. Second, we do not read *Mullane* to mean due process notice requirements do not apply to holders of future property interests. In *Mullane*, the appellant was "appointed special guardian and attorney for all persons known or unknown not otherwise appearing who had *or might thereafter have* any interest in the income of the common trust fund." (*Mullane*, *supra*, 339 U.S. at p. 310, 70 S.Ct. 652, italics added.) In this context, when the court spoke of interests that were "future," it likely was referring to persons who did not currently have a property interest in the common fund but might acquire an interest in the future, not to beneficiaries who currently had future property interests in the fund. On the other hand, if the court did mean current beneficiaries with future interests were not entitled to mailed notice, the court may have determined that, because the common fund involved 113 trusts (*id*. at p. 309, 70 S.Ct. 652), it was too burdensome to expect the trustee to attempt to identify all current holders of future interests in the fund; but even if that was the court's reasoning, it would not apply here since it cannot be said in this case that it would have been burdensome for the trustee to ask the three adult children of McKie Sr. for the names and addresses of their own children. In any event, we do not think the *Mullane* court intended to *exclude* reasonably ascertainable holders of future property interests from due process considerations.

15. Spousal Election And Revocable Trust – Indiana Law. In In the Matter of the Revocable Trust Agreement Created by the Settlor, Anil Kumar Sarkar Dipa Sarkar, v. Anuradha ("Mili") Sarkar Naugle, ___ N.E.3d ___ (Ind. 2020), the issue presented was whether a surviving spouse can satisfy her election to take against the will of

her deceased husband when he transferred the majority of his assets into a revocable trust. The trial court summarized the facts it thought were relevant as follows:

> 10. [ ] Anil's [T]rust was established in 1993, twenty-two (22) years prior to his death, for the purpose of obtaining assistance in personal and business affairs as well as disposing of his property at death. Anil had check writing authority on his [T]rust and could amend or modify it at any time. Both Anil and Dipa were present with [Attorney Lyman] when the original estate planning advice was provided. The couple agreed to dispose of their assets separately and not to each other. Dipa was aware of Anil's [T]rust and its provisions because it was identical to hers. Further, Anil and Dipa used a joint financial adviser, [ ], who testified that the couple's investments were identical. [The financial advisor] testified that Anil and Dipa came together to her office to execute financial documents and that each was aware of the others IRA and trust.
>
> 12. The [c]ourt finds no evidence that Anil's intent in creating the [T]rust was to frustrate Dipa's right to a statutory elective share. The [c]ourt further finds that Anil's [T]rust was not created in contemplation of his death and is therefore not testamentary. Therefore, the [c]ourt finds that Anil's [T]rust assets are not subject to Dipa's statutory elective share.

As stated, the trial court held the surviving spouse could not reach the revocable trust assets. The test in Indiana is intent: did the spouse fund the trust in contemplation of death to negate the other spouse's rights. The opinion reviews the precedent:

> Through *Leazenby v. Clinton Co. Bank & Trust*, 171 Ind.App. 243, 355 N.E.2d 861 (1976) and its progeny, Indiana precedents have shaped the conditions in which a surviving spouse may reach beyond the will into a valid *inter vivos* trust to satisfy the statutory elective right when faced with insufficient probate assets.
>
> In *Leazenby*, we held that an *inter vivos* trust established by a wife successfully transferred her property and removed it from the estate, thereby in effect defeating her husband's interest in his statutory elective share. *Id.* at 866. We reached this conclusion by recognizing that a transfer solely for the purpose of defeating the spouse's statutory share is void. However, we found that wife and husband, a subsequent childless spouse, had maintained separate properties and that wife had gone to the bank to establish a trust for the purpose of obtaining aid in handling her affairs three years prior to her death. *Id.* at 862. The trust agreement reserved to the wife the right to income from the trust for life, the right to control the actions of the trustee, and the right to revoke. *Id.* Husband was granted the right to reside in the settlor's former house for six months following her death. *Id.* As time went on, wife was confined to a nursing home and her separate funds were used to pay for her care. *Id.* The *Leazenby* court observed that it was obvious husband was aware of this situation and had acceded to it. *Id.* at 866. There was no indication that it was the settlor's intent to use the device of a trust to defeat her husband's statutory share in her estate; rather, she had merely conveyed a portion of her estate during her lifetime, which she had every right to do. *See id.* at 866-67.
>
> Approximately ten years later, in *Walker v. Lawson*, 526 N.E.2d 968, 969 (Ind. 1988), our supreme court was faced with the question of whether it was malpractice for an attorney to draft a will, and not a trust, for a client who had recently learned of a fatal diagnosis and who "had come [to the attorney] for the

stated purpose of depriving her husband of any interest in her estate." Acknowledging both the rule set forth in *Leazenby* and the holding of *Crawfordsville Trust Co. v. Ramsey*, 55 Ind.App. 40, 100 N.E.1049 (1913), in which the court upheld the trial court's invalidation of assignments of stock and bonds by a spouse who made the assignments knowing he would soon die and for the sole purpose of defeating his spouse's elective rights with respect to the assigned property, the *Walker* court ruled that neither the conveyance of her land to a trust naming her children as beneficiaries nor a conveyance of that land to herself and her children with survivorship rights would have been effective against the surviving spouse's elective rights. *Id.*

Again after a ten-year interval, this court decided *Dunnewind*, 697 N.E.2d at 487, where we found in favor of the surviving spouse's right of election. Here, the settlor executed a will in 1976 in which she left all her assets to her children from a prior marriage. *Id.* at 487. After discovering she was terminally ill in 1995, she created a trust under which her husband would receive a life estate in the marital residence and household goods, as well as a predetermined sum of money, with the remainder to go to settlor's children. *Id.* The trust made no provision for payment of income to the settlor. Based on the evidence presented, the *Dunnewind* court opined that "there was no showing that the trust was executed to assist the [settlor] with business or financial affairs," and held that "the evidence presented at the hearing supports the trial court's findings that [the settlor] executed the trust in contemplation of her impending death and did so to defeat [husband's] statutory share ... Given such circumstances, the trust fails to defeat the spouse's share given the law announced in *Crawfordsville* and *Walker*." *Id.* at 487, 490. We also noted that the trust had a "testamentary character," because the trust agreement did not give the settlor a life interest in the trust property, yet the trustee, the settlor's daughter, permitted her to reside in the residential property and paid to her the trust's income until the settlor's death. *Id.* The court found that neither the settlor nor the beneficiaries intended the transfer to the trust to take effect until the settlor's death, similar to the finding in *Crawfordsville*. *Id.* at 490.

Finally, in *In re Estate of Weitzman*, 724 N.E.2d 1120, 1121 (Ind. Ct. App. 2000), both husband and wife had children from a prior marriage. Before the marriage, Wife refused to sign a prenuptial agreement that would have waived her elective share rights to her husband's estate. *Id.* Four years into the marriage, husband executed a revocable living trust, benefiting his children and appointing the bank as trustee while husband retained the power to direct all trust investment and receive the income from the trust. *Id.* Within three years, husband transferred significant assets into the trust. *Id.* Wife knew that husband had a trust; however, there was no evidence she was aware of the provisions of the trust. *Id.* at 1121-22. Husband died six years after creating the trust and several years after funding it. *Id.* After describing the nature and effect of an *inter vivos* trust and restating the general rule in *Leazenby* and the policy grounds upon which that decision was reached, the *Weitzman* court stated, "[t]here is one pertinent exception to the rules and policies we relied on in *Leazenby*. When a testator executes a trust in contemplation of his impending death and does so in order to defeat the surviving spouse's statutory share, the trust will be considered testamentary in nature and will not defeat the spouse's share." *Id.* at 1123. Finding that the facts did not negate the possibility that husband's intent was to defeat the surviving spouse's elective share, we reversed the trial court's summary judgment in favor of husband and remanded for trial. *Id.* at 1125.

The court affirmed stating:

> Accordingly, unlike *Weitzman*, where the wife knew that husband had a trust but was unfamiliar with its provisions, here, there is overwhelming evidence from which the trial court could have reasonably inferred that Anil and Dipa were aware of the other spouse's trust provisions and estate planning. *See In re Weitzman*, 724 N.E.2d at 1121. In fact, Anil and Dipa commenced their trust creation with the same attorney and although they later retained individual counsel, they were advised by the same financial planner, and had joint meetings in which their respective assets were discussed. Anil transferred his assets to the Trust with Dipa's full knowledge while at the same time she transferred her own assets to a nearly identical trust. As there is "no conclusive evidence that there was a secreting of the real ownership of the property, or that [Dipa] did not know and fully approve of the trust agreement," we conclude that Anil did not create the Trust with the intent to disinherit Dipa. *See Leazenby*, 355 N.E.2d at 866. Consequently, as there is substantial evidence that Anil did not create the Trust in contemplation of death and with the intent to disinherit Dipa, we affirm the trial court's decision to deny Dipa's claim to satisfy her spousal elective share from the Trust corpus.

16. **Duty to Consider Other Assets When Making Distribution**. Technically, Matter of William J. Raggio Family Trust, ____ P.3d ____ (Nv. 2020), was a discovery action but the substantive issue is fascinating. Widow was trustee and beneficiary of a marital trust and a bypass trust, which had different beneficiaries. She made distribution to herself from the marital trust that ultimately passed to her husband's family, as opposed to the bypass trust that passed to hers. The court approved that action. The opinion states:

> The narrow question before us is whether Dale, as trustee, has an obligation to consider other assets, including those in the Credit Shelter Trust, before making distributions to herself, as beneficiary, from the Marital Trust. We conclude she does not. NRS 163.4175 states, "[e]xcept as otherwise provided in the trust instrument, the trustee is not required to consider a beneficiary's assets or resources in determining whether to make a distribution of trust assets." Thus, Nevada trust law does not obligate a trustee to consider other assets or resources before making a distribution unless the trust instrument itself sets forth such a requirement. Accordingly, to determine whether Dale has such an obligation, we must look to the language of the trust instrument.
>
> Section 5.1 of the Marital Trust states, in relevant part, that the trustee "shall pay to or apply for the benefit of [Dale] as much of the principal of the Trust as the Trustee, in the Trustee's discretion, shall deem necessary for the proper support, care, and maintenance" of Dale. Both Dale and Righetti [remainderman of the marital trust] argue that the term "necessary" is the focal point for our inquiry, and they offer two conflicting interpretations of it. Dale interprets "necessary" as referring only to the *amount* of disbursement needed for her "proper support, care, and maintenance," without regard to her other assets. Righetti, on the other hand, interprets "necessary" as creating a threshold of *financial need.* Under this interpretation, Dale, as trustee, cannot distribute trust funds unless she can first show that without the trust distributions, she could not provide for her own "support, care, and maintenance." Righetti argues that the relevant discovery inquiry in determining whether a distribution is "necessary" to Dale is to determine what other financial means she has for her support, care, and maintenance.

> The district court appears to have adopted Righetti's interpretation of "necessary," in that it creates a threshold of *financial need.* The district court determined that it "cannot determine what is necessary and proper without a complete understanding of the trustee's circumstances, to include standard of living and supportive resources beyond the marital deduction trust." We conclude that this determination was clearly erroneous for several reasons.
>
> ***
>
> We thus conclude that the district court's interpretation is contrary to NRS 163.4175, which requires trustees to consider other assets only if the trust instrument itself invokes the exception. The district court should ***975** have begun its analysis from the position that Dale was not obligated to consider her other assets or resources before making a distribution unless the exception was invoked. Instead, the district court disregarded NRS 163.4175 and began evaluating whether one of William Raggio's "implicit intents was to preserve some trust corpus ... for the benefit of his two daughters and not exhaust the bypass trust in favor of preserving the credit shelter trust." NRS 163.4175 clearly provides that, if a settlor wants trustees to consider a beneficiary's other assets, the settlor must so state in the trust instrument. We cannot infer an exception to NRS 163.4175 based solely on the terms "necessary" and "proper" in the trust instrument, as those terms appear frequently in trusts but their meanings depend on the circumstances and text of the instruments. *See, e.g., Del Tr. Co.*, 95 A.2d at 47 (holding that "upon a full reading of the will in the light of the surrounding circumstances ... [the term "necessary" was] not language of condition[,] but [rather, was] language fixing the standard by which the trustee is to exercise its discretion in determining the amount to be spent"). Rather, it must be clear from the trust as a whole that the settlor's intent is to require the trustee to consider other assets. William Raggio did not express that intent.
>
> Therefore, we conclude the district court erred as a matter of law in compelling discovery of the accounting and distributions of the Credit Shelter Trust. Neither NRS 163.4175 nor the Raggio Trust requires Dale to consider her other assets in making distributions from the Marital Trust, and thus, information about those assets is irrelevant.

17. Georgia Allows Beneficiaries To Amend Trust To Give Themselves The Power To Remove And Replace Trustees. In Trust Under Agreement of Taylor, 164 A.3d 1147 (Pa. 2017), the Pennsylvania Supreme Court held that an otherwise valid amendment to a trust under the uniform act would not be valid if the purpose of the amendment was to allow beneficiaries to remove and replace the trustee. The court reasoned that the uniform act had specific provisions dealing with trustee removal.

Georgia has not adopted the Uniform Trust Code but has several provisions that are similar. The Beneficiaries of a trust may modify the trust if they all agree, the trustee receives notice, and a court finds no violation of a material purpose, and, if the settlor is dead. OCGA § 53-12-61(c)(1). There is also a trustee removal provision, OCGA § 53-12-221(a), that allows removal per the terms of the trust instrument, or upon petition to a court showing "good cause."

In Glass v. Faircloth, 840 S.E.2d 724 (Ga. App. 2020), the beneficiaries wanted to change trustees in a fee dispute. Interestingly, the court noted that because the beneficiaries could amend the trust under Georgia law, it did

not have to grapple with whether the fees were in fact excessive. The court held that the two cited provisions were easily reconcilable:

> First, the Modification Statute operates, as here, only after the settlor's death (whereas the Removal Statute contains no such restriction), when concerns could arise that the settlor did not anticipate and can do nothing to resolve. Second, the Removal Statute, which operates at any time, allows initiation by "any interested person" and does not require consent of any of the beneficiaries. Thus, these two provisions address different scenarios and are not inherently inconsistent, and there is no ambiguity or practical effect that frustrates the purpose of either provision.
>
> ***
>
> Further, "[a]ll statutes are presumed to be enacted by the legislature with full knowledge of the existing condition of the law and with reference to it... [W]hen a statute is amended, from the addition of words it may be presumed that the legislature intended some change in the existing law." In light of this, when the legislature amended the Modification Statute in 2018 to allow trust modification after the death of the settlor (under the conditions enumerated in the statute), the legislature could have limited that authority with respect to removal of trustees. It did not. The Modification Statute instead contains broad authority to modify trusts after the death of the settlor so long as the court determines that the notice provisions are met, all beneficiaries consent, and the purpose of the trust is preserved. This is not an absurd or impracticable result, and it is not inconsistent with the ability to remove a trustee (without the consent of the beneficiaries) at any time due to misconduct or for other good cause. The Modification Statute, unlike the Removal Statute, does not contain a burden to show good cause and encompasses scenarios that do not involve trustee misconduct. In light of the plain statutory language requiring the court to approve a modification under the terms in the Modification Statute, we will not read into the Code a limitation that is absent.

Footnote 17 states:

> The 2018 amendment to the Modification Statute was part of a raft of Trust Code changes adopted in the same bill. See Ga. L. 2018, p. 262. Notably, the Removal Statute does not say a "trustee may *only* be removed" for good cause. Compare with OCGA § 53-12-501 (b) (2) ("This article shall not apply to ... [a] power to appoint or remove a trustee or trust director."). To the contrary, the legislature did not change the language in OCGA § 53-12-221 that affords the authority to remove a trustee in accordance with the terms of the trust, even as it granted authority to modify trust terms under OCGA § 53-12-61.

18. **Gift Causa Mortis**. Sad circumstances produced a fascinating case in In re Estate of Oaks, ___ N.W.2d ___ (Wis. Ct. App. 2020). The facts were simple:

> Stouff and Oaks were in a romantic relationship for over twenty-three years—from February 1995 until Oaks' death on March 8, 2018. They never married, but they lived together for approximately ten years—from 2008 until Oaks' death. Oaks had been divorced twice and had an adult daughter, Cheri Wardell, who was not Stouff's offspring. It is undisputed that Oaks and Wardell did not have a "close relationship" and were "estranged for many years" prior to Oaks' death.

> In the early morning hours of March 8, 2018, Oaks fatally shot himself in the head in the home he shared with Stouff, while Stouff was asleep upstairs. Stouff woke when she heard a loud bang, and when she went downstairs to investigate, she found two handwritten notes on a table. The first note read:
>
>> 3-7-18
>>
>> Lynne Stouff has been my companion and my crutch for a long while.
>>
>> As I leave this existence I want all worldly belongings to be assigned to Lynne.
>>
>> David Oaks
>
> The second note read:
>
>> Lynne—
>>
>> This is all I can go with this—Thank you for being there for me all these years.
>>
>> I love you.
>
> It is undisputed that Oaks died intestate—that is, without a valid will. *See Intestate,* BLACK'S LAW DICTIONARY (11th ed. 2019). It is further undisputed that Oaks died unmarried and that Wardell was his only child. As such, Oaks' entire estate would normally pass to Wardell under the general rules of intestate succession, as set forth in WIS. STAT. § 852.01 (2017-18).

The question before the court was whether a suicide can give rise to gift causa mortis. The court held it could, reviewing authority going both ways from other jurisdictions:

> The Estate argues that Stouff cannot meet the second and third requirements for a gift causa mortis. It concedes Stouff can prove that Oaks gifted property to her in anticipation of his death. However, the Estate argues Stouff cannot prove Oaks gifted that property in anticipation of his death from a present illness or external peril because suicide is not a present illness or external peril. Further, because Oaks died as a result of suicide, the Estate argues he did not die from a present illness or external peril. For these reasons, the Estate contends a gift causa mortis can never occur in the context of a donor's suicide.
>
> While the Estate concedes that no Wisconsin case to date has addressed this issue, it asserts that "[h]istorically, the common law has maintained that a gift causa mortis made in contemplation of the donor's suicide is void." The Estate further contends that various other jurisdictions have followed this historical rule and have held that "death by suicide does not satisfy the requirement that a gift be made in expectation of imminent death from illness or impending peril."
>
> We do not find the Estate's argument in this regard persuasive. In making its argument, the Estate fails to distinguish between the manner of a donor's death and the ultimate cause of the donor's death. While the manner of death may be suicide, that suicide may, in some cases, have been caused by a present mental illness—for instance, depression. Accordingly, even in a case in which the donor died by suicide, a party may be able to show that the donor made a gift in

expectation of his or her death from a present mental illness, and that the present mental illness caused the donor's death. Thus, contrary to the Estate's contention, the fact that a donor died by suicide does not automatically prevent a party from establishing that the donor made a gift causa mortis.

In support of its argument to the contrary, the Estate relies primarily on two cases from other jurisdictions—*Ray v. Leader Federal Savings & Loan Ass'n*, 40 Tenn.App. 625, 292 S.W.2d 458 (1953), and *Pikeville National Bank & Trust Co. v. Shirley*, 281 Ky. 150, 135 S.W.2d 426 (Ky. Ct. App. 1939). However, neither of those cases supports the Estate's argument that a gift causa mortis can never occur in the context of a donor's suicide.

In *Ray*, the Tennessee Court of Appeals was confronted with the following question when analyzing an alleged gift causa mortis: "Does death by contemplated suicide by a person who is presumed to be physically and mentally well, as in the instant case, arise from an apprehension due to a peculiar sickness, peril or danger?" *Ray*, 292 S.W.2d at 467. In answering that question, the court observed there was "nothing in the record to indicate that [the deceased] was not fully possessed of his mental faculties" at the time of his suicide. *Id.* On those facts, the court concluded that "[s]ickness, peril and danger, as used in definitions of [gifts] causa mortis ... mean something other than a determination of an individual who is presumed to be well, physically and mentally, to take his life." *Id.*

As the above excerpts make clear, *Ray* addressed whether a gift causa mortis could occur in circumstances where the donor was "presumed to be physically and mentally well" at the time of his suicide. *Id. Ray* did not address whether a gift causa mortis can occur when the donor's suicide was caused by a present mental illness. Accordingly, *Ray* does not compel a conclusion that a gift causa mortis can never occur when the donor died by suicide.

The Estate's reliance on *Pikeville National Bank* is similarly misplaced. In that case, the Kentucky Court of Appeals concluded certain gifts made before the donor's suicide did not qualify as gifts causa mortis "because vital and necessary elements [were] lacking, one of which is that such gifts must be made in expectation of imminent death from a disease or peril then impending." *Pikeville Nat'l Bank*, 135 S.W.2d at 429. The court reasoned:

> While it is alleged in the petition and admitted by answer that decedent was afflicted with tuberculosis, he did not die of that disease, but came to his death by self-destruction which the record indicates he had contemplated and determined upon several days before he carried his determined purpose into effect. Normal men are the arbiters of their own fate so far as suicide is concerned, since that is a matter within their own power of control.

Id.

The court in *Pikeville National Bank* considered a donor who had contemplated suicide for several days before making a decision to act. In addition, the court presumed that the donor was a "normal" man whose decision to end his life was a rational choice within his own power and control. As in *Ray*, the court did not consider a situation in which the donor died by suicide as a result of a present mental illness. For that reason, neither *Ray* nor *Pikeville National Bank* convinces us that a gift causa mortis can never occur in the context of a donor's suicide.[4]

We find more persuasive two cases from other jurisdictions, in which the courts concluded a gift causa mortis had occurred where the donor's suicide was the result of a present mental illness. In the first of those cases, the evidence showed that the donor was in "a serious state of mental depression" following his divorce. *In re Van Wormer's Estate*, 255 Mich. 399, 238 N.W. 210, 210-11 (1931). He told his mother that he was going to California to "go just as far away as he could from his troubles." *Id.* at 211. Before leaving, the donor purchased stock and directed that it be issued in his brother's name. *Id.* He then traveled to California, and while there he died by suicide. *Id.*

The Michigan Supreme Court concluded the donor's purchase of stock in his brother's name was a gift causa mortis. The court stated a gift causa mortis "cannot be sustained unless it appears from the record that at the time of the transaction the donor believed he was suffering from an affliction from which he might not recover and from which in fact he did not." *Id.* The court then concluded that requirement was satisfied in the case before it, explaining:

> The melancholia which evidently resulted in suicide had fastened itself upon [the] deceased before the date of the gift, and he obviously was convinced at that time that he could not continue on indefinitely in his depressed mental state. He attempted to travel away from his troubles. Weeks later he wrote, as quoted above, that he was then gradually getting a desire to want to live, and added in the same letter that he was then experiencing his first encouragement, and that he would probably return the middle of the summer, 'provided I meet with any measure of improvement.' The end a month later indicates he fought a losing fight. His gift made in contemplation should not be set aside.

Id. at 212.

The New Jersey Supreme Court reached a similar conclusion in *Scherer v. Hyland*, 75 N.J. 127, 380 A.2d 698 (1977). There, the donor was "acutely depressed" during the weeks leading up to her death by suicide. *Id.* at 699. Before her death, she left a note stating that she bequeathed all of her possessions to her romantic partner. *Id.* at 699-700. Under those circumstances, the court concluded the donor had made a gift causa mortis. The court expressly rejected the appellant's contention that suicide is "not the sort of peril that will sustain a gift causa mortis." *Id.* at 702. The court explained:

> While it is true that a gift causa mortis is made by the donor with a view to impending death, death is no less impending because of a resolve to commit suicide. Nor does that fixed purpose constitute any lesser or less imminent peril than does a ravaging disease. Indeed, given the despair sufficient to end it all, the peril attendant upon contemplated suicide may reasonably be viewed as even more imminent than that accompanying many illnesses which prove ultimately to be fatal. And, the notion that one in a state of mental depression serious enough to lead to suicide is somehow "freer" to renounce the depression and thus the danger than one suffering from a physical illness, although it has a certain augustinian appeal, has long since been replaced by more enlightened views of human psychology.

Id. (citations omitted).

Like the Michigan and New Jersey Supreme Courts, we conclude a gift causa mortis can occur in a case where the donor died by suicide as a result of a present

> mental illness. We therefore reject the Estate's assertion that a gift causa mortis can never be enforced in a case where the donor died by suicide.

The court concluded the decedent was a Vietnam veteran with PTSD who was depressed. The court also agreed that delivery occurred through the note:

> Just before ending his life, Oaks left a note on a table in the home he shared with Stouff directing that all of his "worldly belongings" should go to Stouff upon his death. Stouff was already in physical possession of the residence and all of the property inside it, and she had access to indicia of ownership for the rest of Oaks' belongings—i.e., keys to his vehicles, checkbooks, and bank account information. After leaving the note, Oaks fatally shot himself in the head while Stouff was asleep in the upper floor of their residence. Having been awoken by the gunshot, Stouff went downstairs and found the note on the table. We agree with Stouff that under these circumstances, "when Mr. Oaks left the note for Ms. Stouff on the table and when Ms. Stouff found the note, he completed delivery for the purpose of the gift causa mortis analysis." (Emphasis omitted.)
>
> Our supreme court's decision in *Sorenson* further supports this conclusion. In that case, the court affirmed a circuit court's finding that Edith Detjen had made a completed gift to Ann Friedmann of money in a bank account through the "symbolical delivery" to Friedmann of the account passbook. *Sorenson*, 34 Wis. 2d at 55-56, 148 N.W.2d 745. The evidence in *Sorenson* showed that Detjen, who had been hemorrhaging from the mouth, was waiting at home for an ambulance to take her to the hospital. *Id.* at 51, 148 N.W.2d 745. Two of her friends testified that while waiting for the ambulance, Detjen called Friedmann into the room and told Friedmann that "she was making a gift [to her] of the West Side Bank account and that she, Ann Friedmann, should withdraw the money." *Id.*
>
> The friends' testimony differed, however, regarding Detjen's delivery of the account passbook to Friedmann. One friend testified Detjen gave the passbook to Friedmann immediately after informing Friedmann of the gift. *Id.* The other friend testified that Detjen stated the passbook was in a box inside a dresser drawer, but the same friend later testified that she saw a book of the same color as Detjen's passbook in Friedmann's hands. *Id.* at 51-52, 148 N.W.2d 745. Friedmann testified Detjen had given her the passbook when the account was opened and it had been in Friedmann's possession ever since. *Id.* at 52, 148 N.W.2d 745. Our supreme court concluded these differences in the witnesses' testimony were "immaterial," explaining that "[p]roperty validly in the possession of the donee need not be returned to the donor so that it can be handed back to the donee." *Id.* at 55-56, 148 N.W.2d 745. In other words, the fact that Friedmann was—according to her own testimony—already in possession of the account passbook did not prevent Detjen from completing a valid delivery of the gift.
>
> Similarly, in this case, the fact that Stouff was already in possession of Oaks' property by virtue of their cohabitation did not prevent Oaks from making a valid delivery of his property to Stouff for purposes of the fourth requirement for a gift causa mortis. Instead, under the "relaxed rule" that applies when assessing the delivery of a gift between members of the same household, *see Potts*, 127 Wis. 2d at 54, 377 N.W.2d 204, we conclude Oaks delivered his property to Stouff by leaving a note informing her of the gift on a table in their shared residence, which he could be reasonably certain Stouff would find when she came downstairs.

19. Parol Evidence Allowed In Virginia To Interpret Ambiguity. The clause at issue in Larsen v. Stack, 842 S.E. 2d 372 (Va. 2020) read as follows:

> FIFTH: I devise the following described property to my children, namely, Pamela Larsen Stack and Kirk Larsen, subject to my wife, Sandra Flora Larsen, having the right to reside in our home located at 394 Mystic Lane, Wirtz, Virginia, 24184, for so long as she is physically and mentally able to do so, and for my wife, Sandra Flora Larsen to receive the monthly rental payments, as provided for in the PCS Site Agreement (Cell Tower), dated April 16, 2013, for as long as she resides in our home, it being all that certain tract or parcel of land (Tax Parcel #28-90) containing 101.39 acres, more or less, situated, lying, and being in the Gills Creek Magisterial District, Franklin County, Virginia, it being the same property conveyed to Erik Larsen, from James C. Ellis, by Deed dated February 7, 1972, said deed being of record in the Clerk's Office of the Circuit Court of Franklin County, Virginia, in Deed Book 277, at page 38.

A question was whether wife had a life estate in the property. The trial court allowed the decedent's lawyer to testify:

> The circuit court held a hearing regarding the declaratory judgment action on January 3, 2019. During the hearing, the circuit court determined that Erik's will did not clearly establish the scope of Sandra's interest in the house and farm. Consequently, the circuit court permitted W. Colby Brown, the attorney who drafted Erik's will, to testify.
>
> Brown testified that Erik intended for Sandra "to be able to stay on the property, and ... [receive] the money from the cell phone tower." However, Brown clarified that Erik "wanted his children to end up with the property." Brown explained that Erik did not give Sandra a life estate in the property because he was concerned that she would be required to sell such an interest before she could obtain Medicaid coverage.
>
> Brown believed that Erik intended for Sandra to have access to the entire farm as long she was physically and mentally able to reside in the house. Brown explained that "in the event that [Sandra] had to go into a nursing home basically, or ... couldn't live by herself anymore, something like that, then at that point her interest in the property would dissolve ... and then it would go to the children."
>
> At the conclusion of the hearing, the circuit court determined that Sandra did not have a life estate in the property. The circuit court explained that Erik's will gave Sandra the right to reside in Erik's house and the right to access the entire farm. The circuit court then noted that Sandra's rights were "subject to be terminated when she is no longer physically or mentally able to reside in the home."

With respect to the lawyer's testimony, the opinion states:

> Sandra contends that the circuit court erred by considering parol evidence when it construed the limitation that Erik's will placed on her right to reside on the property. Specifically, Sandra argues that the circuit court erred by considering Brown's testimony to determine that Sandra's interest in the property would end

> "in the event she had to go into a nursing home ... or couldn't live by herself anymore." Again, we disagree with Sandra's argument.
>
> As previously stated, parol evidence may be considered when the language of a will is ambiguous. *See Gaymon*, 258 Va. at 230, 519 S.E.2d 142. In such cases, "[p]arol evidence is admissible to enable the court to identify the property intended to be given by will, or to assist it in determining the quantum of interest which is to pass by the will." *Parsons v. Fitchett*, 148 Va. 322, 329, 138 S.E. 491 (1927) (quotation omitted).
>
> Erik's will was ambiguous in several ways. The will did not clearly define the scope of Sandra's right to reside on the property. Notably, the will failed to indicate whether Sandra had the right to access and enjoy the entire property, or whether she only had the right to live in Erik's house.
>
> The will was also ambiguous regarding the limitation that it placed on Sandra's rights. Pursuant to Erik's will, Sandra could reside on the property "for so long as she [was] physically and mentally able to do so." The will did not provide any further guidance concerning this limitation.
>
> Brown's testimony addressed the ambiguous provisions of Erik's will. Brown explained that Erik intended to give Sandra the right to reside on the entire property for as long she was physically and mentally able to live there. Brown then testified that Erik intended for Sandra's interest in the property to end "in the event that she had to go into a nursing home" or she "couldn't live by herself anymore."
>
> We conclude that Brown's testimony was necessary to resolve the ambiguities in the will. Brown's testimony explained Erik's intent regarding the scope of Sandra's rights and the limitation that Erik placed on those rights.
>
> Although Sandra contends that Brown's testimony impermissibly modified the terms of Erik's will, we find that Brown's testimony and the terms of the will were essentially consistent. We note that Erik's will only gave Sandra the right to reside on the property.
>
> Under these circumstances, we conclude that the circuit court did not err by considering Brown's testimony to determine the scope of Sandra's right to reside on the property and the limitation that the will placed on that right.

20. **Separation Agreement Anticipating Divorce Waives Intestate Rights**. In the Matter of Estate of Petelle, ________________________ (Wa. 2020), the parties entered into a separation agreement but husband died before the divorce was adjudicated. The question was whether the agreement waived wife's intestate rights. The majority held it did:

> In the contract, the parties agreed "to make a *complete and final settlement of all their marital and property rights* and obligations on the following terms and conditions." Clerk's Papers (CP) at 43 (emphasis added). The contract also provides that the "contract shall be final and binding upon the execution of both parties, whether or not a legal separation or decree of dissolution is obtained[,]" and, by its terms, the contract remained valid and enforceable against the **estate** of either party if either party died after the execution of the contract. CP at 43-44,

> 48. Though the contract contains a "Full Satisfaction of All Claims" section, the right to intestate succession is not mentioned. CP at 46.
>
> ***
>
> The Court of Appeals reasoned that "[t]his language is, arguably, sufficient to constitute waiver of all marital and property rights flowing from the marital relationship, including the right to intestate succession." *Petelle*, 8 Wash. App. 2d at 721. We agree. This provision is an express declaration to resolve "*all* marital and property rights," leaving no ambiguity that some or any marital or property rights remain unresolved. Our conclusion is further supported by a general purpose of separation contracts—to divide assets and liabilities in preparation for divorce.
>
> ***
>
> The fact that the right to intestate succession was not specifically mentioned in the contract does not limit the clear and explicit language providing the agreement is a complete and final settlement of all marital and property rights. The rights of a surviving spouse under RCW 11.04.015 flow from the marital status. Because the right to intestate succession is a result of the marital status, the right to intestate succession is similar to a marital or property right and we find the right is encompassed in this language.

Three of the nine justices dissented, in an interesting opinion which notes:

> In my view, the parties made their intent known. Michael and Michelle sought to accomplish the general purpose of separation contracts—dividing assets and liabilities in order to resolve the immediacy of their separation and possible divorce. They did not intend for the agreement to extend beyond those events. They understood that their divorce may not occur, in which case had a will been made, it would have had to state that Michelle was Michael's wife and that he specifically intended not to include her in the will. *In re Estate of Lindsay*, 91 Wash. App. 944, 949, 957 P.2d 818 (1998) ("A testator has the right to intentionally disinherit a surviving spouse."); *Strait v. Kennedy*, 103 Wash. App. 626, 634, 13 P.3d 671 (2000) ("[A] simple will or codicil to an earlier will stating that the testator intends to leave nothing to the spouse is sufficient [to disinherit a spouse]."). Specific language disinheriting a spouse is required in a will, and I see no reason why it should not be required in a separation contract. " '[W]here a person has the right to die intestate ... he is charged with full knowledge of who will succeed to his property if he dies intestate [and] the assumption exists that ... he is satisfied with the will the law of the state made for him.' " *Pitzer v. Union Bank of Cal.*, 141 Wash.2d 539, 550, 9 P.3d 805 (2000)(alterations in original) (quoting *Wilson v. Jones*, 281 S.C. 230, 233, 314 S.E.2d 341 (1984)) (discussing *Hesthagen v. Harby*, 78 Wash.2d 934, 481 P.2d 438 (1971)). Because Michael died intestate while married to Michelle, she was his surviving spouse and entitled to take under RCW 11.04.015(1)(c).
>
> I further disagree with the majority that the contractual language is broad enough to demonstrate Michelle knew she was waiving intestate inheritance rights. *See* majority at 851. The majority states that the rights of a surviving spouse flow from marital status, and so they are encompassed in the separation contract's statement resolving all marital rights. *Id*. But "[w]aiver is the intentional relinquishment of a *known* right." *Wagner v. Wagner*, 95 Wash.2d 94, 102, 621 P.2d 1279 (1980) (emphasis added). As noted above, there is no indication in the

> terms and conditions of the separation agreement indicating it extended to testamentary decisions, and I can find no authority from this court or from the legislature characterizing intestate inheritance rights as marital or property rights.
>
> Moreover, the rights of a surviving spouse include more than just dividing assets for dissolution of marriage. They include rights under the wrongful death statute, ch. 4.20 RCW; rights to Social Security survivor benefits; rights under the Employee Retirement Income Security Act, 29 U.S.C. 18; and the right to control the disposition of remains under RCW 68.50.160. Amicus Curiae Mem. in Supp. of Review at 6. Parties in separation and divorce proceedings are often unrepresented or have minimal access to legal assistance. *Id.* at 4-5. We should not assume, as the majority does, that pro se litigants in the past have comprehended the full legal consequence of agreeing to resolve all marital rights, especially considering the complexity of those rights. This result is even more concerning because the statute governing separation contracts, RCW 26.09.070(1), does not mention settling questions of inheritance. Just as we should not assume pro se litigants will recognize that intestate inheritance rights are encompassed in the terms marital and property rights when no prior authority has endorsed this holding, we should not assume these litigants intended to do something the statute does not mention.

21. **Attorney Insurance Policy Does Not Cover Attorney Acting as Trustee**. Philip Farthing, an attorney, was liable to the Higgerson beneficiaries of various family trusts of which he was trustee on account of his negligent investment of trust assets. Did his professional liability policy cover him? That was at issue in ALPS Property & Casualty Insurance Company v. Higgerson, 805 Fed.Appx. 193 (E.D. Va. 2020)(unpublished). The policy covered acting as a trustee but excluded negligent supervision of funds. The opinion states:

> Applying those standards, the court concluded that the policy exclusion for the "negligent supervision" of funds or property clearly and unambiguously applied, foreclosing coverage.[3] *Id.* at *6. Under that ***196** exclusion, the policy does not apply to any claim arising from or in connection with:
>
> > Any conversion, misappropriation, improper commingling or negligent supervision by any person of client or trust account funds or property, or funds or property of any other person held or controlled by an Insured in any capacity or under any authority, including any loss or reduction in value of such funds or property.
>
> J.A. 61–62. By its "clear and express terms," the district court found, that provision "facially applies" to stocks "held or controlled" by Farthing in "any capacity," including his capacity as trustee of the Higgerson family trusts. *ALPS*, 2018 WL 4927366, at *6.
>
> The district court acknowledged, as the Higgerson Defendants argued, that the phrase "negligent supervision" typically connotes "the supervision of other people," not funds or property. *Id.* at *7 n.10. But here, the court held, the context provided by the full provision – with its express reference to the "negligent supervision ... of client or trust account funds or property, or funds or property of any other person," J.A. 62 – "leaves no doubt that it excludes claims arising from the negligent supervision *of funds or property* held or controlled by the insured." *ALPS*, 2018 WL 4927366, at *7 n.10. Moreover, the district court reasoned, case law shows that "supervision" is commonly used to describe the management not only of people but also of investments, including stock

> portfolios. *Id.* at *7 (quoting, *e.g.*, *Migdal v. Rowe Price-Fleming Int'l, Inc.*, 248 F.3d 321, 324 (4th Cir. 2001) (noting that "[m]ost funds are externally managed – each fund contracts with an investment adviser to recommend *and supervise* the fund's investments") (emphasis added)). And all of that, the district court concluded, is consistent with the definition of "supervision" in Black's Law Dictionary – "[t]he series of acts involved in managing, directing, or overseeing persons or projects," *Supervision*, Black's Law Dictionary (10th ed. 2014) – on which Virginia courts have relied for the proposition that "supervision" may refer to the management or oversight of things (such as property) as well as people. *See ALPS*, 2018 WL 4927366, at *8 (citing *Hutton v. Commonwealth*, 66 Va.App. 714, 791 S.E.2d 750, 753 (2016)).
>
> It was equally clear, the district court held, that Farthing's conduct qualified as "negligent" within the meaning of the exclusion. There was no need to consider in this case the "precise contours of the ordinary meaning of the word 'negligence,' " the district court explained, because Farthing's investment activities were "expressly determined to be 'reckless' breaches of his fiduciary duties during the underlying state court lawsuit." *Id.* at *7. An insurer's duty to indemnify is governed by the plain terms of the policy and the "litigated facts" in the underlying state action, *id.* (quoting *CACI Int'1, Inc. v. St. Paul Fire & Marine Ins. Co.*, 566 F.3d 150, 155 (4th Cir. 2009)), and here, the prior finding of recklessness "establishes, as a matter of law, a lack of care that rises to, and exceeds, ordinary negligence," *id.*

22. **Trusts Reformed to Avoid Reciprocity**. In Matter of Jill Petrie St. Clair Trust Reformation**,** ___ P.3d ___ (Kan. 2020), spouses created trusts that were not intended to be reciprocal but the drafter omitted the relevant different provisions as the opinion notes:

> In September 2003, Jill executed a trust agreement establishing the Jill Petrie St. Clair Trust. She named William J. Wallisch the trustee. The trust made her husband, William Paxson St. Clair, a life beneficiary of the trust's income. Upon William's death, the trust's income would then be distributed to Jill and William's children and grandchildren living at the time the trust was created, and the principal would eventually be distributed to the grandchildren or their estates.
>
> In December 2002, before Jill created her trust, William established his own trust with an identical distribution scheme but naming Jill a life beneficiary of the trust's income. Both Jill and William funded their trusts in identical amounts when Jill executed her trust agreement.
>
> M. Wayne Davidson was the attorney who prepared the trusts for Jill and William. One of the purposes of William's trust was to make sure the assets in his trust were not included in his or Jill's taxable estates. Davidson proposed to Jill that she create her own trust to obtain gift tax benefits and to similarly assure that the assets in her trust were not included in William's taxable estate. Davidson drafted Jill's trust with those objectives in mind. To that end, Jill's trust agreement provided that "no part of this Trust shall be included in the Grantor's gross estate for death tax purposes." At the time Jill executed the trust agreement, she believed it contained the necessary provisions for the trust assets to be excluded from her and William's taxable estates, and for the transfers to the trust to be considered completed gifts.
>
> But because of a drafting error, Davidson failed to include two provisions necessary to differentiate the benefits provided to William under Jill's trust from

> the benefits provided to Jill under William's trust. These provisions were necessary to avoid the two trust being considered reciprocal, resulting in the assets of Jill's trust being included in William's estate upon his demise and vice versa. One of the provisions that was erroneously omitted from Jill's trust agreement would have enabled William to annually receive $5,000 or 5% of the assets in Jill's trust. The other provision would have given William a lifetime special power of appointment over the trust assets in Jill's trust that would have enabled him to appoint all or any portion of the assets in Jill's estate to any person other than himself, his creditors, his estate, or the creditors of his estate. These provisions are commonly used by attorneys drafting trusts to avoid creating reciprocal trusts.

The trial court found that the scrivener had committed an error which the Kansas Supreme Court affirmed.

23. Ethical Obligation To Avoid Counseling Or Assisting A Client In A Criminal Or Fraudulent Situation. On April 29, 2020, the American Bar Association issued Formal Opinion 491. As background for the opinion, it notes:

> In the wake of media reports,[2] disciplinary proceedings,[3] criminal prosecutions,[4] and reports on international counter-terrorism enforcement and efforts to combat money-laundering, the legal profession has become increasingly alert to the risk that a client or prospective client[5] might try to retain a lawyer for a transaction or other non-litigation matter that could be legitimate but which further inquiry would reveal to be criminal or fraudulent.[6] For example, a client might seek legal assistance for a series of purchases and sales of properties that will be used to launder money. Or a client might propose an all-cash deal in large amounts and ask that the proceeds be deposited in a bank located in a jurisdiction where transactions of this kind are commonly used to conceal terrorist financing or other illegal activities.[7] On the other hand, further inquiry may dispel the lawyer's concerns.

[footnotes omitted]

The substance relevant to estate planners is as follows:

> As set forth in Section II of this opinion, a lawyer who has knowledge of facts that create a high probability that a client is seeking the lawyer's services in a transaction to further criminal or fraudulent activity has a duty to inquire further to avoid assisting that activity under Rule 1.2(d). Failure to make a reasonable inquiry is willful blindness punishable under the actual knowledge standard of the Rule. Whether the facts known to the lawyer require further inquiry will depend on the circumstances. As discussed in Section III, even where Rule 1.2(d) does not require further inquiry, other Rules may. These Rules include the duty of competence under Rule 1.1, the duty of diligence under Rule 1.3, the duty of communication under Rule 1.4, the duty to protect the best interests of an organizational client under Rule 1.13, the duties of honesty and integrity under Rules 8.4(b) and (c), and the duty to withdraw under Rule 1.16(a). Further inquiry under these Rules serves important ends. It ensures that the lawyer is in a position to provide the informed advice and assistance to which the client is entitled, that the representation will not result in professional misconduct, and that the representation will not involve counseling or assisting a crime or fraud. Section IV addresses a lawyer's obligations in responding to a client who either agrees or does not agree to provide information necessary to satisfy the duty to inquire.

> Finally, Section V examines hypothetical scenarios in which the duty to inquire would be triggered, as well as instances in which it would not.

The opinion contains five examples, three of which easily could be directly relevant to an estate planner:

> #3: A general practitioner in rural North Dakota receives a call from a long-term client asking her to form a limited liability company for the purpose of buying a ranch.[52]
>
> #4: The general practitioner in rural North Dakota receives a call from a new and unknown prospective client saying that the client just won several million dollars in Las Vegas and needs the lawyer to form a limited liability company to buy a ranch.[53]
>
> #5: A prospective client in New York City asks a general practitioner in a mid-size town in rural Georgia to provide legal services for the acquisition of several farms in rural Georgia. The prospective client tells the lawyer that he has made a lot of money in hedge funds and now wants to diversify his investments by purchasing these farms but says he doesn't want his purchases to cause a wave of land speculation and artificially inflate local prices. He wants to wire money into the law firm's trust account over time for the purchases. He asks the lawyer to create a series of LLCs to make strategic (and apparently unrelated) acquisitions.[54]

[footnotes omitted]

The opinion provides no discussion beyond references to the Am. Bar Ass'n Task Force On Gatekeeper Regulation And The Profession, Voluntary Good Practices Guidance For Lawyers To Detect And Combat Money Laundering And Terrorist Financing.

24. **No-Contest Clause Applied**. Missouri has a statute allowing a "test" lawsuit over a no-contest clause. In Knopik v. Shelby Investments, LLC, 597 S.W.3d 189 (Mo. 2020), the beneficiary ignored that statute and just filed a lawsuit alleging a breach by the trustee. The court applied the no-contest clause:

> Gift L.L.C. ("Settlor") created the Knopik Irrevocable Trust ("Trust") in late December 2016. The provisions of the Trust established Shelby Investments, L.L.C. ("Trustee") as the sole trustee and Samuel Knopik ("Beneficiary") as the sole beneficiary of the Trust. The Trust was to provide the Beneficiary with a $100-per-month distribution, beginning in December 2016 and ending in December 2020. Provision 12 of the Trust, denominated "No Contest," provided:
>
> > In case any beneficiary shall (i) contest the validity of this trust, or any provisions hereof, in whole or in part; (ii) make a claim against a trustee for maladministration or breach of trust; or (iii) attempt to remove a trustee for any reason, with or without cause; then such contest or claim and such attempt shall cancel and terminate all provisions for or in favor of the beneficiary making or inciting such contest or claim, without regard to whether such contest or claim shall succeed or not; and all and any provisions or provision herein in favor of the beneficiary so making such contest or claim, or attempting or inciting the same, to be revoked and of no force and effect; and the entire trust estate shall revert to the Settlor and be distributed to the Settlor.

The Trustee made a single distribution to the Beneficiary in February 2017 but made no further distributions pursuant to the terms of the Trust. In August 2017, the Beneficiary filed a petition against the Trustee for breach of trust and to remove the Trustee. The Trustee admitted it made the single payment pursuant to the Trust, despite additional distributions being required. The Trustee further admitted it had indicated to the Beneficiary that it did not intend to make any future payments pursuant to the Trust. The Trustee also raised a counterclaim for declaratory judgment, asking the circuit court to determine that, due to the violation of the "No Contest" provision of the Trust, all provisions of the Trust in favor of the Beneficiary were cancelled and terminated. The Beneficiary and the Trustee each filed motions for summary judgment. The circuit court entered summary judgment in favor of the Trustee on its counterclaim after finding that the Beneficiary's filing of his petition for breach of trust and removal violated the Trust's no-contest clause. The Beneficiary appeals.

***

There is no doubt that the language of the Trust indicated the Settlor's clear intent to impose the result of forfeiture when the Beneficiary filed his petition. Provision 12 of the Trust purported to require forfeiture if the Beneficiary were to contest the validity of the Trust, make a claim against the Trustee for maladministration or breach of trust, or attempt to remove the Trustee for any reason. The petition the Beneficiary filed in the circuit court contained two counts. Count I was titled "Breach of Trust." Count II – "Removal" – sought removal of the Trustee and proposed a replacement trustee. When the Beneficiary filed his petition, violation of the plain language of Provision 12 was evident. The circuit court found the filing of the petition, as pleaded, to be in violation of the Trust's no-contest provision, and the circuit court ordered that all provisions of the Trust in favor of the Beneficiary be cancelled and terminated. The Beneficiary asks for relief by having this Court rule that no-contest clauses are inapplicable when the action is for breach of trust or removal of a trustee.

However, if the Beneficiary wished to challenge the enforceability and applicability of the no-contest clause to the claims in his petition, he should have done so in a proceeding under section 456.4-420. Section 456.4-420, enacted by the Missouri legislature in 2014, addresses a procedure by which an interested person can seek to avoid the effect of no-contest clauses in trusts. The statute provides "for an interlocutory determination whether a particular ... petition ... by the interested person would trigger application of the no-contest clause or would otherwise trigger a forfeiture that is enforceable under applicable law and public policy." Section 456.4-420.1. Upon consideration of the language of the clause, the relationship of the clause to the trust instrument, and the facts of the petition, the circuit court makes a determination that "result[s] in the no-contest clause being enforceable to the extent of the court's ruling." Section 456.4-420.4. This determination is subject to appeal. Section 456.4-420.3.

Section 456.4-420 provided a "safe harbor" in which the Beneficiary should have invoked a challenge to the enforceability and applicability of the no-contest clause to his claims for breach of trust and removal. But the Beneficiary chose to file his petition asserting the exact claims the Trust unambiguously stated would result in forfeiture. Because of the Beneficiary's failure to utilize section 456.4-420, this Court need not reach the issue of either delineating specific exceptions to the application of no-contest clauses or deciding whether a good faith or probable cause exception should be introduced in Missouri.

The court seems to base this tough result for the beneficiary on the beneficiary's failure to start with a different statute, but suppose the beneficiary had asked the clause would apply and the court had said yes? The beneficiary would have been without a remedy. Why Missouri would enforce a trust with so few – maybe no – limits on a trustee is uncertain. A concurrence hints of a backstory that reflects poorly on the court and litigants:

> It has been suggested that the present case is fictitious or collusive. *See* Kimberly E. Cohen, et al. *Advanced Estate Planning Practice Update: Summer 2019* (American Law Institute June 12, 2019) (quoted portion authored by Kathleen R. Sherby) (setting forth the circumstances surrounding this case and concluding: "Based on the circumstantial evidence gathered thus far, *Knopik* appears to be a 'contrived' case, put together by the two disappointed lawyers in [a prior matter]."). The author of this suggestion makes a compelling case but uses facts and inferences both within and outside the record now before this Court. This Court, on the other hand, has authority to dismiss an appeal on the ground that the case is fictitious or collusive only if the record before the Court demonstrates this is so. *State ex rel. Chandler v. McQuillin*, 229 Mo. 523, 130 S.W. 9, 12 (Mo. 1910); *Hahn*, 36 S.W. at 665-66. Here, the record falls short of that standard, and the Court declines to inquire of the parties and their counsel further on this issue.
>
> It is devoutly to be hoped, however, that this case – and the ramifications and remedies that will flow from the pursuit of a fictitious or collusive suit, though they were not invoked here – come to mind the next time counsel or their clients consider feigning a dispute (or the appearance of one) merely for the purpose of securing an advisory opinion.

25. Self-Settled Trust Does Not Become Protected From Creditors After the Settlor's Death. De Prins v. Michaeles, 154 N.E.3d 921 (Ma. 2020), is a decision in response to a question certified by the First Circuit. It involves sad facts, namely the efforts of a murder victim's estate to recover in a wrongful death action against an irrevocable trust created and funded by the decedent four months before the decedent murdered the victim (actually husband and wife). The settlor-decedent was sole beneficiary of the trust.

Massachusetts has adopted the Uniform Trust Code which the court determined was silent on the question, thus requiring the application of common law. The court held that the settlor's death would not affect the asset protection status of a self-settled trust. The opinion discusses the UTC provision this way:

> Section 505 (a) (2) addresses a creditor's ability to reach the assets of an irrevocable trust. It does not specify whether it applies only during a settlor's lifetime or whether it applies after a settlor's death. G. L. c. 203E, § 505 (a) (2). It provides that, where a settlor has created an irrevocable trust, including one that contains a spendthrift provision, a creditor "may reach the maximum amount that can be distributed to or for the settlor's benefit." Id. Where a settlor may reach the assets of an irrevocable trust, the settlor's creditors may also reach those assets. Therefore, as the defendants concede, if Belanger were still alive today, the plaintiff could reach the entirety of the trust's assets because the defendant trustee could, under the express terms of the trust, distribute all such assets to Belanger or for Belanger's benefit.
>
> Because it is unclear from the statutory language whether § 505 (a) (2) addresses a creditor's ability to reach the assets of an irrevocable trust after the settlor's death,

> we look to the other sections of the statute as well as the legislative history. See Ciani, 481 Mass. at 178, 114 N.E.3d 52; Rotondi, 463 Mass. at 648, 977 N.E.2d 1042. When Massachusetts was considering adopting the Uniform Trust Code, an ad hoc committee was created to review and revise it for adoption. Report of the Ad Hoc Massachusetts Uniform Trust Code Committee 1-2 (rev. Jul. 18, 2012) (Report). The committee's comment to G. L. c. 203E, § 505, however, does not shed any additional light as to whether § 505 (a) (2) was intended to allow a creditor to reach an irrevocable trust's assets after the settlor's death or only during the settlor's lifetime.
>
> Looking to the other provisions in the statute, G. L. c. 203E, § 106, provides that the MUTC is to be supplemented by the "common law of trusts and principles of equity." The committee's comment to this section further clarifies that "the [MUTC] is not intended to replace the common law of trusts in Massachusetts except where the [MUTC] modifies it." Report, supra at 7. It is clear, then, that the common law continues to apply where the MUTC does not address the situation at issue, and that the court may apply "principles of equity" to such cases. See G. L. c. 203E, § 106. In accordance with principles of equity, two sections of the MUTC specify that a trust may not be created that is contrary to public policy. See G. L. c. 203E, §§ 105 (b) (3), 404.
>
> * * *
>
> Given the authorities discussed above, to the extent that a trust is self-settled such that the settlor retains the beneficial interest in the trust's assets and does not give such interest to another, it appears that the committee did not intend the MUTC to apply.
>
> In accordance with settled principles of statutory construction, and because the MUTC both (1) expressly provides that it does not replace the common law and (2) fails to address the situation here (i.e., the ability of a creditor to reach the assets of an irrevocable self-settled trust after the settlor's death), we conclude that the common law applies.

Does it matter that the settlor retained no right to modify the trust? Massachusetts law was not entirely clear:

> Here, the defendant trustee relies on State Street Bank & Trust Co. v. Reiser, 7 Mass. App. Ct. 633, 638-639, 389 N.E.2d 768 (1979) (Reiser), for the proposition that a creditor may only reach and apply assets of a discretionary trust after the settlor's death where the settlor reserved the power to amend or revoke the trust and direct the disposition of the trust's assets (i.e., where the trust was revocable). In Reiser, the plaintiff creditor sought to reach and apply trust assets of a revocable trust of a deceased settlor to satisfy a debt owed by the settlor's estate. Id. at 633, 389 N.E.2d 768. The settlor died before repaying the debt, and his estate had insufficient funds to pay it. Id. at 634, 389 N.E.2d 768. The Appeals Court held that the creditor could reach and apply the trust's assets to satisfy the debt. Id. at 638-639, 389 N.E.2d 768. On the facts, the holding of the court in Reiser is merely illustrative of one instance in which a creditor was allowed to reach the assets of a trust of a deceased settlor.12 It does not define the limits of a creditor's ability to so reach.
>
> In another Appeals Court case, a creditor was allowed to reach the assets of an irrevocable spendthrift trust to satisfy a judgment in a personal injury action against the deceased beneficiary's estate because the trust was held to be self-settled. Calhoun v. Rawlins, 93 Mass. App. Ct. 458, 459, 464-465, 106 N.E.3d

> 684 (2018). The beneficiary allegedly caused an automobile collision that seriously injured the plaintiffs and resulted in the beneficiary's death. Id. at 461, 106 N.E.3d 684. In that case, the court focused on the trustees' "complete discretion to distribute" trust assets to the beneficiary or for his benefit. Id. at 460-461, 106 N.E.3d 684. Although the court did not address the effect of the beneficiary's death on the creditor's ability to reach the trust property, it necessarily assumed that the creditor was not *49 prohibited from such reach, as the cause of action giving rise to the personal injury action in which the plaintiffs received judgment accrued simultaneously to the beneficiary's death. Id. at 461, 106 N.E.3d 684.

On balance, the court held for the creditors:

> Although we have found no case law that directly discusses the distinction between the reachability of the assets of a self-settled trust during the settlor's lifetime versus after his death (if one exists), it would be incongruent for a self-settled trust not to protect a settlor's assets from creditors while the settlor is alive but to have it protect the settlor's beneficiaries from the settlor's creditors after the settlor's death when, absent the self-settled trust, they would not be so protected. We therefore hold that a self-settled trust does not become protected from creditors on the settlor's death.
>
> Although the plaintiff does not argue that the conveyance of Belanger's assets to the trust was fraudulent, the timing of the events could give rise to the inference that it was part of a single plan. The De Prinses brought and prevailed in a lawsuit against Belanger in 2007. Belanger's wife committed suicide on October 4, 2008. Within six months of her suicide, Belanger created the trust, transferred substantially all of his assets to the trust, murdered the De Prinses, and then committed suicide.
>
> The defendant argues that Belanger did not have an estate to live on but not one from which to pay his debts, because the defendant did not distribute any trust assets to Belanger prior to his death. According to the defendant's argument, now that Belanger is deceased, it would be impossible for the defendant to distribute any trust assets to Belanger or for Belanger's benefit, so this is not a case where Belanger is able to "have his cake and eat it too." As the First Circuit correctly observed, however, the important point is what is within the trustee's power to do, not what he actually does. Tilcon Capaldi, Inc., supra at 60 ("Thus, even if the trustee chooses not to make any payments to the beneficiary, a creditor may still reach the maximum amount the trustee could pay"). In other words, although the defendant did not distribute any trust assets to Belanger during his lifetime, he could have under the express terms of the trust. Therefore, under the First Circuit's reasoning, the plaintiff should be able to reach the maximum amount the defendant could have distributed during Belanger's lifetime -- all the assets of the trust. See id.
>
> Further, often one of our greatest goals in life is to leave our children the benefit of our property. To prevent the son of two murder victims from financially recovering for their wrongful deaths while protecting the murderer's assets for his beneficiary would contradict the well-established public policy of this Commonwealth and condone the actions of a settlor who, it can be inferred, thought he could use the protection of a trust to shield his assets from the consequences of his violence. The equities here simply do not allow Belanger to murder the plaintiff's parents and then leave the plaintiff with no recovery in the

subsequent wrongful death action, despite Belanger's possessing substantial assets during his lifetime.

26. **Gifts From Revocable Trust Made By Settlor**. In re Estate of Marsh, 951 N.W.2d 486 (Ne. 2020) is a state inheritance tax case dealing in part with the ownership of interests in an LLC called Marcasa. Mr. Marsh, grantor of his revocable trust, gave LLC interests to his beneficiaries even though the trust owned the interests. The trial court held the gifts were valid and the Nebraska Supreme Court agreed. The opinion states:

> In January 2008, Marsh executed eight assignment forms in his individual capacity. Then, in May, Marsh assigned his interest in Marcasa to his trust. Thereafter, the assignment forms executed between 2009 and 2013 showed that they were signed by Marsh as grantor of the trust.
>
> To make a valid inter vivos gift, there must be an intention to transfer title to property, delivery by the donor, and acceptance by the donee. The first two elements relate to intent and actions of the donor. The donor must have a present donative intent and a clear and unmistakable intent to make a gift. Ordinarily, actual delivery is necessary where the subject of the gift is capable of manual delivery, but where actual manual delivery cannot be made, the donor may do that which, under the circumstances, will in reason be considered equivalent to actual delivery. The Ninth Circuit explained that interests in a limited liability company "do not lend themselves to manual delivery. Instead, they are delivered through the execution of papers. As a result, ... it is somewhat artificial to separate the 'delivery' of [a limited liability company] interest from the intention to donate it." Here, intent and delivery are demonstrated by Marsh's history of assigning interests to his daughters and their family members, his execution of the assignments, and his cessation of acting as the owner of those interests after execution of the assignments.
>
> The final element of a gift calls for action by the donee. The exercise by the donee of dominion over the property which is the subject of a gift, or an assertion of a right to the property by the donee, generally will constitute an acceptance. The donees accepted the gifts by acting as the rightful owner of the interests in Marcasa, and their ownership took effect immediately. Their interests were reported on Schedule K-1 tax forms, thereby subjecting them to payment of income taxes attributable to their ownership interests.
>
> The County contends that no transfer of ownership interests occurred, because the cotrustees never executed any of the transfer documents. But under the trust agreement, Marsh retained authority "to withdraw property from the trust." The trust agreement provided the manner to do so—"by an instrument in writing signed by the Settlor and delivered to the Trustee in the lifetime of the Settlor." Here, the assignments at issue were all in writing. And the cotrustees, as either the recipients or the spouses or parents of the recipients, were aware of the assignments. Further, we have stated that whether a deed or other instrument conveying an interest in property has been delivered is largely a question of intent to be determined by the facts and circumstances of the particular case.[31] Marsh's parting with the ownership interests given as gifts and the cotrustees and other donees acting as owners of those respective interests manifest evidence of delivery. The court's decision conforms to the law, is supported by competent evidence, and is not unreasonable.

27. **<u>No "Adoption Out" Under Indiana Trust</u>**. Mildred had a son, Charles, who married Ann. Mildred created an irrevocable trust paying income to Charles, then Ann, then Charles' descendants, per stirpes, and another similar testamentary trust. Charles and Ann had David, who married Joan, and they had three children, Brittany, Matthew, and Molly. David and Joan divorced, Joan married Thomas, who adopted Brittany, Matthew and Molly. The question in <u>Walters v. Corder</u>, 146 N.E.3d 365 (In. App. 2020), was whether the three adopted children remained beneficiaries of Mildred's trusts. The court held that in Indiana the answer is yes:

> We begin with the language that created the trust. Upon David's death, his share of the trust is to be divided among his living children. The term "children" is not defined in the terms of the trust, and the term is not qualified or restricted in any way (other than requiring the children to be "living"). Further, the trust language is silent as to adopted children—whether adopted in or out of the family. At the time Mildred included in her will the Testamentary Trust in 1991, the Indiana Trust Code did not define the term "children."1 Further, caselaw indicates that the ordinary, popular, and legal sense of the word "children" embraces the first generation of offspring. *Casper v. Helvie*, 83 Ind. App. 166, 146 N.E. 123, 127 (1925). All four of David's offspring were living at the time of his death.
>
> We now turn to the circumstances existing at the time Mildred executed her will establishing the Testamentary Trust in 1991. David was married to his first wife, Joan, and they had only one child, Brittany. During the course of their marriage, and while Mildred was alive, David and Joan had their second child, Matthew, in 1992. When Mildred died in 1994, David and Joan were still married, and Joan was pregnant with their third child, Molly. Moreover, the unrefuted designated evidence shows that, prior to her death, Mildred knew that Joan was pregnant with a third child, and that Mildred had a close relationship with both Brittany and Matthew during her lifetime. Mildred never knew that David and Joan got divorced or that David consented to the adoption of Brittany, Matthew, and Molly; these events all occurred after Mildred's death.
>
> As we did with her Testamentary Trust, we examine Mildred's intent with regard to the Irrevocable Trust. The term "issue" is not defined by the terms of the trust, and, other than requiring the issue to be twenty-one, the language of this provision does not restrict or limit the term or create a separate class for adopted children. The document is silent with regard to issue that may be adopted in or out of the family. The term "issue" is not defined in the trust code, but it has been defined in caselaw as meaning "descendants." *Allen v. Craft*, 109 Ind. 476, 9 N.E. 919, 922 (1887); *see also* Black's Law Dictionary (11th ed. 2019) (defining "issue" as lineal descendants; offspring). Here, David was a descendant of Charles, and Brittany, Matthew, Molly, and Raquel are all descendants or offspring of David.
>
> As to the facts and circumstances existing at the time Mildred established this trust in 1968, we have little information. David was only eight years old so Mildred had no knowledge of whether he would marry and/or have children. Beyond that information, there is no evidence that Mildred intended to exclude any of her descendants from this class of beneficiaries.
>
> * * *
>
> The courts of our state have made it abundantly clear that the settlor's intent is the sovereign guide in the interpretation of the terms of a trust. *See, e.g.*, *Doll v. Post*, 132 N.E.3d 34, 38 (Ind. Ct. App. 2019) (primary purpose in construing trust is to ascertain and give effect to settlor's intention), *trans. denied* (2020). We have

> before us no evidence of an intent on the part of Mildred to exclude her three eldest grandchildren from membership in the classes of beneficiaries of these two trusts merely because her grandson gave his consent to their adoption by their stepfather after Mildred's death. Therefore, we determine that, despite the fact that the O'Brien Children were adopted out of the Walters family, they retain their status as beneficiaries in the two trusts as the "children" of David and the "issue" of David's father.

David's daughter, by his second marriage, Raquel, was the objecting party. Her argument was that Indiana adoption and probate law required a different result:

> The purpose of Section 31-19-15-1 " 'is to shield the adoptive family from unnecessary instability and uncertainty arising from unwanted intrusions by the child's biological family.' " *In re Adoption of J.T.A.*, 988 N.E.2d 1250, 1253 (Ind. Ct. App. 2013) (quoting *In re Adoption of K.S.P.*, 804 N.E.2d 1253, 1257 (Ind. Ct. App. 2004)), *trans. denied*. Here, the O'Brien Children are all adults, and the biological family is not trying to interfere with any aspect of the relationship between them and their adoptive family. Rather, their biological great grandmother, with whom two of the three O'Brien Children2 had contact and a relationship from their birth until her death, included them as beneficiaries of her trusts. Although Raquel claims that a determination that the O'Brien Children are beneficiaries under the terms of Mildred's trusts would "undermine the purpose of the adoption statutes," we disagree. Appellant's Br. p. 20. The objective of Section 31-19-15-1 is not advanced by depriving the O'Brien Children of their status as beneficiaries merely because their biological father consented for them to be adopted after the death of the settlor of the trusts. The statute was designed as a shield to protect new adoptive families, not as a sword to prohibit adopted children from receiving a trust distribution, per the settlor's wishes, from a member of the family from which the children have been adopted out. Indeed, allowing this statute to be used in such a manner would contravene one of the cardinal principles of trust law: the settlor has the right to arrange for the distribution of her estate as she sees fit. *Paloutzian v. Taggart*, 931 N.E.2d 921, 925 (Ind. Ct. App. 2010) (citing Jay M. Zitter, Annotation, *Adopted Child as Within Class Named Deed or Inter Vivos Instrument*, 37 A.L.R.5th 237, § 2(a) (1996)).
>
> * * *
>
> In addition, Raquel contends that to conclude that the O'Brien Children are beneficiaries conflicts with both Indiana Code section 29-1-2-8 (1987) of the probate code and Section 6-4.1-1-3 (2012) of the tax code. Section 29-1-2-8 provides that, for purposes of intestate succession, an adopted child will be treated as a natural child of the child's adopting parents and will cease to be treated as a child of the natural parents. Section 6-4.1-1-3 states that, for purposes of inheritance taxes, a legally adopted child is to be treated as if the child were the natural child of the child's adopting parent if the adoption occurred before the individual was totally emancipated. These statutes apply only to intestate distributions and inheritance taxes, respectively, and do not constitute rules of trust construction. For that reason, they are of no significance in ascertaining the intention of a settlor in designating his or her intended beneficiaries when the children were adopted out of the family after the death of the settlor. Stated another way, the question we are presented with is not whether the O'Brien Children would take as heirs if Mildred had died intestate or what class of transferee they are in for purposes of calculating inheritance tax due. Rather, the question is whether Mildred intended to include the O'Brien Children in the

> classes of beneficiaries when she used the term "children" in her Testamentary Trust and when she used the term "issue per stirpes" in her Irrevocable Trust.

28. **The Ethics of Lawyers Working Remotely**. The ethics pronouncements of the American Bar Association are not binding on attorneys or state regulatory authorities. Nonetheless, in the absence of other authority, they can be helpful. On December 16, 2020, the ABA issued Formal Opinion 495 which reaches a common-sense conclusion:

> The purpose of Model Rule 5.5 is to protect the public from unlicensed and unqualified practitioners of law. That purpose is not served by prohibiting a lawyer from practicing the law of a jurisdiction in which the lawyer is licensed, for clients with matters in that jurisdiction, if the lawyer is for all intents and purposes invisible as a lawyer to a local jurisdiction where the lawyer is physically located, but not licensed. The Committee's opinion is that, in the absence of a local jurisdiction's finding that the activity constitutes the unauthorized practice of law, a lawyer may practice the law authorized by the lawyer's licensing jurisdiction for clients of that jurisdiction, while physically located in a jurisdiction where the lawyer is not licensed if the lawyer does not hold out the lawyer's presence or availability to perform legal services in the local jurisdiction or actually provide legal services for matters subject to the local jurisdiction, unless otherwise authorized.

Of course, the out-of-state lawyer must not represent to clients or the public that the lawyer is admitted to practice in the remote jurisdiction. That would be prohibited by Model Rule 5.5(b)(2).

29. **Decanting**. In Hodges v. Johnson, 177 A.3d. 86 (N.H. 2017), two irrevocable trusts were established in 2004 for the benefit of the grantor's wife, children, step-children and other descendants. The Trustees had a discretionary power to "distribute all or any portion of the net income and principal of the trust to any one or more of the group consisting of [the beneficiaries] and distributee trusts, in such amounts and at such times as the Trustee, in the Trustee's discretion, may determine." "Distributee trusts" were defined as any trust under the trust instruments or any other trust established by the grantor. A distributee trust could be for the benefit of one or more, "but not necessarily all," of the beneficiaries.

The Trustees of the two irrevocable trusts decanted trust assets into new trusts and eliminated the grantor's two step-children and one of his biological children from the definition of "descendants" in the new trust instruments, effectively stripping their interests in the trusts. The trust assets were not transferred to the new trusts. The decanting documents provided for the transfer of trust assets upon the settlor's death. Because the parties never made arguments regarding the failure to transfer the assets, both the trial court and the Supreme Court of New Hampshire treated the decantings as if they had occurred when decanting documents were executed and that the failure to transfer assets did not render the decantings invalid.

Under New Hampshire's decanting statute, if a Trustee has the power to make discretionary distributions of principal to one or more beneficiaries, the Trustee may decant the assets to a new trust that eliminates one of those beneficiaries as a beneficiary of the new trust. The statute further provides that "[i]n exercising the power to decant,

a trustee has a duty to exercise the power in a manner that is consistent with the settlor's intent as expressed in the terms of the trust, and the trustee shall act in accordance with the trustee's duties under this chapter and the terms of the first trust." RSA 564-B:4-418.

The trial court set aside the decantings and removed the Trustees. On appeal to the Supreme Court of New Hampshire, the court stated that even though New Hampshire's decanting statute allowed the Trustees to eliminate beneficiaries, and even though the Trustees had the discretion to distribute income and principal in the Trustees' discretion, the Trustees were still subject to the duty of impartiality in carrying out the decanting. The court stated that "a trustee, who makes unequal distributions among beneficiaries and/or eliminates a beneficiary's non-vested interest in an irrevocable trust through decanting, violates the statutory duty of impartiality only when the trustee fails to treat the beneficiaries 'equitably in light of the purposes and terms of the trust.'" (quoting Uniform Trust Code § 803 Cmt.).

The court agreed with the trial court that the decantings were improper and void because the decantings violated the Trustees' duty of impartiality by failing to consider the interests of all of the beneficiaries, both present and remainder. It is difficult to understand why a trustee would think it could decant under such circumstances.

The removed, former trustees asked to be reimbursed from the 2004 trusts for post-trial fees and costs they personally incurred defending the decantings, and asked not to be required to reimburse those trusts for the fees and costs the trusts incurred. The trial court found that the former trustees had committed a serious breach of trust and should not be granted the relief they sought. The Supreme Court of New Hampshire affirmed at Hodges v. Johnson, _____ A.3d. ____ (N.H. 2020). The opinion states:

> The Former Co-Trustees assert that the trial court "inappropriately relied" upon the fact that they did not file a petition for instruction. They argue that the trial court's reliance was improper because: (1)the court "failed to establish a valid foundation or set out any criteria to support its assertion that [they] should have filed a petition";(2) there "was no established law" suggesting that "their decision-making . . . was subject to doubt or conflicting claims";(3) they needed to act expeditiously to prevent the plaintiffs and Joanne from acting detrimentally to the 2004 Trusts; (4) bringing a petition for instruction would have resulted in "hotly contested" and "expensive" litigation;(5) "[t]he decanting decision concerned contingencies that are not appropriate for a petition for instruction"; and(6) even after Hodges, "we do not know how the Former Co-Trustees should have exercised their duty of impartiality."(Emphases omitted.)
>
> However, it is precisely when there is "uncertainty as to the proper application of the law to the facts" that a petition for instruction is warranted. Rock Springs Land and Timber, Inc. v. Lore, 75 P.3d 614, 623 (Wyo. 2003) (quotation omitted).Section 71 of the Restatement (Third) of Trusts provides: "A trustee . . . may apply to an appropriate court for instructions regarding the administration or distribution of the trust if there is reasonable doubt about the powers or duties of the trusteeship or about the proper interpretation of the trust provisions." Restatement (Third) of Trusts, § 71 (2007). "A trustee commits a breach of trust not only by violating a duty as a result of negligence or misconduct but also, ordinarily, by violating a duty because of a mistake concerning the nature or extent

> of the trustee's powers and duties under the terms of the trust or applicable law." Id. cmt. a at 9 (citation omitted).Accordingly, "[t]o avoid undue risk of liability when reasonable doubt exists in these matters, a trustee may seek protection by applying for instructions from an appropriate court." Id. Contrary to the Former Co-Trustees' assertions,
>
>> a trustee need not act at his or her peril in administering a trust. Nor need a trustee act first and discover later whether a particular act was in breach of trust. Instead, a trustee is entitled to judicial instructions whenever there is reasonable doubt about the powers or duties of the trusteeship or about the proper interpretation of the trust provisions. Indeed, a trustee can properly pay the costs of seeking instructions out of the trust estate, unless seeking them was plainly unwarranted, because there was no reasonable uncertainty about the matter in question.
>
> Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, Scott and Ascher on Trusts, § 16.8, at 1070-71(5th ed. 2007)(quotation omitted).
>
> To the extent that the trial court concluded that the circumstances in this case should have caused the Former Co-Trustees to have reasonable doubt as to whether the decantings at issue were proper, we agree. Here, the decanting to exclude beneficiaries of irrevocable trusts were to be accomplished under circumstances suggesting that the settlor directed them so as to disinherit disfavored family members. Those circumstances should have caused the Former Co-Trustees to have reasonable doubt as to the propriety of the decantings.
>
> Thus, we find no error in the trial court's suggestion that, before participating in the decantings, the Former Co-Trustees could have filed a petition for instruction or obtained an independent legal opinion, instead of relying exclusively upon McDonald's [settlor's attorney] advice under circumstances suggesting that he was doing the settlor's bidding to disinherit beneficiaries with whom the settlor was unhappy.

30. **Entity Transparency**. The National Defense Authorization Act, passed by Congress at the end of 2020 and beginning of 2021, contains the Corporate Transparency Act. Of particular interest to estate planners is that entities created by a filing with a state Secretary of State (or similar state office) will need to begin filing beneficial ownership statements with the Financial Crimes Enforcement Network, two years after Treasury issues regulations on the matter. A company with more than 20 full-time employees that files a US federal income tax return showing $5 million or more in gross receipts or sales, and that has a physical presence in the US, need not file, nor will charities and various other regulated businesses (banks, insurance companies, and the like) be required to file. Although business trusts likely do have reporting requirements, thus far private trusts have no reporting obligations but those may be imposed at a future point. Presumably general partnerships need not report because they are common law entities generally not required to make a filing under applicable state law.

Suppose a state wanted to assist entities that preferred not to make reports. If in such a state general partnerships lacked filing requirements then making general partnerships more attractive would seem to be desirable. The problem with general partnerships, from an estate planning point of view, is that they do not restrict management and liquidation rights as is required to obtain discounts, and, more generally, that they do not provide any party with limited liability. Traditionally limited liability and restricted management and liquidation could only be obtained via

entities that require state "incorporation" or a similar step. In the case of limited liability the commonly stated reason is that the public ought to know, or be charged with knowing, of limited liability.

Suppose a state substituted a naming requirement for a filing requirement. For example, the state might provide that a general partnership, created without a filing, would be a traditional general partnership with unlimited liability unless it contained in its name, say, "Limited Liability." A general partnership that contained "Limited Liability" in the name would have the limited liability of a limited liability corporation and would in all respects function as if were an LLC with all "general partners" as managers. For those clients who desired LLC benefits without the requirement of reporting, such an arrangement would be attractive. Quite obviously many other naming conventions could be adopted, for instance a "Special General Partnership" such that a traditional general partnership called Smith & Jones, SGP means it is formed as a general partnership, without formalities, but has adopted the LLC form of operation and liability.

Section Two

Ethics for Estate Planners

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Section Two

Ethics for Estate Planners…………………….... Margaret M. Christensen

PowerPoint Presentation

An Outline of Ethical Considerations in Representing Clients with Diminished Capacity

Relevant Indiana Rules of Professional Conduct 1

Considerations for Practitioners 1

1. Rule 1.14: Subsection (a) v. Subsection (b) 1
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Ethics for Estate Planners

Margaret M. Christensen

June 3, 2021

ETHICS FOR ESTATE PLANNERS

- Confidentiality (Rule 1.6)
- Conflicts of Interest (Rules 1.7 – 1.10)
  - Rule 5.4 (Professional Independence)
- Clients with Diminished Capacity (Rule 1.14)
  - Rule 1.2 (Scope of Representation and Allocation of Authority Between Client and Lawyer)
- Law Related Services (Rule 5.7)
- Advertising (Rule 7.1-7.5)

Confidentiality

Revealing confidential information

Indiana Rule of Professional Conduct 1.6

(a) A lawyer shall not reveal information relating to representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

Revealing confidential information

- ***In re Goebel (1998)***
- **Facts:**
  - Lawyer A represented criminal client
  - His partner, Lawyer B, represented guardianship client
  - Guardianship client happened to be a state witness in criminal case against criminal client
  - Criminal client demanded location of guardianship client from Lawyer A
  - Lawyer A acquiesced, showing criminal client an envelope with the address
  - Criminal client murdered guardianship client's husband
- **Verdict:**
  - Court held confidential information was broad, including all information concerning representation and regardless of the source
  - Lawyer's fear for his own safety did not justify his revelation

SCOPE OF CONFIDENTIALITY

Confidentiality: LAWYER must stay quiet

- Ethical obligation in all contexts.
- Applies to **information** learned from client in scope of representation.
- Client may authorize disclosure.

Privilege: LAWYER AND CLIENT can stay quiet

- Prevents compelled disclosure to tribunal.
- Applies to **communications** with client for purpose of seeking legal advice.
- Client may waive privilege.

Conflicts Of Interest

CONFLICTS OF INTEREST

Rule of Professional Conduct 1.7

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

CONFLICTS OF INTEREST

Rule of Professional Conduct 1.7

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

Conflicts of Interest: Self-Interested Transactions

RENEGOTIATING FEES

- **<u>Rule 1.8.(a)</u>:** "A lawyer shall not enter into a business transaction with a client. . ."
- **<u>Rule 1.8(a), Comment 1</u>**: ". . . Paragraph (a) applies when a lawyer seeks to renegotiate the terms of the fee arrangement with the client after representation begins in order to reach a new agreement that is more advantageous to the lawyer than the initial fee arrangement."
- **<u>Rule 5.7, Comment 5</u>**: When a client-lawyer relationship exists with a person who is referred by a lawyer to a separate law-related service entity controlled by the lawyer, individually or with others, the lawyer must comply with Rule 1.8(a).

WRITING MYSELF INTO THE WILL?

- Rule 1.8(c): A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift unless the lawyer or other recipient of the gift is related to the client.
- For purposes of this paragraph, related persons include a spouse, child, grandchild, parent, grandparent or other relative or individual with whom the lawyer or the client maintains a close, familial relationship.

ACCEPTING GIFTS-Comments To Rule 1.8

- Comment 6: A lawyer may accept a gift from a client, if the transaction meets general standards of fairness. For example, a simple gift such as a present given at a holiday or as a token of appreciation is permitted. (A substantial gift may be voidable under the doctrine of undue influence).
- Comment 7: If effectuation of a substantial gift requires preparing a legal instrument such as a will or conveyance the client should have the detached advice that another lawyer can provide. The sole exception to this Rule is where the client is a relative of the donee.
- Comment 8: A Lawyer may solicit future employment, such as being named the executor of the client's estate.

ACTING AS EXECUTOR:
"special position of obligation & responsibility"

"As an attorney and executor of the estate, the respondent entered into a fiduciary relationship which placed him in a special position of obligation and responsibility. Pleading ignorance of the very mechanics of the job for which he was hired is inconsistent with the essence of his fiduciary position."

Matter of Woolbert, 672 N.E.2d 412, 416 (Ind. 1996)

- (violated 29-1-10-13 by taking unauthorized fees during pendency of supervised estate)
- 1-year supsension

ACTING AS PERSONAL REPRESENTATIVE: *In re Miller*, 730 N.E.2d 171, 172 (Ind. 2000)

- Respondent was appointed personal representative and attorney for an estate pending
- Over 5 years, wrote 111 checks totaling $148,925 from the estate payable to himself. The checks were for varying amounts and were not in sequential order. Of the $148,925, only $80,000 could be identified as attorney fees and executor fees.
- While the respondent, as attorney and personal representative of the estate, had authority to pay himself fees pursuant to Ind. Code 29–1–7.5–3, he breached his fiduciary duty to the estate by paying himself $68,925 more than the identifiable executor and attorney fees.
- 8.4(d) violation (conduct prejudicial to the administration of justice); 12-month suspension

Conflicts of Interest: Third Party Payor

THIRD PARTY PAYING FOR LEGAL SERVICES
Rule 1.7, Comment 13

- **A lawyer may be paid from a source other than the client, including a co-client, if the client is informed of that fact and consents and the arrangement does not compromise the lawyer's duty of loyalty or independent judgment to the client.**
- See Rule 1.8(f). If acceptance of the payment from any other source presents a significant risk that the lawyer's representation of the client will be materially limited by the lawyer's own interest in accommodating the person paying the lawyer's fee or by the lawyer's responsibilities to a payer who is also a co-client, then the lawyer must comply with the requirements of paragraph (b) before accepting the representation, including determining whether the conflict is consentable and, if so, that the client has adequate information about the material risks of the representation.

THIRD PARTY PAYING FOR LEGAL SERVICES
Rule 1.8.

- (f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

    (1) the client gives informed consent;

    (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

    (3) information relating to representation of a client is protected as required by Rule 1.6.

THIRD PARTY PAYING FOR LEGAL SERVICES

Rule 1.8, Comment 11

. . . Because third-party payers frequently have interests that differ from those of the client, including interests in minimizing the amount spent on the representation and in learning how the representation is progressing, lawyers are prohibited from accepting or continuing such representations unless the lawyer determines that there will be no interference with the lawyer's independent professional judgment and there is informed consent from the client.

THIRD PARTY PAYING FOR LEGAL SERVICES
Rule 1.8, Comment 12

Sometimes, it will be sufficient for the lawyer to obtain the client's informed consent regarding the fact of the payment and the identity of the third-party payer.

- Rule 1.6, Confidentiality
- Rule 1.7, Conflict of Interest

THIRD PARTY PAYING FOR LEGAL SERVICES
Rule 5.4: Professional Independence

(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

Comments:

- [1] . . . . Where someone other than the client pays the lawyer's fee or salary, or recommends employment of the lawyer, that arrangement does not modify the lawyer's obligation to the client.
- [2] Rule 1.8 requires informed consent and third-party payor may not dictate legal strategy

Conflicts of Interest: Joint Representation

JOINT REPRESENTATION PERMISSIBLE

There is nothing inherently wrong in representing multiple clients where their interests are aligned.

Cincinnati Ins. Co. v. Wills, 717 N.E.2d 151, 161 (Ind. 1999)

REPRESENTING BOTH SPOUSES

- In Estate Planning?
  - Not Prohibited
- In Prenup?
  - Prohibited by Rule 1.7(a)
- In Divorce?
  - Prohibited by Rule 1.7(a)

Other Conflicts of Interest: Former Client

Former Client

Rule 1.9: Duties to Former Clients

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the *same* or *substantially related* matter in which that person's interests are materially adverse to the interests of the former client

- UNLESS the former client gives informed consent, confirmed in writing

(b) A lawyer shall not knowingly represent a person in the same or substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client

Comments:

- [3] matters are **substantially related** if (1) they involve the same transaction, or dispute; or (2) if there is a substantial risk confidential information obtained in prior representation would materially advance the client's position

Former Client – Substantially Related?

***In re Robak,* 654 N.E.2d 731, 735 (Ind. 1995).**

- Attorney's representation of husband's estate violated rules of professional conduct where the attorney drafted a will for wife with knowledge of a marital property agreement, and wife later sought to invalidate the same agreement, while attorney sought to establish validity of agreement to preserve estate assets.
- The court observed, "[i]n a general sense, [husband's attorney's] duty to aid in the preservation of the estate's assets was materially adverse to the wife's objective of seeking more from the estate than was originally provided to her in the client's estate plan." *Id.* at 735.

***Rust v. Lawson,* 714 N.E.2d 769 (Ind. Ct. App. 1999)**

- No conflict of interest where an attorney previously represented a party in a single criminal case and later represented a couple adopting the party's child, by drafting proposed findings of fact and conclusions of law.
- "[W]e cannot equate [attorney's] representation of Rust and subsequent representation of the Lawsons as a changing of sides in the present matter."

***In re Kirsch*, 83 N.E.3d 699 (Ind. 2017)**

- Attorney violated Rule 1.7 by representing intended adoptive parents and then assisting the birth mother in selecting other adoptive parents).

Former Client – Substantially Related?

Oregon Ethics Op. 2005-148

- Whether Rule 1.9 permits representation of one spouse in a divorce after a lawyer has done joint estate planning for the couple will depend on whether there is a "matter specific" or "information specific" conflict

Pennsylvania Ethics Op. 2005-107 (2005)

- Where lawyer represented married couple to execute reciprocal wills and all communications occurred in the presence of both spouses, the lawyer would be permitted to later represent the husband in the couple's divorce on the understanding that there was no information that the lawyer could use to the disadvantage of the former client

***Atkins v. Trans Union, LLC,* 869 F.3d 514, 520 (7th Cir. 2017)**

- An attorney's former representation of Trans Union did not preclude him from representing a consumer in an action against Trans Union because representation did not involve substantial risk of the attorney using Trans Union's confidential information.

Former Client – Substantially Related?

Lucci v. Lucci, **150 A.D.2d 650 (N.Y. App. Div. 1989)**

- Denyied husband's petition to disqualify his wife's attorneys because there was no substantial relationship between wife's attorney's prior representation of husband in sale of assets, formation of corporation, and purchase of residence and the marital dissolution.

Mathias v. Mathias**, 525 N.W.2d 81 (Wis. Ct. App. 1994)**

- Concluding "as a matter of law that estate planning which is reasonably contemporaneous with initiation of divorce proceedings is substantially related to issues which may arise in those proceedings."

Former Client - Hypothetical

2005

- Attorney Andrew prepares joint estate plant for Husband and Wife.
- In the course of the estate planning matter, Attorney Andrew meets jointly with Husband and Wife to discuss their assets and the structure and value of Wife's company, a medical device manufacturer.
- No valuation of Wife's company, which she estimates to be valued at $3M.
- The only financial information provided to Attorney Andrew by Husband and Wife is openly discussed among Husband, Wife, and Attorney Andrew.
- After Husband and Wife execute their estate planning documents, Attorney Andrew sends termination letter to Husband and Wife.

2010

- Wife contacts Attorney Andrew and asks for representation in seeking a dissolution of her marriage to Husband.
- Attorney Andrew refers Wife to his partner, Attorney Blaire.
- Value of Wife's business is disputed in the dissolution.

Other Conflicts of Interest: Imputed Conflicts

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Imputed Conflicts

Rule 1.10

(a) While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7, 1.9, or 2.2

- UNLESS the prohibition is based on a personal interest of the prohibited lawyer and does not present a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm.

Rule 1.10, Comment [3]

The rule in paragraph (a) does not prohibit representation where neither questions of client loyalty nor protection of confidential information are presented

***But see* Rule 1.8(k)**

Personal conflicts of interest are also imputed to law firm partners, with the exception of sexual relationship with clients

Imputed Conflicts

Definition of "firm" under Rule 1.10

- Comment [1] "firm" includes lawyers employed in a legal services organization or law department
- Comment [2] a firm of lawyers is essentially one lawyer for purposes of the rules governing loyalty to the client

Imputed Conflicts

***Matter of Sexson*, 613 N.E.2d 841 (Ind. 1993)**

- "Association" is treated as a firm if presented to the public suggesting it operates as a firm
  - Shared letterhead
  - Shared phone lines
  - Shared personnel
- Other factors:
  - Private agreements
  - Level of association
  - Access to confidential information

Representing Clients With Diminished Capacity

Rule 1.14: Client with Diminished Capacity

(a) When a client's capacity to make adequately considered decisions in connection with a representation is diminished, whether because of minority, mental impairment or for some other reason, the lawyer **shall**, as far as reasonably possible, maintain a normal client-lawyer relationship with the client.

(Mandatory)

Rule 1.14: Client with Diminished Capacity

(b) When the lawyer reasonably believes that the client has diminished capacity, is at risk of substantial physical, financial or other harm unless action is taken and cannot adequately act in the client's own interest, the lawyer **may** take reasonably necessary protective action, including consulting with individuals or entities that have the ability to take action to protect the client and, in appropriate cases, seeking the appointment of a guardian ad litem, conservator or guardian.

(Permissive)

Rule 1.14: Client with Diminished Capacity

(c) Information relating to the representation of a client with diminished capacity is protected by Rule 1.6. When taking protective action pursuant to paragraph (b), the lawyer is **impliedly authorized under Rule 1.6(a) to reveal information about the client, but only to the extent reasonably necessary to protect the client's interests.**

Rule 1.14: Client with Diminished Capacity

(d) This Rule is not violated if the lawyer acts in good faith to comply with the Rule.

When to Seek a Guardianship

Rule 1.14,

- Comment 5
  - If a lawyer has reasonable belief that a client is at risk of substantial physical, financial or other harm unless action is taken, AND
  - Normal client-lawyer relationship cannot be maintained as provided in paragraph (a) because the client lacks sufficient capacity to communicate or to make adequately considered decisions in connection with the representation, then paragraph (b) permits the lawyer to take protective measures deemed necessary.

When to Seek a Guardianship

Rule 1.14

- Comment 7
  - Is it necessary to protect the client's interests?
  - Is it required by procedural rules?
  - “In many circumstances, however, appointment of a legal representative may be more expensive or traumatic for the client than circumstances in fact require.”

Decision to Seek a Guardianship

- "When a client is unable to act adequately in his own interest, a lawyer may take appropriate action including seeking the appointment of a guardian. **The lawyer may consult with diagnosticians and others, including family members, in assessing the client's capacity and for guidance about the appropriate protective action. The action taken should be the least restrictive of the client's autonomy** that will yet adequately protect the client in connection with the representation.
  - American Bar Association Formal Op. 96-404

- **"In dealing with a client with a disability, the lawyer has a heightened degree of professional responsibility to insure that the best interest of the client is served**."
  - *Alabama State Bar Formal Op. 1995-03.*

Poor Judgment or Diminished Capacity

> "There is no bright line between difficult and disabled clients and, thus, none between the application of subparagraphs (a) and (b). . . . [This determination] can and should be made, however, upon all aspects of the situation, including . . . opinions of medical experts."

Alabama State Bar Formal Op. 1995-03.

Poor Judgment or Diminished Capacity

- “Rule 1.14(b) does not authorize the lawyer to take protective action because the client is not acting in what the lawyer believes to be the client’s best interest.”
  - *Colorado Formal Ethics Op. 126 (2015)*

- “Clearly subsection (b) means more than a belief that a client is a bad businessman.”
  - *Connecticut Informal Ethics Opinion 98-17* (attorney merely noticed that client made “questionable” business decisions)

- “You must believe that your client cannot act in her own best interests, but this **should not be based upon what you believe are ill-considered judgments alone**. If you feel that you have doubts about your client’s ability to act in her best interests, it may be appropriate to seek guidance from an appropriate diagnostician.”
  - *Connecticut Informal Ethics Op. 97-19.*

Poor Judgment or Diminished Capacity

Rule 1.14

- Comment 6
  - Consider and balance such factors as:
    - client's ability to articulate reasoning leading to a decision,
    - variability of state of mind and ability to appreciate consequences of a decision;
    - substantive fairness of a decision; and
    - consistency of a decision with the known long-term commitments and values of the client.
  - In appropriate circumstances, the lawyer may seek guidance from an appropriate diagnostician.

Exploring Less Restrictive Alternatives

- Rule 1.14, Comment 7 requires "least restrictive alternative"
- Seeking appointment of guardian under subsection(b) should only be used as "a last resort."
  - *Alabama State Bar Formal Op. 1995-03.*
- Lawyer representing "marginally competent client" must maintain "as regular a lawyer-client relationship as possible and adjust representation to accommodate a client's limited capacity before resorting to a request for a [guardian]"
  - Oregon Ethics Op. 2005-159
- "Even where the appointment of a guardian is the only appropriate alternative, that course, too, has degrees of restriction…the least restrictive course" might seek a *limited guardianship.*
  - ABA Formal Ethics Op. 96-404 (1996)

Exploring Less Restrictive Alternatives

- "A lawyer may seek appointment of a guardian or to take other protective action with respect to a client, only when the lawyer reasonably believes that the client cannot adequately act in the client's own interest."
  - *Connecticut Informal Ethics Op. 97-19.*

- "Before you attempt any protective action, you must determine that other, less drastic, solutions are no available."
  - *Id.*

Exploring Less Restrictive Alternatives

- "The commentary to 1.14 makes clear that even if maintaining the ordinary client lawyer relationship may not be possible, a client lacking legal competence often has the ability to understand, deliberate upon, and reach conclusions about matter affecting the client's own well being."
  - *Alaska Bar Assoc. Ethics Op. 94-3.*

Exploring Less Restrictive Alternatives

- Consulting with concerned family members
- Durable power of attorney (if capacity to execute)
- Revocable trust (if capacity to execute)
- Using a reconsideration period to permit clarification or improvement of circumstances
- Consulting with/referral to support groups, professional services, adult-protective agencies or others with the ability to protect the client.

Rule 1.14, cmt 5; ABA Formal Op. 96-404.

Maintaining a ‘Normal’ Relationship

- “[t]his obligation implies that the lawyer should continue to treat the client with attention and respect, attempt to communicate and discuss relevant matters, and continue as far as reasonably possible to take action consistent with the client’s directions and decisions.”
  - *Rule 1.14, cmt 5; ABA Formal Op. 96-404*
- Duty to maintain normal relationship precludes lawyer from acting solely as arm of the court by using lawyer’s assessment of client’s “best interests” to justify waiver of client’s rights without consultation, revealing client’s confidences, disregarding client’s wishes, or presenting evidence against client.
  - Colorado Ethics Op. 126 (2015)
- For example, in *In re Flack*, the court held duty to maintain normal client-lawyer relationship with impaired client meant “duty to abide by her estate planning objectives”
  - *In re Flack*, 33 P.3d 1281 (KS. 2001)
- Where a client wishes to be present at trial, his attorney may not make recommendations that contravene client’s wishes, even if in the name of client’s “best wishes.”
  - *In re Lee*, 754 A.2d 426 (Md. Ct. Spec. App. 2000)

Identification of Your Client

- “The fact that a client suffers a disability does not diminish the lawyer's obligation to treat the client with attention and respect. Even if the person has a legal representative, the lawyer should as far as possible accord the represented person the status of client, particularly in maintaining communication.”
  - *Rule 1.14, cmt 2*
- Normal conflict rules apply in the case of a disabled client.

Identification of Your Client

- Your client may not be the person paying the fees.
- Be wary of the third-party payor who wants to call the shots.
- Third-party payor does not affect lawyer’s duty of loyalty or independent judgment to the client. *Rule 1.8(f)*
- Acceptance of payment from third party cannot create material limitation on the lawyer’s representation. *Rule 1.7*

Identification of Your Client

- “The client may wish to have family members or other persons participate in discussions with the lawyer. When necessary to assist in the representation, the presence of such persons generally does not affect the applicability of the attorney-client evidentiary privilege. Nevertheless, **the lawyer must keep the client's interests foremost and, except for protective action authorized under paragraph (b), must look to the client, and not family members, to make decisions on the client's behalf**.”
  - *Rule 1.14, cmt. 3*

Identification of Your Client

- Look to legal representative if one is already appointed
- For minors, typically look to parents as the natural guardians (subject to exceptions depending on the facts)
- "If the lawyer represents the guardian as distinct from the ward, and is aware that the guardian is acting adversely to the ward's interest, the lawyer may have an obligation to prevent or rectify the guardian's misconduct. See Rule 1.2(d)." *Rule 1.14, cmt 4*

Reminder About Confidentiality

(a) A lawyer shall not reveal information relating to representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b). *Rule 1.6*

Disclosures of Client’s Condition

- Disclosure of the client's diminished capacity could adversely affect the client's interests (e.g., proceedings for involuntary commitment).
  - *Rule 1.14, cmt 8; S.C. Bar Ethics Advisory Op. 94-35.*
- Information relating to the representation is protected by Rule 1.6. Therefore, unless authorized to do so, the lawyer may not disclose such information.
- When taking protective action pursuant to paragraph (b), the lawyer is impliedly authorized to make the necessary disclosures, even when the client directs the lawyer to the contrary.
  - *Rule 1.14, cmt 8*

Disclosures of Client's Condition

- "Given the risks of disclosure, paragraph (c) limits what the lawyer may disclose in consulting with other individuals or entities or seeking the appointment of a legal representative. **At the very least, the lawyer should determine whether it is likely that the person or entity consulted with will act adversely to the client's interests before discussing matters related to the client.** The lawyer's position in such cases is an unavoidably difficult one."
  - *Rule 1.14, cmt 8*

Disclosures of Client's Condition

Compare with California, which prohibits guardianship proceedings without client's consent:

"[It]t is unethical for an attorney to institute conservatorship proceedings contrary to the client's wishes, since by doing so the attorney will be divulging the client's secrets and representing either conflicting or adverse interests."

State Bar of Cal. Standing Committee on Prof. Resp. and Cond. Formal Op. No 1989-112.

Disclosures of Client’s Condition

“The lawyer’s professional judgment concerning the client’s competency should be corroborated by professional consultations and reports. The lawyer may also consult with close relatives of the client with the client’s consent and whose advice the client might respect to determine if the refusal to accept the settlement is the result of a significant disability rather than simply unreasonable.”

- *Rhode Island Ethics Op. RI-76.*

Disclosures to Family

- Cannot make disclosures unnecessary to complete objective of representation.
- Attorney, who was hired by father of adult child with diminished capacity to represent child in obtaining Social Security Disability Benefits, could not release results of psychiatric evaluation to father.
  - *Illinois State Bar Association Op. on Prof. Cond. No. 00-02.*

Disclosures to a Physician

- Can make necessary disclosures to evaluate need for guardianship under section (b).
- "The disclosures necessary for the lawyer to seek expert advice when there is reason to suspect impairment threatening serious harm to the client are impliedly authorized in order to carry out the representation within the meaning of Model Rule 1.6."
  - *ABA Informal Opinion 89-1530*
- "Attorney should be commended for soliciting advice from the neurologist in determining the nature of Client's condition"
  - *South Carolina Bar Ethics Advisory Op. 94-35.*

Disclosures to a Physician

- "A lawyer may consult a client's physician concerning a medical condition which interferes with the client's ability to communicate or make decisions concerning the representation even though the client has not consented and is currently incapable of doing so."
- "It is difficult to think of a more appropriate diagnostician with whom the lawyer can consult concerning a client's suspected disability than a physician who, incidentally, is also subject to a duty to maintain confidences communicated by the patient or on the patient's behalf."
  - *ABA Informal Op. 89-1530.*

Disclosures to a Adversary

- "Continued representation should not violate the lawyer-client privilege nor prejudice the client's interests by informing the adversary of the client's mental condition."
  - *Rhode Island Ethics Op.RI-76.*

Disclosures to Tribunals

- Even if lawyer believes that course of action supported by guardian is in the client's best interests, a lawyer must still inform the court of his or her client's opposition to course of action supported by both the guardian and the lawyer.
  - *Alaska Bar Assoc. Ethics Op.94-3.*

Client Disagreement with Guardian

- Client may not be able to articulate convincingly the reasons why the client does not wish to follow the guardian's plan.
- **If the client cannot be persuaded, the lawyer's duty is to represent the interests of the client.**
- If the guardian [still insists on taking the suggested course of action], it is the lawyer's duty to make his client's wishes known to the court.

Alaska Bar Assoc. Ethics Op.94-3.

Termination of Representation

- Conflicting authority among various states
- Some states require the guardian to be appointed before attorney may withdraw
- Others suggest it is the better course, but do not require it.
- California doesn’t allow lawyers to initiate guardianship proceedings against their clients, but does permit withdrawal if the client’s conduct prevents the attorney from carrying out the representation.

Responsibilities Regarding Law-Related Services: Rule 5.7

LAW-RELATED SERVICES:

Rule 5.7(b)

- The term "law-related services" denotes services that might reasonably be performed in conjunction with and in substance are related to the provision of legal services, and that are not prohibited as unauthorized practice of law when provided by a non-lawyer.

LAW-RELATED SERVICES:

- Providing title insurance;
- **Financial planning**;
- Accounting;
- Real estate counseling;
- Legislative lobbying;
- Economic analysis;
- Social work;
- Psychological counseling;
- **Tax preparation**;
- Medical or environmental consulting; and
- Coordinating Parenting Time

RESPONSIBILITIES:

Rule 5.7(a)

A lawyer shall be subject to the Rules of Professional Conduct with respect to the provision of law-related services, [if such] services are provided:

(1) by the lawyer in circumstances that are not distinct from the lawyer's provision of legal services to clients; or

(2) in other circumstance by an entity controlled by the lawyer individually or with others if the lawyer fails to take reasonable measures to assure that a person obtaining the law-related services knows that the services are not legal services and that the protections of the client-lawyer relationship do not exist.

A CAVEAT: Rule 8.4

- Even if activities fall outside of 5.7(a), and are not subject to the Rules of Professional Conduct, 8.4 may apply
- It is misconduct to. . .

  (b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

  (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

  (d) engage in conduct that is prejudicial to the administration of justice;

  (e) state or imply an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law;

RESPONSIBILITIES:

The Rules of Professional Conduct APPLY if:

- The non-legal services are performed out of your office location, phone line, using your legal staff, and shared letterhead;
- If the client doesn't understand that the services are non-legal and that the protections of the client-lawyer relationship do not exist.

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PURPOSE: AVOIDING CONFUSION

Comment 1 to Rule 5.7:

- "... the person for whom the law-related services are performed fails to understand that the services may not carry with them the protections normally afforded as part of the client-lawyer relationship."
- "The recipient of the law-related services may expect":
  - the protection of client confidences,
  - prohibitions against representation of persons with conflicting interests, and
  - obligations of a lawyer to maintain professional independence apply to the provision of law-related services

ATTORNEY MUST ELIMINATE CONFUSION

Rule 5.7, Comment 6:

- The attorney bears the duty to communicate that the ethics rules don't apply:
- Communicate to the person receiving the law-related services, in a manner sufficient to assure that the person understands the significance of the fact, that the relationship of the person to the business entity will not be a client-lawyer relationship.
- The communication should be made ***before*** entering into an agreement for provision of or providing law-related services, and ***preferably should be in writing***.

LAWYER'S BURDEN

Rule 5.7, Comment 7:

- ***The burden is upon the lawyer*** to show that the lawyer has taken reasonable measures under the circumstances to communicate the desired understanding.
- For instance, a sophisticated user of law-related services, such as a publicly held corporation, may require a lesser explanation than someone unaccustomed to making distinctions between legal services and law-related services, such as an individual seeking tax advice from a lawyer-accountant or investigative services in connection with a lawsuit.

SEPARATE LEGAL WORK FROM NON-LEGAL WORK

Rule 5.7, Comment 8:

- "Regardless of the sophistication of the client. . . take special care to keep separate the provision of law-related and legal services in order to minimize the risk that the recipient will assume that the law-related services are legal services."
- "The risk of such confusion is especially acute when the lawyer renders both types of services with respect to the same matter."
- "Under some circumstances the legal and law-related services may be so closely entwined that they cannot be distinguished from each other, and the requirement of disclosure and consultation imposed by paragraph (a)(2) of the Rule cannot be met."

CYA LETTER

- Protect yourself by obtaining “written informed consent”
- Include it in your engagement letter:
  - I am an attorney
  - You have engaged me to perform non-legal services
  - I do not represent you
  - I am not providing legal advice in the course of my PC services
  - The Rules of Professional Conduct do not apply to these services, and the ordinary protections of the attorney-client relationship do not apply
    - Confidentiality
    - Privilege
    - Conflicts

RULE 5.7, COMMENT 10: AREAS OF SPECIAL CONCERN

- Advertising:
  - Rules 7.2-7.5, dealing with advertising and solicitation.
- Confidentiality:
  - Rule 1.6
- Conflict of Interest:
  - Rules 1.7-1.11, especially Rules 1.7(a)(2), 1.8(a), (b) and (f)

Advertising: Referrals

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Advertising

Indiana Rule of Professional Conduct 7.1

A lawyer shall not make a false or misleading communication about the lawyer or the lawyer's services. A communication is false or misleading if it contains a material misrepresentation of fact or law, or omits a fact necessary to make the statement considered as a whole not materially misleading.

Advertising

The Do-Nots: Applies to ads, brochures, press releases, website content, blogs, videos and articles

- Specific words that ***cannot*** be used:
  - "Expert"
  - "Expertise"
  - "Certified" (unless board certification is current)
  - "Specialist"
  - "Authority"
- Content that ***cannot*** create an unjustified expectation about lawyer or firm:
  - Testimonials
  - Endorsements
  - Representations

Advertising

The Do-Nots: Applies to ads, brochures, press releases, website content, blogs, videos and articles

- Other examples of terms that ***cannot*** be used:
  - Statistics on past performance
  - Guarantees or predictions of future performance
  - Superlatives like "most" or "biggest" or "best" that cannot be measured. For example:
    - "We will do the most for our clients." **BAD**
    - "We strive to do the most for our clients" **GOOD** (The key is strive)
  - Quality of service. For example:
    - "We provide high quality legal services." **BAD**
    - "We strive to provide our clients with high quality legal services." **GOOD**
  - Appeals to fear, greed, desire for revenge or emotions
  - Any false, fraudulent or misleading statements
  - Any deceptive statements
  - Any self-laudatory statements

Advertising

Indiana Rule of Professional Conduct 7.2

(b) A lawyer shall not give anything of value to a person for recommending or advertising the lawyer's services except that a lawyer may:

- (4) refer clients to another lawyer or a non-lawyer professional pursuant to an agreement not otherwise prohibited under these Rules that provides for the other person to refer clients or customers to the lawyer, if
  - (i) the reciprocal referral agreement is not exclusive, and
  - (ii) the client is informed of the existence and nature of the agreement.

Thank you

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An Outline of Ethical Considerations in Representing Clients with Diminished Capacity

Margaret M. Christensen & Andrew Pendexter[1]

Relevant Indiana Rules of Professional Conduct

- 1.2 Scope of Representation and Allocation of Authority Between Client and Lawyer
- 1.4 Communication
- 1.6 Confidentiality
- 1.7-1.9 Conflicts
- 1.14 Client with Diminished Capacity
- 2.1 Advisor
- Rule 1.14. Client with Diminished Capacity

Considerations for Practitioners

1. Rule 1.14: Subsection (a) v. Subsection (b)

- Subsection (a) requires that a lawyer maintain a normal client-lawyer relationship with his or her client if at all possible despite a client's diminished capacity. This language is **mandatory**.
- Subsection (b) allows a lawyer to take "reasonably necessary protective action" when a lawyer believes that his or her client has diminished capacity. This language is **permissive**.
- "The language of the general rule [subsection (a)] is mandatory. The language of subsection (b) is permissive but authorizes intervention *only* where the lawyer acts upon *reasonable* belief that the client is not competent to make decisions in his own interest." Connecticut Informal Ethics Opinion 98-17 (emphasis in original).

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2. What Constitutes Sufficient Belief that Client has Diminished Capacity under (b)?

- Facts insufficient to support belief
  - "Clearly subsection (b) means more than a belief that a client is a bad businessman." Connecticut Informal Ethics Opinion 98-17 (noting that attorney noticed that client made "questionable" decisions running his business)
  - "You must believe that your client cannot act in her own best interests, but this **should not be based upon what you believe are ill-considered judgments alone**. If you feel that you have doubts about your client's ability to act in her best interests, it may be appropriate to seek guidance from an appropriate diagnostician." Connecticut Informal Ethics Opinion 97-19.

3. The Decision to Seek a Guardianship

- "A lawyer may seek the appointment of a guardian or take other protective action if the lawyer reasonably believes that his or her client cannot adequately act in the client's own interest. This determination must be made by the lawyer after analysis of all aspects of the situation, including opinions of medical experts. In dealing with a client with a disability, the lawyer has a heightened degree of professional responsibility to insure that the best interest of the client is served." Alabama State Bar Formal Opinion 1995-03.
  - **Seeking appointment of guardian under subsection(b) should only be used as "a last resort."**
  - "A client lacking legal competence often has the ability to understand, deliberate upon, and reach conclusions about matters affecting the client's own well-being. Furthermore, to an increasing extent, the law recognizes intermediate degrees of competence." (Quoting comment to Rule 1.14 of the Alabama Rules of Professional Conduct.)
- "The commentary to 1.14 makes clear that even if maintaining the ordinary client lawyer relationship may not be possible, a client lacking legal competence often has the ability to understand, deliberate upon, and reach conclusions about matter affecting the client's own well being." Alaska Bar Association Ethics Opinion 94-3.

- "A lawyer may seek appointment of a guardian or to take other protective action with respect to a client, only when the lawyer reasonably believes that the client cannot adequately act in the client's own interest." Connecticut Informal Ethics Opinion 97-19.
    - "**Before you attempt any protective action, you must determine that other, less drastic, solutions are no available.**"
        - Examples: "[I]nvolvement of other family members who are concerned about the client's well-being, use of a durable power of attorney or a revocable trust where a client of impaired capacity has the capacity to execute such a document, and referral to support groups or social services that could enhance the client's capacities or ameliorate feared harm." (Quoting ABA Formal Opinion 96-404.)
- "The lawyer's professional judgment concerning the client's competency should be corroborated by professional consultations and reports. The lawyer may also consult with close relatives of the client with the client's consent and whose advice the client might respect to determine if the refusal to accept the settlement is the result of a significant disability rather than simply unreasonable." Rhode Island Ethics Opinion RI-76.
- **California does not allow an attorney to institute guardianship proceedings when client does not agree**: "[It]t is unethical for an attorney to institute conservatorship proceedings contrary to the client's wishes, since by doing so the attorney will be divulging the client's secrets and representing either conflicting or adverse interests." State Bar of California Standing Committee on Professional Responsibility and Conduct Formal Opinion No 1989-112.

4. Confidentiality

- Alabama allows disclosure of confidential information when an attorney reasonably believes doing so is necessary to prevent a client from committing a criminal act that is likely to result in imminent death or serious bodily harm to the client or others. Alabama State Bar Formal Opinion 1995-06.
- "Continued representation should not violate the lawyer-client privilege nor prejudice the client's interests by informing the adversary of the client's mental condition." Rhode Island Ethics Opinion RI-76.

- "[I]t must follow that the disclosures necessary for the lawyer to seek expert advice when there is reason to suspect impairment threatening serious harm to the client are impliedly authorized in order to carry out the representation within the meaning of Model Rule 1.6" ABA Informal Opinion 89-1530.
- Attorney, who was hired by father of adult child with diminished capacity to represent child in obtaining Social Security Disability Benefits, could not release results of psychiatric evaluation to father. Illinois State Bar Association Opinion on Professional Conduct No. 00-02.

5. Confidentiality Considerations

- When considering seeking appointment of guardian, attorney must be "concerned that the disclosure of Client's condition may adversely impact Client's interests, such as leading to involuntary commitment." South Carolina Bar Ethics Advisory Opinion 94-35.

6. Seeking Medical Opinions on Behalf of Client

- Most states encourage attorneys to seek the opinions of medical professionals when determining whether to seek appointment of a guardian under subsection (b).
  - "There is no bright line between difficult and disabled clients and, thus, none between the application of subparagraphs (a) and (b). . . . [This determination] can and should be made, however, upon all aspects of the situation, including . . . opinions of medical experts." Alabama State Bar Formal Opinion 1995-03.
  - "Attorney should be commended for soliciting advice from the neurologist in determining the nature of Client's condition" South Carolina Bar Ethics Advisory Opinion 94-35.
  - "A lawyer may consult a client's physician concerning a medical condition which interferes with the client's ability to communicate or make decisions concerning the representation even though the client has not consented and is currently incapable of doing so." ABA Informal Opinion 89-1530.
    - "The Comment to Model Rule 1.14 . . . encourages the lawyer to seek guidance from an appropriate diagnostician before proceeding. It is difficult to think of a more appropriate diagnostician with whom the lawyer can consult concerning a client's suspected disability than a physician who,

incidentally, is also subject to a duty to maintain confidences communicated by the patient or on the patient's behalf."

7. Client's Disagreement with Guardian's Decisions

- Even if lawyer believes that course of action supported by guardian is in the client's best interests, a lawyer must still inform the court of his or her client's opposition to course of action supported by both the guardian and the lawyer. Alaska Bar Association Ethics Opinion 94-3.
    - "While it is simple to say on a paternalistic level that the client is not competent to know what is in his own best interest, it is equally true that the client may not be able to articulate convincingly the reasons why the client does not wish to [follow the suggested course of action.] If the client cannot be persuaded, the lawyer's duty is to represent the interests of the disabled person. If the guardian [still insists on taking the suggested course of action], it is the lawyer's duty to make his client's wishes known to the court."

8. Conflicts

- Normal conflict rules apply in cases of a disabled client. Alaska Bar Association Ethics Opinion 94-3.
    - Often times in representations involving a disabled person, a third party (family member, etc.) will pay for the disabled person's legal representation.
        - "A lawyer may be paid from a source other than the client, including a co-client, if the client is informed of that fact and consents and the arrangement does not compromise the lawyer's duty of loyalty or independent judgment to the client. See Rule 1.8(f). If acceptance of the payment from any other source presents a significant risk that the lawyer's representation of the client will be materially limited by the lawyer's own interest in accommodating the person paying the lawyer's fee or by the lawyer's responsibilities to a payer who is also a co-client, then the lawyer must comply with the requirements of paragraph (b) before accepting the representation, including determining whether the conflict is consentable and, if so, that the client has adequate information about the material risks of the representation." Indiana Rule of Professional Conduct 1.7 cmt. 13.

9. Withdrawal from Representing a Client with Diminished Capacity

- States are split on if and under what circumstances a lawyer may withdraw from representing a client who he or she believes has a diminished capacity.
  - Attorney may not seek to withdraw from representation of mentally diminished client with psychoses until after a guardian has been appointed for client. South Carolina Bar Ethics Advisory Opinion 94-35.
  - "While the undesirability of filing for protective action may lead some to search for [the rules governing withdrawal], a withdrawal from a client at this time probably occurs when the client needs representation most. Another lawyer may have the same communications problems that you are experiencing. The ABA opinion states that it is a better course of action for lawyers to stay with the representation and seek appropriate protective action, although this does not prohibit withdrawal." Connecticut Informal Ethics Opinion 97-19.
  - Lawyer should seek to have guardian appointed before withdrawal: "[Once guardian is appointed], this would remove the question of the court approved withdrawal as you would have a competent representative to deal with. Notice of your withdrawal could be made to a party who will fully understand the situation and be able to ensure that your client's best interests are protected. In addition this would also help to satisfy your obligation under Rule 1.16(d) not to prejudice your client's claim." Philadelphia Bar Association Ethics Opinion 92-16.
  - California does not allow institution of guardianship proceedings by lawyer, but does allow withdrawal if "client's conduct interfere or unduly inhibit the attorney's ability to carry out the purpose for which the attorney was retained . . . ." State Bar of California Standing Committee on Professional Responsibility and Conduct Formal Opinion No 1989-112.

Section Three

Income Tax Issues After You Structure Your Estate Plan

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Section Three

**Income Tax Issues After You
Structure Your Estate Plan……………………... Richard L. Bartholomew**

PowerPoint Presentation

MIDWEST ESTATE, TAX & BUSINESS PLANNING INSTITUTE 2021

INCOME TAX ISSUES AFTER YOU STRUCTURE YOUR ESTATE PLAN

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Once you have your estate plan in place lets look at some of the income tax issues you may be saddled with

We will look at

- 1. Ease of Set up
- 2. Tax Aspects during life
- 3. Post death tax benefits and
- 4. Post death tax problems / complications

Sole Proprietor

1. No cost set up but unlimited personal liability
2. No separate tax return but full Self Employment (SE) tax on all income
3. Step up in basis generally for everything other than cash basis accounts receivables.

Sole Proprietor cont.

4. Owner still has unlimited personal liability and lack of transferability
   - Entity disappears upon death, but can still sell assets.
   - After step up shouldn't be any gain on sale (other than receivables)

Single Member LLC

1. Formal creation with Sec. of State

   No operating agreement needed

   Liability protection in general
2. Disregarded entity for tax purposes - File Schedule C, or F or E depending on business operations (full SE tax expense)

Single Member LLC cont.

3. Transferable
   - Can change into a multi-member LLC (taxed as a partnership for multiple beneficiaries)
   - Can elect to be a corporation (even an S corporation if correct shareholders) or
   - Keep one member and continue

Single Member LLC cont.

4. If stay a single member LLC still have full SE tax expense

C Corporation

1. Formal creation with Sec. of State
   - Should have bylaws, stock certificates and corporate minute book
   - Liability protection in general
2. Form 1120 separate income tax return
   - Subject to double tax on dividends

C Corporation cont.

2. Entity pays tax at 21% (for now)

- Possible qualification for Section 1202 exclusion from income on sale of stock if original owner of stock; and held for 5 years

3. Entity continues with no interruption after death

C Corporation cont.

4. Only step up in basis of stock (not underlying assets)

C Corporation example

Old (livestock) farm corporation in Indiana

Farmland and house in the corporation so farmer can live in house as a condition of employment

No income to farmer, and full deductions and depreciation on house

C Corporation example cont.

At death, get a step of basis only of the stock of the corporation

Highly appreciated land stuck in corporation

Surviving spouse might not be able to live in the house as a condition of employment because retired

Planning

Look at possible S election

But watch out for Built In Gains Tax

Also watch out for too much passive income that can blow S election (get good CPA involved)

As an S corporation, after death, if sell assets and liquidate in the same year, you should be able to offset a significant amount of capital gains

S Corporation

1. Formal creation with Sec. of State

Should have bylaws, stock certificates and minute book

Liability protection if follow corporate formalities

S Corporation cont.

2. One level of tax (shareholder level)
   - Possible SE tax savings if pay reasonable compensation
3. Still one level of tax after death, and can have multiple owners

S Corporation cont.

4. **Credit shelter trust without proper language will blow S election as ineligible shareholder**
   - Only step up in stock basis, so if going to sell assets, best plan is to liquidate in the same year

S Corporation Example

Only asset in S corporation – Land

FMV = $100,00

Basis of land = $10,000

Joe owns all of the stock and passes away.

Estates basis in stock steps up to $100,000

Example cont.

Sell land for $100,000 and recognize gain of $90,000 and then liquidate

Cash to estate of Joe = 100,000

But what about estate's stock basis at liquidation

Basis

At DOD basis step up to $100,000

K-1 from year of sale of $ 90,000

Basis now up to $190,000

Received cash on Liq of $100,000

Estate has loss on Liq of <$ 90,000>

1041 shows net gain of -0-

Mistake

Don't make a mistake of selling in year 1 and liquidating in year 2

Would recognize gain and pay tax in year 1 and have LTCL in year two that you can only offset with other gains plus $3,000 per year

Planning

Estate planning to get discounts on S corporation stock will work counter to income tax planning

Spouse owned stock won't get step up

Gifts to kids will have carryover basis

Need to compare estate tax rate vs income tax rate

Partnership

- Three types

1. General partnership
2. Limited partnership
3. Multi-Member LLC (default classification)

Partnership

- GP does not require filing with the Sec. of State
- LP's and LLC require filing with the Sec. of State
- All should have operating agreements

Partnership cont.

- GP's or GP of a limited partnership has unlimited personal liability
- LLC's don't
  - But watch because the common language of most operating agreements require any partner/member with a negative 'Capital Account" to contribute money to bring their account back up to -0-

Partnership cont.

2. Partnership tax rules are extremely flexible

- They are also extremely complex
- Operating agreements are typically longer and more expensive than Articles of Incorporation and By-Laws

Partnerships cont.

2. Under recent IRS rules, unless the partnership elects otherwise, any audit adjustments will cause tax at the partnership level for the partners at the date the audit is over

- No throw back to old partners
- What's in your purchase agreement

Partnerships cont.

3. Partnership can make a Section 754 election and allow the estate of a deceased partner or purchaser of a partners interest to actually step up the basis of the assets in the partnership as it relates to them

Partnerships cont.

4. Partnership tax rules are very complicated

- Sale of partnership interest subject to Section 751 hot asset rule, which can convert some LTCG into ordinary income
- Section 754 mandatory if step down would exceed $250,000

LLC Making an S Election

- Under the IRS check the box rules, an LLC may make an election to be taxed as a corporation (even an S corp)
- Caution: many attorneys use partnership operating agreements for their LLC.

LLC Making S Election cont.

- The problem is most partnership agreements reference 704 of the Internal Revenue Code
- That Code Section requires unequal distributions in certain circumstances
- Violation of S rules
- Lose S status (become a C corp.)

Limited Liability Partnership or Master Limited Liability Company aka Series LLC's are taxed as partnerships (see above for good and bad)

Revocable Trust

1. Need trust document, but no registration with State
2. Treated as grantor trust so income tax reporting on Settlors return (no extra returns)
3. Avoids probate

- Step up in basis of assets

Revocable Trust cont.

4. Trust document needs to be well thought out to handle a number of contingencies

- If use commercial trust department, can get expensive
- If don't use trust department trustee may lack expertise

Revocable Trust cont.

4. Popularity of trust recanting is evidence of complexity of drafting trust document to handle multiple situations and changing tax laws

- After death, no longer Grantor trust, w/o proper language may lose "S" shareholder status

Intentionally Defective Grantor Trust

1. Need trust document, but no registration with State
2. Treated as Grantor trust for income tax purposes, but a completed gift for estate purposes

Intentionally Defective Grantor Trust cont.

2. Taxes paid by grantor on trust income are not deemed to be a gift even though the payment (in essence) increases the amount that will go to the remainder beneficiary

Intentionally Defective Grantor Trust cont.

3. Avoids probate, and claims of creditors
4. No step up in basis of the underlying assets

- Same potential issues with drafting for contingencies and changing tax laws

Intentionally Defective Grantor Trust cont.

- If income is not distributed to the beneficiaries (is trapped in the trust) the tax rates are onerous
- Top tax bracket (37%) at $13,050 in 2021 plus 20% capital gains rates at $13,250 and 3.8% Net Investment Income Tax at $13,050

Spousal Lifetime Access Trust

1. Need trust document, but no registration with State
2. Typically created as a Grantor trust so Settlor pays tax on income (which further increases value going to beneficiaries) and simplifies tax reporting

Spousal Lifetime Access Trust cont.

3. Avoids probate
- Appreciation after funding escapes estate tax
4. No step up in basis
- Any income trapped in trust taxed at onerous tax rates
- Most likely can't hold S Stock

Dynasty Trust

1. Need trust document, but no registration with State
2. May start as a Grantor Trust, but after death, will be taxed as a trust
- Onerous tax rates on undistributed income

Dynasty Trust cont.

3. Creditor and divorce proof, and avoids probate
4. No step up in basis of assets and onerous trust tax rates

Special Needs Trust – Self Settled

1. Need trust document, but no registration with State
2. Typically treated as grantor trust so income tax reporting on Settlors return (no extra returns)
3. Avoids probate

- Step up in basis of assets

Special Needs Trust – Self Settled cont.

4. Medicaid payback requirement of the trust document and who pays tax on the gain upon the sale of the assets is an unresolved issue

Special Needs Trust – 3rd Party

1. Need trust document, but no registration with State
2. Trust pays tax on "Undistributed" net income, which is common, at onerous tax rates

Special Needs Trust – 3rd Party cont.

3. Assets avoid Medicaid payback
- Assets avoid probate
4. Income not distributed taxed at onerous tax rates

Charitable (Remainder) Trust

1. Need trust document, but no registration with State
2. Can get very favorable tax treatment by contributing highly appreciated assets to the Charitable Remainder Trust, and having the trust sell them

Charitable (Remainder) Trust

2. Gain is not currently recognized and Donor typically gets a stream of income for life
   - Gain only taxed if distributions exceed annual taxable income earned by the trust

Charitable (Remainder) Trust cont.

3. Remainder goes to charity upon death of income beneficiary
   - Bypasses probate
   - Capital gain often never fully taxed
4. Need charitable intent because family doesn't get assets

Retirement Plan

1. Formal set up according to IRS rules
   - Multiple types – IRA; SEP; 401(k); Profit Sharing Plan, Defined Benefit Plan
2. You get a tax deduction for contributions (lowers your taxes for putting money aside for yourself)

Retirement Plan cont.

- Don't try to create your own business owned by your Self Directed IRA – It will most likely disqualify the IRA

3. Avoids probate if appropriate beneficiary designation

Retirement Plan cont.

4. New rules force most beneficiaries (other than spouse) into maximum 10 year payout instead of life expectancy

- No step up and ordinary income (not capital gains) tax rates on distributions

Example of complex tax rules

- In partnership tax, the phrase "Capital Account" actually has at least three definitions and often result in 3 totally different values

Complex cont.

- Partnership tax rules require that pre-contribution gain be taxed to the partner/member who contributed the property to the entity
- This rule lasts "Forever"
- Possible offset with step up via Section 754

Complex cont.

- Partnership rules require that depreciation on appreciated property contributed to a partnership be allocated to the partners as if the contributing partner sold the asset to the partnership
- That typically means that the K-1 numbers of equal partners are not equal

Complex cont.

- Any distribution of an asset from a corporation (S or C) to a shareholder is treated as a deemed sale of the asset at FMV
- The same is not true for a partnership

One More Complex

- A retirement plan (including an IRA) that invests in a partnership can end up paying tax on the profits under the rules dealing with Unrelated Business Income Tax

Highlights of Things You Might Wish You Hadn't Done

1. Used a trust (such as a Credit Shelter Trust) that receives S corporation stock without the proper trust language
- Corporation can lose S election
- Corporation pays tax plus penalty and interest as well as double taxation

Might Wish You Hadn't cont.

2. Failed to evaluate making an S election on an old C corporation with appreciated assets (especially farmland)
- If you can get past built in gains tax, you might be able to virtually eliminate the gain on sale of the land

Might Wish You Hadn't cont.

3. Sold assets in the S corporation after death and wait to liquidate until the next year

- Will pay tax on gain in year 1 and typically end up with massive long term capital loss carryover that might never be used

Might Wish You Hadn't cont.

4. Failed to talk to your clients CPA about how things like pre-contribution gain is taxed when the partnership (multi-member LLC) sells the property

- 100% of pre-contribution gain is taxed to the one who brought the asset to the party (unlike S corps)

Might Wish You Hadn't cont.

5. Let your client talk you into helping him start a business owned by his self directed IRA

- Virtually every case after the very first one has ended with the IRA being treated as full distributed due to a prohibited transaction

Might Wish You Hadn't cont.

6. Let your client keep their home for more than 3 years after they have both moved into the nursing home (especially if they have reserved a life estate and gifted the remainder to the kids)

Might Wish You Hadn't cont.

- They won't qualify for the exclusion of the gain on the sale of a personal residence under Section 121
- To make things worse, as described in **S Rept No. 91-552 (PL 91-172) p. 204** unless the remainder interest is also sold, the basis allocated to the life estate is -0-

THANK YOU

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Section Four

ANTICIPATING WILL CONTESTS AND HOW TO AVOID THEM

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Section Four

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ANTICIPATING WILL CONTESTS AND HOW TO AVOID THEM

I. THE FLAGS OF CAUTION — REASONS TO ANTICIPATE A WILL CONTEST

An estate planner must always be on guard when drafting instruments which may supply incentive for someone to contest a will. Anytime an individual would take more through intestacy or under a prior will, the potential for a will contest exists, especially if the estate is large. Although will contests are relatively rare, the prudent attorney must recognize situations which are likely to inspire a will contest and take steps during the drafting stage to reduce the probability of a will contest action and the chances of its success.[1]

A. Disinheritance of Close Family Members in Favor of Distant Relative, Friend, or Charity

A will leaving nothing or only nominal gifts to close family members, such as a spouse of many years or children, is ripe for a contest action, especially if the beneficiaries are distant relatives, social friends, or charities. Juries are prone in close cases to invalidate a will which disinherits the surviving spouse and children, although "[i]t is not for courts, juries, relatives, or friends to say how property should be passed by will, or to rewrite a will for a testator because they do not believe he made a wise or fair distribution of his property."[2]

Will contests based on property passing outside of the traditional family are likely to increase because of various societal changes. Many older individuals have significant involvement with people outside of the family in retirement communities and senior citizen organizations. The lifestyles of younger people include more divorces, childless marriages, cohabitation, and same-sex relationships. As a result, estate plans of these individuals are more likely to include gifts to non-family members and thus increase the likelihood of contests. One insightful commentator has noted:

> Inheritance has traditionally been an occasion when families reconfirm the importance of kinship ties. The scant evidence from research on will contests shows more than property is at stake when families go to court. Usually there is concern that a traditional aspect of the family — a role, relationship, or the balance of power — has been violated by the terms of the trust or estate plan. Bequests outside the family — to friends, lovers, step-heirs, and so forth — may never become socially acceptable, even if they are increasingly common. These unconventional estate plans mean that family members will be more prone to litigate instead of accepting a decedent's estate plan . . . . [M]ost families are unable — and unwilling — to inherit less so that friends, organizations or lovers can inherit more.[3]

---

[1] *See* Jeffrey P. Rosenfeld, *To Heir is Human,* PROB. & PROP., July/Aug. 1990, at 21, 25 (3-4% of probated wills reach the trial stage of a will contest); Jeffrey A. Schoenblum, *Will Contests — An Empirical Study,* 22 REAL PROP. PROB. & TR. J. 607 (1987) (extensive discussion of study done on will contests over a nine year period in Nashville, Tennessee).

[2] Stephen v. Coleman, 533 S.W.2d 444, 445 (Tex. Civ. App.—Fort Worth 1976, writ ref'd n.r.e.) (quoting Farmer v. Dodson, 326 S.W.2d 57, 61 (Tex. Civ. App.—Dallas 1959, no writ)).

[3] Jeffrey P. Rosenfeld, *To Heir is Human,* PROB. & PROP., July/Aug. 1990, at 21, 25.

B. Unequal Treatment of Children

A will which treats children unequally, especially if the children receiving disproportionately large amounts have no special needs, is likely to encourage spurned siblings to contest the will. The contestant's appeal to the inherent fairness of all children sharing equally may sway a wavering jury.[4]

C. Sudden or Significant Change in Disposition Plan

When a testator[5] makes a sudden or significant change to the will's dispositive scheme, the beneficiaries of the old will who lose under the new will may be motivated to contest the new will. These beneficiaries will strive to show that the testator lacked capacity to change the will or that the testator was unduly influenced to make the alterations.

D. Imposition of Excessive Restrictions on Bequests

A testator may impose restrictions on gifts to heirs. For example, the will may create a testamentary trust for the children with expenditures limited to certain items (e.g., health care, room and board, and education) or with lump-sum distributions authorized only upon the beneficiary's fulfilling certain criteria (e.g., graduating from college or reaching a certain age). Although the trust may treat all of the testator's children equally, the imposition of restrictions may give the beneficiaries reason to contest the will and, if successful, immediately obtain the estate funds via intestacy without limitations or conditions.

E. Elderly or Disabled Testator

The age, health, mental condition, or physical capacity of a testator may provide unhappy heirs or beneficiaries of prior wills with a basis to claim lack of testamentary capacity or undue influence. Although the mere fact of advanced age, debilitating illness, or severe handicap does not necessarily diminish capacity, these circumstances can play an important role in supporting a will contest.

F. Unusual Behavior of Testator

A peculiar acting testator is apt to give dissatisfied heirs a basis for contesting the will either on the ground that the testator lacked capacity or was suffering from an insane delusion. Despite statements in Texas cases such as, "A man may believe himself to be the supreme ruler of the universe and nevertheless make a perfectly sensible disposition of his property, and the courts will sustain it when it appears that his mania did not dictate its provisions,"[6] a will executed by a person with behavior or beliefs out of the mainstream of society's definition of "normal" is apt to trigger a contest action.

> **Caveat**: This article discusses a wide range of techniques which may be helpful in preventing will contests. These techniques vary widely in both cost and predictability of results. There is no uniform approach to use for all clients. Each case needs to be carefully examined on its own merits before deciding which, if any, of the techniques should be used.

[4] *Cf.* Birk v. First Wichita Nat'l Bank, 352 S.W.2d 781, 783 (Tex. Civ. App.—Fort Worth 1961, writ ref'd n.r.e.) (while determining the enforceability of a conveyance of a beneficiary's expectancy, the court stated, "We think it is neither unreasonable nor unusual for children to agree to share equally in their parent's estate, even where some know or believe they would receive more than an equal share in a testamentary disposition.").

[5] Unless the context otherwise requires, the term "testator" is used in a non-sex specific manner. *See* WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 1219 (1987) (defining "testator" as "*a person* who dies leaving a will" (emphasis added)).

[6] Gulf Oil Corp. v. Walker, 288 S.W.2d 173, 180 (Tex. Civ. App.—Beaumont 1956, no writ) (quoting Fraser v. Jennison, 42 Mich. 206, 3 N.W. 882, 900 (1879)).

II. INCLUDE *IN TERROREM* PROVISION

A. General Background

A *no-contest provision,* also called an *in terrorem* or *forfeiture* clause, provides that a beneficiary who contests the will loses at least some, and typically all, of the benefits given under the will.[7] In terrorem provisions are one of the most frequently used contest prevention techniques. This widespread use is due to the technique's low cost (a few extra lines in the will), low risk (no penalty incurred if the clause is declared unenforceable), and the potential for effectuating the testator's intent (property passing via the will rather than through intestacy or under a prior will).[8]

Below is a simple no-contest provision:

> If any beneficiary under this will [or the trust created herein] contests or challenges this will [or trust] or any of its [their] provisions in any manner, be it directly or indirectly (including the filing of a will contest action), all benefits given to the contesting or challenging beneficiary are revoked and those benefits pass under the terms of this will as if the contesting beneficiary predeceased me without descendants.

Most jurisdictions uphold forfeiture provisions although several deem them invalid. Even if in terrorem provisions are valid and enforceable, they are unpopular with the courts and are strictly construed.[9] Courts avoid forfeiture unless the beneficiary's conduct comes squarely within the conduct the testator prohibited in the will. Courts frequently treat the beneficiary's suit as one to construe or interpret the will, rather than as one to contest the will, to avoid triggering a forfeiture.

No-contest provisions are often justified on the basis that "they allow the intent of the testator to be given full effect and avoid vexatious litigation, often among members of the same family. Such contests often result in considerable waste of the estates and hard feelings that can never be repaired."[10] On the other hand, the enforcement of an in terrorem provision may be against public policy under certain circumstances. For example, a no-contest provision would be a powerful tool in the hands of a person who fraudulently or through undue influence procured the execution of a will naming the person as one of the beneficiaries of the estate. The clause may give the evil-doer an increased chance of success by terrorizing potential contestants who are also given substantial benefits under the will.

Many jurisdictions have cases or statutes limiting the scope of in terrorem provisions so that forfeiture does not occur if the beneficiary has probable cause to contest the will.[11] On the other hand, some states such as Arkansas indicate that"[t]here is no good-faith exception to a direct

---

[7] In early English law, these terms were not used interchangeably. An in terrorem clause was considered to be an empty threat; that is, the beneficiary still received the gift even if the beneficiary contested the will and lost. A true no-contest or forfeiture clause went beyond a mere threat and actually delivered the punishment; that is, the unsuccessful contesting beneficiary sacrificed the gift under the will. In modern practice, the terms are synonymous.

[8] *See generally* THOMAS E. ATKINSON, HANDBOOK OF THE LAW OF WILLS 408-10 (2d ed. 1953); 5 WILLIAM J. BOWE & DOUGLAS H. PARKER, PAGE ON THE LAW OF WILLS § 44.29 (1962); WILLIAM M. MCGOVERN, JR., ET AL., WILLS, TRUSTS AND ESTATES 585-88 (1988); W. Harry Jack, *No-Contest or In Terrorem Clauses in Wills — Construction and Enforcement*, 19 SW. L.J. 722 (1965); Annotation, *Validity and Enforceability of Provision of Will or Trust Instrument for Forfeiture or Reduction of Share of Contesting Beneficiary,* 23 A.L.R.4th 369 (1983); 74 TEX. JUR. 3d *Wills* § 255 (1990).

[9] Hurley v. Blankenship, 267 S.W.2d 99, 100 (Ky.1954).

[10] Gunter v. Pogue, 672 S.W.2d 840, 842-843 (Tex. App.—Corpus Christi 1984, writ ref'd n.r.e.).

[11] See ALASKA STAT. § 13.16.555; UNIF. PROB. CODE §§ 2-517 & 3-905.

attack on a will that contains a no-contest clause."[12]

Courts that support the good faith/probable cause exception do so on several grounds. First, the testator would not have intended to preclude a contest under such circumstances; and second, enforcing the clause would be contrary to public policy if the beneficiary had a legitimate basis for bringing the contest. Nonetheless, a few courts hold that a general condition against contest is enforceable regardless of the contestant's good faith or the existence of probable cause.

B. Indiana

Prior to the amendments to Indiana Code § 29-1-6-2 effective July 1, 2018, *in terrorem* provisions were ineffective. Since then, they are enforceable subject to following exceptions:

- Beneficiary has good cause for bringing the action.
- Non-beneficiary executor brings the action.
- Settlement agreements.
- Determination of whether an action would be a contest.
- Construction and interpretation actions.
- Discretionary actions by the court such as fees and distributions.
- Actions by attorney general if good cause shown or if dealing with charitable gift.

C. Drafting Guidelines

There are no formal requirements for *in terrorem* provisions. Memorializing the testator's intent with clear and unambiguous language is the drafter's foremost consideration because *in terrorem* clauses are strictly construed.[13]

1. Create Substantial Risk

For an *in terrorem* provision to deter a will contest effectively, it must be carefully drafted to place the disgruntled beneficiary at significant risk. The clause should make the beneficiary think, "Do I keep quiet and get a sure thing (although less than I would get by intestacy or a prior will), or do I contest the will and risk receiving nothing?" In other words, the testator hopes that the beneficiary will follow the "one in the hand is worth two in the bush" philosophy. The clause must place the beneficiary in this dilemma and thus it is vital that the potential contestant's gift be large enough to elicit a genuine fear of contesting the will.

For example, assume that X, a married person with two children from a former marriage, anticipates a distributable separate personal property estate of $300,000. If X dies without a valid will, the spouse and each child will receive $100,000 via intestacy.[14] X's wishes are, however, considerably different; X desires to leave the bulk of the estate to the children. If X leaves nothing to the spouse, or only a nominal amount, e.g., $5,000, an *in terrorem* provision will have little impact on the spouse because the spouse gains tremendously if the will is invalid and loses little if the will and accompanying *in terrorem* provision are upheld. However, if X leaves the spouse a substantial sum, e.g., $50,000, the spouse will hesitate to forfeit a guaranteed $50,000, in addition to incurring court costs and legal fees, for fear of taking nothing if the will is upheld, even though the spouse would receive a $100,000 intestate share if the will is invalidated.

2. Describe Triggering Conduct

The *in terrorem* clause should indicate the conduct triggering forfeiture. Does the testator wish to prevent only a will contest or is the intent to prohibit a broader range of conduct? Will forfeiture occur upon the filing of a contest action or must actual judicial proceedings first occur? Is an indirect attack (e.g., where a beneficiary

[12] Sharp v. Sharp, 447 S.W.3d 622 (Ark. Ct. App. 2014).

[13] *See generally* W. Harry Jack, *No-Contest or In Terrorem Clauses in Wills — Construction and Enforcement*, 19 SW. L.J. 722, 735-36 (1965).

[14] TEX. ESTATES CODE § 201.002.

assists another person's contest) punishable the same as a direct attack? Will a contest by one beneficiary cause other beneficiaries to forfeit their gifts (e.g., five beneficiary/heirs are left a significant sum but less then intestacy, one of them agrees to take the risk of contest because the other four secretly agree to make up the loss if the contest fails)? Will a beneficiary's challenge to the appointment of the designated executor trigger forfeiture?

3. Indicate Beneficiary of Forfeited Property

The testator should name the recipient of the property that is subject to forfeiture under an *in terrorem* provision. This is especially important because the beneficiaries involved in will contests are often the testator's children. If a child forfeits a gift due to the application of the *in terrorem* clause, the contestant's children could argue that the gift passes to them because of the anti-lapse statute, i.e., the forfeited property should pass as if the contestant predeceased the testator.[15] If this argument were to prevail, the forestalling effect of the clause would be limited. (In some jurisdictions, a gift over is a prerequisite to validity.[16])

Indicating the beneficiary of forfeited property has an additional benefit — it provides someone with a strong interest in upholding the will. This contingent beneficiary, especially if it is a large charity capable of eliciting the support of the Texas Attorney General, may be able to place significant resources into fighting the contest.[17]

III. EXPLAIN REASONS FOR DISPOSITION

An explanation in the will of the reasons motivating particular dispositions may reduce will contests. For example, a parent could indicate that a larger portion of the estate is being left to a certain child because that child is mentally challenged, requires expensive medical care, supports many children, or is still in school. If the testator makes a large charitable donation, the reasons for benefiting that particular charity may be set forth along with an explanation that family members have sufficient assets of their own. The effectiveness of this technique is based on the assumption that disgruntled heirs are less likely to contest if they realize the reasons for receiving less than their fair (intestate) share.

It is possible, however, for this technique to backfire. The explanation may upset some heirs, especially if they disagree with the facts or reasons given, and thus spur them to contest the will. Likewise, the explanation may provide the heirs with material to bolster claims of lack of capacity or undue influence. For example, assume that the testator's will states that one child is receiving a greater share of the estate because that child frequently visited the aging parent. Another child may use this statement as evidence that the visiting child unduly influenced the parent. If the explanation is factually incorrect, heirs may contest on grounds ranging from insane delusion to mistake or assert that the will was conditioned on the truth of the stated facts.[18]

The language used to explain reasons for a disposition must be carefully drafted to avoid encouraging a will contest or creating testamentary libel. An alternative approach is to provide explanations in a separate document which could be produced in court if needed to defend a will contest, but which would not otherwise be made public.[19]

[15] TEX. ESTATES CODE § 255.153.

[16] *See* GA. CODE § 53-2-107(b) (1997).

[17] *See* Jeffrey L. Crown, *Thwarting the Will Contest,* in STATE BAR OF TEXAS, ADVANCED ESTATE PLANNING & PROBATE L7 (1985).

[18] *See generally* Steve R. Akers, *Anatomy of a Texas Will and Effective Will Drafting,* in STATE BAR OF TEXAS, WILL DRAFTING D-104 (1989).

[19] *See infra* § X, page 25.

IV. AVOID BITTER OR HATEFUL LANGUAGE

A. Encourages Will Contests

If the drafter decides it is advisable to explain the reasons for a particular dispositive scheme, care must be exercised to ensure the explanation does not have the opposite result, i.e., provoking a contest action attributable solely to the will's language. Any explanation of gifts or descriptions of heirs should be even-handed, free of bitterness or spite, and factually correct. An heir who feels slighted both emotionally and monetarily may be more likely to contest than one who is hurt only financially.

B. Potential for Testamentary Libel

"To my grandson . . . I give . . . Ten Dollars . . . I have already given my said grandson the sum of One Thousand Dollars . . . which he squandered. This provision . . . expresses the regard in which I hold my said grandson, who deserted his mother and myself by taking sides against me in a lawsuit, and because he is a slacker, having shirked his duty in World War II."[20]

Testamentary libel may become an issue when a will containing libelous statements is probated and thereby published in the public records. Typically, such situations arise when testators explain their reasons for making, or not making, particular gifts. The question is then presented whether the defamed individuals are entitled to recover from the testator's estate or the executor.

Courts addressing the issue of testamentary libel have reached varying conclusions. Some courts simply delete the offensive material from the probated will, while others hold the estate liable for the damages caused by the libelous material. Other courts, however, rule that there is no cause of action for testamentary libel because statements relating to judicial proceedings are privileged or because actions for personal injuries against the testator died along with the testator.[21]

V. USE HOLOGRAPHIC WILL

Wills entirely in the testator's own handwriting appear to have an aura of validity because they show the testator was sufficiently competent to choose his or her own words explaining intent and to write them down without outside assistance. The attorney may use this somewhat liberal tendency toward holographic wills to good advantage if the attorney anticipates a will contest. Before executing a detailed attested will, the testator could hand write a will which, although not as comprehensive as the formal will, contains a disposition plan preferred to intestacy. If the attested will was invalidated, the holographic will could serve as an unrevoked prior will.[22]

VI. ENHANCE TRADITIONAL WILL EXECUTION CEREMONY[23]

One of the most crucial stages of a client's estate plan is the will execution ceremony—the point at which the client memorializes his or her desires regarding at-death distribution of property. Unfortunately, attorneys may handle this key event in a casual or sloppy fashion. There are even reports of attorneys mailing or hand-delivering unsigned wills to clients along with will execution instructions.[24] Some attorneys allow law clerks or paralegals to

[20] Kleinschmidt v. Mattheiu, 266 P.2d 686, 687 (Or. 1954).

[21] *See* WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS § 113 at 770-71 (4th ed. 1971); 80 AM. JR. 2d *Wills* § 873 (1975); Leona M. Hudak, *The Sleeping Tort: Testamentary Libel,* 12 CAL. W.L. REV. 491 (1976); A.L. Schwartz, Annotation, *Libel by Will*, 21 A.L.R.3d 754 (1968).

[22] Arkansas recognizes handwritten wills without witnesses. ARK STAT. § 28-25-104.

[23] Portions of this section are adapted from Gerry W. Beyer, *Wills Contests – Prediction and Prevention*, 4 EST. PLAN. & COMM. PROP. L.J. 1 (2011).

[24] See *Hamlin v. Bryant*, 399 S.W.2d 572, 575 (Tex. Civ. App.—Tyler 1966, writ ref'd n.r.e.).

supervise a will execution ceremony.[25] This practice is questionable not only because it raises the likelihood of error, but also because the delegation of responsibility may violate the rules of professional conduct proscribing the aiding of a non-lawyer in the practice of law. An unprofessional or unsupervised ceremony may provide the necessary ammunition for a will contestant successfully to challenge a will.

Since the earliest recognition of the power of testation, some type of ceremony has accompanied the exercise of that power. Will ceremonies help demonstrate that the testator was not acting in a casual, haphazard, whimsical, or capricious manner by furnishing proof that the testator deliberated about testamentary desires and had a fixed purpose in mind when making the will. The ceremonies also provide evidence that the will was actually made by the testator, by impressing the act on the minds of witnesses.

A proper ceremony, coupled with sensitive and tactful counseling by the attorney during the entire estate planning process, may make it easier for clients to cope with the inevitability of death. Unfortunately, attorneys have been accused of showing "little concern about the therapeutic counseling that goes on in an 'estate planning' client's experience."[26] You need to remember that many clients make only one will during the client's entire life and that the psychological effects of confronting death are strong. Even if you conduct scores of will ceremonies each year, you must not lose sight of the client's emotions and the psychological benefits that may be obtained through client interviews and will ceremonies.

One commentator has somewhat humorously summarized the psychological benefits of the ceremony as follows:

> When a client comes in to do something about his estate planning problem, he wants a lot of things. He wants solace because he is thinking about the day when he will not be here. He wants approval of what he has done and what he proposes to do. And he wants something else he almost never gets—a ceremony. Now, life offers very few opportunities for high ceremony. Birth is not a very good time. It is too laborious. Marriage is handled in rather a spectacular style. Nobody has been able to do much with divorce on the ceremonial side. For death, there is a ceremony, but it is hard for a decedent to be there to enjoy it. He is the principal.
>
> The estate planning process . . . ought to be a high ceremonial occasion because a client should be getting great intangible satisfactions about these significant decisions that he has made that were embodied in the instruments he leaves behind.[27]

Caveat: The format below is based on Texas law. However, you should be able to conform it to the requirements of your state.

A. Prior to the Ceremony

1. Proofread Will

Before the client arrives for the will execution ceremony, the attorney should carefully proofread the will for errors such as misspellings, omissions, erasures, and overstrikes. To reduce the number of inadvertent errors, it is advisable for another attorney to review the will. The attorney should carefully correct all errors and print a new original. The attorney should not use interlineations, mark-outs, erasures, or correction fluids.

[25] *Palmer v. Unauthorized Practice Comm. of the State Bar*, 438 S.W.2d 374, 376 (Tex. Civ. App.—Houston [14th Dist.] 1969, no writ).

[26] Thomas Shaffer, *The "Estate Planning" Counselor and Values Destroyed by Death,* 55 IOWA L. REV. 376, 376 (1969).

[27] *Estate Planning for Human Beings,* 3 U. MIAMI INST. ON EST. PLAN. § 69.1902 (P. Heckerling ed. 1969) (statement of Dean Willard H. Pedrick, panelist).

2. Assure Internal Integration of Will

The attorney should inspect the will to ensure that all pages are printed or typed on the same kind of paper, that all pages are the same size, that the font types and sizes are consistent throughout the will, that each page is numbered *ex toto* (e.g., page 4 of 10), and that there are no excessive blank spaces.

The attorney needs to securely fasten the pages of the will together, but it is a good idea to wait until after the client reviews the will to facilitate any last minute changes or corrections. If the pages of the will are stapled, the attorney should not remove the staples; multiple staple holes may be evidence of improper page substitution.[28]

3. Review Will with Client

The attorney should review the final draft of the will with the client to confirm that the client understands the will and that it comports with the client's intent. The client should have adequate time to read the will, to ascertain that corrections to prior drafts have been made, and to determine that no unauthorized provisions have inadvertently crept into the will.

Some attorneys now add "errors" into draft wills to make certain their clients actually read them, sometimes providing a "reward" in the form of a gift card at a local store for finding the mistakes.

4. Explain Ceremony to Client

The attorney should explain the mechanics of the will execution ceremony to the testator in language the testator understands. The attorney should avoid legalese because the client may be too embarrassed to admit a lack of understanding. It is helpful for the client to know how the ceremony will proceed and what is expected, e.g., to answer certain questions.

[28] See *Mahan v. Dovers*, 730 S.W.2d 467, 469–70 (Tex. App.—Fort Worth 1987, no writ).

B. The Ceremony

1. Select Appropriate Location

The will execution ceremony should take place in pleasant surroundings. A conference room works well, as does a large office with appropriate tables and chairs. The client should be comfortable and at ease during the ceremony. A relaxed client is more likely to present a better image to the witnesses.

2. Avoid Interruptions

The ceremony should be free of interruptions. Thus, secretaries should hold all telephone calls and be instructed not to interfere with the ceremony. Once the ceremony begins, no one should enter or leave the room until the ceremony is completed. Interruptions disrupt the flow of the ceremony and may cause the supervising attorney to inadvertently omit a key element.

3. Gather Participants

The testator, two or three disinterested witnesses, a notary, and the supervising attorney should gather at the appropriate location. As a precaution against claims of overreaching and undue influence, no one else should be present under normal circumstances.

4. Seat Participants Strategically

The participants need to be seated so each can easily observe and hear the others. The attorney should be conveniently located near the participants to make certain the proper pages are signed in the correct places. If an oblong table is available, an effective seating arrangement is to have the attorney at one end with the notary at the other end and with the testator on one side facing the two witnesses on the other side.

5. Make General Introductions

The attorney should introduce all participants. Although it may be advisable to use witnesses already known to the client, it is a common practice for attorneys to recruit anyone who is around (e.g., secretary, law clerk, delivery person) to serve as the witnesses. Accordingly, it is important to impress the identity of the testator

on the witnesses so that they witness will be able to remember the ceremony should their testimony later be needed.

6. Explain Ceremony

The attorney should explain the importance of the will execution ceremony and inform the client that the ceremony is about to commence. Although Texas law does not require publication for a valid will, it is useful for the witnesses to know the type of document being witnessed.[29] In addition, publication is required for the self-proving affidavit in which the witnesses swear that the testator said the instrument is his or her last will and testament.

7. Establish Testamentary Capacity

If the attorney anticipates a will contest, it is especially important to establish each element of testamentary capacity during the ceremony. The attorney and the testator should engage in a discussion designed to cover the elements of testamentary capacity as found in Texas cases such as *Prather v. McClelland*.[30] For example, the attorney should demonstrate that the testator knows the testator is executing a document disposing of the testator's property upon death, that the testator knows the general nature and extent of the testator's property and the natural objects of the testator's bounty, and that the testator is able to appreciate these things at the same time so as to make reasonable judgments.

8. Establish Testamentary Intent

Questions substantially in the following form should be directed to the testator to demonstrate testamentary intent.

- [Testator's name], is this your will?
- Have you carefully read this will and do you understand it?
- Do you wish to make any additions, deletions, corrections, or other changes to your will?
- Does this will dispose of your property at your death in accordance with your desires?
- Do you request [witnesses' names] to witness the execution of your will?

9. Execution and Self-Proving Affidavit

a. One-Step

If the self-proving affidavit is included as part of the will, the attorney and notary should take the following steps:

- The attorney explains the purpose and effect of a self-proving affidavit, i.e., to make probate easier and more efficient by allowing the will to be admitted without the testimony of witnesses.
- The notary takes the oath of the testator and witnesses.[31]
- The notary asks the testator to answer the following questions which are modeled after the statutory form in Texas Estates Code § 251.1045. When the testator answers these questions, it impresses the ceremony on the witnesses better than if the testator is merely asked to read and sign the affidavit. The testator should answer "yes" to each question.

[29] See *Davis v. Davis*, 45 S.W.2d 240, 241 (Tex. Civ. App.—Beaumont 1931, no writ).

[30] 13 S.W. 543, 546 (Tex. 1890).

[31] See Broach v. Bradley, 800 S.W.2d 677, 678 (Tex. App.—Eastland 1990, writ denied) (holding a self-proving affidavit invalid because the notary had not properly sworn the witnesses). But see *Estate of Flarity*, No. 09-19-00089-CV, 2020 WL 5552140 (Tex. App.—Beaumont Sept. 17, 2020, pet. filed) (holding that Estates Code § 251.104 does not require the oath to be oral; because the Estates Code does not define the term "oath," the Code Construction Act provision, Government Code § 602.001, applies which provides that the term oath "includes the oath in an affidavit").

  - [Testator], is this document your will?
  - Do you willingly make and execute your will in the presence of [witness one] and [witness two] all of whom are present at the same time?
  - Do you do so as your free act and deed?
  - Do you request [witness one] and [witness two] to sign this will in your presence and in the presence of each other?
- Testator initials each page of the will, except the last page, at the bottom or in the margin to reduce later claims of page substitution.
- The testator signs and dates the will.
- The notary asks the witnesses to answer the following questions which are modeled after the statutory form in Texas Estates Code § 251.1045. When the witnesses answer these questions, it impresses the ceremony on the witnesses better than if each witness is merely asked to read and sign the affidavit. The witnesses should answer "yes" to each question.
  - Did [Testator] declare to you that this instrument is [testator's] will?
  - Did [Testator] request that you act as a witness to [testator's] will and signature?
  - Did [Testator] sign this will in your presence and in the presence of the other witness?
  - Is [Testator] eighteen years of age or over? [Or, if the testator is under age eighteen, Is [Testator] married, or been lawfully married, or is a member of the armed forces of the United States or an auxiliary thereof or of the Maritime Service?]
  - Do you believe that [Testator] is of sound mind?
- Each witness initials every page, except the last page, at the bottom or in the margin. This helps reduce claims of page substitution.
- The witnesses sign and date the will in the testator's presence and in the presence of each other.
- The notary signs the affidavit and affixes the appropriate seal or stamp.
- The notary records the ceremony in the notary's record book.[32]

b. Two-Step

The following procedure should be used if the will and self-proving affidavit are separate documents.

(1) Conduct Will Execution

The testator's attorney should take the following steps when the testator executes the will:

- Testator initials each page of the will, except the last page, at the bottom or in the margin to reduce later claims of page substitution.
- Testator completes the testimonium clause by filling in the date and location of the ceremony.
- Testator signs the will at the end. The testator should sign as the testator usually does when executing legal documents to prevent a contest based on forgery.
- The attorney should pay close attention to make certain everything is written in the proper locations.
- Although not a necessary element of a valid will under Texas law, the

[32] TEX. GOV'T CODE § 406.014.

witnesses should watch the testator sign the will so that they may testify to the signing.

(2) Conduct Witness Attestation

- Each witness initials every page, except the page with the attestation clause, at the bottom or in the margin. This helps reduce claims of page substitution.
- One of the witnesses dates the attestation clause to provide additional evidence of when the execution occurred.
- Each witness signs the attestation clause and writes his or her address. Having this information on the will may be helpful should it later become necessary to locate the witnesses.
- The attorney watches carefully to make certain everything is written in the proper locations.
- The testator observes the witnesses signing the will. Although the testator is not required to see the witnesses sign, the attestation must take place in the testator's presence. The term "presence" has been defined as a conscious presence—"the attestation must occur where testator, unless blind, is able to see it from his actual position at the time, or at most, from such position as slightly altered, where he has the power readily to make the alteration without assistance."[33]
- The witnesses observe each other signing. Although this is not required under Texas law, the witnesses will provide better testimony concerning the ceremony if they observe each other signing the will.

(3) Completion of Self-Proving Affidavit

- The attorney explains the purpose and effect of a self-proving affidavit, i.e., to make probate easier and more efficient by allowing the will to be admitted without the testimony of witnesses.
- The notary swears the testator and witnesses.[34]
- The notary asks the testator to answer the following questions which are modeled after the statutory form in Estates Code § 251.104. When the testator answers these questions, it impresses the ceremony on the witnesses better than if the testator is merely asked to read and sign the affidavit. The testator should answer "yes" to each question.
    - [Testator], is this document your last will and testament?
    - Have you willingly made and executed your will?
    - Did you do so as your free act and deed?
- The notary asks the witnesses to answer the following questions which are modeled after the statutory form in Estates Code § 251.104. When the witnesses answer these questions, it

[33] *Nichols v. Rowan*, 422 S.W.2d 21, 24 (Tex. Civ. App.—San Antonio 1967, writ ref'd n.r.e.). See also *Morris v. Estate of West*, 643 S.W.2d 204, 206 (Tex. App.—Eastland 1982, writ ref'd n.r.e.) (deeming that the attestation took place outside of testator's presence because the testator could not have seen the witnesses sign without walking four feet to the office door and fourteen feet down a hallway).

[34] See Broach v. Bradley, 800 S.W.2d 677, 678 (Tex. App.—Eastland 1990, writ denied) (holding a self-proving affidavit invalid because the notary had not properly sworn the witnesses). But see Estate of Flarity, No. 09-19-00089-CV, 2020 WL 5552140 (Tex. App.—Beaumont Sept. 17, 2020, pet. filed) (holding that Estates Code § 251.104 does not require the oath to be oral; because the Estates Code does not define the term "oath," the Code Construction Act provision, Government Code § 602.001, applies which provides that the term oath "includes the oath in an affidavit").

impresses the ceremony on the witnesses better than if each witness is merely asked to read and sign the affidavit. The witnesses should answer "yes" to each question.

- Did [testator] declare to you that this is his/her last will and testament?
- Did [testator] execute this document as his/her last will and testament?
- Did [testator] want [witnesses] to sign it as witnesses?
- Did you sign the will as a witness?
- Did you sign the will in [testator's] presence?
- Did you sign the will at the request of [testator]?
- Was [testator] at the time of will execution eighteen years of age or over (or being under such age, was or had been lawfully married, or was then a member of the armed forces of the United States or of an auxiliary thereof or of the Maritime Service)?
- Was [testator] of sound mind?
- Are you at least fourteen years of age?

- The notary signs the affidavit and affixes the appropriate seal or stamp.
- The notary records the ceremony in the notary's record book.

10. Conclude Ceremony

The attorney should indicate that the will execution ceremony is now completed. If other estate planning documents, such as a directive to physician, self-declaration of guardian, or durable power of attorney, are needed in the estate plan, it is convenient to execute them at the same time because these documents often require witnesses or self-proving affidavits.

C. After the Ceremony

1. Confirm Testator's Intent

The attorney should talk with the testator to confirm that the testator understood what just happened and that the testator does not have second thoughts about the disposition plan.

2. Make Copies of Will

The attorney should retain a photocopy of the executed will so that the attorney may review it on a periodic basis to determine whether revisions are needed due to a change in the law or testator's circumstances. In addition, the copy of the executed will is useful evidence of the will's contents if the original cannot be produced after death, and there is sufficient evidence to overcome the presumption of revocation.[35]

3. Discuss Safekeeping of Original Will

Determining the proper custodian of the original will is a difficult task and an anticipated contest makes it even more difficult. It is important to store the original will in a secure location where it may be readily found after the testator's death. Thus, some testators elect to keep the will at home or in a safe deposit box, and others prefer for the attorney to retain the will. In the normal situation, an attorney should refrain from suggesting to retain the original will because the original is then less accessible to the testator. Consequently, the testator may feel pressured to hire the attorney to change the will and the executor or beneficiaries may feel compelled to hire the attorney to probate the will. Some courts in other jurisdictions hold that an attorney may retain the original will only "upon specific unsolicited request of the client."[36] If a will contest is likely, however, it may be dangerous to permit the client to retain the will because the will then stands a greater chance of being located and destroyed or altered by the

[35] See *Mingo v. Mingo*, 507 S.W.2d 310, 311 (Tex. Civ. App.—San Antonio 1974, writ ref'd n.r.e.) (holding that an unlocated will is presumed revoked if it was last seen in the testator's possession).

[36] *State v. Gulbankian*, 196 N.W.2d 733, 736 (Wis. 1972).

heirs. An attorney may need to urge the testator to find a safe storage place that will not be accessible to the heirs, either now or after death, but yet a location where the will may be found and probated, while taking care not to urge that the attorney act as the will's sanctuary. The executor named in the will, especially if the executor is a non-family member/non-beneficiary or a corporate fiduciary, may be able to provide such a safe haven for the will.

4. Destroy or Preserve Prior Will

When a new will is executed, it is common practice to physically destroy prior wills. If the testator's capacity is in doubt, however, and the testator indicates a preference for the prior will as compared to intestacy, it is a good idea to retain the prior will. If a court holds that the new will is invalid, the attorney may offer the old will for probate much to the chagrin of the contestant.

5. Provide Testator with Post-Will Instructions

The attorney should provide the testator with a list of post-will instructions containing at least the following:

- Discussion of the need to reconsider the will should the testator's life or circumstances change due, for example, to births or adoptions, deaths, divorces, marriages, change in feelings toward beneficiaries and heirs, significant changes in size or composition of estate, or change in state of domicile.
- Explanation that mark-outs, interlineations, and other informal changes are usually insufficient to change the will.[37]
- Instructions regarding safekeeping of the original will.
- Statement that the will must be reviewed if relevant state or federal tax laws change.

[37] See *Leatherwood v. Stephens*, 24 S.W.2d 819, 823 (Tex. Comm'n App. 1930, judgment adopted).

VII. MEMORIALIZE WILL EXECUTION CEREMONY ON VIDEO

Modern video-recording technology provides an inexpensive, convenient, and reliable type of "will insurance" which preserves evidence of the will execution ceremony and its important components, such as the condition and appearance of the testator and the presence of witnesses, along with an accurate reproduction of the exact document which was signed.[38] Although video-recording the will execution ceremony is not common practice, the potential of this technique must not be overlooked. This section begins by detailing the possible uses of a video-recording of the will execution ceremony and the status of the law with regard to the video's admissibility into evidence. The advantages and disadvantages of preparing such a video-recording are examined, followed by a discussion of the video-recorded ceremony itself which includes the major elements needed to fully utilize the advantages of this innovative technique.

A. Uses of Will Execution Video-recording

A meticulously prepared video, recording both the visual and audio aspects of the will execution ceremony, may prove indispensable should a will contest arise. This procedure provides the testator with greater assurance that upon the testator's death the will shall take effect

[38] For further information about videotaping the will execution ceremony, see Gerry W. Beyer, *Videotaping the Will Execution Ceremony — Preventing Frustration of the Testator's Final Wishes*, 15 ST. MARY'S L.J. 1 (1983); Gerry W. Beyer, *Video Requiem: Thy Will be Done*, TR. & EST., July 1985, at 24; Gerry W. Beyer, *Videotaping the Will Execution Ceremony*, Est. Plan. Stud., Oct. 1989, at 1 from which portions of this section are adapted; Gerry W. Beyer & William R. Buckley, *Videotape and the Probate Process: The Nexus Grows*, 42 OKLA L. REV. 43 (1989); William R. Buckley & Alfred W. Buckley, *Videotaping Wills: A New Frontier in Estate Planning*, 11 OHIO N.U.L. REV. 271 (1984); Jodi G. Nash, *A Videowill: Safe and Sure*, A.B.A. J., Oct. 1984, at 87.

and operate as anticipated. Moreover, the video-recording eases the court's task of determining whether the requirements for a valid will were satisfied.

1. Establishes Testamentary Capacity

The testator may answer questions on the video designed to clearly and convincingly demonstrate each element of testamentary capacity. Below are some examples.

- The testator must understand that the testator is executing a will. The testator's statements in front of a video camera regarding the nature of the act about to be performed provides strong evidence of such an understanding.
- The testator must also understand the effect of making a will. The testator's recorded explanation that the testator is making a will to provide for the distribution of the testator's property upon death would demonstrate this requirement.
- The testator must comprehend the general nature and extent of the testator's property. The video-recording can show the testator describing the testator's property and estimating its value.
- The testator must realize who is entitled to the testator's property should the testator die without a will. The testator can discuss the details of the testator's family situation on the video thereby avoiding claims that the testator was unaware of the natural objects of the testator's bounty.
- The testator must be able to appreciate simultaneously what the testator is doing, the testator's property, and the testator's family situation so the testator may form a coherent plan for the distribution of the testator's estate. A video of the testator discussing the testator's will, explaining the testator's situation, and executing the will would tend to prove this important element.

2. Shows Due Execution of Will

A video-recording of the will execution ceremony provides proof that all of the technical requirements for a valid will were satisfied. The video can show the testator declaring the document to be the testator's will and affixing the testator's signature, and the witnesses observing the will execution and thereafter signing in the conscious presence of the testator.

3. Demonstrates Testamentary Intent

The document which allegedly constitutes the testator's will fails unless it can be demonstrated that it is the very instrument by which the testator intended to make a posthumous disposition of the testator's property. The video-recording of the will execution ceremony would show both the testator and the will itself. Thus, the video would provide theoretically irrebuttable evidence that the document claimed to be the testator's will was the same document executed during the ceremony.

4. Shows Contents of Will

In many situations, it may be difficult to determine the contents of a written will. For example, the testator may have inadvertently lost or destroyed the original will or have hidden it so well that the survivors are unable to locate it. Even if the actual will is produced at probate, portions of it may be missing, erased, or illegible. A video provides excellent evidence of the will's contents by showing the testator reading the entire will aloud and by reproducing the will itself on video so it may be read. The recording may also include close-ups of the testator and witnesses initialing each page of the will so that claims of page substitution may be rebutted.

5. Establishes Lack of Undue Influence or Fraud

The video-recording affords the testator with the opportunity to explain that the will is voluntarily made as an act of free will and not as a result of undue influence or fraud. This is particularly important where an unusual disposition is made, such as the disinheritance of a spouse or child.

6. Assists in Will Interpretation and Construction

Statements made by the testator contemporaneous with the will execution could prove very helpful in determining the correct interpretation and construction of various provisions of the will. By explaining what the testator means by certain words and phrases, the testator can preserve evidence of the testator's intent which would prove invaluable should a dispute later arise.

B. Admissibility of Will Execution Video-recording

1. In General

The admissibility of a video-recording depends generally on the following considerations: (1) relevance; (2) fairness and accuracy; (3) the exercise of judicial discretion as to whether the probative value of the recording outweighs the prejudice or possible confusion it may cause; and (4) other evidentiary considerations such as the presence of hearsay.[39] A video of the will execution ceremony may easily be admitted under these standards. A video is not subject to the vagaries of a witness' fading memory, and it presents a more comprehensive and accurate view of the testator and the testator's condition at the time of will execution than does a piecemeal tendering into evidence of witnesses' testimony.

Although jurisdictions differ and courts do not always enumerate a complete list of foundation elements, there is basic agreement that seven elements must be established before a video-recording may be admitted into evidence.[40] Not all judges insist that the party wishing to use a video of the will execution ceremony satisfy each of these elements, but most courts require a showing of unaltered recording, visual and audio clarity, and sufficient identification of the speakers. The key factor in determining admissibility appears to be that the video is a true and accurate representation of the events portrayed.

The elements of a proper predicate are as follows:

a. Proper Functioning of Equipment

The proponent of the video must show that the recording equipment and the recording medium (tape, DVD, memory chip, hard drive, etc.) were in proper working order at the time of the recording so that both audio and visual events were accurately recorded. The operator of the equipment is the most likely individual to provide this testimony.

b. Equipment Operator Competency

The operator of the recording equipment must be competent. It is not necessary to show that the operator was an expert provided the operator had sufficient skill to run the equipment properly.

c. Accuracy of Recording

It must also be established that the recording truly and correctly depicts the events and persons shown. The video portion should be properly focused and the audio portion should be sufficiently loud and clear so that it is understandable and not misleading.

d. Proper Preservation of Recording

The video must have been appropriately preserved. A detailed record of the chain of custody of the recording is often helpful.

e. Lack of Alteration

A showing must be made that the recording has not been altered; no changes, additions, or deletions are allowed. The testimony of someone present during the recording may be used to establish this element as well as the testimony of an expert who has physically and electronically inspected the media for tampering.

[39] *See generally* 3 CHARLES E. SCOTT, PHOTOGRAPHIC EVIDENCE § 1294 (2d ed. 1969 & Supp. 1994).

[40] *See, e.g.,* Allen v. State, 247 S.E.2d 540, 541 (Ga. Ct. App. 1978); Roy v. State, 608 S.W.2d 645, 649 (Tex. Crim. App. 1980); State v. Hewett, 545 P.2d 1201, 1204 n.4 (Wash. 1976).

f. Accurate Identification of Participants

The recorded individuals need to be accurately identified. This should be an easy task because both visual and audio clues are available. Although an extremely competent actor could deceive audio and visual senses, individuals familiar with the parties should be able to spot an impostor.

g. Tape Voluntarily Made

It must also be shown that the recording was voluntarily made without improper inducement. The fact that a testator video-recorded the execution of the testator's will is usually indicative of the voluntary nature of the recording. The recording may portray the entire setting dispelling claims that the recording was made involuntarily. Of course, someone out of camera range could threaten the testator with a gun, hold the testator's family hostage, or threaten to withhold food and medicine.

2. Via Court Decision

a. United States Generally

Despite the increasing availability and popularity of video-recording the will execution ceremony, there are only a few reported cases discussing the use of video in probate actions. The earliest case located was a 1979 Florida case.[41] In affirming the trial court's decision that the appellee had not exercised undue influence over the testator, this court merely mentioned that the record in the case showed that the testator's attorney had arranged for the videotaping of the will execution ceremony. The court did not specifically discuss the contents of the videotape. In a 1984 Alabama case, the court discussed how the testator explored the possibility of having his will videotaped but was advised by his attorney to undergo a psychiatric examination instead.[42] In an unreported case, an Ohio court indicated that an attorney was not responsible for will contest litigation costs for failing to videotape the will execution ceremony.[43] In a 1990 Kansas case, the court mentioned that there was evidence that the will execution ceremony had been taped but that the tape was probably destroyed by the attorney's "overzealous" brother-in-law after both the drafting attorney and the testator had died.[44]

Four cases from the late 1980s directly involve videotapes of the will execution ceremony. In each of these cases, the videotape was carefully examined by the court and then used as evidence to determine the testator's capacity or the presence of undue influence. The first of these cases was decided in 1986 by an Oklahoma appellate court.[45] The videotape showed the testator as well as the conduct of various individuals involved with the will execution ceremony. This recording was one of the factors the court cited as supporting a prima facie showing of undue influence.

In a 1987 Delaware case,[46] the testatrix executed two wills, both videotaped, as well as a non-videotaped codicil to the latter will. The judge found that a long addiction to alcohol had so impaired the testatrix' mental faculties that she lacked capacity to make a valid will. The videotape of the first will execution ceremony established that it was necessary to remind the testatrix of the nature of her investments, and that despite the reminder, she failed to understand their nature. The videotape of the second will also showed that her attorney avoided any mention of her assets. In addition, the fact that the codicil was not videotaped appeared to support the judge's finding that the codicil was procured by undue influence.

[41] Estate of Robertson v. Gallagher, 372 So. 2d 1138, 1140-42 (Fla. Dist. Ct. App. 1979).

[42] Wall v. Hodges, 465 So. 2d 359, 661 (Ala. 1984).

[43] *In re* Estate of Nibert, 1988 WL 102420 (Ohio App.).

[44] *In re* Estate of Raney, 799 P.2d 986, 989-90 (Kan. 1990).

[45] Estate of Seegers v. Combrink, 733 P.2d 418, 421-22 (Okla. Ct. App. 1986).

[46] Stotlar v. Cook, 1987 WL 6091 (Del. Ch.), *aff'd without opinion*, 542 A.2d 358 (Del. 1988).

In an unpublished opinion,[47] an Ohio appellate court indicated that the most compelling evidence presented on the issue of testamentary capacity was a videotape of the will execution ceremony. The following discussion from the opinion is instructive.

> That tape discloses a man near the end of his life suffering the debilitating effects of a series of severe strokes; a man who at times appears totally detached from the proceedings. Viewing the tape clearly reveals the testator's inability to comprehend all that was going on about him. Certainly, one would seriously question his ability to dispose of several million dollars in estate assets by means of a complicated will and trust arrangement. Further, it is apparent from the tape that the whole proceeding was directed and controlled by the decedent's attorney. [The testator's] total participation was prompted by the use of leading questions. The tape further shows that the decedent lacked an accurate understanding of the extent of his property and holdings, his estimates ranging from five to eight million dollars.

In a 1989 Nebraska case, the testatrix was videotaped discussing her distribution plan with her attorney and then executing a codicil to her will.[48] The jury viewed the tape, heard other evidence, and then decided that the testatrix had capacity. The favorable finding on capacity was upheld by the Nebraska Supreme Court despite various difficulties with the tape. For example, the testatrix misstated her age by two years, made mistakes regarding the year her house burned down and the year her husband died, misstated the size of her ranch, and needed to be reminded about the identity of one of her sons. However, the tape showed that she was generally aware of her property and knew where all her sons lived and their occupations. She also explained why she was leaving more property to one of her sons. Some of the contestant's witnesses testified that during the taping the testatrix had her head down, eyes closed, and appeared to be asleep. Another witness stated she was reluctant to witness the codicil because she believed the testatrix did not know what she was doing. Both the jury and the court indicated that the videotape, its faults notwithstanding, justified giving little weight to this testimony.

These decisions may, at first glance, appear somewhat disconcerting because the videotapes were used three out of four times to support findings of invalid wills. The lack of reported decisions in which the videotape bolstered will validity, however, does not reflect poorly on the value of videotaping the will execution ceremony. Instead, the scarcity of reported cases addressing videotaped will execution ceremonies in general, and specifically those using the tape to uphold the will, is likely due to one or more of the following factors.

- A sufficient basis already exists under current law to support the admissibility of a videotape of the will execution ceremony. Thus videotapes may be frequently used at the trial level to support a will in cases which are not reported or appealed.
- Because videotape was not used in the probate process until recently, many testators who have prepared a video have not died. Therefore, the available pool of videotape cases is relatively small.
- The mere existence of the videotape reduces litigation because potential will contestants are reluctant to proceed in the face of the strong evidence provided by the tape.
- Many individuals, already disturbed by the estate planning process and unpleasant thoughts about death, are fearful of the prospect of appearing on camera and thus may prefer to forego using videotape techniques.

[47] Trautwein v. O'Brien, 1989 WL 2149 (Ohio Ct. App.).

[48] Peterson v. Glinn, 439 N.W.2d 516 (Neb. 1989).

- The failure of an attorney to prepare a videotape of the will execution ceremony under circumstances where the reasonably prudent attorney would do so does not lead to malpractice liability in Texas and most other jurisdictions; the lack of privity between the attorney and the intended beneficiaries bars the action.[49]

b. Texas

Hammers v. Powers[50] is the first Texas case to discuss, albeit briefly, the use of a will execution videotape to demonstrate that the testatrix had testamentary capacity and was not under undue influence. In this 1991 opinion, the court examined summary judgment evidence which included affidavits, depositions, and a videotape of the testatrix signing her will. The court found that this evidence established as a matter of law that she had capacity and was not unduly influenced.

In 1999, the court in *In re Estate of Foster*,[51] had before it a case in which a videotaped will execution was introduced into evidence. The record reflected the testimony of one of the beneficiaries who originally challenged the testatrix's testamentary capacity who "stated that if the will had been read to [the testatrix] while the video tape was being made, he would not have objected to the will."[52]

3. Via Legislation

Only two states currently have legislation specifically addressing the admissibility of a video recording of the will execution ceremony: Indiana[53] and Louisiana.[54]

Several other state legislatures have considered bills expressly dealing with videotape and the probate process, but none of the bills have been enacted. During the 1985 session of the Texas Legislature, several bills were introduced relating to using a videotape of the will execution ceremony.[55] These bills were uncomplicated, merely stating that the videotape would be admissible as evidence of the identity and competency of the testator and of any other matter relating to the will and its validity. In 1986, the New Jersey Legislature considered a bill allowing the use of videotape not only as an evidentiary tool but also as the will itself, provided a written transcript accompanied the videotape.[56] The proposal was quite detailed, requiring the videotape to comply with a laundry list of requirements. In 1987, the New York Legislature debated a simple bill allowing a videotape of the will execution ceremony to be used to prove due execution, intent, capacity, authenticity, as well as any other facts that the court decided were relevant to the probate of the testator's will or the administration of the testator's estate.[57]

4. Via Administrative Decision

The Board of Commissioners on Grievances and Discipline of the Supreme Court of Ohio has approved videotaping the will execution ceremony. In a 1988 opinion, the Board stated that "[v]ideotaping the reading and execution of a

[49] *See* Berry v. Dodson, Nunley & Taylor, P.C., 717 S.W.2d 716, 718 (Tex. App.—San Antonio 1986), *writ dism'd by agr.,* 729 S.W.2d 690 (Tex. 1987); Dickey v. Jansen, 731 S.W.2d 581, 582 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.). *See generally* Roger M. Baron, *The Expansion of Legal Malpractice Liability in Texas,* 29 S. TEX. L. REV. 355, 361 (1987). *Cf. In re* Estate of Nibert, 1988 WL 102420 (Ohio App.) (indicating that an attorney was not responsible for will contest litigation costs for failing to videotape the will execution ceremony).

[50] 819 S.W.2d 669 (Tex. App.—Fort Worth 1991, no writ).

[51] 3 S.W.3d 49 (Tex. App.—Amarillo 1999, no pet.).

[52] *Id.* at 53.

[53] IND. CODE § 29-1-5-3. *See generally* William R. Buckley, *Indiana's New Videotaped Wills Statute: Launching Probate into the 21st Century*, 20 VAL. U.L. REV. 83 (1985).

[54] LA. CODE CIV. PROC. art. 2904 (Supp. 2010).

[55] Tex. H.B. 247, 69th Leg. (1985); Tex. S.B. 732, 69th Leg. (1985).

[56] H.B. 3030, 202d N.J. Leg., 1st yr. Sess. (1986).

[57] S. Res. 5098, 210th N.Y. Leg. (1987-88).

will is not prohibited under the Code of Professional Responsibility. The testator should be made aware, however, that the videotape is not meant to replace the written will."[58]

C. Advantages Over Other Types of Evidence

A video-recording of the will execution ceremony has tremendous advantages over the use of other evidence.

1. Accuracy

An unaltered video is highly accurate. The recording reflects the events as they actually occurred during the execution ceremony thus eliminating the necessity of relying upon witnesses whose memories fade and whose impressions change with the passage of time. Likewise, the recording serves as the testator's personal statement of disposition desires without the intervention of an attorney or other scrivener.

2. Improved Testator Evaluation

The testimony of witnesses and the reading of a written will provide incomplete views of the subject under evaluation — the testator and the testator's last wishes. A video of the will execution ceremony preserves valuable non-verbal evidence such as demeanor, voice tone and inflection, facial expressions, and gestures. This type of evidence may be crucial to resolve such issues as testamentary capacity and freedom from undue influence.

3. Deterrent to Will Contest Action

A significant benefit of video-recording the will execution ceremony is the recording's ability to deter will contest actions. The testator is the key witness in an action to set aside a will, but of course, the testator is unable to defend the testator's capacity or disposition desires when the testator's testimony is needed. Fortunately, the video can preserve this important testimony. It is especially important to prepare this evidence when the testator leaves property in an unusual manner (e.g., to a friend or charity to the exclusion of the testator's spouse or children) or when the testator has some type of disability which does not affect testamentary capacity but which may give unhappy heirs an incentive to contest (e.g., a testator who is blind, illiterate, or paralyzed by a stroke).

4. Psychological Benefits

"[F]acing the reality of death and its attendant consequences is one of the most difficult responsibilities in life."[59] A video-recording of the will execution ceremony may help the testator, the testator's survivors, the court, and the jury better cope with this arduous task. The testator may feel more confident that the testator's desires will be carried out because the recording provides more substantial evidence of the testator's intent than the testator's written will alone. The survivors may gain solace from viewing the testator delivering the testator's final message — a loving last memory of the testator. Finally, the court and jury may be more likely to believe what they see and hear on a video than the courtroom testimony of interested persons. Thus, a will disinheriting a needy spouse or child is more likely to stand when the video clearly shows the testator's capacity and intent.

D. Potential Problems

Despite the significant benefits of preparing a video-recording of the will execution ceremony, there are several potential problems. Anyone contemplating using this technique must be aware of possible shortcomings. In some cases, steps may be taken to reduce or eliminate these problems, while in other situations the prudent decision would be not to prepare a video.

1. Poor Appearance of Testator

Although a situation may otherwise seem appropriate for video-recording the will execution ceremony, the attorney may be hesitant

[58] Bd. of Commn'rs on Grievances & Discipline, Sup. Ct. of Ohio, 88-014 (1988).

[59] Charles I. Nelson & Jeanne M. Starck, *Formalities and Formalism: A Critical Look at the Execution of Wills*, 6 PEPPERDINE L. REV. 331, 348 (1979).

to expose the testator to the court. An accurate picture of the testator may lead a judge or jury to conclude that the testator was incompetent or unduly influenced. Similarly, bias against the testator may exist because of the testator's outward appearance; the testator's age, sex, race, disability, or perceived annoying habits may prejudice some individuals.[60]

If the testator's appearance is poor, it may be advisable to forego video-recording the ceremony and use other contest avoidance techniques. If the video is made and turns out badly, several difficult issues arise. Should the video be erased or deleted? If the recording is retained, will it aid the will contestant if shown? What response is proper if during the deposition stage of a will contest the attorney is asked whether the will execution ceremony was video-recorded? What can the attorney do to prevent the potentially damaging recording's introduction short of perjury? There are few, if any, good answers to these questions.

2. <u>Staged</u>

Opposition to the use of a video of the will execution ceremony may stem from the staged nature of the recording which arguably reduces its probative value. This objection is not unique to video-recorded evidence. Commonly, the testimony of live witnesses is rehearsed many times before it is given under oath. A witness in court is subject to cross-examination, however, while it is impossible to question a video and its principal, the testator. This objection should be easily surmounted because, unlike a reenactment or demonstration, the will execution ceremony is a staged event in the first place.

3. <u>Distortion</u>

Video-recordings have the potential to distort the people and events recorded. Viewed on video, the testator may appear different than the testator would in person; the testator may appear heavier, or scars and blemishes may be accented. Although distortions are inadvertent and inherent in any recording process, some distortion could be intentionally done to bolster the testator. For example, the attorney could instruct the camera operator to avoid recording the testator's perceived negative traits which would adversely impact a determination of testamentary capacity.

4. <u>Alteration</u>

There is always a possibility that the video-recording of the will execution ceremony will be altered. The alteration could be accidental through inadvertent erasure, deletion, or exposure to a strong magnetic field. Careful storage procedures, however, greatly reduce these risks.

Intentional alteration through skillful editing and dubbing may also occur, although a video is more difficult to alter than a written document. Even though anyone with correction tape or fluid, scissors, a photocopier, and a bit of evil ingenuity can alter a written document, more sophisticated equipment and skills are required to make undetectable changes to a video. Use of a continuous display time-date generator along with a storage method requiring a documented chain of custody significantly reduces the possibility of tampering.

E. Procedure/Format for Videotaping Will Execution Ceremony

Once the decision is made to video-record the will execution ceremony, caution must be exercised to make certain the recording contains all the necessary elements and does not contain anything detracting from admissibility or evidentiary weight.

1. <u>Inspect Equipment</u>

The recording equipment should be inspected to insure it is in proper working order and a competent operator should be available at the appointed time.

[60] In such cases, an audio-only tape may be appropriate. *See* Joseph S. Horrigan, *Will Contest: Evidence, Procedure, and Experts*, in STATE BAR OF TEXAS, 15TH ANNUAL ADVANCED ESTATE PLANNING AND PROBATE COURSE M-2 (1991).

2. Fully Brief Prospective Testator

The prospective testator should be fully briefed as to how the recording procedure will be conducted. In some situations, a "dress rehearsal" may be necessary to familiarize the testator with the recording process and avoid an appearance of anxiety or nervousness. It is important that the testator is comfortable and at ease with the situation so that the testator appears and sounds natural. Likewise, it must be impressed on the testator that all actions and statements will be recorded. Avoidance of emotional outbursts and unplanned conversation is crucial. The testator should also be instructed to avoid any potentially annoying habits such as fingernail biting and smoking.

3. Prepare Room

The room in which the recording takes place needs to be carefully prepared. Desks, tables, chairs, and so forth should appear neat and uncluttered so nothing detracts from the participants' words and actions. The room should be arranged so that a camera operating from a fixed location can record all relevant events.

4. Gather Participants

Once the room is ready, the appropriate persons should be gathered. In most cases, the only individuals present will be the testator, the attorney, two or three witnesses, a notary, and the equipment operator. To reduce claims of overreaching and undue influence, beneficiaries and family members should be excluded. In addition, no one should enter or leave the room until recording is complete.

5. Position Participants

All participants in the ceremony need to be strategically positioned in the room so that they may be easily recorded performing their various duties. For example, the testator and witnesses should be seated so they, as well as the camera, can observe the execution and attestation of the will.

6. Introductions by Attorney (pre-recording)

Before the recording begins, the attorney should thank everyone for coming and briefly review what is going to happen. The attorney should answer any last minute questions and resolve concerns. Only after everything and everyone is ready should the actual recording begin.

7. Begin Recording; Introduce Setting and Participants

As an introduction, the attorney in charge of the ceremony should identify the situation (a will execution ceremony), state the location of the recording, and give the date and time. The camera should have a time-date generator which continuously records the date and time on the recording. The camera should then pan the entire room and each person should state his or her name, address, and role in the ceremony (e.g., witness, notary).

8. Identify Testator and Establish Awareness of Recording

The camera should then focus on a dialogue between the testator and the attorney. The testator should state the testator's name and explain that the testator is preparing to execute a will to control the disposition of the testator's property upon death. Likewise, the testator should indicate an awareness that the ceremony is being recorded with the testator's full knowledge and consent.

A brief period of recorded "small talk" may also be helpful to establish the testator's competency. The conversation should be crafted to include some references to things in the past to establish long-term memory (e.g., when did you get married, where did you go to high school) and to recent events to demonstrate short-term memory (e.g., what did you eat for breakfast, what did you do last night).

9. Demonstrate Testator's Agreement to Will Terms

The testator should then identify the appropriate document as the testator's will. The testator should read the entire will aloud, and the

camera should zoom in on the will so that each page will be readable during playback. This part of the procedure is very important because it helps ensure that the document probated is identical to the one actually executed. If the testator objects to revealing the contents of the will to the witnesses and other personnel, they may leave the room during the reading of the will. The testator should then state that the testator understands the will and agrees with its dispositive and administrative provisions.

10. Establish Testator Understands Natural Objects of Bounty

The video-recording should establish that the testator understands the natural objects of the testator's bounty. The testator should provide details concerning prior marriage(s), if any (e.g., ex-spouses' names, how the marriages ended, such as by death or divorce). If the testator has any children, the testator should give their names, ages, and addresses along with information regarding other close family members such as parents, siblings, and grandchildren. This part of the ceremony is especially important if a spouse or child is being disinherited in favor of a distant relative, friend, or charity.

11. Establish Testator Understands Nature and Extent of Property

The recording should also demonstrate that the testator understands the nature and extent of the testator's property. To accomplish this, the testator should explain the types and approximate value of the testator's assets. In addition, the testator should state when the property was acquired and the source of payment to help establish the community or separate character of the property. This will help avoid claims that the testator made a will believing the contents or value of the testator's estate to be vastly different from its true condition.

12. Establish Testator Understands Disposition of Property Made by Will

The recording should reflect the testator's understanding of the disposition of the testator's property. If the testator makes controversial or unusual gifts or if close family members are omitted, it may be advisable for the testator to explain the testator's disposition plan and the reasons therefore.[61]

13. Establish Lack of Undue Influence

The video-recording might also be used to rebut claims that the testator was exposed to undue influence. In this regard, the attorney should ask the testator if others have badgered the testator to make a will containing particular provisions. If any of those persons are present, they should be asked to leave. The attorney should also ask the testator whether anyone has threatened to withhold medicine, food, or love or threatened to harm the testator in any way if the will was not written in a certain manner. The attorney should pose sufficient questions to convince someone watching the tape that the will reflects the testator's disposition plan and not that of someone else.

14. Permit Testator to Discuss Will Contest Suspicions

If the testator has any particular fears or suspicions that unhappy heirs are likely to contest the will, the testator should explain the grounds for these concerns. The recording's usefulness to prevent or win a will contest action is increased if the testator discusses the exact grounds for contest and provides appropriate explanations. Prior to the ceremony, the attorney must caution the testator to refrain from using language that might provoke a will contest or be considered slanderous.

15. Conduct Standard Will Execution Ceremony

The next part of the video-recording procedure is the standard will execution ceremony as discussed in § VI. The attorney should ask the testator if the testator requests the witnesses to attest to the signing of the will. The testator should clearly answer in the affirmative. The testator should then initial each page of the will and sign it at the end while the camera focuses on the testator's actions and the witnesses

[61] *See supra* § III, page 3.

observing the testator signing the will. Next, the attorney or a witness should read the attestation clause. All witnesses should then initial each page of the will and sign at the end. The camera should follow the action closely so that the actual attestation and the testator's observation thereof are recorded. The recording should also document the execution of the self-proving affidavit.

The actual ceremony would then be finished and recording would stop.

16. Review Recording

The recording should be viewed to ensure that all appropriate words and actions were clearly recorded. This step also helps establish that the equipment was functioning properly, the operator was competent, and the recording accurately reflects what transpired.

17. Obtain Affidavit of Equipment Operator

The camera operator should sign an affidavit describing the operator's experience and qualifications, explaining the type of equipment used, and stating that the equipment was in proper working order during the recording. This would be helpful if a foundation for admissibility is needed and the camera operator or other witnesses are unavailable.

18. Store Video-recording in Secure Location

The video should be stored so it is safe from fire, theft, magnetic fields, heat, and unauthorized access. This storage location should be readily accessible upon the death of the testator. A common repository is a safe deposit box because its entry records are useful in showing the recording's chain of custody.

F. Conclusion

The legal profession, steeped in tradition and precedent, is often hesitant to adopt new techniques. To provide clients with the best legal services available, however, estate planners must remain abreast of technological developments such as video-recording. Each time a will is prepared, the drafter should determine the likelihood of whether additional evidence of the will execution ceremony will be necessary. If so, serious consideration should be given to video-recording the will execution ceremony. This modern procedure permits the accurate preservation of the testator's words and actions. The superior evidence of the testator's mental and physical condition provided by a video may prove invaluable should a will contest materialize. Although not without its disadvantages, the use of video has a tremendous potential for avoiding a successful will contest and improving the likelihood that testamentary desires are effectuated.

VIII. SELECT WITNESSES THOUGHTFULLY

Little thought is usually given to the selection of witnesses. Typically, witnesses are individuals who just happen to be available at the time of will execution, e.g., secretaries, paralegals, law clerks, and other attorneys. It may be that the testator sees the witnesses for the first and last time at the ceremony. In most cases, this practice is not harmful; the self-proving affidavit removes the necessity for finding the witnesses and the vast majority of wills are uncontested. The situation is considerably different, however, if a contest arises and the testimony of the witnesses as to testamentary capacity or the details of the will execution ceremony is crucial.

A. Witnesses Familiar with Testator

"The jury is likely to give little weight to the testimony of a witness who never saw the testator before or after the execution of the will, and whose opportunity to form a conclusion was limited to the single brief occasion."[62] Accordingly, if the attorney anticipates a will contest, it is prudent to select witnesses previously acquainted with the testator, such as personal friends, co-workers, and business associates. These people are more likely to

[62] 17 MARION K. WOODWARD & ERNEST E. SMITH, III, PROBATE AND DECEDENTS' ESTATES § 336, at 278 (Texas Practice 1971).

remember the ceremony and provide testimony about how the testator acted at the relevant time. In addition, they can compare the testator's conduct at the ceremony with how the testator acted at a time when the contestants concede that the testator had capacity.

Considerable debate exists regarding the wisdom of having health care providers serve as witnesses or attend the will execution ceremony. The doctors and nurses who care for the testator appear well-qualified to testify about the testator's condition. During cross-examination, however, details about the testator's illness may come out that would not otherwise have been discovered. This additional information may prove sufficient to sway the fact-finder to conclude the testator lacked capacity.[63] The danger is heightened if the doctor is a psychiatrist. "The very presence of a psychiatrist may be seized upon by the contestant as indicative of doubt as to testamentary capacity and, by adroit handling, may be caused to operate adversely to the proponent."[64]

B. Supernumerary Witnesses

Although attested wills require only two witnesses under Texas law,[65] extra witnesses may be advisable if a contest is likely. Additional witnesses provide a greater pool of individuals who may be alive, available, and able to recollect the ceremony and the testator's condition.

C. Youthful and Healthy Witnesses

The attorney should select witnesses who are younger than the testator and in good health. Although it is no guaranty, the use of young, healthy witnesses increases the likelihood that they will be available (alive and competent) to testify if the will is contested.

D. Traceable Witnesses

An attorney charged with locating attesting witnesses to counter a will contest is often faced with a difficult task. Witnesses may move out of the city, state, or country. In addition, witnesses may change their names (e.g., a female witness marries and adopts husband's name or a married female divorces and retakes maiden name). To increase the chance of locating crucial witnesses, the attorney should select people who appear easy to trace, e.g., individuals with close family, friendship, business, educational, or political ties with the local community.

E. Witnesses Who Would Favorably Impress the Court and Jury

The attorney should carefully evaluate the personal characteristics of the witnesses. The witnesses should be people who would "make a good impression on the court and jury — substantial people of strong personality who speak convincingly and with definiteness."[66]

IX. OBTAIN AFFIDAVITS OF INDIVIDUALS FAMILIAR WITH TESTATOR

One of the most convincing types of evidence of a testator's capacity is testimony from individuals who observed the testator at and around the time the will was executed. Frequently, however, this testimony is unavailable at the time of the will contest action; the witnesses to the will may be dead, difficult to locate, or lack a good recollection of the testator. The same may be true of other individuals who had personal, business, or professional contacts with the testator. One way of preserving this valuable evidence is to obtain affidavits from these people detailing the testator's conduct, physical and mental condition, and related matters. Affidavits of attesting witnesses, individuals who spoke with the testator on a regular basis, or health care providers (doctors, psychiatrists, nurses) who examined the testator close to the time of will execution, will help

[63] *See* Charles C. Allen, *The Will Contest: An Acid Test of Will Drafting,* 6 ST. LOUIS UNIV. L.J. 1, 18 (1960).

[64] Leon Jaworski, *The Will Contest*, 10 BAYLOR L. REV. 87, 93 (1958).

[65] TEX. ESTATES CODE § 251.051(3).

[66] Jaworski, *supra* note 64, at 91.

protect this potentially valuable testimony should a will contest arise.

X. DOCUMENT TRANSACTIONS WITH TESTATOR VERIFYING INTENT

Under normal circumstances, the testator orally explains the desired disposition plan and the reasons therefore, the attorney takes scribbled notes, the attorney prepares a draft of the will, the testator makes oral corrections, and then the attorney prepares the final version of the will. This procedure supplies little in the way of documentation to refresh the attorney's memory about the details of the testator's situation nor to use as evidence in a will contest action. If a contest is anticipated, all of these steps should be documented in writing, on videotape, or both. For example, the testator could write a letter to the attorney explaining the disposition scheme and motivating factors behind it. The attorney's written reply would warn that a contest may occur because of the disinheritance of prospective heirs, unequal treatment of children, excessive restrictions on gifts, etc. The testator would respond in writing that the testator has considered these factors but prefers to have property pass as originally indicated. The attorney should take detailed notes of all meetings with the testator as well as of the will execution ceremony. The attorney would then carefully preserve these documents for use should the will be contested.[67]

XI. "COINCIDENTAL" DOCTOR APPOINTMENT

On the same day as the testator executes the will, the testator may wish to visit his or her doctor for an annual physical or other routine appointment. If the will is later contested for lack of capacity, the doctor can testify that the testator was seen that day and if mental capacity had been questionable, the doctor would have so indicated in the testator's medical records and taken appropriate steps.

XII. OBTAIN OTHER EVIDENCE TO DOCUMENT TESTATOR'S ACTIONS

Gathering evidence to rebut a will contest is always easier while the testator is alive. Along with affidavits of individuals familiar with the testator and documenting testator's intent, the attorney may want to acquire additional evidence. For example, the testator may have letters from a child showing family discord supporting the testator's reasons for disinheriting the child. Or, the attorney may wish to collect the testator's medical records and may easily do so by having the testator sign a release.

XIII. PRESERVE PRIOR WILL

When a new will is executed, it is common practice to physically destroy prior wills. If the testator's capacity is in doubt, however, and the testator indicates that the testator prefers the prior will to intestacy, it is a good idea to retain the prior will. If a court holds that the new will is invalid, the attorney may offer the old will for probate much to the chagrin of the contestant.[68]

XIV. REEXECUTE SAME WILL ON REGULAR BASIS

What happens when a will contest is successful? The estate passes under a prior will, or if none, via intestacy. As discussed in § XII, it may be a good idea to preserve a prior will if the testator prefers its disposition to intestacy. However, the testator clearly prefers the new will to both the old will and intestacy. Thus, the attorney could have the testator reexecute the same will on a regular basis, for example, once every six months. At the time of the testator's death, the most recent will would be offered for probate. If a contest is successful, then the will executed six months prior would be introduced.

[67] *See* Jaworski, *supra* note 64, at 91-93.

[68] *See* Jaworski, *supra* note 64, at 95.

If that one is likewise set aside, the will executed one year prior would be introduced, and so on until all wills are exhausted. A potential contestant might forego a contest when the contestant realizes that sufficient reasons for contest would have to be proved for many different points in time.[69]

XV. SUGGEST THAT TESTATOR CONSIDER MAKING A MORE TRADITIONAL DISPOSITION

Unusual dispositions, such as those disinheriting close family members, treating like-situated children differently, and imposing excessive restrictions on gifts, are apt to trigger contests. Therefore, the attorney may wish to suggest that the testator consider toning down the disposition plan to bring it closer to conforming to a traditional arrangement. Of course, the client may balk at this recommendation. The attorney should explain that although this may cause the testator to deal with property in an undesired way, it may reduce the motives for a contest and thus increase the chances of the will being uncontested. (Or stated another way, half a loaf is better than no loaf at all.) Alternatively, other estate planning techniques may be used to make unconventional dispositions.

XVI. MAKE SIGNIFICANT INTER VIVOS GIFT TO DISINHERITED HEIR APPARENT AT TIME OF WILL EXECUTION

The testator may wish to make an inter vivos gift, either outright or in trust, to a disinherited heir apparent at the same time the will is executed (i.e., minutes after will execution). This gift should be substantial but, of course, far less than the amount the heir apparent would take via intestacy. After the testator's death, the heir is less likely to contest the will on the basis of lack of testamentary capacity. By asserting lack of capacity, the contestant would be forced to concede that the contestant accepted property from a person who lacked the capacity to make a gift or establish a trust. In addition, should the contest succeed, the heir would be required to return any property already received to the estate or use it to offset the intestate share.

XVII. CONTRACT NOT TO CONTEST

The testator could enter into a contract not to contest with the potential will contestants.[70] In exchange for the payment of money or a transfer of other property, the heirs (or beneficiaries of prior wills) could bind themselves contractually not to contest the will. If the contract is drafted to meet all the elements of a valid contract, it should be enforceable, especially in light of the cases validating a contract to convey an inheritance.[71]

XVIII. RECOMMEND USE OF ALTERNATIVE ESTATE PLANNING TECHNIQUES

Whenever the attorney anticipates a will contest, the attorney should consider using other estate planning techniques to supplement the will. Inter vivos gifts, either outright or in trust, multiple-party accounts, and life insurance, annuities, and other death benefit plans are just some of the alternative techniques available to the estate planner. Although these arrangements may be set aside on grounds similar to those for contesting a will, such as lack of capacity or undue influence, they may be more difficult for a contestant to undo. More people may be involved with the creation or administration of these techniques thereby providing a greater number of individuals competent to testify about the client's mental condition. In addition, the contestant may be estopped from contesting certain arrangements if the contestant has already accepted benefits as,

[69] *See* Brown, *Re-Signed Will-Revisited,* 36 J. ST. B. CAL. 344 (1961); Brown, *The Re-Signed Will,* 35 J. ST. B. CAL. 685 (1960).

[70] *See* Letter from Robert Jorrie, attorney, San Antonio, Texas, to Michael Cenatiempo, attorney, Houston, Texas (Feb. 22, 1994).

[71] *See* Mow v. Baker, 24 S.W.2d 1 (Tex. Comm'n App. 1930, holding approved).

for example, a beneficiary of a trust. Furthermore, many of these techniques may be used to secure other benefits such as tax reduction, reduced need for guardianship, probate avoidance, and increased flexibility.

XIX. ANTE-MORTEM PROBATE

"[T]he post mortem squabblings and contests on mental condition . . . have made a will the least secure of all human dealings."[72]

A. Introduction

The ultimate goal of estate planning is to ascertain and effectuate the intent of each individual to the fullest extent possible within legal boundaries. One of the most common estate planning techniques used to accomplish this laudable purpose is the will, a document memorializing a person's desires regarding the disposition of property, designation of fiduciaries, and other related matters, which is poised to take effect upon the testator's death.

Formal proof of a person's will may not occur in most states until after the testator's death. This procedure prevents the person who has the most important evidence of intent, the testator, from testifying. Consequently, estate planners are constantly striving to ascertain whether all technical requirements for a valid will are satisfied as well as preparing for potential battles against disgruntled heirs preferring an ineffective will so that they may receive a larger portion of the decedent's estate via intestate distribution or an earlier will. A progressive technique with tremendous potential for improving the estate planner's ability to assure that a testator's desires will be carried out upon death is to validate the will during the testator's lifetime — an *ante-mortem* or *living* probate. The testator would then be assured that the testator's wishes will be carried out after death and will be able to die with the knowledge and confidence that the will is safe from contest. [73]

B. Significant Problems With Post-Mortem Probate Under the Law of Most States

Although functioning adequately in the majority of situations, post-mortem probate poses many difficulties which frustrate the intent of the testator as well as waste court time and estate resources. A few of these problems will be discussed along with some of the traditional solutions used to ameliorate these problems.

1. Mere Technical Errors May Invalidate Otherwise Valid Will

Under the law of most states, even the simplest of errors can result in the invalidation of the testator's entire will despite clear and convincing evidence that the testator was competent and truly intended the disposition plan directed in the will. For example, the testator may not be in the presence of the witnesses when they attest to the will.[74] Other situations leading to invalidity include the will having only one witness, an unwitnessed will containing too much material not in the testator's own handwriting to qualify as a holographic will, and the incompetency of one of the witnesses.

To avoid these problems, a person may elect to use various non-probate transfers such as inter vivos trusts, joint ownership with survivorship rights, and outright gifts. Despite the effectiveness of these techniques in many circumstances, they have potentially undesirable consequences, e.g., outright gifts require total control over the property to be sacrificed, trusts may be set aside for lack of capacity or undue influence, and joint ownership may give too

[72] Lloyd v. Wayne Circuit Judge, 23 N.W. 28, 30 (Mich. 1885).

[73] *See* Aloysius A. Leopold & Gerry W. Beyer, *Ante-Mortem Probate: A Viable Alternative*, 43 ARK. L. REV. 131 (1990) (portions of this section are adapted from this article).

[74] Morris v. Estate of West, 643 S.W.2d 204, 206 (Tex. App.—Eastland 1982, writ ref'd n.r.e.) (court invalidated a will because the testator could not have observed the witnesses signing the will without walking four feet to an office door and fourteen feet down a hallway).

many rights to the joint owner. Public policy is not served when the use of non-probate transfers is primarily motivated by fears that testamentary instructions will not be carried out.

2. Spurious Will Contests Encouraged

One of the laudable purposes of a will contest is to ensure that deserving heirs are not deprived of a share of the decedent's estate as a result of the testator's lack of capacity when the will was executed or because a devious person defrauded or exerted undue influence on a susceptible testator. Synthesized by greedy plots of unhappy heirs, however, will contests are often filed to prove lack of mental capacity, fraud, or undue influence where none existed. Even if the contest is unsuccessful, estate funds are wasted and innocent beneficiaries must endure emotional upheaval and delay. Unfounded will contests may also lead to settlements entered into only to prevent further depletion of the estate and which result in distributions not intended by the testator.

3. Testator Unavailable to Testify

An inherent difficulty with post-mortem probate is that it requires the trier of fact to determine the competency and desires of the testator without having the key witness, the testator, available for questioning. Only indirect evidence is available to evaluate the testator's capacity which, whether the testator was incompetent or simply eccentric with property, tends to be a matter of mere speculation. The quality of any evidence, such as the testimony of witnesses to the will, tends to deteriorate with time as memories fade and perceptions change.

A relatively modern technique which may be used to partially solve this problem is to videotape the will execution ceremony. If the will execution ceremony is preserved on videotape, the testator is effectively brought into the courtroom during a contest although, of course, the testator is not subject to cross examination. Despite the tremendous benefits of this technique, it pales in comparison to ante-mortem probate where the actual testator is available for direct observation.

C. Development of Ante-Mortem Probate

In many respects, ante-mortem probate is not a product of this century or even the previous one. Ancient laws and customs recorded in the Bible show how a type of validation of a will during a person's lifetime was used to facilitate inheritance. An early example can be found in the book of Genesis. During the time of Isaac, the accepted way for a father to pass his property to his eldest son was by blessing the son near the end of the father's life.[75] To trick his nearly blind father, Jacob, a younger son, wore a sheepskin to appear hairy like the elder son Essau. The scam worked and Jacob received Isaac's (the testator's) irrevocable blessing (testamentary gift).[76]

There is evidence that early in the development of English ecclesiastical law a testament could be proved during the testator's lifetime at the testator's request.[77] Upon the testator's petition, the testament was recorded and registered but would have no effect until the testator actually died.[78] The testator could still revoke or alter a will so recorded and registered.[79] However, there is little evidence explaining the effect of a pre-death registration on the disgruntled heirs' ability to contest the testament after the testator's death. As the law evolved, these pre-death procedures were abandoned leaving the ecclesiastical courts with jurisdiction over the probate of deceased persons' wills.[80]

While the Anglo-American legal system wrestled with problems triggered by post-mortem probate, the civil law systems of Europe

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[75] *Genesis* 27:1-4.

[76] *Id.* at 27:5-38.

[77] *See* HENRY SWINBURNE, A TREATISE OF TESTAMENTS AND LAST WILLS, Part 6, § 13, at 65-66 (1635) (photograph reprint 1979).

[78] *Id.*

[79] *Id.*

[80] *See* Allen v. Dundas, 3 T.R. 125, 130 (1789).

developed the "authenticated will."[81] Under European notarial procedure, a testator who is fearful of a post-mortem contest can execute a will and thereafter possess both the executed will and evidence of capacity.[82] Unlike their United States counterparts, European notaries are quasi-judicial officers, usually lawyers, who are experienced in determining a testator's capacity and freedom from undue influence at the time of will execution.[83] Once the notary authenticates the will, it gains great credibility and is difficult to set aside in a post-mortem proceeding.[84]

1. The Michigan Attempt at Ante-Mortem Probate

In 1883, the Michigan legislature made a valiant attempt to cope with the disruptive and uncertain post-mortem probate procedures.[85] The testator was authorized to petition the probate judge of the testator's county of residence for the will to be admitted and established as the testator's last will and testament.[86] The petition was required to contain averments that the will was executed by the testator "without fear, fraud, impartiality, or undue influence, and with full knowledge of its contents."[87] The testator was also required to allege that the testator was of sound mind and memory and had full testamentary capacity.[88] In addition, the testator was required to provide the names and addresses of the individuals who would be the testator's heirs were the testator to die intestate as well as other persons whom the testator desired to be parties to the proceeding.[89]

The judge would then set a hearing date, issue citations to the parties named in the petition, and direct publication of a notice of the hearing.[90] After receiving proof that the citations were served and the notice published, the judge would conduct a hearing inquiring into all matters alleged in the petition.[91] In addition, the judge was granted the authority to examine the witnesses to ascertain relevant facts.[92]

If the judge determined that the testator's allegations were true, the judge would issue a decree setting forth these findings.[93] A copy of the decree would be attached to the will, having the same effect as a post-mortem decree and considered conclusive as to the matters stated therein.[94] The statute attached no requirement that the process be repeated if the testator wanted to revoke or alter the will.[95]

The usefulness of this innovative statute was short-lived. The Michigan Supreme Court declared the statute unconstitutional in 1885.[96] Two grounds were propounded for the statute's invalidity: (1) It enabled the testator to avoid the rights of a spouse and child; and (2) it failed to provide for finality of judgment.[97] The finality

[81] *See* John H. Langbein, *Living Probate: The Conservatorship Model,* 77 MICH. L. REV. 63, 65 (1978).

[82] *See id.* at 63-71 (the use of notaries is expensive and thus they are seldom used because there are more economical methods of creating a valid will).

[83] *See id.* (a continental notary is obliged to satisfy him- or herself of the testator's compliance with will formalities and the testator's identity when examining a purported will).

[84] *See id.* (European law attaches an extremely strong presumption of validity to a notary's authentication on the premise that the notary is an expert in legal paperwork who takes statutory responsibilities seriously).

[85] *See* 1883 Mich. Pub. Acts 17.

[86] 1883 Mich. Pub. Acts 17, § 1.

[87] *Id.* § 2.

[88] *Id.*

[89] *Id.*

[90] *Id.* § 3.

[91] *Id.* If any person named in the testator's petition was a minor or under a disability, the judge was required to appoint a guardian ad litem to represent the person. *Id.* § 4.

[92] *Id.* § 4.

[93] *Id.*

[94] *Id.*

[95] *Id.* § 6.

[96] Lloyd v. Wayne Circuit Judge, 56 Mich. 236, 239, 23 N.W. 28, 29 (1885).

[97] *Id.* at 238-39, 23 N .W. at 28-29.

debate stemmed from the statute's policy of determining a will to be valid, yet reserving in the testator the power to freely amend, revoke, or alter the will.[98]

A concurring opinion advocated the rejection of ante-mortem probate outright pointing out that "the living can have no heirs" and that a will cannot be final until the death of the testator.[99] The concurring justices also expressed concern about the possible harm to a family which may flow from the ante-mortem process.[100] Finally, the Michigan Supreme Court seemed to feel that because future potential heirs did not have a legal interest in the proceedings, there was not an adverse party in interest so as to constitute a legal "case or controversy" and thereby convey jurisdiction upon the court. Thus, the issuance of a judicial determination would be paramount to issuing an advisory opinion which Michigan's constitution prohibited.[101]

2. Wills of Native Americans

In 1910, Congress enacted a type of ante-mortem probate applicable to certain Native American tribes under the guardianship of the federal government.[102] This procedure permitted a Native American whose will disposed of certain allotments held under trust by the government to have the Secretary of the Interior approve the will prior to death.[103] The Secretary's approval was final unless fraud was discovered in connection with the execution or procurement of the will within one year after the testator's death.[104]

The potential for development of this ante-mortem technique was never realized. The 1923 regulations governing the Interior Department's approval of wills indicated that the preferred practice was to accept the submitted will, but not to approve it until after the testator's death.[105] This restriction on any true ante-mortem probate has been continued in subsequent regulations.[106]

3. Renewed Interest in the 1930's

After a period of disenchantment followed by disinterest, ante-mortem probate was revived in the 1930's. The National Conference of Commissioners on Uniform State Laws formed a special committee to draft a uniform act creating a procedure to validate a will before the death of the testator.[107] The Committee proposed two methods. The first permitted the testator simply to file the will for safekeeping with the clerk of the court.[108] The second method, described below, was a true ante-mortem probate procedure.[109]

The first tentative draft of the act which delineated the true ante-mortem probate procedure provided that the testator could initiate the ante-mortem process by filing a will with the

[98] *See* Note, *Contemporary Ante-Mortem Statutory Formulations: Observations and Alternatives,* 32 CASE W. RES. L. REV. 823, 827 (1982).

[99] *Lloyd,* 56 Mich. at 240-41, 23 N.W. at 30 (Campbell, J., concurring).

[100] *Id.* at 241-242, 23 N.W. at 30-31(Campbell, J., concurring).

[101] *Id.* at 239, 23 N.W. at 29.

[102] Act of June 25, 1910, ch. 431, § 1, 36 Stat. 886 (codified at 25 U.S.C. § 373 (1990)).

[103] *Id.*

[104] *Id.*

[105] DEPARTMENT OF THE INTERIOR, UNITED STATES INDIAN SERVICE, DETERMINATION OF HEIRS AND APPROVAL OF WILLS, § 37 (1915), *reprinted in* WILLIAM P. FRANCISCO, FEDERAL INDIAN PROBATE LAW 170 (1979). *See generally id.* at 60 (discussing how 1923 Regulations limited practice of approving wills prior to testators' deaths).

[106] *See* 43 C.F.R. § 4.260(b) (1995) (current regulation regarding care of an Native American's will which allows approval as to form only).

[107] Martin, *Report of Special Committee on Uniform Act to Establish Wills Before Death of Testator,* 9 A.L.I. PROC. 463 (1932).

[108] *Id.*

[109] *Id.* The research of the Conference's committee indicated that no state currently had a true ante-mortem probate procedure.

clerk of the court together with a list of the witnesses to the will.[110] The testator would then file a petition naming the testator's spouse and prospective heirs as defendants.[111] Assuming the petition was filed in a court with appropriate jurisdiction, the court would issue service of process to the named defendants.[112] If any process was returned unserved, notice by publication would be substituted.[113]

If, after proper notice and a hearing, the will was admitted to probate, the testator was conclusively presumed to have executed the writing with full testamentary intent and capacity and without "fear, fraud, importunity, or undue influence."[114] Any aggrieved party could appeal the court's judgment, and the testator was free to revoke the will in a subsequent writing or through a written withdrawal without having to bring such action to the attention of the court.[115]

The tentative draft was not met with a positive response. This may have been due to objections that the proposal would place the Commissioners "in the position of advocating new legislation rather than reforming current legislation."[116] On the other hand, many legal commentators of the day supported the concept of ante-mortem probate,[117] advocating systems which allowed for different methods of civil law authentication of testamentary documents.

4. The Texas Attempt at Ante-Mortem Probate

In 1943, the Texas Legislature enacted a comprehensive statute authorizing courts to make declaratory judgments. One of the statute's provisions allowed an interested person under a will to have any question of construction or validity arising thereunder determined by a declaratory judgment.[118] The door to ante-mortem probate was thus opened, and it was less than ten years later that living probate was tested under this statute.

In *Cowan v. Cowan*,[119] two of the testator's three children sought to have the will of their living mother declared invalid on grounds of lack of testamentary capacity, insane delusions concerning the objects of her bounty, and undue influence. Despite the seeming authorization of such actions by the declaratory judgment statute, the court determined that it had no jurisdiction to determine the validity of a will of a person who was still alive. The court reasoned that because it did not have such jurisdiction prior to the enactment of the declaratory judgment statute, it did not subsequently obtain that jurisdiction; the declaratory judgment statute did not create new substantive rights but was only remedial in nature and provided a new method of exercising existing jurisdiction. The court noted that the will was ambulatory and that "those named as beneficiaries are devisees only in the embryo." Additionally, the Probate Code did not permit the probate of a will of a living person.[120]

In 1994, the Texas Real Estate, Probate & Trust Law Council studied the possibility of

[110] First Tentative Draft of Uniform Act to Establish Wills Before Death of Testator § 2(b), 9 A.L.I. PROC. 465 (1932).

[111] *Id.* § 3. The statute also contained a form for the testator to use.

[112] *Id.*

[113] *Id.* The court would appoint a guardian ad litem for minors and individuals with legal disabilities.

[114] *Id.* §§ 2 & 3.

[115] *Id.* §§ 3 & 4.

[116] Howard Fink, *Ante-Mortem Probate Revisited: Can An Idea Have a Life After Death?,* 37 OHIO ST. L.J. 264, 289 (1976) (citing HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS AND UNIFORM STATE LAWS AND PROCEEDINGS, at 143 (1931)).

[117] *See, e.g.,* Daniel H. Redfearn, *Ante-Mortem Probate,* 38 COM. L.J. 571. (1933); David F. Cavers, *Ante-Mortem Probate: An Essay in Preventive Law,* 1 U. CHI. L. REV. 440 (1934); Harry Kutscher, *Living Probate,* 21 A.B.A. J. 427 (1935).

[118] TEX. CIV. PRAC. & REM. CODE § 37.004 (original version substantially similar).

[119] 254 S.W.2d 862, 863 (Tex. Civ. App.—Amarillo 1952, no writ).

[120] TEX. ESTATES CODE § 256.002 (prior versions substantially similar).

drafting a Texas ante-mortem statute. Despite believing that ante-mortem probate would be a useful procedure, the Council decided not to move forward with legislation because of the existence of more pressing concerns.

5. Proposals for the Model and Uniform Probate Codes

During the early 1940's, the drafters of the Model Probate Code (MPC) gave brief consideration to the possibility of including provisions for ante-mortem probate.[121] The introduction to the MPC explains in terse language how the drafters carefully considered ante-mortem probate and concluded that "[t]he practical advantages of such a device are not great in view of the fact that few testators would wish to encounter the publicity involved in such a proceeding."[122]

In the early stages of the development of the Uniform Probate Code (UPC), the drafters again gave serious consideration to inclusion of an ante-mortem procedure.[123] The proposed procedure faired better than the earlier MPC version as evidenced by the summer 1967 draft which contained provisions permitting the testator to petition the court "for an order declaring that his Will has been duly executed and is his valid Will subject only to subsequent revocation."[124] This action would be declaratory in nature and would allow the testator to revoke the submitted will by a simple withdrawal procedure or by a subsequent written will or codicil.[125]

The comments which accompanied the proposed sections reflected the benefits of ante-mortem probate. For example, one comment stated that ante-mortem probate is "often recommended and is of considerable attraction to the public. Its availability offers some insurance against unwarranted Will contests."[126] Despite the initial sanctioning of this progressive estate planning technique, the drafters omitted any reference to ante-mortem probate in subsequent drafts of the UPC. It was not until almost a decade later that a significant resurgence of interest in ante-mortem probate occurred.[127]

6. Academics Develop Ante-Mortem Probate Models

With the onset of the nation's bicentennial came a resurgence of interest in the field of ante-mortem probate. Between 1976 and 1982, many articles were written expressing both the advantages and disadvantages of the ante-mortem alternative.[128] During this period, writers addressed four problem areas: (1) inchoate rights, (2) the living have no heirs, (3) the security of the testator, and (4) the lack of enabling legislation.[129] From these criticisms and concerns, three basic ante-mortem probate models emerged.

a. The Contest Model

The first model, proposed by Professor Howard Fink of The Ohio State University, is closely related to the Michigan Act of 1883. Referred to as the contest model, this proposal places the testator and the prospective heirs in an adversarial situation which allows for a declaratory judgment.[130] Standing is granted, and notification is provided to all persons who would be heirs by intestate succession as well as to all

[121] LEWIS M. SIMES & PAUL E. BASYE, PROBLEMS IN PROBATE LAW 20 (1946) (containing text of MODEL PROBATE CODE).

[122] *Id.*

[123] WILLIAM D. ROLLISON, COMMENTARY ON THE UNIFORM PROBATE CODE 25 (1970).

[124] Summer, 1967, Draft of the Uniform Probate Code § 2-903, *quoted in* WILLIAM D. ROLLISON, *supra* note 123.

[125] *Id.* § 2-906, *quoted in* WILLIAM D. ROLLISON, *supra* note 123, at 26.

[126] *Id.*

[127] WILLIAM D. ROLLISON, *supra* note 123, at 26.

[128] *See, e.g.,* Fink, *supra* note 116, at 264; Langbein, *supra* note 81, at 63.

[129] *See* Note, *supra* note 98, at 830-32.

[130] Fink, *supra* note 116, at 274-75.

beneficiaries under the will.[131] A guardian ad litem is appointed to protect the interest of any unborn or unascertained heirs.[132]

After executing a will, the testator brings suit requesting the court, through a declaratory judgment, to deem the will valid.[133] If, after considering the signatures, number of witnesses, testamentary capacity, and absence of undue influence, the court determines the will is valid, the will would be filed with the court.[134] It could be nullified by repeating the process.[135] All nine jurisdictions currently permitting ante-mortem probate, Alaska[136], Arkansas[137], Delaware[138], New Hampshire[139], North Dakota[140], Nevada[141], Ohio[142], and South Dakota[143], have based their statutes on the contest model.

While the contest model offers some solutions to the problems of ante-mortem probate, it is expensive and leaves many questions unanswered.[144] However, the contest model solves the problem of finality by making the will binding on all parties; it is susceptible to change only by a second judgment.[145] Disclosure of the will's contents and the adversarial nature of the procedure, which may cause unrest and disharmony between family and friends of the testator, are the proposal's greatest flaws.[146]

b. The Conservatorship Model

In 1980, Professor John Langbein of the University of Chicago attempted to solve the problems of the contest model with his proposal of the conservatorship model.[147] This model, like the contest model, relies on a declaratory judgment to establish finality. Unlike the contest model, however, this model tries to avoid the strife involved in intrafamilial litigation by appointing a conservator to litigate the interests of the prospective heirs and beneficiaries.[148] Unfortunately, the conservatorship model is also plagued with the problems of notice, jurisdictional function, and unrest caused by public disclosure of the contents of the will.[149] Because both the contest and conservatorship models rely on declaratory judgments, the will and any contest thereof becomes a part of the public record.

c. The Administrative Model

The administrative model, proposed by University of Georgia Professors Gregory Alexander and Albert Pearson, is a significant departure from the contest and conservatorship models. This model envisions a two-step process: (1) the enactment of empowering legislation;[150] and (2) the revision of the statutory conditions on the rights to contest a will.[151] Under this theory, the ante-mortem experience would be neither judicial nor adversarial. The model relies on an ex parte proceeding in which the testator and the testator's circumstances are considered to

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[131] *Id.*

[132] *Id.*

[133] *Id.*

[134] *Id.*

[135] *Id.*

[136] ALASKA STAT. § 13.12.535-.590.

[137] ARK. CODE § 28-40-201- 203.

[138] 12 DEL. C § 1311.

[139] N.H. REV. STAT. §§ 552:18, 564-B:4-406.

[140] N.D. CENT. CODE § 30.1-08.1-01 to -04.

[141] NEV. REV. STAT. § 30.040.

[142] OHIO REV. CODE § 5817.01-.14

[143] S.D. CODIFIED LAWS § 21-24-3; S.D. CODIFIED LAWS § 55-4-57.

[144] *See* Note, *supra* note 98, at 836.

[145] Fink, *supra* note 116, at 275.

[146] *See* Note, *supra* note 98, at 836.

[147] Langbein, *supra* note 81, at 63, 80.

[148] *See id.* at 78-80.

[149] *Id.*

[150] Gregory Alexander & Albert Pearson, *Alternative Models of Ante-Mortem Probate and Procedural Due Process Limitations on Succession,* 78 MICH. L. REV. 89, 112 (1979).

[151] *Id.*

determine the will's validity rather then a system resembling an accelerated will contest.[152]

The process begins with the testator petitioning the proper court for a determination of the validity of the will.[153] All court proceedings would be in camera to provide the privacy which is lacking in the other models under which the will becomes a matter of public record.[154] Like the conservatorship model, a guardian ad litem would be appointed. However, this guardian would be an investigating agent of the court rather than a fiduciary of the heirs and beneficiaries.[155] The guardian would privately interview the testator to determine the existence of undue influence or lack of capacity.[156] The guardian would not normally be informed of the contents of the will, though the judge could disclose any provisions of the will which are unusual, such as those that disinherit close relatives or make large charitable gifts, to better enable the guardian to conduct a thorough investigation.[157]

The necessity of giving notice of the proceeding to anyone except the guardian ad litem would be eliminated on the pretense that potential heirs have no constitutional right to notice.[158] Under the administrative model, a prospective interest in the estate, were the testator to die intestate, is considered to be too weak to require notice. Family members, however, might receive indirect notice of the ante-mortem probate proceedings should they become aware of the guardian ad litem's investigation.

7. National Conference of Commissioners on Uniform State Laws

Responding to the renewed interest in ante-mortem probate reflected by both state legislatures and legal commentators, the National Conference of Commissioners on Uniform State Laws began investigating the feasibility of ante-mortem probate in 1979. By late 1980, the Uniform Ante-Mortem Probate of Wills Acts drafting committee considered two proposals: (1) a declaratory judgment/contest model format developed by the Joint Editorial Board — Uniform Probate Code (Draft A), and (2) an administrative model based on the writings of Professors Alexander and Pearson drafted by the Ante-Mortem Probate of Wills Act Committee (Draft B).

Draft A reflects the contest approach and was derived from the three state statutes which were already in effect. [159] The most significant difference between the state statutes and Draft A is that under Draft A's procedure any judgment which the testator obtained declaring that the will had been duly executed and is the testator's valid will subject only to revocation, would not be binding on the testator's spouse and descendants. This limitation severely undermines the usefulness of Draft A because it is most often the spouse and descendants who initiate a will contest, especially when they are left less than the amount they would receive under intestacy.

Under the Draft A procedure, the testator begins the process by filing the will and allegations of its proper execution with the appropriate court.[160] The defendants to the action are a representative group chosen from the testator's presumptive heirs and any other persons who have some prospect of being a devisee of the testator, usually because of their status as devisee under a previous will. If the only presumptive heirs are the spouse and descendants of the testator, the defendants would be chosen from those who would be presumptive

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[152] *Id.*

[153] *Id.*

[154] *Id.*

[155] *Id.*

[156] *Id.*

[157] *Id.* at 114.

[158] *Id.* at 115.

[159] UNIF. ANTE-MORTEM PROB. OF WILLS ACT § 1(a) (N.C.C.U.S.L., Draft A, Nov. 1980), *reprinted in,* Aloysius A. Leopold & Gerry W. Beyer, *Ante-Mortem Probate: A Viable Alternative*, 43 ARK. L. REV. 131, 194 (1990).

[160] *Id.* § 1(b).

heirs if the testator had no spouse or descendants.[161]

After proper notice, the court would conduct a hearing to examine the testator, the attesting witnesses, and any other relevant evidence.[162] Additionally, the court would be entitled to make any independent inquiry it deems appropriate. If the court sustains the testator's allegations, the will would be declared valid and the original copy of the will would remain with the court.[163] While this declaration makes the will subject only to subsequent revocation, it does not protect the will from a contest brought by the testator's spouse and descendants. On the other hand, if the court finds for the defendants, it would be a conclusive determination of the will's invalidity.[164]

Draft B adopts an ex parte administrative approach.[165] Once the testator files an application and the original will, the court would appoint a special master to assist the court in making determinations regarding the due execution of the will. The master would interview the testator, the testator's family and friends, and conduct any investigation necessary to ascertain all relevant facts.[166] A written report, subject only to in camera inspection, would then be delivered to the court.

If necessary, the court would have the opportunity to conduct a hearing. This hearing would be closed, and because of its ex parte nature, prior notice would not be given to anyone except the testator and the witnesses. Family members and prospective heirs and beneficiaries would not be allowed to appear, thus ensuring the confidentiality and non-adversarial nature of the proceeding.[167] If the court is satisfied that the formalities for a valid will have been met, it would issue a written determination stating that the will was duly executed and is valid, subject only to the testator's subsequent withdrawal or revocation.[168] This determination of validity is conclusive and binding on all persons. The only way a will admitted to ante-mortem probate under this procedure could be contested would be to allege that the testator subsequently revoked the will.

The Drafting Committee for the Uniform Ante-Mortem Probate of Wills Act failed to adopt either of these proposed drafts. Instead, it decided that a new draft should be developed to incorporate policy decisions made by the Committee which addressed various issues of concern including the strict description of a special master, court retention of the original will, and the binding effect of the decree.[169] Shortly thereafter, the Joint Editorial Board—Uniform Probate Code voted on whether or not to continue the ante-mortem project. Upon learning of the Board's lack of support, as evidenced by an evenly split vote, the Drafting Committee voted to cancel the project, eliminating any hope of a quick response to the need for uniform ante-mortem legislation.[170]

D. Current Status of Ante-Mortem Probate

1. The Original Three

In the waning years of the 1970s, three states enacted ante-mortem statutes based on the contest model: Arkansas, North Dakota, and Ohio. The remaining material in this section is reproduced from a 1997 article prepared by the Ante-Mortem Probate Subcommittee of the

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[161] *Id.* § 1(c).

[162] *Id.* § 2(a).

[163] *Id.* § 3(a).

[164] *Id.* § 3(b).

[165] UNIF. ANTE-MORTEM PROB. OF WILLS ACT (N.C.C.U.S.L., Proposed Draft B, 1980), *reprinted in,* Aloysius A. Leopold & Gerry W. Beyer, *Ante-Mortem Probate: A Viable Alternative*, 43 ARK. L. REV. 131, 197 (1990).

[166] *Id.* § 2(a) & (b).

[167] *Id.* § 3.

[168] *Id.* § 4.

[169] Memorandum to JEB-UPC from R. V. Wellman 8 (Nov. 17, 1980).

[170] Letter from R. V. Wellman to James R. Wade (Oct. 12, 1981).

ACTEC State Laws Committee which conducted a detailed study of these statutes including surveys of ACTEC fellows and judges.[171]

a. North Dakota

The North Dakota Ante-Mortem Probate Act is a concise statute providing a simple method for the testator to obtain a judgment declaring that particular requirements for a valid will have been satisfied.[172] Matters for which a declaratory judgment may be obtained range from compliance with formalities, such as the testator's signature and the required number of witnesses and their signatures, to elements of testamentary capacity and freedom from undue influence.[173]

All of the beneficiaries named in the will, as well as presumptive intestate heirs, are necessary parties to the action.[174] To further solidify the standing of the testator's potential testate and intestate takers, the Act declares that these people have inchoate property rights. These parties must be served with process under the normal North Dakota Rules of Civil Procedure.[175]

If the court determines that the testator properly executed the will, had testamentary capacity, and was not unduly influenced, it declares that the will is valid and orders that it be filed.[176] A subsequent will or written revocation is insufficient to negate the ante-mortem probate; the testator must execute a new will and repeat the entire process to overcome the conclusive validity of the first will.[177]

The ante-mortem proceeding is for the limited purpose of determining the will's validity.[178] As a result, facts found in this proceeding are not admissible into evidence in any other action. In addition, the determination in the ante-mortem proceeding is binding on the parties to the action only in litigation brought to determine the validity of a will; in all other cases, the same fact questions may be relitigated.[179]

Despite being the oldest modern ante-mortem probate statute, having been in effect for almost twenty years, the North Dakota provisions are rarely used. In a 1994 survey of ACTEC fellows and judges in the relevant jurisdictions,[180] only thirty percent of the responding North Dakota practitioners reported ever having been involved in an ante-mortem probate proceeding. Remarkably, the survey also showed that this thirty percent has somewhat aggressively utilized the procedure. One fellow reported participating in six ante-mortem proceedings and the average ante-mortem user was involved with over four proceedings each. Despite the fact that most respondents lacked significant experience with the technique, ninety percent agreed that the ante-mortem option enhanced the state's probate practice.

Respondents favorably received ante-mortem probate because the technique prevents will contests, creates certainty of a will's validity, and permits the testator and witnesses to testify when their memories are fresh. In fact, the only negative comment offered was that ante-mortem probate is seldom used. One fellow suggested that a provision should be added allowing an order to issue without a hearing if no one enters

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[171] See *Ante-Mortem Probate—The Definitive Will Contest Prevention Technique*, 23 ACTEC NOTES 83 (1997), which was prepared as part of the author's work as chair of the Ante-Mortem Probate Subcommittee of the State Laws Committee. Subcommittee members Marguerite Adams, David J. Estes, and Bruce A. Rosenfield made valuable contributions to this article.

[172] N.D. CENT. CODE §§ 30.08.1-01 to -04 (Supp. 1995).

[173] *Id.* § 30.1-08.1-01.

[174] *Id.* § 30.1-08.1-01.

[175] *Id.*

[176] *Id.* § 30.1-08.1-03.

[177] *Id.*

[178] *Id.* § 30.1-08.1-04.

[179] *Id.*

[180] Complete survey results are available from the author upon request.

an objection to the ante-mortem probate proceeding.

The same survey revealed that North Dakota judges have very little experience with the ante-mortem process. Less than ten percent of the respondents had presided over an ante-mortem probate proceeding, and none of the judges who had ante-mortem probate experience had presided over more than one proceeding. Further, North Dakota judges seemed much less convinced of the beneficial nature of ante-mortem probate than their practicing counterparts. Only forty percent of the responding judges thought ante-mortem probate was beneficial; another forty percent felt it was not, and the remaining twenty percent was undecided. The main difference in opinion between the North Dakota bar and bench seems to center on the judges' concern that the process upsets potential beneficiaries and creates premature and, perhaps, unnecessary controversy.

b. Ohio

[Note: This section discusses the prior Ohio statute which was replaced in 2019 by a considerably more comprehensive statute.]

The Ohio statutes that provide for an ante-mortem declaration of the validity of a will are the most detailed of the three states having ante-mortem legislation.[181] The substance of the Ohio provisions, like those of North Dakota, is basically an adoption of the contest model. However, the Ohio statute differs in its extensive procedural rules and in other important aspects. The most significant additions and changes made by the Ohio legislature to the North Dakota statute include: (1) detailed venue and service of process rules,[182] (2) comprehensive rules regarding the process of revoking or modifying a will which has been admitted to ante-mortem probate;[183] (3) a statement that non-use of ante-mortem probate is inadmissible as evidence or as an admission that the testator lacked testamentary capacity or was unduly influenced;[184] (4) the will and a declaration of its validity are filed in a sealed envelope only accessible to the testator — if removed, the declaration no longer has any effect;[185] and (5) the testator may modify or revoke the will using any method allowed under Ohio law; a new ante-mortem proceeding is not required.[186]

In addition to the greater amount of detail, the Ohio statutes have seen the greatest amount of use. Of the Ohio judges responding to the survey, over fifty percent had experience with ante-mortem probate proceedings. Additionally, the total number of ante-mortem cases involving fellows in Ohio far exceeded cases from the other two ante-mortem probate jurisdictions combined. The survey also revealed two main reasons why many attorneys and judges believe that ante-mortem probate may be beneficial. First, ante-mortem probate resolves the competency issue with the best evidence available and, second, it effectively prevents will contests. On the other hand, the primary reasons Ohio practitioners and judges disliked ante-mortem probate centered on the procedure's cost, its potentially cumbersome and complicated nature, and that subsequent modifications or changes to the will can defeat some of the benefits.

Only twenty-three percent of the responding Ohio fellows reported being involved with ante-mortem probate proceedings. Some of the reasons for this relatively infrequent use can be found among the comments of these practitioners:

- "The procedure unduly complicates changing the will."
- "It is too cumbersome and expensive for most clients. The required notices

[181] OHIO REV. CODE ANN. §§ 2107.081-.085 (Banks-Baldwin 1991).

[182] *Id.* § 2107.081-.082.

[183] *Id.* § 2107.084(C).

[184] *Id.* § 2107.081(B).

[185] *Id.* § 2107.084(B).

[186] *Id.* § 2107.084(D).

to interested parties kicks too many sleeping dogs."

- "Guarantees there will be a large amount of conflict in a client's life at a point in time when the client probably does not want it."

The Ohio ante-mortem statutes are also the only ones to generate appellate litigation subsequent to the declaratory judgment. In *Cooper v. Woodard*,[187] the Ohio court of appeals was confronted with an attack on the constitutionality of the ante-mortem provisions. Though the Ohio courts determined that there existed a justiciable controversy, the record of the case contained nothing to rebut the presumption of constitutionality. Therefore, the Ohio ante-mortem statutes were held to pass constitutional muster. Additionally, the court affirmed the lower court's refusal to entertain a motion regarding the interpretation of the will by stressing that the sole purpose of the ante-mortem proceeding is to determine the validity of a will.

Two later cases dealt with the admission of a will to ante-mortem probate under very specific circumstances. In *Fischer v. Green*,[188] the court held that even though the testatrix had previously been deemed so mentally incompetent that she needed a guardian, admission of her will to ante-mortem probate was proper. The testatrix's testamentary capacity was demonstrated to the satisfaction of the court because she knew she was executing a will, the objects of her bounty, and the nature of her property.

In the more recent case of *Horst v. First National Bank*,[189] the testator's disgruntled heirs brought a post-mortem action to set aside the will's declaration of validity. Despite the testator's testimony during the ante-mortem proceeding, which raised a legitimate question as to his capacity, the court held that the proper direct remedy is a timely appeal or a motion for new trial. Because the heirs had notice and failed either to appear at the ante-mortem proceeding or take advantage of the available direct remedies, and because a declaration of validity of a will is not subject to collateral attack, the trial court's dismissal was affirmed.

The *Horst* court also expressly approved a technique developed by Ohio practitioners which allows the testator to sidestep the requirement that all dispositive terms be revealed. Increased privacy is achieved by using a will which leaves everything to a separate trust, the terms of which are not disclosed in the ante-mortem proceeding. In this case, the court declared that there was "no legal error in the failure to serve the copy of the trust [and that] the service of a copy of the will was substantial compliance with the responsibilities explicit in the civil rules requiring notice."[190] Despite this case, however, the Ante-Mortem Probate Subcommittee envisions that contestants will continue to raise due process concerns by making forceful arguments that they need access to the terms of the trust to determine whether the testator had capacity or was subject to undue influence.

Despite the greater awareness of the ante-mortem probate provisions in Ohio and its relatively more frequent use, it nonetheless appears that the technique remains seldom used. The statute appears to be used most often when an attorney has prepared a will for a person who is under guardianship or who is elderly. Few applications are denied because lawyers usually pre-screen clients to determine if they are reasonably competent before attempting to use ante-mortem probate.[191] As one surveyed attorney put it, ante-mortem probate "gives another way to protect against a will contest ("bullet proof" a will), but is only useful (or used) when the testator is definitely competent."

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[187] 1983 WL 6566 (Ohio App.).

[188] No. 82-CA-71(Ohio App., Apr. 8, 1983).

[189] 1990 WL 94654 (Ohio App.).

[190] *Id.* at 3.

[191] Surveyed Ohio judges reported having been involved in 58 ante-mortem proceedings. In only 3 instances was the will denied admission to ante-mortem probate.

c. Arkansas

In 1979, Arkansas became the third state to enact ante-mortem legislation.[192] Although the Arkansas Ante-Mortem Probate Act is closely modeled after the North Dakota provisions, several important changes were made. First, the Arkansas Act is more broadly phrased to permit declaratory judgments concerning the validity of the will rather than limiting the action to specific aspects of the will's validity.[193] Second, and perhaps of greater significance, the Arkansas Act permits will modification or revocation by subsequent will without requiring another ante-mortem proceeding.[194] However, the Arkansas Act does not address whether a revocation by physical act is permitted because the statute only applies to subsequently executed testamentary instruments. Third, the Arkansas Act does not prohibit findings of fact in ante-mortem actions from being used in other proceedings.[195]

The Arkansas Ante-Mortem Probate Act seems to be virtually ignored. Of the Arkansas fellows surveyed, only one out of the twenty-five who replied had participated in an ante-mortem probate proceeding. Despite this near non-use of the ante-mortem probate alternative, Arkansas fellows seem to have very definite and vocal opinions about the procedure. Sixty percent stated that ante-mortem probate is not beneficial, claiming that it violates the testator's privacy, upsets beneficiaries, creates controversy, and increases expenses. Thirty-five percent agreed that ante-mortem probate is beneficial to the state's probate practice, maintaining that it prevents will contests, creates certainty, and provides the testator with peace of mind. Only five percent had no opinion regarding the Act's impact on Arkansas probate practice.

The Arkansas judiciary, on the other hand, is significantly more undecided on the benefits of ante-mortem probate. Nearly eighty percent stated that they were not sure if ante-mortem probate is beneficial or not, and one judge indicated that he had never heard of the concept prior to the survey. None of the responding Arkansas judges had ever presided over an ante-mortem probate proceeding. As one judge stated, "the potential for benefit exists, but I have had no cases filed or resolved in my court." Another felt that because there is not "widespread knowledge in the bar of the statute," practitioners do not use it and therefore judges have no experience with the process.

2. The 2010s Resurgence

a. With Ante-Mortem Statutes

In 2010, Alaska reignited the interest in ante-mortem probate when it enacted the first ante-mortem probate legislation since the Arkansas statute.[196] Nevada considered comprehensive ante-mortem legislation in 2011 but it failed to pass. New Hampshire became the fifth state to authorize ante-mortem probate in 2014[197] with both Delaware[198] and North Carolina[199] following suit in 2015. Ohio made extensive revisions to its provisions in 2019.

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192 ARK. CODE ANN. § 28-40-202 to -203 (Michie 1987).

193 *Compare* ARK. CODE ANN. § 28-40-202(a) (Michie 1987) (declaratory judgment to establish validity of will) *with* N.D. CENT. CODE § 30.1-08.1-01 (Supp. 1995) (declaratory judgment permitted regarding the "signature on the will, the required number of witnesses to the signature and their signatures, and the testamentary capacity and freedom from undue influence of the person executing the will").

194 *Compare* ARK. CODE ANN. § 28-40-203(b) (Michie 1987) *with* N.D. CENT. CODE § 30.1-08.1-03 (Supp. 1995) (ante-mortem probated will remains binding unless new ante-mortem proceeding).

195 *Compare* ARK. CODE ANN. § 28-40-203 (Michie 1987) (no limitation on use of court findings) *with* N.D. CENT. CODE § 30.1-08.1-04 (Supp. 1995) (findings of fact not admissible in other proceedings).

196 ALASKA STAT. § 13.12.530-.590 (also providing for the validation of a trust during the settlor's lifetime). See also Joseph Savoie, *The Commissioners' Model of Ante-Mortem Probate* (2011) [unpublished manuscript on file with author].

197 N.H. REV. STAT. § 564-B:4-406(d).

198 12 DEL. C. § 1311.

199 N.C. GEN. STAT. § 28A-2B-1.

Except for Delaware, the new states follow the contest model. Delaware requires the person who wishes to contest the will to bring a contest action within 120 days after being notified of the contest and receiving a copy of the will.[200]

b. With Declaratory Judgment Statutes

Two states, Nevada[201] and South Dakota, [202] permit ante-mortem probate by listing wills and trusts in their generic declaratory judgment statutes. South Dakota also has a statute permitting a settlor to file a petition to validate an inter vivos trust.[203]

3. Expansion to Other Documents

a. Trusts

Many of the modern statutes also permit settlors to validate inter vivos trusts prior to death. States which permit pre-death validation include Alaska,[204] Delaware,[205] Nevada,[206] New Hampshire,[207] Ohio,[208] and South Dakota.[209]

b. Powers of Appointment

Two states, Delaware[210] and Nevada,[211] also permit a pre-mortem validation proceeding for a person who holds or exercises a power of appointment.

[200] 12 DEL C. § 1311(b).

[201] NEV. REV. STAT. § 30.040 provides that the testator or settlor "may have determined any question of construction or validity arising under the instrument and obtain a declaration of rights, status or other legal relations."

[202] S.D CODIFIED LAWS § 21-24-3.

[203] S.D CODIFIED LAWS § 55-4-57.

[204] ALASKA STAT. § 13.12.535-.590.

[205] 12 DEL. C. § 3546(a).

[206] NEV. REV. STAT. § 30.040.

[207] N.H. REV. STAT. § 564-B:4-406(d).

[208] OHIO REV. CODE § 5817.10.

[209] S.D. CODIFIED LAWS § 55-4-57.

[210] 12 DEL. C § 1312.

[211] NEV. REV. STAT. § 30.040(2).

E. State Statutes Analyzed

a. Standing

Among the nine jurisdictions permitting ante-mortem probate, or pre-death validation by declaratory judgment, Arkansas[212], Delaware[213], Nevada[214], North Dakota[215], and Ohio[216] provide that only the testator can bring the action. Ohio's statute makes this requirement clearer by clarifying that the right is personal to the testator and that it may not be exercised by the testator's guardian or an agent under the testator's power of attorney.[217]

Alaska's statute allows for the testator, a person nominated in the will to serve as a personal representative, or, with the testator's consent, any interested party to bring an ante-mortem action.[218]

North Carolina and New Hampshire both include residency requirements. North Carolina[219] requires that the testator be a resident of the state. New Hampshire[220] allows a testator to bring an ante-mortem action if the testator is domiciled in the state or owns real property within the state. For a trust validation, however, only a settlor has standing to bring the action.[221]

South Dakota's[222] statute allows any interested party to seek a declaratory action for validation of a will. With regard to trusts, however, only a trustee, trust advisor, trust

[212] ARK. CODE § 28-40-202(a).

[213] 12 DEL. C. § 1311(b).

[214] NEV. REV. STAT. § 30.040(2).

[215] N.D. CENT. CODE § 30.1-08.0-01.

[216] OHIO REV. CODE § 5817.02.

[217] *Id.*

[218] ALASKA STAT. § 13.12.530.

[219] N.C. GEN. STAT. § 28A-2B-1(a).

[220] N.H. REV. STAT. § 552:18.

[221] *Id.* § 564-B:4-406.

[222] S.D. CODIFIED LAWS § 21-24-3.

protector or the settlor herself may petition the court for determination of the trust's validity.[223]

Most states requires a nexus between the testator and the state such as being a domiciliary, resident, or owning real property in the state. Alaska, on the other hand, does not require any type of nexus to use its ante-mortem procedure.

b. Revocation

The declaration of the validity of a will or trust does not bar later revocation or modification in most states. Alaska[224], Arkansas[225], Delaware[226], New Hampshire[227], and Ohio[228] permit modification or revocation without the need for another proceeding.

North Carolina leaves the possibility for a revocation or modification up to the discretion of the court. The statute provides that the court may order that the will or codicil not be revoked and that no subsequent will or codicil be valid unless validated through another proceeding.[229]

North Dakota requires the testator to bring a new ante-mortem proceeding to revoke or modify a will which the court has validated through its ante-mortem proceeding.[230] The new proceeding must include the parties relevant to the old will as well as the new will.

c. Effect After Death

The normal benefit of ante-mortem probate is to make the will incontestable after the testator's death. However, North Carolina permits a party to show "by clear and convincing evidence, that before and during the hearing, the [testator] was subject to financial or physical duress or coercion which was so significant that the [testator] would not have reasonably disclosed it at the hearing" and then ask the court for permission to contest the will.[231]

d. Waiver of Physician-Patient Privilege

Ohio is currently the only state to require an express written waiver of the testator's physician-patient privilege.[232] The testator must file the wavier with the complaint. This is consistent with the statutory waiver of physician-patient privilege in a post death contest.[233]

e. Other Proceedings

Five states, Delaware[234], New Hampshire[235], North Carolina[236], North Dakota[237], and Ohio[238] prohibit a testator's nonuse of the ante-mortem procedure to be used as evidence in other proceedings. The remaining state's statutes do not specify whether such failure may be used in other proceedings or as evidence of an admission that the will is not valid.

f. Confidentiality

Confidentiality is specifically addressed by Alaska and North Carolina. Alaska[239] provides that only the notice of filing, the summary of formal proceedings, the dispositional order or modification/termination order be available. All

[223] *Id.* § 55-4-57(g).

[224] ALASKA STAT. § 13.12.575.

[225] ARK. CODE § 28-40-203(b).

[226] 12 DEL. C. § 1311.

[227] N.H. REV. STAT. §§ 552:18, 564-B:4-406.

[228] OHIO REV. CODE §§ 5817.12(A)-(C), 5817.13(A)-(C).

[229] N.C. GEN. STAT. § 28A-2B-4(b).

[230] N.D. CENT. CODE § 30.1-08.0-03.

[231] N.C. GEN. STAT. § 28A-2B-4(a). For an analysis the statute concluding that "[t]his possibility should not exist, see Kyle Frizzelle, *Better to Play Dead? Examining North Carolina's Living Probate Law and Its Potential Effect on Testamentary Disposition*, 39 CAMPBELL L. REV. 187 (2017).

[232] OHIO REV. CODE §§ 5817.02(D), 5817.03(D).

[233] *Id.*

[234] 12 DEL. C. § 1311(d).

[235] N.H. REV. STAT. § 552:18(IX).

[236] N.C. GEN. STAT. § 28A-2B-1(c).

[237] N.D. CENT. CODE § 30.1-08.1-04.

[238] OHIO REV. CODE §§ 5817.02(C), 5817.14(A)-(C), 5817.03(C), 5817.14(D).

[239] ALASKA STAT. § 13.12.585(a)-(c).

other information contained in the records are confidential. The records may be made available only to the petitioner and petitioner's attorney, interested persons (and their attorneys, guardians, and conservators), the judge hearing or reviewing the matter, and clerical and administration staff.[240] North Carolina[241] allows for a party to the proceeding to move to have the file sealed and kept confidential. Only the petitioner named in the petition, the attorney for the petitioner, or a court of competent jurisdiction may view the contents of the file without an order.[242]

Both statutes include a good cause shown provision which allows for the court to order the records be made available to a person not listed in the statute.

g. Inchoate Property Rights

A few states deem beneficiaries possessed of inchoate property rights. These states include Arkansas,[243] New Hampshire,[244] and North Dakota.[245]

F. Concerns with Ante-mortem Probate

The use of ante-mortem probate, while not the best choice for all testators, provides anxious testators with at least three significant interrelated benefits which are not available under post-mortem processes and which are well worth the up-front costs. Included with these benefits are welcome side effects such as the reduction of court time and the preservation of estate resources that otherwise might be wasted in defending post-mortem will contests brought on artificial grounds. Despite these benefits, the practitioner must remember that there are also significant drawbacks to be weighed against these benefits when making the decision to use ante-mortem probate. The psychological effects on the testator and the testator's family associated with disclosure of the contents of the will or the potential embarrassment and conflict that may occur if the testator's mental capacity is litigated are prime considerations. Additionally, presumptive heirs who genuinely believe that the testator lacks capacity or is being unduly influenced may be hesitant to contest while the testator is still living.

Reluctance on the part of the testator to reveal the contents of the will and the potential psychological effects of this disclosure may be avoided using a pour-over will and a separate trust agreement which allows a testator to seek the benefits of ante-mortem probate while ultimately escaping the requirement that all dispositive terms be revealed. The testator's will is validated through ante-mortem probate, however, the terms of the will leave the entire estate to the trust, the terms of which are not disclosed in the proceeding.[246] Thus, the will is declared valid, the ultimate disposition of property is kept secret, and the testator's disposition plan protected. In addition, the testator can easily make changes to the trust, and those changes will impact the final disposition of the testator's property without the necessity of an additional ante-mortem proceeding. To enhance the effectiveness of this technique, the will should expressly incorporate the trust by reference. The ante-mortem probate is likely to make the trust incontestable as well even though the terms of the trust were not disclosed during the ante-mortem proceeding.[247]

240 *Id.*

241 N.C. GEN. STAT. § 28A-2B-5.

242 *Id.*

243 ARK. CODE § 28-40-202(c).

244 N.H. REV. STAT. §§ 552:18(IV), 564-B:4-406(D)(4).

245 N.D. CENT. CODE § 30.1-08.1-02.

246 *See* Horst v. First Nat'l Bank, 1990 WL 94654 (Ohio App.) (heirs claimed that failure to attach copy of inter vivos trust to the declaratory judgment along with the will was fatal error; court found no legal error and stated that inclusion of a copy of the will was substantial compliance).

247 *See* Hageman v. Cleveland Trust Co., 45 Ohio St. 2d 178, 343 N.E. 2d 121, 124 (1976) (holding that "even if a valid trust were not established by decedent's trust agreement, the trust agreement document is incorporated by reference into the will").

From a legal standpoint, questions may be raised concerning the binding effect of a court's declaration that the testator's will is valid. Problems may arise due to claims based on the maxim that "the living have no heirs" or that even if such persons could be reasonably identified at the time of the ante-mortem probate proceeding, they may not be the same as the actual heirs when the testator dies. Another potential problem involves a posthumous challenge on the ground that the testator was, after the declaratory judgment, subject to undue influence which prevented the testator from revoking the will. There is also the chance that ante-mortem probate will raise due process issues if the notice requirements are not carefully drafted and followed.

A final item which estate planners must consider is the fact that while evidence that the testator failed to use ante-mortem probate is generally not admissible in a proceeding to invalidate the will, evidence that the attorney did not inform the testator of the option to use ante-mortem probate may be admissible against the attorney in a malpractice action. In the states where lack of privity between the attorney and estate beneficiaries remains a bar to an attorney's liability to third parties, malpractice liability is not a concern in this situation. However, in states where privity is not a bar to third party litigation, the risk is magnified, as either the personal representative or the beneficiaries may bring a malpractice action. For this reason, practitioners must be aware of ante-mortem probate, explain this option to their clients, especially when a contest is likely, and then document the fact that the client was informed of and refused to use ante-mortem probate.

G. Conclusion

Ante-mortem probate provides testators with the means of bestowing total invincibility to their wills. This protection, however, comes at a price which has both financial and emotional components. Thus, each testator in states authorizing this technique must carefully consider the advantages and drawbacks of ante-mortem probate to determine whether a judgment declaring the will's validity fits his or her individual needs. In situations where a will contest seems all but inevitable, having the will declared valid before the testator's death will provide the testator with certainty and peace of mind that may very well be worth the up-front financial cost and possible emotional strain.

Anticipating Will Contests and How to Avoid Them

Dr. Gerry W. Beyer
Governor Preston E. Smith Regents Professor of Law
Texas Tech University School of Law

Cheap Funerals

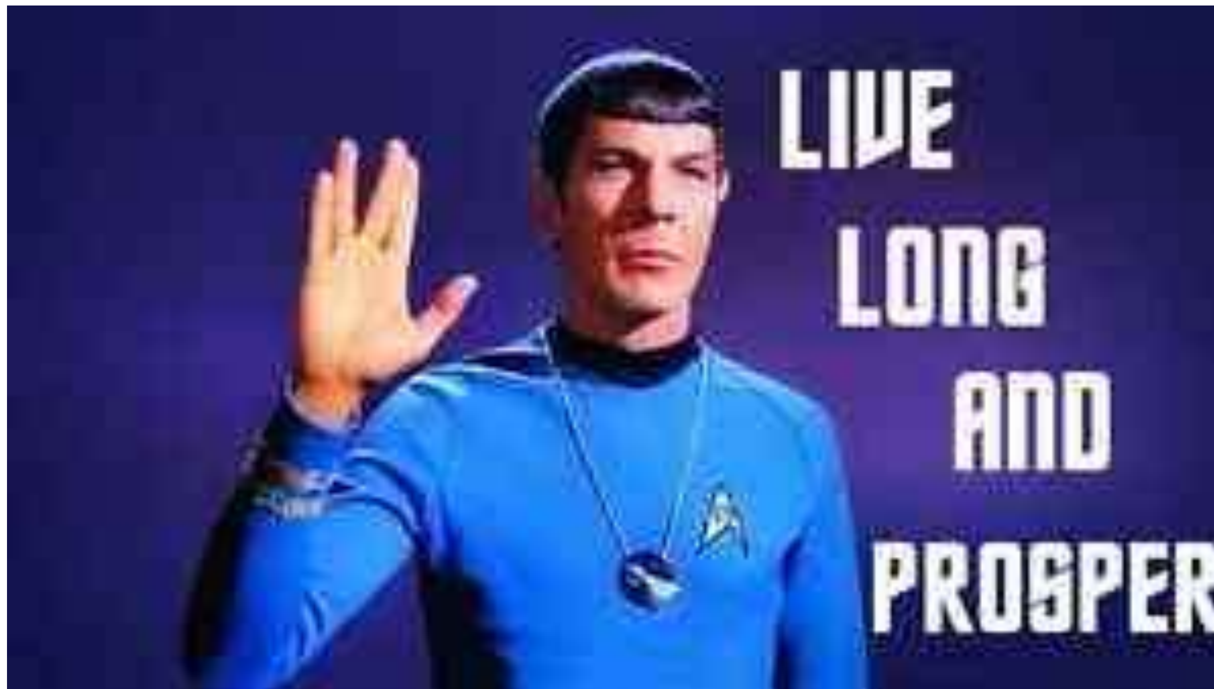
- **In which state are funerals the cheapest?**

Most Complex Probate

- **In which state is probate the most complex?**

Longest Life Expectancy

- **Which state has the longest life expectancy at over 81 years?**



Will Contests Generally

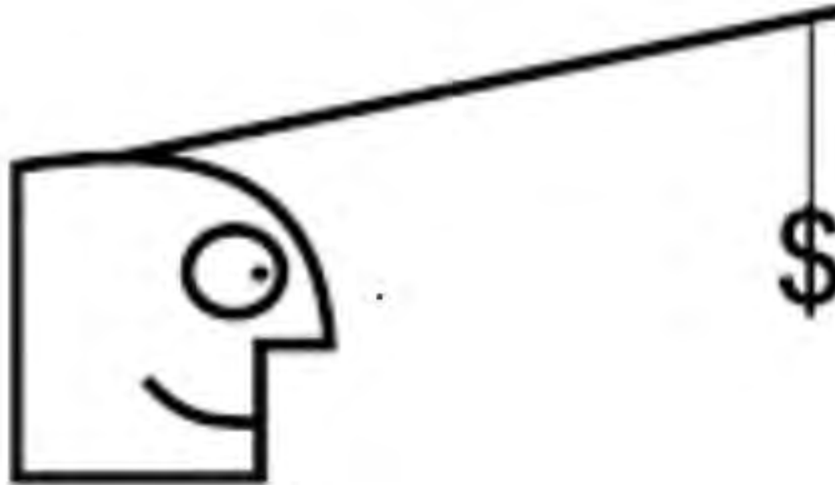
- Rare
  - Less than 5% of wills are contested.

- But, you must be on guard for contest-likely situations and plan accordingly.

PREVENTION
WORKS!

Incentive to Contest

- **Whenever a person would take more either:**
  - **Under intestacy, or**
  - **Under a prior will.**



Reasons to Anticipate Will Contest

- 1. **Exclusion of natural objects of bounty**

Reasons to Anticipate Will Contest

- **2. Unequal treatment of children**

Reasons to Anticipate Will Contest

- 3. Sudden or significant change in disposition plan

Reasons to Anticipate Will Contest

- 4. Excessive restrictions on gifts to beneficiaries who are also heirs

Reasons to Anticipate Will Contest

- **5. Elderly or disabled testator**

Reasons to Anticipate Will Contest

- **6. Testator who behaves strangely**

Techniques – The "Tool Box"

- **1. Include *in terrorem* (no contest) (forfeiture) provision**
  - **Beneficiary who contests and loses forfeits testamentary gift.**

Techniques – The "Tool Box"

- 1. Include *in terrorem* (no contest) (forfeiture) provision
  - Prior to July 1, 2018
    - Void
  - July 1, 2018 and after
    - Valid unless an exception applies
    - Indiana Code § 29-1-6-2

Techniques – The "Tool Box"

- 1. Include *in terrorem* (no contest) (forfeiture) provision
  - Exceptions to enforceability
    - Beneficiary has "good cause" to bring action
    - Non-beneficiary executor brings action
    - Settlement agreement
    - Determination of whether action would be a contest
    - Construction and interpretation actions
    - Discretionary actions by court such as fees and distributions
    - Actions by attorney general if good cause shown or if dealing with charitable gift.

Techniques – The "Tool Box"

- 1. Include *in terrorem* (no contest) (forfeiture) provision
  - Drafting guidelines:
    - Create substantial risk

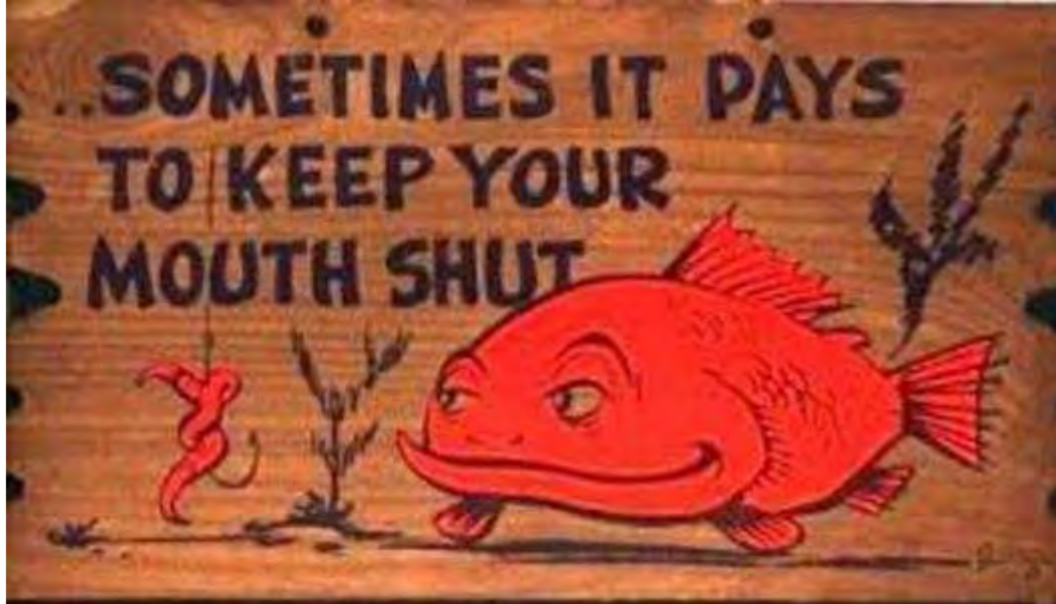
Techniques – The "Tool Box"

- 1. Include *in terrorem* (no contest) (forfeiture) provision

  - Drafting guidelines:
    - Create substantial risk
    - Indicate beneficiary of forfeited property

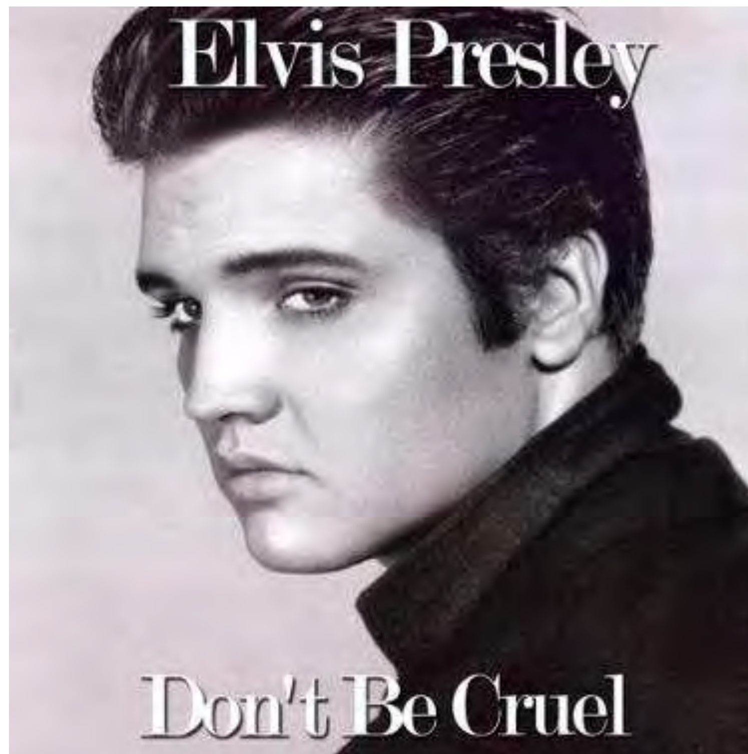
Techniques – The "Tool Box"

- 2. Do not explain reasons for property disposition.



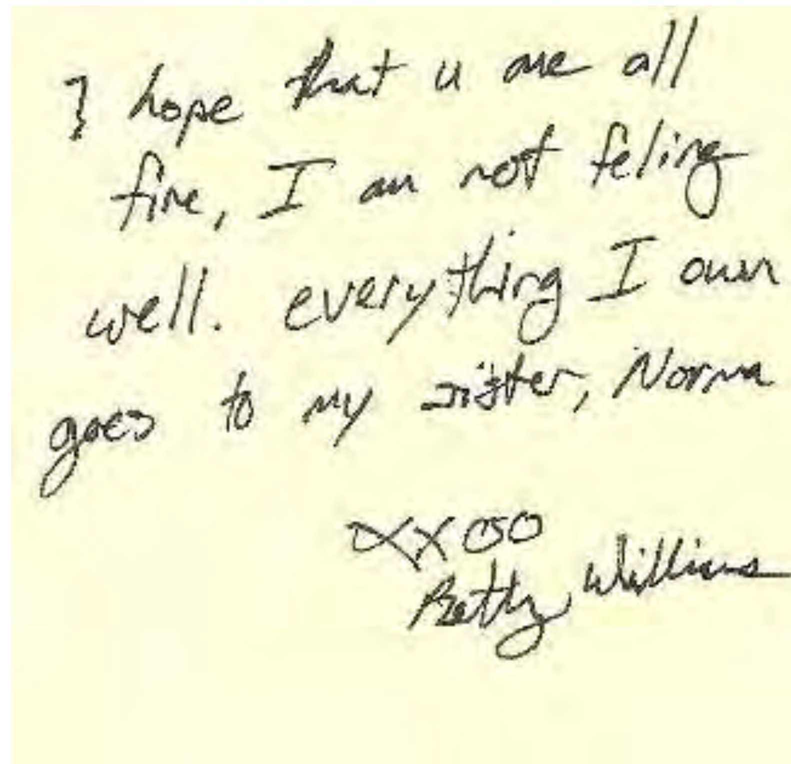
Techniques – The "Tool Box"

- 3. Avoid bitter or hateful language.



Techniques – The "Tool Box"

- **4. Use holographic "back up" will.**



I hope that u are all
fine, I am not feling
well. everything I own
goes to my sister, Norma

XXOO
Betty Williams

Techniques – The "Tool Box"

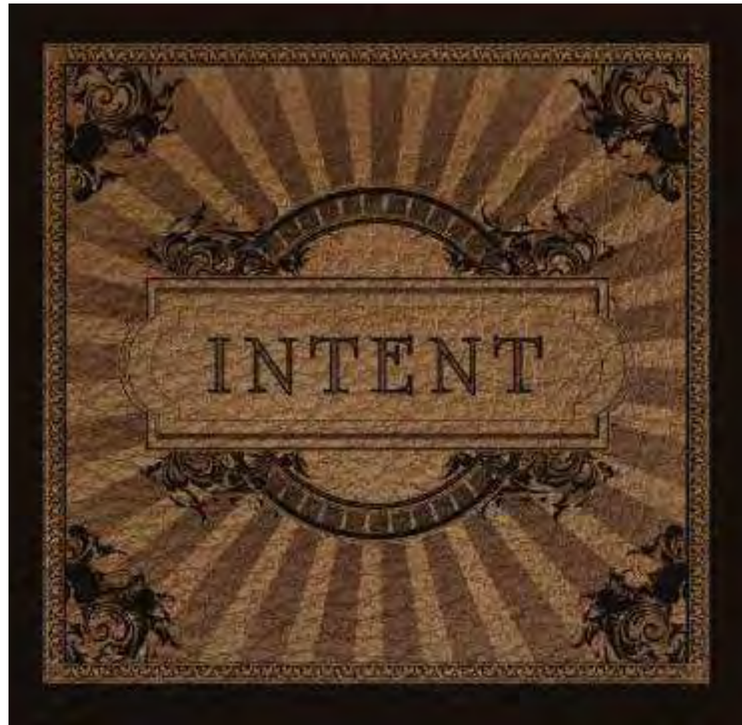
- 5. Enhance will execution ceremony.

Will Execution Ceremony -- Purposes

- **Psychological benefits**

Will Execution Ceremony -- Purposes

- **Effectuate client's intent**



Will Execution Ceremony -- Purposes

- **Limit exposure to malpractice claims**

Will Execution Ceremony Steps Before

- Proofread will carefully
  - "I leave $10.000 to Barry Allen."
  - "I enjoyed cooking my friends and my children."
  - The texting lookout:
    - "The police are now here."
    - "The police are nowhere."

Will Execution Ceremony Steps Before

- Assure internal integration to avoid fraudulent page insertion or removal.
  - Same type, size color, etc. of paper.
  - Same font styles.
  - Same darkness of toner/ink.
  - Ex toto pagination (page x of y).
  - Avoid blank spaces.

Will Execution Ceremony Steps Before

- Review will with client
  - Consider reward if client finds errors (either real ones or ones you inserted as a test).

Will Execution Ceremony Steps Before

- **Explain ceremony to client**

Will Execution Ceremony
The ceremony itself

- **Select proper location**

Will Execution Ceremony
The ceremony itself

- **Seat participants strategically**

Testator/Testatrix

Attorney

Notary

Witness One **Witness Two**

Will Execution Ceremony
The ceremony itself

- Conduct ceremony complying with state law requirements for a valid will.
  - Satisfy publication requirements.
    - Do witnesses need to know document is a will?
  - Satisfy presence requirements.
    - Testator signs in witnesses presence.
    - Witnesses attest in testator's presence.
    - Witnesses attest in each other's presence.

Will Execution Ceremony
The ceremony itself

- Ceremony basics
  - Ask questions to establish capacity (if needed).
  - Ask questions to establish intent.
  - Testator/Testatrix initials each page and signs at end.
  - Witnesses initial each page and attest.
  - Notary completes self-proving affidavit.

Will Execution Ceremony After ceremony

- Discuss safekeeping of will
  - Attorney?
  - Client?
  - Third party?
  - Depends on client's situation?
- Regardless, give or obtain receipt.

Will Execution Ceremony
After ceremony

- Provide post-will instructions
  - Avoid self-help changes.
  - Update will when situation changes:
    - Divorce
    - Births
    - Deaths
    - Change in feelings about included and excluded relatives
    - Change in composition or value of estate
    - Change in tax laws

Techniques – The "Tool Box"

- **6. Video-record will execution ceremony**

Techniques – The "Tool Box"

- 6. Video-record will execution ceremony.
  - Indiana is one of a few states to have a statute (IC 29-1-5-3.2) allowing video as evidence of:
    - Proper execution
    - Testator's intentions
    - Mental state or capacity of testator
    - Authenticity of will
    - Other matters as determined by the court

Techniques – The "Tool Box"

- 6. Video-record will execution ceremony
  - Potential benefits
    - Accurate
    - Preserves otherwise unavailable evidence:
      - Tone of voice
      - Demeanor
      - Gestures
    - Psychological benefit to testator

Techniques – The "Tool Box"

- 6. Video-record will execution ceremony
  - Potential Disadvantages
    - Not wish to expose testator to judge or jury
    - Difficulty if recording turns out bad
    - Alteration
    - Inadvertent destruction
    - Malpractice liability for not making recording
    - Unable to play

Techniques – The "Tool Box"

- 7. Select witnesses thoughtfully

Techniques – The "Tool Box"

- 7. Select witnesses thoughtfully
  - Witnesses familiar with testator
  - Supernumerary witness
  - Young and heathy witnesses
  - Traceable witnesses
  - Witnesses who would favorably impress judge and jury

Techniques – The "Tool Box"

- 8. **Obtain affidavits of individuals familiar with testator.**

Techniques – The "Tool Box"

- 9. Document transactions with testator verifying intent.

Techniques – The "Tool Box"

- **10. "Coincidental" Doctor Appointment**

Techniques – The "Tool Box"

- **11. Obtain other evidence to document testator's actions**

Techniques – The "Tool Box"

- 12. Preserve prior will if better than intestacy.

Techniques – The "Tool Box"

- 13. Reexecute same will on regular basis.

Techniques – The "Tool Box"

- 14. Consider a more "traditional" disposition

Techniques – The "Tool Box"

- 15. "Trick" disinherited potential heir with inter vivos gift on same day as will execution.

Techniques – The "Tool Box"

- 16. "Buy off" disinherited potential heir with a contract not to contest

Techniques – The "Tool Box"

- **17. Use non-probate techniques.**

Techniques – The "Tool Box"

- 18. Ante-Mortem Probate
  - Basic idea
    - Obtain declaratory judgment while testator is alive that will is valid.
    - Thus, cannot contest after testator dies.

Techniques – The "Tool Box"

- 18. Ante-Mortem Probate
  - Status
    - Allowed in Alaska, Arkansas, Delaware, Nevada, New Hampshire, North Dakota, Ohio, and South Dakota.
    - Also authorized in North Carolina BUT can be contested after the testator dies.

Techniques – The “Tool Box”

- 18. Ante-Mortem Probate
  - Advantages:
    - Testator available for observation and to testify.
    - Reduces will contests.
    - Carries out testator’s intent.

Techniques – The "Tool Box"

- 18. Ante-Mortem Probate
  - Disadvantages:
    - Disruptive to family.
    - Contents of will revealed.
    - Potential for testator embarrassment, especially if court determines testator lacks capacity.
    - Cost.

Techniques – The "Tool Box"

- 18. Ante-Mortem Probate
  - Change domicile to take advantage of procedure?

Questions?

Section Five

ELECTRONIC WILLS:

THE CHANGING FUTURE OF THE ESTATE PRACTICE

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Section Five

Electronic Wills: The Changing Future of the Estate Practice..........Dr. Gerry W. Beyer

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ELECTRONIC WILLS:

THE CHANGING FUTURE OF THE ESTATE PRACTICE

I. INTRODUCTION

The last several years have seen rapid development in the area of electronic wills, electronic signing, and remote notarization. Whether you think these are helpful tools, unnecessary ones, or even harmful ones, you need to be aware of these techniques, especially in today's COVID-19 environment where there is an enhanced benefit of being able to provide estate planning services remotely.

II. DEVELOPMENT OF ELECTRONIC WILLS

To place modern electronic wills into perspective, let's start by examining their evolution.[1]

A. The 1983 attempted audiotape will

In *Estate of Reed*,[2] the Wyoming Supreme Court refused to admit to probate an audiotape recording of the deceased's statements allegedly intended by him to constitute his will. After Reed's death, the court found that he had died intestate and appointed co-administrators. The appellant petitioned the court for probate, contending that a tape recording found in a sealed envelope, with the handwritten words: "Robert Reed To be played in the event of my death only!" and signed by Reed, should be admitted as a holographic will. The appellant argued that the voice print on the tape complied with the handwriting requirement for a valid holographic will, reasoning that "in this age of advanced electronics and circuitry the tape recorder should be a method of 'writing.'"[3] The court declined to extend the Wyoming holographic will statute requiring a "writing" to include a tape recording or any "other type of voice print," leaving that decision instead to the state's legislature. To date, this author has located no court in the United States which has recognized an audio or video recording as a valid equivalent of a written will.

B. The landmark Nevada statute

In 2001, Nevada enacted the first piece of legislation on electronic wills. While the statute was groundbreaking, it was far from accessible to the average will-writing individual. At the time the statute came into effect, the technology necessary to create an electronic will in compliance with the law was not yet in existence. Technology had advanced enough to provide biometric authentication abilities, but the statute required the existence of only one authoritative copy of the will for which biometric authentication was entirely unhelpful. Without the requisite software necessary to perform the function of preserving authoritative copies while marking copies of the original as copies, the statute could not be fully implemented as written. The drafters of the legislation anticipated that such software would be shortly available, but no such software was developed. Additionally, this early version of the Nevada law on electronic wills did not provide for attestation of witnesses or a process by which an electronic will could be notarized.[4]

The law on electronic wills remained relatively unchanged for over a decade. During that span, the Nevada statute was never used, and in states where electronic wills disputes arose, alternative methods were applied to determine their validity.

---

[1] For additional background information, see Modernizing The Law To Enable Electronic Wills, (last visited Sept. 2, 2019).

[2] 672 P.2d 829 (Wyo. 1983).

[3] *Id*. at 831.

[4] *See generally* Gerry W. Beyer & Claire G. Hargrove, *Digital Wills: Has the Time Come for Wills to Join the Digital Revolution?*, OHIO N.U.L. REV. 865 (2007).

C. Electronic signature of testator

In 2003, the Court of Appeals of Tennessee determined that a testator created a valid will when he prepared it on his computer and affixed a computer-generated signature to the end of it.[5] Two witnesses watched him make his electronic signature and then both witnesses signed a paper copy. The will was neither electronically witnessed nor stored digitally. The testator's sister argued the will was not valid under Tennessee probate laws. The Court of Appeals held that despite the electronic creation of the will and electronic signature, the will was upheld as a valid writing with the signature being a mark intended to operate as the testator's signature. The fact that the deceased used a computer rather than an ink pen as the tool to make his signature was not so drastically different as to put the testator's will out of compliance with Tennessee law.

D. Electronic signatures of testator *and* witnesses

In 2013, an electronic will was once again the subject of dispute in *In re Estate of Javier Castro*.[6] The testator dictated his will to his brother who used a stylus pen to transcribe the will on a Samsung Galaxy tablet. The testator and both witnesses then signed the will on the tablet using the stylus. The court was faced with deciding whether the will was a writing and whether it was signed in accordance with Ohio law. The court determined that the law of Ohio does not require the writing to be on any particular medium and that to rule otherwise in this case would put restrictions on the meaning of the word "writing" that the legislature did not explicitly intend. The court held that the testator's signature satisfied the requirements of the statute as the signature was considered a graphical image of the testator's signature included on the will and stored by electronic means. This court held that the will was valid under Ohio law even though Ohio law does not provide for electronic wills.

E. Electronic signature without witnesses

Before committing suicide, the decedent left a handwritten note stating, "I am truly sorry about this … My final note, my farewell is on my phone. The app should be open. If not look on evernote, 'Last Note.'" This lengthy electronic document contained the following paragraph devoted to the disposition of his property which ended with his typed name:

> Have my uncle go through my stuff, pick out the stuff that belonged to my dad and/or grandma, and take it. If there is something he doesn't want, feel free to keep it and do with it what you will. My guns (aside from the shotgun that belonged to my dad) are your's to do with what you will. Make sure my car goes to Jody if at all possible. If at all possible, make sure that my trust fund goes to my half-sister Shella, and only her. Not my mother. All of my other stuff is you're do whatever you want with. I do ask that anything you well, you give 10% of the money to the church, 50% to my sister Shella, and the remaining 40% is your's to do whatever you want with.

The court in *In re Estate of Horton*,[7] decided during the summer of 2018 by the Michigan Court of Appeals, agreed with the trial court that this electronic document was sufficient as a will. The court overlooked the lack of normal formalities because there was clear and convincing evidence that the decedent intended the electronic note to act as his will. Note that unlike most states, Michigan has adopted the harmless error rule allowing the court to excuse the lack of traditional formalities if the court finds that doing so will carry out the decedent's intent.

---

[5] *Taylor v. Holt*, 134 S.W.3d 830 (Tenn. Ct. App. 2003).

[6] No. 2013ES00140 (Lorain Cnty. Ohio Ct. Com. Pl. June 19, 2013).

[7] 925 N.W.2d 207 (Mich. Ct. App. 2018).

F. The vetoed Florida bill

In 2017, a Florida bill on electronic wills passed the Florida legislature and was scheduled to take effect on July 1, 2017.[8] The bill provided that an electronic will must exist in an electronic record that is unique and identifiable and must be electronically signed by the testator in the presence of two attesting witnesses. The electronic record that contains the electronic will must be held in the custody of a qualified custodian. In June of 2017, Florida Governor Rick Scott vetoed the bill, citing lack of proper safeguards and delayed implementation of provisions that may improve such safeguards as his reasoning.[9] Governor Scott also expressed concerns about the remote notarization provision. While it was meant to provide increased access to estate planning services, he claimed it did not do enough to ensure authentication of the identity of the parties to the transaction.

G. The foreign cases

Over twenty years ago, a Canadian court probated a word processing document saved on a computer disk as the testator's will. In *Rioux v. Coulombe*,[10] the decedent left a note describing how to locate an envelope containing a computer disk marked "this is my will/Jacqueline Rioux/February 1, 1996." Evidence showed that the testator saved the document to her computer on the same day she committed suicide. Using the Canadian doctrine analogous to substantial compliance, the court admitted the file has her will.

Two South African courts have also favorably dealt with electronic wills. In the 2002 case of *MacDonald v. The Master*,[11] the testator left a holographic message reading, "I, Malcolm Scott MacDonald, ID 5609065240106, do hereby declare that my last will and testament can be found on my PC at IBM under directory C:WINDOWSMYSTUFFMYWILLPERSONAL." After the testator committed suicide, his employer used the testator's password to access the document, printed it, and then deleted the file. The court admitted the will to probate using its analog to the substantial compliance doctrine.

In 2010, another South African court dealt with a draft of the testator's will that was emailed to a will beneficiary. In *Van der Merwe v. Master of the High Court*,[12] the court, as in the prior case, applied the South African equivalent of the substantial compliance doctrine to probate the will. The court held that the testator intended it to be his will and was especially impressed that the same file without changes was located on his computer after his death.

Three Australian cases decided over the past six years are also instructive.

- The Queensland Supreme Court in *In re Yu*[13] probated a will prepared on an iPhone which the decedent signed by typing his name. The court held that the iPhone was a "document" which stated his testamentary desires.
- In *Re Nichol,*[14] the court admitted an unsent text message which it appears the testator intended to send to his brother as a will. The document contained a instructions for the disposition of his property and included smiley face and paperclip emojis. Evidence showed that he wrote the text shortly before committing suicide. The court probated the unsent text message by applying its dispensing power to avoid an intestacy that would have benefitted an estranged spouse.
- In *Radford v. White*,[15] the decedent recorded a video the day he bought a new motorcycle and promptly crashed it, sustaining head injuries. A transcription of the video was admitted

[8] H.B. 277, 2017 Leg., 119th Sess. (Fl. 2017).

[9] *See generally* Letter from Governor Rick Scott to Secretary Ken Detzner (June 26, 2017) (on file with the Department of State, Tallahassee, Fla.).

[10] 19 E.T.R. (2d) 201 (Quebec Sup. Ct. 1996).

[11] 2002 (5) SA 64 (N) (S. Afr.).

[12] 2010 (605/09) ZASCA 99 (S. Afr.).

[13] [2013] QSC 322 (Austl.).

[14] [2017] QSC 220 (Austl.).

[15] [2018] QSC 306 (Austl.).

to probate as his will. After dispensing with the requisite formalities, court noted that a video is a document as defined in the state's wills act.

III. UNIFORM ELECTRONIC WILLS ACT

In an effort to create cohesion between state laws and prevent confusion for the increasingly mobile population, the Uniform Law Commission approved the Uniform Electronic Wills Act (EWA) in July 2019. This Act was a necessity as the Uniform Electronic Transactions Act enacted in almost all states which stipulates that electronic documents containing electronic signatures are to be treated the same as paper documents with wet signatures specifically excludes wills from its coverage. The Prefatory Note explains the three main goals of the EWA as follows:

- "To allow a testator to execute a will electronically, while maintaining protections for the testator that wills law provides for wills executed on something tangible (usually paper);
- "To create execution requirements that, if followed, will result in a valid will without a court hearing to determine validity, if no one contests the will; and
- "To develop a process that would not enshrine a particular business model in the statutes."

A. Electronic will defined

An e-will must be stored on a tangible or electronic medium that is "retrievable in perceivable form." EWA § 2(4). Accordingly, audio and video recordings are not permitted; the will must be in a form readable as text by human eyes at the time of execution. EWA § 5(a)(1). Other than being electronic, the will is treated no differently from other wills under the enacting state's law. EWA § 3.

B. Choice of law

An electronically executed will which does *not* meet the EWA requirements will nonetheless be treated as an e-will under the EWA if the testator executed it in compliance with the law of the jurisdiction where either (1) the testator was physically located at the time of signing or (2) the testator was domiciled or resided when the testator signed the will or died. EWA § 4.

C. Electronic will formalities

The EWA provides a basic list of the formalities for a valid e-will. However, several of the requirements are presented in optional form meaning that enacting states have the ability to customize the e-will requirements. Although options may make e-wills more palatable for legislatures that may be leery about this new will format, it is likely to result in significant variations in the formalities among the enacting states.

D. Readable as text

As discussed above, the testator must be able to read the e-will as text at the time the testator electronically signs the will. EWA § 5(a)(1).

E. Signed by testator

The testator or an authorized proxy in the testator's physical presence must sign the e-will. EWA § 5(a)(2). A signature includes affixing or logically associating with the e-will an electronic symbol or process. EWA § 2(5).

F. Attestation – generally

Two witnesses are required. EWA § 5(a)(3). Unlike about half of the states which authorize paper wills without witnesses if they are in the testator's handwriting (holographic wills), there is no provision for an e-will to escape the witnessing requirement unless (1) the state has adopted the rare procedure of allowing a notarized will to be valid without witnesses or (2) the will proponent uses the state's harmless error statute to excuse the lack of witnesses.

G. Attestation – remote

One of the major choices a state legislature will need to make revolves around the location of the witnesses. The EWA provides two options. EWA § 5(a)(3). First, the two witnesses must be residents of the state in which the testator is

executing the e-will and must be in the testator's *physical* presence. Second, the witnesses only need to be in the testator's *electronic* presence, a procedure known as remote witnessing. Under this approach, audio-video technology akin to Skype or Zoom would be used to "connect" the witnesses to the testator during the execution process.

H. Harmless errors

States are given the option of permitting a person to establish with clear and convincing evidence that an electronic will that fails to meet the requirements of an e-will is nonetheless valid if that is what the testator intended. EWA §§ 5(a) & 6. Note that currently, only about 20% of the states have adopted this approach with respect to paper wills.

I. Revocation

The testator may revoke a e-will by a variety of methods including:

- a subsequent will (paper or electronic) that revokes the e-will, either in total or partially, expressly or by inconsistency, and
- a physical act performed by the testator or an authorized proxy in the testator's presence if there is a preponderance of the evidence that the act was done with the intent to revoke the will. EWA § 7.

Physical act revocation raises a variety of issues.

- What is the physical act? The physical act could include deleting the e-will file from the testator's computer or physically destroying the media on which the e-will is stored (e.g., smashing the computer's hard drive).
- What if there are multiple copies of the e-will? A problem may arise because there may be many copies of the e-will stored in several locations. The comments of the EWA suggest that revocation of one copy should act to revoke all copies.
- What if the testator sends an e-mail stating, "I revoke my e-will" to the person or business storing the e-will? The e-mail message itself is not a physical act on the will and it would be debatable if the message could act as a will because it may not satisfy the formalities of an e-will.
- What if the electronic will cannot be located or the testator or another person (either accidently or purposefully) deleted it? Under the law of most states, failure to produce an original paper will raises a rebuttable presumption that the testator destroyed with the intent to revoke. State law in this regard is likely to apply to e-wills as well.

Because of the inherent ambiguity of physical act revocation both with paper will and e-wills regarding who did the act and the intent of the testator, revocation of an e-will by a subsequent will, be it paper or electronic, would be the more prudent method.

J. Self-proving

Just like paper wills, an e-will may be made self-proving at the time of execution but, unlike paper wills in many states, may not be self-proved at a later time. EWA § 8(a). The self-proving procedure varies depending on whether remote witnessing is used.

- Both witnesses physically present: If the testator and both witnesses are physically present at the same location as the testator when the testator signs the e-will, the will may be self-proved by an officer authorized to administer oaths under the law of the state in which the testator executed the will who attaches or logically associates with the electronic will the officer's certificate. EWA § 8(b). The officer may be physically present or, if the state permits remote notarization, electronically present.
- One or both witnesses electronically present: If the testator and both witnesses are not physically present at the same location as the testator when

> the testator signs the e-will, then the acknowledgment and affidavits need to be done via remote notarization under applicable state law such as the state's adoption of the Revised Uniform Law on Notarial Acts.

The form of the affidavit and jurat are analogous to those for paper wills. EWA § 8(d). The act also provides that signatures of the testator or witnesses on the affidavit can substitute for missing signatures on the e-will itself. EWA § 8(e).

IV. STATE ELECTRONIC WILL STATUTES

As of May 4, 2021, three states have enacted the EWA: Colorado,[16] North Dakota,[17] and Utah.[18] Four states have enacted other electronic will statutes: Nevada (effective July 1, 2017),[19] Indiana (effective July 1, 2018),[20] Arizona (effective July 1, 2019),[21] and Florida (effective July 1, 2020).[22] In addition, Washington, D.C. enacted the COVID-19 Response Supplemental Emergency Amendment Act of 2020 authorizing electronic wills from April 10, 2020 to July 9, 2020.[23]

These statutes, although similar in many aspects, vary significantly on key points. The discussion below provides an overview of these major differences but is not designed to be a comprehensive discussion of the laws of these states. Thus, if you intend to use any of these state's e-will provisions, you will need to study them carefully. The appendix also contains a chart comparing the basic features of the statutes.

A. Use by non-state resident

Florida does not require a testator to have any connection with Florida to execute a Florida e-will. Arizona's law may be used by a person without a connection to Arizona but only if the testator is physically in a state that recognizes e-wills. Nevada also allows its law to be used but only if the authoritative copy is in Nevada.

Ohio, a non-e-will state, will not recognize e-wills unless the testator was physically present in the state which authorizes e-wills when it was signed.[24]

B. Remote witnessing

Florida, Indiana, and Nevada permit remote witnessing with some limitations. In Florida, remote witnessing is not permitted if the testator is classified as a vulnerable adult under state law. In Nevada, only notarized electronic wills may be remotely notarized. Arizona does not allow remote witnessing. As discussed above, the EWA provides alternate provisions regarding remote witnessing.

C. Self-proving and qualified custodians

Like the EWA, Indiana authorizes e-wills to be self-proved. Arizona, Florida, and Nevada permit e-wills to be self-proved but only if a qualified custodian maintains the electronic record of the electronic will. The requirements of who satisfies the requirements of a qualified custodian varies but are typically (1) a person domiciled in the state who is not related to the testator or (2) a beneficiary or an entity organized in the state. States may impose requirements on the custodian such as maintaining a copy of the testator's

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[16] COLO. H.B. 21-1004.

[17] N.D. HB 1007.

[18] UTAH H.B. 6001, 2020 Sixth Special Session.

[19] NEV. REV. STAT. ANN. §§ 133.085-133.088.

[20] IND. CODE ANN. § 29-1-21-1 to 29-1-21-18. For an extensive review of the Indiana legislation, see Jeffrey S. Dible, *Signing (and Working With) Electronic Wills, Trusts and POAs under 2018 House Enrolled Act 1303* (Nov. 13, 2018) (available from author at jdible@fbtlaw.com). Extensive amendments signed by the governor on April 29, 2021. IND. H.B. 1255.

[21] ARIZ. REV. STAT. §§ 14-2518 to 14-2523.

[22] FLA. STAT. §§ 732.521 to 732.526. The first will using this statute was allegedly executed on August 25, 2020. See *Trust & Will Partners With Notarize to Launch First Electronic Will (eWill) in Florida*, PR Newswire (Aug. 25, 2020).

[23] B23-0733 - COVID-19 Response Supplemental Emergency Amendment Act of 2020 (D.C.)

[24] OHIO REV. CODE § 2107.18.

photograph or identification card and storing audio and video recordings of the testator, witnesses, and notary taken at the time each placed their electronic signature on the e-will. Some states have detailed provisions regarding the successor custodians. Businesses are evolving in these states to serve as custodians and provide the platform for executing e-wills.

In Florida, a remote notary must ask the testator statutorily mandated questions and receive verbal answers thereto.

D. Integrity evidence

Several states impose additional requirements to validate an e-will. Such evidence includes digital markers showing that the electronic will has not been altered after its initial execution and witnessing; is tamper evident; displays any changes made to the text of the electronic will after its execution; and displays the city, state, date and time the electronic will was executed by the testator and the attesting witnesses.

E. Disclosures

The Florida statute provides that it is the "best practice" of any provider of an e-will service, including both attorneys and companies, to provide a lengthy set of disclosures to the testator dealing with the procedure for executing, storing, and revoking the e-will. However, failure to provide the instructions does not invalidate the e-will or expose the attorney or company to liability. Indiana has a similar provision.

V. INDIANA

There are two appendices to this article. The first contains the text of Indiana's e-will statutes prior to the amendments the governor signed on April 29, 2021. The second contains the text of the amendments made by HB 1255.

VI. RECOMMENDATIONS

A. "Resistance is futile"[25]

Prior to COVID-19, many people believed that there was no pressing need to authorize e-wills. Perhaps it is true that the situations where e-wills would be a favorable option were rare. Nonetheless, e-wills *are* coming and you need to be prepared or else as one esteemed attorney told this author, "become irrelevant." "At least two major industry players (both online self-help alternatives to local legal advice) have begun to push for states to consider authorization for digital execution of wills, and perhaps other documents (powers of attorney, trusts, etc.) that had long been thought to require "wet" signatures on paper documents."[26]

B. Abuse fears are overstated

Some readers may have serious concerns about evil individuals using nefarious techniques to get testators to execute wills in their favor. Several leading professionals have expressed similar concerns. However, it is the opinion of this author that these abuse fears are overstated. A person who intends to use undue influence, duress, or fraud to "convince" a testator to execute a will may do so for paper wills just as easily as for e-wills.

In addition, a person may already make tremendous changes to property disposition with far fewer formalities than any type of will. For example, by using a computer or smart phone, pay on death designations on bank accounts and retirement accounts can be changed in a matter of minutes as can the beneficiaries of life insurance policies.

C. Support e-will legislation

You may have a strong opinion regarding e-wills. Regardless of whether you think they are a great

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[25] *Star Trek* (standard message used by the Borg when they encounter an alien race they intend to assimilate into their collective).

[26] Robert B. Fleming, *Electronic Wills*, Estate Planning and Community Property CLE at 1 (Mar. 1, 2019).

idea or a bad one, you need to be ready for them as companies that provide the platforms for creating and executing e-wills will lobby state legislatures for their enactment. If estate planners do not "get ahead" of the industry, we may end up with a hodge-podge of incomplete, unworkable, or ill-advised statutes which will not operate to the benefit of the citizens of our state.

D. Use reputable e-will company

Creating an in-house platform for e-wills is a daunting task especially given the detailed requirements imposed by some of the enabling legislation. Accordingly, you should investigate companies that provide e-will services with, if appropriate, remote witnessing and notarization capabilities, and ascertain one that best fits your needs. However, do not "turn over" will execution to these companies. Instead, you will want to maintain control over the ceremony to make certain it satisfies all the requirements.

E. Consider e-will scenarios

If you are in a state with e-will legislation, give serious consideration to the types of situations where an e-will would enhance your client services.

1. The Pandemic

We are right now seeing one of the key reasons for electronic wills – stay at home orders and social distance requirements triggered by COVID-19. If e-wills with remote witnessing were allowed, we could continue to provide estate planning services for our clients.

2. The emergency

Assume that you are at a business meeting in a distant city when a client calls you the evening before she is departing on a vacation to Mongolia. She explains that her brother recently had a serious life-changing stroke and she wants a portion of her estate to be placed into a testamentary special needs trust for his benefit. Absent Star Trek transporter technology, there is no physical way for you and your client to meet to execute an updated will prior to her departure. However, you have your computer with you and can easily update her will to include the trust. After exchanging drafts by e-mail and obtaining the client's agreement on the terms of the will, you can contact your preferred e-will service and conduct the entire ceremony using remote notarization and, if allowed, remote witnessing.

3. The distant client

Assume that your client lives in a remote rural area. For example, some people in Alaska live in areas where access is only by plane or boat and it would a day or more to reach the office of an attorney. As with the emergency situation, you can handle everything remotely even though time is not of the essence.

4. The expert

Assume that you are an expert in a particular aspect of estate planning. Your services are needed by people who live a considerable distance from your office so it would not be practical for these individuals to be your clients. Again, as with the prior situations, you can handle their estate planning tasks remotely.

VII. CONCLUSION

E-wills and related techniques are coming – you cannot stop Skynet[27] from being built. If you want to thrive in the future, you will need to recognize new methods and make appropriate changes to your practice whether you think they are beneficial, unnecessary, or even harmful.

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[27] *Skynet (Terminator)*, (last visited Aug. 7, 2019).

Electronic Wills : the Changing Future of the Estate Practice

Dr. Gerry W. Beyer
Governor Preston E. Smith Regents Professor of Law
Texas Tech University School of Law

Written in Blood

In the Name of God, Amen
This codicil drawn by me on 11 January
2006 and transcribed in mine own hand
I of sound and disposing mind and
memory, of my own free will and volition
devoid of any external influence that
may be contrary to my wishes, Amend
my Last Will & Testament bearing the date
28 June 2001 ——

Wheresoever the name of Marc Albert
Coleman appears, I direct that it
shall be replaced with the name
Aristos John Baylock ——

Inasmuch that Marc Albert Coleman
MB man owes to me a debt on the
property at 1203 Pine Street, Philadelphia
City and County within the Commonwealth of
Pennsylvania, I direct that it be in one
half measure forgiven. Marian Broadway

Tell your children?

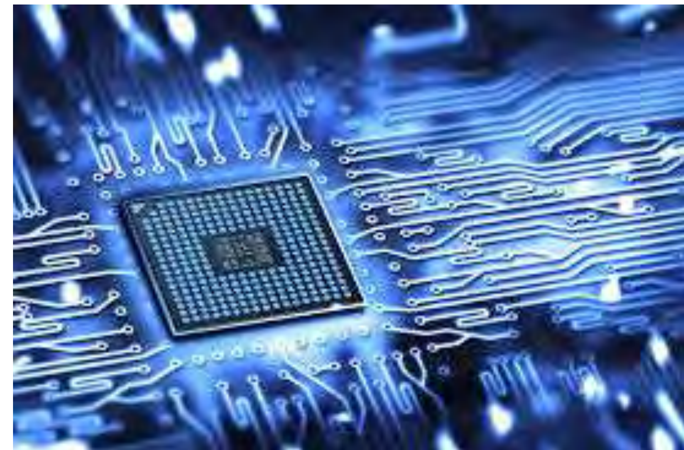
Gabriela Perero

Preserving tattoos

Electronic Wills

Threshold Issue

- **Can a will stored electronically be as effective as a physical-implement-to-writing-surface will to convey property at death despite the fact that machine intervention is needed to "read" the electronic will?**



Placing policies in context

- **The policies of requiring a traditional writing evolved at common law to combat problems with nuncupative (oral) wills.**

Writing Policy #1

- Prevent Creation Fraud
  - English case where nine witnesses claimed they heard old wealthy man claim he wanted his wife to receive all of his property.
    - Later, evidence provided all nine witness and the wife lied.
  - Easier to exert undue influence to get someone to say something than put it in writing.

Writing Policy #2

- Prevent Mistake or Fraud in Probate
  - Make certain will actually exists.
  - Be sure the will's contents are those the testator desired.

Writing Policy #3

- Certainty – Preserve Testator's True Intent
  - Enhances likelihood of property distribution being in accordance with testator intent.

Writing Policy #4

- **Ensure Deliberation and Reflection**
  - **More effort is needed to make a writing than an oral statement.**

WRITING IS HARD.

And if it's not, you're doing it wrong.

Writing Policy #5

- Facilitate Probate Process
  - Easier for a court to deal with a tangible writing than testimony about oral testamentary words.

“Early” Judicial Decisions

The Audio Will

- *Estate of Reed*, 672 P.2d 829 (Wyo. 1983).
- Tape recorded will found in sealed envelope signed and marked in the testator's handwriting, "To be played in the event of my death only."
- Court declined to extend term "writing" to include an oral recording.

The Samsung Galaxy Tablet Will

- *In re Estate of Javier Castro*, No. 2013ES00140 (Loraine Cnty. Ohio Ct. Com. Pl. June 19, 2013).
- Testator's will was written and signed on a tablet computer in a notes application and signed with a stylus pen in the presence of two witnesses.
- The court held this was a sufficient signature.

The Evernote Will

- *In re Estate of Horton*, No. 339737, 2018 WL 3443383 (Mich. Ct. App. July 17, 2018).
- Before a 21-year-old committed suicide, he typed his will on his phone in Evernote, and typed his name at the end of it. The document was unwitnessed and undated. He referred to it as a "farewell" and "Last Note."
- The Probate Court used UPC 2-503 to allow the will applying the "harmless error rule" to overlook the lack of proper formalities.
- On appeal, the Michigan intermediate appellate court affirmed.

The Australian Cases

Unsent Text Message Will

- **Australia (2017):** ***Re Nichol; Nichol v Nichol*** **[2017] QSC 220.**
- **Australian court admits an unsent text message with a smiley face emoji to probate, applying its dispensing power to avoid an intestacy that would benefit estranged spouse.**

- **Case "pushes the envelope" of forgiving alleged harmless errors.**

The Video Will

- *Radford v. White*, QSC 306 (Dec. 17, 2018).
- **Decedent recorded a video the day he bought a new motorcycle and promptly crashed it, sustaining head injuries .**
- **A transcription of the video was admitted to probate as his will.**
- **After dispensing with the requisite formalities, court noted that a video is a document as defined in wills act.**

The Nevada "Experiment"

The "Old" Nevada Statute

- Enacted in 2001 and effective until July 1, 2017
  - Driven by computer industry.
  - Also favored by attorneys thinking it would be easier to send files rather than meet with clients in person.
- Cutting edge statute but a failure
  - Software to preserve authoritative copies while marking copies of the original as copies did not exist.
  - No procedure for attestation of witnesses.
  - No procedure for notarization.

e-Will Non-Uniform States

- **Nevada**
  - **July 1, 2017**
- **Indiana**
  - **July 1, 2018**
- **Arizona**
  - **July 1, 2019**
- **Florida**
  - **July 1, 2020**

Uniform Electronic Wills Act (EWA)

- **Approved in July 2019.**
  - **Colorado**
  - **North Dakota**
  - **Utah**

Uniform Law Commission

Better Laws. Stronger States.

Basic EWA Approach

- Requires the equivalent of text (a "textual record") when executed (no audio or video).
- Two witnesses.
  - Remote witnessing is an optional provision.
- Savings provision – valid if valid where:
  - Testator physically located when executed, or
  - Testator domiciled at time of execution or death.
- Self-proving allowed.
- No special custody rules.

Key e-Will Legislation Factors

- **1. Use by non-state resident?**

Key e-Will Legislation Factors

- **2. Remote witnessing?**

Key e-Will Legislation Factors

- **3. Self-proving and qualified custodians?**

Key e-Will Legislation Factors

- **4. Integrity evidence?**

Key e-Will Legislation Factors

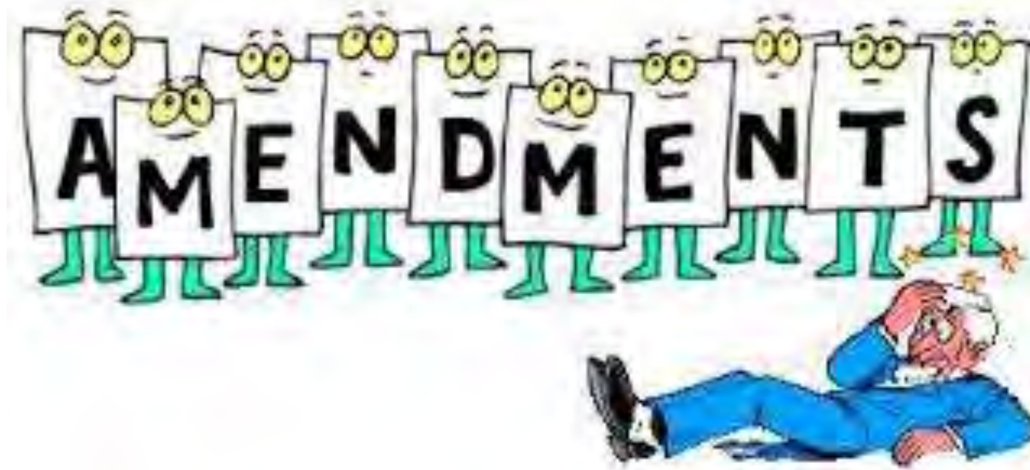
- **5. Disclosures?**

Indiana

- **Original legislation – 2018**

Indiana Amendments

- **Amendments in prior years with extensive amendments signed by the governor on April 29, 2021.**



Overview of Indiana e-Wills

- The Indiana statutes are very detailed.
- Our coverage is only an overview of key features.
- Complete text of the statutes and new amendments are in the appendix to the article.

Overview of Requirements

1. Testator and witnesses are in electronic presence for the entire process.
2. Testator states that the electronic document is the testator's will.
3. Testator electronically signs.
4. Witnesses electronically sign.
5. The testator or other allowed person commands the software to finalize the electronic will.

Ind. Code § 29-1-21-4(a)

Remote Witnessing

- **The testator and witnesses *do not* need to be physically together as was the case prior to the amendments.**

- **Electronic presence, that is being able to interact in real time via audiovisual technology, is sufficient.**

Ind. Code § 29-1-21-4(a)

Witnesses "Together"

- The witnesses do not need to be physically together.
- But, they must be electronically together at the same time with the testator when they electronically sign.

Ind. Code § 29-1-21-4(a)(5)

Self-Help e-Wills Restricted

- **The execution of an e-Will must be supervised by an attorney or a directed paralegal if the testator and the witnesses are not in each other's physical presence.**

Ind. Code § 29-1-21-4(b)

Affidavit of Compliance

- Within a reasonable time after the execution of an e-will, the attorney or directed paralegal must sign a detailed affidavit of compliance.
  - Names, addresses, physical location, ID, etc. of testator and witnesses.
  - Electronic method used (e.g., Zoom).
  - How signatures electronically made.
  - Details about the attorney or directed paralegal.

Ind. Code § 29-1-21-4(c)

Self-proving clause optional

- **The e-will may contain a self-proving clause substantially as provided by statute.**

Ind. Code § 29-1-21-4(e)

Recommended Disclosures

- **An attorney who prepares e-wills and the vendors of e-will programs should provide the testator with extensive advisory instructions.**

- **Failure to provide the instructions does *not* impact the validity of the will.**

Ind. Code § 29-1-21-6

Savings Provision

- Indiana recognizes the validity of e-wills executed under:
  - Indiana law,
  - The state in which the testator was physically located when the testator made the will, and
  - The testator's domicile at the time of:
    - Will execution, or
    - Death.

Ind. Code § 29-1-21-7

Revocation -- Prerequisite

- If attorney or other custodian stores the e-will, the testator must instruct the attorney or custodian in writing to permanently delete or make unreadable and nonretrievable the electronic record associated with the e-will.

Ind. Code § 29-1-21-8(a) & (e)

Revocation -- Methods

- Express revocation by a new:
  - Paper will, or
  - Electronic will.
- If no custodian used, delete all copies of the e-will or make them unreadable and nonretrievable.
- A revocation document executed with statutory formalities.

Ind. Code § 29-1-21-8

Converted copy

- **If something "goes wrong" with the e-will, the testator, attorney, or custodian can attempt to recreate it and create a "converted copy" which then can be probated as a traditional paper will.**

Ind. Code § 29-1-21-9

Custodians of e-Wills

- **The testator may, but is not required to, authorize another person to have custody of the e-will.**
- **The statute outlines the duties and responsibilities of the custodian to protect the e-will and associated document integrity evidence.**

Ind. Code § 29-1-21-10 & 11

Custodian Destruction of e-Wills

- A custodian may destroy an e-will under certain circumstances such as:
  - 5 years after admission to probate,
  - 10 years after testator's death,
  - 100 years after execution of e-will, and
  - After testator revokes the e-will.

Ind. Code § 29-1-21-12

Gap e-Wills

- Electronic wills executed between these two days have special rules in enhance the likelihood of their validity:
  - On or after March 31, 2020, and
  - Before January 1, 2021.

Ind. Code § 29-1-21-4.1

The Counterpart Will

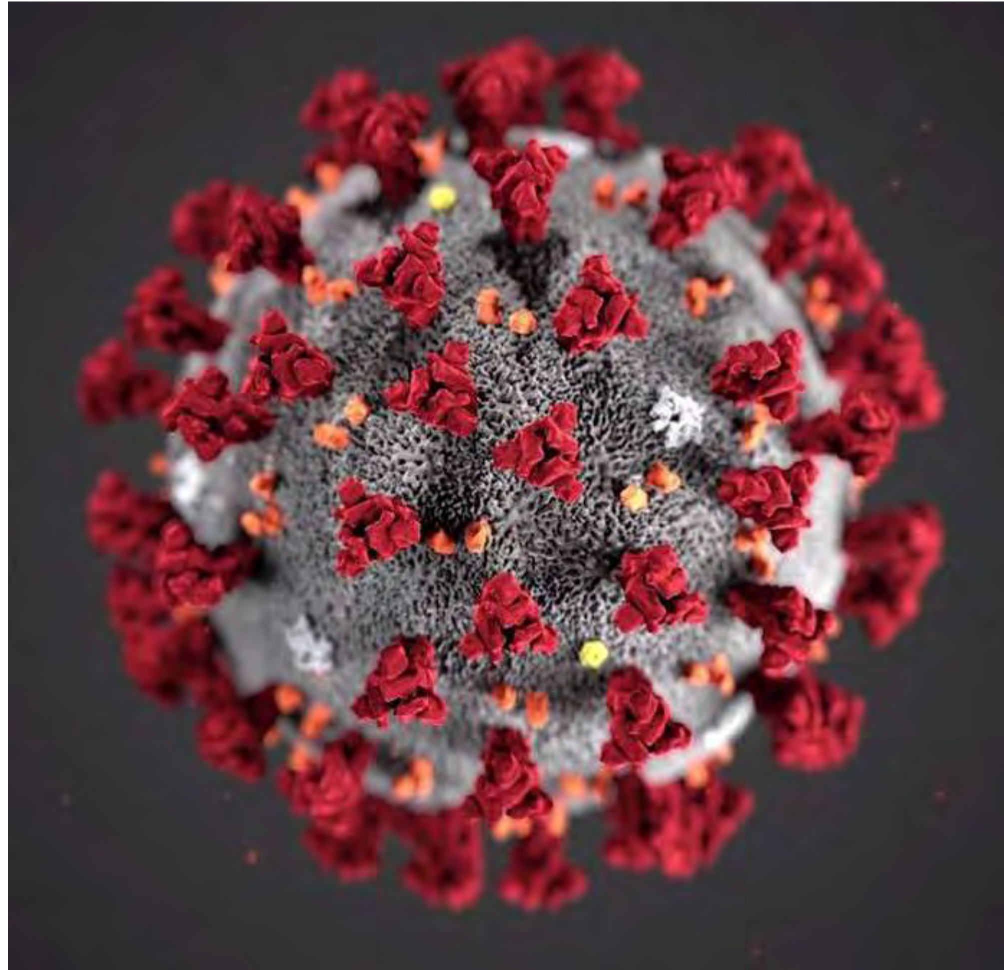
- The testator signs a paper will while witnesses watch on video.
- The witnesses then sign a paper counterpart of the will. Each witness may sign a different counterpart.
- Within five days, the parts need to be assembled into one document.
- The attorney prepares a comprehensive affidavit of compliance in accordance with statutory requirements.

Ind. Code § 29-1-5-3

Other Electronic Documents

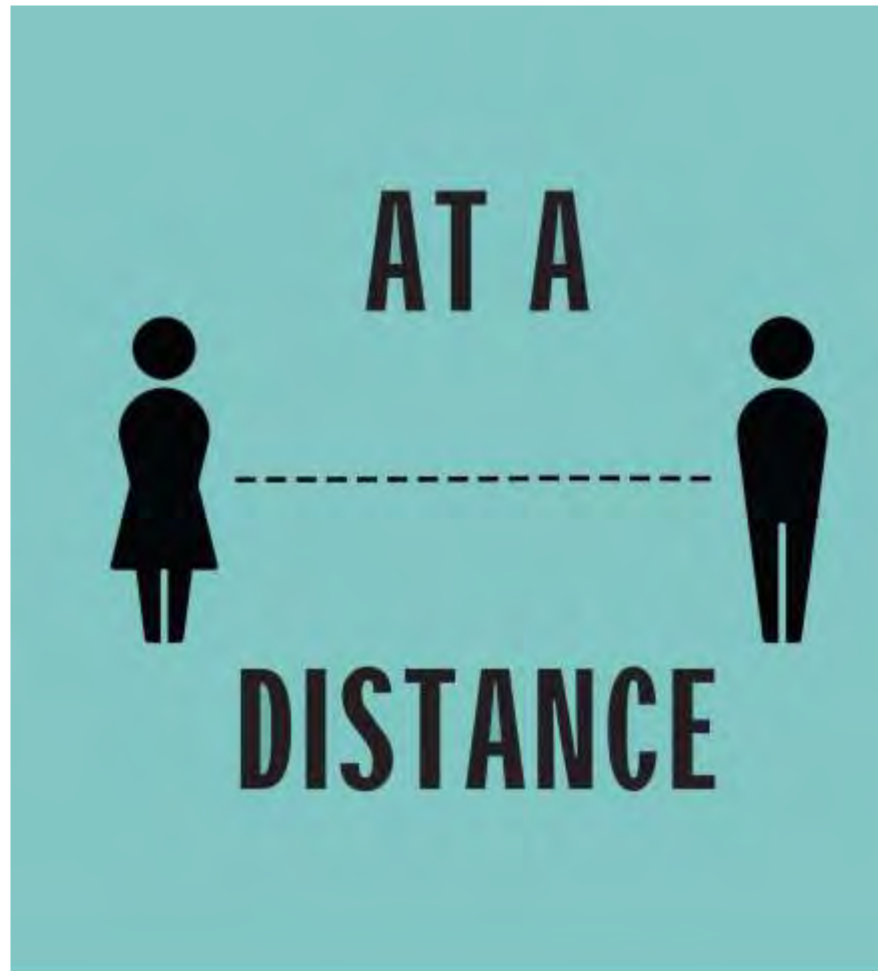
- Inter vivos trusts
  - Ind. Code § 30-4-1.5-4
- Powers of attorney
  - Ind. Code § 30-5-4-1.3

E-wills Scenarios -- The Pandemic



E-wills Scenarios – The Emergency

E-wills Scenarios – The Distant Client



E-wills Scenarios – The Expert

Questions?

West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-1

29-1-21-1 Purpose

Effective: July 1, 2018
Currentness

Sec. 1. The purpose of this chapter is to provide rules for the valid execution, attestation, self-proving, and probate of wills that are prepared and signed electronically. This chapter shall be applied fairly and flexibly so that a testator whose identity can be verified, who has testamentary capacity, and who is acting free from duress and undue influence may execute a valid electronic will consistent with the testator's intent. If an electronic will is properly and electronically signed by the testator and by the witnesses and is maintained as an electronic record or as a complete converted copy in compliance with this chapter, all the normal presumptions that apply to a traditional paper will that is validly signed and executed apply to an electronic will.

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-1, IN ST 29-1-21-1

The statutes and Constitution are current with all legislation of the 2021 First Regular Session of the 122nd General Assembly effective through April 20, 2021.

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West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-2

29-1-21-2 Application

Effective: July 1, 2018
Currentness

Sec. 2. (a) Except as provided in subsection (b), electronic wills are exclusively governed by this chapter.

(b) If this chapter does not provide an explicit definition, form, rule, or statute concerning the creation, execution, probate, interpretation, storage, or use of an electronic will, the applicable statute from this article shall apply to the electronic will.

Credits
As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-2, IN ST 29-1-21-2
The statutes and Constitution are current with all legislation of the 2021 First Regular Session of the 122nd General Assembly effective through April 20, 2021.

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KeyCite Yellow Flag - Negative Treatment
Proposed Legislation

West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-3

29-1-21-3 Definitions

Effective: July 1, 2019
Currentness

Sec. 3. The following terms are defined for this chapter:

(1) "Actual presence" means that:

(A) a witness; or

(B) another individual who observes the execution of the electronic will;

is physically present in the same physical location as the testator. The term does not include any form of observation or interaction that is conducted by means of audio, visual, or audiovisual telecommunication or similar technological means.

(2) "Affidavit of regularity" means an affidavit executed by a custodian or other person under section 13 of this chapter with respect to the electronic record for an electronic will or a complete converted copy of an electronic will.

(3) "Complete converted copy" means a document in any format that:

(A) can be visually perceived in its entirety on a monitor or other display device;

(B) can be printed; and

(C) contains:

(i) the text of the electronic will;

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(ii) the electronic signatures of the testator and the witnesses;

(iii) a readable copy of any associated document integrity evidence that may be a part of or attached to the electronic will; and

(iv) a self-proving clause concerning the electronic will, if the electronic will is self-proved.

(4) "Custodian" means a person, other than:

(A) the testator who executed the electronic will;

(B) an attorney;

(C) a person who is named in the electronic will as a personal representative of the testator's estate; or

(D) a person who is named or defined as a distributee in the electronic will;

who has authorized possession or control of the electronic will. The term may include an attorney in fact serving under a living testator's durable power of attorney who possesses general authority over records, reports, statements, electronic records, or estate planning transactions.

(5) "Custody" means the authorized possession and control of at least one (1) of the following:

(A) A complete copy of the electronic record for the electronic will, including a self-proving clause if a self-proving clause is executed.

(B) A complete converted copy of the electronic will, if the complete electronic record has been lost or destroyed or the electronic will has been revoked.

(6) "Document integrity evidence" means the part of the electronic record for the electronic will that:

(A) is created and maintained electronically;

(B) includes digital markers showing that the electronic will has not been altered after its initial execution and witnessing;

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(C) is logically associated with the electronic will in a tamper evident manner so that any change made to the text of the electronic will after its execution is visibly perceptible when the electronic record is displayed or printed;

(D) will generate an error message, invalidate an electronic signature, make the electronic record unreadable, or otherwise display evidence that some alteration was made to the electronic will after its execution; and

(E) displays the following information:

(i) The city and state in which, and the date and time at which, the electronic will was executed by the testator and the attesting witnesses.

(ii) The text of the self-proving clause, if the electronic will is electronically self-proved through use of a self-proving clause executed under section 4(c) of this chapter.

(iii) The name of the testator and attesting witnesses.

(iv) The name and address of the person responsible for marking the testator's signature on the electronic will at the testator's direction and in the actual presence of the testator and attesting witnesses.

(v) Copies of or links to the electronic signatures of the testator and the attesting witnesses on the electronic will.

(vi) A general description of the type of identity verification evidence used to verify the testator's identity.

(vii) The text of the advisory instruction, if any, that is provided to the testator under section 6 of this chapter at the time of the execution of the electronic will.

(viii) The content of the cryptographic hash or unique code used to complete the electronic record and make the electronic will tamper evident if a public key infrastructure or similar secure technology was used to sign or authenticate the electronic will and if the vendor or the software for the technology makes inclusion feasible.

Document integrity evidence may, but is not required to, contain other information about the electronic will such as a unique document number, client number, or other identifier that an attorney or custodian assigns to the electronic will or a link to a secure Internet web site where a complete copy of the electronic will is accessible. The title, heading, or label, if any, that is assigned to the document integrity evidence (such as “certificate of completion”, “audit trail”, or “audit log”) is immaterial.

(7) “Electronic” has the meaning set forth in IC 26-2-8-102.

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(8) "Electronic record" has the meaning set forth in IC 26-2-8-102. The term may include one (1) or both of the following:

(A) The document integrity evidence associated with the electronic will.

(B) The identity verification evidence of the testator who executed the electronic will.

(9) "Electronic signature" has the meaning set forth in IC 26-2-8-102.

(10) "Electronic will" means the will of a testator that:

(A) is initially created and maintained as an electronic record;

(B) contains the electronic signatures of:

(i) the testator; and

(ii) the attesting witnesses; and

(C) contains the date and times of the electronic signatures described by clause (B)(i) and (B)(ii).

The term may include a codicil that amends an electronic will or a traditional paper will if the codicil is executed in accordance with the requirements of this chapter.

(11) "Executed" means the signing of an electronic will. The term includes the use of an electronic signature.

(12) "Identity verification evidence" means either:

(A) a copy of the testator's government issued photo identification card; or

(B) any other information that verifies the identity of the testator if derived from one (1) or more of the following sources:

(i) A knowledge based authentication method.

(ii) A physical device.

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(iii) A digital certificate using a public key infrastructure.

(iv) A verification or authorization code sent to or used by the testator.

(v) Biometric identification.

(vi) Any other commercially reasonable method for verifying the testator's identity using current or future technology.

(13) "Logically associated" means electronically connected, cross referenced, or linked in a reliable manner.

(14) "Sign" means valid use of a properly executed electronic signature.

(15) "Signature" means the authorized use of the testator's name to authenticate an electronic will. The term includes an electronic signature.

(16) "Tamper evident" means the feature of an electronic record, such as an electronic will or document integrity evidence for an electronic will, that will cause any alteration of or tampering with the electronic record, after it is created or signed, to be perceptible to any person viewing the electronic record when it is printed on paper or viewed on a monitor or other display device. The term applies even if the nature or specific content of the alteration is not perceptible.

(17) "Traditional paper will" means a will or codicil that is signed by the testator and the attesting witnesses:

(A) on paper; and

(B) in the manner specified in IC 29-1-5-3 or IC 29-1-5-3.1.

(18) "Will" includes all wills, testaments, and codicils. The term includes:

(A) an electronic will; and

(B) any testamentary instrument that:

(i) appoints an executor; or

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(ii) revives or revokes another will.

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018. Amended by P.L.10-2019, SEC.116, eff. July 1, 2019; P.L.231-2019, SEC.18, eff. July 1, 2019.

I.C. 29-1-21-3, IN ST 29-1-21-3

The statutes and Constitution are current with all legislation of the 2021 First Regular Session of the 122nd General Assembly effective through April 20, 2021.

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Proposed Legislation

West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-4

29-1-21-4 Signatures; self-proving clauses; validity; testator's intent

Effective: July 1, 2018
Currentness

Sec. 4. (a) To be valid as a will under this article, an electronic will must be executed by the electronic signature of the testator and attested to by the electronic signatures of at least two (2) witnesses in the following manner:

(1) The testator and the attesting witnesses must be in each other's actual presence when the electronic signatures are made in or on the electronic will. The testator and witnesses must directly observe one another as the electronic will is being signed by the parties.

(2) The testator and attesting witnesses must comply with:

(A) the prompts, if any, issued by the software being used to perform the electronic signing; or

(B) the instructions by the person, if any, responsible for supervising the execution of the electronic will.

(3) The testator must state, in the actual presence of the attesting witnesses, that the instrument to be electronically signed is the testator's will.

(4) The testator must:

(A) electronically sign the electronic will in the actual presence of the attesting witnesses; or

(B) direct another adult individual who is not an attesting witness to sign the electronic will on the testator's behalf in the actual presence of the testator and the attesting witnesses.

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(5) The attesting witnesses must electronically sign the electronic will in the actual presence of:

(A) the testator; and

(B) one another;

after the testator has electronically signed the electronic will.

(6) The:

(A) testator; or

(B) other adult individual who is:

(i) not an attesting witness; and

(ii) acting on behalf of the testator;

must command the software application or user interface to finalize the electronically signed electronic will as an electronic record.

The process described in this section may include as part of the electronic record for the electronic will any identity verification evidence pertaining to the testator or any document integrity evidence for the electronic will.

(b) An electronic will may be self-proved:

(1) at the time that it is electronically signed; and

(2) before it is electronically finalized;

by incorporating into the electronic record of the electronic will a self-proving clause described under subsection (c). An electronic will is not required to contain an attestation clause or a self-proving clause in order to be a valid electronic will.

(c) A self-proving clause under subsection (b) must substantially be in the following form:

"We, the undersigned testator and the undersigned witnesses, whose names are signed to the attached or foregoing instrument, declare:

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(1) That the testator executed the instrument as the testator's will.

(2) That, in the actual and direct physical presence of both witnesses, the testator signed the will or directed another individual who is not one of the witnesses to sign for the testator in the testator's presence and in the witnesses' actual and direct physical presence;

(3) That the testator executed the will as a free and voluntary act for the purposes expressed in it;

(4) That each of the witnesses, in the actual and direct physical presence of the testator and each other, signed the will as a witness;

(5) That the testator was of sound mind when the will was executed; and

(6) That, to the best knowledge of each attesting witness, the testator was, at the time the will was executed, at least eighteen (18) years of age or was a member of the armed forces or of the merchant marine of the United States or its allies.

____

(insert date) (insert signature of testator)

____

(insert date) (insert signature of witness)

____

(insert date) (insert signature of witness)".

A single signature from the testator and from each attesting witness may be provided for any electronic will bearing or containing a self-proving clause.

(d) An electronic will that is executed in compliance with subsection (a) shall not be rendered invalid by the existence of any of the following attributes:

(1) An attestation clause.

(2) Additional signatures.

(3) A self-proving clause that differs in form from the exemplar provided in subsection (c).

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(4) Any additional language that refers to the circumstances or manner in which the electronic will was executed.

(e) This section shall be construed in a manner that gives effect to the testator's intent to execute a valid will.

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-4, IN ST 29-1-21-4

The statutes and Constitution are current with all legislation of the 2021 First Regular Session of the 122nd General Assembly effective through April 20, 2021.

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Proposed Legislation

West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-5

29-1-21-5 Video recording of execution of electronic will

Effective: July 1, 2018
Currentness

Sec. 5. Subject to the Indiana Rules of Evidence and the Indiana Rules of Trial Procedure, a video recording of an electronic will's execution or a video recording of a testator either before or after the execution of an electronic will may be admissible as evidence of the following:

(1) The proper execution of an electronic will in compliance with section 4 of this chapter.

(2) The intentions of the testator.

(3) The mental state or capacity of the testator.

(4) The absence of undue influence or duress with respect to the testator.

(5) Verification of the testator's identity.

(6) Evidence that a complete converted copy of an electronic will should be admitted to probate.

(7) Whether a will whose execution failed to fully comply with section 4 of this chapter should be admitted to probate as a valid traditional paper will.

(8) Any other matter the court considers relevant to the probate of an electronic will.

Credits
As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

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29-1-21-5 Video recording of execution of electronic will, IN ST 29-1-21-5

I.C. 29-1-21-5, IN ST 29-1-21-5
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Proposed Legislation

West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-6

29-1-21-6 “Form vendor”; advisory instructions; failure to provide advisory instructions

Effective: July 1, 2018
Currentness

Sec. 6. (a) As used in this section, “form vendor” means any person who provides a testator with an electronic will form or a user interface for creating, completing, or executing an electronic will. The term includes:

(1) an attorney who prepares an electronic will for a testator; and

(2) any vendor or licensor of estate planning software of digital estate planning forms.

(b) It is consistent with best practices to provide the following advisory instruction with each electronic will:

“IMPORTANT Instructions to the Signatory of an Electronic Will

A. The procedure for proper execution (electronic signing and witnessing) of your electronic will is as follows:

(1) You (the testator) and the two (2) attesting witnesses must be actually present in the same location throughout the execution process. Indiana law does not permit attesting witnesses to observe or participate in the signing process from a location that is apart or separate from the testator's location or act as an attesting witness through use of remote audio, remote visual, or remote audiovisual software or technology.

(2) Both attesting witnesses must be adults and should not be individuals who will be gifted money or other property under the terms of your electronic will. If a witness named in the electronic will is named as a beneficiary or legatee or entitled to money or property under the terms of the electronic will, the beneficiary or legatee named in the electronic will may only receive money, property, or shares reserved for them under state intestacy laws.

(3) You, as the testator, must inform the attesting witnesses that the document you will be signing is your will.

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(4) You (the testator) and the two (2) attesting witnesses may use the same computer or device or different computers and devices to make your respective electronic signatures on the electronic will.

(5) The online user interface or software application for your will may require you and the attesting witnesses to use a password, validation code, token, or other security feature in order to prevent identity theft or impersonation and permanently link each of you, as individuals, to your respective electronic signatures.

(6) You (the testator) and the two (2) attesting witnesses should follow the instructions provided by the online user interface or software application when making your respective electronic signatures on your electronic will. You (the testator) should electronically sign the electronic will first followed by each of the attesting witnesses. If you (the testator) are physically unable to type, press keys, or otherwise enter commands on the computer or device being used to electronically sign the electronic will, you may instruct another adult who is not an attesting witness to enter your electronic signature on your electronic will for you. Any individual who enters your electronic signature on your electronic will on your behalf must do so in your actual presence.

(7) The software application or online user interface may create a date and time stamp for your electronic signature and for the electronic signature of each attesting witness.

(8) The execution of your electronic will is complete after you and the attesting witnesses have completed making your electronic signatures by clicking or executing a command that saves or submits your respective electronic signatures in the software application or online interface.

(9) You are strongly encouraged to save a complete copy of your electronic will in a portable and printable format. An electronic will preserved in this manner should include all information related to the execution process of your electronic will, including information that is compiled or stored by the software application or online user interface. The related information described in this subdivision should be viewable and printable as a self-contained and permanent part of the electronic record for your electronic will.

B. If you used a software application or an online user interface to generate, finalize, and sign your electronic will, the software or user interface may also offer you the ability to securely store the electronic record of your electronic will. You may be required to create or establish a user identification, password, or other security feature in order to store the electronic record of your electronic will in this way. You should carefully safeguard your user identification, password, security questions, and personal information used to securely save or store your electronic will. The information that you are being asked to safeguard will likely be required in order to:

(1) generate;

(2) replace;

(3) retrieve; or

(4) revoke;

your electronic will at a later date.

C. The only proper and valid way for you to revoke your electronic will is to:

(1) sign a new electronic will or a traditional paper will that revokes all previous wills executed by you; or

(2) permanently and irrevocably make unreadable and nonretrievable the electronic record for your electronic will.

If you are holding the electronic record for your electronic will on your own computer or digital storage device and not making use of a third party custodian or online storage or cloud based document storage service to store or safeguard your electronic will, you may personally delete permanently or make unreadable the electronic record associated with your electronic will. Before doing so, you are encouraged to make and save a printable, permanent copy of the complete electronic record associated with your electronic will, including any related information pertaining to the execution or signing process of your electronic will, so that the contents of your revoked electronic will may be discovered later by a probate court or any other interested persons in the event of a dispute concerning the validity of any later will that you decide to make.

If you are making use of a third party custodian or online or cloud based document storage service to store or safeguard your electronic will, the valid revocation of your electronic will requires you to personally issue a written or electronic revocation document to each third party custodian who has custody of a copy of the electronic record associated with your electronic will. A valid revocation document must instruct the custodian to permanently delete or make unreadable and nonretrievable the electronic record associated with your electronic will. A valid revocation document must be signed by you and two (2) attesting witnesses while following the same procedures required for the execution of a new traditional paper will or new electronic will.".

(c) A failure to provide the text of the advisory instruction in subsection (b) does not affect the validity of the electronic will if the electronic will is otherwise properly executed in the manner set forth in this chapter.

(d) A failure to provide the advisory instruction described in subsection (b) may not be the predicate for any form of civil or other liability.

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-6, IN ST 29-1-21-6

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West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-7

29-1-21-7 Legal execution

Effective: July 1, 2018
Currentness

Sec. 7. An electronic will is legally executed if the manner of its execution complies with the law of:

(1) this state;

(2) the jurisdiction that the testator is actually present in at the time of execution; or

(3) the domicile of the testator at the time of execution or at the time of the testator's death.

Credits
As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-7, IN ST 29-1-21-7
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Proposed Legislation

West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-8

29-1-21-8 Revocation

Effective: July 1, 2018
Currentness

Sec. 8. (a) This section describes the exclusive methods for revoking an electronic will. Before a testator completes or directs the revocation of an electronic will, the testator shall:

(1) comply with; or

(2) direct a third party custodian to comply, as applicable, with;

subsection (e).

(b) A testator may revoke and supersede a previously executed electronic will by executing a new electronic will or traditional paper will that explicitly revokes and supersedes all prior wills. However, if the revoked or superseded electronic will is held in the custody or control of more than one (1) custodian, the testator shall use the testator's best efforts to contact each custodian and to instruct each custodian to permanently delete and render nonretrievable each revoked or superseded electronic will in the manner described in subsection (d).

(c) If a testator is not using the services of a custodian to store the electronic record for an electronic will, the testator may revoke the electronic will by permanently deleting each copy of the electronic record associated with the electronic will in the testator's possession or control or by rendering the electronic record for the associated electronic will unreadable and nonretrievable.

(d) The testator may revoke the testator's electronic will by executing a revocation document that:

(1) is signed by the testator and two (2) attesting witnesses in a manner that complies with IC 29-1-5-3(b) or with section 4 of this chapter;

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(2) refers to the date on which the electronic will that is being revoked was signed; and

(3) states that the testator is revoking the electronic will described in subdivision (2).

A revocation document under this subsection may be signed and witnessed with the electronic signature of the testator and two (2) attesting witnesses, or signed and witnessed with signatures on paper as described in IC 29-1-5-6.

(e) If a testator is using the services of an attorney or a custodian to store the electronic record associated with the testator's electronic will, the testator may revoke the electronic will by instructing the custodian or attorney to permanently delete or make unreadable and nonretrievable the electronic record associated with the electronic will. An instruction issued under this subsection must be made in writing to the custodian or attorney as applicable. A custodian or attorney who receives a written instruction described in this subsection shall:

(1) sign an affidavit of regularity under section 13 of this chapter with respect to the electronic will to be revoked by the testator;

(2) create a complete converted copy (as defined in section 3(3) of this chapter) of the electronic will being revoked;

(3) make the signed affidavit of regularity a permanent attachment to or part of the complete converted copy;

(4) follow the testator's written instruction by:

(A) permanently deleting the electronic record for the revoked electronic will; or

(B) rendering the electronic record associated with the revoked electronic will unreadable and nonretrievable; and

(5) transmit or issue the complete converted copy of the revoked electronic will to the testator.

(f) If the electronic record for a particular electronic will or a complete converted copy of the electronic will cannot be found after the testator's death, the presumption that applied to a lost or missing traditional paper will shall be applied to the lost or missing electronic will.

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-8, IN ST 29-1-21-8

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29-1-21-8 Revocation, IN ST 29-1-21-8

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West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-9

29-1-21-9 Complete nonelectronic copies of will

Effective: July 1, 2018
Currentness

Sec. 9. (a) If:

(1) a person discovers an accurate and substantially complete copy of an electronic will that:

(A) bears the signatures of the testator and attesting witnesses; and

(B) lacks some other portion of the electronic will; or

(2) the electronic record for an electronic will becomes lost or corrupted so that the absence of unauthorized alteration or tampering cannot be assured by viewing the electronic record;

the attorney, custodian, or living testator with access to a complete nonelectronic copy of the electronic will or the person described in subdivision (1) may prepare a complete converted copy of the electronic will using all available information.

(b) A person who creates a complete converted copy of an electronic will under subsection (a) shall sign an affidavit that specifies the following:

(1) When the electronic will was created if not specified in the body of the electronic will.

(2) When the electronic will was discovered.

(3) How the electronic will was discovered.

(4) The method and format that the electronic will was stored under (if known).

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(5) The methods (if any) used to:

(A) prevent alterations to the electronic record; or

(B) ensure the accuracy and authenticity of the electronic record.

(6) Whether the electronic will has been altered since its creation.

(7) Confirmation that an electronic record, including any associated document integrity evidence for the electronic will, was created at the time the testator made the electronic will.

(8) Confirmation by the person responsible for:

(A) creating the complete converted copy; and

(B) signing the affidavit;

that, to the best of the person's knowledge, the electronic record has not been altered while in the custody of the current custodian or any prior custodian.

(9) Confirmation that the complete converted copy is a complete and correct duplication of:

(A) the electronic will; and

(B) the date, place, and time of the electronic will's execution by the testator and the attesting witnesses.

(c) A complete converted copy derived from a complete and correct electronic will may be offered for and admitted to probate in the same manner as a traditional paper will.

(d) A complete converted copy derived from a complete and correct self-proved electronic will shall be presumed to be valid and, absent any objection, admitted to probate without the need for additional proof.

(e) If a complete converted copy is generated from a complete and intact electronic record associated with an electronic will at or after the time of its execution, the person who generates the complete converted copy is not required to sign the affidavit described in subsection (b).

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Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-9, IN ST 29-1-21-9

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West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-10

29-1-21-10 Custodians; appointment; responsibilities; succession; transfer

Effective: July 1, 2019
Currentness

Sec. 10. (a) Any person with the written authorization of the testator may maintain, receive, or transfer custody of:

(1) the electronic record associated with an electronic will;

(2) any document integrity evidence associated with an electronic record or electronic will; or

(3) a complete converted copy of the electronic will.

A testator may identify and designate an adult individual as the custodian of the testator's electronic will within the electronic record of an electronic will.

(b) A custodian of an electronic will, any accompanying self-proving clause, or any document integrity evidence logically associated with the electronic will, has the following responsibilities:

(1) To use best practices to maintain custody of the electronic record for the electronic will and any accompanying document integrity evidence.

(2) To use best practices and commercially reasonable means to:

(A) maintain the privacy and security of the electronic record associated with an electronic will; and

(B) exercise reasonable care to guard against unauthorized:

(i) disclosure of; and

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(ii) alteration of or tampering with;

the electronic record.

(3) To maintain electronic and conceptual separation between different testators and their respective electronic records and electronic wills if the custodian maintains custody of two (2) or more electronic records or electronic wills.

(4) To promptly generate a complete converted copy of each electronic will and all accompanying document integrity evidence after receiving a written request to do so from a living testator, the court, or another authorized person.

(5) To promptly respond to a written instruction from the living testator or another person with written authorization originating from the living testator to transfer custody of the electronic will to a successor custodian.

(6) To transfer the entire electronic record of the electronic will to a successor custodian upon the receipt of a written instruction requesting the transfer of the entire electronic record of an electronic will to a successor custodian.

(7) To provide an executed delivery receipt to the outgoing custodian who transfers:

(A) the electronic record;

(B) the electronic will;

(C) any accompanying document integrity evidence; or

(D) information pertaining to the format in which the electronic record or electronic will is received;

if the receiving custodian agrees to assume responsibility for an electronic record or an electronic will and all associated documents from an outgoing custodian.

(8) To perform the following upon the death of the testator:

(A) To relinquish possession and control of the:

(i) electronic record associated with the testator's electronic will; or

(ii) complete converted copy of the testator's electronic will (if applicable);

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to a person authorized to receive these items under section 11 of this chapter.

(B) To comply with the court order requiring the electronic filing or delivery of the electronic will and any accompanying document integrity evidence or a complete converted copy of the electronic will, as applicable, with the court.

(C) To provide an accurate copy of:

(i) an electronic record; or

(ii) a complete converted copy of the testator's electronic will;

to any interested person who requests a copy for the purpose of submitting the electronic will for probate.

(D) To furnish, for any court hearing or matter involving an electronic will currently or previously stored by the custodian, any information requested by the court pertaining to the custodian's policies, practices, or qualifications as they relate to the maintenance, production, or storage of electronic wills.

(c) A proposed successor custodian has no obligation to accept delivery of an electronic will from an outgoing custodian or to accept the responsibility of maintaining custody of an electronic record associated with an electronic will. A successor custodian's execution of a delivery receipt under subsection (b)(7) constitutes acceptance of the appointment as successor custodian.

(d) If a custodian wishes to discontinue custody of an electronic will, the custodian must send written notice to the testator or, if the testator's whereabouts are unknown, to any other person:

(1) holding written authority from the testator; or

(2) identifiable from the custodian's records.

(e) A written notice described in subsection (d) must inform the testator or other person authorized to act on the testator's behalf that the custodian will transfer custody of the electronic record associated with the electronic will to a successor custodian chosen by the current custodian unless the testator or person authorized to act on behalf of the testator provides the custodian with written direction not later than thirty (30) days after the written notice described in subsection (d) was first issued.

(f) If the testator or person authorized to act on the testator's behalf does not respond to the current custodian with a contrary written instruction before the end of the thirty (30) day period described in subsection (e), the custodian may, in order of decreasing priority, dispose of the electronic record associated with the electronic will in one (1) of the following ways:

(1) The current custodian may transfer custody of the electronic record for the electronic will to a successor custodian previously designated by the testator.

(2) The current custodian may transfer custody of the electronic will to a successor custodian selected by the current custodian.

(3) The current custodian may transmit a complete converted copy of the electronic will and accompanying affidavit of regularity under section 13 of this chapter to the testator or other person authorized to act on behalf of the testator.

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018. Amended by P.L.10-2019, SEC.117, eff. July 1, 2019.

I.C. 29-1-21-10, IN ST 29-1-21-10

The statutes and Constitution are current with all legislation of the 2021 First Regular Session of the 122nd General Assembly effective through April 20, 2021.

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West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-11

29-1-21-11 Death of testator

Effective: July 1, 2018
Currentness

Sec. 11. (a) After a testator's death becomes known to a custodian or other person authorized to act on behalf of the testator, custody of the electronic record associated with the testator's will or a complete converted copy of the testator's electronic will shall be delivered to one (1) of the following individuals, in decreasing order of priority, unless the testator has left other written instructions concerning the disposition of the testator's electronic will:

(1) A person nominated in the electronic will as a personal representative of the testator's estate and having priority to seek appointment.

(2) A surviving spouse of the testator.

(3) A living adult child of the testator.

(4) A living parent of the testator.

(5) A living adult sibling of the testator.

(6) A beneficiary named or defined in the electronic will and entitled to share in the testator's residuary probate estate.

(7) The clerk of the probate court having jurisdiction over the testator's estate if the custodian or other person authorized to act on behalf of the testator has knowledge of:

(A) the testator's domicile; or

(B) the location of the testator's property at the time of the testator's death.

The custodian or other person may use any means of delivery, including electronic means, that is commercially reasonable.

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(b) After the death of a testator, subsection (a) and IC 29-1-7-3(b) and IC 29-1-7-3(c) shall apply to electronic wills and permit the personal representative named in an electronic will or any other interested person to file a verified written application requesting a probate court with subject matter jurisdiction to order the delivery of the electronic will to the clerk of the probate court.

(c) If a custodian or other person has possession of both the electronic record for a deceased testator's electronic will and a complete converted copy of the electronic will:

(1) the custodian or other person shall deliver only the complete converted copy of the electronic will if delivery is made to the clerk of the probate court under subsection (a)(7); and

(2) the custodian or other person shall deliver both the electronic record and the complete converted copy of the electronic will if delivery is made to a person named in the testator's written instructions or to any other person listed in subsection (a).

(d) If the custodian or other person delivers the electronic will to the clerk of the probate court under subsection (a)(7) or subsection (b), the custodian or other person shall deliver only a complete converted copy of the electronic will to the clerk, unless the court rules or other applicable laws specifically require otherwise.

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-11, IN ST 29-1-21-11

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West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
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IC 29-1-21-12

29-1-21-12 Destruction

Effective: July 1, 2018
Currentness

Sec. 12. (a) As used in this section, "destroy" means any act that:

(1) permanently deletes the electronic record associated with an electronic will; or

(2) renders the electronic record associated with an electronic will unreadable and nonretrievable.

(b) Any custodian or attorney holding an electronic will may destroy the electronic record associated with the electronic will and any accompanying document integrity evidence (as applicable) at any time following the:

(1) fifth anniversary of a testator's will being admitted to probate;

(2) fifth anniversary of the date that the custodian ceases to have custody of the electronic will;

(3) tenth anniversary of the testator's death;

(4) one hundredth anniversary of an electronic will's execution; or

(5) valid revocation of an electronic will.

(c) This section does not require a custodian, attorney, or other person to destroy a complete converted copy of an electronic will.

Credits
As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-12, IN ST 29-1-21-12

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29-1-21-12 Destruction, IN ST 29-1-21-12

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West's Annotated Indiana Code
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IC 29-1-21-13

29-1-21-13 Affidavit of regularity

Effective: July 1, 2018
Currentness

Sec. 13. A custodian or other person required or permitted to create an affidavit of regularity under this chapter may use a form that substantially complies with the following format:

"Affidavit of Regularity for Electronic Will

(1) Beginning on (insert date of first possession of the electronic will by the signatory of this affidavit) and continuing to the date and time of this affidavit, the undersigned person has had possession of (circle all that apply):

(A) the electronic record for the electronic will;

(B) a complete converted copy of the electronic will;

of (insert name of testator), which was electronically executed on (insert date of electronic signing and attestation or insert reference to time and date stamp).

(2) (Insert client number, customer number, document number, or other unique identifier if any) is the unique identifier that the undersigned person assigned to this electronic will in the undersigned person's records.

(3) The undersigned person believes that the testator (circle one (1) of the following):

(A) Is currently alive.

(B) Died on or about (insert date of testator's death).

(4) The undersigned person is (circle all of the following that apply):

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(A) Transferring custody of the electronic record for the electronic will to the living testator of the electronic will.

(B) Transferring custody of the electronic record for the electronic will to (insert name and address of successor custodian).

(C) Transferring a complete converted copy of the electronic will to (insert the name and address of the authorized recipient).

(D) Submitting the electronic record for the electronic will to the (insert the name of the court) for probate.

(E) Submitting a complete converted copy for the electronic will to the (insert the name of the court) for probate.

(5) If the undersigned person is transferring or submitting the electronic record for the electronic will, it is in the following format (insert description of the format).

(6) If the undersigned person is transferring or submitting the electronic record for the electronic will, the undersigned person affirms, under penalty of perjury, that the electronic record has been in the undersigned person's possession or control for the period of time stated in paragraph (1) and that during the specified period of time the electronic record showed no indication of unauthorized alteration or tampering.

(7) The undersigned person affirms, under penalty of perjury, that (circle one (1) of the following):

(A) The undersigned has no knowledge of the testator's later execution of a will or codicil that amends, revokes, or supersedes the electronic will described in paragraph (1).

(B) The undersigned believes that the testator purportedly revoked or amended the electronic will described in paragraph (1) on (insert date, if known, or approximate time frame if date is not known), by (insert known details about the amendment or revocation).

(8) The undersigned person is (circle one (1) if applicable):

(A) The living testator who executed the electronic will.

(B) An attorney admitted to practice law in the state of Indiana.

(C) An attorney in fact or other person acting on the written authority of the testator.

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(D) A personal representative nominated in the electronic will.

(E) An interested person (as defined in IC 29-1-1-3) with respect to the estate of the testator.

(F) A custodian currently in compliance with all applicable requirements under IC 29-1-21-10.

____

(insert date and time of custodian's or other person's signature)

____

(insert name and signature of custodian or other person signing)

____

(insert job title or position of signatory if signatory is not an individual).".

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-13, IN ST 29-1-21-13

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West's Annotated Indiana Code
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IC 29-1-21-14

29-1-21-14 Evidence

Effective: July 1, 2018
Currentness

Sec. 14. (a) Regardless of the number of custodians or other persons who receive, hold, or transfer copies of an electronic record for an electronic will to other custodians, other authorized persons, or the testator:

(1) the electronic record, including any accompanying document integrity evidence (if applicable), is prima facie evidence of:

(A) the validity of the electronic will; and

(B) freedom from unauthorized alteration or tampering unless evidence of alteration or tampering is evident on the face of the electronic record;

(2) a complete converted copy of an electronic will is prima facie evidence of:

(A) the validity of the electronic will; and

(B) freedom from unauthorized alteration or tampering;

if the electronic will was executed in compliance with this chapter; and

(3) except as provided in section 16(e)(2) of this chapter, a custodian or other person is not required to make or issue an affidavit regarding the custodian's or other person's custody of the electronic record for an electronic will or custody of a complete converted copy of the electronic will. Any custodian or other person may, however, make an affidavit of regularity under section 13 of this chapter if any objection is asserted or any doubt is raised concerning the validity of the electronic will or about any alleged unauthorized alteration of the electronic will.

(b) The presumption of:

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(1) validity; and

(2) freedom from unauthorized alteration or tampering;

described in subsection (a) may be rebutted by clear and convincing evidence or by evidence that the testator executed another electronic will or traditional paper will at a later date.

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-14, IN ST 29-1-21-14

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West's Annotated Indiana Code
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IC 29-1-21-15

29-1-21-15 Electronic copy

Effective: July 1, 2018
Currentness

Sec. 15. (a) As used in this section, "electronic will copy" means a complete converted copy of an electronic will that is deposited with a circuit court clerk under IC 29-1-7-3.1.

(b) The following shall apply to the deposit of an electronic will copy with circuit court clerks:

(1) IC 29-1-7-3.1(a).

(2) IC 29-1-7-3.1(b).

(3) IC 29-1-7-3.1(d).

(4) IC 29-1-7-3.1(e).

(5) IC 29-1-7-3.1(g).

(6) IC 29-1-7-3.1(h).

(7) IC 29-1-7-3.1(i).

(8) IC 29-1-7-3.1(j).

(c) A person or depositor may deposit an electronic will copy with the circuit court clerk under IC 29-1-7-3.1 by:

(1) submitting a paper copy of the complete converted copy of the electronic will copy to the clerk; or

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(2) electronically filing a readable and printable copy of the completed converted copy of the electronic will copy with the clerk if permitted by court rules.

(d) If the circuit court clerk receives a paper copy of a complete converted copy, the clerk shall promptly do the following:

(1) Place the electronic will copy in an envelope.

(2) Securely seal the envelope.

(3) Give or send a confirmation receipt verifying reception of the electronic will copy to the person or depositor.

(e) If the circuit court clerk receives an electronic copy of a complete converted copy of an electronic will, the clerk shall do the following:

(1) Print the entire complete converted copy.

(2) Place the printed copy described in subdivision (1) in an envelope.

(3) Securely seal the envelope.

(4) Give or send a confirmation receipt verifying reception of the will to the person or depositor.

(f) The circuit court clerk, after sealing a complete converted copy of an electronic will in an envelope as described in subsection (e), shall do the following:

(1) Designate the:

(A) date of deposit;

(B) name of the testator; and

(C) name and address of the depositor;

on the envelope.

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(2) Index the electronic will alphabetically by the name of the testator.

An envelope and electronic will copy deposited under this section or IC 29-1-7-3.1 is confidential under IC 5-14-3.

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-15, IN ST 29-1-21-15

The statutes and Constitution are current with all legislation of the 2021 First Regular Session of the 122nd General Assembly effective through April 20, 2021.

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Proposed Legislation

West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-16

29-1-21-16 Filings

Effective: July 1, 2018
Currentness

Sec. 16. (a) As used in this section and for the purpose of offering or submitting an electronic will in probate under IC 29-1-7, the "filing of an electronic will" means the electronic filing of a complete converted copy of the associated electronic will.

(b) When filing an electronic will, the filing of any accompanying document integrity evidence or identity verification is not required unless explicitly required by the court.

(c) If a person files an electronic will:

(1) for the purpose of probating the electronic will; and

(2) including accompanying:

(A) document integrity evidence;

(B) identity verification evidence; or

(C) evidence described in both clauses (A) and (B);

in the filing or in response to a court order under subsection (e)(2), the person shall file a complete and unredacted copy of the evidence described in clauses (A) and (B) as a nonpublic document under Ind. Administrative Rule 9(G). All personally identifying information pertaining to the testator or the attesting witnesses shall be redacted in the publicly filed copy.

(d) If an electronic will includes a self-proving clause that complies with section 4(c) of this chapter, the testator's and witnesses' compliance with the execution requirements shall be presumed upon the filing of the electronic will with the court without the

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need for any additional testimony or an accompanying affidavit. The presumption described in this subsection may be subject to rebuttal or objection on the grounds of fraud, forgery, or impersonation.

(e) After determining that a testator is dead and that the testator's electronic will has been executed in compliance with applicable law, the court may:

(1) enter an order, without requiring the submission of additional evidence, admitting the electronic will to probate as the last will of the deceased testator unless objections are filed under IC 29-1-7-16; or

(2) require the petitioner to submit additional evidence regarding:

(A) the proper execution of the electronic will; or

(B) the electronic will's freedom from unauthorized alteration or tampering after its execution.

The court may require the submission of additional evidence under subdivision (2) on the court's own motion or in response to an objection filed under IC 29-1-7-16.

(f) The additional evidence that the court may require and rely upon under subsection (e)(2) may include one (1) or more of the following:

(1) Readable copies of the document integrity evidence or the identity verification evidence associated with the electronic will.

(2) All or part of the electronic record (if available) in a native or computer readable form.

(3) A sworn or verified affidavit from:

(A) an attorney or other person who supervised the execution of the electronic will; or

(B) one (1) or more of the attesting witnesses.

(4) An affidavit signed under section 9(b) of this chapter by a person who created a complete converted copy of the electronic will.

(5) A sworn or verified affidavit from a qualified person that:

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(A) describes the person's training and expertise;

(B) describes the results of the person's forensic examination of the electronic record associated with:

(i) the electronic will at issue; or

(ii) any other relevant evidence; and

(C) affirms that the electronic will was not altered or tampered with after its execution.

(6) Any other evidence, including other affidavits or testimony, that the court considers material or probative on the issues of proper execution or unauthorized alteration or tampering.

(g) If the court enters an order admitting an electronic will to probate after receiving additional evidence, any of the additional evidence may be disputed through a will contest that is timely filed under IC 29-1-7-17.

Credits
As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-16, IN ST 29-1-21-16
The statutes and Constitution are current with all legislation of the 2021 First Regular Session of the 122nd General Assembly effective through April 20, 2021.

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IC 29-1-21-17

29-1-21-17 Rejection

Effective: July 1, 2019
Currentness

Sec. 17. (a) This section shall apply to the situation created by:

(1) the rejection of a petition to probate a deceased testator's electronic or traditional paper will; or

(2) the revocation of a deceased testator's electronic will due to the timely filing of a will contest as described in IC 29-1-7-17.

(b) The following terms are defined for this section:

(1) "Other electronic will" means:

(A) an electronic will that the same testator purportedly executed in compliance with applicable laws on a date that preceded the date of execution seen in the rejected will; or

(B) an electronic will that the same testator purportedly executed in compliance with applicable laws on a date that followed the date of execution seen on the rejected will;

where the petitioner or proponent for the electronic will is not aware of any other paper will or electronic will executed by the testator at a date later than the date of the testator's purposed execution of the other electronic will.

(2) "Rejected will" means a will that is rejected for a reason described in subsection (a).

(c) On or before the end of the time period specified in IC 29-1-7-15.1(g)(2) or IC 29-1-7-15.1(g)(3), any interested person may file a petition requesting probate of another electronic will associated with the testator. A complete converted copy of the other electronic will and an affidavit of regularity must accompany any petition filed under this subsection. The complete converted copy of another electronic will is prima facie evidence of:

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(1) the substance of the other electronic will; and

(2) the proper execution of the other electronic will.

(d) Section 16 of this chapter shall apply to any proceeding concerning the probate of another electronic will of a deceased testator. In the absence of:

(1) clear and convincing evidence; and

(2) written evidence;

of the testator's contrary intentions, the court shall presume that the deceased testator would have preferred the probate and enforcement of the testator's other electronic will to intestacy.

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018. Amended by P.L.231-2019, SEC.19, eff. July 1, 2019.

I.C. 29-1-21-17, IN ST 29-1-21-17

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Proposed Legislation

West's Annotated Indiana Code
Title 29. Probate
Article 1. Probate Code
Chapter 21. Electronic Wills

IC 29-1-21-18

29-1-21-18 Digital or electronic transfer or transmission

Effective: July 1, 2018
Currentness

Sec. 18. (a) For purpose of IC 29-3, IC 30-5, and IC 32-39:

(1) the electronic record for an electronic will is a "digital asset" as that term is defined in IC 32-39-1-10;

(2) the electronic record for an electronic will is not an "electronic communication" as defined in 18 U.S.C. 2510(12) or IC 32-39-1-12;

(3) the digital or electronic transfer or transmission of the electronic record for an electronic will between any two (2) persons other than the testator and the testator's attorney is an electronic communication as defined in 18 U.S.C. 2510(12) or IC 32-39-1-12;

(4) a custodian (as defined in section 3(4) of this chapter) of an electronic will is a "custodian" as defined in IC 32-39-1-8; and

(5) the following individuals are "users" for purposes of IC 32-39 if the testator, attorney, or other authorized person contracts with another person to store the electronic record for the electronic will:

(A) The testator of an electronic will.

(B) The attorney representing the testator.

(C) Any other person with authorized possession of or authorized access to the electronic record for the electronic will.

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(b) The execution or revocation of an electronic will is not a contract or a "transaction in or affecting interstate or foreign commerce" for purposes of the federal E-SIGN Act, 15 U.S.C. 7001.

(c) The execution or revocation of an electronic will is not a contract or "transaction" for purposes of IC 26-2-8 and the exclusion stated in IC 26-2-8-103(b)(1) continues in effect with respect to electronic wills and codicils.

Credits

As added by P.L.40-2018, SEC.2, eff. July 1, 2018.

I.C. 29-1-21-18, IN ST 29-1-21-18

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H 04/29/2021 Signed by the Governor

First Regular Session of the 122nd General Assembly (2021)

PRINTING CODE. Amendments: Whenever an existing statute (or a section of the Indiana Constitution) is being amended, the text of the existing provision will appear in this style type, additions will appear in **this style type**, and deletions will appear in ~~this style type.~~

Additions: Whenever a new statutory provision is being enacted (or a new constitutional provision adopted), the text of the new provision will appear in **this style type**. Also, the word **NEW** will appear in that style type in the introductory clause of each SECTION that adds a new provision to the Indiana Code or the Indiana Constitution.

Conflict reconciliation: Text in a statute in *this style type* or ~~*this style type*~~ reconciles conflicts between statutes enacted by the 2020 Regular Session of the General Assembly.

HOUSE ENROLLED ACT No. 1255

AN ACT to amend the Indiana Code concerning probate.

Be it enacted by the General Assembly of the State of Indiana:

SECTION 1. IC 29-1-1-3, AS AMENDED BY P.L.231-2019, SECTION 5, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 3. (a) The following definitions apply throughout this article, unless otherwise apparent from the context:

(1) "Child" includes an adopted child or a child that is in gestation before the death of a deceased parent and born within forty-three (43) weeks after the death of that parent. The term does not include a grandchild or other more remote descendants, nor, except as provided in IC 29-1-2-7, a child born out of wedlock.

(2) "Claimant" means a person having a claim against the decedent's estate as described in IC 29-1-14-1(a).

(3) "Claims" includes liabilities of a decedent which survive, whether arising in contract or in tort or otherwise, expenses of administration, and all taxes imposed by reason of the person's death. However, for purposes of IC 29-1-2-1 and IC 29-1-3-1, the term does not include taxes imposed by reason of the person's death.

(4) "Court" means the court having probate jurisdiction.

(5) "Decedent" means one who dies testate or intestate.

(6) "Devise" or "legacy", when used as a noun, means a testamentary disposition of either real or personal property or both.

(7) "Devise", when used as a verb, means to dispose of either real or personal property or both by will.
(8) "Devisee" includes legatee, and "legatee" includes devisee.
(9) "Directed paralegal" means a nonlawyer assistant who is employed, retained, or otherwise associated with a licensed attorney or law firm and whose work is directly supervised by a licensed attorney, as required by Rule 5.3 of the Rules of Professional Conduct.
~~(9)~~ **(10)** "Distributee" denotes those persons who are entitled to the real and personal property of a decedent under a will, under the statutes of intestate succession, or under IC 29-1-4-1.
~~(10)~~ **(11)** "Estate" denotes the real and personal property of the decedent or protected person, as from time to time changed in form by sale, reinvestment, or otherwise, and augmented by any accretions and additions thereto and substitutions therefor and diminished by any decreases and distributions therefrom.
~~(11)~~ **(12)** "Expenses of administration" includes expenses incurred by or on behalf of a decedent's estate in the collection of assets, the payment of debts, and the distribution of property to the persons entitled to the property, including funeral expenses, expenses of a tombstone, expenses incurred in the disposition of the decedent's body, executor's commissions, attorney's fees, and miscellaneous expenses.
~~(12)~~ **(13)** "Fiduciary" includes a:
(A) personal representative;
(B) guardian;
(C) conservator;
(D) trustee; and
(E) person designated in a protective order to act on behalf of a protected person.
~~(13)~~ **(14)** "Heirs" denotes those persons, including the surviving spouse, who are entitled under the statutes of intestate succession to the real and personal property of a decedent on the decedent's death intestate, unless otherwise defined or limited by the will.
(15) For purposes of IC 29-1-5, and with respect to testators and attesting witnesses, "in the presence of" has the meaning set forth in subdivision (16).
(16) For purposes of IC 29-1-5, and with respect to testators and attesting witnesses, "presence" means a process of signing and witnessing in which:
(A) the testator and witness are:
(i) directly present with each other in the same physical

space; or

(ii) able to interact with each other in real time through use of any audiovisual communications technology now known or later developed;

(B) the testator and witness are able to positively identify each other; and

(C) each witness is able to interact with the testator and with each other by observing:

(i) the testator's expression of intent to make a will;

(ii) the testator's actions in executing or directing the execution of the testator's will; and

(iii) the actions of other witnesses when signing the will.

The term includes the use of technology or learned skills for the purpose of assisting with hearing, eyesight, and speech, or for the purpose of compensating for a hearing, eyesight, or speech impairment.

~~(14)~~ **(17)** "Incapacitated" has the meaning set forth in IC 29-3-1-7.5.

~~(15)~~ **(18)** "Interested persons" means heirs, devisees, spouses, creditors, or any others having a property right in or claim against the estate of a decedent being administered. This meaning may vary at different stages and different parts of a proceeding and must be determined according to the particular purpose and matter involved.

~~(16)~~ **(19)** "Issue" of a person, when used to refer to persons who take by intestate succession, includes all lawful lineal descendants except those who are lineal descendants of living lineal descendants of the intestate.

~~(17)~~ **(20)** "Lease" includes an oil and gas lease or other mineral lease.

~~(18)~~ **(21)** "Letters" includes letters testamentary, letters of administration, and letters of guardianship.

~~(19)~~ **(22)** "Minor" or "minor child" or "minority" refers to any person under the age of eighteen (18) years.

~~(20)~~ **(23)** "Mortgage" includes deed of trust, vendor's lien, and chattel mortgage.

~~(21)~~ **(24)** "Net estate" refers to the real and personal property of a decedent less the allowances provided under IC 29-1-4-1 and enforceable claims against the estate.

~~(22)~~ **(25)** "No contest provision" refers to a provision of a will that, if given effect, would reduce or eliminate the interest of a beneficiary of the will who, directly or indirectly, initiates or

otherwise pursues:

(A) an action to contest the admissibility or validity of the will;

(B) an action to set aside a term of the will; or

(C) any other act to frustrate or defeat the testator's intent as expressed in the terms of the will.

(26) "Observe" means to perceive another's actions or expressions of intent through the senses of eyesight or hearing, or both. The term includes perceptions involving the use of technology or learned skills to:

(A) assist the person's capabilities of eyesight or hearing, or both; or

(B) compensate for an impairment of the person's capabilities of eyesight or hearing, or both.

(27) "Observing" has the meaning set forth in subdivision (26).

~~(23)~~ **(28)** "Person" means:

(A) an individual;

(B) a corporation;

(C) a trust;

(D) a limited liability company;

(E) a partnership;

(F) a business trust;

(G) an estate;

(H) an association;

(I) a joint venture;

(J) a government or political subdivision;

(K) an agency;

(L) an instrumentality; or

(M) any other legal or commercial entity.

~~(24)~~ **(29)** "Personal property" includes interests in goods, money, choses in action, evidences of debt, and chattels real.

~~(25)~~ **(30)** "Personal representative" includes executor, administrator, administrator with the will annexed, administrator de bonis non, and special administrator.

~~(26)~~ **(31)** "Petition for administration" means a petition filed under IC 29-1-7-5 for the:

(A) probate of a will and for issuance of letters testamentary;

(B) appointment of an administrator with the will annexed; or

(C) appointment of an administrator.

~~(27)~~ **(32)** "Probate estate" denotes the property transferred at the death of a decedent under the decedent's will or under IC 29-1-2, in the case of a decedent dying intestate.

~~(28)~~ **(33)** "Property" includes both real and personal property.
~~(29)~~ **(34)** "Protected person" has the meaning set forth in IC 29-3-1-13.
~~(30)~~ **(35)** "Real property" includes estates and interests in land, corporeal or incorporeal, legal or equitable, other than chattels real.
~~(31)~~ **(36)** "Unit" means the estate recovery unit of the office of Medicaid policy and planning established under IC 12-8-6.5-1.
~~(32)~~ **(37)** "Unit address" means the unit's mailing address that appears on the unit's Internet web site.
~~(33)~~ **(38)** "Will" includes all wills, testaments, and codicils. The term also includes a testamentary instrument which merely appoints an executor or revokes or revives another will.

(b) The following rules of construction apply throughout this article unless otherwise apparent from the context:

(1) The singular number includes the plural and the plural number includes the singular.
(2) The masculine gender includes the feminine and neuter.

SECTION 2. IC 29-1-5-3 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 3. (a) This section applies to a will executed before, on, or after July 1, 2003. A will, other than a nuncupative will, must be executed by the signature of the testator and of at least two (2) witnesses on:

(1) a will under subsection (b);
(2) a self-proving clause under section 3.1(c) of this chapter; or
(3) a self-proving clause under section 3.1(d) of this chapter.

(b) A will may be attested as follows:

(1) The testator, in the presence of two (2) or more attesting witnesses, shall signify to the witnesses that the instrument is the testator's will and either:
(A) sign the will;
(B) acknowledge the testator's signature already made; or
(C) at the testator's direction and in the testator's presence have someone else sign the testator's name.
(2) The attesting witnesses must sign in the presence of the testator and each other.

An attestation or self-proving clause is not required under this subsection for a valid will.

(c) Under the supervision of an attorney or directed paralegal, the testator and the witnesses may execute and complete the will in two (2) or more original counterparts that exist in a tangible and readable paper form with:

(1) the testator's signature placed on one (1) original counterpart in the presence of attesting witnesses; and

(2) the signatures of the witnesses placed on one (1) or more different counterparts of the same will;

in a tangible and readable paper form. If a will is signed and witnessed in counterparts under this subsection, the testator or an individual acting at the testator's specific direction must physically assemble all of the separately signed paper counterparts of the will and the signatures of the testator and all attesting witnesses not later than five (5) business days after all the paper counterparts have been signed by the testator and witnesses. If the testator directs another individual to assemble the separate, signed paper counterparts of the will into a single composite paper document, the five (5) business day period does not commence until the compiling individual receives all of the separately signed paper counterparts. Any scanned copy or photocopy of the composite document containing all signatures shall be treated as validly signed under this section and may be electronically filed to offer the will for probate under IC 29-1-7. If the testator dies after executing a will under this subsection but before the separate counterparts are assembled into a single composite paper document, the intervening death of the testator shall not affect the validity of the will.

(d) An attorney or directed paralegal must supervise the execution of a will that is signed and witnessed in counterparts as described in subsection (c). An attorney or directed paralegal may supervise the execution of a will in counterparts even if the supervising attorney or directed paralegal is one (1) of the will's attesting witnesses. When an attorney or directed paralegal supervises the execution of a will in counterparts as described in subsection (c), the attorney or directed paralegal must sign, date, and complete an affidavit of compliance within a reasonable time after all paper counterparts of the will have been signed by the testator and the witnesses. An affidavit of compliance under this subsection must be sworn or affirmed by the signing attorney or directed paralegal under the penalties of perjury and must contain the following information:

(1) The name and residence address of the testator.

(2) The name and:

(A) residential address; or

(B) business address;

for each witness who signs the will.

(3) The address, city, and state in which the testator was physically located at the time the testator signed an original counterpart of the will.
(4) The city and state in which each attesting witness was physically located when the witness signed an original counterpart of the will as a witness.
(5) A description of the method and form of identification used to confirm the identity of the testator to the witnesses and to the supervising attorney or directed paralegal, as applicable.
(6) A description of the audiovisual technology or other method used by the supervising attorney or paralegal, as applicable, the testator, and the witnesses for the purpose of interacting with each other in real time during the signing process.
(7) A description of the method used by the testator and the witnesses to identify the location of each page break within the text of the will and to confirm that the separate paper counterparts of the will were identical in content.
(8) A general description of how and when the attorney or paralegal, as applicable, physically combined the separate, signed paper counterparts of the will into a single composite paper document containing the will, the signature of the testator, and the signatures of all attesting witnesses.
(9) The name, business or residence address, and telephone number of the attorney or directed paralegal who supervised the execution and witnessing of the will in counterparts.
(10) Any other information that the supervising attorney or directed paralegal, as applicable, considers to be material with respect to:
(A) the testator's capacity to sign a valid will; and
(B) the testator's and witnesses' compliance with subsection (c).

(e) When a party files a petition under IC 29-1-7 to probate a will that was executed and witnessed in counterparts under subsection (c), the party shall file a true copy of the affidavit of compliance under subsection (d) with the petition or at any time ordered by the court. A party who files a copy of the affidavit of compliance may redact private information from the affidavit in a manner consistent with Rule 5 of the Indiana Rules on Access to Court Records. If a will is executed and witnessed in counterparts under subsection (c) but without the supervision of an attorney or

directed paralegal and that will is later offered for probate under IC 29-1-7, the will is voidable in the discretion of the court, upon objection to probate filed under IC 29-1-7-16, or upon a timely filed will contest under IC 2-29-7-17.

~~(c)~~ **(f)** A will that is executed substantially in compliance with subsection (b) will not be rendered invalid by the existence of:

(1) an attestation or self-proving clause or other language; or

(2) additional signatures;

not required by subsection (b).

~~(d)~~ **(g)** A will executed in accordance with subsection (b) is self-proved if the witness signatures follow an attestation or self-proving clause or other declaration indicating in substance the facts set forth in section 3.1(c) or 3.1(d) of this chapter.

~~(e)~~ **(h)** This section shall be construed in favor of effectuating the testator's intent to make a valid will.

SECTION 3. IC 29-1-5-3.1 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 3.1. (a) This section applies to a will executed before, on, or after July 1, 2003. When a will is executed, the will may be:

(1) attested; and

(2) made self-proving;

by incorporating into or attaching to the will a self-proving clause that meets the requirements of subsection (c) or (d). If the testator and witnesses sign a self-proving clause that meets the requirements of subsection (c) or (d) at the time the will is executed, no other signatures of the testator and witnesses are required for the will to be validly executed and self-proved.

(b) If a will is executed by the signatures of the testator and witnesses on an attestation clause under section 3(b) of this chapter, the will may be made self-proving at a later date by attaching to the will a self-proving clause signed by the testator and witnesses that meets the requirements of subsection (c) or (d).

(c) A self-proving clause must contain the acknowledgment of the will by the testator and the statements of the witnesses, each made under the laws of Indiana and evidenced by the signatures of the testator and witnesses (which may be made under the penalties for perjury) attached or annexed to the will in form and content substantially as follows:

We, the undersigned testator and the undersigned witnesses, respectively, whose names are signed to the attached or foregoing instrument declare:

(1) that the testator executed the instrument as the testator's will;

(2) that, in the presence of both witnesses, the testator signed or acknowledged the signature already made or directed another to sign for the testator in the testator's presence;
(3) that the testator executed the will as a free and voluntary act for the purposes expressed in it;
(4) that each of the witnesses, in the presence of the testator and of each other, signed the will as a witness;
(5) that the testator was of sound mind when the will was executed; and
(6) that to the best knowledge of each of the witnesses the testator was, at the time the will was executed, at least eighteen (18) years of age or was a member of the armed forces or of the merchant marine of the United States or its allies.

	______________
	Testator
______________	______________
Date	Witness
	______________
	Witness

(d) A will is attested and self-proved if the will includes or has attached a clause signed by the testator and the witnesses that indicates in substance that:
(1) the testator signified that the instrument is the testator's will;
(2) in the presence of at least two (2) witnesses, the testator signed the instrument or acknowledged the testator's signature already made or directed another to sign for the testator in the testator's presence;
(3) the testator executed the instrument freely and voluntarily for the purposes expressed in it;
(4) each of the witnesses, in the testator's presence and in the presence of all other witnesses, is executing the instrument as a witness;
(5) the testator was of sound mind when the will was executed; and
(6) the testator is, to the best of the knowledge of each of the witnesses, either:
(A) at least eighteen (18) years of age; or
(B) a member of the armed forces or the merchant marine of the United States or its allies.

(e) If the testator and the attesting witnesses executed the will in two (2) or more counterparts on paper under section 3(c) of this chapter, the self-proving clause, if applicable, for the will must

substantially be in the following form:

"We, the undersigned testator and undersigned witnesses, respectively, whose names are signed to the attached or foregoing instrument, declare the following:

(1) That the undersigned testator and witnesses interacted with each other in real time through the use of technology, and each witness was able to observe the testator and other witnesses throughout the signing process.

(2) That the testator executed a complete counterpart of the instrument, in a readable form on paper, as the testator's will.

(3) That, in the presence of both witnesses, the testator:

(A) signed the paper counterpart of the will;

(B) acknowledged the testator's signature already made; or

(C) directed another individual to sign the paper counterpart of the will for the testator in the testator's presence.

(4) That the testator executed the will as a free and voluntary act for the purpose expressed in the will.

(5) That each of the witnesses, in the presence of the testator and of each other, signed one (1) or more other complete paper counterparts of the will as a witness.

(6) That each paper counterpart of the will that was signed by the witness was complete, in readable form, and with content identical to the paper counterpart signed by the testator.

(7) That the testator was of sound mind when the will was executed.

(8) That, to the best knowledge of each witness, the testator was at least eighteen (18) years of age at the time the will was executed or was a member of the armed forces or of the merchant marine of the United States or its allies.".

~~(e)~~ **(f)** This section shall be construed in favor of effectuating the testator's intent to make a valid will.

SECTION 4. IC 29-1-5-3.2 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 3.2. Subject to the applicable Indiana Rules of Trial Procedure **and the Indiana Rules of Evidence,** a ~~videotape~~ **video recording, one (1) or more photographs, or an audio recording made or captured during part or all of a will's execution** may be admissible as evidence of the following:

(1) The proper execution of a will.

(2) The intentions of a testator.

(3) The mental state or capacity of a testator.

(4) The authenticity of a will.

(5) Matters that are determined by a court to be relevant to the probate of a will.

SECTION 5. IC 29-1-5-3.3 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 3.3. (a) This section applies to a will that is signed and witnessed:**

(1) on or after March 31, 2020;

(2) before January 1, 2021; and

(3) in reliance on the Indiana supreme court's order signed and filed on March 31, 2020, under case number 20S-MS-237, or, as supplemented or extended by the supreme court's order signed and filed on May 1, 2020, under case number 20S-MS-237, and by the supreme court's orders signed and filed on May 29, 2020, and November 10, 2020, under case number 20S-CB-123.

(b) Notwithstanding any other law or provision, a will described in subsection (a) that was signed and witnessed in compliance with:

(1) the procedures and requirements set forth in the Indiana supreme court's order signed and filed on March 31, 2020, under case number 20S-MS-237, or, as supplemented or extended by the supreme court's order signed and filed on May 1, 2020, under case number 20S-MS-237 and by the supreme court's order signed and filed on November 10, 2020, under case number 20S-CB-123; or

(2) the procedures and requirements set forth in section 3.1 of this chapter or IC 29-1-21-4;

is not required to be reexecuted or reratified by the testator or the witnesses in compliance with the witnessing procedures specified under section 3 or 3.1 of this chapter as those chapters existed on June 30, 2020.

(c) A proponent who offers a will for probate may demonstrate prima facie compliance with subsection (b) by relying on the contents of a self-proving clause or by describing compliance in a verified petition under IC 29-1-7-4. A person contesting the validity of a will described in subsection (a) has the burden of proving noncompliance with subsection (b).

SECTION 6. IC 29-1-21-3, AS AMENDED BY P.L.231-2019, SECTION 18, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 3. The following terms are defined for this chapter:

~~(1) "Actual presence" means that:~~

~~(A) a witness; or~~

~~(B) another individual who observes the execution of the electronic will;~~

~~is physically present in the same physical location as the testator. The term does not include any form of observation or interaction that is conducted by means of audio, visual, or audiovisual telecommunication or similar technological means.~~

~~(2)~~ **(1)** "Affidavit of regularity" means an affidavit executed by a custodian or other person under section 13 of this chapter with respect to the electronic record for an electronic will or a complete converted copy of an electronic will.

~~(3)~~ **(2)** "Complete converted copy" means a document in any format that:

(A) can be visually perceived in its entirety on a monitor or other display device;

(B) can be printed; and

(C) contains:

(i) the text of the electronic will;

(ii) the electronic signatures of the testator and the witnesses;

(iii) a readable copy of any associated document integrity evidence that may be a part of or attached to the electronic will; and

(iv) a self-proving clause concerning the electronic will, if the electronic will is self-proved.

~~(4)~~ **(3)** "Custodian" means a person, other than:

(A) the testator who executed the electronic will;

(B) an attorney;

(C) a person who is named in the electronic will as a personal representative of the testator's estate; or

(D) a person who is named or defined as a distributee in the electronic will;

who has authorized possession or control of the electronic will. The term may include an attorney in fact serving under a living testator's durable power of attorney who possesses general authority over records, reports, statements, electronic records, or estate planning transactions.

~~(5)~~ **(4)** "Custody" means the authorized possession and control of at least one (1) of the following:

(A) A complete copy of the electronic record for the electronic will, including a self-proving clause if a self-proving clause is executed.

(B) A complete converted copy of the electronic will, if the complete electronic record has been lost or destroyed or the electronic will has been revoked.

(5) "Directed paralegal" means a nonlawyer assistant who is employed, retained, or otherwise associated with a licensed attorney or law firm and whose work is directly supervised by a licensed attorney, as required by Rule 5.3 of the Rules of Professional Conduct.

(6) "Document integrity evidence" means the part of the electronic record for the electronic will that:

(A) is created and maintained electronically;

(B) includes digital markers showing that the electronic will has not been altered after its initial execution and witnessing;

(C) is logically associated with the electronic will in a tamper evident manner so that any change made to the text of the electronic will after its execution is visibly perceptible when the electronic record is displayed or printed;

(D) will generate an error message, invalidate an electronic signature, make the electronic record unreadable, or otherwise display evidence that some alteration was made to the electronic will after its execution; and

(E) displays the following information:

(i) The city and state in which, and the date and time at which, the electronic will was executed by the testator and the attesting witnesses.

(ii) The text of the self-proving clause, if the electronic will is electronically self-proved through use of a self-proving clause executed under section ~~4(c)~~ **4(f)** of this chapter.

(iii) The name of the testator and attesting witnesses.

(iv) The name and address of the person responsible for marking the testator's signature on the electronic will at the testator's direction and in the ~~actual~~ presence of the testator and attesting witnesses.

(v) Copies of or links to the electronic signatures of the testator and the attesting witnesses on the electronic will.

(vi) A general description of the type of identity verification evidence used to verify the testator's identity.

(vii) The text of the advisory instruction, if any, that is provided to the testator under section 6 of this chapter at the time of the execution of the electronic will.

(viii) The content of the cryptographic hash or unique code used to complete the electronic record and make the

electronic will tamper evident if a public key infrastructure or similar secure technology was used to sign or authenticate the electronic will and if the vendor or the software for the technology makes inclusion feasible.

Document integrity evidence may, but is not required to, contain other information about the electronic will such as a unique document number, client number, or other identifier that an attorney or custodian assigns to the electronic will or a link to a secure Internet web site where a complete copy of the electronic will is accessible. The title, heading, or label, if any, that is assigned to the document integrity evidence (such as "certificate of completion", "audit trail", or "audit log") is immaterial.

(7) "Electronic" has the meaning set forth in IC 26-2-8-102.

(8) "Electronic record" has the meaning set forth in IC 26-2-8-102. The term may include one (1) or both of the following:

(A) The document integrity evidence associated with the electronic will.

(B) The identity verification evidence of the testator who executed the electronic will.

(9) "Electronic signature" has the meaning set forth in IC 26-2-8-102.

(10) "Electronic will" means the will of a testator that:

(A) is initially created and maintained as an electronic record;

(B) contains the electronic signatures of:

(i) the testator; and

(ii) the attesting witnesses; and

(C) contains the date and times of the electronic signatures described by clause (B)(i) and (B)(ii).

The term may include a codicil that amends an electronic will or a traditional paper will if the codicil is executed in accordance with the requirements of this chapter.

(11) "Executed" means the signing of an electronic will. The term includes the use of an electronic signature.

(12) "Identity verification evidence" means either:

(A) a copy of the testator's government issued photo identification card; or

(B) any other information that verifies the identity of the testator if derived from one (1) or more of the following sources:

(i) A knowledge based authentication method.

(ii) A physical device.

(iii) A digital certificate using a public key infrastructure.
(iv) A verification or authorization code sent to or used by the testator.
(v) Biometric identification.
(vi) Any other commercially reasonable method for verifying the testator's identity using current or future technology.

(13) "Logically associated" means electronically connected, cross referenced, or linked in a reliable manner.

(14) "Observe" means to perceive another's actions or expressions of intent through the senses of eyesight or hearing, or both. The term includes perceptions involving the use of technology or learned skills to:
(A) assist the person's capabilities of eyesight or hearing, or both; or
(B) compensate for an impairment of the person's capabilities of eyesight or hearing, or both.

(15) "Observing" has the meaning set forth in subdivision (14).

(16) "In the presence of" has the meaning set forth in subdivision (17).

(17) "Presence" means a process of signing and witnessing a will in which:
(A) the testator and the witnesses:
(i) are directly present with each other in the same physical space; or
(ii) are able to interact with each other in real time through the use of audiovisual technology now known or later developed;
(B) the testator and witnesses are able to positively identify each other; and
(C) each witness is able to interact with the testator and with each other by observing:
(i) the testator's expression of intent to execute the electronic will;
(ii) the testator's actions in executing or directing the execution of the testator's electronic will; and
(iii) the actions of every other witness in signing the will.

The term includes the use of technology or learned skills for the purpose of assisting with hearing, eyesight, and speech, or for the purpose of compensating for a hearing, eyesight, or speech impairment.

~~(14)~~ **(18)** "Sign" means valid use of a properly executed electronic signature.

~~(15)~~ **(19)** "Signature" means the authorized use of the testator's name to authenticate an electronic will. The term includes an electronic signature.

~~(16)~~ **(20)** "Tamper evident" means the feature of an electronic record, such as an electronic will or document integrity evidence for an electronic will, that will cause any alteration of or tampering with the electronic record, after it is created or signed, to be perceptible to any person viewing the electronic record when it is printed on paper or viewed on a monitor or other display device. The term applies even if the nature or specific content of the alteration is not perceptible.

~~(17)~~ **(21)** "Traditional paper will" means a will or codicil that is signed by the testator and the attesting witnesses:

(A) on paper; and

(B) in the manner specified in IC 29-1-5-3 or IC 29-1-5-3.1.

~~(18)~~ **(22)** "Will" includes all wills, testaments, and codicils. The term includes:

(A) an electronic will; and

(B) any testamentary instrument that:

(i) appoints an executor; or

(ii) revives or revokes another will.

SECTION 7. IC 29-1-21-4, AS ADDED BY P.L.40-2018, SECTION 2, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 4. (a) To be valid as a will under this article, an electronic will must be executed by the electronic signature of the testator and attested to by the electronic signatures of at least two (2) witnesses in the following manner:

(1) ~~The testator and the attesting witnesses must be in each other's actual presence when the electronic signatures are made in or on the electronic will. The testator and witnesses must directly observe one another as the electronic will is being signed by the parties.~~ **The testator, the attesting witnesses, and any individual who signs for the testator under subdivision (4)(B) must be in each other's presence when the electronic signatures are made in or on the electronic will. A person, including an attorney or directed paralegal, who supervises the execution of the electronic will may act and sign as one (1) of the attesting witnesses if the person does not sign the electronic will at the testator's direction under subdivision (4)(B). The testator and witnesses must be able to interact**

with each other and the witnesses must be able to observe the testator and each other as the electronic will is being signed.

(2) The testator and attesting witnesses must comply with:

(A) the prompts, if any, issued by the software being used to perform the electronic signing; or

(B) the instructions by the person, if any, responsible for supervising the execution of the electronic will.

(3) The testator must state, in the ~~actual~~ presence of the attesting witnesses, that the instrument to be electronically signed is the testator's will.

(4) The testator must:

(A) electronically sign the electronic will in the ~~actual~~ presence of the attesting witnesses; or

(B) direct another adult individual who is not an attesting witness to sign the electronic will on the testator's behalf in the ~~actual~~ presence of the testator and the attesting witnesses.

(5) The attesting witnesses must electronically sign the electronic will in the ~~actual~~ presence of:

(A) the testator; and

(B) ~~one another;~~ **each other;**

after the testator has electronically signed the electronic will.

(6) The:

(A) testator; or

(B) other adult individual who is:

(i) not an attesting witness; and

(ii) acting on behalf of the testator;

must command the software application or user interface to finalize the electronically signed electronic will as an electronic record.

The process described in this section may include as part of the electronic record for the electronic will any identity verification evidence pertaining to the testator or any document integrity evidence for the electronic will.

(b) If the testator and the witnesses are not in each other's physical presence when the electronic will is signed and witnessed and if the testator and the witnesses use audiovisual technology to satisfy the presence requirement in subsection (a) and section 3(17) of this chapter, an attorney or a directed paralegal must supervise the signing and the witnessing of the electronic will.

(c) Within a reasonable time after an attorney or a directed paralegal supervises the signing and witnessing of an electronic will in the manner described in subsection (b), the attorney or directed

paralegal must sign an affidavit of compliance. An affidavit of compliance under this subsection must be sworn to or affirmed by the signing attorney or directed paralegal under the penalties of perjury and must contain:

(1) the name and residential address of the testator;

(2) the name and:

(A) residential address; or

(B) business address;

for each witness who signs the electronic will;

(3) the address, city, and state in which the testator is physically located at the time the testator signs the electronic will;

(4) the city and state in which each attesting witness is physically located when the witness signs the electronic will as a witness;

(5) a description of the method and form of identification used to confirm the identity of the testator to the witnesses and supervising attorney or directed paralegal;

(6) a description of the method used by the supervising attorney or paralegal, testator, and the witnesses for the purpose of interacting with each other in real time during the signing process;

(7) a brief description of the method used to add or capture the electronic signature of the testator and the witnesses;

(8) the name, business or residential address, and telephone number of the attorney or directed paralegal who supervised the execution of the electronic will; and

(9) any other information that the supervising attorney or directed paralegal considers to be material to:

(A) the testator's capacity to sign a valid will; and

(B) the testator's and witnesses' compliance with subsection (a).

(d) When a party files a petition under IC 29-1-7 to probate an electronic will that was executed and witnessed in the manner described in subsection (b), the party shall file a true copy of the affidavit of compliance under subsection (c) with the petition or at any time ordered by the court. A party who files a copy of the affidavit of compliance may redact private information from the affidavit in a manner consistent with Rule 5 of the Rules on Access to Court Records. If an electronic will is executed and witnessed under subsection (c) but without the supervision of an attorney or directed paralegal and that will is later offered for probate under

IC 29-1-7, the will is voidable in the discretion of the court, upon objection to probate filed under IC 29-1-7-16, or upon a timely filed will contest under IC 29-1-7-17.

~~(b)~~ **(e)** An electronic will may be self-proved:

(1) at the time that it is electronically signed; and

(2) before it is electronically finalized;

by incorporating into the electronic record of the electronic will a self-proving clause described under subsection ~~(c).~~ **(f).** An electronic will is not required to contain an attestation clause or a self-proving clause in order to be a valid electronic will.

~~(c)~~ **(f)** A self-proving clause under subsection ~~(b)~~ **(e)** must substantially be in the following form:

"We, the undersigned testator and the undersigned witnesses, whose names are signed to the attached or foregoing instrument, declare:

(1) That the testator executed the instrument as the testator's will;

(2) That, in the ~~actual and direct physical~~ presence of both witnesses, the testator signed the will or directed another individual who is not one of the witnesses to sign for the testator in the testator's presence and in the witnesses' ~~actual and direct physical~~ presence;

(3) That the testator executed the will as a free and voluntary act for the purposes expressed in it;

(4) That each of the witnesses, in the ~~actual and direct physical~~ presence of the testator and each other, signed the will as a witness;

(5) That the testator was of sound mind when the will was executed; and

(6) That, to the best knowledge of each attesting witness, the testator was, at the time the will was executed, at least eighteen (18) years of age or was a member of the armed forces or of the merchant marine of the United States or its allies.

__________	______________________
(insert date)	(insert signature of testator)
__________	______________________
(insert date)	(insert signature of witness)
__________	______________________
(insert date)	(insert signature of witness)".

A single signature from the testator and from each attesting witness may be provided for any electronic will bearing or containing a self-proving clause.

~~(d)~~ **(g)** An electronic will that is executed in compliance with subsection (a) shall not be rendered invalid by the existence of any of

the following attributes:

(1) An attestation clause.
(2) Additional signatures.
(3) A self-proving clause that differs in form from the exemplar provided in subsection ~~(c).~~ **(f).**
(4) Any additional language that refers to the circumstances or manner in which the electronic will was executed.

~~(e)~~ **(h)** This section shall be construed in a manner that gives effect to the testator's intent to execute a valid will.

SECTION 8. IC 29-1-21-4.1 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 4.1. (a) This section applies to a will or codicil that is electronically signed and witnessed:**

(1) on or after March 31, 2020;
(2) before January 1, 2021; and
(3) in reliance on the Indiana supreme court's order signed and filed on March 31, 2020, under case number 20S-MS-237, as supplemented or extended by the supreme court's order signed and filed on May 1, 2020, under case number 20S-MS-237, and by the supreme court's orders signed and filed on May 29, 2020, and November 10, 2020, under case number 20S-CB-123.

(b) Notwithstanding any other law or provision, a will or codicil described in subsection (a) that was electronically signed and witnessed in compliance with:

(1) the procedures and requirements set forth in the Indiana supreme court's order signed and filed on March 31, 2020, under case number 20S-MS-237 and as supplemented or extended by the supreme court's order signed and filed on May 1, 2020, under case number 20S-MS-237 and by the supreme court's order signed and filed on November 10, 2020, under case number 20S-CB-123; or
(2) the procedures and requirements set forth in section 4 of this chapter;

does not need to be reexecuted or reratified in compliance with the witnessing procedures specified under section 4 of this chapter or IC 29-1-5-3 as they existed on June 30, 2020.

(c) A proponent who offers an electronic will for probate may demonstrate prima facie compliance with subsection (b) by relying on the contents of a self-proving clause or by describing compliance in a verified petition under IC 29-1-7-4. A person contesting the validity of an electronic will described in subsection

(b) has the burden of proving noncompliance with subsection (b).

SECTION 9. IC 29-1-21-5, AS ADDED BY P.L.40-2018, SECTION 2, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 5. Subject to the **applicable** Indiana Rules of Evidence and the Indiana Rules of Trial Procedure, a video recording, **one (1) or more photographs, or an audio recording of part or all** of an electronic will's execution or a video recording of a testator either before or after the execution of an electronic will may be admissible as evidence of the following:

(1) The proper execution of an electronic will in compliance with section 4 of this chapter.
(2) The intentions of the testator.
(3) The mental state or capacity of the testator.
(4) The absence of undue influence or duress with respect to the testator.
(5) Verification of the testator's identity.
(6) Evidence that a complete converted copy of an electronic will should be admitted to probate.
(7) Whether a will whose execution failed to fully comply with section 4 of this chapter should be admitted to probate as a valid traditional paper will.
(8) Any other matter the court considers relevant to the probate of an electronic will.

SECTION 10. IC 29-1-21-6, AS ADDED BY P.L.40-2018, SECTION 2, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 6. (a) As used in this section, "form vendor" means any person who provides a testator with an electronic will form or a user interface for creating, completing, or executing an electronic will. The term includes:

(1) an attorney who prepares an electronic will for a testator; and
(2) any vendor or licensor of estate planning software of digital estate planning forms.

(b) It is consistent with best practices to provide the following advisory instruction with each electronic will:

"IMPORTANT Instructions to the ~~Signatory of~~ **Person Signing** an Electronic Will

A. The procedure for proper execution (electronic signing and witnessing) of your electronic will is as follows:

(1) You (the testator) and the two (2) attesting witnesses must be ~~actually present in the same location~~ **able to interact with each other in real time** throughout the execution process **and the witnesses must be able to observe you and each other as**

your electronic will is being signed. Effective on and after __________, 2021 and on or after March 31, 2020 in some situations covered by emergency orders of the Indiana Supreme Court, Indiana law ~~does not permit~~ **has permitted** attesting witnesses to observe or participate in the signing process from a location that is apart or separate from the testator's location ~~or~~ **and to** act as ~~an attesting witness~~ **witnesses** through use of remote audio, remote visual, or remote audiovisual software or technology.
(2) Both attesting witnesses must be adults and should not be individuals who will be gifted money or other property under the terms of your electronic will. If a witness named in the electronic will is named as a beneficiary or legatee or entitled to money or property under the terms of the electronic will, the beneficiary or legatee named in the electronic will may only receive money, property, or shares reserved for them under state intestacy laws.
(3) You, as the testator, must inform the attesting witnesses that the document you will be signing is your will.
(4) You (the testator) and the two (2) attesting witnesses may use the same computer or device or different computers and devices to make your respective electronic signatures on the electronic will.
(5) The online user interface or software application for your will may require you and the attesting witnesses to use a password, validation code, token, or other security feature in order to prevent identity theft or impersonation and permanently link each of you, as individuals, to your respective electronic signatures.
(6) You (the testator) and the two (2) attesting witnesses should follow the instructions provided by the online user interface or software application when making your respective electronic signatures on your electronic will. You (the testator) should electronically sign the electronic will first followed by each of the attesting witnesses. If you (the testator) are physically unable to type, press keys, or otherwise enter commands on the computer or device being used to electronically sign the electronic will, you may instruct another adult who is not an attesting witness to enter your electronic signature on your electronic will for you. Any individual who enters **or makes** your electronic signature on your electronic will on your behalf must do so in your ~~actual~~ presence. **For this purpose, and on**

and after _______, 2021, the requirement of presence is satisfied by use of any two-way audiovisual communication method that allows you and the witnesses to interact and observe each other in real time as described in subdivision (1).

(7) The software application or online user interface may create a date and time stamp for your electronic signature and for the electronic signature of each attesting witness.

(8) The execution of your electronic will is complete after you and the attesting witnesses have completed making your electronic signatures by clicking or executing a command that saves or submits your respective electronic signatures in the software application or online interface.

(9) You are strongly encouraged to save a complete copy of your electronic will in a portable and printable format. An electronic will preserved in this manner should include all information related to the execution process of your electronic will, including information that is compiled or stored by the software application or online user interface. The related information described in this subdivision should be viewable and printable as a self-contained and permanent part of the electronic record for your electronic will.

B. If you used a software application or an online user interface to generate, finalize, and sign your electronic will, the software or user interface may also offer you the ability to securely store the electronic record of your electronic will. You may be required to create or establish a user identification, password, or other security feature in order to store the electronic record of your electronic will in this way. You should carefully safeguard your user identification, password, security questions, and personal information used to securely save or store your electronic will. The information that you are being asked to safeguard will likely be required in order to:

(1) generate;
(2) replace;
(3) retrieve; or
(4) revoke;

your electronic will at a later date.

C. The only proper and valid way for you to revoke your electronic will is to:

(1) sign a new electronic will or a traditional paper will that revokes all previous wills executed by you; or

(2) permanently and irrevocably make unreadable and nonretrievable the electronic record for your electronic will.

If you are holding the electronic record for your electronic will on your own computer or digital storage device and not making use of a third party custodian or online storage or cloud based document storage service to store or safeguard your electronic will, you may personally delete permanently or make unreadable the electronic record associated with your electronic will. Before doing so, you are encouraged to make and save a printable, permanent copy of the complete electronic record associated with your electronic will, including any related information pertaining to the execution or signing process of your electronic will, so that the contents of your revoked electronic will may be discovered later by a probate court or any other interested persons in the event of a dispute concerning the validity of any later will that you decide to make.

If you are making use of a third party custodian or online or cloud based document storage service to store or safeguard your electronic will, the valid revocation of your electronic will requires you to personally issue a written or electronic revocation document to each third party custodian who has custody of a copy of the electronic record associated with your electronic will. A valid revocation document must instruct the custodian to permanently delete or make unreadable and nonretrievable the electronic record associated with your electronic will. A valid revocation document must be signed by you and two (2) attesting witnesses while following the same procedures required for the execution of a new traditional paper will or new electronic will.".

(c) A failure to provide the text of the advisory instruction in subsection (b) does not affect the validity of the electronic will if the electronic will is otherwise properly executed in the manner set forth in this chapter.

(d) A failure to provide the advisory instruction described in subsection (b) may not be the predicate for any form of civil or other liability.

SECTION 11. IC 29-1-21-8, AS ADDED BY P.L.40-2018, SECTION 2, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 8. (a) This section describes the exclusive methods for revoking an electronic will. Before a testator completes or directs the revocation of an electronic will, the testator shall:

(1) comply with; or

(2) direct a third party custodian to comply, as applicable, with; subsection (e).

(b) A testator may revoke and supersede a previously executed electronic will by executing a new electronic will or traditional paper will that explicitly revokes and supersedes all prior wills. However, if the revoked or superseded electronic will is held in the custody or control of more than one (1) custodian, the testator shall use the testator's best efforts to contact each custodian and to instruct each custodian to permanently delete and render nonretrievable each revoked or superseded electronic will in the manner described in subsection (d).

(c) If a testator is not using the services of a custodian to store the electronic record for an electronic will, the testator may revoke the electronic will by permanently deleting each copy of the electronic record associated with the electronic will in the testator's possession or control or by rendering the electronic record for the associated electronic will unreadable and nonretrievable.

(d) The testator may revoke the testator's electronic will by executing a revocation document that:

(1) is signed by the testator and two (2) attesting witnesses in a manner that complies with IC 29-1-5-3(b) or with section 4 of this chapter;

(2) refers to the date on which the electronic will that is being revoked was signed; and

(3) states that the testator is revoking the electronic will described in subdivision (2).

A revocation document under this subsection may be signed and witnessed with the electronic signature of the testator and two (2) attesting witnesses, or signed and witnessed with signatures on paper as described in IC 29-1-5-6.

(e) If a testator is using the services of an attorney or a custodian to store the electronic record associated with the testator's electronic will, the testator may revoke the electronic will by instructing the custodian or attorney to permanently delete or make unreadable and nonretrievable the electronic record associated with the electronic will. An instruction issued under this subsection must be made in writing to the custodian or attorney as applicable. A custodian or attorney who receives a written instruction described in this subsection shall:

(1) sign an affidavit of regularity under section 13 of this chapter with respect to the electronic will to be revoked by the testator;

(2) create a complete converted copy (as defined in section ~~3(3)~~ **3(2)** of this chapter) of the electronic will being revoked;

(3) make the signed affidavit of regularity a permanent attachment to or part of the complete converted copy;

(4) follow the testator's written instruction by:

(A) permanently deleting the electronic record for the revoked electronic will; or

(B) rendering the electronic record associated with the revoked electronic will unreadable and nonretrievable; and

(5) transmit or issue the complete converted copy of the revoked electronic will to the testator.

(f) If the electronic record for a particular electronic will or a complete converted copy of the electronic will cannot be found after the testator's death, the presumption that applied to a lost or missing traditional paper will shall be applied to the lost or missing electronic will.

SECTION 12. IC 29-1-21-16, AS ADDED BY P.L.40-2018, SECTION 2, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 16. (a) As used in this section and for the purpose of offering or submitting an electronic will in probate under IC 29-1-7, the "filing of an electronic will" means the electronic filing of a complete converted copy of the associated electronic will.

(b) When filing an electronic will, the filing of any accompanying document integrity evidence or identity verification is not required unless explicitly required by the court.

(c) If a person files an electronic will:

(1) for the purpose of probating the electronic will; and

(2) including accompanying:

(A) document integrity evidence;

(B) identity verification evidence; or

(C) evidence described in both clauses (A) and (B);

in the filing or in response to a court order under subsection (e)(2), the person shall file a complete and unredacted copy of the evidence described in clauses (A) and (B) as a nonpublic document under Ind. Administrative Rule 9(G). All personally identifying information pertaining to the testator or the attesting witnesses shall be redacted in the publicly filed copy.

(d) If an electronic will includes a self-proving clause that complies with section ~~4(c)~~ **4(f)** of this chapter, the testator's and witnesses' compliance with the execution requirements shall be presumed upon the filing of the electronic will with the court without the need for any additional testimony or an accompanying affidavit. The presumption described in this subsection may be subject to rebuttal or objection on the grounds of fraud, forgery, or impersonation.

(e) After determining that a testator is dead and that the testator's electronic will has been executed in compliance with applicable law,

the court may:

(1) enter an order, without requiring the submission of additional evidence, admitting the electronic will to probate as the last will of the deceased testator unless objections are filed under IC 29-1-7-16; or

(2) require the petitioner to submit additional evidence regarding:

(A) the proper execution of the electronic will; or

(B) the electronic will's freedom from unauthorized alteration or tampering after its execution.

The court may require the submission of additional evidence under subdivision (2) on the court's own motion or in response to an objection filed under IC 29-1-7-16.

(f) The additional evidence that the court may require and rely upon under subsection (e)(2) may include one (1) or more of the following:

(1) Readable copies of the document integrity evidence or the identity verification evidence associated with the electronic will.

(2) All or part of the electronic record (if available) in a native or computer readable form.

(3) A sworn or verified affidavit from:

(A) an attorney or other person who supervised the execution of the electronic will; or

(B) one (1) or more of the attesting witnesses.

(4) An affidavit signed under section 9(b) of this chapter by a person who created a complete converted copy of the electronic will.

(5) A sworn or verified affidavit from a qualified person that:

(A) describes the person's training and expertise;

(B) describes the results of the person's forensic examination of the electronic record associated with:

(i) the electronic will at issue; or

(ii) any other relevant evidence; and

(C) affirms that the electronic will was not altered or tampered with after its execution.

(6) Any other evidence, including other affidavits or testimony, that the court considers material or probative on the issues of proper execution or unauthorized alteration or tampering.

(g) If the court enters an order admitting an electronic will to probate after receiving additional evidence, any of the additional evidence may be disputed through a will contest that is timely filed under IC 29-1-7-17.

SECTION 13. IC 29-1-21-18, AS ADDED BY P.L.40-2018, SECTION 2, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE

UPON PASSAGE]: Sec. 18. (a) For ~~purpose~~ **purposes** of IC 29-3, IC 30-5, and IC 32-39:

(1) the electronic record for an electronic will is a "digital asset" as that term is defined in IC 32-39-1-10;

(2) the electronic record for an electronic will is not an "electronic communication" as defined in 18 U.S.C. 2510(12) or IC 32-39-1-12;

(3) the digital or electronic transfer or transmission of the electronic record for an electronic will between any two (2) persons other than the testator and the testator's attorney is an electronic communication as defined in 18 U.S.C. 2510(12) or IC 32-39-1-12;

(4) a custodian (as defined in section ~~3(4)~~ **3(3)** of this chapter) of an electronic will is a "custodian" as defined in IC 32-39-1-8; and

(5) the following individuals are "users" for purposes of IC 32-39 if the testator, attorney, or other authorized person contracts with another person to store the electronic record for the electronic will:

(A) The testator of an electronic will.

(B) The attorney representing the testator.

(C) Any other person with authorized possession of or authorized access to the electronic record for the electronic will.

(b) The execution or revocation of an electronic will is not a contract or a "transaction in or affecting interstate or foreign commerce" for purposes of the federal E-SIGN Act, 15 U.S.C. 7001.

(c) The execution or revocation of an electronic will is not a contract or "transaction" for purposes of IC 26-2-8 and the exclusion stated in IC 26-2-8-103(b)(1) continues in effect with respect to electronic wills and codicils.

SECTION 14. IC 29-3-14-7, AS ADDED BY P.L.68-2019, SECTION 4, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 7. (a) A supported decision making agreement must:

(1) name at least one (1) supporter;

(2) describe the decision making assistance that each supporter may provide to the adult and how supporters may work together; and

(3) if appropriate, be executed by the adult's guardian.

(b) A supported decision making agreement may:

(1) appoint more than one (1) supporter;

(2) appoint an alternate to act in the place of a supporter under circumstances specified in the agreement; or

(3) authorize a supporter to share information with any other supporter or others named in the agreement.

(c) A supported decision making agreement must be:

(1) in writing;

(2) dated; and

(3) signed by the adult in the presence of a notary.

(d) A supported decision making agreement must contain a separate consent signed by each supporter named in the agreement indicating the supporter's:

(1) relationship to the adult;

(2) willingness to act as a supporter; and

(3) acknowledgment of the duties of a supporter.

(e) An adult who meets the requirements to enter into a supported decision making agreement under section 4 of this chapter may sign a supported decision making agreement in any manner, including electronic signature, permitted under ~~IC 30-5-4-1(5)~~ **IC 30-5-4-1(b)** or IC 30-5-11-4(a).

SECTION 15. IC 30-4-1.5-4, AS AMENDED BY P.L.56-2020, SECTION 8, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 4. (a) Any of the following persons may create a valid inter vivos trust by electronically signing an electronic trust instrument, with no witness requirement or acknowledgment before any notary public, if the electronic trust instrument sufficiently states the terms of the trust in compliance with ~~IC 30-4-2-1(b):~~ **IC 30-4-2-1(c):**

(1) A settlor.

(2) An agent of a settlor who is an attorney in fact.

(3) A person who holds a power of appointment that is exercisable by appointing money or property to the trustee of a trust.

(4) An adult who **is not an ineligible person under subsection (b) and who electronically signs the electronic trust instrument:**

(A) ~~is not a trustee named in the electronic trust instrument;~~ **at the settlor's direction;** and

(B) ~~electronically signs the electronic trust instrument:~~ **in the direct physical presence of the settlor.**

~~(i) at the settlor's direction; and~~

~~(ii) in the direct physical presence of the settlor.~~

If an adult electronically signs the trust instrument under subdivision (4), the trust instrument must indicate that the adult signer is signing at the direction of the settlor and in the settlor's direct physical presence

and must state that the adult signer is not a relative of the settlor, is not a trustee named in the electronic trust instrument, and is not entitled to any beneficial interest or power of appointment under the electronic trust instrument. For all purposes under this article, a trust instrument electronically signed under ~~subdivisions~~ **subdivision** (1), (2), or (4) is the creation of the named settlor.

(b) The following persons are ineligible to sign an electronic trust instrument at the direction of the settlor under subsection (a)(4):

(1) A trustee named in the electronic instrument.

(2) A relative of the settlor.

(3) A person who is entitled to receive a beneficial interest in the trust or a power of appointment under the electronic trust instrument.

~~(b)~~ **(c)** The following persons may use the electronic record associated with an electronic trust instrument to make a complete converted copy of an electronic trust instrument immediately after its execution or at a later time when a complete and intact electronic record is available:

(1) The settlor.

(2) A trustee who accepts appointment under the electronic trust instrument.

(3) An attorney representing the settlor or the trustee.

(4) Any other person authorized by the settlor.

If a complete converted copy is generated from a complete and intact electronic record associated with an electronic trust instrument, the person who generates the complete converted copy is not required to sign the affidavit described in subsection ~~(d).~~ **(e).**

~~(c)~~ **(d)** If:

(1) a person discovers an accurate but incomplete copy of an electronic trust instrument;

(2) the electronic record for the electronic trust instrument becomes:

(A) lost; or

(B) corrupted; or

(3) freedom from tampering or unauthorized alteration cannot be authenticated or verified;

a living settlor, attorney, custodian, or person responsible for the discovery of the incomplete electronic trust instrument may prepare a complete converted copy of the electronic trust instrument using all available information if the person creating the complete converted copy of the electronic trust instrument has access to a substantially

complete, nonelectronic copy of the electronic trust instrument.

~~(d)~~ **(e)** A person who creates a complete converted copy of an electronic trust instrument under subsection ~~(c)~~ **(d)** shall sign an affidavit that affirms or specifies, as applicable, the following:

(1) The date the electronic trust instrument was created.

(2) The time the electronic trust instrument was created.

(3) How the incomplete electronic trust instrument was discovered.

(4) The method and format used to store the original electronic record associated with the electronic trust instrument.

(5) The methods used, if any, to prevent tampering or the making of unauthorized alterations to the electronic record or electronic trust instrument.

(6) Whether the electronic trust instrument has been altered since its creation.

(7) Confirmation that an electronic record, including the document integrity evidence, if any, was created at the time the settlor made the electronic trust instrument.

(8) Confirmation that the electronic record has not been altered while in the custody of the current custodian or any prior custodian.

(9) Confirmation that the complete converted copy is a complete and correct duplication of the electronic trust instrument and the date, place, and time of its execution by the settlor or the settlor's authorized agent.

~~(e)~~ **(f)** A complete converted copy derived from a complete and correct electronic trust instrument may be docketed under IC 30-4-6-7 or, absent any objection, offered and admitted as evidence of the trust's terms in the same manner as the original and traditional paper trust instrument of the settlor. Whenever this article permits or requires the trustee of a trust to provide a copy of a trust instrument to a beneficiary or other interested person, the trustee may provide a complete converted copy of the electronic trust instrument. A complete and converted copy is conclusive evidence of the trust's terms unless otherwise determined by a court in an order entered upon notice to all interested persons and after an opportunity for a hearing.

SECTION 16. IC 30-4-2-1, AS AMENDED BY P.L.56-2020, SECTION 9, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 1. (a) A trust in either real or personal property is enforceable only if there is written evidence of the terms of the trust bearing the signature of any of the following persons:

(1) The settlor.

(2) The settlor's authorized agent.

(3) An adult who **is not an ineligible person under subsection (b) and who signs the trust's written terms:**

(A) ~~is not a trustee named in the trust's written terms;~~ **at the settlor's direction;** and

(B) ~~signs the trust's written terms:~~ **in the direct physical presence of the settlor.**

~~(i) at the settlor's direction; and~~

~~(ii) in the direct physical presence of the settlor.~~

If an adult signs at the settlor's direction under subdivision (3), the written evidence of the trust's terms must identify that adult signer, ~~and~~ must state that the adult is signing at the direction of the settlor and in the settlor's direct physical presence, **and must state that the adult signer is not a relative of the settlor, is not a trustee named in the trust's terms, and is not entitled to any beneficial interest or power of appointment under the trust's terms.**

(b) The following persons are ineligible to sign the written terms of a trust at the direction of the settlor under subsection (a)(3):

(1) A trustee named in the trust's written terms.

(2) A relative of the settlor.

(3) A person who is entitled to receive a beneficial interest in the trust or a power of appointment under the trust's written terms.

~~(b)~~ **(c)** Except as required in the applicable probate law for the execution of wills, no formal language is required to create a trust, but the terms of the trust must be sufficiently definite so that the trust property, the identity of the trustee, the nature of the trustee's interest, the identity of the beneficiary, the nature of the beneficiary's interest, and the purpose of the trust may be ascertained with reasonable certainty.

~~(c)~~ **(d)** It is not necessary to the validity of a trust that the trust be funded with or have a corpus that includes property other than the present or future, vested or contingent right of the trustee to receive proceeds or property, including:

(1) as beneficiary of an estate under IC 29-1-6-1;

(2) life insurance benefits under section 5 of this chapter;

(3) retirement plan benefits; or

(4) the proceeds of an individual retirement account.

~~(d)~~ **(e)** A trust created under:

(1) section 18 of this chapter for the care of an animal; or

(2) section 19 of this chapter for a noncharitable purpose;

has a beneficiary.

~~(e)~~ **(f)** A trust has a beneficiary if the beneficiary can be presently ascertained or ascertained in the future, subject to any applicable rule against perpetuities.

~~(f)~~ **(g)** A power of a trustee to select a beneficiary from an indefinite class is valid. If the power is not exercised within a reasonable time, the power fails and the property subject to the power passes to the persons who would have taken the property had the power not been conferred.

~~(g)~~ **(h)** A trust may be created by exercise of a power of appointment in favor of a trustee.

SECTION 17. IC 30-5-2-3.6 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 3.6. "Directed paralegal" means a nonlawyer assistant who is employed, retained, or otherwise associated with a licensed attorney or law firm and whose work is directly supervised by a licensed attorney, as required by Rule 5.3 of the Rules of Professional Conduct.**

SECTION 18. IC 30-5-4-1, AS AMENDED BY P.L.101-2008, SECTION 9, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 1. **(a)** To be valid, a power of attorney must meet the following conditions:

(1) Be in writing.
(2) Name an attorney in fact.
(3) Give the attorney in fact the power to act on behalf of the principal.
(4) Be signed by the principal or at the principal's direction:
(A) in the presence of a notary public; **or**
(B) in the presence of witnesses as described under sections 1.3, 1.5, 1.7, and 1.9 of this chapter.

~~(5)~~ **(b)** In the case of a power of attorney signed at the direction of the principal, the notary must state that the individual who signed the power of attorney on behalf of the principal did so at the principal's direction.

SECTION 19. IC 30-5-4-1.3 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 1.3. (a) This section applies to a power of attorney executed in the presence of witnesses under section 1 of this chapter on or after March 31, 2020.**

(b) Any person who, at the time of attestation, is competent to be a witness in this state may act as an attesting witness to the execution of a power of attorney. A subsequent incapacity of an attesting witness does not impair the effectiveness of a previously executed power of attorney.

(c) A power of attorney executed under section 1(a)(4)(B) of this chapter is void if:

(1) a subscribing witness to the execution of the power of attorney has an interest in the power of attorney as described in subsection (d); and

(2) the power of attorney cannot be proved without the witness's testimony or proof of the witness's signature as a witness.

(d) A person serving as a subscribing witness to the execution of a power of attorney has an interest in the power of attorney if:

(1) the power of attorney names the person as the principal's attorney in fact or successor to the attorney in fact;

(2) the power of attorney grants a power or beneficial interest to the person other than an appointment of the person as the principal's attorney in fact or successor to the attorney in fact; or

(3) the witness is related to a person described in subdivision (1) or (2).

(e) For purposes of this section, a witness is related to a person described in subdivision (1) or (2) if the person is:

(1) the spouse of the witness; or

(2) a descendant of the witness.

SECTION 20. IC 30-5-4-1.5 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 1.5. (a) This section applies to a power of attorney executed in the presence of witnesses under section 1 of this chapter on or after March 31, 2020.**

(b) A power of attorney executed in the presence of witnesses under section 1(a)(4)(B) of this chapter must be executed by the signatures of the principal and at least two (2) witnesses on:

(1) a power of attorney under subsection (c);

(2) a self-proving clause under section 1.7(c) of this chapter; or

(3) a self-proving clause under section 1.7(d) of this chapter.

(c) A power of attorney may be attested as follows:

(1) By having the principal, in the presence of two (2) or more attesting witnesses, signify to the witnesses that the instrument is the principal's power of attorney and:

(A) sign the power of attorney;

(B) acknowledge the principal's signature already made; or

(C) at the principal's direction and in the principal's presence, have someone else sign the principal's name.

(2) By having the attesting witnesses sign, in the presence of the principal and each other, the power of attorney.

An attestation or self-proving clause is not required under this subsection in order to execute a valid power of attorney.

(d) Only if the execution and completion of the power of attorney is supervised by an attorney or directed paralegal, a principal and at least two (2) attesting witnesses may execute and complete a power of attorney in two (2) or more original counterparts that exist in a tangible and readable paper form with:

(1) the principal's signature placed on one (1) original counterpart in the presence of attesting witnesses; and

(2) the signatures of the remaining witnesses placed on one (1) or more different counterparts affiliated with the same power of attorney;

in a tangible and readable paper form. If a power of attorney is signed and witnessed in counterparts under this subsection, the principal or an individual acting at the principal's specific direction must physically assemble all of the separately signed paper counterparts of the power of attorney and the signatures of the principal and all attesting witnesses not later than five (5) business days after all the paper counterparts have been signed by the principal and witnesses. If the principal directs another individual to assemble the separate, signed paper counterparts of the will into a single composite paper document, the five (5) business day period does not commence until the compiling individual receives all of the separately signed paper counterparts. Any scanned copy or photocopy of the composite document containing all signatures shall be treated as validly signed under this section.

(e) An attorney or directed paralegal must supervise the execution of a power of attorney in counterparts as described in subsection (d). An attorney or directed paralegal may supervise the execution of a power of attorney in counterparts even if the supervising attorney or directed paralegal is one (1) of the power of attorney's attesting witnesses.

(f) Within a reasonable time after an attorney or a directed paralegal supervises the execution of a power of attorney in counterparts as described in subsection (d), the attorney or directed paralegal must sign an affidavit of compliance. An affidavit of compliance under this subsection must be sworn to or affirmed by the signing attorney or directed paralegal under the penalties of perjury and must contain:

(1) The name and residential address of the principal.
(2) The name and:
(A) residential address; or
(B) business address;
for each witness who signs the power of attorney.
(3) The address, city, and state in which the principal was physically located at the time the principal signed an original counterpart of the power of attorney.
(4) The city and state in which each attesting witness was physically located when the witness signed an original counterpart of the power of attorney as a witness.
(5) A description of the method and form of identification used to confirm the identity of the principal to the witnesses and to the supervising attorney or paralegal, as applicable.
(6) A description of the audiovisual technology or other method used by the supervising attorney or paralegal, as applicable, the principal, and the witnesses for the purpose of interacting with each other in real time during the signing process.
(7) A description of the method used by the principal and the witnesses to identify the location of each page break within the text of the principal and to confirm that the separate paper counterparts of the power of attorney were identical in content.
(8) A general description of how and when the attorney or paralegal, as applicable, physically combined the separate, signed paper counterparts of the power of attorney into a single composite paper document containing the power of attorney, the signature of the principal, and the signatures of all attesting witnesses.
(9) The name, business or residential address, and telephone number of the attorney or directed paralegal who supervised the execution and witnessing of the power of attorney in counterparts.
(10) Any other information that the supervising attorney or paralegal, as applicable, considers to be material with respect to:
(A) the principal's capacity to sign a valid power of attorney; and
(B) the principal's and witnesses' compliance with subsection (c).
After the attorney or directed paralegal signs an affidavit of

compliance under this subsection, the attorney or directed paralegal must preserve an accurate copy of the signed affidavit with a scanned copy or photocopy of the completely signed power of attorney. An affidavit of compliance signed under this subsection is admissible as prima facie evidence that the principal and witnesses executed the power of attorney in counterparts that comply with the requirements of subsection (c).

(g) A power of attorney that substantially complies with subsections (c) and (d) may not be rendered invalid by the existence of:

(1) an attestation or self-proving clause;
(2) additional signatures; or
(3) other additional language;

not required by subsection (c).

(h) A power of attorney executed in accordance with subsections (c) and (d) is self-proved if the witness signatures follow an attestation or self-proving clause or other declaration indicating, in substance, the facts set forth in section 1.7(d) or 1.7(e) of this chapter.

(i) This section shall be construed to favor the effectuating of the principal's intent to make a valid power of attorney.

SECTION 21. IC 30-5-4-1.7 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 1.7. (a) This section applies to a power of attorney executed in the presence of witnesses under section 1 of this chapter on or after March 31, 2020.**

(b) When a power of attorney is executed, the power of attorney may be:

(1) attested; and
(2) made self-proving;

by incorporating into or attaching to the power of attorney a self-proving clause that meets the requirements of subsection (d) or (e). If the principal and witnesses sign a self-proving clause that meets the requirements of subsection (d) or (e) at the time the power of attorney is executed, no other signature of the principal or witnesses is required in order for the power of attorney to be validly executed and self-proved.

(c) If a power of attorney is executed by the signatures of the principal and witnesses on an attestation clause under section 1.5(c) of this chapter, the power of attorney may be made self-proving at a later date by attaching to the power of attorney a self-proving clause that:

(1) is signed by the principal and witnesses; and
(2) meets the requirements specified in subsections (d) and (e).
(d) A self-proving clause must:
(1) contain the acknowledgment of the power of attorney by the:
(A) principal; and
(B) statements of the witnesses;
under the laws of Indiana;
(2) evidence the acknowledgment described in subdivision (1) by the signatures of the principal and witnesses (which may be made under the penalties of perjury); and
(3) be attached or annexed to the power of attorney in a form that is substantially as follows:
"We, the undersigned principal and the undersigned witnesses, respectively, whose names are signed to the attached or foregoing instrument declare that:
(1) the principal executed the instrument as the principal's power of attorney;
(2) in the presence of both witnesses, the principal signed or acknowledged the signature already made or directed another to sign for the principal in the principal's presence;
(3) the principal executed the power of attorney as a free and voluntary act for the purposes expressed in it;
(4) each of the witnesses, in the presence of the principal and of each other, signed the power of attorney as a witness;
(5) the principal was of sound mind when the power of attorney was executed; and
(6) to the best knowledge of each witness, the principal was, at the time the power of attorney was executed, at least eighteen (18) years of age or was a member of the armed forces or the merchant marine of the United States or its allies.
Date __________
Principal __________
Witness __________
Witness __________".
(e) A power of attorney is attested and self-proved if the power of attorney includes or has attached a clause signed by the principal and the witnesses that indicates that:
(1) the principal signified that the instrument is the principal's power of attorney;
(2) in the presence of least two (2) witnesses, the principal signed the instrument or acknowledged the principal's

signature already made or directed another to sign for the principal in the principal's presence;
(3) the principal executed the instrument freely and voluntarily for the purposes expressed in it;
(4) each of the witnesses, in the principal's presence and in the presence of all other witnesses, is executing the instrument as a witness;
(5) the principal was of sound mind when the power of attorney was executed; and
(6) the principal is, to the best knowledge of each of the witnesses:
(A) at least eighteen (18) years of age; or
(B) a member of the armed forces or the merchant marine of the United States or its allies.

(f) If the principal and the attesting witnesses executed the power of attorney in two (2) or more counterparts on paper under section 1.5(d) of this chapter, the self-proving clause, if any, for that power of attorney must substantially be in the following form:

"We, the undersigned principal and the undersigned witnesses, respectively, whose names are signed to the attached or foregoing instrument declare:
(1) that the undersigned principal and witnesses interacted with each other in real time through the use of technology and the witnesses were able to observe the principal throughout the signing process;
(2) that the principal executed a complete counterpart of the instrument, in readable form on paper, as the principal's power of attorney;
(3) that, in the presence of both witnesses, the principal signed the paper counterpart of the power of attorney or acknowledged the principal's signature already made or directed another individual to sign the paper counterpart of the power of attorney for the principal in the principal's presence;
(4) that the principal executed the power of attorney as a free and voluntary act for the purposes expressed in it;
(5) that each of the witnesses, in the presence of the principal and of each other, signed one (1) or more other complete counterparts of the power of attorney as a witness;
(6) that each paper counterpart of the power of attorney that was signed by a witness was complete, in readable form, and with content identical to the paper counterpart signed by the

principal;

(7) that the principal was of sound mind when the power of attorney was executed; and

(8) that, to the best knowledge of each of the witnesses, the principal was, at the time the power of attorney was executed, at least eighteen (18) years of age or was a member of the armed forces or the merchant marine of the United States or its allies.

Date __________

Principal __________

Witness __________

Witness __________".

(g) This section shall be construed to favor the effectuating of the principal's intent to make a valid power of attorney.

SECTION 22. IC 30-5-4-1.9 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 1.9. (a) Subject to the Indiana Rules of Evidence and the Indiana Rules of Trial Procedure:**

(1) a video or audio recording of a principal captured or made either before or after the execution of a power of attorney; or

(2) a video recording, one (1) or more photographic images, or an audio recording capture made during part or all of the execution of a power of attorney;

may be admissible as evidence under this section.

(b) Recordings or images described in subsection (a) may be admissible as evidence of the following:

(1) The proper execution of a power of attorney.

(2) The intentions of the principal.

(3) The mental state or capacity of a principal.

(4) The authenticity of a power of attorney.

(5) Matters that are determined by a court to be relevant to the probate of a power of attorney.

SECTION 23. IC 30-5-4-2, AS AMENDED BY P.L.143-2009, SECTION 27, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 2. (a) Except as provided in subsection (b), a power of attorney is effective on the date the power of attorney is signed in accordance with section ~~1(4)~~ **1(a)(4)** of this chapter.

(b) A power of attorney may:

(1) specify the date on which the power will become effective; or

(2) become effective upon the occurrence of an event.

(c) If a power of attorney becomes effective upon the principal's incapacity and:

(1) the principal has not authorized a person to determine whether the principal is incapacitated; or

(2) the person authorized is unable or unwilling to make the determination;

the power of attorney becomes effective upon a determination that the principal is incapacitated that is set forth in a writing or other record by a physician, licensed psychologist, or judge.

(d) A person authorized by the principal in the power of attorney to determine that the principal is incapacitated may:

(1) act as the principal's personal representative under the Health Insurance Portability and Accountability Act of 1996 (42 U.S.C. 201 et seq.) and any rules or regulations issued under that act; and

(2) obtain access to the principal's health care information and communicate with the principal's health care provider.

SECTION 24. IC 30-5-11-3, AS AMENDED BY P.L.231-2019, SECTION 39, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 3. The following terms are defined for this chapter:

(1) "Affidavit of regularity" means an affidavit executed by a custodian or other person under section 9 of this chapter with respect to the electronic record for an electronic power of attorney or a complete converted copy of an electronic power of attorney.

(2) "Complete converted copy" means a document in any format that:

(A) can be visually viewed in its entirety on a monitor or other display device;

(B) can be printed; and

(C) contains the text of an electronic power of attorney and a readable copy of any associated document integrity evidence that may be a part of or attached to the electronic power of attorney.

(3) "Custodian" means a person other than:

(A) the principal who executed the electronic power of attorney;

(B) an attorney; or

(C) a person who is named in the electronic power of attorney as an attorney in fact or successor attorney in fact under the power of attorney.

(4) "Custody" means the authorized possession and control of at least one (1) of the following:

(A) A complete copy of the electronic record for the electronic power of attorney.

(B) A complete converted copy of the electronic power of attorney if the complete electronic record has been lost or destroyed or the electronic power of attorney has been revoked.

(5) "Directed paralegal" means a nonlawyer assistant who is employed, retained, or otherwise associated with a licensed attorney or law firm and whose work is directly supervised by a licensed attorney, as required by Rule 5.3 of the Rules of Professional Conduct.

~~(5)~~ **(6)** "Document integrity evidence" means the part of the electronic record for the electronic power of attorney that:

(A) is created and maintained electronically;

(B) includes digital markers showing that the electronic power of attorney has not been altered after its initial execution by the principal;

(C) is logically associated with the electronic power of attorney in a tamper evident manner so that any change made to the text of the electronic power of attorney after its execution is visibly perceptible when the electronic record is displayed or printed;

(D) will generate an error message, invalidate an electronic signature, make the electronic record unreadable, or otherwise display evidence that some alteration was made to the electronic power of attorney after its execution; and

(E) displays the following information:

(i) The city and state in which, and the date and time at which, the electronic power of attorney was executed by the principal.

(ii) The name of the principal.

(iii) The name and address of the person responsible for marking the principal's signature on the electronic power of attorney at the principal's direction and in the principal's presence, as applicable.

(iv) A copy of or a link to the electronic signature of the principal on the electronic power of attorney.

(v) A general description of the type of identity verification evidence used to verify the principal's identity.

(vi) The content of the cryptographic hash or unique code used to complete the electronic record and make the electronic power of attorney tamper evident if a public key infrastructure or a similar secure technology was used to sign or authenticate the electronic power of attorney and if the vendor or software for the technology makes inclusion feasible.

Document integrity evidence may, but is not required to, contain other information about the electronic power of attorney such as a unique document number, client number, or other identifier that an attorney or custodian assigns to the electronic power of attorney or a link to a secure Internet web site where a complete copy of the electronic power of attorney is accessible. The title, heading, or label, if any, that is assigned to the document integrity evidence (such as "certificate of completion", "audit trail", or "audit log") is immaterial.
~~(6)~~ **(7)** "Electronic" has the meaning set forth in IC 26-2-8-102.
~~(7)~~ **(8)** "Electronic power of attorney" means a power of attorney created by a principal that:
(A) is initially created and maintained as an electronic record;
(B) contains the electronic signature of the principal creating the power of attorney;
(C) contains the date and time of the electronic signature of the principal creating the power of attorney; and
(D) is notarized.
The term includes an amendment to or a restatement of the power of attorney if the amendment or restatement complies with the requirements described in section 5 of this chapter.
~~(8)~~ **(9)** "Electronic record" has the meaning set forth in IC 26-2-8-102. The term may include one (1) or both of the following:
(A) The document integrity evidence associated with an electronic power of attorney.
(B) The identity verification evidence of the principal who executed the electronic power of attorney.
~~(9)~~ **(10)** "Electronic signature" has the meaning set forth in IC 26-2-8-102.
~~(10)~~ **(11)** "Executed" means the signing of a power of attorney. The term includes the use of an electronic signature.
~~(11)~~ **(12)** "Identity verification evidence" means either:
(A) a copy of a government issued photo identification card belonging to the principal; or
(B) any other information that verifies the identity of the principal if derived from one (1) or more of the following sources:
(i) A knowledge based authentication method.
(ii) A physical device.
(iii) A digital certificate using a public key infrastructure.
(iv) A verification or authorization code sent to or used by the

principal.

(v) Biometric identification.

(vi) Any other commercially reasonable method for verifying the principal's identity using current or future technology.

~~(12)~~ **(13)** "Logically associated" means electronically connected, cross referenced, or linked in a reliable manner.

(14) "Observe" means to perceive another's actions or expressions of intent through the senses of eyesight or hearing, or both. The term includes perceptions involving the use of technology or learned skills to:

(A) assist the person's capabilities of eyesight or hearing, or both; or

(B) compensate for an impairment of the person's capabilities of eyesight or hearing, or both.

(15) "Observing" has the meaning set forth in subdivision (14).

~~(13)~~ **(16)** "Sign" means valid use of a properly executed electronic signature.

~~(14)~~ **(17)** "Signature" means the authorized use of the principal's name to authenticate a power of attorney. The term includes an electronic signature.

~~(15)~~ **(18)** "Tamper evident" means the feature of an electronic record, such as an electronic power of attorney or document integrity evidence for an electronic power of attorney, that will cause the fact of any alteration or tampering with the electronic record, after it is created or signed, to be perceptible to any person viewing the electronic record when it is printed on paper or viewed on a monitor or other display device. The term applies even if the nature or specific content of the alteration is not perceptible.

~~(16)~~ **(19)** "Traditional paper power of attorney" means a power of attorney or an amendment to or a restatement of a power of attorney that is signed by the principal on paper.

SECTION 25. IC 30-5-11-4, AS ADDED BY P.L.40-2018, SECTION 4, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 4. (a) A principal, or person acting at the principal's direction, may ~~in the presence of a notary,~~ create a valid power of attorney by electronically signing an electronic power of attorney:

(1) in the presence of a notary; or

(2) in the presence of witnesses under sections 4.3, 4.5, 4.7, and 4.9 of this chapter.

(b) The:

(1) principal;

(2) attorney in fact under the electronic power of attorney;

(3) attorney representing the principal or attorney in fact; or

(4) other person authorized by the principal;

may use the electronic record to make a complete converted copy of the electronic power of attorney on or near the time of its execution or at a later time when the full electronic record is available.

(c) A complete converted copy derived from a complete and correct electronic power of attorney may be offered and admitted into evidence as though it were an original and traditional paper power of attorney without the need for additional proof or evidence of authenticity. Whenever this article permits or requires an attorney in fact to provide a copy of a power of attorney to an interested person, the attorney in fact may provide a complete converted copy of the electronic power of attorney. A complete and converted copy is conclusive evidence of the power of attorney's terms unless otherwise determined by a court in an order entered upon notice to all interested persons and after an opportunity for a hearing.

SECTION 26. IC 30-5-11-4.1 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 4.1. (a) This section applies to a power of attorney that is electronically signed and notarized:**

(1) on or after March 31, 2020; and

(2) before January 1, 2022.

(b) If a power of attorney described in subsection (a) was electronically signed and notarized by a notary public using audiovisual communication technology to positively identify the principal or someone signing at the principal's direction, the resulting power of attorney must be treated as validly executed under this chapter if it complies with all other requirements of section 4 of this chapter as they existed on June 30, 2020.

SECTION 27. IC 30-5-11-4.3 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 4.3. (a) This section applies to an electronic power of attorney executed in the presence of witnesses under section 4(a)(2) of this chapter on or after March 31, 2020.**

(b) Any person who, at the time of attestation, is competent to be a witness in this state may act as an attesting witness to the execution of an electronic power of attorney, and the witness's subsequent incapacity will not impair the effectiveness of the

power of attorney.

(c) An electronic power of attorney is void if:

(1) a subscribing witness to the execution of the power of attorney has an interest in the power of attorney; and

(2) the power of attorney cannot be proved without the witness's testimony of proof or the witness's signature.

(d) For purposes of this section, a person serving as a subscribing witness to the execution of an electronic power of attorney has an interest in an electronic power of attorney if:

(1) the power of attorney names the person as the principal's attorney in fact or successor to the attorney in fact;

(2) the power of attorney grants a power or beneficial interest to the person other than appointment of the person as the principal's attorney in fact or successor to the attorney in fact; or

(3) the witness is related to a person described in subdivision (1) or (2).

(e) For purposes of this section, a witness is related to a person described in subsection (d)(1) or (d)(2) if the person is:

(1) the spouse of the witness; or

(2) a descendant of the witness.

SECTION 28. IC 30-5-11-4.5 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 4.5. (a) This section applies to an electronic power of attorney executed in the presence of witnesses under section 4(a)(2) of this chapter on or after March 31, 2020.**

(b) An electronic power of attorney executed in the presence of witnesses under section 4(a)(2) of this chapter must be executed by the signatures of the principal and at least two (2) witnesses on:

(1) an electronic power of attorney under subsection (c);

(2) a self-proving clause under section 4.7(c) of this chapter; or

(3) a self-proving clause under section 4.7(d) of this chapter.

(c) An electronic power of attorney may be attested as follows:

(1) The principal, in the presence of two (2) or more attesting witnesses, shall signify to the witnesses that the instrument is the principal's power of attorney and:

(A) sign the power of attorney;

(B) acknowledge the principal's signature already made; or

(C) at the principal's direction and in the principal's presence, have someone else sign the principal's name.

(2) The attesting witnesses must sign in the presence of the principal and each other.

An attestation or self-proving clause is not required under this subsection for a valid power of attorney.

(d) If the principal and the attesting witnesses are not in each other's physical presence when the electronic power of attorney is signed and witnessed and if the principal and the witnesses use audiovisual technology to satisfy the presence requirement in subsection (a), an attorney or a directed paralegal must supervise the signing and the witnessing of the electronic power of attorney.

(e) Within a reasonable time after an attorney or a directed paralegal supervises the signing and witnessing of an electronic power of attorney in the manner described in subsection (d), the attorney or directed paralegal must sign an affidavit of compliance. An affidavit of compliance under this subsection must be sworn to or affirmed by the signing attorney or directed paralegal under the penalties of perjury and must contain:

(1) the name and residential address of the principal;

(2) the name and:

(A) residential address; or

(B) business address;

for each attesting witness who signs the electronic power of attorney;

(3) the address, city, and state in which the principal is physically located at the time the principal signs the electronic power of attorney;

(4) the city and state in which each attesting witness is physically located when the witness signs the electronic power of attorney as a witness;

(5) a description of the method and form of identification used to confirm the identity of the principal to the witnesses and supervising attorney or directed paralegal;

(6) a description of the method used by the supervising attorney or paralegal, principal, and the witnesses for the purpose of interacting with each other in real time during the signing process;

(7) a brief description of the method used to add or capture the electronic signature of the principal and the witnesses;

(8) the name, business or residential address, and telephone number of the attorney or directed paralegal who supervised the execution of the electronic power of attorney; and

(9) any other information that the supervising attorney or

directed paralegal considers to be material to:

(A) the principal's capacity to sign a valid power of attorney; and

(B) the principal's and witnesses' compliance with subsection (a).

After the attorney or directed paralegal signs an affidavit of compliance under this subsection, the attorney or directed paralegal must preserve an accurate copy of the signed affidavit with a scanned copy or photocopy of the completely signed power of attorney. An affidavit of compliance signed under this subsection is admissible as prima facie evidence that the principal and witnesses executed the power of attorney in counterparts that comply with the requirements of subsection (c).

(f) An electronic power of attorney that is executed in substantial compliance with subsection (c) will not be rendered invalid by the existence of:

(1) an attestation or self-proving clause or other language; or

(2) additional signatures;

not required by subsection (c).

(g) An electronic power of attorney executed in accordance with subsection (c) is self-proved if the witness's signatures follow an attestation or self-proving clause or other declaration indicating, in substance, the facts set forth in section 4.7(d) or 4.7(e) of this chapter.

(h) This section shall be construed to favor the effectuation of the principal's intent to make a valid power of attorney.

SECTION 29. IC 30-5-11-4.7 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 4.7. (a) This section applies to an electronic power of attorney executed in the presence of witnesses under section 4(a)(2) of this chapter on or after March 31, 2020.**

(b) When an electronic power of attorney is executed, the power of attorney may be:

(1) attested; and

(2) made self-proving;

by incorporating into or attaching to the power of attorney a self-proving clause that meets the requirements of subsection (d) or (e) at the time the electronic power of attorney is executed and no other signatures of the principal and witnesses are required for the power of attorney to be validly executed and self-proved.

(c) If an electronic power of attorney is executed by the

signatures of the principal and witnesses on an attestation clause under section 4.5(c) of this chapter, the power of attorney may be made self-proving at a later date by attaching to the power of attorney a self-proving clause signed by the principal and witnesses that meets the requirements of subsection (d) or (e).

(d) A self-proving clause must contain the acknowledgment of the power of attorney by the principal and the statements of the witnesses, each made under the laws of Indiana and evidenced by the signatures of the principal and witnesses (which may be made under the penalties of perjury) attached or annexed to the power of attorney in a form and with content substantially similar to the following:

"We the undersigned principal and the undersigned witnesses, respectively, whose names are signed to the attached or foregoing instrument declare:

(1) that the principal executed the instrument as the principal's power of attorney;
(2) that the principal and the witnesses interacted with each other in real time either in the same physical space or through the use of technology and the witnesses were able to observe the principal throughout the signing process;
(3) that, in the presence of both witnesses, the principal electronically signed the power of attorney or acknowledged the principal's electronic signature already made or directed another individual to electronically sign for the principal in the principal's presence;
(4) that the principal executed the power of attorney as a free and voluntary act for the purpose expressed in it;
(5) that each of the witnesses, in the presence of the principal and each other, signed the electronic power of attorney as a witness;
(6) that the principal was of sound mind when the power of attorney was executed; and
(7) that, to the best knowledge of each of the witnesses, the principal was, at the time the power of attorney was executed, at least eighteen (18) years of age or was a member of the armed forces or the merchant marine of the United States or its allies.
Date __________
Principal __________
Witness __________
Witness __________".

(e) An electronic power of attorney is attested and self-proved if the electronic record for the power of attorney includes a clause signed by the principal and the witnesses that indicates, in substance, that:

(1) the principal signified that the instrument is the principal's power of attorney;

(2) in the presence of at least two (2) witnesses, the principal electronically signed the instrument or acknowledged the principal's electronic signature already made or directed another individual to sign for the principal in the principal's presence;

(3) the principal executed the instrument freely and voluntarily for the purposes expressed in it;

(4) each of the witnesses, in the principal's presence and in the presence of each other, electronically signed the instrument as a witness;

(5) the principal was of sound mind when the power of attorney was executed;

(6) the principal was, to the best knowledge of each witness, either:

(A) at least eighteen (18) years of age; or

(B) a member of the armed forces or the merchant marine of the United States or its allies.

(f) This section shall be construed to favor the effectuating of the principal's intent to make a valid power of attorney.

SECTION 30. IC 30-5-11-4.9 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 4.9. (a) Subject to the Indiana Rules of Evidence and the Indiana Rules of Trial Procedure:**

(1) a video or audio recording of a principal captured or made either before or after the execution of an electronic power of attorney; or

(2) a video recording, one (1) or more photographic images, or an audio recording captured or made during part or all of the execution of an electronic power of attorney;

may be admissible as evidence under this section.

(b) Recordings for images described in subsection (a) may be admissible as evidence of the following:

(1) The proper execution of an electronic power of attorney.

(2) The intentions of the principal.

(3) The mental state or capacity of a principal.

(4) The authenticity of an electronic power of attorney.

(5) Matters that are determined by a court to be relevant to the probate of an electronic power of attorney.

SECTION 31. IC 32-17-14-12, AS ADDED BY P.L.143-2009, SECTION 41, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 12. (a) A deed of gift, bill of sale, or other writing intended to transfer an interest in tangible personal property is effective on the death of the owner and transfers ownership to the designated transferee beneficiary if the document:

(1) expressly creates ownership in beneficiary form;

(2) is in other respects sufficient to transfer the type of property involved; and

(3) is executed by the owner and acknowledged before a notary public or other person authorized to administer oaths **or executed in the presence of a disinterested witness.**

(b) A beneficiary transfer document described in this section is not required to be supported by consideration or delivered to the transferee beneficiary.

(c) This section does not preclude other methods of transferring ownership of tangible personal property that are permitted by law and have the effect of postponing enjoyment of the property until after the death of the owner.

(d) For purposes of this section, a witness is disinterested if the witness is not:

(1) the designated transferee beneficiary;

(2) the spouse of the designated transferee beneficiary;

(3) a descendant of the designated transferee beneficiary; or

(4) the spouse of a descendant of the designated transferee beneficiary.

(e) A disinterested witness may prove the owner's execution of a deed of gift, bill of sale, or other writing under this section as a witness may prove the signature of a grantor, principal, or affiant making a conveyance, mortgage, or other instrument of writing under IC 32-21-2-3(a).

SECTION 32. IC 32-21-1-11 IS REPEALED [EFFECTIVE UPON PASSAGE]. ~~Sec. 11. If executed in a foreign country, conveyances, mortgages, and other instruments in writing that would be admitted to record under the recording laws of this state must be acknowledged by the grantor or person executing the instrument and proved before any diplomatic or consular officer of the United States, duly accredited, or before any officer of the foreign country who, by the laws of that country, is authorized to take acknowledgments or proof of conveyances. If the acknowledgment or proof is in the English~~

~~language and attested by the official seal of the officer acknowledging it, the instrument may be admitted to record. However, if the acknowledgment or proof is in a language other than English or is not attested by an official seal, then the instrument must be accompanied by a certificate of a diplomatic or consular officer of the United States attesting:~~

~~(1) that the instrument is duly executed according to the laws of the foreign country;~~

~~(2) that the officer certifying the acknowledgment or proof had legal authority to do so; and~~

~~(3) to the meaning of the instrument, if the instrument is made in a foreign language.~~

SECTION 33. IC 32-21-1-12 IS REPEALED [EFFECTIVE UPON PASSAGE]. ~~Sec. 12. It is not necessary to affix a private seal or ink scroll necessary to validate a conveyance of land or an interest in land executed by a natural person, business trust, or corporation. It is not necessary for the officer taking the acknowledgment of the conveyance to use an ink scroll or seal unless the officer is required by law to keep an official seal.~~

SECTION 34. IC 32-21-1-13, AS AMENDED BY P.L.231-2019, SECTION 46, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 13. (a) **As used in subsection (b), "conveyance" means any electronic record (as defined in IC 26-2-8-102) or any paper or other tangible medium or document that is:**

(1) ~~Except for a bona fide~~ **a** lease **or memorandum of lease** for a term ~~not~~ exceeding three (3) years;

(2) a ~~conveyance~~ **deed** of:

(A) land; or

(B) ~~of~~ any interest in land; ~~shall be made by a deed that is:~~

(3) a mortgage; or

(4) a land contract or memorandum of land contract for the sale and purchase of land.

(b) A conveyance must:

(1) ~~written; and~~ **be in writing;**

(2) ~~subscribed, sealed, and acknowledged~~ **be executed or signed** by the:

(A) lessor or landlord;

(B) grantor (as defined in IC 32-17-1-1); or ~~by the grantor's attorney.~~

(C) land contract seller; and

(3) have an acknowledgment (as defined in IC 33-42-0.5-2) or

a proof (as defined in and permitted under IC 32-21-2).

~~(b)~~ **(c)** If a transfer on death deed under IC 32-17-14 has been recorded before the death of the owner (as defined in IC 32-17-14-3) with the recorder of deeds in the county in which the real property is situated, a subsequent conveyance of the real property is void if it is not recorded before the death of the owner with the recorder of deeds in the county in which the real property is situated.

SECTION 35. IC 32-21-1-14 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 14. A conveyance of land by **an** attorney **in fact (as defined in IC 30-5-2-2)** is not good unless the attorney **in fact** is empowered by a ~~written instrument~~ **power of attorney (as defined in IC 30-5-2-7)** that:

(1) is ~~subscribed, sealed, and acknowledged by the attorney's principal in the same manner that is required for a conveyance by the attorney's principal.~~ **executed or signed by the principal (as defined in IC 30-5-2-8); and**

(2) has an acknowledgment (as defined in IC 33-42-0.5-2) or a proof (as defined in and permitted under IC 32-21-2).

SECTION 36. IC 32-21-2-4 IS REPEALED [EFFECTIVE UPON PASSAGE]. ~~Sec. 4. (a) This section applies when a conveyance, mortgage, or other instrument that is required to be recorded is acknowledged in any county in Indiana other than the county in which the instrument is required to be recorded.~~

~~(b) The acknowledgment must be:~~

~~(1) certified by the clerk of the circuit court of the county in which the officer resides; and~~

~~(2) attested by the seal of that court.~~

~~However, an acknowledgment before an officer having an official seal, if the acknowledgment is attested by that official seal, is sufficient without a certificate.~~

SECTION 37. IC 32-21-2-5 IS REPEALED [EFFECTIVE UPON PASSAGE]. ~~Sec. 5. To record in Indiana a conveyance that is acknowledged outside Indiana but within the United States, the conveyance must be:~~

~~(1) certified by the clerk of any court of record of the county in which the officer receiving the acknowledgment resides; and~~

~~(2) attested by the seal of that court.~~

~~However, an acknowledgment before an officer having an official seal that is attested by the officer's official seal is sufficient without a certificate.~~

SECTION 38. IC 32-21-2-6 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 6. ~~A deed may be~~

~~proved according to the rules of common law before any officer who is authorized to take acknowledgments. A deed that is proved in the manner provided in this section~~ **An instrument that complies with this article, IC 33-42, and IC 36-2-11** is entitled to be recorded.

SECTION 39. IC 32-21-2-7 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 7. **(a)** The ~~following~~ **form set forth in this subsection** ~~or~~ **and** any other form substantially the same ~~is a~~ **are** good or sufficient ~~form of~~ **forms for an** acknowledgment of ~~a~~ **an instrument that is described in section 3 of this chapter and to be recorded:** ~~deed or mortgage:~~

(1) An acknowledgment that complies with IC 33-42-0.5-2 and IC 33-42-9-12.

(2) An acknowledgment for a remote notarial act that complies with:

(A) IC 33-42-0.5-2;

(B) IC 33-42-0.5-26;

(C) IC 33-42-9-12; and

(D) IC 33-42-17-7.

(3) An acknowledgment that complies with IC 33-42-0.5-2 and IC 33-42-9-12(a) and contains the following or substantially the same information:

"Before me, E.F., **a _________________** ~~(judge or justice, as the case may be)~~ **(describe the notarial officer type)** this _____ day of _______, A.B. acknowledged the execution of the **foregoing or** annexed **_______________** ~~deed, (or mortgage, as the case may be.)~~ **(describe the type of instrument).".**

(b) The form set forth in this subsection and any other forms substantially the same are good or sufficient forms for a proof of an instrument that is described in section 3 of this chapter and to be recorded:

(1) A proof that complies with section 1.7 of this chapter and IC 33-42-9-12.

(2) A proof that complies with section 1.7 of this chapter and IC 33-42-9-12(a) and contains the following or substantially the same information:

"Before me, E.F., a _________________ (describe the notarial officer type) this _____ day of _______, appeared A.B. being personally known to me or identified to me by a sufficient credential, whose name is subscribed as a witness to the foregoing instrument, who, being duly sworn by me, deposes and says that the foregoing instrument was executed and delivered by C.D. (describe the signer or principal to the

instrument) while being personally observed by A.B.".

SECTION 40. IC 32-21-2-8 IS REPEALED [EFFECTIVE UPON PASSAGE]. ~~Sec. 8. (a) If before a public officer authorized to receive acknowledgment of deeds:~~

~~(1) the grantor of a deed intends to sign the deed with the grantor's mark; and~~

~~(2) in all other cases when the public officer has good cause to believe that the contents and purport of the deed are not fully known to the grantor;~~

~~it is the duty of the public officer before signature to fully explain to the grantor the contents and purport of the deed.~~

~~(b) The failure of the public officer to comply with subsection (a) does not affect the validity of a deed.~~

SECTION 41. IC 32-21-2-9 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 9. ~~A certificate of the acknowledgment of a conveyance or other instrument in writing that is required to be recorded, signed, and sealed by the officer taking the acknowledgment shall be written on or attached to the deed. When by law the certificate of the clerk of the proper county is required to accompany the acknowledgment, the certificate shall state that:~~

~~(1) the officer before whom the acknowledgment was taken was, at the time of the acknowledgment, acting lawfully; and~~

~~(2) the clerk's signature to the certificate of acknowledgment is genuine.~~

An instrument's acknowledgment or proof as required under section 3 of this chapter is incomplete when the instrument does not include the certificate described in IC 33-42-9-12.

SECTION 42. IC 32-21-2-11 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 11. ~~(a) This section applies to a conveyance or other instrument entitled by law to be recorded.~~

~~(b) The recorder of the county in which the land included in a conveyance or other instrument is situated shall record the deed or other instrument together with the requisite certificate of acknowledgment or proof endorsed on the deed or other instrument or annexed to the deed or other instrument.~~

~~(c) Unless a~~ **If an instrument is recorded without an acknowledgment's or proof's** certificate ~~of acknowledgment is recorded with a deed,~~ **as required under this article and IC 33-42-9-12,** the ~~record of the conveyance or other~~ instrument or a transcript **of the instrument** may not be read or received in evidence.

SECTION 43. IC 32-21-2-12 IS AMENDED TO READ AS

FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 12. The:

(1) **acknowledgment's or proof's** certificate of ~~the acknowledgment of a conveyance or~~ **an** instrument ~~of writing;~~ **as required under this article and IC 33-42-9-12;**

(2) ~~the record;~~ **instrument;** or

(3) ~~the~~ transcript of the ~~record;~~ **instrument;**

is not conclusive and may be rebutted and the force and effect of it contested by a party affected by the ~~conveyance or~~ instrument.

SECTION 44. IC 32-21-2-15, AS ADDED BY P.L.127-2017, SECTION 7, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 15. ~~Beginning January 1, 2018, a document~~ **An instrument** concerning real property that may be recorded with a county recorder under this title may be recorded electronically **as an electronic document** as provided under IC 32-21-2.5.

SECTION 45. IC 32-21-2.5-1, AS ADDED BY P.L.127-2017, SECTION 8, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 1. As used in this chapter, "document" **or "documents"** means ~~information that is:~~

~~(1)~~ **an electronic record (as defined in IC 26-2-8-102) or information that is:**

(1) inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form; and

(2) eligible to be recorded in the land records maintained by a county recorder.

SECTION 46. IC 32-21-2.5-7, AS ADDED BY P.L.127-2017, SECTION 8, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 7. ~~(a) This section is effective January 1, 2018.~~

~~(b)~~ **(a)** If a law requires, as a condition for recording, that a document:

(1) be an original;

(2) be on paper or another tangible medium; or

(3) be in writing;

the requirement is satisfied by an electronic document ~~satisfying~~ **that satisfies** this chapter, **IC 32-21-2, IC 36-2-11, and the notarial act requirements set forth under IC 33-42 for an acknowledgment as defined under IC 33-42-0.5-2 or for a proof as defined under IC 32-21-2-1.7.**

~~(c)~~ **(b)** If a law requires, as a condition for recording, that a document be signed, the requirement is satisfied by an electronic signature.

~~(d)~~ **(c)** ~~A requirement~~ **If a law requires, as a condition for recording,** that a document or a signature associated with a document be notarized, ~~acknowledged, verified, witnessed, or made under oath~~ **the requirement** is satisfied if the electronic ~~signature of the person authorized to perform that act, and all other information required to be included, is attached to or logically associated with the document or signature. A physical or an electronic image of a stamp, impression, or seal does not have to accompany an electronic signature.~~ **document:**

(1) has an electronic signature; and

(2) complies with IC 32-21-2-3.

SECTION 47. IC 32-21-2.5-8, AS ADDED BY P.L.127-2017, SECTION 8, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 8. (a) As used in this section, "paper document" **or "paper documents"** means a ~~document~~ **tangible record** that is received by a county recorder in a form that is not electronic.

(b) ~~Beginning January 1, 2018,~~ **On or before July 1, 2022,** a county recorder **shall receive for recording, indexing, storage, archiving, access to, searching of, retrieval, and transmittal all electronic documents proper for recording. A county recorder shall also accept electronically any fee or tax that the county recorder is authorized to collect under applicable laws. A county recorder shall**

~~(1) who implements any of~~ **implement** the **processing of electronic documents proper for recording** ~~functions listed in this section shall do so~~ in compliance with:

(1) this article;

(2) IC 33-42;

(3) IC 36-2-7.5;

(4) IC 36-2-11; and

(5) IC 36-2-13; and

the standards ~~established~~ **adopted** by the electronic recording commission created under section 9 of this chapter.

~~(2) may receive, index, store, archive, and transmit electronic documents;~~

~~(3) may provide for access to, and for search and retrieval of, documents and information by electronic means.~~

~~(4)~~ **(c) A recorder** who accepts electronic documents for recording shall:

~~(A)~~ **(1)** continue to accept paper documents as authorized by state law; and

~~(B)~~ **(2)** place entries for ~~both types of~~ **paper documents and electronic** documents in the same index.

~~(5)~~ **(d) A recorder who accepts electronic documents for recording** may:

(1) convert paper documents accepted for recording into electronic form;

~~(6)~~ **(2)** ~~may~~ convert into electronic form information recorded before the county recorder began to ~~record~~ **accept and index** electronic documents; **or**

~~(7) may accept electronically any fee or tax that the county recorder is authorized to collect; and~~

~~(8)~~ **(3)** ~~may~~ agree with other officials of a state or a political subdivision of a state, or of the United States, on procedures or processes to facilitate the electronic satisfaction of prior approvals and conditions precedent to recording and the electronic payment of fees and taxes.

SECTION 48. IC 32-21-2.5-10, AS ADDED BY P.L.127-2017, SECTION 8, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 10. In applying and construing this chapter, consideration must be given to the need to promote uniformity of the law with respect to ~~its subject matter among states that enact it.~~ **this article, the Uniform Electronic Transactions Act under IC 26-2-8, IC 33-42, IC 36-2-7.5, and IC 36-2-11, as well as similar laws enacted in other states.**

SECTION 49. IC 32-21-2.5-12 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 12. (a) The recorder shall record a paper or tangible copy of an electronic record (as defined in IC 26-2-8-102) that is otherwise eligible under Indiana law to be recorded if the paper or tangible copy of the electronic record:**

(1) contains an image of an electronic signature or signatures;

(2) contains an acknowledgment or proof as required by IC 32-21-2-3; and

(3) has been certified by a notarial officer, as described in IC 33-42-9-7(a), to be a true and correct copy of the electronic record as provided in subsection (c).

(b) A printed document that is a paper or tangible copy of an electronic record and certified to be a true and correct copy as described in subsection (c) satisfies any requirement of law that, as a condition for recording, requires the printed document to:

(1) be an original or be in writing;

(2) be signed or contain an original signature if the document contains an electronic signature of the person required to sign the document; and

(3) have an acknowledgment or proof according to Indiana law if the document contains an electronic signature of the notarial officer authorized to perform that act and all other information required to be included.

(c) A notarial officer who makes an acknowledgment or proof under IC 32-21 or IC 33-42 may certify that a paper or tangible copy of an electronic record is a true and correct copy of an electronic record by:

(1) executing and attaching the notarial officer's official seal to a tangible paper certificate; or

(2) affixing or attaching the certificate to the paper or tangible copy of an electronic record.

(d) The form of the certificate required under subsection (c) must be substantially as follows:

"State of __________

County of __________

I certify that the foregoing and attached document entitled __________ (insert document title), dated __________ (insert document date) and containing _____ pages, is a true and correct copy of an electronic record printed by me or under my supervision. I further certify that, at the time of printing, no security features present on the electronic record indicated any changes or errors in an electronic signature or other information in the electronic record after the electronic record's creation or execution.

Signed this _____ day of _____, _____

__________ (signature of notarial officer)

__________ (printed name of notarial officer)

__________ (include notarial officer's commission number, official seal, commission county of residence or employment, and commission expiration date as required by applicable law).".

SECTION 50. IC 32-21-3-2.5 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 2.5. As used in this chapter, "proof" has the meaning set forth in IC 32-21-2-1.7.**

SECTION 51. IC 32-21-9-1 IS REPEALED [EFFECTIVE UPON PASSAGE]. ~~Sec. 1. (a) In addition to the acknowledgment of written instruments and the performance of other notarial acts in the manner and form otherwise authorized by the laws of this state, a person:~~

~~(1) who is serving in or with the armed forces of the United States wherever located;~~

~~(2) who is serving as a merchant seaman outside the limits of the~~

~~United States included within the fifty (50) states and the District of Columbia; or~~

~~(3) who is outside the limits of the United States by permission, assignment, or direction of any department or office of the United States government in connection with any activity pertaining to the prosecution of any war in which the United States is engaged;~~

~~may acknowledge any instruments, attest documents, subscribe oaths and affirmations, give depositions, execute affidavits, and perform other notarial acts before any commissioned officer with the rank of second lieutenant or higher in the active services of the Army of the United States or the United States Marine Corps or before any commissioned officer with the rank of ensign or higher in the active service of the United States Navy or the United States Coast Guard, or with equivalent rank in any other component part of the armed forces of the United States.~~

~~(b) The commissioned officer before whom a notarial act is performed under this section shall certify the instrument with the officer's official signature and title in substantially the following form:~~

~~With the Armed Forces (or other component part of)~~
~~) ss~~
~~the armed forces) of the United States at [1]_______________)~~
~~The foregoing instrument was acknowledged this ___________~~
~~day of ______ 20___ by [2]_____ serving (in) the armed forces of the~~
~~(with)~~
~~United States) ___________ (as a merchant seaman outside the limits of the United States) (as a person not in the armed forces, but outside the limits of the United States by permission, assignment, or direction of a department of the United States Government in connection with an activity pertaining to the prosecution of the war), before me, a commissioned officer in the active service of the (Army of the United States) (United States Marine Corps) (United States Navy) (United States Coast Guard) (or equivalent rank in any other component part of the armed forces).~~

~~(Signature of officer)~~
____
____
~~Rank and Branch~~

~~Footnote 1. In the event that military considerations preclude disclosure of the place of execution or acknowledgment the words "an undisclosed place" may be supplied instead of the appropriate city or county, state, and country.~~

~~Footnote 2. If by a natural person or persons, insert name or names; if by a person acting in a representative or official capacity or as~~

~~attorney-in-fact, then insert name of person acknowledging the instrument, followed by an accurate description of the capacity in which he acts including the name of the person, corporation, or other entity represented.~~

SECTION 52. IC 32-21-9-2 IS REPEALED [EFFECTIVE UPON PASSAGE]. ~~Sec. 2. An acknowledgment or other notarial act made substantially in the form prescribed by section 1 of this chapter is prima facie evidence:~~

~~(1) that the person named in the instrument as having acknowledged or executed the instrument:~~

~~(A) appeared in person before the officer taking the acknowledgment;~~

~~(B) was personally known to the officer to be the person whose name was subscribed to the instrument; and~~

~~(C) acknowledged that the person signed the instrument as a free and voluntary act for the uses and purposes set forth in the instrument;~~

~~(2) if the acknowledgment or execution is by a person in a representative or official capacity, that the person acknowledging or executing the instrument acknowledged it to be the person's free and voluntary act in such capacity or the free and voluntary act of the principal, person, or entity represented; and~~

~~(3) if the acknowledgment or other notarial act is by a person as an officer of a corporation, that the person was known to the officer taking the acknowledgment or performing any other notarial act to be a corporate officer and that the instrument was executed and acknowledged for and on behalf of the corporation by the corporate officer with proper authority from the corporation, as the free and voluntary act of the corporation.~~

SECTION 53. IC 32-21-9-3 IS REPEALED [EFFECTIVE UPON PASSAGE]. ~~Sec. 3. An instrument acknowledged or executed as provided in this chapter is not invalid because of a failure to state in the instrument the place of execution or acknowledgment.~~

SECTION 54. IC 32-21-9-4 IS REPEALED [EFFECTIVE UPON PASSAGE]. ~~Sec. 4. An acknowledgment or other notarial act made substantially as provided in this chapter constitutes prima facie proof of the facts recited in the instrument and, without further or other authentication, entitles any document so acknowledged or executed to be filed and recorded in the proper offices of record and received in evidence before the courts of this state, to the same extent and with the same effect as documents acknowledged or executed in accordance with any other provision of law now in force or that may be enacted.~~

SECTION 55. IC 32-39-2-4, AS AMENDED BY P.L.163-2018, SECTION 23, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 4. If a deceased user consented to, or a court directs, disclosure of the contents of electronic communications of the user, the custodian shall disclose to the personal representative of the estate of the user the content of an electronic communication sent or received by the user if the personal representative gives the custodian the following:

(1) A written request for disclosure in physical or electronic form.
(2) A certified or authenticated copy of the death certificate of the user.
(3) A copy of the letters (as defined in ~~IC 29-1-1-3(a)(18))~~ **IC 29-1-1-3(a)(21))** of the personal representative or of the order of no supervision or order of unsupervised administration issued to the personal representative under IC 29-1-7.5.
(4) Unless the user provided direction using an online tool, a copy of the user's will, trust, power of attorney, or other record evidencing the user's consent to disclosure of the content of electronic communications.
(5) If requested by the custodian:
(A) a number, username, address, or other unique subscriber identifier or account identifier assigned by the custodian to identify the user's account;
(B) evidence linking the account to the user; or
(C) a finding by the court that:
(i) the user had a specific account with the custodian, identifiable by the information specified in clause (A);
(ii) disclosure of the content of electronic communications of the user would not violate 18 U.S.C. 2701 et seq., 47 U.S.C. 222, or other applicable law;
(iii) unless the user provided direction using an online tool, the user consented to disclosure of the content of electronic communications; or
(iv) disclosure of the content of electronic communications of the user is reasonably necessary for administration of the user's estate.

SECTION 56. IC 32-39-2-5, AS AMENDED BY P.L.163-2018, SECTION 24, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 5. Unless the user prohibited disclosure of the user's digital assets or a court directs otherwise, a custodian shall disclose to the personal representative of the estate of a deceased user a catalogue of electronic communications sent or received by the user

and digital assets, other than the content of electronic communications, of the user, if the personal representative gives the custodian:

(1) a written request for disclosure in physical or electronic form;

(2) a certified or authenticated copy of the death certificate of the user;

(3) a copy of the letters ~~(as defined in IC 29-1-1-3(a)(18))~~ **(as defined in IC 29-1-1-3(a)(21))** of the personal representative or of the order of no supervision or order of unsupervised administration issued to the personal representative under IC 29-1-7.5; or

(4) if requested by the custodian:

(A) a number, username, address, or other unique subscriber identifier or account identifier assigned by the custodian to identify the user's account;

(B) evidence linking the account to the user;

(C) an affidavit stating that disclosure of the user's digital assets is reasonably necessary for administration of the user's estate; or

(D) a finding by the court that:

(i) the user had a specific account with the custodian, identifiable by the information specified in clause (A); or

(ii) disclosure of the user's digital assets is reasonably necessary for administration of the user's estate.

SECTION 57. IC 32-39-2-12, AS AMENDED BY P.L.163-2018, SECTION 25, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 12. (a) The legal duties imposed on a fiduciary charged with managing tangible property, including:

(1) the duty of care;

(2) the duty of loyalty; and

(3) the duty of confidentiality;

also apply to a fiduciary charged with managing digital assets.

(b) A fiduciary's or designated recipient's authority with respect to a digital asset of a user:

(1) except as otherwise provided in section 1 of this chapter, is subject to the applicable terms of service;

(2) is subject to other applicable law, including copyright law;

(3) is limited by the scope of the fiduciary's duties; and

(4) may not be used to impersonate the user.

(c) A fiduciary with authority over the property of a decedent, protected person, principal, or settlor has the right to access any digital asset:

(1) in which the decedent, protected person, principal, or settlor

had a right or interest; and

(2) that is not held by a custodian or subject to a terms-of-service agreement.

(d) A fiduciary acting within the scope of the fiduciary's duties is an authorized user of the property of the decedent, protected person, principal, or settlor for the purpose of applicable computer fraud and unauthorized computer access laws, including IC 24-4.8-2, IC 24-5-22, IC 35-43-1-7, IC 35-43-1-8, IC 35-43-2-3, and IC 35-45-13.

(e) A fiduciary with authority over the tangible, personal property of a decedent, protected person, principal, or settlor:

(1) has the right to access the property and any digital asset stored in the property; and

(2) is an authorized user for the purpose of computer fraud and unauthorized computer access laws, including IC 24-4.8-2, IC 24-5-22, IC 35-43-2-3, and IC 35-45-13.

(f) A custodian may disclose information in an account to a fiduciary of the user when the information is required to terminate an account used to access digital assets licensed to the user.

(g) A fiduciary of a user may request that a custodian terminate the user's account. A request for termination must be in writing, in either physical or electronic form, and must be accompanied by:

(1) if the user is deceased, a certified or authenticated copy of the death certificate of the user;

(2) a copy of:

(A) the letters ~~(as defined in IC 29-1-1-3(a)(18))~~ **(as defined in IC 29-1-1-3(a)(21))** of the personal representative or of the order of no supervision or order of unsupervised administration issued to the personal representative under IC 29-1-7.5;

(B) the court order;

(C) the power of attorney; or

(D) the trust;

giving the fiduciary authority over the account; and

(3) if requested by the custodian:

(A) a number, username, address, or other unique subscriber identifier or account identifier assigned by the custodian to identify the user's account;

(B) evidence linking the account to the user; or

(C) a finding by the court that the user had a specific account with the custodian, identifiable by the information specified in clause (A).

SECTION 58. IC 33-42-0.5-18, AS ADDED BY P.L.59-2018, SECTION 25, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE

UPON PASSAGE]: Sec. 18. "Notarial act" means the following acts with respect to either a tangible or an electronic record:

(1) Taking an acknowledgment.
(2) Administering an oath or affirmation.
(3) Taking a verification on an oath or affirmation.
(4) Attesting to or witnessing a signature.
(5) Attesting to or certifying a copy of:
(A) a tangible document or record; or
(B) an electronic document or record.
(6) Taking a proof (as defined in IC 32-21-2-1.7).
~~(6)~~ **(7)** Noting a protest of a negotiable record.
~~(7)~~ **(8)** Any other act authorized by common law or the custom of merchants.

SECTION 59. IC 33-42-9-7, AS AMENDED BY P.L.59-2018, SECTION 47, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 7. (a) A notarial act may be performed by the following individuals:

(1) Notaries public.
(2) An official court reporter acting under IC 33-41-1-6.
(3) Judges and justices of Indiana courts.
(4) The secretary of state.
(5) The clerk of the supreme court.
(6) Mayors, clerks, clerk-treasurers of towns and cities, township trustees, in their respective towns, cities, and townships.
(7) Clerks of circuit courts and master commissioners in their respective counties.
(8) Judges of United States district courts of Indiana, in their respective jurisdictions.
(9) United States commissioners appointed for any United States district court of Indiana, in their respective jurisdictions.
(10) A precinct election officer (as defined in IC 3-5-2-40.1) and an absentee voter board member appointed under IC 3-11-10 or IC 3-11.5-4, for any purpose authorized under IC 3.
(11) A member of the Indiana election commission, a co-director of the election division, or an employee of the election division as defined under IC 3-6-4.2.
(12) County auditors in their respective counties.
(13) County recorders in their respective counties.
~~(13)~~ **(14)** Any member of the Indiana general assembly anywhere in Indiana.
~~(14)~~ **(15)** The adjutant general of the Indiana National Guard, specific active duty members, reserve duty members, or civilian

employees of the Indiana National Guard designated by the adjutant general of the Indiana National Guard for any purpose related to the service of an active duty or reserve member of the Indiana National Guard.

(b) The signature and title of an individual performing a notarial act in Indiana is prima facie evidence of the fact that:

(1) the signature is genuine; and

(2) the individual holds the designated title.

SECTION 60. IC 33-42-9-12, AS AMENDED BY P.L.177-2019, SECTION 19, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 12. (a) A notarial act must be authenticated by a certificate bearing the date of the notarial act and the signature of the notarial officer. A properly completed certificate must conform to the following conditions:

(1) The certificate must be completed contemporaneously with the performance of the notarial act.

(2) The certificate must be signed and dated by the notarial officer. If the notarial officer is a notary public, the certificate must be signed in the manner on file with the secretary of state for the specific notary public.

(3) The certificate must identify the jurisdiction in which the notarial act is performed as follows:

(A) For a notarial act that is not a remote notarial act, the county and state in which the principal **or witness** appears before the notarial officer.

(B) For a remote notarial act, the information required by IC 33-42-17-7(a)(3).

(4) The certificate must display the title of the notarial officer.

(5) If the notarial officer is a notary public, the certificate must display:

(A) the expiration date of the notary public's commission; and

(B) either of the following:

(i) The Indiana county of the notary public's commission.

(ii) If the notary public is not a resident of Indiana but is primarily employed in Indiana, the Indiana county where the notary public is primarily employed.

(b) A notary public who performs a notarial act on a tangible record shall:

(1) affix, display, or emboss the notary public's official seal; and

(2) print or type the notary public's name underneath the notary public's signature on a certificate of acknowledgment, ~~jurat,~~ **proof (as defined in and permitted under IC 32-21-2),** or other

official record unless the name of the notary public:
(A) appears in printed form on the record; or
(B) appears as part of the notary public's official seal; and
is legible when the record is photocopied.

(c) If a notarial act is performed on a public record by a notarial officer other than a notary public, the information described in subsection (a)(2) through (a)(4) must be affixed, displayed, or embossed upon the certificate and accompanied by the notarial officer's official seal.

(d) If a notarial act is performed on an electronic record by a notary public:
(1) the electronic notarial certificate must contain the information described in subsection (a)(2) through (a)(5); and
(2) the notary public's electronic seal must be attached to or associated with the electronic notarial certificate.

(e) If a notarial act is performed on an electronic record by a notarial officer other than a notary public:
(1) the electronic notarial certificate must contain the information described in subsection (a)(2) through (a)(4); and
(2) the notarial officer's official seal must be attached to or associated with the electronic notarial certificate.

(f) A certificate of a notarial act or an electronic notarial certificate is sufficient if it meets the requirements described in subsections (a) and (b) and:
(1) is in a form permitted by the laws of this state;
(2) is in a form permitted by the laws of the jurisdiction in which the notarial act was performed; or
(3) sets forth the actions of the notarial officer.

(g) By executing a certificate of a notarial act or an electronic notarial certificate, a notarial officer certifies that the notarial officer has complied with this chapter.

(h) A notarial officer may not affix a signature to or associate a certificate of a notarial act or an electronic notarial certificate with a record until a notarial act has been performed.

(i) A certificate of a notarial act or an electronic notarial certificate must be attached to or associated with each tangible record or electronic record in a manner consistent with the applicable requirements of subsections (a) through (f).

(j) An official:
(1) certificate of a notarial act bearing a notarial officer's official seal; or
(2) electronic notarial certificate bearing a notarial officer's

electronic seal;

constitutes presumptive evidence of the facts stated in cases, where, by law, the notarial officer is authorized to certify facts.

(k) A notarial officer may subsequently correct any information included or omitted from a certificate of a notarial act or an electronic notarial certificate executed by the notarial officer.

(l) Changes or corrections may never be made to the impression of an official seal.

SECTION 61. IC 33-42-17-7, AS ADDED BY P.L.59-2018, SECTION 64, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 7. (a) An electronic notarial certificate of a remote notarial act must:

(1) specify that the notarial act is a remote notarial act;

(2) include a space in which a remote notary public may indicate whether the principal in the remote notarial act appeared before the remote notary public under section 4(a)(1) or 4(a)(2) of this chapter; and

(3) specify the:

(A) city and county in Indiana in which the remote notary public is physically located when the remote notary public performs the remote notarial act; and

(B) city, county, state or province, and country in which the principal is physically located when the principal signs the document.

(b) Completion of either of the following forms satisfies the requirements of this section **where a principal appears before a remote notary public:**

"State of Indiana
County of________________
City of___________________
I certify that the attached or associated electronic record
entitled____ and
dated___________________________ was signed by the
principal__________________ who was located in this
city_________________, county___________, state or
province_______________, and country_____________ and
notarized by me, the remote notary public, on this
date__________________ in this city and county____________,
Indiana.
Signed_____________________________, remote notary public.
Printed name of remote notary public_____________________
Date notary public commission expires____________________".

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"State of Indiana
County of________________
City of___________________
I certify that the attached or associated electronic record entitled____ and dated____________ was acknowledged and signed by the principal__________________ who was located in this city___________________, county_____________, state or province______________, and country_____________ and who appeared by audio visual communication on this date, was notarized by me, the remote notary public, on this date_________ in this city and county_____________________, Indiana.
Signed_____________________________, remote notary public.
Printed name of remote notary public ____________________
Date notary public commission expires___________________".

SECTION 62. IC 33-42-17-12, AS ADDED BY P.L.59-2018, SECTION 64, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 12. ~~(a) An individual performing a notarial act as described in IC 33-42-9-8, IC 33-42-9-9, IC 33-42-9-10, or IC 33-42-9-11 may not perform the notarial act as a remote notarial act unless:~~

~~(1) the individual performing the remote notarial act is:~~
~~(A) a notary public commissioned by the secretary of state under IC 33-42-2; and~~
~~(B) registered as a remote notary public under section 2 of this chapter;~~
~~(2) the remote notarial act is performed in accordance with this chapter; and~~
~~(3) the individual performing the remote notarial act complies with this chapter.~~

~~(b)~~ A remote notarial act performed in accordance with this chapter is considered to have been performed in Indiana, regardless of the physical location of the principal at the time the remote notarial act is performed.

SECTION 63. IC 34-41-1-2 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 2. The circumstances under which seals are required on deeds and other instruments conveying land are governed by ~~IC 32-21-1-12 and~~ IC 34-37-1.

SECTION 64. IC 36-2-11-3, AS AMENDED BY P.L.127-2017, SECTION 71, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE

UPON PASSAGE]: Sec. 3. **(a)** The recorder shall keep the recorder's office in a building provided at the county seat by the county executive. The recorder shall keep the recorder's office open for business during regular business hours on every day of the year except Sundays and legal holidays. However, the recorder may close the recorder's office on days specified by the county executive according to the custom and practice of the county.

(b) If a county office is closed for three (3) or more business days pursuant to an executive order issued under IC 10-14-3, the county executive and the county recorder shall provide notice to the public on an Internet web site maintained by or on behalf of the county executive and the recorder. The notice must be provided to the public within five (5) business days of the executive order being issued. The notice may include information on how the public can submit documents to the recorder's office in paper, electronic, or digital formats and how payment must be provided for services rendered by a specific county office.

(c) A county office's failure to comply with subsection (b) shall not:

(1) invalidate any instrument submitted to the recorder pursuant to:

(A) IC 29-1-7-23(d);

(B) IC 32-21; or

(C) this chapter; or

(2) subject the recorder, the recorder's office, or any county office personnel to civil liability under IC 34-13-3 or any other provision of Indiana law.

SECTION 65. IC 36-2-11-16, AS AMENDED BY P.L.129-2008, SECTION 2, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 16. (a) This section does not apply to:

(1) an instrument executed before November 4, 1943;

(2) a judgment, order, or writ of a court;

(3) a will or death certificate; or

(4) an instrument executed or acknowledged outside Indiana.

(b) Whenever this section prescribes that the name of a person be printed, typewritten, or stamped immediately beneath the person's signature, the signature must be written on the instrument, directly preceding the printed, typewritten, or stamped name, and may not be superimposed on that name so as to render either illegible. However, the instrument may be received for record if the name and signature are, in the discretion of the county recorder, placed on the instrument so as to render the connection between the two apparent.

(c) Except as provided in subsection (d), the recorder may receive for record an instrument only if all of the following requirements are met:

(1) The name of each person who executed the instrument is legibly printed, typewritten, or stamped immediately beneath the person's signature or the signature itself is printed, typewritten, ~~or~~ stamped, **or logically associated with the instrument.**

(2) The name of each witness to the instrument is legibly printed, typewritten, or stamped immediately beneath the signature of the witness or the signature itself is printed, typewritten, ~~or~~ stamped, **or logically associated with the instrument.**

(3) The name of each ~~notary public~~ **notarial officer** whose signature appears on the instrument is legibly printed, typewritten, or stamped immediately beneath the signature of the ~~notary public~~ **notarial officer** or the signature itself is printed, typewritten, ~~or~~ stamped, **or logically associated with the instrument.**

(4) The name of each person who executed the instrument appears identically in the body of the instrument, in the acknowledgment or ~~jurat,~~ **proof (as defined in and permitted under IC 32-21-2)** in the person's signature, and beneath the person's signature.

(5) The execution of the instrument and the acknowledgment or proof (as defined in and permitted under IC 32-21-2), complies with IC 33-42.

~~(5)~~ **(6)** If the instrument is a copy, the instrument is marked "Copy".

(d) The recorder may receive for record an instrument that does not comply with subsection (c) if all of the following requirements are met:

(1) A printed or typewritten affidavit of a person with personal knowledge of the facts is recorded with the instrument.

(2) The affidavit complies with this section.

(3) The affidavit states the correct name of a person, if any, whose signature cannot be identified or whose name is not printed, typewritten, or stamped on the instrument as prescribed by this section.

(4) When the instrument does not comply with subsection (c)(4), the affidavit states the correct name of the person and states that each of the names used in the instrument refers to the person.

(5) If the instrument is a copy, the instrument is marked "Copy".

(e) The recorder shall record a document presented for recording or a copy produced by a photographic process of the document presented for recording if:

(1) the document complies with other statutory recording

requirements; and
(2) the document or copy will produce a clear and unobstructed copy.

(f) An instrument, document, or copy received and recorded by a county recorder is conclusively presumed to comply with this section. A recorded copy shall have the same effect as if the original document had been recorded.

SECTION 66. **An emergency is declared for this act.**

____
Speaker of the House of Representatives

____
President of the Senate

____
President Pro Tempore

____
Governor of the State of Indiana

Date: ________________ Time: ________________

HEA 1255 — Concur

Section Six

THE SECURE ("SETTING EVERY COMMUNITY UP FOR RETIREMENT ENHANCEMENT" OR "SENDING EVERYONE COWERING UNDER REDUCED EXPECTATIONS") ACT AND OTHER RECENT DEVELOPMENTS IN ESTATE PLANNING FOR RETIREMENT ASSETS

A Presentation for the 48th Annual Midwest Estate, Tax & Business Planning Institute
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Section Six

The Secure ("Setting Every Community Up for Retirement Enhancement" or "Sending Everyone Cowering Under Reduced Expectations") Act and Other Recent Developments in Estate Planning for Retirement Assets…………………………………....Robert K. Kirkland

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I. INTRODUCTION

A. If you take a step back and honestly assess the portion of total estate planning time spent for a client on planning for the client's retirement benefits, do you feel it is proportionately appropriate?

B. Prior to 2010, one could argue that, due to the relative estate/gift tax rates and exemptions then applicable and the number of clients to which the estate/gift tax applied, the majority of our planning time was necessarily focused on estate and gift tax planning techniques, to the potential detriment of appropriately considering the planning options with respect to retirement benefits.

C. I wish to make the case that, in the current tax law environment, especially with the enactment of the new tax law, planners should spend a disproportionate amount of planning time with respect to clients' retirement benefits.

1. According to the Urban-Brookings Tax Policy Center, the current estate and gift tax rates and exemptions impact only .15% of the U.S. population in general (and this was prior to the TCJA of 2017).

2. To the contrary, almost every client we encounter in the planning context has a retirement plan interest of sufficient size to warrant a greater amount of our attention.

D. Let us remind ourselves why retirement benefits are so unique so as to warrant a disproportionate amount of our planning time.

1. During a participant's life, retirement plan assets, while enjoying terrific income tax deferral options, remain "pregnant" with future income tax liability.

2. Maximum funding of retirement plan assets is a very effective asset protection technique.

3. The mere completion of a beneficiary designation form, which happens on many occasions with the assistance of someone who provides no tax or planning advice whatsoever, greatly impacts the amount and the timing of income taxation on the distribution of these benefits.

4. Unlike any other asset, directing retirement benefit assets to a trust involves a myriad of complicated rules and planning implications, as well as potential non-sensical income tax results (albeit a different set of implications under the SECURE Act).

5. Unlike most items of inheritance, every dollar distributed from a qualified retirement plan to a non-charitable beneficiary is subject to income tax.

6. In some states, a beneficiary's interest in a deceased participant's retirement plan can continue to enjoy creditor protection.

7. Retirement plan benefits open the door for a variety of proactive charitable planning techniques (especially after the SECURE Act!)

E. All references in this outline to an IRA shall be deemed to refer to a non-Roth IRA, unless specifically provided otherwise.

II. DESIGNATION OF INDIVIDUALS AS BENEFICIARIES OF QUALIFIED PLANS/IRAS

A. You Must Follow the Literal Guidelines of the Retirement Plan Document in Completing a Qualified Plan Beneficiary Designation (however, reformation is not out of the question).

1. In Ruiz v. Publix Super Markets, Inc., Case No. 8:17-cv-735-T-24 TGW, the U.S. District Court of the Middle District of Florida held that substantial compliance with plan requirements for designation of a beneficiary of a qualified retirement plan was not good enough to constitute an effective beneficiary designation.

2. The District Court relied heavily on the principles of the Supreme Court decision in Kennedy v. Plan Administrator for DuPont Savings and Investment Plan, 555 U.S. 285 (2009). A recent Fifth Circuit Court of Appeals decision affirms these basic principles in Kinder Morgan Incorporated v. Crout, (No. 19-20037, 05/18/2020).

3. In a slip opinion which does not include the background facts, the Appellate Division of the New York Supreme Court reversed the decree of the Surrogate's Court of New York County and allowed a reformation of an IRA beneficiary designation. This changed the beneficiary from a "philanthropic fund" to the decedent's spouse of thirty-nine (39) years. *Matter of Sukenik*, 2018 NY Op. 04658 (June 21, 2018).

B. Distribution Rules During Life and After Death.

1. Distributions During the Taxpayer's Lifetime

a. In order to advise your client in structuring his or her IRA beneficiary designation, you have to be familiar with the minimum distribution rules. The required minimum distribution ("RMD") rules specify how long a taxpayer (and after the taxpayer's death, the beneficiary(s)) may defer withdrawals from retirement accounts. IRC § 401(a)(9).

b. During life, the taxpayer must generally begin taking withdrawals by April 1 of the year after the taxpayer reaches age 72. This date is referred to as the required beginning date ("RBD"). (For certain employees, the RMDs do not have to begin until the calendar year of retirement if the employee retires after age 72).

c. An IRS table that takes into account the taxpayer's life expectancy sets the RMD amount the taxpayer must withdraw in each year after the RBD. Treas. Reg. § 1.401(a)(9)-5.

(1) Unless the account owner's spouse is more than ten (10) years younger than the account owner, then the account owner will use the "Uniform Lifetime Table." Treas. Reg. § 1.401(a)(9)-9(A-2).

(2) If there is a spouse more than ten (10) years younger, then the account owner uses the "Joint and Last Survivor Table." Treas. Reg. § 1.401(a)(9)-9(A-3).

d. Distributions from qualified retirement plans that are taken before the taxpayer reaches the age of 59 ½ are subject to an additional 10% "early withdrawal" tax, unless the distribution falls within a statutory exception. IRC § 72(t).

(1) Code §72(t) was amended recently to expand the "Public Safety Employee" exception to the general rule of requiring a 10% additional tax on early distributions. Specifically, the Defending Public Safety Employees Retirement Act (H.R. 2146) was enacted after being signed by President Obama on June 29, 2015. One aspect of this legislation allows retired federal public safety officers to access their Thrift Savings Plan funds at age 50 without incurring the 10% early withdrawal penalty.

e. Recently, the courts have clarified under what circumstances this 10% tax will be imposed.

(1) In Kott v. C.I.R., T.C. Summ.Op. 2015-42 (2015), a taxpayer who was younger than age 59 ½ and delinquent in his mortgage payments withdrew funds from his 401(k) plan account in order to use such funds to avoid foreclosure. The Tax Court held that the taxpayer was liable for the 10% early distribution penalty as the Code does not include an exception for a general "financial hardship." While the Tax Court noted Reg. § 1.401(k)-1(d)(3)(iii)(B)(4), which allows for distributions to be made to employees for payments necessary to prevent eviction from the employee's principal residence or foreclosure, the Tax Court held that this exception only permitted the hardship distributions be made, and does not exempt the distributions from the 10% additional early distribution tax.

(2) In Adams v. Commissioner, the taxpayer lost his job with the Department of Defense and immediately filed suit for wrongful termination based on discrimination. Because he could not find another comparable job, the taxpayer took out over $220,000 from his IRA; he was under 59½ years old at the time. He reported all but $70,000 as income, and did not self-assess the premature withdrawal penalty. Upon examination by the IRS, Adams claimed that the penalty should not apply, as the withdrawals resulted from discrimination at work and were needed for medical care and "to fight for justice." The Service said fine, please

provide receipts and other documentation. Adams never provided any documentation, and the Tax Court held that the 10% premature withdrawal penalty applied (as well as the other penalties for underreporting income).

(3) In *In re* Bradford, 2015 WL 4549603 (Bankr. M.D. Ga., July 20, 2015), a Georgia bankruptcy court indicated that the early distribution tax imposed by §72(t) is an excise tax, and not a punitive tax measure, for purposes of bankruptcy.

(a) In examining the legislative history behind §72(t) of the Code and several relevant Supreme Court cases, the court held that this tax was enacted to deter debtor conduct rather that to support the government. Specifically, the court believed that the tax sought "to prevent retirement plans from being treated as savings accounts, to recapture a measure of tax benefits that have been provided prior to the withdrawal, and to deter the use of retirement funds for nonretirement purposes." *In re* Cassidy, 983 F.2d at 164.

(b) Next, the Court determined whether the penalty was entitled to priority as compensation of the government's actual pecuniary loss. After finding that the government sustains little loss if any when the tax recoups a loss to the government incurred through the taxpayer's deferment of income and that the losses claimed by the IRS do not constitute actual pecuniary loss, the Court held that Code § 72(t) is not entitled to priority.

(c) Ultimately, the court found the exaction was neither a tax, as it was not enacted to support the government, nor a penalty in compensation for actual pecuniary loss under Code § 507(a)(8). Therefore, the 10% exaction was not entitled to priority in the debtor's bankruptcy case.

f. How to reduce your clients RMDs.

(1) Your client can buy a qualified longevity annuity contract. This contract does not start paying the client an annuity until the client attains age 85. The funds used to purchase the annuity will have many years to accumulate and grow, so the income eventually received will be larger. Normally, such a delayed annuity is not permitted for IRAs, as the minimum distribution rules require RMDs no later than the RBD. The IRS has made an exception for qualified longevity annuities with up to $125,000 of the IRA balance, or 25% of the IRA owner's total IRA balance if it is less than $125,000.

(2) If a client is still working after attaining age 72, he or she may be entitled to reduce compensation income by tax deductible contributions to some type of retirement plan. These tax deductible contributions provide a current tax deduction reducing the income tax effect of his or her RMDs from other IRAs. If the client is self-employed, the client can adopt a SEP-IRA, to which such contributions may be made.

(3) If your client works for a non-profit entity, or a for-profit company if the client has less than 5% ownership in that company, and such entity has a qualified retirement plan that accepts rollovers from IRAs, the client can rollover his or her IRA into the company plan and then not have to take RMDs from that plan until actual retirement from that employer.

(4) If the client participates in an employer's qualified retirement plan, and has "after-tax money" in that plan, then upon retirement from that company the client should request that the plan send a direct rollover of all pre-tax money to a traditional IRA and the after-tax money to a Roth IRA. In essence, this is a tax-free Roth IRA conversion.

(5) Of course, there is always the plain old Roth conversion of the client's traditional IRA, as Roth IRAs do not require RMDs during the owner's life. However, the client must be willing to pay tax on the amount converted as though it were distributed from the plan at that time.

(6) We also have the ability to make a Qualified Charitable Distribution, discussed in more detail later in this outline.

2. Distributions After Death if the Spouse is Beneficiary.

a. The concept of a spousal rollover was NOT changed by the SECURE Act. We are all familiar with the rules enabling a spouse to roll over retirement benefits upon the death of his or her spouse, and they will not be repeated

here. However, there are a few recent developments in this area that are worth discussing.

b. In 2009, the ACTEC Estate Planning for Employee Benefits Committee initially requested that the IRS issue a revenue ruling with respect to spousal rollovers of qualified plan and IRA benefits when an estate or trust is named beneficiary of a decedent's interest.

(1) This request was repeated in 2010 and again earlier this year, and guidance on this issue has been requested in connection with the ACTEC recommendations for the IRS Guidance Priority Plan in each of the last eight (8) years. So far, this has fallen upon deaf ears.

(2) Several hundred favorable private letter rulings have been issued over the last ten years, and it makes no sense for taxpayers to expend the filing fee required for a private ruling.

(3) As an example, in PLR 201511036, the IRS allowed spousal rollover treatment when the decedent's estate was named as beneficiary of several IRAs, and the spouse was the executor of the estate, the Trustee of decedent's trust, and was the income beneficiary and had a general power of appointment over the trust which was ultimately to receive the IRA proceeds.

(4) The most recent rulings in this regard include PLR 201821008, wherein the "default" beneficiary was the IRA owner's estate, and

the surviving spouse was the personal representative of the decedent's estate and the sole beneficiary of the estate. This favorable ruling was issued even though the IRA provider withheld taxes on the IRA distribution prior to paying the net amount over to the estate. The spouse received good advice, as she deposited the amount of the net proceeds plus the amount of the taxes withheld into a spousal rollover IRA in her name. In PLR 201831004, the IRS approved a spousal rollover when the beneficiary was the decedent's "Survivor's Trust" under a joint spousal trust, under which the surviving spouse was the sole income and principal beneficiary and had an unlimited power of appointment over the Trust. A similar result was more recently obtained in PLR 201923002.

(5) PLR 201839005, wherein the decedent did NO estate planning, the IRS examined a ruling request involving decedent's retirement plan under which the decedent failed to designate any post-death beneficiary. The plan provided that, in such event, the plan benefit was payable to decedent's estate. Under applicable state law, decedent's estate would be split between surviving spouse and children. The children all executed valid disclaimers of their interests in the decedent's estate, leaving spouse as the sole beneficiary of the estate. The IRS blessed spousal rollover treatment, after all of these timely post-death maneuvers.

(6) PLR 201901005 involved similar facts as PLR 201839005, except a Trust was named as IRA beneficiary. Trust timely disclaimed

its interest, and then son and two grandchildren all timely disclaimed their respective interests in decedent's estate, leaving only the spouse as a beneficiary of the estate. IRS again blessed spousal rollover treatment.

(7) PLR 201944003 reached a similar result with respect to a Survivor's trust share of a joint community property trust.

c. The Impact of the Windsor Ruling.

(1) As we all know, on June 26, 2013, the U.S. Supreme Court held in U.S. v. Windsor, 133 S.Ct. 2675 (2015) that Section 3 of the Defense of Marriage Act "DOMA" is unconstitutional.

(2) The IRS issued follow-up guidance for same-sex marriages in Revenue Ruling 2013-17 and Notice 2014-19.

(3) Generally, participants and their spouses who are in same-sex marriages must be treated as married for all purposes under a qualified retirement plan as of June 26, 2013.

(a) A sponsor of a qualified retirement plan may elect to recognize same-sex marriages as of a date that is prior to June 26, 2013, for some or all purposes under the plan. A plan amendment would be required to implement this optional retroactive effective date.

(b) If a qualified plan defines "spouse", "legally married spouse", "spouse under federal law", etc. in a manner consistent with

Windsor, or does not define those terms, then the plan does not need to be amended so long as the plan has been properly administered.

(c) However, if the plan's definitions of these terms are not consistent with the holding in Windsor, then the plan must be amended.

(4) For ERISA, Internal Revenue Code, and DOL Regulation purposes, the following is true:

(a) The term "spouse" includes an individual married to a person of the same gender IF he or she is lawfully married under state law (including foreign jurisdictions).

(b) The term "marriage" includes a marriage between individuals of the same gender.

(c) The term "spouse" does not include an individual in a registered domestic partnership or a civil union, and the term "marriage" does not include a registered domestic partnership or a civil union.

(d) A same-sex marriage validly entered into in a state or foreign jurisdiction that permits same-sex marriages will be recognized regardless of whether the couple moves to or lives in a state that does not permit or recognize same-sex marriages.

(5) In Schuett v. FedEx Corporation, et al., No. 15-CV-0189, N.D. Calif., 2016 U.S. Dist. LEXIS 224, the Federal District Court in the

Northern District of California applied Windsor retroactively, allowing a lesbian widow to pursue her claim to spousal benefits under her deceased spouse's pension plan. This same sex couple was married on June 19, 2013, and one of the spouse's passed away one (1) day later. Six (6) days later, the United States Supreme Court issued its decision in Windsor.

d. The impact of the Obergefell holding.

(1) Following in the wake of Windsor in 2013, on June 26, 2015, the United States Supreme Court in Obergefell v. Hodges, 135 S.Ct. 2584 (2015) held that same-sex married couples are entitled to equal protection under the laws of every state, and that their marriages must be recognized nationwide. As such, any state prohibitions against the recognition of a same-sex marriage were held to violate the 14th Amendment and were invalidated.

(2) Because state laws banning same sex marriage are effectively invalidated, after Obergefell, same-sex couples are afforded the same spousal rights that other couples enjoy. Spousal rights that occur independent of proactive planning and that are now equally granted to same-sex couples include, among others, (i) spousal survivorship rights under state pension or other retirement benefits, even in states that previously did not recognize same-sex marriage and the ability to file tax returns as a married couple and (ii) take advantage of the married couple's state estate tax exemption where applicable.

(3) After Windsor, same-sex married couples are to receive equal treatment under federal law and are to be treated the same as any other married couple for federal tax purposes and for other benefits under federal law (including spousal rights under ERISA, etc.). Now, in the aftermath of Obergefell, same-sex couples have been elevated to equal stature with other marriages and are entitled to equal protection under the laws of every state.

3. Distributions After Death if a Non-Spouse is Beneficiary (Non-Spouse Rollovers)

a. If someone other than the spouse is the beneficiary, under the SECURE Act, the beneficiary's RMD now depends on whether there is a (1) "Designated Beneficiary", (2) "Eligible Designated Beneficiary", or (3) "non-Designated Beneficiary" of the account.

b. The term "Designated Beneficiary" is specifically defined in Treasury Regulation § 1.401(a)(9)-5, and was not changed by the SECURE Act. Although individuals qualify as Designated Beneficiaries, estates, states, charities, and business entities do not qualify as Designated Beneficiaries for these purposes. Treas. Reg. § 1.401(a)(9)-4. As discussed in more detail later in this outline, only certain trusts qualify as a Designated Beneficiary.

c. The term "Eligible Designated Beneficiary" has been introduced by the SECURE Act. An Eligible Designated Beneficiary is:

(1) The surviving spouse of the participant.

(2) A minor child of the participant (not just any minor child). The life expectancy payout applies to the child until the child attains the age of majority…..then the ten year rule starts. There is lots of uncertainty as to when the age of majority is reached.

(3) A disabled individual (as defined in Internal Revenue Code Section 72(m)(7)). The life expectancy payout applies to the disabled individual, and upon his death, the ten year rule starts.

(4) A chronically ill individual (as defined in Internal Revenue Code Section 7702B(c)(2)). The life expectancy payout applies to the chronically ill individual, and upon his death, the ten year rule starts.

(5) An individual who is less than ten years younger than the participant. The life expectancy payout applies to this beneficiary, and upon his death, the ten year rule starts.

d. A trio of 2016 private letter rulings illustrate the rigidity of the Designated Beneficiary rules. In each of these letter ruling fact patterns, the taxpayer had designated a beneficiary on his IRA showing three separate trusts, each of which qualified as a Designated Beneficiary. Later that year, the taxpayer's

financial advisors joined another firm and became affiliated with a different custodian, which required new IRA documents. At that time, the custodian had the taxpayer sign new beneficiary forms, which named the taxpayer's estate as the primary beneficiary. Upon the owner's death, this error was discovered and the trustees of the trusts petitioned the local probate court to reform the beneficiary designation retroactive to the time before the mistaken form was executed by the decedent which relief was granted by the local court. However, in each of these rulings, the IRS refused to recognize the reformed designations, and held that the estate was the beneficiary at the time of the taxpayer's death, and therefore, none of the IRAs had a Designated Beneficiary.

e. If there is a Designated Beneficiary -

(1) If the taxpayer died before the taxpayer's RBD, then the beneficiary's interest must be withdrawn within ten (10) years after the participant's death. BUT, there is NO requirement of annual distributions!

(2) If the taxpayer died after the taxpayer's RBD, then the beneficiary's RMD is based on an IRS table that takes into account the longer of (i) ten (10) years after the participant's death; or (ii) the taxpayer's life expectancy from the Single Life Table, based on the taxpayer's age in the calendar year of the taxpayer's death ("the ghost life expectancy"). Admittedly, the SECURE Act, while not repealing this second possible method of distribution, casts some doubt on its

continued viability. This second option was created by regulation, not the Code, so the SECURE Act did not directly repeal it. Many commentators, including Natalie Choate and this author, believe that it survives, and needs to be clarified by subsequent regulations in response to the SECURE Act. This is important, as a participant who dies between the ages of 73 and 80 will have a remaining life expectancy of greater than ten years.

f. If there is an Eligible Designated Beneficiary –

(1) For most of the Eligible Designated Beneficiaries, a life expectancy payout may still be taken, using existing IRS life tables. Upon the death of the Eligible Designated Beneficiary, the ten-year payout rule then ensues.

(2) For a minor child of the participant, a life expectancy payout is used until the earlier of the death of the child or the child attaining the age of majority. Thereafter, a ten-year payout rule is used.

g. If there is no Designated Beneficiary –

(1) If the taxpayer died before the taxpayer's RBD, then the beneficiary must withdraw all of the retirement account within 5 years of the taxpayer's death.

(2) If the taxpayer died <u>after</u> the taxpayer's RBD, then the beneficiary's RMD is based on the Single Life Table that takes into account the deceased taxpayer's life expectancy immediately before death ("the ghost life expectancy").

h. The beneficiary may withdraw more than the RMD in a given year, but the beneficiary must withdraw at least the RMD each year to avoid IRS imposition of a penalty.

(1) Although payouts other than lump sum distributions in IRAs are common, not all IRAs offer this option.

(2) <u>Many</u> qualified plans typically require a lump sum distribution upon death.

(3) However, the Pension Protection Act of 2006 added Code § 402(c)(11), which now allows a non-spouse Designated Beneficiary to rollover a qualified plan account into an IRA by a trustee to trustee transfer.

4. Sixty (60) day rollover for inherited retirement benefits.

a. A participant, IRA owner or spousal beneficiary may take distributions of qualified plan or IRA assets and roll them over into another qualified plan or IRA within sixty (60) days of such distribution. However, any other non-spousal beneficiary cannot do such a rollover, but may do a direct trustee-to-trustee transfer.

b. Recent Private Letter Rulings have addressed specific scenarios that allow for a waiver of the 60-day rollover requirement:

(1) In PLR 201529016, the IRS, pursuant to Code §402(c)(3)(B), waived the 60-day rollover requirement where the taxpayer's failure to timely rollover funds was due to her medical and emotional condition following her spouse's death that impaired her ability to manage her financial affairs.

(2) In PLR 201529017, pursuant to Code §408(d)(3)(I), the IRS waived the 60-day requirement where the taxpayer's failure to timely rollover funds was due to the financial institution's failure to follow the taxpayer's instructions to keep those funds in his IRA.

(3) In PLR 20152901, again, pursuant to Code § 408(d)(3)(I), the IRS waived the 60-day rollover requirement where the taxpayer's failure to timely rollover funds was due to the bank making unauthorized distributions from his retirement accounts.

c. Rev. Proc. 2016-47, issued on August 24, 2016 establishes a "self-certification" procedure enabling the taxpayer to complete a rollover without the expense and hassle of a private letter ruling request.

(1) Prior to this Revenue Procedure, you could obtain a waiver of the 60-day rollover deadline only by making application to the IRS, paying a $10,000 filing fee, and waiting at least a year to get an answer.

(2) To qualify for this new self-certification approach, you must satisfy three requirements.

(a) You must not have been previously denied a waiver by the IRS for this particular distribution.

(b) You must have been unable to complete the rollover due to one or more of the eleven reasons listed below; and

(c) You must complete the rollover as soon as practical after you are no longer prevented from doing so due to the reasons you have certified.

(3) The following eleven (11) reasons are "blessed" by the IRS as justifying a waiver:

(a) An error was committed by the financial institution receiving the contribution or making the distribution to which the contribution relates.

(b) The distribution was made in the form of a check which was misplaced and never cashed.

(c) The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was an eligible retirement plan.

(d) The taxpayer's principal residence was severely damaged.

(e) A member of the taxpayer's family died.

(f) The taxpayer or a member of the taxpayer's family was seriously ill.

(g) The taxpayer was incarcerated.

(h) Restrictions were imposed by a foreign country.

(i) Postal error.

(j) The distribution was made on account of a levy under Internal Revenue Code Section 6331 and the proceeds of the levy have been returned to the taxpayer.

(k) The party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite the taxpayer's reasonable efforts to obtain the information.

(4) Be careful! If the taxpayer's return is audited, and a material misstatement was made in the self-certification of the rollover of an IRA

distribution or one of the other requirements for self-certification was in fact not met, the IRS can still disallow the waiver, which will lead to income taxes, plus interest, plus penalties.

C. Separate Accounts and Multiple Beneficiaries.

1. If there are multiple beneficiaries of a retirement account, it is still important in some situations to establish separate accounts on a post-mortem basis. Treas. Reg. § 1.401(a)(9)-5, A-7(a)(1).

2. If separate accounts are "established" for multiple beneficiaries prior to December 31 of the year after the calendar year of the taxpayer's death, then the RMD rules will apply separately to each such separate account. Treas. Reg. § 1.401(a)(9)-4, A-5(c); Treas. Reg. § 1.401(a)(9)-8, A-2(a)(2).

a. To establish separate accounts, the beneficiaries' interests must be fractional (i.e. not pecuniary). In addition, some affirmative act is required to establish the separate accounts (i.e., a physical division of a single account into completely separate accounts, or using separate account language on the beneficiary designation form).

b. Whenever possible, it is best to create the separate accounts with appropriate language directly on the beneficiary designation form, especially after the SECURE Act, vis a vis potential Eligible Designated Beneficiaries.

3. Is separate account treatment available when a trust is the beneficiary of an IRA?

a. Treas. Reg. § 1.401(a)(9)-4, A-5(c) clearly provides that the separate account rules are not available to individual beneficiaries of a trust with respect to the trust's interest in the participant's retirement plan.

b. PLR 201503024 provides a lesson to the effect that, you should not believe every word you read in IRS regulations! This PLR involved an IRA wherein the decedent's trust was named as beneficiary, and such trust provided for ultimate distribution of its residuary to five (5) individual beneficiaries. In PLR 201503024, the IRS made the following rulings:

(1) The decedent's trust constitutes a "see-through" trust within the meaning of the Section 401(a)(9) regulations.

(2) Five separate beneficiary IRAs, established by the Trustee for each of the five residuary trust shares, will be considered "inherited IRAs" within the meaning of Section 408 of the Code.

(3) Sections 401(a)(9) and 408 of the Code do not preclude the division of decedent's IRA and the establishment of the five beneficiary IRAs, each in the name of the decedent for the benefit of one of the five beneficiaries of the trust.

(4) The trustee-to-trustee transfers to the five beneficiary IRAs will not constitute taxable distributions, nor will they be considered attempted rollovers.

(5) The trustee-to-trustee transfers to the five beneficiary IRAs will not cause the beneficiary IRAs to lose their qualified status under Section 408(a) of the Code.

(6) Each of the individuals may receive the required minimum distribution under Section 401(a)(9) of the Code from his or her respective beneficiary IRA, using the life expectancy of the oldest of the five individuals who remains a beneficiary as of the Beneficiary Determination Date of September 30, 2014 (applying the old life expectancy payout rule).

c. A similar result was recently obtained in PLR 201924013.

d. Recent PLRs 201909003 and 201927009 extended this rationale and result to the context of an estate with multiple individual beneficiaries.

e. I have used these PLRs on multiple occasions to persuade providers to allow this result.

D. Eliminating Unwanted Beneficiaries Prior To September 30th.

1. The deadline for determining who the initial beneficiaries of a retirement account are is the date of the taxpayer's death.

2. However, between the taxpayer's death and September 30th of the year following the year of the taxpayer's death, known as the Beneficiary Determination Date ("BDD"), non-individual beneficiaries may be removed by a disclaimer of the interest, creating separate accounts, or eliminating them as beneficiaries by distributing their benefits outright to them in full. Treas. Reg. § 1.401(a)(9)-4, A-4(a). <u>This is still true under the SECURE Act</u>!

E. Roth IRAs

1. Although we do not have near as much heartburn about the structure of beneficiary designations on Roth IRAs, the above-described RMD rules apply to the beneficiaries of a Roth IRA, and the RMD is computed as though the decedent had died before his RBD. Treas. Reg. § 1.408A-6, Q&A (14)(b).

2. As you know, contributions to a Roth IRA have already been taxed, and therefore, qualified distributions from such Roth IRAs are not subject to income tax. Nonetheless, it is still important to defer distributions from the Roth IRA as long as possible, so that the assets inside the Roth IRA continue to appreciate income tax free. Accordingly, it is still critical for the beneficiary of a Roth IRA to be considered a "Designated Beneficiary" or an "Eligible Designated Beneficiary".

3. If the Roth IRA owner is interested in generation-skipping planning with adult grandchildren, naming the adult grandchildren as the beneficiaries of the Roth IRA will be a more efficient utilization of the GST

exemption than naming them as beneficiary of a traditional IRA (since parts of the traditional IRA proceeds will be consumed by income tax liability).

F. What if the IRA owner is incapacitated, and there is no or an inadequate beneficiary designation in place?

1. An agent under a durable power of attorney will need to be specifically empowered to make a new beneficiary designation.

2. Here is suggested sample language –

> "To make contributions to and withdrawals from, rollovers, voluntary contributions, or any elections with respect to any retirement plans, including an individual retirement account, and to designate beneficiaries for any rollovers consistent with my overall estate plan;"

3. If there is no general durable power of attorney in place, then a court-appointed conservator (guardian in some states) will need specific court authority, and the acceptance of the IRA custodian, in order to make an effective beneficiary designation.

III. LEAVING RETIREMENT ASSETS TO TRUSTS

A. Situations In Which Trusts Are Crucial

1. In some situations a trust must be named as beneficiary, such as when (i) the beneficiary is a special needs child that relies on government benefits,

(ii) the beneficiary is a second spouse whom you want to have limited access to the trust principal, (iii) the beneficiary is a minor, (iv) the beneficiary is a spendthrift, has substance abuse problems, etc., and (v) when retirement account assets must be used to fund a credit shelter trust. (discussed below).

2. In these situations, the client may decide the reasons for naming a trust as beneficiary of the IRA outweigh the lost income tax deferral, or may decide a look-through trust is appropriate.

B. What Are Look-Through Trusts, or See-Through Trusts?

1. A trust that qualifies as a Designated Beneficiary is often referred to as a "look-through trust" or "see-through trust". This has not changed under the SECURE Act.

a. If a taxpayer names a look-through trust as the beneficiary, then the trust will qualify as Designated Beneficiary (same as the old law), and **may** qualify as an Eligible Designated Beneficiary.

b. In essence, for these purposes, the trust is ignored and the beneficiaries of the trust are treated as the beneficiaries of the retirement account. This analysis remains important under the SECURE Act.

2. A trust must satisfy five tests to qualify as a Designated Beneficiary. These rules were not changed by the SECURE Act.

a. The first four tests are as follows: (i) the trust must be valid under state law, (ii) the trust must be irrevocable or become irrevocable at the taxpayer's death, (iii) the trust beneficiaries must be identifiable, and (iv) certain documentation must be provided to the plan administrator or IRA custodian by October 31 of the year after the taxpayer's death.

b. If these four tests are met, then the trust is a Designated Beneficiary.

c. There is, in essence, a fifth test for the trust to be a Designated Beneficiary, as all of the beneficiaries of the trust must be individuals the oldest of whom can be identified.

d. What Trust Beneficiaries Can Be Ignored?

(1) It is many times a challenge to draft a trust that only has individual beneficiaries and where it is possible to ascertain the oldest beneficiary (especially when the IRS has not told us which contingent beneficiaries can be ignored!).

(2) The regulations provide that if the first four tests above are met, then the beneficiaries of the trust are considered beneficiaries of the retirement account. The question is, which beneficiaries must be considered?

(3) The regulations provide two rules in this regard.

(i) The general rule is that with respect to determining if there is a beneficiary of the trust that is not an individual (which would disqualify the trust as a Designated Beneficiary), and determining who is the oldest beneficiary, a "contingent beneficiary" must be taken into account.

(ii) The second rule provides that, a person will not be considered a beneficiary for purposes of determining who is the beneficiary with the shortest life expectancy, or whether a person who is not an individual is a beneficiary, merely because the person could become the successor to the interest of one of the employee's beneficiaries after that beneficiary's death. However, the preceding sentence does not apply to a person who has any right (including a contingent right) to an employee's benefit beyond being a mere potential successor to the interest of one of the employee's beneficiaries upon that beneficiary's death.

(iii) This rather unhelpful regulation tells us that a "contingent beneficiary" must be taken into account, but a "mere potential successor" beneficiary can be ignored. However, it does not bother to define these terms!

e. ACTEC has requested a revenue ruling on this issue on at least five occasions, the most recent query being made last year. Stay tuned!

f. Recent private IRS letter rulings have not been terribly helpful in providing additional guidance as to which contingent remainder

beneficiaries can be ignored.

(1) Under the IRS's analysis in these rulings, if a trust is to distribute the assets outright to a beneficiary upon a life income beneficiary's death, then the only remainder beneficiaries that must be counted are the individuals that would receive those assets, provided those individuals are alive on the taxpayer's death and they have already attained the required age to receive the assets outright.

(2) This ruling is not helpful to dynasty trusts or lifetime trusts with periodic principal distributions or withdrawal rights, as the beneficiary may never be required to take outright ownership of the trust assets.

g. In informal conversations with some of my colleagues, the IRS representative who has been writing many of the above-described private letter rulings over the years made a few observations in this regard.

(1) For example, in a trust share created for a minor, which terminates and fully distributes at a stated age which the minor has not attained as of the Determination Date (i.e., the 9/30 date), then the "first tier remaindermen" who would take if the minor died on that Determination Date must be taken into account.

(2) In a trust for a surviving spouse's life, which terminates at spouse's death, the beneficiaries to be taken into account are the spouse

and the remaindermen who would take if the spouse died on the Determination Date. However, if the trust continues after the spouse's death, then additional contingent beneficiaries must be taken into account.

(3) What about a trust with a power of appointment?

(a) If it is a general power of appointment, there will be no Designated Beneficiary, per this IRS representative!

(b) If the permissible appointees are limited to all individuals in the world younger than the powerholder, the agent agreed that this class would be "identifiable" and Designated Beneficiary treatment would be allowed.

h. PLR 201633025, published in mid-August of 2016, sheds very important light on the IRS' current thinking on this issue.

(1) In this ruling, a trust was named as beneficiary of an IRA. Under the terms of the trust, the Trustee is to distribute all of the net income of the trust to the decedent's child, and the trustee also has discretion to make principal distributions to the child or the child's issue for health, education, support or maintenance. When the child attains age fifty (50), the trust will terminate and all remaining income and principal will be distributed to the child.

(2) If the child dies prior to attaining age fifty (50), the trust provided that the trust will terminate and will be distributed to the children of the

child. If the child and all of the child's issue are deceased prior to the final distribution of the trust assets, the trustee shall distribute the remaining trust assets to the decedent's siblings. If the child, all the child's issue, and the decedent's siblings are all then deceased, then the rest of the trust shall be distributed to various charitable organizations.

(3) The IRS ruled that the only beneficiaries which must be taken into account are the child and the child's children for purposes of determining whether the trust qualifies as a "Designated Beneficiary" for RMD purposes. Therefore, the trust qualified as a "see-through" trust and the trust may receive minimum distributions after the owner's death based on the child's life expectancy. All other potential recipients of the trust were deemed to be mere potential successors! Of course, under the new SECURE Act, this ruling only allows the usage of a ten year period instead of a five year distribution period in a similar fact pattern.

i. PLR 201840007 is a great recent example of post-mortem maneuvering in order to achieve "see-through" trust treatment and resulting stretching of an IRA payable to decedent's revocable trust.

(1) Decedent's trust was named as the primary beneficiary of decedent's 401(k).

(2) Upon decedent's death, the trust splits into three (3)

separate describing trusts for each of decedent's three (3) oldest children.

(3) After decedent's death, the Trustee of the trust engineered a severance agreement which split each of the three children's trusts into a Trust A and Trust B. Each Trust A and Trust B has different sets of descendants as default remainder beneficiaries.

(4) Each discretionary trust has that child as primary beneficiary. Upon the death of such child, if he or she has attained age thirty (30), such child has a broad special power of appointment, with the potential appointees including any person or charity, other than the child's estate, the creditors of the child, or the creditors of the child's estate.

(5) On September 30 of the year following the decedent's death, as to the Trust share receiving the IRA, each of the three children executed a Partial Release of Power of Appointment, whereby each released his or her right to appoint to any charity or any individual other than an individual younger than the oldest child.

(6) The IRS ruled that each of the subtrusts qualified as see-through trusts, and RMD's may be stretched over the life expectancy of the oldest child. <u>Under the SECURE Act, this successful see-through ruling would only buy a ten-year stretch.</u>

C. "Conduit Trusts"

1. Fortunately, the 401(a)(9) regulations do provide a type of safe harbor trust, a "conduit trust", where a beneficiary will be treated as a Designated Beneficiary.

a. A conduit trust requires the trustee to distribute all of the retirement account withdrawals to the beneficiary.

b. The trustee may use conduit trust assets to pay expenses attributable to such assets.

c. As the trust may not accumulate any assets withdrawn from the retirement account, the IRS allows the trust beneficiary to be treated as the oldest beneficiary of the retirement account.

2. Although conduit trusts have the advantage of certainty as they are specifically described in the treasury regulations, they also have a major disadvantage.

a. A conduit trust cannot withdraw retirement account proceeds and accumulate them inside of the trust.

b. This is often contrary to the intent of the client, who may be using a trust to prevent the retirement account assets from being distributed to the beneficiary for one reason or another.

3. In PLR 201902023, the IRS ruled that, when a revocable trust named as IRA beneficiary establishes a subtrust with conduit trust provisions to hold

any retirement plan benefits payable to the revocable trust, such structure achieves the status of a conduit trust and a Designated Beneficiary.

4. Under the SECURE Act, depending directly on how an existing conduit trust is drafted, it may very well tie the hands of the individual beneficiary by either forcing the entire IRA to be paid out in the tenth year, or forcing the IRA to be paid out in ten annual installments. To the contrary, an accumulation trust which qualifies as a Designated Beneficiary allows the Trust to take out the distributions at any time within the ten-year period. Accordingly, the usage and drafting of a conduit trust must be carefully evaluated going forward.

5. However, a conduit trust will be very important for preserving Eligible Designated Beneficiary status for a trust for certain beneficiaries.

a. A conduit trust for a spouse, unlike an accumulation trust, results in the spouse being considered the sole beneficiary of the IRA, the trust not having to begin minimum distributions until the end of the year in which the decedent would have attained age 72, the spouse's life expectancy, recalculated annually, being the applicable distribution period, and ten year rule will not apply while the spouse is alive.

b. A conduit trust for a minor child will allow a modified stretch, until the child reaches the age of majority, followed by a ten year distribution period.

D. Accumulation Trusts

1. A trust that allows accumulation of retirement account withdrawals (an "Accumulation Trust") may also qualify as a Designated Beneficiary.

a. As noted above, the only IRS guidance in this area is embodied in the above-described private letter rulings.

b. If a trust does not fit within such framework and is not a conduit trust, it is unclear how remote of a contingent beneficiary the IRS will take into account.

c. To be safe, one must draft the trust assuming the IRS may take into account all contingent beneficiaries. Although this may be possible by adding certain savings clauses to the trust, there still is no specific guidance that this approach works.

d. Obtaining a private letter ruling may provide certainty, but is expensive and time-consuming. It appears a private letter ruling may be granted while the account owner is still living or after the account owner's death.

2. Finally, the compressed income tax brackets of a trust lead to a significant tax cost to the usage of an accumulation trust.

a. A trust pays the highest rate of tax after the first $12,750 in income.

b. If significant amounts will likely be accumulated, the income tax cost is a significant detriment to consider before utilizing this type of trust.

3. Naming an accumulation trust for an Eligible Designated Beneficiary as IRA beneficiary is problematic.

a. Despite the fact that the primary beneficiary of an accumulation trust is an Eligible Designated Beneficiary, other countable beneficiaries of the trust are not Eligible Designated Beneficiaries, and thus the trust will not qualify as an Eligible Designated Beneficiary. An accumulation trust for either a spouse or a minor child will NOT qualify as an Eligible Designated Beneficiary.

b. The one exception under the SECURE Act allows an accumulation trust for a chronically ill or disabled beneficiary to qualify as an Eligible Designated Beneficiary, despite the existence of future other trust beneficiaries. The trust will be considered an "applicable multi-beneficiary trust" ("AMBT") if such trust has more than one beneficiary, each of which qualify as Designated Beneficiaries, and at least one of such beneficiaries is either a disabled or chronically ill beneficiary. If the applicable multi-beneficiary trust is required by the terms of the instrument to be divided immediately upon the death of the participant into separate trusts for each beneficiary, the RMD rules will be applied

separately to the Eligible Designated Beneficiary. As long as there is no beneficiary other than a chronically ill or disabled beneficiary who has any right to the IRA until the death of all chronically ill or disabled beneficiaries, then this specific trust share will qualify for the stretch over the life of the chronically ill or disabled.

E. Marital Trusts

1. We are all aware that one of the major requirements for a marital trust (either a general power of appointment trust or a QTIP trust) is that the surviving spouse be entitled all income of the Trust, at least annually.

2. Rev. Rul. 2006-26, 2006-1 C.B. 939, considered whether the "all income" requirement of I.R.C. §2056 and Treas. Reg. §§20.2056(b)-5(f)(1) and 20.2056(b)-7(d)(2) was satisfied in three fact situations. In each, a marital deduction trust held an IRA or a defined contribution plan.

a. Assuming that a QTIP marital trust was governed by the law of a state that had adopted the 1997 version of the Uniform Principal & Income Act ("UPIA"), the ruling concluded that the trust may not meet the "all income" requirement if: (1) the trust language did not require the trustee to distribute to the spouse the greater of all the income of the IRA (considered as if the IRA were a separate trust) or the annual required minimum distribution under I.R.C. §408(a)(6), and (2) the governing law included §§409(c) and (d) of the 1997 version of the UPIA.

(1) This was because UPIA §409(c) provided that a required minimum distribution from the IRA was allocated 10 percent to income and 90 percent to principal of the recipient trust, whereas the view of the IRS was that such an apportionment between principal and income was not based on the total return of the IRA and did not reflect a reasonable apportionment of the total return between income and remainder beneficiaries.

(2) If the trust language did not require the distribution of at least the income of the IRA when the spouse exercised the spouse's right to direct a withdrawal and UPIA §409(c) applied, the "all income" requirement may not be satisfied, according to the ruling.

(3) Although §409(d) of UPIA 1997 states that a trustee must allocate a larger portion of any distribution to income to the extent that doing so is necessary to qualify for the marital deduction, the Service in Rev. Rul. 2006-26 stated that this provision was ineffective to reform an instrument for tax purposes, analogizing the statute to a savings clause in a document that would be ineffective to reform the document for federal tax purposes.

b. This ruling set forth a "safe harbor" that would apply if a QTIP election were made over <u>both</u> the trust and the IRA or retirement plan and the spouse had the power exercisable annually to compel the trustee to withdraw the

income earned on the IRA or retirement plan and to distribute that income and all income earned on the other trust assets to the spouse.

c. The ruling concluded that marital trusts governed by §§409(c) and (d) of UPIA 1997 could not qualify for the safe harbor.

3. The Uniform Law Commission considered Rev. Rul. 2006-26 and made the changes discussed below to permit trusts governed by the 2008 version of the UPIA to qualify for the above-described safe harbor.

a. The 2008 UPIA §409 retains a 90/10 allocation for trusts other than QTIP and general power of appointment marital trusts.

b. However, for trusts intended to qualify for the estate tax marital deduction, the trustee is required to separately determine the income of each "separate fund" in such a trust for each accounting period. Separate funds include annuities, IRAs, pensions, profit sharing and bonus sock funds and stock ownership plans.

(1) All distributions received by a trust from such a separate fund are considered income until the income determined in this manner is reached. Distributions in excess of that amount are considered principal.

(2) If the distributions are less than this amount, the 2008 UPIA §409 states that the spouse may require that the trustee allocate principal from a source other than the separate fund to income, to make up the difference.

(3) Subsection (f) of the 2008 UPIA §409 requires that a trustee demand that the person administering the fund distribute the internal income to the trust upon the request of the surviving spouse.

(4) Under UPIA 2008, if a trustee cannot determine the income of a separate fund, the trustee is to apply a percentage between 3 and 5 percent, depending on the adopting state's choice, to the fund's value to determine the income.

(5) Further, if the value of the separate fund cannot be determined, the trustee is to compute an income equivalent by multiplying the I.R.C. §7520 rate by the present value of the payments, based on the §7520 rate.

4. The Service has published no new guidance on this issue since the 2008 revisions to the UPIA.

a. A new revenue ruling replacing Rev. Rul. 2006-26 and concluding that the "all income" requirement is satisfied by marital trusts governed by the laws of a state adopting §409 of UPIA 2008 is needed.

b. ACTEC has formally requested that the Service to issue a revenue ruling concluding that marital trusts governed by UPIA 2008 that hold IRAs or defined contribution plan benefits satisfy the "all income" requirement. (The UPIA was further amended in the summer of 2018 by the Uniform Law Commission, specifically in Sections 102(19(C), 203(e)(1) and 309(b), placing

limits on a Trustee's power to adjust between income and principal, so as to avoid marital deduction qualification issues.)

F. Separate Accounts for Trusts

1. Treasury Regulations provide that the separate account rules are not available to beneficiaries of a trust with respect to the trust's interest in the employee's benefit.

a. The IRS now takes the position that separate account treatment is not available when a single trust is named as beneficiary.

b. Under the IRS's interpretation, if all of the separate truss created under a revocable trust are look through trusts, then the RMDs of all such separate trusts will be based on the oldest beneficiary of all of the separate trusts together, not the oldest beneficiary of each trust share at issue.

c. Therefore, on the beneficiary designation form, it is best to directly name the separate trusts to be created, as opposed to naming the funding trust. For example, instead of naming the "John T. Smith Revocable Trust" as the beneficiary, designate each separate share of the John T. Smith Revocable Trust as fractional beneficiaries.

2. However. . . see PLR201503024 (release January 16, 2015), which <u>in effect</u> allowed separate account treatment <u>in part</u> for a trust which paid out equally to five children.

G. Outright to Spouse Versus a Marital Trust

1. Leaving qualified retirement assets outright to the surviving spouse is always the best tax strategy, as long as it fits the client's objectives.

2. On many occasions, a client is extremely reticent to leaving retirement assets outright to a spouse, for a variety of reasons, including the existence of a second marriage, asset protection concerns, spendthrift concerns, or disability concerns.

a. A "QTIP" Trust for a surviving spouse has the following consequences:

(1) The surviving spouse cannot rollover the IRA, and therefore distributions from the IRA must begin in the calendar year after the first spouse's death, instead of being deferred until the surviving spouse attains the age 72. Therefore, if the surviving spouse is younger than 72 years old, a tremendous tax deferral opportunity will be lost.

(2) Minimum distributions during the spouse's life will be based on a single life expectancy table. If the benefits were left outright to the surviving spouse, then once the spouse begins distributions of her rolled over IRA, she uses the Uniform Lifetime Table, which is based on the joint life expectancy of the surviving spouse and a hypothetical new spouse who is ten years younger. Thus, the QTIP trust beneficiary designation forces larger annual distributions and less income tax deferral.

(3) The distributions from the IRA will be subject to more income taxes than if the benefits were payable to the spouse outright. Each state's law regarding principal and income allocations are different, but in any event, a portion of the received IRA distributions will constitute "principal" for trust accounting purposes and such principal will be retained in the QTIP trust and taxed at trust income tax rates. As we all know, a trust reaches the highest income tax bracket at approximately $12,750 in income.

(4) If the intention is for the QTIP Trust to qualify for the estate tax marital deduction, then the trust must receive the <u>greater of</u> the minimum distribution amount, or the amount of income earned by the IRA. If the income earned by the IRA exceeds the minimum distribution amount, then greater amounts must be distributed from the IRA and less deferral is achieved.

b. As an alternative to the QTIP Trust technique in second marriage situations, I have been successful in persuading clients to instead leave a fractional amount to the surviving spouse and fractional amounts to the children of the first marriage.

c. Another alternative is to leave the total retirement asset amounts to the surviving spouse, and "compensate" the children of the first marriage with non-retirement assets.

d. If asset protection, spendthrift protection, or some other disability protection is the objective motivating the client to consider a trust for the spouse, we must make sure that the client understands the real cost in naming a trust versus naming the spouse outright.

IV. ESTATE PLANNING IN LIGHT OF THE SECURE ACT

A. Initial steps for the Estate Planner

1. Sending a client alert to everyone…..a quick concise notice aimed at getting their attention and inspiring them to contact us for possible new planning.

2. A more targeted outreach to those high net worth clients with large IRAs or QRPs.

3. Have your assistant globally search your client data base for certain key words, like "conduit trust"…. "special needs trust"

B. Immediate Issues to Address

1. Existing conduit trust planning in place

2. Taking steps to preserve "Eligible Designated Beneficiary" status.

a. Review plans where a spousal trust is the named beneficiary of an IRA.

b. Trusts for Minor children as IRA beneficiaries must be re-evaluated.

c. The designation of a special needs trust as IRA beneficiary should be reviewed and tweaked in light of the SECURE Act.

3. The immediate concerns to convey to our clients…..

a. The <u>rea</u>l post-death value of our clients' IRA and QRP interests have been potentially diminished significantly.

b. How will this income tax increase be paid?

c. A new reason for the ILIT wealth replacement concept?

d. More customized beneficiary designations!

C. Charitable Planning

1. Such a change will provide even more incentive for benefitting charity with IRAs upon death.

2. Funding a CRT with an IRA will achieve some of the deferral lost with the limited availability of the IRA stretch technique.

a. This should only be considered by the charitably inclined.

b. Computations specific to your fact pattern must be made in order to ascertain the real stretching benefit of this approach.

D. This law change will add more fuel to the fire in Roth IRA conversion planning.

E. If generation skipping planning is a major objective of a client, utilizing IRAs to push taxable inheritance down to lower bracket beneficiaries should be strongly considered.

F. The planner should anticipate to the extent feasible the possible use of disclaimers by designated beneficiaries of the IRA, in the structuring of the IRA owner's beneficiary designation, as such beneficiaries attempt to do their own post-death income tax planning.

G. Consider adding new boilerplate to your revocable trust forms.

1. Consider a springing separate share for a trust beneficiary who turns out to be disabled or chronically ill at the decedent's death

2. Consider a savings clause which precludes any non-disabled beneficiaries and any non-chronically ill beneficiaries from being eligible to receive any trust benefits during the life of the disabled or chronically ill beneficiary of an a cumulation trust, to preserve Eligible Designated Beneficiary treatment.

3. Limit the class of potential appointees under a power of appointment to the extent necessary to preserve Eligible Designated Beneficiary treatment of an accumulation trust for disabled or chronically ill beneficiaries.

4. Consider inserting an elective process, by a trustee or trust protector, whereby either a conduit trust or accumulation trust becomes effective in or before the Beneficiary Determination Date for the Trust.

H. Trusteed IRAs should see increased utilization.

I. You can find the SECURE Act as a new subparagraph (H) to Internal Revenue Code Section 401(a)(9), along with new definitions in Code Section 401(a)(9)(E).

V. CREDITOR ACCESS TO INHERITED IRAs

A. It is always big news when an "estate planning" topic is addressed by the U.S. Supreme Court, and it happened most recently in the summer of 2014 in Clark v. Rameker, 573 U.S. ____, 134 S.Ct. 2242 (June 12, 2014).

1. In Clark, the United States Supreme Court granted c*ertiorari* to resolve a conflict between the Circuits on the issue of whether a beneficiary of an inherited IRA can claim a federal bankruptcy exemption from creditors for such inherited IRA.

2. The federal bankruptcy law provides an exemption for "[r]etirement funds to the extent that those funds are in a fund or account that is exempt from taxation under §§ 401, 403, 408, 408A, 414, 457 or 501(a) of the Internal Revenue Code of 1986." 11 U.S.C. §§ 522(b)(3)(c), 522(d)(12) (It is

noteworthy that an "inherited IRA" is an IRA classification specifically recognized by Code Section 408(d).)

3. In a <u>unanimous</u> decision, the Court first defined "retirement funds" as funds set aside for the day when an individual is no longer working, and then cited three (3) characteristics which, in the view of the Court, prevents inherited IRAs from being considered "retirement funds."

a. First, the holder of an inherited IRA may never make contributions thereto, as opposed to traditional IRAs and Roth IRAs which receive tax incentives for the accumulation of additional funds for retirement.

b. Second, a holder of an inherited IRA is required to withdraw money from such account, without regard to how far away that person is from retirement.

c. Third, the holder of an inherited IRA may withdraw all of the funds at any time without penalty, and use them for any purpose, while the owner of a traditional IRA or a Roth IRA must wait until attaining age 59½ in order to withdraw funds from such accounts without penalty.

4. In a crowning blow, the Court stated that nothing about an inherited IRA's legal characteristics prevents or discourages an individual from using the entire balance immediately after bankruptcy for purposes of current consumption.

B. The history behind Clark.

1. Remember that IRAs belonging to the original account owner are generally exempt from the account owner's creditors in federal bankruptcy and otherwise.

2. One major source of confusion in this area is, although bankruptcy law is federal law decided in federal bankruptcy courts, many states opt out of the federal bankruptcy scheme, thus activating the application of state exemption statutes in federal bankruptcy cases (some states, like Texas, allow a debtor to select state or federal exemptions). The majority of states opt out, and thus the bankruptcy exemptions are decided under state exemption laws.

3. Prior to Clark, there were twelve (12) reported cases dealing with beneficiaries of inherited IRAs within the federal bankruptcy context.

a. Eight of these courts (all of which are in "opt-out" states, except for Texas) found that the inherited IRAs were not exempt from the bankrupt estate in federal bankruptcy, including: *In re* Sims, 241 B.R. 467 (Bankr. N.D. Okla. 1999); *In re* Greenfield, 289 B.R. 146 (Bankr. S.D. Cal. 2003); *In re* Navarre, 332 B.R. 24 (Bankr. M.D. Ala. 2004); *In re* Taylor, Bank. No. 05-93559, 2006 WL 1275400 (Bankr. C.D. Ill. May 9, 2006); *In re* Kirchen, 344 B.R. 908 (Bankr. E.D. Wis 2006); *In re* Jarboe, 365 B.R. 717 (Bankr. S.D. Tex. 2007); *Robertson v. Deeb*,

16 So. 3d 936 (Fla. 2d DCA 2009); and *In re* Chilton, 2010 WL 817331 (Bankr. E.D. Tex. March 5, 2010).

b. Four of the courts found that the inherited IRA was exempt in federal bankruptcy, those being: *In re* McClelland, Bank No. 07-40300, 2008 WL 89901 (Bankr. D. Idaho Jan. 7, 2008); *In re* Nessa, 2010 Bankr. Lexis 931 (B.A.P. 8th Cir. Apr. 9, 2010); *In re* Tabor, 2010 105 AFTR 2d (Bankr. M.D. Pennsylvania June 18, 2010); and *In re* Hamlin, 465 B.R. 863 (BAP 9th Cir. 2012).

c. The Nessa decision (in a non-opt-out state) led many district courts, in unreported decisions, to allow the inherited IRA to be an exempt asset, until Clark came along.

C. Clark is NOT the Last Word!

1. In some opt-out states, the interpretation of existing statutes with broad exemption language may allow the exemption of inherited IRAs for state exemption purposes, and state exemptions are recognized under U.S. Bankruptcy Code § 522(b)(3)(A).

a. The state of Kansas has such a broad statute which could arguably be construed to exempt inherited IRAs.

b. However, in Mosby v. Clark (In Re Mosby), 15-5193-JWL (D Kan. Oct. 30, 2015), the Kansas District Court held that an inherited IRA is not exempt under the Kansas exemption statute. The very recent case of In Re:

Todd, Case No. 15-11083 (U.S. Bankr., NDNY 2018), held that the applicable New York exemption statute was not intended to include inherited IRAs within the exemption from bankruptcy.

2. In my home state of Missouri, along with Alaska, Arizona, Delaware, Florida, Nevada, North Carolina, Ohio, South Carolina, Texas and Wyoming, the Clark holding is completely irrelevant, as these states have statutes which specifically exempt inherited IRAs for state exemption purposes and have opted to use the state exemptions for federal bankruptcy law purposes. Idaho has case law to this effect.

3. In a post-Clark decision, the federal Bankruptcy Court in New Jersey held that a debtor's inherited IRA was not property of the bankruptcy estate under New Jersey law. *In re* Andolino, 525 B.R. 588 (Bankr. D.N.J. 2015). The Bankruptcy Court stated that the question of inclusion in the estate must be reached first, before the Clark analysis of the application of an exemption can be made. (The Todd decision in New York also rejected an Andolino argument regarding inclusion of the inherited IRA.)

4. In another post-Clark decision, the federal Bankruptcy Court in Tennessee held that an IRA account was protected from creditors, even though the IRA owner had used part of the funds during the 60 day rollover period to purchase a home, as the owner ultimately deposited the exact amount eligible for rollover into

the IRA. The In Re: Chaundry court rejected the bankruptcy trustee's contention that the rollover was not qualified unless the IRA owner deposited the exact same funds received from the predecessor plan.

5. In October of 2019, the appellate court affirmed the Bankruptcy Court in Minnesota's ruling that a divorced former spouse who had received one-half of his ex-spouse's 401(k) and IRA upon the divorce could not claim an exemption in bankruptcy for such retirement assets. In Re: Lebakken, (No. 18-6018, 8th Circuit Court of Appeals). The courts relied on Clark in reaching this decision.

D. Use of spendthrift trusts as an alternative asset protection device.

1. If you are in a state where the applicable exemption is either indefinite or not existent, you should consider naming a spendthrift trust for the benefit of any beneficiary with creditor issues as the beneficiary of the IRA.

2. However, if the RMD amount received by the trust must be distributed from the trust (i.e. in a conduit trust), the Uniform Trust Code reverses the common law spendthrift protection for this type of a distribution interest and allows any creditor to attach the RMD amount from a spendthrift trust.

3. As an alternative, consider a "Trusteed IRA." If the provider offers a Trusteed IRA, and the Trusteed IRA agreement contains a spendthrift clause, then creditor protection should be accomplished.

VI. IRA OWNERS/RETIREMENT PLAN ADMINISTRATORS BEHAVING BADLY

A. Prohibited transactions disqualifying an IRA from recognition as such.

1. As discussed previously, IRAs are tax exempt as well as exempt from bankruptcy proceedings. However, when an IRA engages in a prohibited transaction, those exemptions are lost. One prohibited transaction occurs when an IRA is transferred to, or used by or for the benefit of, a disqualified person.

2. In Ellis v. Commissioner, Decision No. 14-1310, (8th Cir. June 5, 2015), the 8th Circuit affirmed a Tax Court holding that an IRA owner engaged in prohibited transactions under Code §4975(c) by directing his IRA to acquire a membership interest in an LLC with the expectation that the LLC would employ him (and in fact he received wages from the LLC). The facts of this case arose out of a business established in Harrisonville, Missouri, wherein Mr. Ellis invested almost his entire rollover IRA ($321,253) in a 98% membership interest in an LLC, under which Ellis served as General Manager. As a result of these transactions, the IRA lost its status as an individual retirement account and its entire fair market value was treated as taxable income as of the date of its establishment.

3. A different result was reached in *In re* Nolte, 2015 Westlaw 2128670 (Bankr. E.D. Va. 2015). At Nolte's instructions, the IRA investment advisor invested $100,000 out of the IRA in a 5% interest in an LLC. Nolte later served on the Board of the LLC but received no compensation. In a bankruptcy proceeding, a creditor objected to the debtor's discharge on the basis that the IRA had lost its exemption because Nolte had engaged in a prohibited transaction under Code §4975. In this case, the Bankruptcy Court found that merely investing in a 5% interest in an entity in which the IRA owner served on the Board was not a prohibited transaction, and the IRA was not disqualified.

4. In contrast to Nolte, Mr. Kellerman's IRA was found not to be exempt due to actions taken by Mr. Kellerman. *In re* Kellerman, 2015 Westlaw 3377907 (Bankr. E.D. Ark. 2015). Kellerman formed a partnership between his self-directed IRA and another LLC which was wholly owned by Kellerman. Kellerman ordered the IRA custodian to sell a substantial portion of the assets of the IRA and purchase a tract of land, in which the LLC and his IRA owned undivided interests. After finding that the IRA had engaged in prohibited transactions, the Court held the IRA had been disqualified and was not entitled to a bankruptcy exemption.

5. In McGaugh v. Commissioner, T.C. Memo. 2016-28, the taxpayer's IRA custodian initially refused to purchase shares in a closely-held

entity since it was not on the custodian's approved buy list. The taxpayer then instructed the custodian to wire IRA funds directly to the corporation whereupon shares were issued by the Corporation in the name of the IRA which were then delivered by the taxpayer to the IRA custodian. Despite the fact that the taxpayer "pulled all strings" and controlled the wired funds in the transaction, the Tax Court held that the taxpayer was merely acting as a conduit for the custodian and that this transaction did not constitute constructive receipt of IRA proceeds. However, in Vandenbosch v. Commissioner, T.C. Memo. 2016-29, the taxpayer moved funds from his IRA to a joint account, followed by a move from the joint account into the taxpayer's personal account, followed by the taxpayer wiring the funds directly to a borrower, in exchange for a note from the borrower payable to the taxpayer and not the taxpayer's IRA. Here, the court held that the taxpayer was not a mere conduit in the same manner as in McGaugh, and the court held constructive receipt of IRA funds had occurred.

6. In Marks v. Commissioner, the taxpayer used the prohibited transaction rule to his advantage, in a very interesting outcome. In 2005, the taxpayer loaned funds from her IRA to a relative, and received two separate promissory notes. In 2013, while trying to execute a rollover of the IRA, the taxpayer failed to get the notes re-titled in to the new IRA. The IRS issued a deficiency for approximately $100,000 in taxable income, alleging that the full

value of the promissory notes must be included in taxpayer's 2013 income as distributions from the IRA. The taxpayer successfully argued that a prohibited transaction occurred in 2005, rendering the IRA unqualified in that year, and thus no taxable distribution occurred in 2013. AND, the statute of limitations had run on the 2005 income tax year, when the prohibited transaction occurred. Marks v. Commissioner, T.C. Memo 2018-49 (April 2018).

B. Claim of Breach of Fiduciary Duty against Plan Trustees

1. In Tibble v. Commissioner, 135 S.Ct. 1823 (2015), retirement plan participants brought suit against the plan for investing in mutual funds with high fees as opposed to low-cost mutual funds. The 9th Circuit had found that the statute of limitations of six years after "the date of the last action which constituted a part of the breach or violation" was a bar to this suit, because the mutual funds in question were purchased more than six years before the suit was instituted. However, the Supreme Court reversed this decision, holding that the plan trustees engaged in a continuing breach of their duty of prudence in failing to monitor the investments, and remanded the case to the trial court for determination of whether that issue was timely raised.

C. Loss of Bankruptcy Exemption

1. In Running v. Miller, 77 F.3d 711 (8th Cir. 2015), the taxpayer purchased an annuity from Minnesota Life Insurance Company for a lump sum

purchase payment of $267,319. Miller used funds from his IRA to make this payment. Miller later filed for bankruptcy and claimed that the annuity was exempt from the bankruptcy estate as an individual retirement account. The bankruptcy trustee objected, and the bankruptcy court overruled her objection. The bankruptcy trustee had claimed that, because Miller had used the IRA funds to purchase an annuity with a lump-sum premium, the funds thus became property of the bankruptcy estate.

VII. NAMING CHARITY(S) AS BENEFICIARY OF THE IRA

A. If a client indicates a desire to leave funds to charity(s) upon his or her death, the first words out of our mouths should be to consider making such at-death gifts from qualified retirement plans or traditional IRAs.

1. If the client's estate plan contemplates benefits both to charity and to children or other individual beneficiaries, the most efficient income tax planning is accomplished by satisfying the charitable gifts with retirement plan assets, and using other assets to leave to the individual beneficiaries. While the charity will not pay income tax on <u>any</u> inheritance it receives, including retirement plan benefits, individual beneficiaries will pay income tax on the distribution of a retirement plan interest, and will not pay income tax on almost all other forms of inheritance.

2. In addition to satisfying the client's charitable desires, a variety of charitable giving techniques involving retirement benefits will help realize additional estate planning objectives as well.

3. With this planning, charitable intent should be more important than tax savings!

4. In contrast, since Roth IRAs pass to the designated beneficiary without any income tax liability, naming charity as beneficiary of the Roth IRA is not tax efficient.

B. There are various techniques for leaving retirement benefits to charity(s) upon a taxpayer's death.

1. The easiest way to leave retirement plan benefits to charity(s) is to name the charity(s) as a direct beneficiary of one hundred percent (100%) of the benefits payable upon the taxpayer's death.

a. A properly completed beneficiary designation form in this regard is easy to accomplish.

b. Although all of the income associated with retirement benefits will be included in the income of the charitable organization named as beneficiary, such charity's income tax exemption will make the retirement plan benefit distribution not taxable.

c. In addition, the deceased taxpayer's estate will receive a dollar for dollar estate tax charitable deduction for the estate tax value of the retirement plan interest.

2. In many instances, the client will want to leave a specific dollar amount to one or more charities, with the balance of the retirement plan interest passing to other individual beneficiaries (i.e., his or her lineal descendants, per stirpes).

a. This usually requires an attachment to the beneficiary designation form setting forth the specific amount gift, and a description of the residual beneficiaries.

b. In my experience, you should be sure at the planning stage that the retirement plan administrator will accept and honor this attachment!

c. In order for the individual beneficiaries to be able to use separate accounts and a deferred payout, it will be necessary to be sure that the charity(s) are "cashed out" (i.e., fully paid from the retirement plan) before September 30 of the year following the year of the taxpayer's death.

d. Be careful doing this through a trust vehicle!

(1) In PLR 201438014, decedent's Trust was named as beneficiary of his IRA, and the Trust provided for payment of pecuniary bequests to two charities and the residue to be distributed to individuals.

(2) A state court ordered a reformation of the Trust, providing that either the Trust's transfers to the charities were to be treated as direct bequests of the IRA amounts to the charities, or such transfers were to be considered to be made out of the trust's gross income pursuant to the terms of the governing instrument.

(3) The IRS ruled that the Trust must treat the payments to the charities as sales or exchanges (since the IRA is being used to satisfy a pecuniary legacy), and the Trust must include in its gross income the amount of the IRA used to satisfy the charitable legacies. Further, the Trust is <u>not</u> entitled to a charitable income tax deduction for these distributions. The bottom line was, because the purpose of the reformation was not to resolve a conflict but merely to obtain tax benefits, then the IRS will not respect the reformation and treat it as part of the governing instrument. PLR 201438014.

e. Careful drafting will be necessary when an IRA is designated to be distributed to a Trust, which contains residuary charitable bequests.

(1) Chief Counsel Memorandum 200848020 (July 28, 2008), provides that a Trust is denied a charitable income tax deduction after it receives taxable IRA distributions and then distributes some of those amounts to charities.

(a) CCM 200848020 involved a decedent who

left his IRA payable to his Trust upon his death, which benefited his six children and several charities. The Trust received distributions from the IRA, and the Trustee immediately paid those amounts to the charities, leaving the six children as the only remaining beneficiaries of the Trust. The Chief Counsel's Office concluded that the Trust had taxable income from the IRA distribution, but was not entitled to claim an offsetting charitable deduction (remember only an estate may claim an income tax charitable "set aside" deduction").

(b) In order for the distribution of IRA proceeds to charity to be deductible by the Trust, the Trust must meet the legal requirement for a trust to claim a charitable income deduction. In order to claim a charitable income tax deduction, the charitable payment must be traced to income and must generally be made pursuant to the terms of the governing instrument specifically requiring income to be paid to a charity. IRC § 642(c).

(c) In the Trust involved in CCM 200848020, there was no specific instruction to distribute income to a charity, just a general provision for a percentage of the residuary to be paid to several charities. Therefore, the Trust could not claim the charitable income tax reduction.

(2) Ostensibly, one solution would be to include a clause in the Trust document that instructs all residuary charitable gifts to be made, to the extent possible, from property that constitutes "income in respect of the

decedent" as that term is defined under the U.S. income tax laws.

(a) However, Treas. Reg. § 1.642(c)-3(b)(2) provides that instructions in a trust instrument to distribute specific types of income to a charity will not be respected for federal income tax purposes unless the instruction has an "economic effect independent of income tax consequences".

(b) The examples in this Regulation provide that, unless the amount to be paid to charity is dependent upon the type of income from which it is to be paid, the above-described ordering provision is considered to not have economic effect independent of income tax consequences.

(3) Interestingly, in PLR 201444024, where the Trust was named as the beneficiary of decedent's IRA and the Trust provided that, after two pecuniary bequests to individuals, the residue shall be immediately distributed to charity, the IRS held that the Trust may re-title the name of the IRA to reflect the name of the charity in a non-taxable transfer, and the charity, not the trust, will include the taxable amount of the IRA distributions in charity's income for tax purposes, as if the charity were the direct beneficiary.

(4) The alternative answer at the planning stage is to draft the beneficiary designation of the IRA so as to mirror the dispositive provisions of the Trust (i.e., list the children and the charities and their respective percentages on the IRA designation itself, rather than sending the IRA to the decedent's Trust).

(5) In addition, the will and/or revocable trust of the decedent must provide that no estate taxes are to be charged against or paid out of the charity's share of trust assets.

f. Charitable Remainder Trusts. This technique involves a charitable remainder trust ("CRT") as that term is defined in IRC § 664.

(1) Income tax consequences

(a) Since a charitable remainder trust is exempt from income tax, the distribution of all the retirement benefits to a charitable remainder trust results in no current income tax liability.

(b) The individual beneficiaries of the charitable remainder trust will receive their lifetime interest earned from the <u>entire amount</u>, as opposed to an after-tax amount, of the distributed retirement benefit interest.

(c) However, the tax-deferred income received by the CRT must be "booked" from day one by the CRT, and will gradually "leak out" to the individual beneficiaries with the distribution of each lifetime payment. Under the "tiered" approach to income taxation of CRT distributions, the distribution to the individual lifetime beneficiary is deemed first to be derived from ordinary income earned in all prior years and the

current year, to the extent such amount has not already been allocated to a prior distribution.

(d) Although an individual IRA beneficiary is entitled to a Section 691(c) income tax deduction for the portion of federal estate taxes attributable to retirement plan benefits, this deduction is rarely if ever available to an individual beneficiary of a CRT, as all of the tiers of ordinary income, capital gain income and tax-exempt income would need to be exhausted before any CRT distribution would carry out the use of the IRD deduction.

(2) Estate tax consequences

(a) The decedent's estate is entitled to a federal estate tax charitable deduction for the actuarial value of the charitable remainder interest at the time of the decedent's death.

(b) The actuarial value of the charitable remainder interest must be at least ten percent (10%) of the date of death value of the trust in order for the CRT to be qualified.

(c) Because the non-charitable actuarial interest in the CRT is taxable in the decedent's estate, the decedent's tax clause in his or her will or revocable trust will need to provide for payment of any estate

tax attributable to the non-charitable CRT interest from other sources of the decedent's estate.

(3) Leaving a retirement plan interest to a CRT is not a good idea in all situations.

(a) If the individual beneficiary or beneficiaries are young enough, the actuarial value of the charitable interest may not exceed ten percent (10%) of the total value of the trust, and the trust will not qualify as a CRT. However, a term of years could be used to make the CRT work in this situation.

(b) If the CRT will receive a large amount of retirement benefits, it is possible that there will not be enough non-retirement assets to pay any estate tax due because of the actuarial value of the non-charitable interest in the CRT.

(4) With the severe limitation of the "stretch IRA" technique as a result of SECURE, a designation of a charitable remainder trust will allow some "stretching" to still occur.

4. Charitable Lead Trusts

a. Since a charitable lead trust ("CLT") is the theoretical opposite of a charitable remainder trust (i.e., the initial stream of payments is paid to a charity for a term of years, with the remainder passing to one or more individuals at the end of the term), this seems on its face to be a viable technique.

b. However, the charitable lead trust has one important characteristic which is different from a CRT; the CLT is not exempt from income tax. Therefore, when all of the retirement benefits are distributed to the CLT, the trust must pay income tax on the entire amount of benefits distributed.

c. Because of the drastic income tax consequences, one should not advise leaving retirement benefits to a CLT.

VIII. LIFETIME GIFTS OF QUALIFIED RETIREMENT BENEFITS TO CHARITY

A. Lifetime Gifts From Retirement Plan Distributions

1. For some of our clients, the most readily available funds with which to make lifetime charitable gifts are their retirement plan funds.

2. Except for the charitable IRA rollover discussed below, the only way for this client to make such a gift is to withdraw funds from the qualified plan or IRA and then gift such funds to the charity.

a. This of course results in the immediate taxation of the distributed assets from the plan on the donor's income tax return.

b. One would hope that the income tax charitable deduction will result in a "wash" of this income for income tax purposes. However, there are some circumstances which will prevent a complete wash of the income.

(1) If the charitable donations exceed the applicable percentage of AGI limits, then a complete wash will not result.

(2) For high income taxpayers, there is an automatic reduction of itemized deductions under Code § 68 which could also prevent a complete wash of the income.

(3) Of course, if the taxpayer is under age 59½ at the time of the withdrawal, he or she will suffer a ten percent (10%) penalty on the distribution. The charitable deduction will not in any way reduce this penalty.

(4) If the taxpayer resides in a state that does not allow a charitable deduction in computing its state income tax, then a complete wash will not be possible.

(5) Of course, any individual who does not itemize deductions would not achieve a wash of the income since he or she would not be itemizing the charitable deduction. There will be many more non-itemizers under the new tax law, with the increase of the amount of the standard deduction!

B. Gifts of RMD Amounts to Charity(s)

1. A taxpayer who is already receiving RMDs from his or her IRA or qualified plan may use the distributed amounts for charitable giving.

2. Although the above-described obstacles may prevent a complete wash of the income, since the taxpayer is required to receive the RMD

in any event, he or she may as well attempt to receive some income tax relief through charitable giving.

C. There are Potential Charitable Gifts of Unique Retirement Plan Benefits That Can Be Beneficial During Life

1. An individual under age 59½ may avoid the ten percent (10%) premature withdrawal penalty through implementing a "series of substantially equal periodic payments" from a retirement plan, and such taxpayer could use those payments to make offsetting charitable gifts.

2. In certain limited circumstances, wherein a distribution is made from a qualified plan of employer stock which includes "net unrealized appreciation", the taxpayer is not immediately taxed on such net unrealized appreciation at the time of the plan distribution. Instead, taxation of this unrealized appreciation is deferred, and may be completely avoided through certain future charitable gifts.

3. A lump sum distribution from a qualified plan to a participant who is born before January 2, 1936 (or to the beneficiaries of such a participant) may exclude the distribution from the recipient's gross income and is taxed under a different rate schedule. In some circumstances, the distributee may give the distributed amount to charity, and effectively deduct the gift from his or her other income, since the lump sum distribution is taxed at a much lower rate.

4. “Qualified replacement property” received by a business owner who has sold his or her stock to an ESOP, wherein the owner did not have to pay income tax on the sale, may be gifted to charity to avoid permanently some or all of the tax on such sale.

D. IRA Charitable Rollover

1. Congress has had an on-again/off-again love affair with the IRA Charitable Rollover.

a. The 2006 Pension Protection Act first established the “IRA Charitable Rollover” concept. After being allowed to expire in 2008, this provision was renewed temporarily two more times, and expired again on January 1, 2014.

b. The “Public Good IRA Rollover Act” was introduced in the Senate on November 21, 2013, which sought to renew and make permanent the IRA Charitable Rollover. Comparable legislation was introduced in the House in early 2014, and passed on July 17, 2014. Finally, on December 16, 2014, the Senate signed off on several “extenders,” including this provision, which was signed into law by the President on December 19, 2014. Unfortunately, the IRA Charitable Rollover provision expired <u>again</u> as of January 1, 2015!

c. After months of watching two separate bills which proposed to enact the IRA Charitable Rollover on a permanent basis sit idle in the

House of Representatives, action finally came in December, 2015. President Obama signed the "Protecting Americans from Tax Hikes Act" into law on December 18, 2015. Among other things, this Act finally makes the IRA Charitable Rollover permanent.

2. What constitutes an "IRA Charitable Rollover"?

a. A "Qualified Charitable Distribution" is an otherwise taxable distribution from an IRA (not including an ongoing SEP or SIMPLE IRA) owned by an individual who is at least age 70½, and that is paid directly from the IRA to "eligible charitable organizations."

b. A taxpayer can exclude from gross income up to One Hundred Thousand Dollars ($100,000) of a Qualified Charitable Distribution made for a given year.

(1) The Qualified Charitable Distribution can be used to satisfy any required minimum distributions from the IRA for that year.

(2) Likewise, the amount of the Qualified Charitable Distribution excluded from gross income is not shown as an itemized deduction for a charitable contribution.

c. An eligible charitable organization for these purposes includes a public charity, other than a donor advised fund or supporting organizations. Individuals can make a Qualified Charitable Distribution to a private

operating foundation or to a private foundation that elects to meet certain conduit rules in the year of the distribution.

d. The donor must instruct their IRA administrator to make the contribution directly to the eligible charity.

3. TRAP CREATED BY THE SECURE ACT

a. A working individual who is 70 ½ or older can make tax-deductible contributions to a traditional IRA (in 2020, the maximum deductible contribution is $7,000)

b. Under the SECURE Act, if such an individua ever makes a tax-deductible contribution to a traditional IRA after attaining age 70 1/2 , then the amount of a qualified charitable distribution from an IRA that can be excluded from taxable income is reduced by that amount.

c. If your client wants to make charitable gifts from his or her IRA, they should never make a tax-deductible contribution to their IRA after attaining age 70 ½.

4. Who really benefits from this continued IRA Charitable Rollover technique?

a. A high income donor who itemizes deductions and whose charitable contribution deductions are reduced by the percentage of income limitation (otherwise, such individuals who receive a distribution from their IRA and

make a corresponding charitable contribution, must count the entire distribution as income and receive a charitable deduction for a lesser amount).

b. Individuals who do not itemize their deductions.

c. Individuals in certain states where the operation of the state income tax law would offer greater benefits as a result of a charitable rollover.

d. Those rare individuals who already exceed their percentage of income limitation in terms of charitable contribution limits (i.e., more than 50% of their adjusted gross income for gifts of cash to public charities).

IX. THE TAX CUTS AND JOBS ACT OF 2017?

A. Although the Tax Cuts and Jobs Act makes vast revisions to the Internal Revenue Code, very few of these revisions affect estate planning for retirement assets.

B. Roth IRA Conversions.

1. The Act eliminates the taxpayer's right to recharacterize or undo a Roth IRA Conversion. For any Roth IRA Conversions made in taxable year 2018 and going forward, the taxpayer will no longer be able to undo the conversion.

2. The provision disallowing this recharacterization says that it "shall apply to taxable years beginning after December 31, 2017." This vagueness left us wondering whether any Roth Conversions made during 2017 could be undone, or whether this new provision applied to Roth Conversions made during

2017 so that no recharacterization could be made after December 31, 2017. The IRS has since issued a pronouncement, indicating that 2017 conversions can be re-characterized as late as an extended return due date of October 15.

C. Making Roth IRA contributions through the "back door".

1. Although the Tax Cuts and Jobs Act is silent on this, the Conference Committee's statement explaining the law confirms that an individual who is under age 70-1/2 and who has current compensation income can make an annual contribution to a Traditional IRA and then convert that Traditional IRA to a Roth IRA, with <u>no</u> income limit on the amount being converted. This allows an individual, whose adjusted gross income is above the limit permitting an annual compensation to a Roth IRA, to still accomplish a Roth IRA through the proverbial "back door."

Section Seven

Special Needs Issues and Updates

by Robert W. Fechtman

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DISCLAIMER

Although every effort has been made to obtain the best information available for presentation herein, the reader must recognize that many of the issues in this area, particularly as they relate to public benefits, are part of a rapidly changing body of law and administrative interpretation.

The author makes no warranties about the legal conclusions stated herein and this is not intended as legal advice to any individual. Application of the principals discussed in this paper to specific cases should only be taken upon the advice of knowledgeable counsel.

Special Needs Issues and Updates

by Robert W. Fechtman

I. Self-Settled Special Needs Trusts

A. The Self-Settled Special Needs Trust Under OBRA '93[1]

A special needs trust is a trust that can hold funds for the benefit of a disabled individual, and can use those funds to provide items and services for that individual to improve his or her quality of life, without jeopardizing eligibility for public benefits, such as Medicaid and Supplemental Security Income ("SSI").

The trustee of the special needs trust must have sole and absolute discretion over the use of the trust funds for the sole benefit of the recipient of public benefits. This means that the trust must be worded so that the trustee is not required to make any payments of income or trust principal directly to the recipient of public benefits.

Even though the special needs trust is designed to preserve eligibility for public benefits such as Medicaid and SSI, it is actually quite surprising to see the many different ways that special needs trust funds have been used for the benefit of recipients of public benefits, without causing any problems with those public benefits.

A self-settled special needs trust, which is a special needs trust that holds assets originally belonging to the recipient of public benefits, such as Medicaid and SSI, must meet certain requirements if it is not to interfere with eligibility for those public benefits:

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[1] 42 U.S.C. §1396p(d)(4).

1. The recipient of public benefits must be less than sixty-five (65) years old at the time the trust is established.
2. The special needs trust must be established by the disabled individual, a parent, grandparent or guardian of the disabled individual, or by a court.
3. The special needs trust must be irrevocable.
4. The trust must include a provision that states that any funds remaining in the trust at the death of the trust beneficiary (the recipient of public benefits) are available to reimburse the state or states for Medicaid costs paid on behalf of that trust beneficiary. Although, in the case of a pooled special needs trust, such as The Arc of Indiana Master Trust, the trust is allowed to retain a portion of any remaining funds for the benefit of other beneficiaries of the pooled trust, prior to the reimbursement to the State. The Arc Trust retains one-half (1/2) of any funds remaining at the death of the trust beneficiary.

II. Third-Party Special Needs Trusts.

When the special needs trust holds assets that originally belonged to someone other than the disabled individual (a parent or grandparent, for example) the trust **does not** need to include a provision that states that any funds remaining in the trust at the death of the trust beneficiary (the recipient of public benefits) are available to reimburse the state or states for Medicaid costs paid on behalf of that trust beneficiary. Also, in the case of a pooled special needs trust, such as The Arc of Indiana Master Trust, the trust does not necessarily retain a portion of any remaining funds for the benefit of other beneficiaries of the pooled trust. In fact, The Arc retains none of the funds remaining at the death of the trust beneficiary, unless the individual who funded the trust wishes to leave any of the remaining funds for the benefit of other beneficiaries of The Arc.

So, the parent of a child with special needs can use a special needs trust to make sure that their child is taken care of after they are gone, and the parent can ensure that any of the trust funds that are not used for the benefit of that child go to other members of the family when that child passes away. This is the best of both worlds. Medicaid and SSI can assist the disabled individual, the special needs trust can supply supplemental items and services to improve the quality of life, and the trust funds remaining at the death of the disabled individual can come back to the family, without Medicaid or SSI having any claim to any of these funds.

The Indiana Health Coverage Program Policy Manual ("IHCPPM") Section 2615.75.20.10 deals with trusts established on or after August 11th, 1993 that are not governed by OBRA '93. It says, these trusts "must be reviewed for the purpose of determining the 'availability' of the trust. Some examples are trusts created by a Will (testamentary trust) . . . ." The general rule regarding availability of resources is given at IHCPPM Section 2605.15.00, which states: "Resources are available if the owner has the unrestricted right, authority or legal ability to liquidate or dispose of the property or his share of the property. Resources must be available in order to be counted in the eligibility determination."

A. A Testamentary Special Needs Trust for a Surviving Spouse

405 IAC 2-3-1.1 includes language regarding a Medicaid transfer penalty that will be implemented if the Medicaid applicant or recipient failed to take action to receive assets which they were entitled to receive by law.

This aspect of the rule will impact a nursing home spouse, if the community spouse happens to be the first to die, and he or she does not leave enough to the nursing home spouse to satisfy the spousal allowance specified by Ind. Code §1-4-1 and/or the statutory right of election specified by Ind. Code §1-3-1. The rule will invoke a Medicaid transfer penalty, even if the

surviving, nursing home spouse simply fails to elect to take against the Will of the deceased community spouse. However, the rule also provides knowledgeable counsel with a very effective solution to the potential problem of the Medicaid transfer penalty. Under 405 IAC 2-3-1.1(i)(4), the rule states:

> "In the case of a surviving spouse who fails to take a statutory share of a deceased spouse's estate, no penalty will be imposed if the deceased spouse has made other equivalent arrangements to provide for a spouse's needs. 'Other equivalent arrangements' includes, but is not limited to, a trust established for the benefit of the surviving spouse."

Since, in this scenario, the surviving spouse is a nursing home spouse who is receiving Medicaid assistance, the community spouse will want to use a special needs trust for the benefit of that surviving spouse. The special needs trust will be designed to leave all of the discretion regarding the distribution of income and principal with the trustee of the trust, so that the trust assets can be used to supplement, not supplant, the Medicaid assistance to which the surviving spouse is entitled.

The community spouse will not want to use an *inter vivos* trust as the special needs trust. An *inter vivos* trust established after August 11th, 1993, and funded with the assets of the Medicaid recipient or the Medicaid recipient's spouse, will be governed by 42 U.S.C. 1396p(d)(4)(A). Accordingly, the entire principal of the trust will be considered as a countable resource of the Medicaid recipient, even though the trust is worded as a special needs trust.

A testamentary special needs trust will not cause a problem with the ongoing Medicaid eligibility of the nursing home spouse, because the special needs language leaves all of the discretion regarding distributions to the trustee, and the trust assets are not "available" to the Medicaid recipient. Counsel should be sure to fund the special needs trust with enough of the community spouse's assets to satisfy the spousal allowance and the statutory right of election

relevant to the particular case. The author has recently been using the following language for this purpose:

> "In the event my *husband/wife, *, survives me by thirty (30) days, then I devise and bequeath to *, as Trustee, in trust for the benefit of *(spouse), an amount sufficient to prevent any period of ineligibility for Medicaid for *(spouse) based on the statutory rights of a spouse to elect to Take Against the Will of a deceased spouse as set forth in Ind. Code §29-1-3, or any successor section, and also based on the Surviving Spouse Allowance as set forth in Ind. Code §29-1-4, or any successor section."

For clients who have utilized an *inter vivos* trust to avoid the necessity of opening a probate estate for administration through a court, the special needs trust described above should still be established through a Will. However, there is no need to do away with the *inter vivos* trust. Simply specify that the proper funds will go from the *inter vivos* trust to the trustee of the special needs trust created in a Will, and this special needs trust will come into being at the death of the testator or testatrix, as a result of the Will being spread of record with a court pursuant to Ind. Code §29-1-7-3.

B. The "Tandem" Special Needs Trust

Parents or grandparents who establish third-party special needs trusts for children or grandchildren with special needs very often choose only a succession of family members to be the trustees. It is certainly possible that most family members will be able to do the job of trustee with a reasonable amount of guidance from the attorney who drafted the special needs trust, but there may be times when another source of help to the trustee will be desirable.

A "tandem" special needs trust works by pairing the third-party special needs trusts with The Arc of Indiana Master Trust. In this arrangement, family members act as trustees, to be in charge of the investments, but the The Arc, with its many years of experience with thousands of beneficiaries of its pooled special needs trust, is in the best position to manage the actual trust distributions and the resulting need to report these trust distributions to the pertinent public benefits agencies.

C. Special Needs Trusts Incorporating the Power to Withdraw Additions

It is possible to incorporate the power to withdraw additions with the concept of a special needs trust, if the testator wishes additions to the special needs trust to qualify for the annual exclusion for estate tax purposes. It is important, however, not to do this by using the typical *Crummey* powers, which allow the beneficiary of the trust to withdraw these additions. If the beneficiary has the power to withdraw additions, the local Medicaid authorities would certainly have a good argument that this power changes the character of the money that is in the special needs trust, making the trust a self-settled special needs trust rather than a third-party special needs trust.

The way around this problem is to simply give someone other than the disabled beneficiary of the special needs trust the power to withdraw the additions. This is supported by the Tax Court case of *Cristofani v. Commissioner*, 97 T.C. 74 (1991), where the tax court allowed the annual exclusion for gifts to a trust where the power to withdraw the additions was held by vested contingent remaindermen.

III. The Special Needs Trust Fairness Act

When the Omnibus Budget Reconciliation Act of 1993 (OBRA ’93) was passed, there was apparently a mistake in the wording of the statute as it relates to special needs trusts, because the individual him or herself was not included in the list of individuals and entities eligible to establish a special needs trust. Considering the fact that OBRA ’93 was passed more than 24 years ago, a fix for this mistake has been a long time coming!

The Special Needs Trust Fairness Act has been making its way through Congress for years, and, finally, President Obama signed it into law on December 13, 2016, as part of the 21st Century Cures Act (P.L. 114-255). Therefore, as of December 13, 2016, an individual with a disability may establish his or her own special needs trust.

IV. Military Survivor Benefit Plans

Section 624 of the National Defense Authorization Act of 2015, known as the Disabled Military Child Protection Act, provides that a military Survivor Benefit Plan can name a self-settled special needs trust to receive the benefits for the veteran's child who has a disability. This is a major change to the law that allows veterans to leave money for the benefit of children who have disabilities without causing them to lose eligibility for needs-based public benefits.

V. The ABLE Act

The Achieving a Better Life Experience ("ABLE") Act[2] was signed into law on December 19, 2014. The law allows eligible individuals with disabilities the ability to establish, or to have established for them by their legal representatives, "ABLE accounts" that will be similar to 529 college savings plans, although the expenditures from the ABLE accounts must be on "qualified disability expenses." ABLE accounts allow more individual choice and control over spending on qualified disability expenses, while preserving eligibility for needs-based public benefits, such as Medicaid and SSI.

The ABLE Act creates a new form of 529 account, which is tax-favored in various ways, but this new form of 529 account is also quite different from the 529 college savings plans.

The ABLE Act required the Secretary of the Treasury to issue regulations or other necessary guidance within six months of enactment of the law. The Secretary did so by issuing proposed regulations in the Federal Register on June 22, 2015. During the 90-day comment period, and at the public hearing, which was held on October 14, 2015, interested parties identified three areas of concern with these proposed regulations, and the Internal Revenue

[2] 26 U.S.C. §529A

Service ("IRS") announced changes in all three of these areas on November 20, 2015. There were other concerns with issues raised by The ABLE Act itself, and changes to the Act were implemented through the Consolidated Appropriations Act of 2016 (commonly known as the "Tax Extenders Bill"). The IRS has now issued its final regulations, and these final regulations are generally favorable to ABLE account owners.

On March 21, 2016, the Social Security Administration ("SSA") issued an update to its Program Operations Manual System ("POMS") regarding The ABLE Act. SI 01130.740 doesn't seem to include any surprises, but it is interesting to note that it includes a list of "qualified disability expenses" as follows:

(1) Education;

(2) Housing (this is the same as the rules for "in-kind support and maintenance");

(3) Transportation;

(4) Employment training and support;

(5) Assistive technology and related services;

(6) Health;

(7) Prevention and wellness;

(8) Financial management and administrative services;

(9) Legal fees;

(10) Expenses for ABLE account oversight and monitoring;

(11) Funeral and burial; and,

(12) Basic living expenses.

On March 21, 2016, Governor Mike Pence signed S.B. 11, and Indiana thereby implemented The ABLE Act. Yes, this is the same day that the SSA issued its updated POMS,

and, perhaps not coincidentally, Indiana's ABLE legislation contains a list of "qualified disability expenses" that is almost identical to the list above. The only real difference is that basic living expenses is not on the list, and (12) is instead "other expenses approved by the federal government for a qualified ABLE program."

Senate Enrolled Act 11 establishes an ABLE Board of Authority, consisting of the Treasurer of the State of Indiana, the Secretary of the Indiana Family and Social Services Administration ("FSSA"), the Budget Director, and the Executive Director of the Indiana Housing and Community Development Authority, plus five members to be appointed by the governor. One member who has significant experience in actuarial analysis, accounting, investment management, or other areas of finance that are relevant to the Authority, **one member who has significant legal expertise and knowledge of estate planning**, one member who is a representative of a statewide organization that advocates on behalf of individuals with disabilities, one member who is an individual with a disability, and one member who is a family member of an individual with disability. Not more than three of the appointed members of the board may belong to the same political party!

The official name of the program is INvestABLE Indiana. The website for the program is located at in.savewithable.com. The ABLE account may be started with as little as $25.00. Investment costs range from 0.34% to 0.38%. There is a quarterly maintenance fee of $15.00, but subtract $3.75 from this quarterly fee with e-mail delivery of statements and confirmation of distributions. Investment options include FDIC-insured bank accounts, and mutual fund and ETF allocations that reflect the owner's risk tolerance. The owner of the ABLE account may name an Authorized Agent (e.g., a financial advisor) with one of four different levels of access to and control over the account.

A. Key Characteristics of ABLE Accounts

1. An eligible individual may have only on ABLE account. This is different than 529 college savings plans, where an individual may be the beneficiary of more than one account.

2. Originally, the ABLE account was required to be established in the state where the eligible individual resides, but this restriction was removed in the Tax Extenders Bill.

3. The eligible individual may establish his or her own ABLE account. This is a departure from the original rules for what are usually called self-settled special needs trusts under 42 U.S.C. §1396p(d)(4)(A), where the beneficiary of the trust was not allowed to establish the trust for him or herself, until that was changed by the Special Needs Trust Fairness Act, as described above, on December 13, 2016.

4. An ABLE account may not receive annual contributions in excess of the annual gift tax exemption under 26 U.S.C. §2503(b). According to the regulations, the states will have to return these excess contributions to the individual contributors, but, happily, these distributions from the ABLE accounts will not be included in the gross income of the beneficiaries of the ABLE accounts. This rule is relaxed for working account owners, who may contribute an additional amount to their own ABLE account. This individual amount is equal to the federal poverty level of income for a single-person household, in the state in which the account owner resides, or the gross wages of the account owner, whichever is less.

5. An ABLE account may not hold aggregated contributions in excess of the individual states' limits for 529 accounts. Again, according to the regulations, the

states will have to return these excess contributions to the individual contributors, but these distributions from the ABLE accounts will not be included in the gross income of the beneficiaries of the ABLE accounts. The current limit for 529 accounts in Indiana is $450,000.00.

6. If the ABLE account balance exceeds $100,000, the beneficiary will lose eligibility for SSI, but not for Medicaid. On the bright side of things, these SSI benefits will not be terminated due to the excess funds in the ABLE account, but will merely be suspended until the account balance goes back down below $100,000.

7. Payments made from an ABLE account for food and shelter costs of the owner of the account will not count as In-kind Support and Maintenance for SSI purposes. See page 22 of this paper for a full description of the concept of In-kind Support and Maintenance (ISM). When you understand this concept, you will see that the fact that distributions from an ABLE account do not count as ISM, and therefore do not reduce SSI, is one of the best features of an ABLE account!

8. ABLE accounts may only be established for individuals whose onset of disability was prior to age 26. If the individual was receiving Social Security benefits under Title II of the Social Security Act (Social Security Disability Insurance) or Title XVI of the Social Security Act (SSI) prior to age 26, this will obviously be enough to prove that the onset of their disability was prior to age 26. Otherwise, they will have to complete a “disability certification.” Originally, this disability certification was required to include a copy of the individual’s diagnosis relating to the individual’s relevant impairment or impairments, signed by a physician who met the criteria of section 1861(r)(1) of the Social Security Act, but this restriction was removed in the Tax

Extenders Bill. Now, the disability certification need only indicate that the eligible individual has received a signed physician's diagnosis, and this diagnosis will be retained by the eligible individual and presented to the IRS upon request.

9. ABLE accounts may only be used for "qualified disability expenses." Qualified disability expenses include expenses for education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral and burial expenses, and other expenses that may be included in the regulations. The regulations state the Treasury Department's intent, based on the legislative purpose of assisting individuals with disabilities, to construe the term "qualified disability expenses" broadly to permit the inclusion of basic living expenses, and not to limit those expenses to items for which there is a medical necessity, or to items that benefit no one other than the disabled individual. They use the specific example of smart phones, which they say could be considered qualified disability expenses if they are an effective and safe communication or navigation aid for a child with autism.

10. If an ABLE account beneficiary is at any time no longer disabled, even temporarily, his or her ABLE account retains its ABLE account status, and no taxable distribution of the account balance is deemed to have occurred. The regulations also say that there may be no more contributions to the ABLE account beginning on the first day of the year following the year in which the account beneficiary ceased being disabled, and account distributions will not be qualified disability expenses if they are made during a time when the account beneficiary is not disabled.

11. Earnings on an ABLE account and distributions from the account for qualified disability expenses are not included in the gross income of the contributor or the account beneficiary. Contributions to an ABLE account must be made in cash from the contributor's after-tax income. In other words, the contributor does not get a tax deduction for making a contribution to an ABLE account, but, of course, he or she doesn't get a tax deduction for making a contribution to a 529 college savings plan, either. However, any contribution to an ABLE account is treated as a completed gift to the account beneficiary which is not a future interest in property, and it is not treated as a qualified transfer under 26 U.S.C. §2503(e).

12. If an ABLE account beneficiary moves to another state, the account balance may be rolled over to a new ABLE account in the new state. There are some restrictions on this provision of the law. According to the regulations, the rollover must happen with a period of 60 days, and an ABLE account may not be rolled over twice within the same 12-month period.

13. An ABLE account may be rolled over into an ABLE account for a different beneficiary, if the second beneficiary is a blind or disabled family member of the first beneficiary. This "family member" must be a sibling of the initial account beneficiary, and the rollover must occur during the lifetime of the initial account beneficiary.

14. A program will not be treated as a qualified ABLE program unless it provides that account beneficiaries may, directly or indirectly, direct the investments of any contributions to the program, or any earnings thereon, no more than two times in any calendar year. This provision of the Act must be the result of the

advocacy efforts of the crafters of the legislation, who understandably want individuals with disabilities to have a say in the investment of funds to be used by them for their own benefit.

15. At the time of the account beneficiary's death, all ABLE accounts must reimburse the state for its Medicaid expenses on behalf of the account beneficiary, whether the contributions to that account were made by the account beneficiary or by other individuals, such as the account beneficiary's parents or grandparents. This "payback" to the state is much more clearly defined, and is a little bit more lenient, than the payback required with self-settled special needs trusts under 42 U.S.C. §1396p(d)(4)(A) and (d)(4)(C), because it is specifically limited to those Medicaid expenses paid for the account beneficiary after the establishment of the account, and it is net of any premiums paid to a Medicaid Buy-In program under any State Medicaid plan. In Indiana, our Medicaid Buy-In program is called MED Works, and it is a Medicaid program for disabled workers, who pay small premiums for their Medicaid based on the amount of their income. If the ABLE account contains more than enough funds at the time of the account beneficiary's death to reimburse the state for its Medicaid expenses, any remaining funds may go to family members or other heirs of the account beneficiary. There may certainly be times when it makes sense for third parties, such as parents or grandparents, to fund ABLE accounts for their children and grandchildren, but it is worth noting that this is the first time we have ever been required to include a payback to the state for funds contributed by third parties.

B. When Would An Individual Choose to Establish and/or Fund an ABLE Account?

Given all the advantages and disadvantages of the ABLE accounts, as described them above, and weighing those against the advantages and disadvantages of a special needs trust (the full description of the advantages and disadvantages of a special needs trust is beyond the scope of this paper), when would an individual choose to establish and/or fund an ABLE account, for himself or for someone else?

We must exclude those individuals who are categorically ineligible, like those individuals who are not disabled according to Social Security criteria and/or whose onset of disability was not prior to age 26, or like those individuals who do not reside in a state that offers an ABLE program or has contracted with another state to offer an ABLE program for them. We must also rule out times when it is not possible or desirable to add funds to an existing ABLE account, like when contributions equal to the annual gift tax exclusion amount have already been added that year, or like when the ABLE account has accumulated funds equal to that state's limit on accumulation in a 529 account, or like when a further contribution to the ABLE account will make the balance exceed $100,000 and cause the account beneficiary to lose his or her eligibility for SSI.

In the author's humble opinion, we should also rule out, for the most part, contributions to ABLE accounts by third parties, due to the mandatory payback provision, which reimburses the state for its Medicaid expenses on the account beneficiary's behalf at the time of the account beneficiary's death. There are other ways for third parties to make contributions to an account for a disabled individual, without causing that individual to lose his or her eligibility for needs-based public benefits. A third-party special needs trust is almost always a good option. If the concern is responsible management of the funds, or a trustee who knows how to make

distributions without causing problems with public benefits eligibility, The Arc of Indiana Master Trust (a pooled special needs trust) has been handling these issues for 28 years now, and there is no payback provision in The Arc of Indiana Master Trust when the funds were contributed by third parties. The Arc of Indiana does charge a fee for managing the trust accounts, but, because The Arc of Indiana is a not-for-profit organization, its fees are relatively quite low, especially when compared to the average bank or trust company.

1. The SSI and/or Medicaid recipient who saves money. Even though SSI pays no more than $794 per month in 2021, there are some SSI recipients who still manage to save money. If they accumulate funds in excess of the SSI resource limit of $2,000, then they lose their SSI. This problem would only be compounded for an individual who is on Medicaid and receives SSDI, which is often a larger monthly amount than SSI, since it is based on the wages of the worker on whose account it is being drawn. The SSDI will not be affected by the accumulation of savings, but the Medicaid resource limit is $2,000, just like SSI. An ABLE account might be a very handy solution. Whenever the individual's personal bank account accumulates to nearly $2,000, the individual may simply move some of it over to his or her ABLE account.

2. The SSI and/or Medicaid recipient who receives a small inheritance or a small personal injury settlement. Keeping in mind the $2,000 resource limit for both SSI and Medicaid, a small inheritance or a small personal injury settlement could obviously cause an individual to lose these benefits. As long as the inheritance or settlement is less than the annual gift tax exclusion amount, then an ABLE account is probably a good solution to the public benefits eligibility problem. If the inheritance or settlement arrives in, let's say, December, it might even be possible to spread the contributions to the ABLE account out over two years,

thereby doubling the amount of money that can be dealt with in this way. With a settlement, it might even make sense to work a structured settlement annuity into the settlement, so the annual payments from the annuity are less than the annual gift tax exclusion amount, and then the ABLE account could be funded every year for the life of the annuity.

3. The parent or grandparent with a small estate and a fear of lawyers. As discussed above, the ABLE account is not generally attractive for funding by third parties, due to the payback provision. A special needs trust is probably a better option. However, it might make sense to use an ABLE account for a total bequest less than the annual gift tax exclusion amount, if the parent or grandparent doesn't care about the payback.

4. The parents very interested in giving their child more autonomy and control. Maybe the parents are more concerned about giving their child the sense of personal dignity and autonomy that would result from having control over at least small amounts of money, and they are less concerned about the payback provision and other limitations of the ABLE Act. The parents can't just put $10,000 into the child's personal bank account, because that would cause the child to lose his SSI and/or Medicaid. But, they could put that same $10,000 into and ABLE account for the child, thereby giving the child almost complete control over the use of the funds.

5. The trustee of the special needs trust who wants to give a beneficiary more control. Just like with family contributions, a trustee can't just put $10,000 into the trust beneficiary's personal bank account, because that would cause the beneficiary to lose his SSI and/or Medicaid. If the trust beneficiary receives SSI, the trustee can't give him or her a gift card, either, because the SSI rules count gift cards as income to the SSI recipient in the month they are received. It might be desirable for a trustee to fund an ABLE account for the trust beneficiary, from time to time.

VI. The SSA's Trust Review Process

The SSA has implemented a very extensive trust review process. In a nutshell, if an SSI applicant or recipient is the beneficiary of a trust, that trust is reviewed at the time of that individual's application for SSI, and also whenever changes are made to that trust or whenever there are changes in the SSI POMS relevant to that trust. According to the POMS, if there is a problem with the trust that is caused by a change in the SSI POMS that was implemented after the trust was submitted to the SSA and reviewed by them, then the SSA must give the SSI recipient 90 days to fix the problem with the trust. Otherwise, there is no grace period, and the individual will lose his or her SSI until the problem is fixed to the satisfaction of the SSA. The following is a list of a few of the issues that have been causing problems throughout the country.

A. The "Two Ten Buck Rule"

In the case of a self-settled special needs trust where the trust beneficiary receives SSI, it is important to understand the way the SSA thinks about two issues.

First, the SSA thinks that Indiana law does not allow an individual to establish a "dry" trust. So, if a parent or grandparent establishes a self-settled special needs trust for the trust beneficiary and does not "seed" the trust with a little bit of his or her own money before the trust beneficiary places his or her own funds into the trust, the SSA will determine that the trust is not a valid trust, and the trust beneficiary will therefore be disqualified from SSI. This is not an issue when the trust is established by a court.

Second, the SSA thinks that Indiana's statutory version of the Doctrine of Worthier Title indicates that a trust that purports to be irrevocable is actually revocable, if there is only one beneficiary of the trust. The SSA does not consider the state to be a trust beneficiary by way of the "pay-back" clause, and the SSA does not accept a general category of persons (such as "heirs at

law") to be a trust beneficiary, so it is important to make certain in these cases that there are at least two specific, named beneficiaries of the trust. Otherwise, the SSA will determine that the trust is revocable, which would obviously disqualify the trust beneficiary from SSI

The solution to both of these problems is something that David Lillesand, a National Academy of Elder Law Attorneys ("NAELA") member from Florida, calls the "Two Ten Buck Rule." Have the parent or grandparent who establishes the trust put $10 of his or her own money into the trust before the trust beneficiary adds his or her own funds to the trust. Then, specify that, when the trust beneficiary dies, someone else gets $10, after the pay-back to the state but before the heirs at law get the balance, if any.

B. Early Termination Provisions

In the case of (d)(4)(A) and (d)(4)(C) trusts (i.e., those trusts that have a "payback clause"), early termination of the trust (i.e., termination prior to the death of the beneficiary of the trust) triggers the payback. This rule is delineated in the POMS at SSI 01120.199.

It certainly makes sense to say the trust has been terminated early, if, during the lifetime of the trust beneficiary, the trust is actually terminated and the money is distributed to that beneficiary. However, the SSA believes that there are other events when the trust is being terminated early, such as when a (d)(4)(A) trust distributes money out to a (d)(4)(C) trust, or the other way around.

As mentioned above, the "tandem trust" is a way to leave a family member in charge of the trust investments, but rely on a pooled special needs trust, like The Arc of Indiana Master Trust, to handle the trust distributions and reporting requirements with the public benefits agencies. In the case of a tandem trust, a (d)(4)(A) trust is paired with a (d)(4)(C) trust, and money is allowed to flow from the (d)(4)(A) trust to the (d)(4)(C) trust, thereby making it possible for the trustee of the (d)(4)(A) trust to concentrate on investing the trust funds while relying on the trustee of the

(d)(4)(C) trust to manage the distributions of the funds without losing eligibility for needs-based public benefits.

Sad to say, the author has had to remove these tandem trust provisions from all of his (d)(4)(A) trusts. If the reader is relying on old trust forms provided by the author, please make a note of this change!

C. Legal Authority for a Parent or Grandparent to Establish a (d)(4)(A)

As mentioned earlier in this paper, a (d)(4)(A) trust must be established by a parent, a grandparent, a guardian or a court. However, it is important to note that the SSA requires a parent or grandparent to have some sort of legal authority to establish the trust. So, in the case of a minor or an incapacitated adult, a parent or grandparent must get that legal authority from a court, through a guardianship or a protective order. In the case of a competent adult, the author has developed a very limited power of attorney, to be signed by the intended beneficiary of the trust, that authorizes the parent or grandparent only to establish a trust as described in 42 U.S.C. §1396p(d)(4)(A).

D. The Sole Benefit Rule

As will be explained later in this paper, the SSA believes that self-settled special needs trusts must be for the sole benefit of the beneficiary, whatever that means. The author has only had a problem with this issue one time, but perhaps that problem was a sign of larger problems to come.

The author often has a long paragraph in each special needs trust that describes many of the ways that the trustee may use trust funds for the benefit of the disabled beneficiary of the trust, including paying family members as caregivers and making handicap modifications to a caregiver's home. In the lone case described above, the representative of the Social Security Field Office opined that a trust provision allowing family members to be paid as caregivers and allowing the trustee to use trust funds to make handicap modifications to a caregiver's home violated the

supposed sole benefit rule. The path of least resistance is to make whatever changes to the trust will prevent the necessity of an appeal, so, in this case, the author simply removed the offending paragraph.

E. Source of Funds

The source of the funds that were deposited into the special needs trust is obviously important when determining whether the trust is a self-settled or third-party special needs trust, and the ramifications of this distinction are paramount. A self-settled special needs trust will reimburse the state or states for their Medicaid expenses on behalf of the beneficiary at the time of the beneficiary's death, and a third-party special needs trust will not. The SSA seems to be obsessed with this issue for at least the last few years. If the trust is a third-party special needs trust, one must be prepared to prove that the funds came from a third-party source. Keep receipts or other paperwork related to the initial deposit. It is not enough to show that the funds came from the estate of so-and-so. Did the Will of the decedent leave the funds to a trust for the beneficiary, or did the Will leave the funds directly to that beneficiary? If there was no Will or other testamentary document, then there is nothing for it but to admit that any resulting special needs trust is self-settled.

VII. Tax Issues for Special Needs Trusts

A. Grantor Trust Rules

The income tax consequences of the trust must be considered in drafting the trust. Under the grantor trust rules[3], a self-settled special needs trust will generally be considered a grantor-type trust, because the income and principal are payable to the injured party, who is considered to be the

[3] Internal Revenue Code ("IRC") §§671-678.

grantor.[4] This is a beneficial result with respect to income taxation, because trust income tax rates are "compressed," which means that trusts reach the higher income tax rates more quickly than do individuals. Therefore, counsel will almost always want to qualify self-settled special needs trusts as grantor-type trusts for the purposes of income taxation, so the trust income will be taxed at the lower, personal income tax rates of the trust beneficiary.

A self-settled special needs trust will only be considered to be a grantor-type trust if the trust beneficiary is able to exercise sufficient control over the trust so as to create an ownership interest in the trust. The grantor trust rules do a good job of defining the elements of control that will create the necessary ownership interest, but it is the author's opinion that there is one such element of control which rises above the rest as the simplest way to create the ownership interest, without interfering with the special needs status of trust or the public benefits eligibility of the trust beneficiary. Give the trust beneficiary the power to reacquire the trust corpus by substituting other property of equal value.[5]

It is important that there not be any "adverse party" who can defeat the grantor-type trust status by interfering with the control that the trust beneficiary has over the trust. An adverse party is any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power which he or she possesses respecting the trust.[6] A remainder beneficiary would have a substantial beneficial interest in the trust, and it is therefore important to make sure that the trust beneficiary does not have to get permission or approval from

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[4] IRC §677.

[5] IRC §675(4)(C).

[6] IRC §672(a).

any other party when exercising his or her control over the trust as discussed in the previous paragraph.

If the special needs trust is a grantor-type trust, then the income to the trust will flow through to the trust beneficiary's individual income tax return. This may cause the trust beneficiary to owe income taxes that he or she does not have the ability to pay, so the trust should include a provision that allows the trustee to pay the income tax liability of the trust beneficiary.

In the case of a grantor-type trust, it is probably easiest to invest the trust assets under the social security number of the trust beneficiary. That way, the trust beneficiary will simply receive a 1099 at the end of the year, and this 1099 may be added to any other tax documents received by the trust beneficiary, so that the beneficiary's tax preparer may prepare the beneficiary's personal income tax return (form 1040). In this situation, there will be no need for the trust to acquire a tax identification number of its own, or what the IRS calls an Employer Identification Number ("EIN"), and the trustee will not have to prepare a fiduciary income tax return (form 1041).

B. IRAs and Special Needs Trusts

1. Lifetime transfer of an IRA to an SNT

A Private Letter Ruling "PLR" from February 21, 2006, allows the lifetime transfer of an inherited IRA to a self-settled special needs trust. The PLR may be found at ftp://ftp.irs.gov/pub/irs-wd/0620025.pdf.

A decedent, age 69, and therefore not having reached his required beginning date, was the owner of an IRA naming his four sons as beneficiaries. One of his sons is disabled and on Medicaid and other public benefits. His mother is his legal guardian. Upon the decedent's death, the custodian of the IRA established separate shares for the four beneficiaries, and the disabled son's guardian got permission from a state court to establish a self-settled special needs

trust and to transfer the inherited IRA to the trust. The guardian, who was now also the trustee of the special needs trust, sought the PLR to indicate that the transfer to the trust would not be a taxable event, since the trust qualified as a grantor-type trust, and to allow the required minimum distributions from the IRA to be based on the age of the disabled beneficiary of the trust.

The PLR agrees that the transfer of the inherited IRA to the trust is not a taxable event, and that the disabled beneficiary's life expectancy is the proper basis for calculating the required minimum distributions from the IRA.

The PLR discusses four points that give some direction to those trying to apply its holding to other cases. These points are:

1. The trust is a grantor-type trust due to a power, held by the grantor alone or by a non-adverse party, to distribute any portion of income to the grantor or the grantor's spouse, or to accumulate income for future distribution. Since the trustee is the beneficiary's mother and an heir at law, she had previously executed a disclaimer of any remainder interest. The PLR assumes that this disclaimer is effective.

2. The PLR assumes that the required minimum distributions for the year following the year of the decedent's death and all subsequent years have been made, and that the division of the IRA into separate shares was properly accomplished by September 30th of the year following the year of the decedent's death.

3. The special needs trust permits payment of any or all of the trust principal or income to or for the benefit of the disabled beneficiary of the trust, or accumulation of undistributed income to be added to the trust principal. In other words, the trust is not a "conduit" trust requiring distribution of at least the required minimum distribution amount.

4. The IRA held in the special needs trust will not be the actual, inherited IRA, or even the separate share established by the IRA custodian after the decedent's death. The special needs trust will instead be funded by a trustee to trustee transfer of the separate share to a new IRA, naming the special needs trust as the owner.

On the negative side, it is important to remember that PLRs are only binding upon the IRS in the specific case for which they were obtained. On the positive side, though, this PLR did not make much of the fact that this was an *inherited* IRA, so there is some hope that these same principals may be applied to cases involving non-inherited IRAs.

2. The SNT as a beneficiary of an IRA

When naming a special needs trust as the beneficiary of an IRA, which is a common issue when parents are planning for the needs of a child with disabilities, it is important to make sure that one thinks about the Applicable Distribution Period ("ADP") for the IRA and the trust beneficiary whose life expectancy will determine the ADP.

If the trust qualifies as a "see-through trust," the IRA can be distributed in annual installments over the life expectancy of the oldest trust beneficiary. This will almost always be a longer ADP than would be the case if the trust did not qualify as a "see-through trust."

In order for the trust to qualify as a "see-through trust," a trust must satisfy five requirements from the regulations. These are found at Reg. §1.401(a)(9)-4, A-5(b), and they are:

1. The trust must be valid under state law;
2. The trust must be irrevocable, or it must, by its terms, become irrevocable upon the death of the retirement plan participant;
3. The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the retirement plan must be identifiable from the trust instrument;
4. The trustee must provide certain documentation to the retirement plan administrator, and this may simply be a copy of the trust document; and,
5. All trust beneficiaries must be individuals.

A conduit trust is a trust where the trustee is required by the terms of the trust to distribute to the individual trust beneficiary or beneficiaries any distribution the trustee receives from the retirement plan. A properly drafted conduit trust would certainly qualify as a "see-through trust." However, a conduit trust will obviously not work as a special needs trust,

because it is partly the accumulation of the trust income that makes a special needs trust effective in keeping the trust beneficiary eligible for needs-based public benefits.

An accumulation trust will qualify as a "see-through trust," as long as the trust principal will pass outright at the disabled trust beneficiary's death to other now-living individuals, such as the trust beneficiary's siblings. If this type of accumulation trust is used, a charity should not be named as a remainder beneficiary, since that would trigger a necessary five-year pay-out of the IRA. Also, the remainder beneficiaries of the accumulation trust should be individuals close in age to the disabled trust beneficiary, because the life expectancy of the oldest member of this group will determine the ADP. Remember that all of these remainder beneficiaries must be living at the time of the execution of the trust document. In other words, it is not enough to state that the remainder beneficiaries consist of a group, such as nieces and nephews, but those specific nieces and nephews must be listed, by name.

The SECURE Act has no doubt been discussed extensively during other parts of this program. Therefore, you know already that disabled beneficiaries of IRAs are allowed to play by the old rules. If clients have more than one child and one of those children has a disability, it is worth considering whether the child with a disability should get even more than his or her share of the pre-tax retirement accounts.

VIII. Supplemental Security Income

A. The POMS

While SSI eligibility is technically based on federal statutes (42 U.S.C. §§1381-1383f), and federal regulations (20 C.F.R. §§416.101-416.2227), the only thing that the SSA staff are going to look at is the SSA's own Program Operations Manual System (POMS). The POMS are

also the only set of detailed guidelines for you to use to draft and administer a Special Needs Trust (SNT) properly.

If it strikes you as strange, or even illegal, for an agency to rely more-or-less solely on its own manual for administering an enormous and complex program, get over it. They do it all the time! My friend and colleague, Nell Graham Sale, calls it the "ad hocracy." Besides, in the case of Chevron, *USA, Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, the United States Supreme Court held that an agency's interpretation of the applicable statutes will be given deference, absent statutory or regulatory prohibitions. More to the point, in the case of *Washington State Dept. of Social & Health Services v. Guardianship Estate of Keffeler*, 537 U.S. 371, the U.S. Supreme Court specifically applied the *Chevron* holding to the SSA POMS.

You will find the POMS specific to SSI at https://secure.ssa.gov/apps10/poms.nsf/chapterlist!openview&restricttocategory=05. The concepts in the SSI POMS that bear on this presentation are "income," in-kind support and maintenance," and "deeming." Citations to particular SSI POMS will all start with SI, as in SI 00810.005.

B. Income

If you make a distribution from the SNT that will count as income for SSI purposes, you want to know about it, because income can cause the loss of the entire SSI benefit for the months when the income is paid.

According to SI 00810.005, income is any item an individual receives in cash or in-kind that can be used to meet his or her need for food or shelter.

Unfortunately for trustees, SI 01120.201.I.1.e, introduced in January 2009, considers gift cards and gift certificates to be cash equivalents. If a gift card can be used to buy food or shelter, it

is unearned income in the month of receipt, and any unspent balance becomes a resource beginning the month after the month of receipt. Even if the gift card is for a particular store, and that store does not sell food or shelter items, SI 00830.522 indicates that it is still unearned income, unless the card has a legally enforceable prohibition on the card being sold for cash.

There is a relatively new kind of credit card that works more-or-less like a gift card and is acceptable for SSI purposes, though. If the card is owned and controlled by the trustee, and if the card is restricted so that it cannot be used to purchase food, the possession and use of the card by the trust beneficiary and the payments made to the credit card by the trustee will not be considered to be income to or a resource of the trust beneficiary. See SI 01120.201.I.1.e. The POMS name the True Link Visa Prepaid Card as an example of this kind of "administrator-managed prepaid card." The authors have used True Link Visa cards fairly extensively in conjunction with various SNTs, and the cards work very well and have not affected public benefits eligibility.

C. In-Kind Support and Maintenance

If you make a distribution from the SNT that will count as In-Kind Support and Maintenance (ISM), you want to know about this, too, because there will be a reduction of the SSI benefit. However, ISM is subject to the Presumed Maximum Value (PMV) rule, which is described in SI 00835.300. The PMV is a cap on the amount of the ISM that can be charged by the SSA. In other words, the PMV means that there is a maximum amount that the SSI recipient's SSI can be reduced by ISM. In general terms, the amount of the PMV is one-third of the Federal Benefit Rate (the maximum SSI payment to an individual), plus $20.00. So, for a trust beneficiary receiving the usual monthly SSI benefit of $794.00 (for 2021), ISM in any given month reduces the SSI for that

month to no less than $509.00. For example, if the amount of the ISM is an electric bill in the amount of $500.00, the trust beneficiary will still receive $509.00 in SSI for that month.

Trust distributions to a third party for items that are for food or shelter for the SSI recipient are considered to be ISM. Shelter is defined by SI 00835.465D.1 as:

1. Mortgage payments (including property insurance required by the holder of the mortgage;
2. Real property taxes (reduced by any tax rebate or credit);
3. Rental payments;
4. Heating fuel;
5. Gas;
6. Electricity;
7. Water;
8. Sewer; and,
9. Garbage removal.

Obviously, ISM is much better for the trust beneficiary than income, and, therefore, a trustee can do much more to improve the quality of the life of the trust beneficiary with ISM than with any trust distribution that would be considered by the SSA to be income.

If a trust pays a credit card bill for the trust beneficiary, that credit card payment will count as ISM to the extent that the credit card was used to pay for food or shelter items, according to SI 01120.201.I.1.d.

D. Deeming

The definition of the "household" is essential to an understanding of the concept of "deeming." Income and assets of all of the other members of the household will be deemed to be

income and assets of the SSI recipient, and could obviously therefore affect his or her eligibility for SSI or the amount of SSI he or she is entitled to receive.

SI 01310.140 states that the household consists of a person, or group of persons sharing common living quarters and facilities, living in a residence under such domestic arrangements and circumstances as to create a single economic unit. In each case where there is a household, the household includes:

1. The eligible individual, his or her spouse, and any of the couple's children (or any children of either member of the couple); or,
2. The eligible child, his or her parent or parents, and any children of the parents.

SI 01310.115 defines an eligible child as a natural or adopted child under age 18 who lives in a household with one or both parents, is not married, and is eligible for SSI. SI 01310.145 defines a parent whose income and resources are subject to deeming as one who lives in the same household with an eligible child and is a natural parent of the child, an adoptive parent of the child, or the spouse of the natural or adoptive parent of the child.

When a trustee is asked to make a distribution that would be considered to be income to any member of the household of the trust beneficiary, or a distribution for the purchase of something that would be considered to be a non-exempt resource of any member of the household of the trust beneficiary, the trustee will certainly want to evaluate each of these requests carefully to determine what impact there will be on the SSI payment to the trust beneficiary.

E. The Sole Benefit Rule

The so-called Sole Benefit Rule does not apply to third-party SNTs!

Not all experts agree that there is even such a thing as the Sole Benefit Rule, and this author is among those who think that the whole thing was made up by bureaucrats who can't read or have

too much time on their hands. However, the reality of the situation is that the SSA embraces this concept, and a trustee therefore violates the Sole Benefit Rule at his or her peril.

SI 01120.201.F.2 is the only POMS section that addresses the rule, and it says: “Consider a trust established for the sole benefit of an individual if the trust benefits no one but that individual, whether at the time the trust is established or at any time for the remainder of the individual's life.” Note that the POMS section only pertains to the establishment of a trust, not the ongoing administration of the trust.

The section goes on to give exceptions to the rule when payments are made to third parties that result in the receipt of goods or services by the trust beneficiary, payment of third party travel expenses that are necessary in order for the trust beneficiary to obtain medical treatment, and payment of third party travel expenses to visit a trust beneficiary who resides in an institution, nursing home, or other long-term care facility (e.g., group homes and assisted living facilities), or other supported living arrangement in which a non-family member or entity is being paid to provide or oversee the individual’s living arrangement (the travel must be for the purpose of ensuring the safety and/or medical well-being of the individual).

There is another exception to the rule for administrative expenses. It says: “The trust may also provide for reasonable compensation for a trustee(s) to manage the trust, as well as reasonable costs associated with investment, legal or other services rendered on behalf of the individual with regard to the trust. In defining what is reasonable compensation, consider the time and effort involved in providing the services involved, as well as the prevailing rate of compensation for similar services considering the size and complexity of the trust. NOTE: You should not routinely question the reasonableness of a trustee’s compensation. However, you should consider whether

compensation is being provided to a family member or if there is some other reason to question the reasonableness of the compensation."

Obviously, the self-settled SNT cannot be drafted to name a specific person other than the disabled trust beneficiary who will benefit from the trust during the disabled trust beneficiary's lifetime, but the rule does not say that the trustee may not make any distributions to persons other than the disabled trust beneficiary.

There are certain debts and obligations of the trust beneficiary that it would seemingly be difficult or impossible for the trustee of an SNT to avoid paying from the SNT, even if the trustee is excessively worried about the Sole Benefit Rule. How could a trustee refuse to pay court-ordered child support or alimony, when this refusal could cause the trust beneficiary to be subject to criminal prosecution or enforceable civil judgments? Or, how could the trustee refuse to provide food, clothing and shelter to children in the care of the trust beneficiary, when that too could cause the trust beneficiary to be subject to criminal prosecution?

A trustee of a trust that holds the proceeds of a personal injury settlement or judgment should also consider the fact that the purpose of the settlement or judgment is to make the injured party whole, so that party can, among other things, support his or her family.

There is no federal law, federal regulation, or even an SSI POMS provision that addresses the use of self-settled SNT funds to support the disabled trust beneficiary's spouse or children. Self-settled trusts are generally not protected from the claims of legitimate creditors. Since there is no clear guidance in the law explaining what violates the Sole Benefit Rule, and since many of us are Sole Benefit Rule deniers, anyway, these questions all come down to judgment calls on the part of the trustee.

It probably makes the most sense to consider the underlying reasonableness of the request. If the family wants to take the disabled trust beneficiary on a vacation, obviously he or she can't go alone, so the trust will have to pay for at least one other person to go with him or her on the trip. Despite what the rule is in New Mexico (as explained above), it probably makes sense to pay mom $15 an hour to provide necessary care to her disabled trust beneficiary son, when it would cost at least twice that to hire skilled personnel through a home health care agency.

Special Needs Issues and Updates

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Special Needs Trusts

Self-settled SNTs
- (d)(4)(A) “Under 65” SNTs
- (d)(4)(C) “Pooled” SNTs

Third-party SNTs
- “Tandem” SNTs

Testamentary SNTs

The Special Needs Trust Fairness Act

Allows individuals to establish their own self-settled special needs trusts, where the old law provided that only parents, grandparents, legal guardians, or courts could establish these trusts.

Military Survivor Benefit Plans

The Disabled Military Child Protection Act now allows veterans to name a self-settled special needs trust for a child with a disability as a beneficiary of a military Survivor Benefit Plan.

The SSA’s Trust Review Process

The SSA has a very extensive trust review process, and this has presented some new challenges and highlighted some old challenges that should be of great concern to any attorney who drafts special needs trusts.

The “Two Ten Buck Rule”

The SSA thinks that Indiana law does not allow a “dry trust,” so the trust must be seeded with $10 before the trust beneficiary deposits his or her own money.

The SSA thinks an irrevocable trust is revocable if there is only one beneficiary (the Doctrine of Worthier Title?), so send that same $10 out to someone else when the trust beneficiary dies, after reimbursement to the state(s).

Early Termination Provisions

Any clause that allows the early termination of a self-settled special needs trust without reimbursing the state(s) will invalidate the trust.

The SSA has decided that a provision allowing some trust funds to be transferred to a pooled special needs trust is an early termination.

Legal Authority to Establish a Special Needs Trust

The SSA is questioning the legal authority of individuals to establish or fund self-settled special needs trusts.

Use a power of attorney signed by the trust beneficiary, or show instructions given by a guardian to a trial attorney or bank, to demonstrate this legal authority.

The Sole Benefit Rule

The SSA has specific POMS (the SSA equivalent of regulations) that indicate that a self-settled special needs trust must be used for the “sole benefit” of the trust beneficiary.

It seems that a trust that is written without detailed instructions about what the trustee may and may not do in terms of trust distributions will be more likely to pass the SSA’s sole benefit test.

The Source of the Trust Funds

The new obsession of the SSA is determining the source of the funds that are being held in trust. If you have a third-party trust without a Medicaid payback, be prepared to prove that the funds being held in trust came from someone other than the trust beneficiary or his or her spouse. Receipts or statements or deposit slips will probably be necessary. Something official, in writing!

Transferring IRAs to Self-Settled Special Needs Trusts

PLR 2006-20025:

- Must be a grantor trust;
- Must not be a “conduit” trust; and,
- There have been four or five additional PLRs, and they all involved inherited IRAs.

Naming a Special Needs Trust as the Beneficiary of an IRA

SNT is by definition an “accumulation trust.”

However, the SNT will qualify as a “see-through trust,” as long as the trust principal will pass outright at the trust beneficiary’s death to other now-living individuals.

These other individuals should not be significantly older than the trust beneficiary.

A charity is not a proper designated beneficiary of an IRA, and this triggers the “five-year payout” rule.

The SECURE Act :

Individuals who are disabled according to the IRS rules (more lenient than the SSA rules) get to play by the old playbook.

This means that the rules delineated by the forgoing slide continue to be meaningful with special needs planning, including with SNTs.

Perhaps this means that the SNT should be the beneficiary of more than its fair share of the pre-tax retirement accounts.

Incorporating the Power to Withdraw Additions

Traditional Crummey powers are a concern for a disabled trust beneficiary who may be on needs-based public benefits.

Cristofani v. Commissioner, 97 T.C. 74 (1991), allows other vested contingent remaindermen of the trust to hold the power to withdraw the additions.

Basic Rules of ABLE Accounts:

To be eligible for an ABLE account, one must be disabled according to Social Security criteria.

The onset of an eligible individual's disability must be prior to age 26.

If the individual was not receiving Social Security benefits prior to age 26, he or she will have to complete a disability certification.

If the individual is ever in a situation where he or she is no longer disabled, the ABLE account will retain its tax-deferred status.

Basic Rules of ABLE Accounts, Cont.:

An eligible individual may have only one ABLE account.

Total annual contributions to an ABLE account may be no more than the annual gift tax exclusion amount according to IRC 2503(b).

An eligible individual may establish his or her own ABLE account.

The eligible individual is considered to be the owner of the ABLE account.

Basic Rules of ABLE Accounts, Cont.:

ABLE accounts may only be used for “qualified disability expenses.

The IRS has now issued final regulations and the SSA has updated its POMS with ABLE rules.

The ABLE Act itself authorizes expenses for things like education, health and wellness, housing, transportation, legal fees, financial management, employment training and support, assistive technology, personal support services, oversight and monitoring, and funeral and burial expenses.

Basic Rules of ABLE Accounts, Cont.:

The existence of the ABLE account will not affect the owner’s eligibility for needs-based public benefits, like Medicaid and SSI.

If the balance of the ABLE account exceeds $100,000.00, the owner’s SSI will be suspended.

All ABLE accounts must reimburse Medicaid expenses at the time of the owner’s death, regardless of who contributed the money to the ABLE account!

Basic Rules of ABLE Accounts, Cont.:

When an SSI recipient receives help with food and shelter expenses, there is a dollar-for-dollar reduction of the SSI benefit, with a maximum reduction of one-third of the Presumed Maximum Value of SSI, which is $750.00 per month in 2018.

This is called In-kind Support and Maintenance (ISM).

When an SSI recipient uses his or her ABLE account for food and shelter expenses, this is NOT considered to be ISM, and SSI is not reduced.

INvestABLE Indiana:

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P.O. Box 219342

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INvestABLE Indiana, Cont.:

The eligible individual may establish and manage his or her own ABLE account, or a parent or legal guardian or someone designated by the eligible individual under a power of attorney may establish and manage the ABLE account on the eligible individual's behalf.

The owner of the ABLE account may name an Authorized Agent (e.g., a financial advisor) with one of four different levels of access to and control over the account.

INvestABLE Indiana, Cont.:

ABLE accounts generally are limited to total annual funding equivalent to the annual gift tax exclusion according to IRC 2503(b).

However, employed account owners are allowed to contribute additional funds. The additional amount is equal to the federal poverty level of income for a single-person household (in the account owner’s state of residence) or the account owner’s gross wages, whichever is less.

INvestABLE Indiana, Cont.:

The ABLE account may be started with as little as $25.00.

Investment costs range from 0.34% to 0.38%.

There is a quarterly maintenance fee of $15.00, but subtract $3.75 from this quarterly fee with e-mail delivery of statements and confirmations.

The owner of the account may change investments twice per calendar year, and choose any investments for new contributions.

INvestABLE Indiana, Cont.:

Investment options include FDIC-insured bank accounts with Fifth Third Bank.

These accounts may be accessed by check or debit card.

Investment options also include allocations among mutual funds and Exchange Traded Funds (ETFs), and the owner of the ABLE account may choose the investments that reflect his or her risk tolerance.

INvestABLE Indiana, Cont.:

There is no income tax deduction for creating or funding an ABLE account, but, if the funds are used to pay for qualified disability expenses, there will be no income taxation on the interest or gain in value of the ABLE assets.

INvestABLE Indiana will report annually to the IRS and the Social Security Administration. Both agencies may want to verify expenses from the ABLE account, so it is important to keep receipts!

INvestABLE Indiana, Cont.:

When the ABLE account is used for non-qualified expenses, the earnings portion of the withdrawal will be treated by the IRS as income to the owner of the account, and it will be taxed at that individual's personal income tax rate, plus a 10% federal tax penalty and applicable state taxes!

Section Eight

48TH ANNUAL MIDWEST ESTATE TAX & BUSINESS PLANNING INSTITUTE

LEGISLATION AND CURRENT CASES IN ESTATES, TRUSTS AND GUARDIANSHIPS

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Section Eight

Legislation and Current Cases in Estates, Trusts and Guardianships………………....MaryEllen K. Bishop

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LEGISLATIVE UPDATE FOR 2021

Credit is given to Jeffrey S. Dible, Esq. of Frost Brown Todd LLC for his contribution of the Legislative portion of this Paper. Jeff is a tireless contributor to the ISBA list serve and a tireless volunteer on legislative efforts in Indiana that apply to Estates, Trusts, Guardianships, Tax and Real Estate issues. He works extremely hard to make our work more efficient and productive and to allow us to better serve our clients. A special thanks to Jeff for all he does.

HEA 1056: A narrow-scope "fix" for the recording statute

In 2020 Senate Enrolled Act 204 started out as a property rights or eminent domain bill. Senate Bill 340 included a short but disastrous amendment, which replaced "or" with "and" in one line of I.C. § 32-21-2-3(a)(1).

The bottom-line result of this amendment was that on or after July 1, 2020, any deed, mortgage, affidavit, TOD deed, power of attorney, or other document submitted to a county recorder had to contain ***both*** the standard notarized acknowledgement of the grantor or other signer *AND* a notarized "witness proof" signed by an adult witness who had seen the grantor or other signer execute the deed or other document.

In the summer of 2020, the ISBA's PTRP Section produced a comprehensive overhaul bill to remove the inconsistencies and "land mines" from title 32 with respect to recordable documents; to undo the "witness proof" *requirement* that had been added by SEA 340; and to respond constructively to severe strains that the COVID-19 pandemic had placed on real estate document recording processes, which resulted in county recorders in a few Indiana counties shutting their offices altogether and ceasing all processing of recordable documents received.

The ISBA's PTRP Section supported a much shorter bill, which would just reverse SEA 340's change to I.C. § 32-21-2-3 and make a few other corrections to the "technical deficiencies" recording statute, I.C. § 32-21-4-1. That proposal became the six-page House Bill 1056, which was passed unanimously by the House on January 26 of this year passed unanimously by the Senate on February 15, and signed by Gov. Holcomb on February 18, 2021.

House Enrolled Act 1056, made the following positive changes to the Indiana Code:

- Adds a broad definition of "instrument" as used in document recording statutes (new § 32-21-2-1.5).
- Adds a detailed definition of "proof" [as in "witness proof"] in the context of recordable documents and notarial acts (new § 32-21-2-1.7).
- Completely rewrites I.C. § 32-21-2-3 to confirm that in order to be recorded, an "instrument" must have at least one (but only needs one) of two notarial acts: an acknowledgement as already defined in I.C. § 33-42-0.5-2 *or* a "proof" (as defined

in new I.C. § 32-21-2-1.7). The revised § 32-21-2-3 explicitly refers to the rules in I.C. 33-42 to control what an "acknowledgement" or a "proof" must contain in order to be a valid notarial act (including who qualifies as a "notarial officer").

- In new subsection 32-21-2-3(f), confirms that if a recordable instrument is signed in a foreign country and if the notarized acknowledgement or proof is not in English, the instrument must include a translation into English.
- Revises and clarifies the "technical deficiencies recording statute," I.C. § 32-21-4-1 as follows:
    - Expands the scope of the "conveyances" covered and protected by this statute, to include TOD deeds, land contracts or land contract memoranda, transfer affidavits, and other non-testamentary instruments "concerning land or an interest in land," in addition to the previous categories of deeds, mortgages, and leases for more than 3 years.
    - In the key operative subsection (now subsection (d)), confirms that if an instrument is recorded despite having any of several types of technical defects (including whether the instrument contained both a notarized acknowledgement and a notarized witness proof), or if the instrument included an acknowledgement that relied on an executive order of the Governor or an order of the Indiana Supreme Court, then the recorded instrument is treated as validly recorded and provides constructive notice of its contents as of the date of recording.
- Adds a statement of legislative findings in new § 32-21-4-0.5, to confirm that the changes made in I.C. § 32-21-4-1 [*previous bullet points above*] are intended to express the original legislative intent more clearly and will not upset any vested substantive rights.

House Enrolled Act 1252: miscellaneous technical corrections and additions to the Probate Code and POA Act

HEA 1252 contains many of the PTRP Section's miscellaneous proposals that were submitted to the Probate Code Study Commission in September 2020. House Bill 1252 was returned to the House on March 31 with Senate Amendments, and the House voted 89 to 0 on April 12th to accept the Senate amendments. HEA 1252 was signed by the Speaker of the House on April 13th.

All provisions in HEA 1252 will become effective on July 1, 2021 and comprise the following:

- HEA 1252 makes a technical change in terminology in I.C. § 29-1-7-15.1 (the title clearing statute for estates) by replacing "real estate" with "real property" throughout the section.
- HEA 1252 revises the wording but not the substance of I.C. § 29-1-7-15.2 (which applies when a personal representative is not appointed for a decedent's estate within 7 months after the date of death), to clarify that if real property of the estate

is sold by the P R under an exception to I.C. § 29-1-7-15.1(b) to satisfy liens of record or to pay administration expenses, all remaining net sales proceeds continue to be protected under subsection 15.1(b), so that ordinary unsecured creditors of the estate cannot force the use of those remaining or surplus sales proceeds to pay their unsecured claims.

- HEA 1252 creates the position and powers of a "tenant representative" who can represent the interests of a deceased tenant or a disabled (incapacitated) tenant who is absent from a rental dwelling, for the purpose of dealing with the landlord and authorizing the representative to surrender possession of the dwelling to the landlord and to receive the tenant's personal property and security deposit refund, etc. The policy goals are (a) to allow the landlord to re-rent the vacant dwelling more quickly, (b) to provide an orderly procedure under which a security deposit and tangible personal property can be collected and distributed even if no one has a strong incentive to use "small estate affidavit" procedures for other purposes, and (c) to provide the landlord with protection from liability as a result of dealing with a tenant representative who has authority.
    - HEA 1252 adds new § 32-31-2-23 to define how a "tenant representative" can be designated or appointed (and by whom), who is eligible to serve as a tenant representative, what the tenant representative's powers, when a tenant representative's authority ceases, and how a landlord is protected from liability as a result of dealing in good faith with a tenant representative.
    - The following persons, in decreasing order of priority, are eligible to accept appointment and to serve as a tenant representative:
        - A person designated by the tenant in any written document delivered to the landlord
        - A person designated in writing in a written lease between the tenant and the landlord
        - An attorney in fact named by the tenant in a POA
        - A temporary guardian or guardian of the person appointed for the tenant
        - An heir of the tenant
        - A person selected and appointed by the probate court upon a petition by any interested person
    - HEA 1252 adds new § 29-1-8-11 to the "small estate" chapter 8 and adds new § 29-3-3-8 to the guardianship statute, to describe how a tenant representative can exercise powers to receive a deceased or disabled and absent tenant's tangible personal property from the landlord, to collect a security deposit refund from the landlord, to distribute collected tangible personal property among the deceased or disabled tenant's distributees, and to provide signed affidavits or releases to the landlord as needed.

- The authority of a tenant representative for a deceased tenant will generally cease when letters testamentary or letters of administration are issued to a personal representative of the deceased tenant's estate.
- The authority of a tenant representative for a disabled tenant who is absent from the rental dwelling will generally cease when a guardian is appointed for the tenant's property.
- Not more than once annually, a tenant representative can be compelled to provide an accounting (analogous to an accounting that an attorney in fact must provide under I.C. § 30-5-6-4) and can seek court approval of the representative's accounting and actions.

- HEA 1252 closes a loophole in our 1991 durable POA statute, by amending the definition of "principal" in I.C. § 30-5-2-8, to clarify that an individual must be at least 18 years of age or be serving in the U. S. military in order to be eligible to sign a valid POA.
- In the guardianship statute, HEA 1252 revises subsection (e) of I.C. § 29-3-12-1, so that if a guardianship of the property terminates as result of the death of the protected person, and if the probate court authorizes the guardian to spend or distribute the remaining guardianship property to pay final expenses (instead of transferring those remaining assets to the deceased protected person's estate, the order in which expenses and claims must be paid is consistent with the Probate Code's priorities in I.C. § 29-1-14-9. On the Senate side, the specific wording of the amendments to subsection (e) were the result of successful negotiations between Jeff R. Hawkins and the Indiana Attorney General's Office.

House Enrolled Act 1255: Portion of the Act that deals with Document recording and real property changes only

These provisions in HEA 1255 "dovetail" with (but do not overlap or duplicate) the corrective amendments made in the shorter House Enrolled Act 1056. HEA 1255's recording statute provisions include the following:

- Revision of I.C. § 32-21-1-14, which applies to the recording of a conveyance document signed by an attorney in fact under a POA, so that the cross-references to "acknowledgement" and to "proof" are to the correct amended sections.
- A rewritten I.C. § 32-21-2-6, which no longer refers to "proving" a deed under common law methods, and which now states simply that if an instrument complies with IC 33-42 [details of acknowledgements and notarial acts], chapter IC 36-2-11 [recording in general], and article 32-21, then the instrument is entitled to be recorded.
- HEA 1255 revises I.C. § 32-21-2-7, to provide updated and corrected sample forms for a notarized "acknowledgement" and a notarized "proof."
- HEA 1255 repeals a pair of archaic sections, I.C. §§ 32-21-2-8 and 32-21-2-9, so that the statutes in IC 33-42 will control with respect to notarial officers, notarial acts, and acknowledgements.

- HEA 1255 rewrites I.C. § 32-21-2-15 to state that an "instrument concerning real property" that is in recordable form "may be recorded electronically as an electronic document as provided under IC 32-21-2.5.
- HEA 1255 revises I.C. § 32-21-5-8 to require that on or before July 1, 2022, a county recorder shall (a) implement the processing of "electronic documents proper for recording," ***and*** (b) "receive for recording, indexing, storage, archiving, access to, searching of, retrieval, and transmittal all electronic documents proper for recording."
- Section 50 in HEA 1255 adds a new section 32-21-2.5-12, which provides procedures and standards for certifying the accuracy of a tangible copy or paper copy of an electronic record, and which requires a county recorder to record such a certified paper copy or tangible copy if it contains an image of the electronic signature(s).
- HEA 1255 restores "county recorders" to the list of "notarial officers" in I.C. § 33-42-9-7 who are authorized to perform notarial acts.
- HEA 1255 removes important impediments from I.C. § 33-42-17-12, which previously prevented a remote notarial act *performed outside Indiana* from being treated as valid under I.C. §§ 33-42-9-8 through 33-42-9-12, unless the non-Indiana notarial officer complied with requirements to "register with" the Indiana Secretary of State. Now, § 33-42-17-12 simply says that a "remote notarial act performed in accordance with this chapter is considered to have been performed in Indiana, regardless of the physical location of the principal at the time the remote notarial act is performed.
- Adds two new subsections to I.C. § 36-2-11-3, regarding the operations and closures of county recorders' offices:
    - New subsection (b) states that if a county office is closed for 3 or more business days pursuant to an executive order issued under the emergency management and disaster law (IC 10-14-3), the county recorder must provide notice to the public on a web site about how to continue to submit documents for recording and to pay recording fees during the closure period.
    - New subsection (c) states that a recorder's office's failure to comply with the notice requirements under subsection (b) will not invalidate any instrument submitted for recording and will not subject the county recorder or other county personnel to civil liability.

Senate Enrolled Act 204: The comprehensive overhaul of Indiana's health care advance directive statutes

The provisions of Senate Enrolled Act 204 will become effective on July 1, 2021. It creates a new single type of health care advance directive that Hoosiers can sign and use anytime on or after July 1, for the purpose of (1) appointing one or more health care representatives and/or (2) stating specific instructions, wishes, and/or treatment preferences.

After a 1.5-year transition period ends on December 31, 2022, the new-style advance directive will *replace* three documents used under current law:

- The durable POA for health care under I.C. § 30-5-5-16;
- The "appointment of health care representative" (HCRA) under I.C. § 16-36-1-7; and
- The "living will declaration" under I.C. § 16-36-4-10.

Those are the three statutes (out of the "three and a half") that will eventually be mostly superseded. During the 1.5-year transition period, any Hoosier could sign any one or more of those three documents *OR* the new-style advance directive, and the latest signed document will control over earlier-signed documents. If a Hoosier signs any one or more of the three documents (health care POA, HCRA, living will) during the transition period *and does not replace them*, those documents will remain valid and enforceable under SEA 204.

However, after the end of the transition period on December 31, 2022, if a Hoosier wants to sign a *new* health care advance directive to replace old ones or to perform any of the "functions" served by the above three documents under current law, that Hoosier will have to use and sign the new-style advance directive. For example, if a Hoosier signs a new general POA after December 31, 2022 which contains health care powers, the health care powers will be void, but the rest of the powers in the POA will be valid and enforceable. *See* Section 74 of SEA 204, adding new subsection (c) to I.C. § 30-5-5-16.

As enacted, SEA 204 runs 75 pages, and it inserts numerous cross-references into a large number of Indiana statutes, mostly in title 16. But the core content of SEA 204 is found in the 26 pages that start on page 28 of the Enrolled Act, and which adds a new, consolidated chapter 7 to IC 16-36, to state all the signing requirements, procedures, presumptions, default settings, and other rules that will apply to the new-style advance directive and to related issues of patient capacity and consent to health care.

Between 80 and 90 percent of the content in new chapter 16-36-7 was reproduced verbatim or adapted from statutory rules that have long existed in I.C. 16-36-1 (the "Health Care Consent Act" which dates back to 1987) or in various sections of Indiana's durable POA statute (which dates back to 1991). In consolidating existing rules and adding new rules in new chapter 16-36-7, the working group followed five top-priority principles:

- To preserve all of the design and drafting flexibility that Hoosiers and their lawyers have under current law when creating durable powers of attorney that confer health care powers;
- To avoid prescribing an inflexible *official* form of advance directive, which would have stifled innovation and excessively limited individuals' choices;
- To put the list of permitted optional provisions and the list of presumptions and default settings (if the advance directive is silent on an issue) in a pair of easy-to-find sections within new chapter 16-36-7;
- To eliminate confusing inconsistencies between the POA statute and the Health Care Consent Act and to state clear rules that apply to determinations of patient capacity or incapacity and to the revocation or amendment of health care advance directives; and

- To remove the restrictions (from the living will statute) on what kinds of wishes, instructions and treatment preferences a competent individual can express about requesting, refusing or discontinuing life-prolonging procedures.

Generally, when a new-style health care advance directive is signed and in place and when the individual signer does not have capacity to personally consent to health care or issue new instructions, heath care providers will have the same responsibilities, the same "good faith" standard of conduct, and the same protection from liability as providers do now with respect to health care POAs and HCRAs under current law. The rules are just stated more clearly in new chapter 16-36-7.

The lettered paragraphs below refer to many (but not all) of the important new or amended provisions included in SEA 204:

(a) A competent individual who signs a new-style advance directive ("AD") is a "declarant" under new chapter 16-36-7, and the surrogate decision maker who is named in an AD is a "health care representative." *See* new §§ 16-36-7-4 and 16-36-4-13.

(b) New § 16-36-7-28 specifies the permitted content and functions of the single new-style advance directive. It can combine the appointment of one or more health care representatives ("HCRs") with statements of specific instructions, wishes and treatment preferences, or the AD can include either type of content but exclude the others. *See* new § 16-36-7-2 and 16-36-7-28(a). Anything that can currently be accomplished in a health care POA, living will declaration, or HCRA can be accomplished in a new-style AD.

(c) For the first time in title 16, new chapter 16-36-7 includes explicit definitions of "best interests," "incapacitated," "informed consent," "observe," "presence," "presence," and "writing."

(d) If an individual declarant signs a new-style AD and retains the capacity to consent to health care (has not become incapacitated), instructions, orders and consents issued by that competent declarant will always supersede and control over (1) the instructions of a health care representative named in the AD *and* (2) any specific treatment preferences or instructions stated in the AD. *See* new §§ 16-36-7-27(e), 16-36-7-32(a), 16-36-7-34(11), 16-36-7-35(b), and 16-36-7-36(a).

(e) A later signed AD will supersede and revoke an earlier-signed AD by the same declarant, unless the later-signed AD explicitly says that the earlier AD remains in effect. *See* new §§ 16-36-7-32(a)(1) and 16-36-7-34(4).

(f) A specific treatment preference or instruction stated within an AD will supersede all oral statements by the declarant on the same specific subject. *See* new § 16-36-7-27(g).

(g) The signing formalities for the new-style advance directive (AD) are stated in new § 16-36-7-28. The AD can be signed electronically or on paper, and the declarant can sign the AD personally or can direct some other adult (not one of the witnesses and not one of the named health care representatives) to sign for the declarant. Regardless of the format (paper or electronic), proper completion of the AD requires *either one* of the following, in addition to the signature of the declarant:

- The signatures of two adult witnesses, at least one of whom is not the spouse or other relative of the declarant (*see* new § 16-36-7-28(b)(1) and (c)(1)); or
- Signing or acknowledgement by the declarant in the presence of a notarial officer, including any method of remote on-line notarization (RON) that satisfies the requirements for remote notarial acts under IC 33-42-17 (*see* new § 16-36-7-28(b)(1) and (c)(2)).

(h) New § 16-36-7-28 explicitly permits a competent declarant to accomplish the signing and witnessing of a valid AD using two other methods, if the declarant does not have access to or cannot use technology for electronic or digital signing of the AD with remote witnessing or remote notarization:

- Subsection 28(d) allows the declarant and the witnesses or the notarial officer sign and complete the AD on paper in separate counterparts, so long as the signing process is properly supervised and the separate signed counterparts are combined into a complete, fully signed document within 10 business days after the supervisor or organizer of the signing receives all the signed counterparts.
- Subsections (e) through (i) of new section 28 permits a declarant and the witnesses to sign and complete an AD using "telephonic [audio only] interaction between the declarant and the witnesses, IF it is not possible for the declarant to sign the AD with direct physical presence or with signing in counterparts or with remote witnessing technology, *AND IF* all witnesses satisfy themselves that they have verified the declarant's identity and that the declarant is of sound mind and has capacity to consent. No person can be compelled to act as a witness for an AD signed through telephonic interaction.

(i) A non-exclusive list of optional provisions, which *can* be included in a new-style advance directive (AD), is stated in new § 16-36-7-29. These are based closely on rules found in the current durable POA statute or on rules that can be inferred from the current POA statute and the Health Care Consent Act.

(j) If a new-style AD is silent on an issue, the governing presumption or default setting can be found in new § 16-36-7-34.

(k) New § 16-36-7-35 states the rules and procedures for determining whether a declarant who has signed an AD (or an individual who has no effective AD in place) has become incapacitated or has recovered from a period of incapacity. In a dispute, the authority of the probate court to make such determinations remains paramount.

(l) New § 16-36-70-36 states the general authority, responsibility, and standard of conduct for each health care representative who is appointed and acting under a new AD.

(m) New § 16-36-7-37 states the general responsibilities, compliance duties and standard of conduct for health care providers in response to instructions stated in a valid AD or instructions by a health care representative who is appointed and acting under a valid

AD. The duties of health care representatives are essentially the same as under I.C. § 30-5-7-4 (in the current POA statute).

(n) New § 16-36-7-30(a) requires the Indiana State Health Department (ISDH) to maintain on its web site an updated list of advance directive resources, including links to sample forms of AD that comply with new chapter 16-37-7. The introduced version of Senate Bill 204 originally required ISDH to develop and publish a sample form of new-style advance directive. ISDH's in-house attorneys did not like this idea, so the compromise was that ISDH would publish clickable links to other web sites offering sample AD forms.

(o) New § 16-36-7-30(b) states that a "declarant is not required to use any official or unofficial form to prepare and sign a valid advance directive." The working group behind SEA 204 anticipates that larger hospital chains, bar associations, patient advocacy and health care choice groups, and social welfare organizations will engage in friendly competition to offer advance directive forms that comply with the new statutory requirements.

(p) Under the existing POST (***P***hysician ***O***rders for ***S***cope of ***T***reatment) statute, I.C. 16-36-6, when a qualified person (patient) or his or her health care representative signs a POST that contains medical orders, those orders can include and usually do include an order in Section A which addresses DNR (do not resuscitate) issues, and which tells health care providers what to do (or not to do) if the signing patient suffers cardiac or pulmonary arrest. Under the existing statute, the POST can be approved and signed by treating physician *OR* by an advanced practice registered nurse (APRN) or physician assistant (PA).

(q) DNR orders can also be issued as a part of an "out-of-hospital" [OOH] DNR order and declaration under I.C. 16-36-5. However, the pre-2021 text of I.C. 16-36-5 did not allow an OOH DNR order and declaration to be signed by an APRN or PA. Therefore, Sections 46 through 58 of Senate Enrolled Act 204 amend various sections in I.C. 16-36-5 to allow an APRN or a PA, as well as a treating physician, to sign and approve an OOH DNR order.

(r) In addition, and because the use of OOH DNR declarations and orders remains practically important, especially for terminally ill individuals who are homebound or who are living in nursing facilities, SEA 204 adds provisions to I.C. 16-36-5, including definitions of "observe," "presence," and "telephonic interaction," so that a competent but qualified patient (who is eligible to sign an out-of-hospital DNR declaration) can accomplish the signing, with the required witnesses, by signing separate paper counterparts and/or by using audio-only telephonic interaction. *See* new §§ 16-36-5-4.3, 16-36-5-4.5, 16-36-5-7.7, 16-36-5-7.9, 16-36-5-9.5, and 16-36-5-11(d) and (e).

CASE LAW UPDATE FOR 2020-2021

PROBATE

BURIAL – WRONGFUL – REMEDY. *Salyer v. Wash. Regular Baptist Church Cemetery*, 141 N.E.3d 384 (Ind. 2020). Salyer purchased 5 contiguous burial plots for her family. Cemetery sold one of Salyer's lots to another person. Salyer filed suit seeking damages and return of her gravesite. The trial court awarded Salyer an adjacent burial plot and denied her requests for damages and fees. The Court of Appeals affirmed. The Supreme Court granted transfer. The Court found that the burial of a person in one of Salyer's plots was wrongful burial under the wrongful burial statute and that the decedent's remains must be removed. The Court affirmed the denial of damages and fees.

ISSUE – ADOPTION - OUT OF FAMILY. *Walters v. Corder,* 146 N.E.3d 965 (Ind. App. 2020) trans. denied, 152 N.E.3d 595. Mildred Goodman set up an irrevocable trust for her son, Charles. The trust was to pay income to Charles for life, then income to Charles' wife for her life. At wife's death, the property was to be distributed to the issue of Charles, per stirpes. Charles had one son, David. David had three children with his wife, Joan- Brittany, Matthew and Molly. Mildred also had a Will that created a trust for her grandson, David. The income was to be paid to David for his lifetime, remainder to David's then living children, share and share alike. Mildred died in 1994. Great-grandchildren Brittany and Matthew were alive when Mildred died, and Mildred knew that Joan was pregnant with Molly. David and Joan divorced the year after Mildred's death. David married Michelle and they had a daughter Raquel. Joan remarried and David allowed her husband to adopt Brittany, Matthew and Molly. David died in 2017. The sole issue in this case was whether Brittany, Matthew and Molly would be included in the beneficiary classes (then living children or issue of Charles) under the two trusts. The probate court entered judgment for the three children to be included in the class. Raquel appealed. Raquel argued that she was the only biological child of David sine the other three children had been adopted out of the bloodline. The Court of Appeals noted that the primary goal in construing a trust is to ascertain and give effect to the intent of the settlor. The term children was not defined in either trust and the trusts were silent as to adopted children. Mildred had a strong relationship with Brittany and Matthew and knew that Joan was pregnant before she died. David and Joan were still married when Mildred died. The Court affirmed the decision of the probate court because it had no evidence of any intent on the part of Mildred to exclude her three great grandchildren from membership in the class of beneficiaries merely because her grandson gave his consent to their stepfather adopting them after Mildred died.

WILL CONTEST – PRESUMPTION OF REVOCATION – REBUTTAL. *Trowbridge v. Estate of Everett Thomas Trowbridge,* 150 N.E.3d 220 (Ind. App. 2020). Trowbridge's brother filed a Petition for Issuance of Letters of Administration, asserting that decedent died intestate.

Brother was appointed personal representative. A few months later, Trowbridge's ex-wife filed a Petition for Probate of Will and Appointment of Co-Personal Representative, asserting that Trowbridge died testate and that she had a copy of the purported will. Brother filed an objection to probate of the will. After hearing, the trial court denied probate of the will, and the ex-wife appealed. The Court of Appeals reversed and remanded, finding that trial court misplaced the burden of proof. After hearing on remand, the trial court again denied probate of the will. Ex-wife again appealed.

At the first hearing three witnesses testified: brother, an attorney and the ex-wife. Brother testified that after his brother died, he and his father went to Trowbridge's house and opened the safe. Brother said he found many important papers inside the safe but no will. In addition, Brother testified that he searched the house but didn't find a will. The attorney testified about a meeting he had with the ex-wife in October 2018. Specifically, he said the ex-wife called him in early October and told him she had Trowbridge's will. She then met with the attorney at his office and showed him the will. The attorney testified that when the ex-wife brought in the Will, she told him that in that Trowbridge had given her the document and had written on it the combination of the safe at his house where the original will would be kept. The attorney therefore concluded that the document she brought in was a signed copy of the original will and that the original was kept in the safe.

On the first appeal, the appellate court reversed and remanded. The court reasoned that the outcome was generated by applying a presumption that a will in the testator's possession later found missing, was missing because the testator destroyed it with intent to revoke. The Court stated that there must be a predicate finding of possession for something to be missing from one's possession. The Court of Appeals felt that without any such evidence, the trial court afforded the Estate the presumption that the original was destroyed with intent to revoke. Had the presumption been supported by the evidence, it would have shifted to the ex-wife the burden of going forward with evidence to rebut the presumption. The trial court had summarily concluded that the ex-wife failed to rebut the presumption with admissible and relevant evidence. The Court of Appeals held that because the trial court misplaced the burden of proof, the decision was contrary to law.

On remand the trial court found The Last Will and Testament had the following relevant characteristics:

a. It appears that the typewriting is not the original typewriting that would have come as the original print from a printer. It appears to be a photocopy;

b. The handwritten information on the Will appears to be a photocopy of the original handwritten print;

c. The handwritten safe combination appears to be a photocopy of the original handwritten print;

d. The Court cannot determine by a preponderance of the evidence that the signatures on the Will are original signatures despite the testimony that they were;

e. There was no testimony by a handwriting or document expert to support a conclusion that the Will was an original;

f. The only testimony presented to support the fact that the original Will was not destroyed was that of ex-wife wherein she said that Trowbridge told her that he was giving her the original.

The Court found that the ex-wife did not possess the original Will. The Court therefore concluded that by virtue of the characteristics of the proffered Will, the absence of expert testimony that it was an original document, and the Court's finding that the original Will was to have been in the safe, that ex-wife had failed to prove by a preponderance that the proffered Will is the original Will, therefore, she had not overcome the presumption of revocation.

The Court of Appeals noted that although they affirmed the probate court's conclusion that the Estate was entitled to the presumption that Trowbridge destroyed his will with the intent to revoke it, they agreed with the ex-wife that the trial court did not engage in the proper analysis to determine whether she rebutted that presumption. The Court felt there was ample evidence in the record to support ex-wife's rebuttal of the presumption. They therefore reversed on the issue and remanded with instructions for the trial court to issue a new order applying the correct analysis.

WILL CONTEST – UNDUE INFLUENCE. *Moriarty v. Moriarty,* 150 N.E.3d 616 (Ind. App. 2020); trans. denied 159 N.E.3d 566. William and Doreen Moriarty had 2 daughters, Cathy and Paula. Doreen died in April, 2016 after being married to William for 58 years. William was a devoted husband and father. Cathy and Paula had close relationships with their parents. Dr. Fry is a cardiologist who treated both Doreen and William. Doreen was his patient until her death. In April 2015, William became Dr. Fry's patient after he was hospitalized and diagnosed with congestive heart failure. At an appointment in May 2016, right after Doreen's death, William told Dr. Fry that he had been under a great deal of stress due to the prolonged and complex illness of his wife. Eve (Appellant), who had met William at Holy Spirit Parish when Doreen was still living, began dating William within weeks of Doreen's death. Cathy learned about Eve in an email from her father, but did not realize that they were dating. William never mentioned Eve to Paula. Paula noticed a change in her relationship with her father when he stopped calling or emailing her in June, 2016. That same month William told Cathy not to visit him which she thought was very strange. In August 2016, Cathy visited her father anyway and he told her that he was "engaged to be engaged". Cathy had no idea what he meant. On October 25, 2016, Eve and William married. It was Eve's fourth marriage. William's daughters, grandsons, sister, sister-in-law, and longtime close friends were not invited to the wedding and many did not even know he was getting married.

In the Fall of 2016, William and Eve purchased a home in Fishers for $412,620.11 in cash from an account owned solely by William. William was physically reliant on others for assistance with activities of daily living. Yet in March 2017, Eve fired William's long-time home healthcare

service provider. In March, 2017, William signed a request to surrender his Prudential life insurance policy. Eve testified that she had not seen the request before William died, however she later admitted to writing everything on the form except William's signature. The policy's surrender value was deposited into an account owned jointly by William and Eve. On April 6, 2017, William executed the Purported Will. The Purported Will bequeathed all tangible personal property and the residue of William's estate to Eve and nominated Eve as personal representative. The Purported Will provided that if Eve did not survive William, his estate was to be distributed to Cathy and Paula. The Purported Will was prepared by Eve's attorney, who did not follow his ordinary practices when meeting with a client to prepare an estate plan. He dropped off a draft of the Purported Will at William and Eve's house, but did not have in-person interaction with William until the signing of the Purported Will. Eve was home when the Purported Will was signed at the residence. Eve prepared the check that William signed to pay for the preparation of the Purported Will. A month later, William died. On May 22, 2017, Cathy and Paula filed a verified petition for supervised administration of their father's estate. The following day, Eve filed a petition for probate of the Purported Will without court supervision. The two matters were consolidated, and the Court appointed a special administrator. Cathy and Paula filed a verified complaint alleging that the Purported Will was invalid because William was of unsound mind when he executed it and/or the Purported Will was a product of undue influence. They also alleged that Eve tortiously interfered with their inheritance.

Based on the evidence presented at trial, and specifically based on, (a) the testimony of Cathy and Paula and William's long-time friends that William would never have excluded Cathy and Paula from his life or estate plan, (b) the expert medical testimony of Dr. Stephen Rappaport (a geriatrician who frequently determines patients' decision-making capacity) who opined that William lacked the capacity to reasonably evaluate and judge the treatment of him by third parties, and (c) William giving Doreen's sentimental personal property to Scott Bowers at a time when he and Paula were in the midst of a highly contentious, drawn-out divorce, the trial court found that William lacked the mental capacity to determine Paula and Cathy's deserts, with respect to their treatment of and conduct toward him. Further the trial court concluded that William was susceptible to undue influence based on (a) the death of Doreen, (b) his untreated anxiety and depression, (c) his severe CHF, (d) his isolation from his family and long-time friends, and (e) his dependency on others. The trial court found that Eve exercised undue influence over William at the time he executed the Purported Will. The trial court held that Eve's exercise of undue influence over William was tortious interference with Paula's and Cathy's expected inheritance which allowed them to attach joint bank accounts, the house and their new car. Eve appealed.

The Court of Appeals held that the trial court's findings supported the conclusion that Eve exercised undue influence over William at the time he executed the Purported Will. Accordingly, the trial court's order that the Purported Will was a product of Eve's exercise of undue influence over William is not clearly erroneous and therefore affirmed the trial court's judgment in favor of Cathy and Paula that the Purported Will is invalid. Eve also contended that the evidence and

findings failed to support the conclusion that William did not intend for her to receive the inter vivos transfers. The Court of Appeals felt that Eve's argument ignored findings related to undue influence, many of which applied to the inter vivos transfers as well. The Court concluded that Eve's argument was a request to reweigh the evidence, which they declined to do. The trial court's judgment in favor of Cathy and Paula on their tortious interference of inheritance claim was also affirmed.

JOINT ACCOUNT – CLOSE – OWNERSHIP. *Solomon v. Lindsey,* 163 N.E.3d 302 (Ind. App. 2020). In 1998, Martin invested $50,000 with Rydex. The application listed Paul J. Martin as owner and his daughter, Lia J. Lindsey, as joint owner with right of survivorship. Lindsey did not contribute any funds to the account but both she and her father signed the application. The Rydex account was retitled with Guggenheim. The account was always owned by "Paul J. Martin or Lia J. Lindsey" as joint tenants with right of survivorship. In 2018, Solomon, Martin's wife, called Guggenheim and requested that all funds in the joint account be withdrawn and the account closed. Solomon did most of the talking, but Martin gave his consent. The Guggenheim representative gave Solomon a confirmation number to confirm the actual redemption. Martin died three days later on July 9, 2018. On the day of Martin's death, Guggenheim issued a check to "Paul J. Martin or Lia J. Lindsey" in the amount of $351,878.68.

Solomon was appointed personal representative of Martin's estate. On August 20, 2018, Solomon, **as** PR, endorsed the check and deposited it into the Estate account. Approximately 45 days later, Lindsey contacted Guggenheim and learned about Martin's request and the check. Lindsey filed a Verified Complaint to Recover Property Transfer, naming Solomon in both her individual and representative capacities, seeking recovery of $351,878.68. After Solomon filed an answer, Lindsey filed a motion for summary judgment, alleging that she was the surviving party to the joint account and the proceeds are hers by operation of law. The trial court entered an order granting summary judgment to Lindsey and directing that the funds be immediately paid to Lindsey. The trial court reasoned that Martin did not follow the statutory procedure to close a joint account and on his date of his death the funds remined in a joint account with Lindsey. Solomon appealed.

Solomon PR first claimed that the trial court erred in applying Indiana law to this case, arguing that the Guggenheim accounts are located in Maryland and Maryland law applied. The Court of Appeals noted that the choice of law for contract and tort cases is the law of the place where the breach or wrong took place or the place with the most contacts, in holding that Indiana law applied. Martin lived in Indiana, the paperwork was signed in Indiana and the statements were mailed to Indiana. The Court reviewed Indiana Code section 32-17-11-18(a) which defines ownership of a joint account upon death and states that "[s]ums remaining on deposit at the death of a party to a joint account belong to the surviving party ... as against the estate of the decedent unless there is clear and convincing evidence of a different intention at the time the account is created." There is a presumption that a survivor to a joint account is the intended recipient of the proceeds in the account. The Court found that the fact that Martin withdrew all the funds does not overcome the

presumption that Lindsey, named a joint owner with rights of survivorship when the account was created, was the intended recipient of the proceeds in the account because Martin did not communicate to Guggenheim in writing that his intent had changed. Indiana Code section 32-17-11-19 states that the "provisions of section 18 ... as to rights of survivorship are determined by the form of the account at the death of a party." When Martin died, the form of the account was a joint account with rights of survivorship in Lindsey. Until the check was cashed, the funds retained their original characteristic as sums on deposit in a joint account with rights of survivorship. The fact that the check was made out to Martin <u>or</u> Lindsey on a joint account did not strip the account of its survivorship rights. Judgment affirmed.

WILL – CONSTRUED – GIFT OR OPTION TO PURCHASE. *Schaefer v. Estate of Cletus P. Schaefer*, 2021 Ind. App. LEXIS 109. Cletus Schaefer ("Cletus") had four children: Joy, Jill, Donald, and Kenneth. Cletus executed a Last Will and Testament and three codicils. This case involves the language in the third codicil ("Third Codicil"). Cletus and Kenneth jointly owned Schaefer & Schaefer, LLC. and Cletus and Kenneth owned the farm real estate as joint tenants with rights of survivorship.

The language of the Third Codicil stated "unto my son, Kenneth J. Schaefer, I bequeath the following: all my interest and ownership in Schaefer and Schafer, LLC, any and all farm machinery, tools and farm vehicles, all conditioned upon said Kenneth paying unto my estate the sum of one thousand Dollars ($1,000.00) per acre for the approximate 240 acres more specifically described in Deeds bearing instrument numbers 2009R-03979 and 2009R-03980 which said sum shall be paid within five (5) calendar months from the date of my estate being opened for administration, and I hereby direct my Co-Executrixes to distribute said sum unto my daughters, Joy Brock and Jill Mehling, and my son, Donald Schaefer, share and share alike equally as joint tenants with rights of survivorship and not as tenants in common. Should my son, Kenneth, not fully perform this condition precedent, then, and upon that event, farm machinery, tools, farm vehicles, and my interest in Schaefer and Schaefer, LLC shall be sold and the proceeds shall be divided equally, share and share alike among my four (4) children as joint tenants with rights of survivorship and not as tenants in common."

When Cletus died, the title to the real estate referenced above vested in Kenny automatically by virtue of joint title on the deeds. Within five months of Cletus' death, Kenneth paid the monies as directed under the Third Codicil and the Estate accepted the payment.

The Personal Representatives filed a Petition for Beneficiary Kenneth Schaefer to Disclose Assets, Respond to Discovery Request, and Permit Appraisal of the assets owned by the LLC and held by Kenneth. Kenneth objected arguing that the Personal Representatives of the Estate were not entitled to proceed with the collection and investment of the various farm equipment because Kenneth purchased the equipment in question under the terms of the Third Codicil three years prior. The Personal Representatives took the position that Kenneth's payment pursuant to the Third Codicil was a condition precedent to the vesting of a specific bequest of the stated assets (farm

machinery, tools and farm vehicles instead of option to purchase, and that paying the required $1,000.00 per acre he purchased his bequest free and clear of any claim by the beneficiaries.

The trial court declared that Cletus' intent from the language the Third Codicil was to provide a gift to Kenneth that was contingent upon the satisfaction of the condition precedent. Accordingly, the property covered by paragraph D (2) of the Third Codicil was subject to abatement and the Personal Representatives were authorized to conduct discovery regarding the property. Kenneth appealed.

On appeal, Kenneth argued that the trial court erred when it held the language created a gift; contending the language created an option to purchase. If the language created a gift, the property was still part of the estate, and subject to abatement. If the language created an option to purchase, Kenneth would own the property free and clear and it is not subject to abatement for debts of the estate. The Court of Appeals identified the issue to be the interpretation of the language to evince Cletus' intent to bequeath a gift or as an option to purchase. The Court of Appeals analyzed the amount Kenneth paid pursuant to that language, and noted it was not the market value of the property at the time Kenneth purchased it. Relying on *Drake v. Old Nat'l Trust Co*., 871 N.E.2d 352, 355 (Ind. Ct. App. 2007), reh'g denied, trans. denied., the Court described an option to purchase when the party may purchase something at its appraised value, not at a greatly reduced price. The Court reached its decision that the portion Kenneth paid for, $277,500, was a testamentary option to purchase and the remaining value of the property was a testamentary gift.

TRUST CASES

FRAUDULENT TRANSFERS – BADGES OF FRAUD. *Mandir Trust v. Mich. City*, 2021 Ind. App. LEXIS 131. This case involves efforts by Michigan City to satisfy default judgments against Sheonarayan and Jaidevi for incurred and future investigation and remediation costs associated with property where the Erincraft Manufacturing facility operated (the "Erincraft Property"). In 1985, the President of Erincraft Enclosures, Inc., filed an "Assumed Business Name Certificate" for Erincraft Manufacturing Co. located on the Erincraft Property. The certificate named twelve partners, including three of Sheonarayan and Jaidevi's children; Sheela, Srawan and Anil, who resided in Michigan City. Srawan and Anil conveyed the Erincraft Property to Jaidevi in 1994. In August 2001, Sheonarayan executed a deed as "settler" establishing a public trust in the name of his deceased mother, with its registered office in India. Twelve originating trustee members, including Sheonarayan and Anil, signed the deed which indicated that Sheonarayan was to serve as the first managing trustee.

In 2003, the Redevelopment Commission authorized an environmental assessment at the Erincraft Property. The assessment revealed soil and groundwater contamination above the default closure concentrations. In 2006, Michigan City obtained ownership of the Erincraft Property from Jaidevi through court action. In 2009, Jaidevi, Sheonarayan, and the trust, signed an agreement written in

Hindi which, when translated into English, indicated that Jaidevi and Sheonarayan were "in need of money for [their] personal matters" and addressed the transfer to the trust of eight parcels of property in LaPorte County (the "Parcels") purportedly owned and possessed by them, including their primary residence. On July 20, 2015, Michigan City filed a complaint against several prior owners and operators, including Jaidevi, Erincraft, Inc., to recover costs associated with investigating and remediating the properties. On August 3, 2015, Jaidevi deeded the Parcels to Sheonarayan, and Srawan served as a witness.

On December 4, 2017, the court entered a default judgment against Jaidevi and held her liable for Michigan City's incurred and future investigation and remediation costs, prejudgment interest, and reasonable attorney fees and expenses. On June 4, 2019, Michigan City sought to add Sheonarayan as a new defendant, as well as Srawan, Anil, and various Erincraft entities. The court granted the motion, as well as Michigan City's motion for leave to serve by publication, indicating it had attempted to serve Sheonarayan by certified mail in August and that the summonses and complaint were returned unserved. In September 2019, Sheonarayan recorded a notarized Indiana general warranty deed purporting to convey seven of the Parcels, including their residence, to the trust and Jaidevi recorded a notarized Indiana general warranty deed purporting to convey the eighth Parcel to the trust.

On March 20, 2020, the trust manager filed a response to the motion to set aside fraudulent transfers, providing a spreadsheet that listed purported payment amounts, dates, and check numbers and an affidavit stating the trust purchased the property. On July 31, 2020, the court held a hearing. The trust was represented by counsel, but neither Jaidevi nor Sheonarayan appeared by counsel or in person. The court heard arguments from Michigan City and the trust and took the matter under advisement. On September 3, 2020, the trial court entered its order granting Michigan City's Motion to Set Aside Fraudulent Transfers as voidable under I.C. 32-18-2-14 (Indiana UFTA).

The Court of Appeals decision includes a thorough discussion of the Indiana UFTA. In support of their finding that the trial court did not commit error, the Court concluded there was an absence of sales disclosure forms or other documents proving the payment of consideration, and therefore a reasonable factfinder could conclude the trust was not a good faith purchaser of the Parcels for reasonably equivalent value. Further, the evidence failed to reveal any receipts, cancelled checks, or other documentary evidence indicating that any payments, including the $10.00 initial payment, have, in fact, been made, or that the balance due has been paid in full. "This lack of evidence gives rise to the reasonable inference, as the trial court concluded, that 'there was no consideration." Judgment affirmed.

TRUSTEE – BREACH – DAMAGES – FEES. *Zartman v. Zartman*, *2021* Ind. App. LEXIS 114. William Zartman Jr. ("William Jr.") and Marilyn Zartman were married and had three children: William III, Brenda, and Paul. William Jr. and Marilyn owned a 303-acre farm in Miami County and Fulton County. In 1980, William Jr. and Marilyn established the William Zartman Jr.

Revocable Trust ("William Jr.'s Trust") and the Marilyn Zartman Revocable Trust ("Marilyn's Trust"). In 1993, William Jr. and Marilyn executed First Amendments to both trusts. This appeal concerns only Marilyn's Trust. This is the second appeal in this matter. The parties only have the first and last pages of Marilyn's Trust and were unable to locate a copy of the First Amendment to her Trust. William Jr. and Marilyn showed the First Amendment of their respective trusts to Paul shortly after the documents were signed. Paul read the documents, which were identical except for the names of the trusts, signatures, and the pronouns used in the documents. Paul saw the documents again in 2009. In a deposition, William III testified that the First Amendment of William Jr.'s Trust and the First Amendment of Marilyn's Trust were identical except for the names.

By 2003, each trust owned a one-quarter interest in the farm, and William III and his wife, Kim, owned a one-half interest in the farm. Marilyn died in August 2004, and William Jr. died in February 2010. In March 2011, William III, as trustee of Marilyn's Trust, conveyed Marilyn's Trust's one-quarter interest in the farm to himself and his wife, Kim, as tenants in common. In the trustee's deeds, William III warranted that he was appointed the successor trustee under the trust and that, under the trust agreements, he had the "full power to execute" the trustee's deeds. William III and Kim immediately transferred the one-quarter interest in the farm to Zartman Farms, of which William III and Kim are member managers. William III and Kim warranted as Grantors in the deeds that they were lawfully seized of said land in fee simple; and that they had good right and lawful authority to sell and convey said land. The other family members filed a motion for summary judgment and argued, in part, that the March 2011 deeds conveying Marilyn's Trust's one-quarter interest in the farm to William III and Kim were void. In February 2018, the trial court denied the motion for summary judgment. The trial court determined that the content of Marilyn's Trust had to be resolved by a jury. The jury returned a verdict For William III and the siblings filed the first appeal.

On remand after the first appeal, it was determined that upon Marilyn's death, William Jr. and William III became co-trustees of Marilyn's Trust. Upon the death of William Jr., William III and Brenda became the co-trustees of Marilyn's Trust. Therefore, William III's transfer of Marilyn's Trust's interest in the farm to himself and his wife violated Indiana Code Section 30-4-3-4 because the power to transfer property was required to be exercised by the co- trustees jointly. The Trustee's Deeds dated March 14, 2011, were therefore null and void. On remand the trial court: (1) determined the content of Marilyn's Trust; (2) determined that William III committed breach of trust by transferring the property to himself; (3) voided the transfer of property; (4) ordered William III to pay for lost income to the trust; and (5) ordered William III to pay Appellees' attorney's fees. The trial court ordered the payment of $134,799.98 in lost income for 2011 to 2019. The trial court then ordered William III to pay reasonable attorney fees in the amount of $110,000.00 as a result of his breach of trust as authorized by Indiana Code Section 30-4-3-22(e), William III appealed that decision.

The Court of Appeals opinion contains a great review of Indiana law on breach of trust and remedies for breach of trust. The court reasoned that given the extraordinarily lengthy litigation, which involved complex issues, two summary judgment proceedings, a jury trial, and two appeals, we cannot say that the trial court abused its discretion when it awarded Appellees $110,000.00 in attorney's fees. Further, the trial court properly granted summary judgment to Appellees, voided the deeds at issue here, ordered Appellants to pay lost profits, and ordered William III to pay Appellees' attorney's fees. Judgment affirmed.

***__2019 Opinion__ CONTENTS – PROOF – BEST EVIDENCE RULE**. Zartman v. Zartman, 127 N.E.3d 242 (Ind. App. 2019). There were three children of the deceased: Brenda, Paul and William III. William Jr. operated a farm and, in later years William III worked the farm with his father. William Jr. and Marilyn each established revocable trusts. Each trust held one-quarter of the farm, and the remaining half of the farm had been transferred to William III. Marilyn died in August 2004, and William Jr. died in February 2010. Thereafter, William III, as a trustee of Marilyn's trust, transferred to himself the one-quarter of the farm held by her trust. Paul and Brenda first initiated litigation against William III in Florida after the death of William Jr., who was a resident of Florida. The Florida court determined that William III had committed a breach of the trust and removed William III as trustee. It also declared that it had no jurisdiction over Indiana real estate. Back in Indiana, Paul and Brenda filed suit against William III seeking, among other things, to set aside William III's conveyance and to recover lost income on that land. Following a trial, however, the jury returned a verdict in favor of William III.*

The Court of Appeals reversed and remanded. Paul and Brenda presented four issues on appeal but one was particularly dispositive, that being whether the trial court erred in its application of Evidence Rule 1008, the best evidence rule. None of the parties had a complete copy of either Marilyn's trust document or the amendments. Because the parties had only the first and last pages of Marilyn's original trust document, they turned to the series of rules about "best evidence" to prove the content of the trust and the amendment. The Court reviewed Evidence Rules 1002, 1004, 1007 and 1008. Designated evidence included a copy of William Jr.'s First Amendment, and deposition testimony of William III that he saw the First Amendments to the trusts of both parents and that the only difference was the substitution of names. Evidence also showed that Paul had seen the First Amendment to Marilyn's trust shortly after it was signed, and, with the exception of the substitution of names, gender pronouns, and the like where appropriate, Marilyn's First Amendment was the same as William Jr.'s. This evidence was undisputed and established the content of Marilyn's First Amendment. However, in denying Paul and Brenda's motion, the trial court interpreted Rule 1008 as demanding that disputes about the content of a lost writing be decided by the jury. Paul and Brenda, however, argued the content in the context of a summary judgment motion. In that case, the Court concluded that it would be illogical to read Rule 1008 as requiring a trial judge to disregard undisputed designated evidence and held that Rule 1008 required evidentiary disputes about the content of a lost writing to be determined by a jury only during a jury trial and not during summary judgment. The trial court misconstrued its role in determining the contents of Marilyn's trust for purposes of deciding summary judgment. The case

was therefore remanded so that the trial court could reconsider its ruling on summary judgment in accordance with these directions and sustain the present judgment, or not, accordingly.

GUARDIANSHIP CASES

GUARDIAN – TEMPORARY – MARRIAGE. *Estate of Moster v. Deschand*, 158 N.E.3d 775 (Ind. App. 2020). On November 30, 2012, Voltz, one of Donald L. **Moster's**, Sr. ("Donald") daughters, filed a Verified Emergency Petition for Emergency Guardianship over Donald. The Petition stated that the Protected Person was physically and mentally disabled and unable to provide for his care. It stated that Donald had been diagnosed with Parkinson's Disease resulting in dementia and memory loss. The Petition listed Donald's residence as being in Noblesville and stated that he had left Indiana and has been in Illinois for two weeks. The Petition sought emergency relief without a hearing or notice to Donald, alleging that there would be immediate and irreparable injury to the protected person because he was not receiving adequate medical care, did not have his anti-psychotic medication and was not receiving his insulin. A physician's report was attached stating that Donald was incapacitated by his Psychosis. The same day the Petition was filed the Court issued an order appointing Voltz as an emergency temporary guardian over Donald and his **estate.**

On January 10, 2013, Donald filed a motion to terminate the temporary guardianship. He filed a report from an Illinois physician, dated December 5, 2012, which concluded that the patient is competent to understand the decisions he makes and the consequences thereof. On February 6, 2013, the trial court issued an order affirming the appointment of a temporary guardian. On March 2, 2013, Donald married Rose M. **Deschand** ("Rose") in Illinois. March 4, 2013, Donald filed a "Motion for Order Clarifying Term of Appointment of Temporary Guardian," stating that under 29-3-3-4(a)(4), the order was to have been for a specified period not to exceed ninety (90) days' and that the ninety days ran on February 28, 2013, at which time, by operation of law, the temporary guardianship terminated.

On March 6, 2013, Donald was examined by another physician but with the assistance of a sign language interpreter. That examination reported Donald's Mini- Mental Status examination score as 29/30, ruling out any significant cognitive problems. Thereafter Donald filed a "Motion to Compel Delivery of Property and Petition for Contempt and for Sanctions," stating that Voltz closed bank accounts containing assets belonging to Donald and had two cashier's checks issued in her own name. An entry was made on the Guardianship docket that the temporary guardianship had expired and ordering Voltz to file her final report and accounting within thirty days. Voltz filed her final accounting and the parties filed a stipulation of dismissal, reporting to the court that they had reached a mediated settlement agreement. The mediated settlement agreement, signed by each of Donald's children, acknowledged that Donald was married to Rose and required that all of Donald's real and personal property be placed in a revocable trust to be maintained and managed

for the benefit of Donald during his lifetime, and upon his death, would pass to Donald's children in accordance with Donald's will. The Guardianship was dismissed without the appointment of a permanent guardian, and the mediated settlement agreement was not filed with the court.

Donald remained married to Rose up until his death. Upon Donald's death, Rose petitioned to be appointed personal representative of Donald's **estate**. The trial court issued an order appointing Rose and ordering supervised administration of Donald's **estate**. Months later, Voltz filed her petition to probate Donald's Last Will and Testament and to be appointed personal representative. The trial court granted Voltz's petition and appointed her as successor personal representative**.** She then filed a motion to void the marriage of Rose and Donald. The trial court held a hearing on Voltz's motion and denied the motion to void the marriage. Voltz filed a motion for leave to file an interlocutory appeal, which the trial court granted. Voltz appealed.

Voltz argues that the trial court erred in denying her motion to void the marriage. Voltz maintains that the trial court found Donald to be incapacitated on November 30, 2012 when the temporary guardianship was granted and reaffirmed that finding on February 5, 2013 when it denied Donald's motion to terminate the guardianship and that there was no further event that changed the court's determination.

The Court of Appeals first noted that marriage is a civil contract, the validity of which may be challenged in court. *In re Estate of Holt*, 870 N.E.2d 511, 514 (Ind. Ct. App. 2007), *trans. denied*. Indiana Code section 31-11-8-4 provides: "A marriage is void if either party to the marriage was mentally incompetent when the marriage was solemnized. The burden rests upon the challenger to prove that a party was incapable of understanding the nature of the marriage contract. *Id.* " 'The presumption in favor of the validity of a marriage consummated according to the forms of law is one of the strongest known.' " *Id.* (quoting *Bruns v. Cope,* 182 Ind. 289, 105 N.E. 471, 473 (1914), *overruled in part on other grounds by Nat'l City Bank of Evansville v. Bledsoe,* 237 Ind. 130, 144 N.E.2d 710 (1957)).

In reaching its decision the Court reasoned that the temporary guardianship was done ex parte and without a hearing or notice to Donald. The order was issued based exclusively on Voltz's allegations in the Guardianship Petition and the attached physician's report, which was done without a sign language interpreter, and the physician relied heavily upon statements made by Voltz. Under Indiana Code section 29-3-3-4, the temporary guardianship over Donald expired after ninety days as a matter of law. Therefore, the temporary guardianship expired on March 1, 2013. at no point in the proceedings was there a motion to extend or renew the temporary guardianship and the accompanying finding of incapacity or an order extending or renewing the same. Therefore, the temporary guardianship expired on March 1, 2013 as did the finding of incapacity.

The trial court found that there was insufficient evidence of a lack of physical and mental capacity of Donald to void his marriage to Rose. This finding is bolstered by the fact that no one pursued any legal proceeding to void the marriage prior to Donald's death. Further, evidence presented

during the proceedings, including a psychiatric evaluation of Donald and a neurological examination conducted on March 6, 2013, contained no finding or opinion that Donald was either physically or mentally incapacitated, and these examinations also contained statements by Donald that contradicted some allegations in the Guardianship Petition that was filed by Voltz. Therefore, the trial court did not err when it denied Voltz's motion to void the marriage between Rose and Donald. Judgment Affirmed

GUARDIAN – MOTHER'S VISITATION. *Prater v. Wineland,* 160 N.E.3d 540 (Ind. App. 2020) Prater is the Mother of an eleven-year-old daughter, R.W., who is under guardianship with her paternal grandparents, the Winelands'. In 2016, Mother, who was incarcerated, wrote the trial court that Grandparents had not allowed her to speak on the phone with R.W. Mother, who had been attending parenting classes and A.A. meetings, informed the trial court that she was being released from jail on December 1, 2016. She asked the trial court to schedule a hearing on visitation. A hearing was scheduled in October 2016. However, the Grandparents' made numerous requests for continuances, and the hearing was not held until May 2017. Following the hearing, the trial court declined modification of the guardianship order. In August 2017, Mother sent the trial court another letter requesting visitation with R.W. because she had not seen her daughter in eight months, and Grandparents were not returning calls or texts. Mother was again incarcerated and so the trial court took no action on Mother's request. Mother sent the trial court additional letters in 2018 and 2019 requesting contact with R.W. She asked the court to review her requests. In June 2019, Mother, who was then incarcerated in the Department of Correction, asked the trial court to please have a court hearing to at least give her a chance. The trial court took no action. In March 2020, Mother filed a *pro se* petition for visitation. The trial court summarily denied the petition without a hearing, finding that the guardians may decide what is best for the child. Mother appealed.

The Court of Appeals noted that Indiana has long recognized that the rights of parents to visit their children is a precious privilege that should be enjoyed by noncustodial parents. *Patton v. Patton*, 48 N.E.3d 17, 21 (Ind. Ct. App. 2015) (quoting *Duncan v. Duncan,* 843 N.E.2d 966, 969 (Ind. Ct. App.2006), *trans. denied*). Indiana Code § 31-17-4-1 specifically provides that "a parent not granted custody of the child is entitled to reasonable parenting time rights, unless the court finds, *after a hearing*, that parenting time by the noncustodial parent might endanger the child's physical health or significantly impair the child's emotional development." The Court of Appeals held that the trial court erred when it denied Mother's visitation petition without a hearing. The Court further noted that "in *Manis v. McNabb*, 104 N.E.3d 611, 621 (Ind. Ct. App. 2018), this Court held that "a trial court has the authority to determine whether parenting time is warranted and order reasonable parenting time for a parent whose child is placed with a guardian." In that case, the court of Appeal also held that when a trial court orders parenting time in a guardianship, it cannot allow the guardian to determine the parent's parenting time with her child during the course of the guardianship as it would have the potential to deprive the parent and child of time together and an

opportunity to develop a meaningful relationship. The Court reversed and remanded with instructions.

GUARDIAN – POWERS AFTER DEATH – CHECK – ESTATE PLANNING. *In re Donnell Lee Roberts*, 2021 Ind. App. LEXIS 130. Frady and Roberts were longtime friends. They opened a joint checking account with Greenfield Banking Company ("Greenfield Bank"). Several months later, Frady petitioned for appointment as guardian over the person and estate of Roberts with Roberts consent. Merrill Lynch issued Roberts a required minimum distribution check ("RMD Check") from his Individual Retirement Rollover Account in the amount of $145,754.33.

After Roberts received the RMD Check, he prepared a deposit ticket, and gave the check and the deposit slip to Frady. Before Frady and Roberts could get to the bank that week Roberts passed away. Frady deposited the RMD Check in the joint Greenfield Bank account on the same day that Roberts died. Roberts died intestate, but Roberts and his attorney had discussed writing a will in which Roberts intended to leave almost everything to Frady. However, the attorney never drafted anything for Roberts. An Estate was opened for Roberts, and his nephew was appointed as Personal Representative. Frady submitted a final accounting in the guardianship and a petition to approve the final accounting. The Estate filed objections to the final accounting in the guardianship, including an objection to the deposit of the RMD Check after Roberts' death, claiming that the RMD Check became an asset of the Estate when Roberts died.

Nearly a year after Roberts' death, Frady filed a request for authority to exercise estate planning powers: the first requested authority to change the beneficiary designation on a Merrill Lynch bank account containing over $700,000; and for authority to make gifts on behalf of Roberts. The following day, without holding a hearing, the trial court denied both petitions. The trial court held a hearing on the petition to approve the final accounting and the Estate's objections. The trial court concluded, in part, that: "The RMD Check was received by [Roberts] prior to his death, and Merrill Lynch reflected the RMD Check funds as having been withdrawn from the Merrill Lynch IRRA on November 17, 2017. The Guardian Final Accounting also reflects the disbursement of the RMD Check funds on November 17, 2017, from the Merrill Lynch IRA, and the corresponding addition to the Greenfield Bank Account ending in 1415 on November 22, 2017. Frady testified at the hearing that Roberts had not endorsed the check at the time of his death. The RMD Check funds became an asset of the Estate at the time of Roberts's passing, and Frady as guardian was required to deliver the RMD Check to the representative of the Estate, pursuant to IC 29-3-12-1(e)(1) (B)." Frady appealed arguing that the deposit of the check was valid and that the trial court should have held a hearing on estate planning for Roberts.

The Court of Appeals held that even though a Guardian's powers cease upon the protected person's death, the guardian may "exercise other powers that are necessary to complete the performance of the guardian's trust." Ind. Code § 29-3-12-1(e)(1)(A). The Court found that the record was clear that Roberts gave Frady the RMD check to be deposited in the Greenfield Bank account. The fact that the account was jointly owned by Roberts and Frady was a coincidence, and did not negate

the fact that depositing the check constituted the completion, as guardian, of a task entrusted to him. The Court concluded that Frady depositing a check as instructed after the death of Roberts falls within the purview of Indiana Code section 29-3-12-1(e)(1)(A). Therefore, the trial court erred in sustaining the Estate's objection regarding the RMD check. As to estate planning for Roberts, the Court held that upon Roberts' death and the termination of the guardianship, the guardian's ability to estate plan does not constitute an action necessary to "complete the performance of the guardian's trust." The court concluded that the trial court was not required to hold a hearing prior to dismissing Frady's petition to exercise estate planning.

MEDICAID CASES

MEDICAID – ELIGIBILITY – ANNUITY – INCOME. *Hotmer v. Ind. Family & Soc. Servs. Admin.*, 150 N.E.3d 705 (Ind. App. 2020). In April 2017, Hotmer entered a nursing home for long-term care. While in the nursing home, he purchased two eight-year annuities with his wife as payee. He also named her as the primary beneficiary after his death. The annuity contract documents listed Hotmer as the annuitant of the annuities. The contracts were both irrevocable; neither the Annuitant nor the Beneficiary could be changed. In October 2017, Hotmer applied for Medicaid benefits. The FSSA office denied his application on the basis that the annuity payments put his monthly income above the applicable eligibility limit. Hotmer petitioned for administrative review and an administrative law judge overturned the denial. The ALJ concluded that the annuity payments were made solely in the name of Hotmer's wife, they were considered available only to his wife, and therefore Hotmer's income did not exceed the limit. FSSA petitioned for review of the ALJ's decision. FSSA's ultimate authority remanded to the ALJ for findings. On remand, the ALJ again found that the annuity income was not countable. FSSA again petitioned for review and FSSA's ultimate authority issued a decision that it was clear that Hotmer was the owner of the annuities. As owner the income source must be attributed to him regardless of who he has assigned as a payee, and that the State's original decision to deny Medicaid to Hotmer was sustained. Hotmer petitioned for judicial review of the decision under the Indiana Administrative Orders and Procedures Act. The trial court affirmed FSSA's decision and Hotmer appealed. According to FSSA, Hotmer was entitled to the annuity payments as the owner and therefore the income was attributed to him. The court disagreed. The annuity contracts were irrevocable. Hotmer could not change the payee without breaching the contracts. The Court concluded that FSSA's denial of Medicaid benefits was arbitrary and capricious, and the Court reversed and remanded.

WRONGFUL DEATH CASES

WRONGFUL DEATH – DISTRIBUTION – ADULTERY. *Estate of Phelps v. Book,* 152 N.E.3d 1 (Ind. App. 2020). Kara, Hailey, and Colby are the children of decedent Thomas with his

first wife. Thomas and Erica were married in October 2013, and had one daughter together. Prior to their marriage, Tom and Erica entered into a prenuptial agreement which provided that in the event that their marriage was terminated other than by the death of one of them, or in the event of a *legal separation*, Erica agreed to waive all rights to Tom's property. Tom and Erica separated in August 2014, and Erica left the marital home to live with her parents. In February, 2015, Erica filed for divorce. Erica became romantically involved with another man and became pregnant with that man's child.

On October 19, 2015, Tom was killed when he was struck by a car. He died intestate. Maloy was appointed as special administratrix to file a wrongful death action which was ultimately settled. The trial court held a hearing to determine how to distribute the wrongful death proceeds and pay estate administration fees. The court determined that (1) Erica was living in a state of adultery and therefore not entitled to one-half of Tom's net probate estate; (2) Erica was entitled to a share of the proceeds of the wrongful death claim because such proceeds were not part of Tom's probate estate and because under the terms of the prenuptial agreement, Erica and Tom were not legally separated at the time of his death; and (3) Erica was entitled to one-half of the net proceeds of the wrongful death claim, with Tom's four children each entitled to a one-eighth share. The Phelps children appealed alleging that the trial court erred in allocating Erica a share of the net proceeds of the wrongful death action.

The Indiana Wrongful Death Statute (I.C. § 34-23-1-1) provides that the portion of any wrongful death payment made for medical, hospital, funeral and burial expense inures to the estate for payment of those expenses and the remainder of the damages inure to the exclusive benefit of the widow or widower and to the dependent children, to be distributed in the same manner as the personal property of the deceased. The Phelps children argued that Erica should not receive one-half of the net proceeds of the wrongful death action because the Indiana intestacy statutes provides that if a spouse has left the other and is living in adultery at the time of the other spouse's death, the adulteress spouse shall take no part of the estate or trust of the deceased spouse. Since the wrongful death statute provides that the widow is entitled to a share of the net proceeds of the wrongful death action in the same manner as the personal property of the deceased, and since Erica was not entitled to a share of the intestate estate due to the fact that she was living in a state of adultery, the children argue that Erica should not be entitled to any share of the net proceeds of the wrongful death action.

The Appellate Court noted that although the adultery section of the intestacy statute may deprive Erica of the right to receive distributions from Tom's estate, the wrongful death proceeds are not part of Tom's estate. The adultery statute acts to bar an adulterous spouse from taking part of decedent's estate, which does not include the proceeds from a wrongful death claim. Therefore, the trial court properly determined that Erica was entitled to one-half of the net proceeds of the wrongful death settlement, and affirmed the judgment of the trial court.

Section Nine

48th Annual Midwest Estate Tax & Business Planning Institute
Indiana Continuing Legal Education Forum

AVAILABLE AND FLEXIBLE METHODS FOR SIGNING, WITNESSING OR NOTARIZING INDIANA WILLS, POAS, AND HEALTH CARE ADVANCE DIRECTIVES

(under 2021 Legislation)

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Jeff Dible has used his best efforts to include accurate and up-to-date information in this paper. Citations and URL links to new or amended Indiana statutes are to the latest versions available on the Indiana General Assembly's web site. Sample form provisions and signing / witnessing blocks are offered for illustrative purposes and as general guidance for drafting, and not as legal advice to any particular individuals.

Section Nine

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Available and Flexible Methods for Signing, Witnessing or Notarizing Indiana Wills, POAs, and Health Care Advance Directives (Under 2021 Legislation)

(1) A summary of signing methods available for Indiana Wills in various fact situations

	Fact Pattern for (and Constraints on) the Testator (T)	Suggested and Available Signing Method(s)	Applicable Statute(s)	Details of Signing & Witnessing Requirements
A	T ***can*** meet in person in same space with 2 witnesses and ***can*** sign the Will on paper	Traditional signing meeting with T and witnesses in same physical space	I.C. §§ 29-1-5-3 and 29-1-5-3.1	No new requirements under I.C. § 29-1-5-3 and 29-1-5-3.1 as amended by HEA 1255
B	T ***can*** meet in person in same space with 2 witnesses but ***cannot*** hold a pen to sign on paper	• T directs some third person to sign T's name on paper Will in direct presence of T and the witnesses • T and witnesses use digital technology to electronically sign the Will in each other's direct presence	I.C. § 29-1-5-3(b)(1)(A) [*paper Will*] I.C. § 29-1-21-4(a)(4)(B) [*electronic Will*]	• Under unchanged Indiana law, the person who signs at T's direction cannot be one of the witnesses and must sign in T's direct presence • A testator who cannot hold a pen and sign may be able to tap a screen or click a mouse to add his or her digital or electronic signature to the electronic record for the Will

	Fact Pattern for (and Constraints on) the Testator (T)	**Suggested and Available Signing Method(s)**	**Applicable Statute(s)**	**Details of Signing & Witnessing Requirements**
C	T and the witnesses can sign in separate rooms or spaces in the same building and ***can*** pass the original Will (single document) between them	T signs the Will on paper with "remote witnessing" and the original Will is *carried* to the separate location where the 2 witnesses sign the same original Will	I.C. § 29-1-1-3(a)(15), (16), (26), and (27) [*definitions of "presence" and "observe"*] to allow use of technology to satisfy "presence" requirement I.C. § 29-1-5-3(b) [*signing procedure*]	• If T and the witnesses can talk by phone in real time and see each other through a glass window, that fits the definition of "presence" • T and the witnesses could also satisfy the "presence" require-ment by using 2-way real time audiovisual technology (FaceTime, etc.) to observe and interact with each other throughout the signing meeting
D	T and the witnesses must remain physically separated and miles apart but T has access to and ***can*** use an electronic or digital signing method	T and the witnesses electronically sign the electronic record for the Will while interacting using 2-way audiovisual technology	I.C. § 29-1-21-3(14) thru (17) [*definitions of "presence" and "observe"*] I.C. § 29-1-21-4(b) thru (d) [*signing procedure*]	• T and the witnesses must use 2-way real time audiovisual technology to interact • A licensed attorney or paralegal must supervise the signing (§ 29-1-21-4(b)) • Attorney or paralegal must complete an affidavit of compliance (subsec. 4(c)) • File the compliance affidavit when the Will is filed for probate (subsec. 4(d))

	Fact Pattern for (and Constraints on) the Testator (T)	Suggested and Available Signing Method(s)	Applicable Statute(s)	Details of Signing & Witnessing Requirements
E	T and the witnesses must remain physically separated and miles apart AND T doesn't have access to or ***cannot*** use an electronic or digital signing method	T and the witnesses sign identical counterparts of the Will on paper while interacting using 2-way audiovisual technology	I.C. § 29-1-1-3(a)(15), (16), (26), and (27) [*definitions of "presence" and "observe"*] I.C. § 29-1-5-3(c) thru (e) [*signing procedure, including combining separate signed counterparts into composite document within 5 business days*]	• T and the witnesses must use 2-way real time audiovisual technology to interact • A licensed attorney or paralegal must supervise the signing (§ 29-1-5-3(c)) • Attorney or paralegal must complete an affidavit of compliance (subsec. 3(d)) • File the compliance affidavit when the Will is filed for probate (subsec. 3(e))

If a testator and witnesses signed a traditional Will on paper *OR* an electronic will on or after March 31, 2020 and before January 1, 2021, *AND* if the signing and witnessing method used complied with either —

- the Indiana Supreme Court's emergency order in Case No. 20S-MS-237, as extended during 2020 *or*
- the signing methods added or amended by HEA 1255,

then the testator does not need to "re-execute" or "re-ratify" the Will in the direct physical presence of witnesses (which was required under the Supreme Court's emergency order). *See* Section 5 of HEA 1255 [*adding* I.C. § 29-1-5-3.3] and Section 8 of HEA 1255 [*adding* I.C. § 29-1-21-4.1]. The Supreme Court's emergency order (permitting remote witnessing of Wills) currently expires on July 1, 2021. **The negative implication of this rule** is that if a testator signs a traditional paper Will or electronic Will with remote witnessing after December 31, 2020 and before the effective date (April 29, 2021) of HEA 1255, then that testator is required to re-execute the Will using either direct presence or (if signing occurs after April 29, 2021) using one of the added or amended procedures under HEA 1255.

(2) Further details on the Will signing, trust signing, and POA signing changes in the first 46 pages of House Enrolled Act 1255.

House Bill 1255 was the PTRP Section's massive "probate and property bill," and many of the changes in this Bill were driven by practical lessons learned during the COVID-19 pandemic, when it became either extremely difficult or impossible for many legally competent Hoosiers to sign valid Wills and POAs in the direct physical presence of attesting witnesses or a notary public. The Indiana Supreme Court's March 31, 2020 emergency order in Case 20S-MS-237 helped a little, but provided only a temporary solution until July 1, 2021 and required that the testator re-execute his or her Will (after the public health emergency ended) in compliance with current statutes. For strategic reasons, the ISBA decided to combine the pandemic-driven Probate Code expansion of signing methods with the real property / recording provisions from the "stakeholder bill" into one large bill, on the rationale that both sets of legislative changes would be more likely to pass if they were combined into one "must pass" bill.

On April 1, the House concurred in the Senate's amendments to House Bill 1255, and the Speaker of the House and Senate Pro Tempore signed the Bill by April 8th. Gov. Holcomb signed HEA 1255 on April 29, 2021. The official version of HEA 1255 is here: http://iga.in.gov/legislative/2021/bills/house/1255#document-2cf7f99a

The following are the main changes that the first 51 pages of HEA 1255 makes in titles 29 and 30. All provisions in HEA 1255 are effective upon passage (April 29, 2021).

(a) For "traditional" wills signed on paper, HEA 1255 adds new definitions of "presence," "in the presence of," "observe," and "observing" to I.C. § 29-1-1-3(a), so that the "presence" requirement can be satisfied through the use of technology for real-time two-way interaction between the testator and the witnesses, if they are not directly present with each other in the same physical space. *See* **Part (3)** below.

(b) For electronic wills, HEA 1255 adds substantially similar definitions of "presence," "in the presence of," "observe," and "observing," to I.C. § 29-1-21-3.[1]

(c) For traditional paper wills, electronic wills, and POAs signed on paper or electronically, HEA 1255 adds a new defined term, "directed paralegal," meaning a nonlawyer assistant who is employed or retained by a licensed attorney and who works under that attorney's direct supervision. *For context, see paragraphs (e) and (i) below.*

[1] Section 6 of HEA 1255 also deletes the definition of "actual presence" from I.C. § 29-1-21-3, which states the definitions that apply in the electronic wills chapter.

(d) For traditional wills signed on paper, HEA 1255 amends I..C. § 29-1-5-3 by inserting two new lettered subsections (c) and (d), which allow the will to be signed by the testator and the two witnesses on separate but identical paper counterparts, which must be combined after signing into a single composite document that contains all signatures. This signing method will be useful to competent testators who are unable to use electronic or digital signature technology and in situations where the testator and the witnesses cannot physically handle and pass around the single original will printed on paper. *See* pages 11 and 12 below.

(e) Under new subsection (d) of I.C. § 29-1-5-3, if a traditional will is going to be signed and witnessed on paper in counterparts:

- An attorney or directed paralegal must supervise the execution and witnessing of the will in counterparts.
- The attorney or paralegal who supervises must sign an "affidavit of compliance" after assembling the completed will that was signed and witnessed in counterparts. See pages 12 and 20-21 below.
- The attorney's or paralegal's affidavit of compliance must be filed with the probate petition or at any later time ordered by the probate court.
- Under the last sentence of subsection (d), if the will was signed in counterparts *without* the required supervision by an attorney or directed paralegal, the will is not void but is *voidable* in the discretion of the probate court, *or* if an objection to probate is filed under I.C. § 29-1-7-16, *or* if a timely will contest is filed under I.C. § 29-1-7-17. [2]

(f) For traditional wills signed on paper *in counterparts*, HEA 1255 adds a new subsection (e) to I.C. § 29-1-5-3.1, prescribing a new self-proving clause. *See* pages 15 and 19 below.

(g) HEA 1255 amends I.C. § 29-1-5-3.2 to clarify that an audio recording, photograph(s), or video recording made during *part* or *all* of the signing of a traditional will may be admissible in evidence.

(h) HEA 1255 amends the execution and witnessing requirements for electronic wills in I.C. § 229-1-21-4 to permit "remote witnessing," so long as the testator and the witnesses interact in real time in ways that satisfy the new, broader

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[2] These changes were added by a Senate amendment to House Bill 1255 during the week of March 15-19, in order to overcome opposition (to signing in counterparts in general) by 1 to 3 members of the Senate Judiciary Committee. For the distinction between "void" and "voidable," *see* **Troxel v. Troxel**, 737 N.E.2d 745 (Ind. 2000) [applied to a probate court order issued without subject matter jurisdiction].

definitions of "presence" and "observe." In the prescribed self-proving clause for electronic wills in I.C. § 29-1-21-4(e) and elsewhere in section 29-1-21-4, the words "actual presence" and "actual and direct physical presence" are replaced by "presence." *See* **Part (4)** on pages 23-24 below.

(i) For electronic wills, HEA 1255 adds two new subsections (b) and (c) to I.C. § 29-1-21-4, to add these requirements *if remote witnessing is used*: [3]

- An attorney or a directed paralegal must supervise the execution and witnessing of that electronic will.
- The attorney or paralegal who supervises the execution and remote witnessing of the electronic will must sign an "affidavit of compliance" containing prescribed content. *See* pages 25-26 and 29-31 below.
- If that electronic will is offered for probate, the proponent must file a copy of the affidavit of compliance with the probate petition or later when ordered to do so by the probate court.
- Under the last sentence of subsection (d), if the electronic will was signed with remote witnessing but *without* the required supervision by an attorney or directed paralegal, the electronic will is not void but is *voidable* in the discretion of the probate court, *or* if an objection to probate is filed under I.C. § 29-1-7-16, *or* if a timely will contest is filed under I.C. § 29-1-7-17.

(j) Note that under I.C. §§ 29-1-5-5 (for traditional paper wills) and 29-1-21-7 (for electronic wills), a testator who is physically present in Indiana when he or she signs a will has to comply with these Indiana execution requirements; the testator won't be able to use an on-line document assembly service (Willing.com, Trust and Will.com, etc.) that purports to rely on and invoke the law of another jurisdiction (*e.g.*, Nevada) that has looser standards for remote witnessing.

(k) HEA 1255 modifies the prescribed content of the self-proving clause for an electronic will in new subsection (e) of I.C. .§ 29-1-21-4, so that "presence" replaces "actual and direct physical presence."

(l) **Inter vivos trust signing.** In 2020, the signing procedures for inter vivos trusts signed on paper and for electronic inter vivos trust instruments were revised to explicitly allow the competent settlor to direct someone else to sign the trust instrument at the settlor's presence and at the settlor's direction —a

[3] These changes were added by a Senate amendment to House Bill 1255 during the week of March 15-19, in order to overcome opposition (to remote witnessing in general) by 1 to 3 members of the Senate Judiciary Committee.

technique that was already permitted for wills and durable powers of attorney. However, the 2020 amendments did not limit who could act to sign the settlor's name on a trust instrument at the settlor's direction. Because valid inter vivos trust instruments can be validly signed with just the settlor's signature (no witnesses or notarization required), there is some potential that a dishonest individual could use undue influence or trickery to have the settlor direct that individual to sign the settlor's name on a trust instrument, which names the individual as the controlling trustee or which names the individual as a significant beneficiary.

(m) Sections 14 and 15 of HEA 1255 amend I.C. §§ 30-4-1.5-4 [for electronic trust instruments] and 30-4-2-1 [for trust instruments signed on paper] to prohibit the following persons from signing the trust instrument at the settlor's direction:

- o A trustee named in the trust instrument.
- o A relative of the settlor.
- o A person who is entitled to receive a beneficial interest in the trust assets or a power of appointment under the terms of the trust.

If settlor's signature is placed on the trust instrument by an eligible individual who signs for the settlor and at the settlor's direction, the trust instrument must state that the signer is not in any of the above three categories.

(n) **Signing POAs with 2 witnesses instead of notarization.** Sections 16 through 21 of HEA 1255 are effective upon passage (April 29, 2021) and apply to durable powers of attorney signed on paper on or after March 31, 2020 using the signatures of two or more attesting witnesses *instead of* a notarized acknowledgement. The public policy objective is to permit a competent principal to sign a durable POA with two witnesses if it is logistically too difficult to arrange for the principal to interact with a notary public or other notarial officer. [4]

- o New § 30-5-4-1.3 defines which persons are treated as "having an interest in the power of attorney" and who therefore cannot act as attesting witnesses.

[4] For example, a completely competent principal may be living under lockdown conditions, may be unable to meet in person with a notary, and may not have access to (or be able to use) audiovisual technology that would allow the POA to be signed electronically with remote on-line notarization that complies with I.C. 33-42-17.

- o New § 30-5-4-1.5 specifies the signing procedures when a durable POA is signed on paper with two attesting witnesses instead of notarization, either with or without "signing in counterparts."
- o If the durable POA will be signed in paper counterparts with 2 attesting witnesses, subsection (d) of new § 30-5-4-1.5 requires that an attorney or a directed paralegal supervise the signing, and requires that the supervising attorney or paralegal make and keep an "affidavit of compliance" with content specified in subsection (e).
- o New § 30-5-4-1.7 specifies the content of two *optional* self-proving clauses that can be included in a durable POA that is signed on paper with two attesting witnesses, or signed and attached to the POA later. Subsections 1.7(d) and (e) state the content of a self-proving clause to use when the POA is *not* signed and witnessed in separate counterparts. Subsection (f) states the content of the self-proving clause that should be used when the POA is signed and witnessed on paper in separate counterparts.
- o New § 30-5-4-1.9 explicitly makes photographs and audio and/or video recordings of POA signings admissible in evidence to show validity and compliance with signing formalities.

(o) For durable POAs that are signed electronically, HEA 1255 adds definitions of "observe" and "observing" to I.C. § 30-5-11-3, so that real-time two-way interaction using audiovisual technology can be used by the principal and by the notary or the witnesses to satisfy the "in the presence" requirement.

(p) For electronic powers of attorney, HEA 1255 amends I.C. § 30-5-11-4 to permit either electronic signing in the presence of a notary *or* electronic signing in the "presence" of two witnesses.

(q) Sections 25 through 28 of HEA 1255 add four new sections (4.3, 4.5, 4.7,. and 4.9) to the electronic POAs chapter, which are analogous in purpose and content to the new sections described in paragraph (n) above for durable POAs signed on paper.

- o New § 30-5-11-4.3 defines which persons are treated as "having an interest in the electronic power of attorney" and who therefore cannot act as attesting witnesses.
- o New § 30-5-11-4.5 specifies the signing procedures when POA is signed electronically with two attesting witnesses instead of notarization.
- o If the durable POA will be signed electronically with 2 attesting witnesses who use technology to interact with the principal, subsection (d) of new § 30-5-11-4.5 requires that an attorney or a directed paralegal supervise the

signing, and requires that the supervising attorney or paralegal make and keep an "affidavit of compliance" with content specified in subsection (e).

- New § 30-5-11-4.7 specifies the content of the *optional* self-proving clause that can be included in an electronic POA that is signed on paper with two attesting witnesses, or signed and attached to the electronic POA later. Subsections 4.7(d) and (e) state the content of a self-proving clause for use when the electronic POA is signed and witnessed with direct presence among the principal and the witnesses *or* when the principal and witnesses use technology to interact and to satisfy the "presence" requirement. .

- New § 30-5-11-4.9 explicitly makes photographs and audio and/or video recordings of electronic POA signings admissible in evidence to show validity and compliance with signing formalities.

(r) New § 30-5-11-4.1 applies to any electronic POA that is signed and notarized on or after March 31, 2020 and on or before January 1, *2022*. If such an electronic POA was electronically notarized using audiovisual technology that allowed the notary to positively identify the principal or someone signing at the principal's direction, and if the electronic POA complied with the other requirements of I.C. § 30-5-11-4, then the electronic POA must be treated as executed in compliance with chapter 30-5-11, even if the methods used for electronic notarization technically did not comply with other legal requirements in effect in 2020.

(s) Finally, and for transfers or registrations of *tangible personal property* in TOD beneficiary form on or after the date of enactment (April 29, 2021), HEA 1255 amends I.C. § 32-17-14-12 so that a deed of gift, bill of sale, or other document used to designate the "owner" and the TOD beneficiaries can be signed in the presence of a disinterested witness *instead of* with a notarized acknowledgement. New subsection (d) defines "disinterested witness."

(3) Excerpts from HEA 1255's changes to the Probate Code for traditional Wills signed on paper *and* sample form provisions.

The following Probate Code provisions, as added or amended by House Enrolled Act 1255, apply to traditional Wills signed on paper with "remote witnessing" and/or with "signing in counterparts" on or after the date of enactment (April 29, 2021). Text added by HEA 1255 is shown in **bold**.

SECTION 1. IC 29-1-1-3, AS AMENDED BY P.L.231-2019, SECTION 5, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 3. (a) The following definitions apply throughout this article, unless otherwise apparent from the context:

. . . .

(9) "Directed paralegal" means a nonlawyer assistant who is employed, retained, or otherwise associated with a licensed attorney or law firm and whose work is directly supervised by a licensed attorney, as required by Rule 5.3 of the Rules of Professional Conduct.

. . . .

(15) For purposes of IC 29-1-5, and with respect to testators and attesting witnesses, "in the presence of" has the meaning set forth in subdivision (16).

(16) For purposes of IC 29-1-5, and with respect to testators and attesting witnesses, "presence" means a process of signing and witnessing in which:

(A) the testator and witness are:

(i) directly present with each other in the same physical space; or

(ii) able to interact with each other in real time through use of any audiovisual communications technology now known or later developed;

(B) the testator and witness are able to positively identify each other; and

(C) each witness is able to interact with the testator and with each other by observing:

(i) the testator's expression of intent to make a will;

(ii) the testator's actions in executing or directing the execution of the testator's will; and

(iii) the actions of other witnesses when signing the will.

The term includes the use of technology or learned skills for the purpose of assisting with hearing, eyesight, and speech, or for the purpose of compensating for a hearing, eyesight, or speech impairment.

. . . .

(26) "Observe" means to perceive another's actions or expressions of intent through the senses of eyesight or hearing, or both. The term includes perceptions involving the use of technology or learned skills to:

(A) assist the person's capabilities of eyesight or hearing, or both; or

(B) compensate for an impairment of the person's capabilities of eyesight or hearing, or both.

(27) "Observing" has the meaning set forth in subdivision (26).

. . . .

SECTION 2. IC 29-1-5-3 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 3. (a) This section applies to a will executed before, on, or after July 1, 2003. A will, other than a nuncupative will, must be executed by the signature of the testator and of at least two (2) witnesses on:

(1) a will under subsection (b);

(2) a self-proving clause under section 3.1(c) of this chapter; or

(3) a self-proving clause under section 3.1(d) of this chapter.

(b) A will may be attested as follows:

(1) The testator, in the presence of two (2) or more attesting witnesses, shall signify to the witnesses that the instrument is the testator's will and either:

(A) sign the will;

(B) acknowledge the testator's signature already made; or

(C) at the testator's direction and in the testator's presence have someone else sign the testator's name.

(2) The attesting witnesses must sign in the presence of the testator and each other.

An attestation or self-proving clause is not required under this subsection for a valid will.

(c) Under the supervision of an attorney or directed paralegal, the testator and the witnesses may execute and complete the will in two (2) or more original counterparts that exist in a tangible and readable paper form with:

(1) the testator's signature placed on one (1) original counterpart in the presence of attesting witnesses; and

(2) the signatures of the witnesses placed on one (1) or more different counterparts of the same will;

in a tangible and readable paper form. If a will is signed and witnessed in counterparts under this subsection, the testator or an individual acting at the testator's specific direction must physically assemble all of the separately signed paper counterparts of the will and the signatures of the testator and all attesting witnesses not later than five (5) business days after all the paper counterparts have been signed by the testator and witnesses. If the testator directs another individual to assemble the separate, signed paper counterparts of the will into a single composite paper document, the five (5) business day period does not commence until the compiling individual receives all of the separately signed paper counterparts. Any scanned copy or photocopy of the composite document containing all signatures shall be treated as validly signed under this section and may be electronically filed to offer the will for probate under IC 29-1-7. If the testator dies after executing a will under this subsection but before the separate counterparts are assembled into a single composite paper document, the intervening death of the testator shall not affect the validity of the will.

(d) An attorney or directed paralegal must supervise the execution of a will that is signed and witnessed in counterparts as described in subsection (c). An attorney or directed paralegal may supervise the execution of a will in counterparts even if the

supervising attorney or directed paralegal is one (1) of the will's attesting witnesses. When an attorney or directed paralegal supervises the execution of a will in counterparts as described in subsection (c), the attorney or directed paralegal must sign, date, and complete an affidavit of compliance within a reasonable time after all paper counterparts of the will have been signed by the testator and the witnesses. An affidavit of compliance under this subsection must be sworn or affirmed by the signing attorney or directed paralegal under the penalties of perjury and must contain the following information:

(1) The name and residence address of the testator.

(2) The name and:

(A) residential address; or

(B) business address;

for each witness who signs the will.

(3) The address, city, and state in which the testator was physically located at the time the testator signed an original counterpart of the will.

(4) The city and state in which each attesting witness was physically located when the witness signed an original counterpart of the will as a witness.

(5) A description of the method and form of identification used to confirm the identity of the testator to the witnesses and to the supervising attorney or directed paralegal, as applicable.

(6) A description of the audiovisual technology or other method used by the supervising attorney or paralegal, as applicable, the testator, and the witnesses for the purpose of interacting with each other in real time during the signing process.

(7) A description of the method used by the testator and the witnesses to identify the location of each page break within the text of the will and to confirm that the separate paper counterparts of the will were identical in content.

(8) A general description of how and when the attorney or paralegal, as applicable, physically combined the separate, signed paper counterparts of the will into a single composite paper document containing the will, the signature of the testator, and the signatures of all attesting witnesses.

(9) The name, business or residence address, and telephone number of the attorney or directed paralegal who supervised the execution and witnessing of the will in counterparts.

(10) Any other information that the supervising attorney or directed paralegal, as applicable, considers to be material with respect to:

(A) the testator's capacity to sign a valid will; and

(B) the testator's and witnesses' compliance with subsection (c).

(e) When a party files a petition under IC 29-1-7 to probate a will that was executed and witnessed in counterparts under subsection (c), the party shall file a true copy of the affidavit of compliance under subsection (d) with the petition or at any time ordered by the court. A party who files a copy of the affidavit of compliance may redact private information from the affidavit in a manner consistent with Rule 5 of the Indiana Rules on Access to Court Records. If a will is executed and witnessed in counterparts under subsection (c) but without the supervision of an attorney or directed paralegal and that will is later offered for probate under IC 29-1-7, the will is voidable in the discretion of the court, upon objection to probate filed under IC 29-1-7-16, or upon a timely filed will contest under IC 2-29-7-17.

~~(c)~~ **(f)** A will that is executed substantially in compliance with subsection (b) will not be rendered invalid by the existence of:

(1) an attestation or self-proving clause or other language; or

(2) additional signatures;

not required by subsection (b).

~~(d)~~ **(g)** A will executed in accordance with subsection (b) is self-proved if the witness signatures follow an attestation or self-proving clause or other declaration indicating in substance the facts set forth in section 3.1(c) or 3.1(d) of this chapter.

~~(e)~~ **(h)** This section shall be construed in favor of effectuating the testator's intent to make a valid will.

SECTION 3. IC 29-1-5-3.1 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 3.1. (a) This section applies to a will executed before, on, or after July 1, 2003. When a will is executed, the will may be:

(1) attested; and

(2) made self-proving;

by incorporating into or attaching to the will a self-proving clause that meets the requirements of subsection (c) or (d). If the testator and witnesses sign a self-proving clause that meets the requirements of subsection (c) or (d) at the time the will is executed, no other signatures of the testator and witnesses are required for the will to be validly executed and self-proved.

(b) If a will is executed by the signatures of the testator and witnesses on an attestation clause under section 3(b) of this chapter, the will may be made self-proving at a later date by attaching to the will a self-proving clause signed by the testator and witnesses that meets the requirements of subsection (c) or (d).

(c) A self-proving clause must contain the acknowledgment of the will by the testator and the statements of the witnesses, each made under the laws of Indiana and evidenced by the signatures of the testator and witnesses (which may be made under

the penalties for perjury) attached or annexed to the will in form and content substantially as follows:

We, the undersigned testator and the undersigned witnesses, respectively, whose names are signed to the attached or foregoing instrument declare:

(1) that the testator executed the instrument as the testator's will;

(2) that, in the presence of both witnesses, the testator signed or acknowledged the signature already made or directed another to sign for the testator in the testator's presence;

(3) that the testator executed the will as a free and voluntary act for the purposes expressed in it;

(4) that each of the witnesses, in the presence of the testator and of each other, signed the will as a witness;

(5) that the testator was of sound mind when the will was executed; and

(6) that to the best knowledge of each of the witnesses the testator was, at the time the will was executed, at least eighteen (18) years of age or was a member of the armed forces or of the merchant marine of the United States or its allies.

____
Testator

________________ ______________________
Date Witness

____
Witness

(d) A will is attested and self-proved if the will includes or has attached a clause signed by the testator and the witnesses that indicates in substance that:

(1) the testator signified that the instrument is the testator's will;

(2) in the presence of at least two (2) witnesses, the testator signed the instrument or acknowledged the testator's signature already made or directed another to sign for the testator in the testator's presence;

(3) the testator executed the instrument freely and voluntarily for the purposes expressed in it;

(4) each of the witnesses, in the testator's presence and in the presence of all other witnesses, is executing the instrument as a witness;

(5) the testator was of sound mind when the will was executed; and

(6) the testator is, to the best of the knowledge of each of the witnesses, either:

(A) at least eighteen (18) years of age; or

(B) a member of the armed forces or the merchant marine of the United States or its allies.

(e) If the testator and the attesting witnesses executed the will in two (2) or more counterparts on paper under section 3(c) of this chapter, the self-proving clause, if applicable, for the will must substantially be in the following form:

"We, the undersigned testator and undersigned witnesses, respectively, whose names are signed to the attached or foregoing instrument, declare the following:

(1) That the undersigned testator and witnesses interacted with each other in real time through the use of technology, and each witness was able to observe the testator and other witnesses throughout the signing process.

(2) That the testator executed a complete counterpart of the instrument, in a readable form on paper, as the testator's will.

(3) That, in the presence of both witnesses, the testator:

(A) signed the paper counterpart of the will;

(B) acknowledged the testator's signature already made; or

(C) directed another individual to sign the paper counterpart of the will for the testator in the testator's presence.

(4) That the testator executed the will as a free and voluntary act for the purpose expressed in the will.

(5) That each of the witnesses, in the presence of the testator and of each other, signed one (1) or more other complete paper counterparts of the will as a witness.

(6) That each paper counterpart of the will that was signed by the witness was complete, in readable form, and with content identical to the paper counterpart signed by the testator.

(7) That the testator was of sound mind when the will was executed.

(8) That, to the best knowledge of each witness, the testator was at least eighteen (18) years of age at the time the will was executed or was a member of the armed forces or of the merchant marine of the United States or its allies.".

~~(e)~~ **(f)** This section shall be construed in favor of effectuating the testator's intent to make a valid will.

SECTION 4. IC 29-1-5-3.2 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 3.2. Subject to the applicable Indiana Rules of Trial Procedure **and the Indiana Rules of Evidence,** a videotape **video recording, one (1) or more photographs, or an audio recording made or captured during part or all of a will's execution** may be admissible as evidence of the following:

(1) The proper execution of a will.

(2) The intentions of a testator.

(3) The mental state or capacity of a testator.

(4) The authenticity of a will.

(5) Matters that are determined by a court to be relevant to the probate of a will.

SECTION 5. IC 29-1-5-3.3 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 3.3. (a) This section applies to a will that is signed and witnessed:**

(1) on or after March 31, 2020;

(2) before January 1, 2021; and

(3) in reliance on the Indiana supreme court's order signed and filed on March 31, 2020, under case number 20S-MS-237, or, as supplemented or extended by the supreme court's order signed and filed on May 1, 2020, under case number 20S-MS-237, and by the supreme court's orders signed and filed on May 29, 2020, and November 10, 2020, under case number 20S-CB-123.

(b) Notwithstanding any other law or provision, a will described in subsection (a) that was signed and witnessed in compliance with:

(1) the procedures and requirements set forth in the Indiana supreme court's order signed and filed on March 31, 2020, under case number 20S-MS-237, or, as supplemented or extended by the supreme court's order signed and filed on May 1, 2020, under case number 20S-MS-237 and by the supreme court's order signed and filed on November 10, 2020, under case number 20S-CB-123; or

(2) the procedures and requirements set forth in section 3.1 of this chapter or IC 29-1-21-4;

is not required to be reexecuted or reratified by the testator or the witnesses in compliance with the witnessing procedures specified under section 3 or 3.1 of this chapter as those chapters existed on June 30, 2020.

(c) A proponent who offers a will for probate may demonstrate prima facie compliance with subsection (b) by relying on the contents of a self-proving clause or by describing compliance in a verified petition under IC 29-1-7-4. A person contesting the validity of a will described in subsection (a) has the burden of proving noncompliance with subsection (b).

Sample (suggested) self-proving signature / witnessing block and affidavit with a single set of signatures, for a Will signed on paper WITH remote witnessing but WITHOUT signing in counterparts [*recommended additional content is in **red***]:

UNDER THE PENALTIES FOR PERJURY, we, the undersigned Testator and the undersigned witnesses, whose names are signed to the attached or foregoing instrument, declare:

(1) That the Testator identified and signed the instrument (which consists of ____ pages in total) as the Testator's will;

(2) That at the time they signed the attached or foregoing will, the Testator and the two witnesses were all physically located in ______________________ [*describe building and state address*] but, for medical or health reasons, the testator was unable to interact directly with the witnesses in the same room or physical space;

(3) That the Testator and the two undersigned witnesses used ______________________ [*insert name or description of audio-video communication technology or other interaction method used*] to remain in simultaneous or contemporaneous, real-time audible and visible communication with each other throughout the signing process;

(4) That by using the technology or method described in the preceding paragraph, the Testator and both of the undersigned witnesses were able to clearly observe the execution of the will by the Testator and by each witness, respectively;

(5) That each of the two witnesses positively verified the identity of the Testator by ________________________ [*specify identity proofing method used, such as viewing the Testator's government-issued photo I.D. or hearing the testator's correct answers to questions based on personal information about the Testator*];

(6) That while being continuously viewed by both of the two witnesses using the technology or other method described above in Paragraph (3) above, the Testator signed the hard copy original of the will on paper [*optional text follows*] or directed another individual, ___________________________, who is not one of the witnesses, to sign for the Testator in the Testator's presence;

(7) That after the Testator signed the hard copy original of the Will as described in Paragraph (6), a person (_________________________) who supervised or facilitated signing process physically transported that hard copy original to the other room or separate space in which the two witnesses were located and from which the witnesses observed and participated in the signing process;

(8) That the Testator signed the will as a free and voluntary act for the purposes expressed in it;

(9) That each of the witnesses, while being continuously observed by the Testator and each other using the technology or other method described in Paragraph (3) above, signed the same hard copy original of the will that contained the Testator's signature;

(10) That the Testator was of sound mind when the will was executed; and

(11) That, to the best knowledge of each attesting witness, the Testator was, at the time the will was executed, at least eighteen (18) years of age or was a member of the armed forces or of the merchant marine of the United States or its allies.

Date signed: ________________ ______________________________________
[*Testator's printed name*]

Date signed: ________________ ______________________________________
[*Witness 1's printed name*]
[*Witness 1 address – recommended*]

Date signed: ________________ ______________________________________
[*Witness 2's printed name*]
[*Witness 2 address – recommended*]

[*Name and address of attorney, paralegal, or other person supervising the signing and witnessing – optional but recommended*]

Sample self-proving signature / witnessing block and affidavit with a single set of signatures, for "signing in counterparts" with remote witnessing [*recommended additional text is in* ***red***]:

UNDER THE PENALTIES FOR PERJURY, we, the undersigned Testator and undersigned witnesses, respectively, whose names are signed to the attached or foregoing instrument, declare the following:

(1) That the undersigned Testator and witnesses interacted with each other in real time through the use of technology, and each witness was able to observe the Testator and the other witnesses throughout the signing process.

(2) That the Testator was located in _______________ and at ___________________ [*describe location and address*] throughout the signing process.

(3) That the first witness was located in ______________ and at __________________ [*describe location and address*] throughout the signing process.

(4) That the second witness was located in ______________ and at __________________ [*describe location and address*] throughout the signing process.

(5) That the Testator executed a complete counterpart of the instrument, in a readable form on paper, as the Testator's will.

(6) That, in the presence of both witnesses, the Testator:

(A) signed the paper counterpart of the will;

(B) acknowledged the Testator's signature already made; or

(C) directed another individual to sign the paper counterpart of the will for the Testator in the Testator's presence.

(7) That the Testator executed the will as a free and voluntary act for the purpose expressed in the will.

(8) That each of the witnesses, in the presence of the Testator and of each other, signed one (1) or more other complete paper counterparts of the will as a witness.

(9) That each paper counterpart of the will that was signed by the witness was complete, in readable form, and with content identical to the paper counterpart signed by the Testator.

(10) That the Testator was of sound mind when the will was executed.

(11) That, to the best knowledge of each witness, the Testator was at least eighteen (18) years of age at the time the will was executed or was a member of the armed forces or of the merchant marine of the United States or its allies.".

Date signed: _______________ ___________________________________

[*Testator's printed name*]

Date signed: _______________ ____________________________________
[*Witness 1's printed name*]
[*Witness 1 address – recommended*]

Date signed: _______________ ____________________________________
[*Witness 2's printed name*]
[*Witness 2 address – recommended*]

[*Name, address and telephone number of attorney or directed paralegal who supervises the signing and witnessing – strongly recommended*]

Sample "affidavit of compliance" to be signed by the supervising attorney or directed paralegal under I.C. § 29-1-5-3(c) through (e), for a traditional Will signed on paper "in counterparts" with remote witnessing:

[*Add case caption later for petition to probate will and/or to appoint personal representative*]

Affidavit of Compliance under I.C. § 29-1-5-3(d)
For Remotely-Witnessed Will Signed in Counterparts

The undersigned individual affirms, under the penalties for perjury, that all the following information is true and accurate:

[*Choose 1 version of ¶ 1*]

1. The undersigned individual is an attorney currently licensed to practice law in the State of Indiana and has Attorney I.D. number ___________.

1. The undersigned individual is a [*choose one of the following identifiers*] paralegal / nonlawyer assistant who is employed or retained by or associated with ____ __________________ [*name of licensed Indiana attorney*] and who works directly under the supervision of that licensed attorney.

2. Under the undersigned individual's supervision and on __________________, 20____, the Testator, ______________________, signed an original counterpart of h__ will on paper, while in the presence (as defined in I.C. § 29-1-1-3(a)(16)) of two adult Witnesses identified below.

3. The residential address of the Testator, ________________, is _____________ ____________________.

4. The name and the residential address or business address of each of the two Witnesses to the will are as follows:

	Witness 1	**Witness 2**
Witness Name:	______________________	______________________
Witness's residential or business address:	______________________ ______________________	______________________ ______________________

5. Throughout the signing process described in this affidavit, the Testator was physically located in [*describe location and address*] _______________ at ___________ ____________________, and the above-named witnesses were physically located in [*describe location(s) and city/cities and state(s))*] _______________ at _____________ ____________________, [respectively].

6. Throughout the signing process described in this affidavit, the undersigned individual was physically located in [*describe location and address*] _______________ at _____________________________.

7. Throughout the signing process described in this affidavit, the following audiovisual technology or other method was used to establish and maintain two-way, real time interaction between and among the Testator, the two Witnesses, and the undersigned individual and to satisfy the "presence" requirement as defined in I.C. § 29-1-1-3(a)(16) [*describe software application and/or technology used*]: _____________ ________________________.

8. Before the Testator signed an original counterpart of h___ will on paper, the following method and form of identification were used to confirm the Testator's identity to the undersigned individual and to the two Witnesses [*check and fill in one*]:

_______ Visual display of the Testator's government-issued photo I.D. [*describe type of I.D.*] __________________________

_______ Private personal identifying information for the Testator, accurately recited by the Testator [*specify type of identifying information*]

_______ Other method [*specify, such as other knowledge-based authentication or Testator's repetition of a prearranged password*]

9. [*OPTIONAL*] The following method was used to confirm or establish the Testator's soundness of mind, freedom from duress, and capacity to sign a valid will, to the satisfaction of the two Witnesses: [*specify details*] ______________________.

10. While remaining in real-time, two-way interaction with the Testator and with each other as described in Paragraph 7 above, each of the two Witnesses signed a paper

counterpart of the will, which was identical in content to the paper counterpart signed by the Testator.

11. The Testator's will, including the signature blocks and the self-proving clause or affidavit (if any), comprise a total of ______ pages, and the signatures of the Testator and the two Witnesses appear on page(s) _____ and _____ of paper counterparts of the will.

12. With the assistance and supervision of the undersigned individual, and before they signed counterparts of the will on paper, the Testator and the two Witnesses used the following method to identify the location of each page break within the text of the will and to confirm that the separate paper counterparts of the will were identical in content: [*describe*] ____

13. On ________________, 20____, the undersigned individual received physical delivery and possession of all the original paper counterparts of the Testator's will, as separately signed by the Testator and the two Witnesses.

14. On _________________, 20____ [*date within 5 business days after the date in ¶ 13*], the undersigned individual combined all of the separately signed paper counterparts of the Testator's will into a single composite paper document containing all pages and all text of the will and the signatures of the Testator and of both / all the Witnesses. The undersigned individual also produced a complete electronic copy of that single composite paper document in ______ format, suitable for electronic filing under Indiana Trial Rules 86 and 87.

____
[*Signature of attorney or paralegal*]
Printed name of attorney or paralegal
Business or residence address [*required*]
Telephone number [*required*]
E-mail address [*recommended*]

(4) Excerpts from HEA 1255's changes to the Probate Code for electronic Wills *and* sample form provisions.

The following Probate Code provisions, as added or amended by House Enrolled Act 1255, apply to electronic wills signed with "remote witnessing" on or after the date of enactment (April 29, 2021). Text added by HEA 1255 is shown in **bold**.

SECTION 6. IC 29-1-21-3, AS AMENDED BY P.L.231-2019, SECTION 18, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 3. The following terms are defined for this chapter:

~~(1) "Actual presence" means that:~~

~~(A) a witness; or~~

~~(B) another individual who observes the execution of the electronic will;~~

~~is physically present in the same physical location as the testator. The term does not include any form of observation or interaction that is conducted by means of audio, visual, or audiovisual telecommunication or similar technological means.~~

. . . .

(5) "Directed paralegal" means a nonlawyer assistant who is employed, retained, or otherwise associated with a licensed attorney or law firm and whose work is directly supervised by a licensed attorney, as required by Rule 5.3 of the Rules of Professional Conduct.

. . . .

(14) "Observe" means to perceive another's actions or expressions of intent through the senses of eyesight or hearing, or both. The term includes perceptions involving the use of technology or learned skills to:

(A) assist the person's capabilities of eyesight or hearing, or both; or

(B) compensate for an impairment of the person's capabilities of eyesight or hearing, or both.

(15) "Observing" has the meaning set forth in subdivision (14).

(16) "In the presence of" has the meaning set forth in subdivision (17).

(17) "Presence" means a process of signing and witnessing a will in which:

(A) the testator and the witnesses:

(i) are directly present with each other in the same physical space; or

(ii) are able to interact with each other in real time through the use of audiovisual technology now known or later developed;

(B) the testator and witnesses are able to positively identify each other; and

(C) each witness is able to interact with the testator and with each other by observing:

(i) the testator's expression of intent to execute the electronic will;

(ii) the testator's actions in executing or directing the execution of the testator's electronic will; and

(iii) the actions of every other witness in signing the will.

The term includes the use of technology or learned skills for the purpose of assisting with hearing, eyesight, and speech, or for the purpose of compensating for a hearing, eyesight, or speech impairment.

. . . .

SECTION 7. IC 29-1-21-4, AS ADDED BY P.L.40-2018, SECTION 2, IS AMENDED TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: Sec. 4. (a) To be valid as a will under this article, an electronic will must be executed by the electronic signature of the testator and attested to by the electronic signatures of at least two (2) witnesses in the following manner:

(1) ~~The testator and the attesting witnesses must be in each other's actual presence when the electronic signatures are made in or on the electronic will. The testator and witnesses must directly observe one another as the electronic will is being signed by the parties.~~ **The testator, the attesting witnesses, and any individual who signs for the testator under subdivision (4)(B) must be in each other's presence when the electronic signatures are made in or on the electronic will. A person, including an attorney or directed paralegal, who supervises the execution of the electronic will may act and sign as one (1) of the attesting witnesses if the person does not sign the electronic will at the testator's direction under subdivision (4)(B). The testator and witnesses must be able to interact with each other and the witnesses must be able to observe the testator and each other as the electronic will is being signed.**

(2) The testator and attesting witnesses must comply with:

(A) the prompts, if any, issued by the software being used to perform the electronic signing; or

(B) the instructions by the person, if any, responsible for supervising the execution of the electronic will.

(3) The testator must state, in the ~~actual~~ presence of the attesting witnesses, that the instrument to be electronically signed is the testator's will.

(4) The testator must:

(A) electronically sign the electronic will in the ~~actual~~ presence of the attesting witnesses; or

(B) direct another adult individual who is not an attesting witness to sign the electronic will on the testator's behalf in the ~~actual~~ presence of the testator and the attesting witnesses.

(5) The attesting witnesses must electronically sign the electronic will in the ~~actual~~ presence of:

(A) the testator; and

(B) ~~one another~~; **each other;**

after the testator has electronically signed the electronic will.

(6) The:

(A) testator; or

(B) other adult individual who is:

(i) not an attesting witness; and

(ii) acting on behalf of the testator;

must command the software application or user interface to finalize the electronically signed electronic will as an electronic record.

The process described in this section may include as part of the electronic record for the electronic will any identity verification evidence pertaining to the testator or any document integrity evidence for the electronic will.

(b) If the testator and the witnesses are not in each other's physical presence when the electronic will is signed and witnessed and if the testator and the witnesses use audiovisual technology to satisfy the presence requirement in subsection (a) and section 3(17) of this chapter, an attorney or a directed paralegal must supervise the signing and the witnessing of the electronic will.

(c) Within a reasonable time after an attorney or a directed paralegal supervises the signing and witnessing of an electronic will in the manner described in subsection (b), the attorney or directed paralegal must sign an affidavit of compliance. An affidavit of compliance under this subsection must be sworn to or affirmed by the signing attorney or directed paralegal under the penalties of perjury and must contain:

(1) the name and residential address of the testator;

(2) the name and:

(A) residential address; or

(B) business address; for each witness who signs the electronic will;

(3) the address, city, and state in which the testator is physically located at the time the testator signs the electronic will;

(4) the city and state in which each attesting witness is physically located when the witness signs the electronic will as a witness;

(5) a description of the method and form of identification used to confirm the identity of the testator to the witnesses and supervising attorney or directed paralegal;

(6) a description of the method used by the supervising attorney or paralegal, testator, and the witnesses for the purpose of interacting with each other in real time during the signing process;

(7) a brief description of the method used to add or capture the electronic signature of the testator and the witnesses;

(8) the name, business or residential address, and telephone number of the attorney or directed paralegal who supervised the execution of the electronic will; and

(9) any other information that the supervising attorney or directed paralegal considers to be material to:

(A) the testator's capacity to sign a valid will; and

(B) the testator's and witnesses' compliance with subsection (a).

(d) When a party files a petition under IC 29-1-7 to probate an electronic will that was executed and witnessed in the manner described in subsection (b), the party shall file a true copy of the affidavit of compliance under subsection (c) with the petition or at any time ordered by the court. A party who files a copy of the affidavit of compliance may redact private information from the affidavit in a manner consistent with Rule 5 of the Rules on Access to Court Records. If an electronic will is executed and witnessed under subsection (c) but without the supervision of an attorney or directed paralegal and that will is later offered for probate under IC 29-1-7, the will is voidable in the discretion of the court, upon objection to probate filed under IC 29-1-7-16, or upon a timely filed will contest under IC 29-1-7-17.

~~(b)~~ **(e)** An electronic will may be self-proved:

(1) at the time that it is electronically signed; and

(2) before it is electronically finalized;

by incorporating into the electronic record of the electronic will a self-proving clause described under subsection ~~(c).~~ **(f).** An electronic will is not required to contain an attestation clause or a self-proving clause in order to be a valid electronic will.

~~(c)~~ **(f)** A self-proving clause under subsection ~~(b)~~ **(e)** must substantially be in the following form:

"We, the undersigned testator and the undersigned witnesses, whose names are signed to the attached or foregoing instrument, declare:

(1) That the testator executed the instrument as the testator's will;

(2) That, in the ~~actual and direct physical~~ presence of both witnesses, the testator signed the will or directed another individual who is not one of the witnesses to sign for the testator in the testator's presence and in the witnesses' ~~actual and direct physical~~ presence;

(3) That the testator executed the will as a free and voluntary act for the purposes expressed in it;

(4) That each of the witnesses, in the ~~actual and direct physical~~ presence of the testator and each other, signed the will as a witness;

(5) That the testator was of sound mind when the will was executed; and

(6) That, to the best knowledge of each attesting witness, the testator was, at the time the will was executed, at least eighteen (18) years of age or was a member of the armed forces or of the merchant marine of the United States or its allies.

____________________	______________________________
(insert date)	(insert signature of testator)
____________________	______________________________
(insert date)	(insert signature of witness)
____________________	______________________________
(insert date)	(insert signature of witness)".

A single signature from the testator and from each attesting witness may be provided for any electronic will bearing or containing a self-proving clause.

~~(d)~~ **(g)** An electronic will that is executed in compliance with subsection (a) shall not be rendered invalid by the existence of any of the following attributes:

(1) An attestation clause.

(2) Additional signatures.

(3) A self-proving clause that differs in form from the exemplar provided in subsection ~~(c).~~ **(f).**

(4) Any additional language that refers to the circumstances or manner in which the electronic will was executed.

~~(e)~~ **(h)** This section shall be construed in a manner that gives effect to the testator's intent to execute a valid will.

SECTION 8. IC 29-1-21-4.1 IS ADDED TO THE INDIANA CODE AS A **NEW** SECTION TO READ AS FOLLOWS [EFFECTIVE UPON PASSAGE]: **Sec. 4.1. (a) This section applies to a will or codicil that is electronically signed and witnessed:**

(1) on or after March 31, 2020;

(2) before January 1, 2021; and

(3) in reliance on the Indiana supreme court's order signed and filed on March 31, 2020, under case number 20S-MS-237, as supplemented or extended by the supreme court's order signed and filed on May 1, 2020, under case number 20S-MS-237, and by the supreme court's orders signed and filed on May 29, 2020, and November 10, 2020, under case number 20S-CB-123.

(b) Notwithstanding any other law or provision, a will or codicil described in subsection (a) that was electronically signed and witnessed in compliance with:

(1) the procedures and requirements set forth in the Indiana supreme court's order signed and filed on March 31, 2020, under case number 20S-MS-237 and as supplemented or extended by the supreme court's order signed and filed on May 1, 2020, under case number 20S-MS-237 and by the supreme court's order signed and filed on November 10, 2020, under case number 20S-CB-123; or

(2) the procedures and requirements set forth in section 4 of this chapter;

does not need to be reexecuted or reratified in compliance with the witnessing procedures specified under section 4 of this chapter or IC 29-1-5-3 as they existed on June 30, 2020.

(c) A proponent who offers an electronic will for probate may demonstrate prima facie compliance with subsection (b) by relying on the contents of a self-proving clause or by describing compliance in a verified petition under IC 29-1-7-4. A person contesting the validity of an electronic will described in subsection (b) has the burden of proving noncompliance with subsection (b).

Sample self-proving signature / witnessing block and affidavit for an electronic will signed and witnessed with remote witnessing (NOTE that under I.C. § 29-1-21-4(g), an electronic will or its self-proving clause may contain "additional language that refers to the circumstances or manner in which the electronic will was executed."):

Optional but recommended wording appears in **red**.

UNDER THE PENALTIES FOR PERJURY, we, the undersigned Testator and undersigned witnesses, respectively, whose names are signed to the attached or foregoing instrument, declare the following:

(1) That throughout the signing process described below, the undersigned Testator and witnesses interacted with each other in real time through the use of technology; the Testator was able to observe each witness; and each witness was able to observe the Testator and the other witness.

(2) That the Testator was located in _______________ and at ___________________ [*describe location and address*] throughout the signing process.

(3) That the first witness was located in ______________ and at __________________ [*describe location and address*] throughout the signing process.

(4) That the second witness was located in _____________ and at _________________ [*describe location and address*] throughout the signing process.

(5) That in the presence of both witnesses, the Testator signed the will or directed another individual who is not one of the witnesses to sign for the Testator in the Testator's presence and in the witnesses' presence.

(6) That the Testator executed the will as a free and voluntary act for the purposes expressed in the will.

(7) That each of the witnesses, in the presence of the Testator and of each other, signed the will as a witness.

(8) That the Testator was of sound mind when the will was executed.

(9) That, to the best knowledge of each witness, the Testator was at least eighteen (18) years of age at the time the will was executed or was a member of the armed forces or of the merchant marine of the United States or its allies.".

Date signed: _______________ ___________________________________
[*Testator's printed name*]

Date signed: _______________ ___________________________________
[*Witness 1's printed name*]
[*Witness 1 address – recommended*]

Date signed: _______________ ___________________________________
[*Witness 2's printed name*]
[*Witness 2 address – recommended*]

[*Name, address and telephone number of attorney or directed paralegal who supervises the signing and witnessing – strongly recommended*]

Sample "affidavit of compliance" to be signed by the supervising attorney or directed paralegal under I.C. § 29-1-21-4(b) through (d), for a will that is electronically signed with remote witnessing:

[*Add case caption later for petition to probate will and/or to appoint personal representative*]

Affidavit of Compliance under I.C. § 29-1-21-4(c)
For Remotely-Witnessed Will Signed Electronically

The undersigned individual affirms, under the penalties for perjury, that all the following information is true and accurate:

[*Choose 1 version of ¶ 1*]

1. The undersigned individual is an attorney currently licensed to practice law in the State of Indiana and has Attorney I.D. number ___________.

1. The undersigned individual is a [*choose one of the following identifiers*] paralegal / nonlawyer assistant who is employed or retained by or associated with ____ __________________ [*name of licensed Indiana attorney*] and who works directly under the supervision of that licensed attorney.

2. Under the undersigned individual's supervision and on ___________________, 20____, the Testator, ______________________, signed h__ will as an electronic record, while in the presence (as defined in I.C. § 29-1-21-3(17)) of two adult Witnesses identified below.

3. The residential address of the Testator, _________________, is ______________ ___________________.

4. The name and the residential address or business address of each of the two Witnesses to the will are as follows:

	Witness 1	Witness 2
Witness Name:	__________________________	___________________________
Witness's residential or business address:	_________________________ _________________________	_________________________ _________________________

5. Throughout the signing process described in this affidavit, the Testator was physically located in [*describe location and address*] __________________ at ___________ ________________________, and the above-named witnesses were physically located in [*describe location(s) and city/cities and state(s))*] _________________ at ________________ ________________________, [respectively].

6. Throughout the signing process described in this affidavit, the undersigned individual was physically located in [*describe location and address*] _________________ at ________________________________.

7. Throughout the signing process described in this affidavit, the following audiovisual technology or other method was used to establish and maintain two-way, real time interaction between and among the Testator, the two Witnesses, and the

undersigned individual and to satisfy the "presence" requirement as defined in I.C. § 29-1-21-3(17) [*describe software application and/or technology used*]: ________________
_____________________________.

8. Before the Testator electronically signed h___ will, the following method and form of identification were used to confirm the Testator's identity to the undersigned individual and to the two Witnesses [*check and fill in one*]:

________ Visual display of the Testator's government-issued photo I.D. [*describe type of I.D.*] _____________________________

________ Private personal identifying information for the Testator, accurately recited by the Testator [*specify type of identifying information*]

________ Other method [*specify, such as other knowledge-based authentication or Testator's repetition of a prearranged password*]

9. [*OPTIONAL*] The following method was used to confirm or establish the Testator's soundness of mind, freedom from duress, and capacity to sign a valid will, to the satisfaction of the two Witnesses: [*specify details*] ___________________________.

10. While remaining in real-time, two-way interaction with the Testator and with each other as described in Paragraph 7 above, each of the two Witnesses electronically signed the electronic record for the Testator's will.

11. The electronic signatures of the Testator and the Witnesses were captured or added to the electronic record for the will in the following manner [*describe user interface, software or other method used*]: _______________________________.

12. The electronic record for the Testator's will, including the signature spaces and the self-proving clause or affidavit (if any), but excluding any document integrity evidence, comprise a total of ______ pages, and the signatures of the Testator and the two Witnesses appear on page(s) _____ and _____ of the electronic record for the will.

13. On ________________, 20____, the undersigned individual used the fully-signed electronic record for the will to generate a complete converted copy (as defined in I.C. § 29-1-21-3(2)) of the will, in ______ format, suitable for electronic filing under Indiana Trial Rules 86 and 87.

____
[*Signature of attorney or paralegal*]
Printed name of attorney or paralegal
Business or residence address [*required*]
Telephone number [*required*]
E-mail address [*recommended*]

(5) The comprehensive overhaul of three of Indiana's health care advance directive statutes in Senate Enrolled Act 204.

The provisions of Senate Enrolled Act 204 (P.L. 50-2021) will become effective on July 1, 2021. It creates a new single type of health care advance directive that Hoosiers can sign and use anytime on or after July 1, for the purpose of (1) appointing one or more health care representatives and/or (2) stating specific instructions, wishes, and/or treatment preferences. SEA 204 was signed by the Governor on April 15, 2021. The full text is at http://iga.in.gov/legislative/2021/bills/senate/204#document-da83451c.[5]

After a 1.5-year transition period ends on December 31, 2022, the new-style advance directive will *replace* three documents used under current law:

- The durable POA for health care under I.C. § 30-5-5-16;
- The "appointment of health care representative"(HCRA) under I.C. § 16-36-1-7; and
- The "living will declaration" under I.C. § 16-36-4-10.

Those are the three statutes that will eventually be mostly superseded. During the 1.5-year transition period, any Hoosier could sign any one or more of those three documents *OR* the new-style advance directive, and the latest signed document will control over earlier-signed documents. If a Hoosier signs any one or more of the three documents (health care POA, HCRA, living will) during the transition period *and does not replace them*, those documents will remain valid and enforceable under SEA 204.

However, after the end of the transition period on December 31, 2022, if a Hoosier wants to sign a *new* health care advance directive to replace old ones or to perform any of the "functions" served by the above three documents under current law, that Hoosier will have to use and sign the new-style advance directive. For example, if a Hoosier signs a new general POA after December 31, 2022 which contains health care powers, the health care powers will be void, but the rest of the powers in the POA will be valid and enforceable. *See* Section 74 of SEA 204, adding new subsection (c) to I.C. § 30-5-5-16.

As enacted, SEA 204 runs 75 pages, and it inserts numerous cross-references into a large number of Indiana statutes, mostly in title 16. But the core content of SEA 204 is found in the 26 pages that start on page 28 of the Enrolled Act, and which adds a new, consolidated chapter 7 to IC 16-36, to state all the signing requirements, procedures,

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[5] As enacted, SEA 204 contained an error on the last line of page 35, in I.C. § 16-36-7-28(c)(1): The words "Signed in the declarant's direct physical presence" should have read "Signed in the declarant's presence." This error was fixed in the Conference Committee Report for House Bill 1436 (P.L. 199-2021), which was approved by the House and Senate on April 22nd and signed by Gov. Holcomb on April 29, 2021.

presumptions, default settings, and other rules that will apply to the new-style advance directive and to related issues of patient capacity and consent to health care.

Between 80 and 90 percent of the content in new chapter 16-36-7 was reproduced verbatim or adapted from statutory rules that have long existed in I.C. 16-36-1 (the "Health Care Consent Act" which dates back to 1987) or in various sections of Indiana's durable POA statute (which dates back to 1991). In consolidating existing rules and adding new rules in new chapter 16-36-7, the working group followed five top-priority principles:

- To preserve all of the design and drafting flexibility that Hoosiers and their lawyers have under current law when creating durable powers of attorney that confer health care powers;
- To avoid prescribing an inflexible *official* form of advance directive, which would have stifled innovation and excessively limited individuals' choices;
- To put the list of permitted optional provisions and the list of presumptions and default settings (if the advance directive is silent on an issue) in a pair of easy-to-find sections within new chapter 16-36-7;
- To eliminate confusing inconsistencies between the POA statute and the Health Care Consent Act and to state clear rules that apply to determinations of patient capacity or incapacity and to the revocation or amendment of health care advance directives; and
- To remove the restrictions (from the living will statute) on what kinds of wishes, instructions and treatment preferences a competent individual can express about requesting, refusing or discontinuing life-prolonging procedures.

Generally, when a new-style health care advance directive is signed and in place and when the individual signer does not have capacity to personally consent to health care or issue new instructions, heath care providers will have the same responsibilities, the same "good faith" standard of conduct, and the same protection from liability as providers do now with respect to health care POAs and HCRAs under current law. The rules are just stated more clearly in new chapter 16-36-7.

The lettered paragraphs below refer to many (but not all) of the important new or amended provisions included in SEA 204:

(a) A competent individual who signs a new-style advance directive ("AD") is a "declarant" under new chapter 16-36-7, and the surrogate decision maker who is named in an AD is a "health care representative." *See* new §§ 16-36-7-4 and 16-36-4-13.

(b) New § 16-36-7-28 specifies the permitted content and functions of the single new-style advance directive. It can combine the appointment of one or more

health care representatives ("HCRs") with statements of specific instructions, wishes and treatment preferences, or the AD can include either type of content but exclude the others. *See* new § 16-36-7-2 and 16-36-7-28(a). Anything that can currently be accomplished in a health care POA, living will declaration, or HCRA can be accomplished in a new-style AD.

(c) For the first time in title 16, new chapter 16-36-7 includes explicit definitions of "best interests," "incapacitated," "informed consent," "observe," "presence," "presence," and "writing."

(d) If an individual declarant signs a new-style AD and retains the capacity to consent to health care (has not become incapacitated), instructions, orders and consents issued by that competent declarant will always supersede and control over (1) the instructions of a health care representative named in the AD *and* (2) any specific treatment preferences or instructions stated in the AD. *See* new §§ 16-36-7-27(e), 16-36-7-32(a), 16-36-7-34(11), 16-36-7-35(b), and 16-36-7-36(a).

(e) A later signed AD will supersede and revoke an earlier-signed AD by the same declarant, unless the later-signed AD explicitly says that the earlier AD remains in effect. *See* new §§ 16-36-7-32(a)(1) and 16-36-7-34(4).

(f) A specific treatment preference or instruction stated within an AD will supersede all oral statements by the declarant on the same specific subject. *See* new § 16-36-7-27(g).

(g) The signing formalities for the new-style advance directive (AD) are stated in new § 16-36-7-28. The AD can be signed electronically or on paper, and the declarant can sign the AD personally or can direct some other adult (not one of the witnesses and not one of the named health care representatives) to sign for the declarant. Regardless of the format (paper or electronic), proper completion of the AD requires *either one* of the following, in addition to the signature of the declarant:

- The signatures of two adult witnesses, at least one of whom is not the spouse or other relative of the declarant (*see* new § 16-36-7-28(b)(1) and (c)(1)); or
- Signing or acknowledgement by the declarant in the presence of a notarial officer, including any method of remote on-line notarization (RON) that satisfies the requirements for remote notarial acts under IC 33-42-17 (*see* new § 16-36-7-28(b)(1) and (c)(2)).

(h) New § 16-36-7-28 explicitly permits a competent declarant to accomplish the signing and witnessing of a valid AD using two other methods, if the declarant does not have access to or cannot use technology for electronic or digital signing of the AD with remote witnessing or remote notarization:

- Subsection 28(d) allows the declarant and the witnesses or the notarial officer sign and complete the AD on paper in separate counterparts, so long as the signing process is properly supervised and the separate signed counterparts are combined into a complete, fully signed document within 10 business days after the supervisor or organizer of the signing receives all the signed counterparts. *See also* **Part 6** starting on page 36 below.

- Subsections (e) through (i) of new section 28 permits a declarant and the witnesses to sign and complete an AD using "telephonic [audio only] interaction between the declarant and the witnesses, IF it is not possible for the declarant to sign the AD with direct physical presence or with signing in counterparts or with remote witnessing technology, <u>*AND*</u> <u>*IF*</u> all witnesses satisfy themselves that they have verified the declarant's identity and that the declarant is of sound mind and has capacity to consent. No person can be compelled to act as a witness for an AD signed through telephonic interaction. *See also* pages 38, 39, and 45-46 below.

(i) A non-exclusive list of optional provisions, which <u>*can*</u> be included in a new-style advance directive (AD), is stated in new § 16-36-7-29. These are based closely on rules found in the current durable POA statute or on rules that can be inferred from the current POA statute and the Health Care Consent Act.

(j) If a new-style AD is silent on an issue, the governing presumption or default setting can be found in new § 16-36-7-34.

(k) New § 16-36-7-35 states the rules and procedures for determining whether a declarant who has signed an AD (or an individual who has no effective AD in place) has become incapacitated or has recovered from a period of incapacity. In a dispute, the authority of the probate court to make such determinations remains paramount.

(l) New § 16-36-70-36 states the general authority, responsibility, and standard of conduct for each health care representative who is appointed and acting under a new AD.

(m) New § 16-36-7-37 states the general responsibilities, compliance duties and standard of conduct for health care providers in response to instructions stated in a valid AD or instructions by a health care representative who is appointed and acting under a valid AD. The duties of health care representatives are essentially the same as under I.C. § 30-5-7-4 (in the current POA statute).

(n) New § 16-36-7-30(a) requires the Indiana State Health Department (ISDH) to maintain on its web site an updated list of advance directive resources, including links to sample forms of AD that comply with new chapter 16-37-7. In or about 2014, and without being asked or ordered to do so, ISDH

developed and published a sample form and 1-page instruction sheet for the Appointment of Health Care Representative (HCRA) under I.C. § 16-36-1-7. The introduced version of Senate Bill 204 originally required ISDH to develop and publish a sample form of new-style advance directive. ISDH's in-house attorneys balked at doing this, even after they were shown how easy it would be (*see* **Appendix 3** on page 57). So, the compromise was that ISDH would publish clickable links to other web sites offering sample AD forms.

(o) New § 16-36-7-30(b) states that a "declarant is not required to use any official or unofficial form to prepare and sign a valid advance directive." The working group behind SEA 204 anticipates that larger hospital chains, bar associations, patient advocacy and health care choice groups, and social welfare organizations will engage in friendly competition to offer advance directive forms that comply with the new statutory requirements.

(6) Additional details of signing methods and optional provisions for the new-style advance directive for health care under SEA 204.

A new-style advance directive can be signed in a variety of ways on or after July 1, 2021, depending on the factual circumstances of the signer (declarant) and on how if at all the declarant is limited in his or her ability to interact in person with witnesses and to get access to and use technology.

A. The Declarant IS able to interact face-to-face with 2 witnesses or a notary, and IS able to sign with a pen and to pass paper documents back and forth:

- The Declarant can sign the advance directive on paper in the direct presence of 2 witnesses or a notary public, and have the witnesses sign or the notary complete the notarial certificate on each signed paper original of the advance directive. I.C. § 16-36-7-28(b)(1).

B. The Declarant IS able to interact face-to-face with 2 witnesses or a notary BUT cannot hold a pen to physically sign an Advance Directive:

- *Alternative 1*: The Declarant can direct some adult third person (not one of the witnesses and not one of the named health care representatives) to sign the advance directive for the declarant in the declarant's presence, and have the witnesses sign or the notary complete the notarial certificate on each signed paper original of the advance directive. I.C. § 16-36-7-28(b)(2).
- *Alternative 2*: The Declarant can use an electronic or digital method to add his or her electronic signature to the advance directive, and the two witnesses can sign electronically OR the notary public can complete an electronic notarial certificate. I.C. § 16-36-7-28(b).

C. The Declarant is NOT able to interact face-to-face and in the same space with 2 witnesses or a notary, and Declarant is NOT permitted to pass paper documents back and forth, BUT the Declarant IS able to maintain line-of-sight contact with

the witnesses or a notary through a glass window or using real-time A-V technology:

- *Alternative 3*: In their separate physical locations, and while maintaining line-of-sight contact, the Declarant and the 2 witnesses can sign the advance directive on paper in 2 or 3 separate counterparts. Some person must combine the separately signed counterparts into a single composite document (containing all signatures) within 10 business days after receiving the signed counterparts. I.C. § 16-36-7-28(d).
- *Alternative 4*: In their separate physical locations, and while maintaining line of sight contact, the Declarant and a notary public can sign separate paper counterparts of the advance directive. If the declarant and the notary can see each other through a glass window and can speak and hear each other by telephone, a notary public holding a regular notary commission can complete the notarial certificate on one of the paper counterparts. If the declarant and the notary are able to maintain line-of-sight contact only by using two-way A-V technology, the notary public should have a "remote notary public" commission and should use a technology platform from one of the approved vendors[6] to verify the Declarant's identity and to complete a remote notarial certificate. In any event, some person must combine the separately signed paper counterparts into a single composite document within 10 business days after receiving all of the separately signed counterparts.
- *Alternative 5*: In their separate physical locations, and while maintaining line of sight contact through a glass window or by using 2-way A-V technology, both the Declarant and 2 witnesses can electronically sign the advance directive. I.C. § 16-36-7-28(c).
- *Alternative 6:* In their separate physical locations, and while maintaining line of sight contact through a glass window or by using 2-way A-V technology, both the Declarant and a notary public can electronically sign the advance directive. If A-V technology is used to maintain contact between the Declarant and the notary and to satisfy the "presence" requirement, an Indiana notary should have a commission as a remote notary public and should use a technology platform from one of the approved vendors to verify the Declarant's identity and to complete a remote notarial certificate. I.C. § 16-36-7-28(c)(2).

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[6] As of April 10, 2021, the Indiana Secretary of State had approved eight (8) vendors' technologies for use by Indiana remote notaries public in performing remote online notarizations. *See* https://inbiz.in.gov/certification/notary#verticalTab5. For an example of one vendor's remote notarization platform, which accommodates a broader range of documents than deeds and other real property documents, *see* www.docverify.com.

D. The Declarant is NOT able to interact face-to-face with 2 witnesses or a notary, and is NOT able to use electronic or signing technology, AND is not able to use or does not have access to 2-way A-V technology to have line-of-sight visual interaction with 2 witnesses or a notary:

- *Alternative 7*: The Declarant and two witnesses can **interact solely by telephone call** to confirm the Declarant's identity and capacity and to accomplish the signing of the advance directive on paper, either in counterparts or with quick successive signing by the Declarant and the witnesses. I.C. § 16-36-7-28(e) through (h).

Alternative 7 (using telephonic interaction alone) is consistent with long-standing clinical practice under which a patient's informed consents to treatment *and* designation of a health care surrogate decision maker have been accomplished through the use of telephone calls, without face-to-face visual interaction between the patient and witnesses. New I.C. § 16-36-7-24 defines "telephonic interaction."

When a competent patient (declarant) has nothing more complicated or advanced than a flip phone and when that patient is living under "lockdown" conditions and cannot receive and see visitors for the purpose of handling and signing documents on paper, there are obvious practical challenges involved in verifying the identity of a patient / declarant who can only be *heard* and *spoken to* by phone, without visual interaction.

Under subsection (e) of I.C. § 16-36-7-28, the use of telephonic interaction *alone* to accomplish the signing of an advance directive is an extraordinary alternative, and should be used only if it is "impossible or impractical for the declarant to use audiovisual technology to interact with the two (2) witnesses and to satisfy the presence requirement under section 19 of this chapter . . . ."

This part of new I.C. § 16-36-7-28 encountered some serious opposition in the Senate Judiciary Committee. Sen. Mike Young's concern was that with telephone-only interaction between the declarant and the witnesses, the witnesses could not view the declarant's government-issued photo I.D. during the signing process. The compromise solution, in two Senate Amendments, was to add a sentence to subsection 28(e) and to add what is now subsection (f). These amendments have created the following additional constraints on the use of telephonic interaction:

- When telephonic interaction is used, the advance directive must be signed by two witnesses. The alternative of notarization is not available, because under IC 33-42, an Indiana notarial officer needs to have some sort of line-of-sight visual interaction with the signer (declarant).
- Potential witnesses cannot be compelled to participate in the signing of an advance directive using telephonic interaction. *See* the second sentence of I.C. § 16-36-7-28((e). If a potential witness is not comfortable with the process, the

declarant and his or her advisors or caregivers will have to keep trying until two willing witnesses can be found.

- Under I.C. § 16-36-7-28(f), each witness who participates in the signing using purely telephonic interaction must be able to positively identify the declarant and to conclude, to the satisfaction of the witness, that the declarant is of sound mind and has capacity to sign the advance directive.

- "Knowledge-based authentication" methods can be used to satisfy the witnesses that the declarant has been positively identified and is not an impostor and is not signing the advance directive under the duress of some undisclosed silent person sitting at the declarant's elbow or bedside, at the other end of the phone call.

    - If the declarant has a government-issued photo I.D., the declarant's lawyer or other advisor could arrange to obtain a copy of that photo I.D. *before* the phone call and provide that copy to each witness. During the phone call, the declarant can be asked to accurately repeat information that appears on the photo I.D.

    - During the phone call, the witnesses or a person supervising the signing can ask "unique personal information" questions, to which only the declarant would have the correct answers.

    - Before the phone call and the signing ceremony, the declarant and his or her lawyer or other advisor can agree on a code word or phrase that the declarant can easily remember, and which the declarant can repeat at the request of the lawyer or advisor at the time the advance directive is signed. If the declarant feels under duress during the phone call, the declarant could intentionally fail to state the correct code word or phrase.

    - If a trustworthy caregiver or bystander with a separate smart phone can be in the same room with the declarant during the phone call and the signing ceremony, that caregiver or bystander can call the lawyer or other person during or just before the phone call to confirm that the declarant is not an impostor and is not acting under duress.

(7) Text of key provisions from Senate Enrolled Act 204, stating definitions, content, and signing formalities for the new-style advance directive under the Act.

NOTE: The following excerpts from Senate Enrolled Act 204 (P.L. 50-2021) are effective July 1, 2021 and state the relevant definitions, contents, and signing requirements for the "new-style" advance directive under I.C. § 16-36-7-28. A copy of the entire text of SEA 204 in Word format is available from Jeff Dible upon e-mailed request.

SECTION 63. IC 16-36-7 IS ADDED TO THE INDIANA CODE AS A **NEW** CHAPTER TO READ AS FOLLOWS [EFFECTIVE JULY 1, 2021]:

Chapter 7. Health Care Advance Directives

IC 16-36-7-1

Sec. 1. (a) A death as a result of the withholding or withdrawal of life prolonging procedures in accordance with:

(1) a declarant's advance directive; or

(2) any provision of this chapter;

does not constitute a suicide.

(b) This chapter does not authorize euthanasia or any affirmative or deliberate act or omission to end life other than to permit the natural process of dying.

(c) This chapter does not establish the only legal means that an individual may use to:

(1) communicate or confirm the individual's desires or preferences to receive or refuse life prolonging treatment or other health care; or

(2) give one (1) or more other persons authority to consent to health care or make health care decisions on the individual's behalf.

(d) This chapter does not affect the consent provisions set forth in:

(1) IC 16-34; or

(2) IC 16-36-1-3.5.

(e) This chapter does not modify any requirements or procedures under IC 33-42 concerning the performance of valid notarial acts.

(f) Nothing in this chapter prohibits a health care provider from relying on a document that:

(1) is signed by an adult who has not been determined to be incapacitated; and

> (2) in the context of the relevant circumstances, clearly communicates the individual's intention to give one (1) or more specified persons authority to consent to health care or make health care decisions on the individual's behalf.

IC 16-36-7-2

Sec. 2. As used in this chapter, "advance directive" means a written declaration of a declarant who:

> (1) gives instructions or expresses preferences or desires concerning any aspect of the declarant's health care or health information, including the designation of a health care representative, a living will declaration made under IC 16-36-4-10, or an anatomical gift made under IC 29-2-16.1; and
>
> (2) complies with the requirements of this chapter.

. . .

IC 16-36-7-17

Sec. 17. As used in this chapter, "notarial officer" means a person who is authorized under IC 33-42-9-7 to perform a notarial act (as defined in IC 33-42-0.5-18). The term includes a notary public.

IC 16-36-7-18

Sec. 18. (a) As used in this chapter and with respect to interactions between a declarant and a witness, "observe" means to perceive another's actions or expressions of intent through the senses of eyesight or hearing, or both. A person is able to observe another's actions or expressions of intent even if the person uses technology or learned skills to:

> (1) assist the person's capabilities of eyesight or hearing, or both; or
>
> (2) compensate for an impairment of the person's capabilities of eyesight or hearing, or both.

(b) As used in this chapter and with respect to interactions between a declarant and a notarial officer, "observe" means that the notarial officer is able to see and hear, in real time, the declarant's actions and expressions of intent either in the declarant's physical presence or through audiovisual communication as defined in IC 33-42-0.5-5.

IC 16-36-7-19

Sec. 19. (a) As used in this chapter and with respect to interactions between a declarant and a witness who signs or participates in the signing of an advance directive or other document under this chapter, "presence", "present", and "to be present" means that throughout the process of signing and witnessing the advance directive or other document the following must occur:

> (1) The declarant and the witness are:
>
> > (A) directly present with each other in the same physical space;

(B) able to interact with each other in real time through the use of any audiovisual technology now known or later developed; or

(C) able to speak to and hear each other in real time through telephonic interaction when:

(i) the identity of the declarant is personally known to the witness;

(ii) the witness is able to view a government issued, photographic identification of the declarant; or

(iii) the witness is able to ask any question of the declarant that authenticates the identity of the declarant and establishes the capacity and sound mind of the declarant to the satisfaction of the witness.

(2) The witnesses are able to positively identify the declarant by viewing a government issued, photographic identification of the declarant, or by receiving accurate answers from the declarant that authenticate the identity of the declarant and establish the capacity and sound mind of the declarant to the satisfaction of the witness.

(3) Each witness is able to interact with the declarant and each other witness, if any, by observing:

(A) the declarant's expression of intent to execute an advance directive or other document under this chapter;

(B) the declarant's actions in executing or directing the execution of the advance directive or other document under this chapter; and

(C) the actions of each other witness in signing the advance directive or other document.

The requirements of subdivisions (2) and (3) are satisfied even if the declarant and one (1) or all witnesses use technology to assist with one (1) or more of the capabilities of hearing, eyesight, or speech to compensate for impairments of any one (1) or more of those capabilities.

(b) As used in this chapter and with respect to interactions between a declarant and a notarial officer who signs or participates in the signing of an advance directive or other document under this chapter, "presence", "present", and "to be present" means that throughout the process of signing, acknowledging, and notarizing the advance directive or other document the following must occur:

(1) The declarant and the notarial officer are:

(A) directly present with each other in the same physical space; or

(B) able to interact with each other in real time through the use of any audiovisual technology, now known or later developed, whose use complies with IC 33-42.

(2) The notarial officer is able to positively identify the declarant by using an identity proofing method permitted under IC 33-42-0.5-16.

(3) Each witness or the notarial officer is able to interact with the declarant and each other witness, if any, by observing the declarant's:

(A) expression of intent to execute an advance directive or other document under this chapter; and

(B) actions in executing or directing the execution of the advance directive or other document under this chapter.

If the declarant appears before the notarial officer in a manner that satisfies the definitions of "appear" and "appearance" as defined in IC 33-42-0.5, then the declarant and the notarial officer satisfy the presence requirement described in this chapter. The requirements specified in subdivisions (2) and (3) are satisfied even if the testator and the notarial officer use technology to assist with one (1) or more of the capabilities of hearing, eyesight, or speech to compensate for impairments of any one (1) or more of those capabilities.

. . . .

IC 16-36-7-28

Sec. 28. (a) An advance directive signed by or for a declarant under this section may accomplish or communicate one (1) or more of the following:

(1) Designate one (1) or more competent adult individuals or other persons as a health care representative to make health care decisions for the declarant or receive health information on behalf of the declarant, or both.

(2) State specific health care decisions by the declarant.

(3) State the declarant's preferences or desires regarding the provision, continuation, termination, or refusal of life prolonging procedures, palliative care, comfort care, or assistance with activities of daily living.

(4) Specifically disqualify one (1) or more named individuals from:

(A) being appointed as a health care representative for the declarant;

(B) acting as a proxy for the declarant under section 42 of this chapter; or

(C) receiving and exercising delegated authority from the declarant's health care representative.

(b) An advance directive under this section must be signed by or for the declarant using one (1) of the following methods:

(1) Signed by the declarant in the presence of two (2) adult witnesses or in the presence of a notarial officer.

(2) Signing of the declarant's name by another adult individual at the specific direction of the declarant, in the declarant's presence, and in the presence of the two (2) adult witnesses or a notarial officer. However, an individual who signs the declarant's name on the advance directive may not be a witness, the notarial officer, or a health care representative designated in the advance directive.

(c) An advance directive signed under this section must be witnessed or acknowledged in one (1) of the following ways:

(1) Signed in the declarant's ~~direct physical~~ presence by two (2) adult witnesses, at least one (1) of whom may not be the spouse or other relative of the declarant.[7]

(2) Signed or acknowledged by the declarant in the presence of a notarial officer, who completes and signs a notarial certificate under IC 33-42-9-12 and makes it a part of the advance directive.

If the advance directive complies with either subdivision (1) or (2), but contains additional witness signatures or a notarial certificate that is not needed, the advance directive is still validly witnessed and acknowledged. A remote online notarization or electronic notarization of an advance directive that complies with IC 33-42-17 complies with subdivision (2).

(d) A competent declarant and the witnesses or a notarial officer may complete and sign an advance directive in two (2) or more counterparts in tangible paper form, with the declarant's signature placed on one (1) original counterpart and with the signatures of the witnesses, if any, or the notarial officer's signature and certificate on one (1) or more different counterparts in tangible paper form, so long as the declarant and the witnesses or notarial officer comply with the presence requirement as described in section 19 of this chapter, and so long as the text of the advance directive states that it is being signed in separate paper counterparts. If an advance directive is signed in counterparts under this subsection:

(1) the declarant;

(2) a health care representative who is designated in the advance directive;

(3) a person who supervised the signing of the advance directive in that person's presence; or

(4) any other person who was present during the signing of the advance directive;

must combine all of the separately signed paper counterparts of the advance directive into a single composite document that contains the text of the advance directive, the

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[7] As enacted, SEA 204 erroneously said "direct physical presence" instead of "presence" in § 16-36-7-28(c)(1). This error was corrected in the Conference Committee Report for House Enrolled Act 1436, which Gov. Holcomb signed on April 29, 2021.

signature of the declarant, and the signatures of the witnesses, if any, or the notarial officer. The person who combines the separately signed counterparts into a single composite document must do so not later than ten (10) business days after the person receives all of the separately signed paper counterparts. Any scanned copy, photocopy, or other accurate copy of the composite document that contains the complete text of the advance directive and all signatures will be treated as validly signed under this section. The person who creates the signed composite document under this subsection may include information about compliance within this subsection in an optional affidavit that is signed under section 41 of this chapter.

(e) If facts and circumstances, including physical impairments or physical isolation of a competent declarant, make it impossible or impractical for the declarant to use audiovisual technology to interact with the two (2) witnesses and to satisfy the presence requirement under section 19 of this chapter, the declarant and the witnesses may use telephonic interaction throughout the signing process. A potential witness cannot be compelled to use telephonic interaction alone to accomplish the signing of an advance directive under this section. A declarant and a notarial officer may not use telephonic interaction to accomplish the signing of an advance directive or other document under this chapter.

(f) If an advance directive is signed under subsection (e), the witnesses must be able to positively identify the declarant by receiving accurate answers from the declarant that:

(1) authenticate the identity of the declarant; and

(2) establish the capacity and sound mind of the declarant to the satisfaction of the witness.

(g) The text of the advance directive signed under subsection (e) must state that the declarant and the witnesses used telephonic interaction throughout the signing process to satisfy the presence requirement.

(h) An advance directive signed under subsection (e) is presumed to be valid if it recites that the declarant and the witnesses signed the advance directive in compliance with Indiana law.

(i) A health care provider or other person who disputes the validity of an advance directive signed under subsection (e) has the burden of proving the invalidity of the advance directive or noncompliance with subsection (e) by a reasonable preponderance of the evidence.

(j) If a declarant resides in or is located in a jurisdiction other than Indiana at the time when the declarant signs a writing that communicates the information described in subsection (a), the writing must be treated as a validly signed advance directive under this chapter if the declarant was not incapacitated at the time of signing and if the writing was:

(1) signed and witnessed or acknowledged in a manner that complies with subsections (b) and (c); or

(2) signed in a manner that complies with the applicable law of the jurisdiction in which the declarant was residing or was physically located at the time of signing.

Appendix 1

Quick Reference Guide to the Indiana Advance Directive for Health Care (2021)

Source: Indiana Code, Title 16, Article 36, Chapter 7 (Part of Public Law 50-2021)

Basic elements of the new Indiana advance directive (AD)

(1) No official or mandatory form for the AD

(2) Basic permitted and typical contents:

- (a) Name 1 or more health care representatives (HCRs)
- (b) State specific health care decisions and/or treatment preferences, including preferences for life-prolonging procedures or palliative care [*The statute contains no limitations on the expression of treatment preferences]*
- (c) [*Optional*] Disqualify named individual(s) from receiving delegated authority or serving as a HCR

(3) Signing requirements:

- (a) Declarant (patient or signer) signs on paper or electronically ***OR*** directs some adult (not a health care representative and not a witness) to sign declarant's name in declarant's direct presence
- (b) Declarant signs in the "presence" of 2 adult witnesses ***OR*** signs in the "presence" of a notary public or other notarial officer [*see back page for ways to satisfy "presence' requirement*]
- (c) The 2 witnesses ***OR*** the notarial officer also sign the AD electronically or on paper

Basic presumptions and rules IF the advance directive (AD) does NOT explicitly say otherwise:

A. The AD and the authority of each named HCR is effective upon signing and remains in effect until the AD is revoked in writing (Oral revocation possible only in the direct presence of a health care provider)

B. A later-signed AD supersedes and revokes an earlier-signed AD by the same Declarant

C. Unless HCRs are listed in order of priority (primary & backup, etc.), 2 or more HCRs named in the same AD have concurrent, equal, and independently exercisable authority and are not required to act jointly

D. If Declarant still has capacity to consent to health care, orders and instructions by Declarant will control over any decisions by a HCR and any specific instructions stated in in the AD

E. Any health care representative (HCR) can delegate authority under the AD in writing to any competent adult(s) or other persons (a delegation should be signed in the same manner as an AD)

F. The HCR has authority to compete anatomical gifts, to authorize an autopsy, and to arrange for burial or cremation of the Declarant's remains after Declarant's death

G. The HCR can access Declarant's medical records & health information under HIPAA and state law

H. The HCR has authority to consent to mental health treatment for the Declarant

I. Each HCR has authority to sign a POST / POLST or an out-of-hospital DNR declaration for Declarant if Declarant is found to be a qualified [eligible] person

J. The HCR has authority to apply for public benefits (including Medicaid and CHOICE) for Declarant and to access Declarant's financial and asset records for that purpose

K. Each HCR is entitled to collect reasonable compensation and expense reimbursement for actions taken and services performed for or on behalf of Declarant

Appendix 1

Standard of conduct for each health care representative:

- Defer to Declarant's personal decisions and judgment at all times when Declarant has capacity to consent to health care and is able to communicate instructions, wishes, and treatment preferences
- Take into account Declarant's explicit or implied intentions and preferences and make only the health care decisions that Declarant would have made
- Act in good faith and in Declarant's best interests if Declarant's specific preferences are not known
- Remain reasonably available to consult with Declarant's health care providers and to provide informed consent for Declarant if Declarant does not have capacity

Optional provisions that CAN be included in an advance directive (AD) [*see I.C. §§ 16-36-7-29 and 16-36-7-34; not a complete list*]:

1. State a delayed effective date or triggering event (*e.g.*, future incapacity) and/or a specific ending date for the AD or for any HCR's authority
2. Keep an earlier-signed AD or an earlier-appointed HCR's authority in effect after a new AD is signed
3. Prohibit or restrict the delegation of authority by the HCR to other specific persons
4. Require another person to witness or approve a revocation of or amendment to the AD
5. Name 2 or more HCRs in a stated order of priority or confirm that they are authorized to act alone and independently
6. Require multiple HCRs to act jointly or on a majority vote basis to exercise some or all health care powers
7. Prohibit an HCR from collecting compensation or state an hourly rate or other standard for determining HCR's reasonable compensation
8. Designate some person other than a HCR to serve as an advocate or monitor
9. Authorize any person (proxy) who is listed in I.C. §16-36-7-42 and -43 to make a written demand that any HCR provide a written accounting or report of the HCRs actions on behalf of Declarant

Methods for signing that satisfy the "presence" requirement between Declarant and the 2 witnesses or between the Declarant and the notarial officer [*see* I.C. §§ 16-36-7-19 and -28]:

In-Person Options		Remote Options		
Declarant and 2 witnesses or Declarant and the notarial officer sign on paper in direct physical presence of each other	Declarant and 2 witnesses or Declarant and the notarial officer sign electronically in direct physical presence of each other	Sign identical counterparts on paper; Declarant & witnesses or notary interact using 2-way audiovisual technology; assemble signed counterparts within 10 business days	Declarant and 2 witnesses or Declarant and notary sign electronically while interacting using 2-way audiovisual technology	Declarant and 2 witnesses sign with audio-only interaction by telephone during signing [*Witnesses must be able to positively identify Declarant & confirm capacity*]

NOTE: An Indiana notary public must comply with Indiana law and regulations, including regulations for "remote notarial acts," if Declarant and notary interact at a distance using audiovisual technology.

Sample of a "longer" advance directive form that complies with I.C. § 16-36-7-28:

ADVANCE DIRECTIVE
for Health Care Decisions

I, _________________________ [*insert name*] am an adult resident of __________ County, Indiana. I currently have the capacity to make my own decisions about my health care. Under Indiana Code 16-36-7, I am signing this Advance Directive in order to (a) appoint one or more Health Care Representatives who are named below *and* (b) give written instructions and state my wishes and preferences about life prolonging procedures and other treatment, if I later become terminally ill or suffer from a chronic or incurable condition and if I am unable to personally give my own instructions and make my own health care decisions.

If this Advance Directive does not specifically address a specific issue, then I intend that the rules and principles in I.C. 16-36-7 will apply and control, but in a manner consistent with my known wishes and preferences. If this Advance Directive is silent on an issue and if my wishes and preferences cannot be reliably determined, I intend that my Health Care Representative and health care providers act in a manner consistent with my best interests.

Effective Date

This Advance Directive and my Health Care Representative(s)' power and authority under it are [*choose and initial only one; if no space is initialed or checked, this document will be effective immediately upon signing*]:

_____ Effective upon signing

______ Effective only when a licensed doctor later determines that I am incapacitated

______ Effective on and after this date: ________________

After this Advance Directive becomes effective, then unless I state a specific expiration date below, it will remain in effect even if I later become incapacitated, disabled, or incompetent.

My Health Care Representative(s)

I appoint the following person(s) as my Health Care Representative(s), with full authority to make and communicate health care decisions and give informed consent on my behalf, but subject to the conditions stated in the next section ("My Continuing Right to Act and Decide Personally") below:

Priority (if any)	Name of Representative and Telephone Number(s)	Mailing Address and e-mail address (if any)
______		
______		

Initial or check ***ONE*** *space below. If no space below is initialed, each Health Care Representative will have authority to act individually and independently.*

_____ The Representative with the lowest priority number (filled in above) and who is able and available to act has the exclusive authority to act

_____ Each Representative may act individually and independently on my behalf and has no duty to consult with my other Representatives

If I have listed 2 or more Health Care Representatives in order of priority, and if the Representative with the highest priority (lowest number) is not reasonable able or reasonably available to act, I intend that the Representative who has the next highest priority who is reasonably able and available to act will have authority to act for me.

I understand that if I am not capable of giving informed consent to health care and if no Health Care Representative listed above and no person holding validly-delegated authority is reasonably able and available to act for me, then the relatives and other individuals (proxies) who are defined or listed in Ind. Code § 16-36-7-42 will have authority, in the priority indicated, to make or issue health care decisions and instructions for me.

My Continuing Right to Act and Decide Personally

Even if I have made this Advance Directive effective immediately upon signing, I have the right and the power to act personally to make my own health care decisions, and to issue my own instructions and consents to health care providers. All health care providers must first communicate with me, unless a licensed health care provider who has treated or examined me has concluded in writing that I am not able to personally give informed consent to treatment or to make my own health care decisions. Until I have been determined to be incapacitated under the preceding sentence, I have the right to overrule, block or veto any health care decision that any Health Care Representative (named above) makes or attempts to make for me.

Decision-Making Standards for My Health Care Representative(s)

Whenever a Health Care Representative named above makes health care decisions or issues instructions or consents on my behalf, I expect my Health Care Representative to act in good faith and in my best interests, on the basis of what my Health Care Representative believes I would decide to do if I were capable of making decisions and giving consents myself and if I had all the pertinent information available to my Health Care Representative.

I understand that under applicable law, a physician or other health care provider has the right to refuse to comply with any health care decision or instruction made or issued by me personally or by my Health Care Representative if that decision or instruction requests treatment that the physician or other health care provider concludes is medically inappropriate for me.

Discontinuing or Refusing Life-Prolonging Procedures

______ Unless I have initialed this space at the left, the following paragraph will apply.

I also authorize my Health Care Representative to make decisions in my best interests concerning withdrawal or withholding of health care. If, at any time and based on my previously expressed preferences and the diagnosis and prognosis, my Health Care Representative is satisfied that certain health care is not or would not be beneficial to me or that such health care would be excessively burdensome, then my Health Care Representative may express my will that any or all health care be discontinued or not instituted, even if death may result. My Health Care Representative must try to discuss this decision with me. However, if I am unable to communicate, my Health Care Representative may make such a decision for me, after consultation with my physician or physicians and other relevant health care givers. In his or her best judgment about what is appropriate, my Health Care Representative may (but is not required to) discuss any decision under this paragraph with members of my family who are available.

My Wishes and Preferences About Specific Life-Prolonging Procedures

[*Insert the signer's customized statement of wishes and preferences and/or specific instructions for end-of-life care, based on the signer's personal values and concepts for quality of life and dignity, etc.*]

If my treating physician or other licensed health care provider has determined with reasonable certainty that I am terminally ill or in a persistent and irreversible coma:

- If I have no pulse and if am not breathing, do not attempt resuscitation (DNR).
- Maximize my comfort through symptom management and relieve my pain and suffering through available measures, including the administration of medication to me through any route.
- Do not provide artificial nutrition or hydration (tube feeding) to me, except for the provision of fluids to the extent necessary to deliver pain medication.
- Do not transfer me from my current location to a hospital for life-sustaining treatment unless my comfort needs cannot be satisfied in my current location.

Optional Provisions and Restrictions

_______ Unless I have initialed this space at left, then after my death, each Health Care Representative is authorized to make or carry out instructions for the disposition of my remains (burial or cremation), to complete anatomical gifts, and to authorize an autopsy.

_______ I designate and appoint ___________________________ [*name an adult individual or another person*] as my advocate, who has all the authority stated in IC 16-36-7-29(10), including the authority to monitor, audit and evaluate the actions of my Health Care Representative(s), to receive my health information, and to take remedial actions for me and in my best interests.

_______ To any friend or relative or friend of mine who could act as my proxy under IC 16-36-7-42 and -43, I give the authority to demand and to receive, from my Health Care Representative(s), a narrative description or other appropriate accounting of the actions taken and decisions made by my Health Care Representative(s).

_______ A later revocation of or amendment to this Advance Directive, even if signed personally by me, will not be valid unless the revocation or amendment contains the signed written approval of my following professional advisor or other individual [*Name the other individual who must approve a future amendment or revocation*] ____.

_______ I specifically disqualify the following individual(s): _________________________ ___________________________ from later being appointed as a Health Care Representative for me, and from receiving delegated authority from any of my Health Care Representative(s), and from acting as my proxy under IC 16-36-7-42 and -43.

_______ My Health Care Representative(s) named above are **NOT** authorized to delegate authority to other persons. *If this space is NOT initialed, any Health Care Representative may delegate his or her authority to a competent adult or other person in a written document that the Representative signs in the same manner as this Advance Directive.*

_______ My Health Care Representative(s) are **NOT** authorized to consent to mental health treatment for me. *If this space is NOT initialed, each Health Care Representative will have authority to consent to mental health treatment for me if I am not capable of consenting.*

_______ My Health Care Representative(s) are **NOT** entitled to receive compensation from my money or property for the acts and services that they perform on my behalf. *If this space is NOT initialed, each Health Care Representative will be entitled to receive reasonable compensation from my money or property.*

Initial not more than one of the next two paragraphs. *If neither of the next two paragraphs is initialed, my Health Care Representative(s) will have full authority to apply for public benefits for me and to have access to the necessary financial records.*

_______ My Health Care Representative(s) are **NOT** authorized to apply for public benefits (such as Medicaid and the CHOICE program) on my behalf.

_______ My Health Care Representative(s) ARE authorized to apply for public benefits (such as Medicaid and the CHOICE program) on my behalf, but my Health Care Representative(s) are **NOT** authorized to have access to information about my income, assets and financial records unless such information is provided by me or by my attorney-in-fact acting under a separate power of attorney.

Signature

Sign below with a written signature OR an electronic signature. You may direct another adult (who is not one of your named Health Care Representatives, and not the Notary Public or one of the witnesses) to make your signature for you in your "presence." See IC § 16-36-7-19 for a definition and explanation of the "presence" requirement.

Your signature must be made in the "presence" of a Notary Public OR in the "presence" of two adult witnesses. Either the countersigning by two witnesses OR notarization is sufficient; both are not required. If you use two witnesses, at least one witness cannot be your spouse or another relative.

Please initial one space below to confirm the signing method used:

Signed on paper in direct presence of witnesses or notary public ____________	Signed electronically with 2-way audio-visual interaction with witnesses __________	Signed by Declarant and witnesses or notary in 2 or more paper counterparts ________	Signed by Declarant and two witnesses with telephonic interaction _________

Signed on this _______ day of ______________________ 20_____.

____
Signature of Declarant (signer)

____
Printed name of adult (if any) who signs for Declarant

____
Printed name of Declarant

Date of birth: ____________________ [*optional*]

Complete ONE of the two following blocks

Signatures of 2 Adult Witnesses

Each of the undersigned Witnesses confirms that he or she has received satisfactory proof of the identity of the Declarant and is satisfied that the Declarant is of sound mind and has the capacity to sign the above Advance Directive. **At least one of the undersigned Witnesses is not a spouse or other relative of the Declarant.**

____
Signature of Adult Witness 1

____
Printed Name of Adult Witness 1

____
Signature of Adult Witness 2

____
Printed Name of Adult Witness 2

Notarization

STATE OF INDIANA)
) SS:
COUNTY OF____________)

Before me, a Notary Public, personally appeared ______________________________ [*name of signing Declarant*], who acknowledged the execution of the foregoing Advance Directive as his or her voluntary act, and who, having been duly sworn, stated that any representations therein are true.

Witness my hand and Notarial Seal on this _____ day of ____________, 20____.

____
Signature of Notary Public

____
Notary's Printed Name (*if not on seal*)

____
Commission Number (*if not on seal*)

____
Commission Expires (*if not on seal*)

____
Notary's County of Residence

Sample of a "short" advance directive form that complies with I.C. § 16-36-7-28:

ADVANCE DIRECTIVE
for Health Care Decisions

I, ________________________ [*insert name*] am an adult resident of __________ County, Indiana. I currently have the capacity to make my own decisions about my health care.

If this Advance Directive does not specifically address a specific issue, then I intend that the rules and principles in I.C. 16-36-7 will apply and control, but in a manner consistent with my known wishes and preferences. If this Advance Directive is silent on an issue and if my wishes and preferences cannot be reliably determined, I intend that my Health Care Representative and health care providers act in a manner consistent with my best interests.

Effective Immediately

This Advance Directive and my Health Care Representative(s)' power and authority under it are effective immediately and will remain in effect even if I later become incapacitated, disabled, or incompetent.

My Health Care Representative(s)

I appoint the following person(s) as my Health Care Representative(s) in decreasing order of priority, but subject to the conditions stated in the next section ("My Continuing Right to Act and Decide Personally") below.

Priority	Name of Representative and Telephone Number(s)	Mailing Address and e-mail address (if any)
First		
Second		

At all times, my Health Care Representative who has the highest priority and who is reasonably available to act has the full authority to make and communicate health care decisions and give informed consent on my behalf, but subject to my right to act personally.

My Continuing Right to Act and Decide Personally

Although I have made this Advance Directive effective immediately upon signing, I have the right and the power to act personally to make my own health care decisions, to issue my own instructions and consents to health care providers. All health care providers must first communicate with me, unless a licensed health care provider who has treated or examined me has concluded in writing that I am not able to personally give informed consent to treatment or to make my own health care decisions. Until I have been determined to be incapacitated under the preceding sentence, I have the right to overrule, block or veto any health care decision that any Health Care Representative (named above) makes or attempts to make for me.

Decision-Making Standards for My Health Care Representative(s)

Whenever a Health Care Representative named above makes health care decisions or issues instructions or consents on my behalf, I expect my Health Care Representative to act in good faith and in my best interests, on the basis of what my Health Care Representative believes I would decide to do if I were capable of making decisions and giving consents myself and if I had all the pertinent information available to my Health Care Representative.

My Wishes and Preferences About Life-Prolonging Procedures [*illustrative sample only*]

If I am competent to give my own consents and instructions for my health care, my orally-stated instructions will always supersede and control over the instructions I have stated below.

I authorize my Health Care Representative to make decisions in my best interests concerning withdrawal or withholding of health care. If, at any time and based on my previously expressed preferences and the diagnosis and prognosis, my Health Care Representative is satisfied that certain health care is not or would not be beneficial to me or that such health care would be excessively burdensome, then my Health Care Representative may

express my will that any or all health care be discontinued or not instituted, even if death may result. My Health Care Representative must try to discuss this decision with me. However, if I am unable to communicate, my Health Care Representative may make such a decision for me, after consultation with my physician and other relevant health care givers. In his or her best judgment about what is appropriate, my Health Care Representative may (but is not required to) discuss any decision under this paragraph with members of my family who are available.

If my treating physician or other licensed health care provider has determined with reasonable certainty that I am terminally ill or in a persistent and irreversible coma:

- If I have no pulse and if am not breathing, do not attempt resuscitation (DNR).
- Maximize my comfort through symptom management and relieve my pain and suffering through available measures, including the administration of medication to me through any route.
- Do not provide artificial nutrition or hydration (tube feeding) to me, except for the provision of fluids to the extent necessary to deliver pain medication.
- Do not transfer me from my current location to a hospital for life-sustaining treatment unless my comfort needs cannot be satisfied in my current location.

Signature

You may direct another adult (who is not one of your named Health Care Representatives, and not the Notary Public or one of the witnesses) to make your signature for you in your presence. See IC § 16-36-7-19 for a definition and explanation of the "presence" requirement.

Your signature must be made in the "presence" of a Notary Public OR in the "presence" of two adult witnesses. Either the countersigning by two witnesses OR notarization is sufficient; both are not required. If you use two witnesses, at least one witness cannot be your spouse or another relative.

Please initial one space below to confirm the signing method used:

Signed on paper in direct presence of witnesses or notary public ____________	Signed electronically with 2-way audio-visual interaction with witnesses __________	Signed by Declarant and witnesses or notary in 2 or more paper counterparts ________	Signed by Declarant and two witnesses with telephonic interaction _________

Signed on this _______ day of ______________________ 20_____.

____
Signature of Declarant (signer)

____
Printed name of adult (if any) who signs for Declarant

____
Printed name of Declarant

Complete ONE of the two following blocks

Signatures of 2 Adult Witnesses

Each of the undersigned Witnesses confirms that he or she has received satisfactory proof of the identity of the Declarant and is satisfied that the Declarant is of sound mind and has the capacity to sign the above Advance Directive. **At least one of the undersigned Witnesses is not a spouse or other relative of the Declarant**.

____
Signature of Adult Witness 1

____
Printed Name of Adult Witness 1

____
Signature of Adult Witness 2

____
Printed Name of Adult Witness 2

Notarization

STATE OF INDIANA)
) SS:
COUNTY OF____________)

Before me, a Notary Public, personally appeared ______________________________ [*name of signing Declarant*], who acknowledged the execution of the foregoing Advance Directive as his or her voluntary act, and who, having been duly sworn, stated that any representations therein are true.

Witness my hand and Notarial Seal on this _____ day of ____________, 20____.

____
Signature of Notary Public

____
Notary's Printed Name (*if not on seal*)

____
Commission Number (*if not on seal*)

____
Commission Expires (*if not on seal*)

____
Notary's County of Residence

Jeff Dible provided the following "tracked changes" document to the ISDH, to illustrate how relatively easy it would be to adapt the existing State sample form for a HCRA into a sample form for the new-style advance directive under I.C. § 16-36-7-28.

INDIANA ~~HEALTH CARE REPRESENTATIVE APPOINTMENT~~ADVANCE DIRECTIVE FOR HEALTH CARE

State Form ~~[illegible]~~ __________ (~~[illegible]~~08-21)

Indiana State Department of Health – IC 16-36-~~4, IC 16-36-~~7

INSTRUCTIONS: See instructions ~~on back~~after Page 2.

Patient / ~~Appointor~~ Declarant Information		
~~Patient~~ Declarant Last Name	~~Patient~~ Declarant First Name	~~Patient~~ Declarant Middle Initial
~~Patient~~ Declarant Birthday *(mm/dd/yyyy)*	Medical Record Number of Healthcare Facility or Provider *(optional)*	Healthcare Facility or Provider *(optional)*
Appointment of Health Care Representative		
I, being at least eighteen (18) years of age, of sound mind, and capable of consenting to my health care, hereby appoint the person(s) named below as my lawful health care representative in all matters affecting my health care, including but not limited to providing consent or refusing to provide consent to medical care, surgery, and/or placement in health care facilities, including extended care facilities, unless otherwise provided in this ~~appointment~~advance directive. This ~~appointment shall become effective at such time~~advance directive is effective immediately unless I have stated a delayed effective date or other triggering condition below. ~~and from time to time as my attending physician determines that I am incapable of consenting to my health care~~. I understand that if I have previously named a health care representative, the designation below supersedes (replaces) any prior named Health Care Representative(s) in a health care power of attorney or other document. I authorize my health care representative to make decisions in my best interest concerning withdrawal or withholding of health care if I am not capable of personally giving my own consents and instructions. If at any time based on my previously expressed preferences and the diagnosis and prognosis my health care representative is satisfied that certain health care is not or would not be beneficial or that such health care is or would be excessively burdensome, then my health care representative may express my will that such health care be withheld or withdrawn and may consent on my behalf that any or all health care be discontinued or not instituted, even if death may result. My health care representative must try to discuss this decision with me. However, if I am unable to communicate, my health care representative may make such a decision for me, after consultation with my physician or physicians and other relevant health care givers. To the extent appropriate, my health care representative may also discuss this decision with my family and others to the extent they are available. I specify the following additional terms, ~~and~~ conditions, wishes, and treatment preferences *(if any)*:		
Name of Representative Appointed	Address of Representative *(number and street, city, state, and ZIP code)*	Telephone Number of Representative
Signature of Patient / ~~Appointor~~ Declarant or Designee *(must be signed in the appointor's presence)*	Printed Name of Patient / ~~Appointor~~ Declarant or Designee	~~Date of Appointment~~Date signed *(mm/dd/yyyy)*

<table>
<tr><td>Signature of Witness # 1</td><td>Printed Name of Witness # 1</td><td>Date (mm/dd/yyyy)</td></tr>
<tr><td>Signature of Witness # 2</td><td>Printed Name of Witness # 2</td><td>Date (mm/dd/yyyy)</td></tr>
<tr><td colspan="3">Instead of signing in the "presence" of two witnesses (see Instructions), the Declarant (Patient) may sign this document in the "presence" of a Notary Public.</td></tr>
<tr><td>STATE OF INDIANA)
) ss:
COUNTY OF)</td><td colspan="2">Before me, a Notary Public, personally appeared the Declarant, ____________, who acknowledged his or her execution of the foregoing Advance Directive as his or her voluntary act, and who, having been duly sworn, stated that any representations therein are true.

Witness my hand and Notarial Seal on ____________, 20____.</td></tr>
<tr><td>

____
Signature of Notary Public</td><td>

____
Printed Name of Notary Public</td><td>Commission No. ____________

Commission Expires: ____________

Resident of ____________ County</td></tr>
<tr><td>PLACE NOTARY SEAL HERE

</td><td></td><td></td></tr>
</table>

INSTRUCTIONS FOR STATE FORM ~~56184~~ ____________, INDIANA ADVANCE DIRECTIVE FOR HEALTH CARE ~~REPRESENTATIVE APPOINTMENT~~

1. There are numerous types of advance directives. The Indiana State Department of Health encourages individuals to consult with their attorney, health planner, and health care providers in completing any advance directive.

2. This state form is not required for an appointment of a health care representative. An individual may use a form designed by their attorney or other entity to specifically meet the individual's needs. To be valid, any form must comply with statutory requirements.

3. An individual is not required to complete ~~a health care representative appointment form~~an advance directive. An individual may always chose to not appoint a health care representative. If there is no appointed representative, state medical consent laws would determine who may consent to your healthcare.

4. The medical record number and health care facility or provider is not required for the appointment to be effective. It may be included as a means of assisting the health care provider in identifying the correct patient and locating the ~~appointment~~ advance directive in the correct medical record.

5. In this advance directive, ~~T~~the patient ~~/ appointor~~(declarant) may specify ~~in the appointment appropriate~~additional appropriate terms and conditions, including but not limited to the appointment of additional or alternate health care representative(s) and/or statements of additional wishes, instructions, or treatment preferences. ~~an authorization to the representative to delegate the authority to consent to another~~.

6. ~~The authority granted becomes effective according to the terms of the appointment.~~So long as the patient (declarant) has the ability (capacity) to give his or her own instructions and consents to health care, the patient (declarant) always has the power to give instructions that reverse or overrule any consents or instructions given by the health care representative, and to state new treatment preferences and wishes to replace what is stated in the advance directive.

7. ~~The appointment does not commence until the appointor becomes incapable of consenting~~This advance directive form is worded so that the authority of the named health care representative(s) is effective immediately upon signing. The patient (declarant) may add wording so that the authority of the named representative is effective after a stated date or after the patient (declarant) has been determined to be incapable of consenting to health care . ~~The authority granted in the appointment is not effective if the patient / appointor regains the capacity to consent~~.

8. Unless the advance directive ~~appointment~~ provides otherwise, a representative appointed under this section who is reasonably available and willing to act has priority to act in all matters of health care for the patient (~~/ appointor~~declarant), except when the patient ~~/ appointor~~(declarant) is capable of consenting and chooses to issue his or her own health care decisions and instructions.

9. The ~~appointment of a health care representative~~advance directive must be ~~witnessed by an adult other than the health care representative~~signed by the declarant (patient) or by some adult other than a named representative who signs in the declarant's presence. In addition, the Advance Directive must be completed with EITHER the signatures of two (2) adult witnesses OR the certificate of a Notary Public who observes the signing of the advance directive. .

   a. A health care representative named in the advance directive OR a person who signs the advance directive for the declarant cannot sign as either of the two witnesses.

   ~~a.~~b. The advance directive can be signed and witnessed or signed and notarized on paper or electronically, using a number of permitted methods. *See* IC 16-36-7-28 or consult an attorney if the declarant does not wish to sign or cannot sign in the direct physical presence of the witnesses or the Notary Public.

10. In making all decisions regarding the patient's / appointor's health care, the health care representative shall act:
    a. In the best interest of the patient / appointor consistent with the purpose expressed in the ~~appointment~~advance directive.
    b. In good faith.

11. A health care representative who resigns or is unwilling to comply with the ~~written appointment~~written terms of the advance directive may not exercise further power under the ~~appointment~~ advance directive and shall so inform the following:
    c. The ~~patient / appointor~~patient (declarant).
    d. The patient's ~~/ appointor's~~(declarant's) legal representative if one is known.
    e. The health care provider if the representative knows there is one.

12. An individual who is capable of consenting to health care may revoke:
    a. The advance directive ~~appointment~~ at any time by notifying the representative ~~orally or~~ in writing;
    ~~a.~~b. The advance directive by signing a later advance directive that does not explicitly say that the prior document remains in effect; or
    c. The authority granted to the representative by notifying the health care provider ~~orally or~~ in writing.

    Without revoking the advance directive or the authority of a named health care representative, an individual who is capable of consenting may make a health care decision or instruction that overrules a decision or instruction by the representative.

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4/30/2021 5:15 pm

ICLEF 48th Annual Midwest Estate, Tax & Business Planning Institute

Available and Flexible Methods for Signing, Witnessing, or Notarizing Indiana Wills, POAs and Health Care Advance Directives

(under 2021 Legislation)

Jeffrey S. Dible

June 4, 2021

jdible@fbtlaw.com

Sources of Rules and Signing Procedures in 2021 Legislation

- For Wills, inter vivos trusts and POAs: House Enrolled Act 1255 (P.L. 185-2001), signed and effective April 29, 2021
- For Advance Directives for health care:
  - Senate Enrolled Act 204 (P.L. 50-2021), effective July 1, 2021
  - A single-line error in SEA 204 as enacted was corrected in section 8 of HEA 1436 (conference committee report), signed by the Governor on April 29, 2021

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Suggested Sample Forms in the 61-page Paper

- Page 17 (p. 19 of PDF): signature block and self-proving affidavit for a Will signed on paper *WITH* remote witnessing but *WITHOUT* signing in counterparts
- Page 19 (p. 21 of PDF): signature block and self-proving affidavit for a Will signed on paper *in counterparts and with remote witnessing*
- Page 20 (p. 22 of PDF): sample affidavit of compliance under I.C. § 29-1-5-3(d) to be signed by supervising lawyer or paralegal for a Will signed on paper in counterparts and with remote witnessing

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Suggested Sample Forms in the 61-page Paper (continued)

- Page 28 (p. 30 of PDF): signature block and self-proving affidavit for a Will signed electronically *WITH* remote witnessing
- Pages 29-31 (pp. 31-33 of PDF): sample affidavit of compliance under I.C. § 29-1-21-4(c) to be signed by supervising lawyer or paralegal for an ***electronic Will*** signed *WITH* remote witnessing
- **Appendix 2,** starting on page 49 (p. 51 of PDF): Jeff Dible's "longer" sample form of new Advance Directive for health care to illustrate some of the drafting choices and the signature format; *usable on or after July 1, 2021*

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Suggested Sample Forms in the 61-page Paper (continued)

- Starting on page 53 (p. 55 of PDF) in **Appendix 2**: Jeff Dible's "shortest" sample form of new Advance Directive for health care, containing fewer choices and optional provisions than the "longer" form; *usable on or after July 1, 2021*
- **Appendix 3** starting on page 57 (p. 59 of PDF): a definitely unofficial illustration (redline format) of how the State Health Department's current sample form for "Indiana Health Care Representative Appointment" (SF 56184) could be transformed into a sample form of the new Advance Directive for health care under IC 16-36-7

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Applicable "coverage" dates for paper or electronic Wills signed in reliance on the Supreme Court's emergency order(s)

- Emergency order issued on 3-31-2020 in Case No. 20S-MS-237 was extended several times and permits "remote witnessing" of Wills for a period expiring on July 1, 2021
- Most recent extension of "remote witnessing" under the MS-237 order was in 11-10-2020 order in Case No. 20S-CB-123; July 1, 2021 expiration date remains unchanged
- The Supreme Court's orders required the testator to "re-execute" or "re-ratify" the Will using regular direct-presence witnessing procedures within 90 days after the public health emergency expires

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Applicable "coverage" dates for paper or electronic Wills signed in reliance on the Supreme Court's emergency order(s)

- For Wills signed on paper or electronically with remote witnessing between 3-31-2020 and 12-31-2020 inclusive, testator need not "re-execute" or "re-ratify" the Will with "direct presence" witnessing ***IF*** –
  - The Will was signed in compliance with the Supreme Court order in MS-237, ***OR***
  - The Will was signed in compliance with the procedures added or amended in HEA 1255
- *See* new I.C. § 29-1-5-3.3 (for Wills signed on paper) and new I.C. § 29-1-21-1-4.1 (for electronic wills)

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Applicable "coverage" dates for paper or electronic Wills signed in reliance on the Supreme Court's emergency order(s)

- If a Will was signed electronically or on paper ***after*** 12-31-2020 and *before* 4-29-2021 with remote witnessing in reliance on the MS-237 order:
  - The testator cannot rely on the retroactive saving provisions added by HEA 1255, because those only apply to Wills signed *before* January 1, 2021
  - The testator should "re-execute" or "re-ratify" the Will using regular "direct presence" witnessing
- If the testator is alive and has capacity on or after April 29, 2021 (the effective date of HEA 1255), it may be easier to sign a new or updated Will using any permissible witnessing method under HEA 1255

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

See the table on pp. 1-3 of the 61-page paper

(1) A summary of signing methods available for Indiana Wills in various fact situations

	Fact Pattern for (and Constraints on) the Testator (T)	Suggested and Available Signing Method(s)	Applicable Statute(s)	Details of Signing & Witnessing Requirements
A	T *can* meet in person in same space with 2 witnesses and *can* sign the Will on paper	Traditional signing meeting with T and witnesses in same physical space	I.C. §§ 29-1-5-3 and 29-1-5-3.1	No new requirements under I.C. § 29-1-5-3 and 29-1-5-3.1 as amended by HEA 1255
B	T *can* meet in person in same space with 2 witnesses but *cannot* hold a pen to sign on paper	• T directs some third person to sign T's name on paper Will in direct presence of T and the witnesses • T and witnesses use digital technology to electronically sign the Will in each other's direct presence	I.C. § 29-1-5-3(b)(1)(A) [*paper Will*] I.C. § 29-1-21-4(a)(4)(B) [*electronic Will*]	• Under unchanged Indiana law, the person who signs at T's direction cannot be one of the witnesses and must sign in T's direct presence • A testator who cannot hold a pen and sign may be able to tap a screen or click a mouse to add his or her digital or electronic signature to the electronic record for the Will

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

- The new statutory rules for “remote witnessing” and “signing in counterparts” rely on new, broader definitions of “presence,” “in the presence of,” and “observe”
  - *See* I.C. § 29-1-1-3(a)(15), (16), and (26) for Wills signed on paper
  - *See* I.C. § 29-1-21-3(14), (16) and (17) for electronic wills
- “Presence,” as defined, includes ***both*** “direct presence” (traditional) interaction between testator and witnesses in the same physical space ***AND*** the use of technology to maintain 2-way, real-time, line-of-sight interaction between testator and witnesses

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

- Five (5) permitted patterns or methods for valid interaction between the testator and the witnesses, depending on –
  - o Whether the Will is going to be signed on paper or electronically
  - o Whether the testator is physically unable (lockdown, home quarantine, etc.) to interact with the witnesses directly and in the same space
  - o What kinds of technologies the testator has access to and is able to use
- Most testators will be able to use more than one method to sign their Wills and interact with witnesses

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

- Signing Pattern or Method **A** (from the table on p. 1)
  - Testator interacts directly with the witnesses in the same physical space and the Will is signed and witnessed on paper, with testator signing
  - Relies on traditional "direct presence"
  - No change in the rules or procedures under I.C. § § 29-1-5-3 and -3.1
  - Requires less billable time by the lawyer and/or paralegal to prepare for the signing method
  - If properly supervised, arguably more "secure" in guarding against undue influence and in allowing the witnesses to assess testator's capacity

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

- Signing Pattern or Method **B** (from the table on p. 1)
  - Testator interacts directly with the witnesses in the same physical space and the Will is signed and witnessed on paper or electronically, but testator directs someone to sign testator's name in his or her direct presence
  - Method B does not rely on remote witnessing
  - No change in the rules or procedures under I.C. § § 29-1-5-3(b)(1)(A) [paper] or 29-1-21-4(a)(4)(B) [electronic]
  - As under pre-2021 law, the person who signs for testator at testator's direction cannot be one of the witnesses

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

- Signing Pattern or Method **C** (from the table on p. 2)
  - Testator is physically isolated from the witnesses but can maintain line-of-sight interaction with them (through a window or using A-V technology) ***AND*** the paper original of the Will can be "shuttled" or transported between the room where the testator signs and the nearby space(s) where the witnesses sign
  - Method C relies on the expanded definitions of "presence" and "observe" in I.C. § 29-1-1-3(a)
  - The signing and witnessing procedure satisfies the [unchanged] wording of I.C. § 29-1-5-3(b)

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

- Signing Pattern or Method **D** (from the table on p. 2)
  - The witnesses are physically separated from the testator by significant distance ***OR*** it is not possible to "shuttle" or transport the single paper original from the testator's location to the separate location(s) where the witnesses are
  - The testator and witnesses are able to use technology to satisfy the "presence" requirement and to sign the Will electronically
  - Method D relies on electronic signing and remote witnessing under I.C. § 29-1-21-4(b) thru (d)
  - An attorney or "directed paralegal" must supervise the signing (explained in later slides)

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

- Signing Pattern or Method **E** (from the table on p. 3)
  - The witnesses are physically separated from the testator by significant distance ***OR*** it is not possible to "shuttle" or transport the single paper original from the testator's location to the separate location(s) where the witnesses are
  - The testator and/or witnesses are limited to signing the Will on paper because of lack of access to or inability to use electronic signing
  - The testator and witnesses sign identical paper counterparts of the Will on paper
  - An attorney or "directed paralegal" must supervise the signing (explained in later slides)

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

- Signing Pattern or Method **E** (signing in counterparts on paper – *continued*)
  - Signing in counterparts is described in subsections (c) through (e) of I.C. § 29-1-5-3
  - The self-proving clause or affidavit has more content, under I.C. § 29-1-5-3.1(e)
  - I.C. § 29-1-5-3(c) requires the testator or someone else to assemble the separately signed counterparts of the Will into a combined document containing all signatures, within 5 business days after receiving all separately signed counterparts
  - The supervising attorney or directed paralegal must sign an affidavit of compliance

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

A detour: When and why HEA 1255 requires a licensed lawyer or a “directed paralegal” to supervise the signing of a Will

- A few members of the Indiana Senate Judiciary Committee objected to allowing remote witnessing (for paper or electronic Wills) or signing in counterparts (for paper Wills) because of the increased risk of impersonation, fraudulent signing or alteration, or signing as a result of undue influence or duress
- The compromise solution (which allowed House Bill 1255 to receive Senate approval) was to require a licensed lawyer or a “directed paralegal” to supervise the signing when Method D or Method E (below) is used

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

Detour (continued): When and why HEA 1255 requires a licensed lawyer or a "directed paralegal" to supervise the signing of a Will

- **Policy idea**: Having a lawyer or paralegal supervise the signing will reduce the likelihood of defective execution, fraud, or lack of capacity when remote witnessing or signing in counterparts is used
- Indiana Code does not sufficiently define "paralegal"
- Potential problem of untrained non-lawyers hanging out shingles, claiming to be "paralegals," and offering to supervise the signing and witnessing of Wills
- Definitions of "directed paralegal" added in I.C. § § 29-1-1-3(a)(9) and 29-1-21-3(5)

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

Detour (continued): When and why HEA 1255 requires a licensed lawyer or a "directed paralegal" to supervise the signing of a Will

- The lawyer or paralegal who supervises the signing of a Will with remote witnessing and/or signing in counterparts must sign an "affidavit of compliance"
- The required content of the affidavit of compliance is similar but not identical for paper Wills (§ 29-1-5-3(d)) and for electronic Wills (§ 29-1-21-4(c))
- The affidavit of compliance must be filed with the petition to probate the Will ***OR*** in response to an order by the probate court (§ § 29-1-5-3(e) or 29-1-21-4(d))

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

Detour (continued): When and why HEA 1255 requires a licensed lawyer or a “directed paralegal” to supervise the signing of a Will

- When remote witnessing or signing in counterparts is used in the signing of a Will, requiring that a licensed lawyer or paralegal supervise the signing does not mean that such supervision will occur (DIY Wills using on-line forms or document assembly software, etc.)
- Therefore, the non-existence of an “affidavit of compliance” is not jurisdictional, and if a licensed lawyer or directed paralegal did not supervise the signing, the Will is ***voidable*** but not void; *see* I.C. § § 29-1-5-3(e) and 29-1-21-4(d)

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

Detour (continued): If a Will is signed with remote witnessing or signing in counterparts ***without*** the supervision of a licensed lawyer or paralegal and if that Will is offered for probate, what is the significance of that Will being ***voidable***?

- The probate court can declare that Will to be void in the court's discretion
- The Will becomes void upon the filing of an objection to probate under § 29-1-7-16 or upon the timely filing of a will contest under § 29-1-7-17
- Conversely, if no interested person files or has an incentive to object to the Will, it can be probated despite the lack of supervised execution

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Permissible Signing Methods for Wills Under House Enrolled Act 1255

Some caveats about using the now-available methods for signing Wills using remote witnessing and/or signing in counterparts

- If a client is physically and logistically able to sign using traditional "direct presence" witnessing, will that client agree to pay for the additional professional time required to arrange for signing with other methods and to comply with additional requirements?
- If 2-way, real-time A-V technology will be used to satisfy the "presence" requirement:
  - What will the camera(s) show and not show at the testator's and each witness's location?
  - To record or not to record each signing?

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House Enrolled Act 1255 has no effect on our cross-border "borrowing" statutes

- An Indiana resident testator who wants to take advantage of more liberal "remote witnessing" rules under some other state statute (*e.g.,* Nevada) will not be able to sign an electronic will while physically located in Indiana and avoid the specific Indiana requirements for remote witnessing and signing in counterparts
  - The borrowing statute (§ 29-1-5-5) for traditional Wills remains unchanged (as amended in 2018)
  - The borrowing statute (§ 29-1-21-7) for electronic wills remains unchanged (as added in 2018)
  - Must comply with the law of the State where the testator is physically located at time of signing

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Slight change in signing requirements for an inter vivos trust under House Enrolled Act 1255

- SEA 50 in 2020 modified the Trust Code to allow the settlor of an inter vivos trust to *direct some other person* to sign the settlor's name on the trust instrument in the settlor's direct physical presence
  - Analogous to what has been allowed for decades with Wills and durable powers of attorney
  - Perceived problem: As amended in 2020, the Trust Code would allow an unscrupulous "friend" or family member to fraudulently sign a trust instrument purportedly "at the direction" of the settlor and to name himself or herself as a significant beneficiary

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Slight change in signing requirements for an inter vivos trust under House Enrolled Act 1255

- The solution included in HEA 1255 is to restrict the class of individuals who are authorized to sign the settlor's name at the settlor's direction
- I.C. § 30-4-2-1(b) [*for trusts signed on paper*] and § 30-4-1.5-4(b) [*for electronic trust instruments*] make the following persons ***ineligible*** to sign for the settlor:
  - A trustee named in the trust instrument
  - A person who would receive a beneficial interest or a power of appointment under the trust's terms
  - A relative of the settlor
- Recite in the trust instrument that the person signing is not any of the 3 types of ineligible person

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Signing Durable POAs with 2 witnesses under House Enrolled Act 1255

- At the height of the pandemic (and for some Hoosiers, continuing even now), lockdown or social distancing rules made it extremely difficult or impossible for some competent individuals to interact directly and in person with a notary to execute a durable POA
- The number of Indiana notaries who hold "remote notary public commissions" and who can perform remote online notarizations is still fairly small
- The solution (the brainchild of subcommittee member Jeff R. Hawkins) was to amend the durable POA statute to allow a valid durable POA to be signed with the signatures of 2 disinterested adult witnesses ***instead of*** notarization of the principal's signature

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Signing Durable POAs with 2 witnesses under House Enrolled Act 1255

Sections 21 through 31 in HEA 1255 amend four sections in the current POA statute and add several sections to IC 30-5 which will apply to both traditional POAs signed on paper ***and*** electronic POAs

- Generally effective on and after 3-31-***2020***
- Adopt substantially the same definitions of “presence” and “observe” that apply to Wills
- Define the persons who are ineligible to be subscribing witnesses
- Ineligible persons (who cannot witness the POA) include a named attorney in fact, a person receiving some other power under the POA, and a relative (spouse or descendant) of any such person

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Signing Durable POAs with 2 witnesses under House Enrolled Act 1255

(*continued*) Under the rules for paper and electronic POAs that are signed with 2 witnesses instead of a notarized acknowledgement of the principal's signature:

- The new sections added by HEA 1255 permit signing in counterparts (with remote witnessing) only if an attorney or directed paralegal supervises and signs an affidavit of compliance
- The same new definition of "directed paralegal" is borrowed from IC 29-1 and added to the POA statute
- For POAs signed on paper or electronically with witnesses instead of notarization, see the optional self-proving clauses in I.C. § § 30-5-4-1.7 and 30-5-11-5-4.7

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Retroactive validation of some electronically-signed POAs under House Enrolled Act 1255

- We ***now*** know that the Supreme Court's emergency order in Case No. 20S-MS-236 did *NOT* validate the use of "remote electronic notarization" for the signing of POAs unless the notary had a remote notary commission. HEA 1255 added new § 30-5-11-4.1:
  - Applies to POAs electronically notarized on or after 3-31-2020 and before 1-01-2022 if all ***other*** statutory requirements (for valid POAs) as of 6-30-2020 were satisfied
  - Such an electronically signed and notarized POA is valid if A-V technology was used "to positively identify the principal or someone signing at the principal's direction"

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Senate Enrolled Act 204 (P.L. 50-2021)

(Overhaul of health care advance directive statutes)

- Effective July 1, 2021
- Creates one form of new-style advance directive for health care that replaces these 3 existing documents:
  - Durable POA containing health care powers
  - Appointment of Health Care Representative (HCRA) under I.C. § 16-36-1-7
  - Living Will declaration under IC 16-36-4
- The new-style advance directive can be signed and used anytime on or after July 1, 2021
- During an 18-month transition period ending 12-31-2022, the 3 documents under existing law (listed above) can continue to be used or newly signed

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Senate Enrolled Act 204

(Overhaul of health care advance directive statutes)

- During the transition period ending on 12-31-2022, if an individual signs both a new-style advance directive and any of the "old" documents under existing law, the document that is signed last will control
- After 12-31-2022, any competent individual can leave existing advance directives (old or new) in place, but any new advance directive signed after 12-31-2022 will have to comply with the new statute (I.C. § 16-36-7-28)
- After 12-31-2022, Hoosiers can still sign broad or narrow durable POAs for general purposes, but any health care powers and provisions in a durable POA signed in 2023 or later will be void

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Senate Enrolled Act 204

(Overhaul of health care advance directive statutes)

- The rules and requirements for the new-style advance directive are all in new chapter 7 in IC 16-36
- New IC 16-36-7:
  - Preserves for Hoosiers and for their lawyers and advisors the same “design and drafting” flexibility that they have under the current POA statute
  - Reorganizes and clarifies existing legal rules that are currently difficult to find (in titles 16 and 30) or which frequently conflict or are vague
  - Collects all options, default rules and presumptions into three sections in new chapter 7
  - Codifies best practices by clinicians and attorneys

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Senate Enrolled Act 204

(Overhaul of health care advance directive statutes)

The new-style advance directive under I.C. § 16-36-7-28:

- Can include the appointment of 1 or more health care representatives (HCRs) ***and*** specific orders or instructions ***and*** wishes and treatment preferences for end-of-life care, custodial care, and/or palliative care
- Can be signed on paper or electronically, with or without remote witnessing
- Uses definitions of "presence" and "observe" that are substantially similar to HEA 1255's definitions
- Must be signed ***either*** with a notarized acknowledgement ***or*** the signatures of 2 witnesses

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Senate Enrolled Act 204

Appendix 1 to the paper contains a quick reference guide

Quick Reference Guide to the Indiana Advance Directive for Health Care (2021)

Source: Indiana Code, Title 16, Article 36, Chapter 7 (Part of Public Law 50-2021)

Basic elements of the new Indiana advance directive (AD)

(1) → No official or mandatory form for the AD

(2) → Basic permitted and typical contents:

- (a)→Name 1 or more health care representatives (HCRs)
- (b)→State specific health care decisions and/or treatment preferences, including preferences for life-prolonging procedures or palliative care [*The statute contains no limitations on the expression of treatment preferences*]
- (c)→[*Optional*] Disqualify named individual(s) from receiving delegated authority or serving as a HCR

(3) → Signing requirements:

- (a)→Declarant (patient or signer) signs on paper or electronically *OR* directs some adult (not a health care representative and not a witness) to sign declarant's name in declarant's direct presence
- (b)→Declarant signs in the "presence" of 2 adult witnesses *OR* signs in the "presence" of a notary public or other notarial officer [*see back page for ways to satisfy "presence" requirement*]
- (c)→The 2 witnesses *OR* the notarial officer also sign the AD electronically or on paper

Basic presumptions and rules IF the advance directive (AD) does NOT explicitly say otherwise:

A.→The AD and the authority of each named HCR is effective upon signing and remains in effect until the AD is revoked in writing (Oral revocation possible only in the direct presence of a health care provider)

B.→A later-signed AD supersedes and revokes an earlier-signed AD by the same Declarant

C.→Unless HCRs are listed in order of priority (primary & backup, etc.), 2 or more HCRs named in the same AD have concurrent, equal, and independently exercisable authority and are not required to act jointly

D.→If Declarant still has capacity to consent to health care, orders and instructions by Declarant will control over any decisions by a HCR and any specific instructions stated in in the AD

E.→Any health care representative (HCR) can delegate authority under the AD in writing to any competent adult(s) or other persons (a delegation should be signed in the same manner as an AD)

F.→The HCR has authority to compete anatomical gifts, to authorize an autopsy, and to arrange for burial or cremation of the Declarant's remains after Declarant's death

G.→The HCR can access Declarant's medical records & health information under HIPAA and state law

H.→The HCR has authority to consent to mental health treatment for the Declarant

I.→Each HCR has authority to sign a POST / POLST or an out-of-hospital DNR declaration for Declarant if Declarant is found to be a qualified [eligible] person

J.→The HCR has authority to apply for public benefits (including Medicaid and CHOICE) for Declarant and to access Declarant's financial and asset records for that purpose

K.→Each HCR is entitled to collect reasonable compensation and expense reimbursement for actions taken and services performed for or on behalf of Declarant

Standard of conduct for each health care representative:

- Defer to Declarant's personal decisions and judgment at all times when Declarant has capacity to consent to health care and is able to communicate instructions, wishes, and treatment preferences
- Take into account Declarant's explicit or implied intentions and preferences and make only the health care decisions that Declarant would have made
- Act in good faith and in Declarant's best interests if Declarant's specific preferences are not known
- Remain reasonably available to consult with Declarant's health care providers and to provide informed consent for Declarant if Declarant does not have capacity

Optional provisions that CAN be included in an advance directive (AD) [*see I.C. §§16-36-7-28 and 16-36-7-34; not a complete list*]

1.→State a delayed effective date or triggering event (e.g., future incapacity) and/or a specific ending date for the AD or for any HCR's authority	6.→Require multiple HCRs to act jointly or on a majority vote basis to exercise some or all health care powers
2.→Keep an earlier-signed AD or an earlier-appointed HCR's authority in effect after a new AD is signed	7.→Prohibit an HCR from collecting compensation or state an hourly rate or other standard for determining HCR's reasonable compensation
3.→Prohibit or restrict the delegation of authority by the HCR to other specific persons	8.→Designate some person other than a HCR to serve as an advocate or monitor
4.→Require another person to witness or approve a revocation of or amendment to the AD	9.→Authorize any person (proxy) who is listed in I.C. §16-36-7-42 and -43 to make a written demand that any HCR provide a written accounting or report of the HCR's actions on behalf of Declarant
5.→Name 2 or more HCRs in a stated order of priority or confirm that they are authorized to act alone and independently	

Methods for signing that satisfy the "presence" requirement between Declarant and the 2 witnesses or between the Declarant and the notarial officer [*see I.C. §§ 16-36-7-19 and -23*]

In-Person Options		Remote Options		
Declarant and 2 witnesses or Declarant and the notarial officer sign on paper in direct physical presence of each other	Declarant and 2 witnesses or Declarant and the notarial officer sign electronically in direct physical presence of each other	Sign identical counterparts on paper; Declarant & witnesses or notary interact using 2-way audiovisual technology; assemble signed counterparts within 10 business days	Declarant and 2 witnesses or Declarant and notary sign electronically while interacting using 2-way audiovisual technology	Declarant and 2 witnesses sign with audio-only interaction by telephone during signing [*Witnesses must be able to positively identify Declarant & confirm capacity*]

NOTE: An Indiana notary public must comply with Indiana law and regulations, including regulations for "remote notarial acts," if Declarant and notary interact at a distance using audiovisual technology.

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Senate Enrolled Act 204

(Overhaul of health care advance directive statutes)

- Signing on paper in counterparts is permitted under I.C. § 16-36-7-28(d), so long as someone assembles the separately signed counterparts into a composite document containing all signatures, within 10 business days after that person receives all of the counterparts
- If a new-style advance directive is signed by the declarant with the signatures of 2 adult witnesses instead of notarization:
  - At least 1 of the adult witnesses cannot be the spouse or another relative of the declarant
  - The witnesses can interact with the declarant in person, through a glass window, or using any kind of 2-way, real time audiovisual technology

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Senate Enrolled Act 204

(Overhaul of health care advance directive statutes)

- If a new-style advance directive is signed by the declarant (signer) with a notarized acknowledgement, "remote notarization" can be used so long as the declarant and notarial officer comply with the rules and procedures in IC 33-42-17 for remote notarial acts
- If a competent declarant wants to sign a new-style advance directive, is physically isolated, cannot interact in person with a notary or witnesses, and does not have access to or cannot use A-V technology for electronic signing with remote witnessing, I.C. § 16-36-7-28(e) through (g) allow the declarant and the witnesses to accomplish the signing through "telephonic [audio only] interaction"

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Senate Enrolled Act 204

(Overhaul of health care advance directive statutes)

- In clinical practice (in hospitals, nursing facilities), there is long and fairly rich history of using just the telephone to have competent patients interact with health care providers and witnesses ***AND*** to document informed consent, etc.
- If "telephonic [audio only] interaction" is used (as a last resort) to accomplish the signing and witnessing of a new-style advance directive:
  - No person can be compelled to act as a witness
  - Each witness needs to feel satisfied that the declarant has been positively identified *AND* is of sound mind and is capable of consenting to health care

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Senate Enrolled Act 204

(Overhaul of health care advance directive statutes)

The Indiana State Dept. of Health (ISDH) is required to update its "advance directive resources" web page to include links to other organizations that do or will offer info and sample forms consistent with SEA 204

- ISDH was unwilling to commit to publish a sample form of advance directive (*see* **Appendix 3**)
- There will be no officially prescribed form, because having a required statutory form inhibits innovation
- Hospital chains, patient advocacy organizations, bar associations, etc. have 18 months to develop and roll out their own suggested forms
- *See* two of J. Dible's sample forms in **Appendix 2**

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Senate Enrolled Act 204

(Overhaul of health care advance directive statutes)

Suggested strategies for drafting your own “new style” advance directive form(s):

- Find the copyright-protected “Five Wishes” form (which will comply with I.C. § 16-3-7-28 as a stand-alone advance directive) and “borrow” some ideas
- Start with your own favorite health care POA form, change the heading, change “principal” to “declarant,” change “Agent” to “health care representative,” and modify the execution block
- Look at Jeff Dible’s longer and shorter sample forms in **Appendix 2**, study I.C. § § 16-36-7-29, -34, and -36, and determine what optional provisions to include in your own advance directive form(s)

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Thank you for your kind attention.

See the main paper (61 pages) for further details and for sample form provisions. For Word versions of Jeff Dible's sample forms for new-style advance directives or for a copy of the 2-page quick-reference sheet, send an e-mail request.

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Section Ten

What the Cool Kids are Doing in Estate Planning

Professor Samuel A. Donaldson
Georgia State University, College of Law
Atlanta, Georgia

Section Ten

What the Cool Kids are Doing
in Estate Planning…………………….… Professor Samuel A. Donaldson

PowerPoint Presentation

What the Cool Kids Are Doing in Estate Planning

Samuel A. Donaldson
Georgia State University College of Law
Atlanta, Georgia

What's Changed and Changing?

- Global pandemic and economy
  - Asset values recovering
  - Low interest rates (but rising)
  - Health issues
- More legislation?
  - Timing
  - Need for tax revenues
  - Reduced exclusions?

Our Agenda

- Taking advantage of the current climate (making **lemonade** from lemons)
- Using up exclusion with **leveraged wealth transfers**
- Creating "**non-grantor trusts**" to defer or avoid state income tax
- Using **charitable remainder trusts** as IRA and retirement plan beneficiaries
- Maximizing the **step-up in basis** for income tax purposes
- Ultra-long-term GRATs (**99-year GRATs**)
- Spousal Lifetime Access Trusts (**SLATs**)

Making Lemonade out of Lemons

- Harvesting capital gains
- Roth IRA conversions
- Leveraged wealth transfers

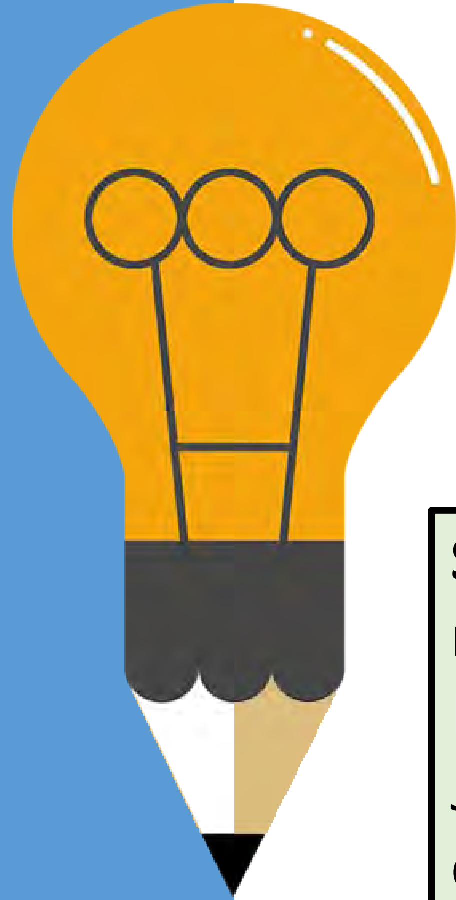
Gifts in Anticipation of a Reduced Exclusion

Some Great Techniques in the Current Climate

- Installment **Sales to Defective Trusts**
- Charitable Lead Annuity Trusts (**CLATs**)

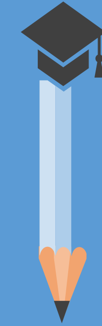
Issues to Consider

- **Disclaimer** if exclusion stays steady or value declines
- Give third party a power to confer a **general power of appointment** to the grantor
- **Give value**, not property!



Gift of "a limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS ($2,096,000.00) as of December 31, 2008 ***, as determined by a qualified appraisal within ninety (90) days of … this Assignment"

Sale of "a limited partner interest having a fair market value of TWENTY MILLION AND NO/100THS DOLLARS ($20,000,000.00) as of January 2, 2009 ***, as determined by a qualified appraisal within one hundred eighty (180) days of … this Assignment"

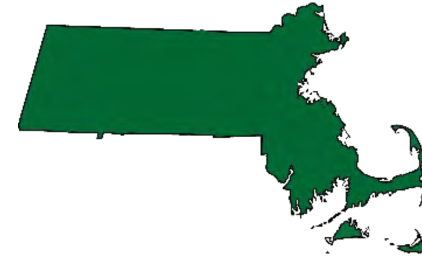


Nelson v. Comm'r, T.C. Memo. 2020-81 (June 10, 2020)

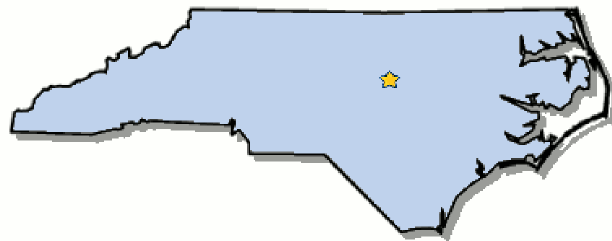
Non-grantor Trusts to Save on State Income Tax

Grantor

Trustee

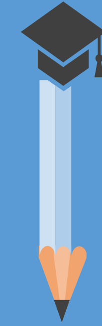


Assets



Beneficiary

NONGRANTOR TRUST
with undistributed income



North Carolina Dept. of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust

Non-grantor Trusts to Save on State Income Tax

- Create a non-grantor trust administered in a state without income tax
  - Local trustee
  - Spendthrift clause
  - Beneficiary has no say in trustee removal or replacement
- Transfer income-producing assets to the trust as "incomplete gift" (often by keeping a power to appoint by will)
  - Trustee pays federal income tax
  - No current state income tax
- No state income tax until distribution made to in-state beneficiary!
- Stepped up basis at grantor's death!

Charitable Remainder Trusts for Retirement Plans

Replaces life expectancy pay-out with **10-year payout** for all BUT "*eligible designated beneficiaries*"

(1) Surviving spouse
(2) Participant's minor child
(3) Disabled beneficiary
(4) Chronically ill beneficiary
(5) Beneficiary less than 10 years younger than participant

Age for starting RMDs raised from 70-½ to 72 for those born after 6/30/49

No more age cap for traditional IRA contributions

For pre-2020 deaths, 10-year payout starts at designated beneficiary's death

Setting
Every
Community
Up for
Retirement
Enhancement
Act

Charitable Remainder Trusts for Retirement Plans

- Name a CRT as the beneficiary of an IRA or qualified plan
  - Pays annuity to individual beneficiary for life
  - Remainder to charitable organization
- Although a 5-year payout period applies, the CRT is tax-exempt
  - Income will be taxed to individual beneficiary as payments are made
  - Thus resembles a lifetime stretch-out!

Ideas for Maximizing Stepped-Up Basis

EVERYONE

- Near-death exercise of grantor trust swap power
- Give trust beneficiaries a narrowly-crafted general power of appointment
- Upstream sales

MARRIED COUPLES

- Use QTIP trust on death of first spouse
- Establish a trust in a community property state

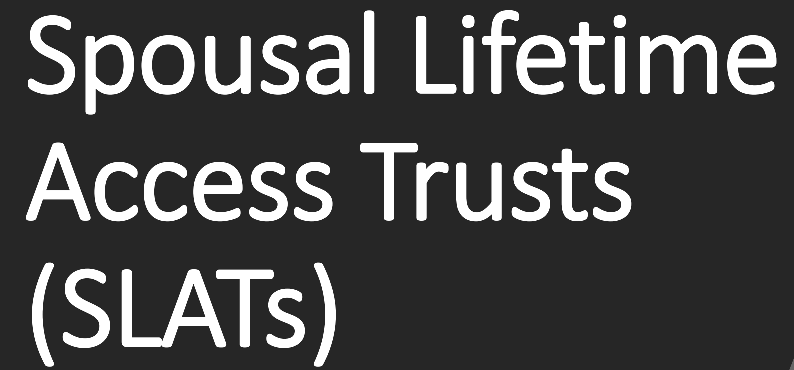
Ultra-Long-Term GRATs (aka "99-Year GRATs")

- Create traditional zeroed-out GRAT but with very long term
- If (when) the grantor dies, gross estate inclusion determined by the formula to the right →
- If the §7520 rate at death is higher than §7520 rate when GRAT formed, likely only a portion of the assets will be subject to estate tax at death

$$\frac{\text{Annuity amount}}{\text{§7520 rate at death}}$$

<u>EXAMPLE</u>: $10 million transfer to 60-year GRAT created today when §7520 rate is 1.2%

- Annuity amount = $234,762
- If §7520 rate at death 20 years later is 6.0%, then gross estate inclusion = $3,912,700
- But if assets grow at 5%, trust will have $35,866,401
- So only 11% of trust assets included in gross estate!


Spousal Lifetime
Access Trusts
(SLATs)

Anti-Clawback Regulations

- Basic exclusion amount is now the GREATER OF:
  - Exclusion amount at death, or
  - Exclusion amount previously used for lifetime taxable gifts
- No adverse effects on portability election
  - Deceased Spousal Unused Exclusion Amount (DSUE Amount) does not change,
  - DSUE stays fixed regardless of what happens to basic exclusion amount

Spousal Lifetime Access Trusts (SLATs)

- Donor Spouse (DS) creates irrevocable trust for benefit of Beneficiary Spouse (BS) and others
- Structured like a “credit shelter trust” or “exemption trust” or “bypass trust”
- Gift to the SLAT does not qualify for the marital deduction, so it uses up the DS’s exclusion
- Usually structured as a grantor trust for income tax purposes
- No estate tax upon BS’s death
- BS can have testamentary limited power of appointment

Thank you

Section Eleven

Dealing with Uncle Sam, Everyone's Least Favorite Relative in the Family Business

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Section Eleven

Dealing with Uncle Sam, Everyone's Least Favorite Relative in the Family Business............................ Professor Samuel A. Donaldson

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DEALING WITH UNCLE SAM, EVERYONE'S LEAST FAVORITE RELATIVE IN THE FAMILY BUSINESS

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I. INTRODUCTION

A. SCOPE OF MATERIALS

These materials are intended as a primer on basic business tax issues most relevant to the closely-held enterprise that's already operating as a going concern. These materials are not concerned with the "choice of entity" question facing entrepreneurs at the inception of the business. There are many other excellent, comprehensive resources to assist planners at the inception of the business. See, e.g., Dwight Drake, BUSINESS PLANNING: CLOSELY HELD ENTERPRISES (5th ed. 2018); Richard A. Shaw and Thomas J. Nichols, *Choice of Entity in Light of Recent and Proposed Tax Changes*, 68 NEW YORK UNIVERSITY ANNUAL INSTITUTE ON FEDERAL TAXATION, Ch. 13 (2010); Richard A. Mann, Michael O'Sullivan, Larry Robbins, and Barry S. Roberts, *Starting from Scratch: A Lawyer's Guide to Representing a Start-Up Company*, 56 ARK. L. REV. 773 (2004).

Instead, these materials offer a brief overview of the basic income tax mechanics of each entity form and a discussion of several particular estate planning strategies available (and the particular pitfalls present) depending on the entity that walks through the door with the client. We are not concerned here with whether the client should do business as a corporation or partnership; rather, we are concerned with what to do once the business has already been operating for some time and has proven successful. The answers to that question often depend on the form in which the business operates. These materials do not address strategies applicable to all closely-held business interests. The installment payment of federal estate tax attributable to closely-held business interests under IRC §6166, for example, is not covered in these materials because this benefit applies to C corporations, S corporations, and partnerships. Instead, these materials focus on techniques that are unique to certain of the entity forms.

B. THE INTERNAL REVENUE CODE SEES ONLY THREE ENTITIES

A client's business will almost always come in one of seven forms: (1) a sole proprietorship; (2) a general partnership; (3) a limited partnership; (4) a limited liability partnership; (5) a limited liability company; (6) an S corporation; and (7) a C corporation. For federal tax purposes, however, there are only three types of business entities. The first form described above (sole proprietorship) is simply disregarded for federal tax purposes, so all items of income and deduction attributable to the business are added to the owner's other items of income and deduction on his or her (or their) Form 1040.

The next three forms (general partnership, limited partnership, limited liability partnership) are treated as partnerships for federal tax purposes, meaning they will subject to the marvelous complexities of Subchapter K. Any of these three forms are welcome to elect corporation status, but that is rarely done for domestic entities.

The fifth form, the limited liability company, will be treated as a sole proprietorship for federal tax purposes if it has only one owner; if it has multiple owners it will be treated as a partnership unless the owners elect to have the entity taxed as a corporation.

The last two forms, the corporations, have no choice. From a federal tax perspective, they are corporations and nothing else. Of course, an S corporation is a pass-through entity, meaning that the entity will generally not be liable for payment of federal income tax. The items of income, gain, loss, deduction, and credit of an S corporation are attributed to its shareholders in proportion to their ownership interests as if they derived such items themselves (though the character of any given item is determined at the entity level). Subsequent distributions of after-tax earnings from the S corporation are not again subject to tax as dividends. This is the major distinction between S corporations and C corporations. C corporations are separate taxable entities. Their taxable incomes are subject to a different progressive rate table, and distributions of after-tax earnings and profits are gross income to the recipient shareholders. Under current law, this "double tax" is mitigated to some extent because dividends received from domestic corporations and certain foreign corporations are taxed at the same rate as net capital gains (*i.e.,* at zero percent, 15 percent, or 20 percent, though the latter two rates will be 3.8 percent higher where the IRC §1411 surcharge on net investment income applies). This preferential rate for "qualified dividend income" applies to dividends on common and preferred shares from both closely-held and publicly-traded corporations.

II. C CORPORATIONS

A. THE BASIC MECHANICS

1. Formation

From a tax perspective, forming a corporation is one of life's easier tasks. Generally, a taxpayer will not have to recognize gain on the transfer of property to a corporation solely in exchange for shares of the corporation's stock. IRC §351(a). Taxpayers will have to recognize any realized gain, however, if: (1) they receive property from the corporation in addition to the corporation's stock, IRC §351(b); (2) they do not own at least 80 percent of the corporation's stock, IRC §351(a); (3) they contribute services (rather than property) to the corporation, IRC §351(d); or (4) the amount of any indebtedness secured by the contributed property exceeds the taxpayer's adjusted basis in such property at the time of contribution, IRC §357(c).

EXAMPLE: Abbott and Costello each contribute a capital asset to a newly-formed corporation in exchange for 50 percent of the corporation's stock. Although neither of them owns 80 percent of the stock individually, all contemporaneous capital contributions are aggregated. Thus, neither will recognize the realized gain from the transaction because their transfers will be aggregated.

If a taxpayer enjoys non-recognition upon contribution, the basis of the shares received from the corporation is equal to the aggregate adjusted bases of the property transferred. IRC §358. Likewise, the corporation's basis in the contributed property is the same basis the contributing shareholder had in the property. IRC §362(a). If a taxpayer recognizes gain from the capital contribution, the taxpayer's basis in the acquired stock (and the corporation's basis in the contributed property) is generally its fair market value.

2. Operation

The C corporation is a separate taxable entity. It completes a Form 1120 to report its taxable income and, as of 2018, pays tax at a flat rate of 21 percent. IRC §11. C corporations may also be subject to additional "penalty taxes" where the corporate form is abused. These penalty taxes are discussed later in these materials.

3. Distributions

The signature feature of subchapter C is the double tax on corporate earnings. A corporate distribution will be included in the shareholder's gross income to the extent the distribution represents the "earnings and profits" of the corporation. IRC §§301(c)(1); 316(a). The distribution, however, will subject to a maximum tax rate of 23.8 percent. See IRC §§1(h)(11); 1411. Additional amounts in excess of the corporation's earnings and profits are presumed to be a return of the shareholder's contributed capital. IRC §301(c)(2). Consequently, the additional amounts received are tax-free to the extent of the shareholder's stock basis. If the shareholder's

stock basis is used up and additional amounts still remain, the excess will be taxed as capital gain. IRC §301(c)(3). If the corporation distributes property, the shareholder takes a fair market value basis in the property. IRC §301(d).

If distributions of cash or property trigger the double tax, should distributions of the corporation's own stock also be taxable to the shareholder? In *Eisner v. Macomber*, 252 U.S. 189 (1920), the Supreme Court held that pro rata stock distributions were not taxable to the shareholders. Taxpayers then pushed the envelope: they created elaborate classes of stock that could be converted into cash or property or the corporation's common stock at the demand of a shareholder. The Service objected to these elaborate classes of stock as disguised dividend distributions, and some courts agreed. Congress has since cleared the air through a general rule proclaiming that stock distributions are tax-free. IRC §305(a). That general rule is subject to a number of exceptions, see IRC §305(b), but most proportionate stock distributions remain tax-free. If a shareholder receives stock tax-free, the shareholder must allocate his or her basis in the old shares among the old and new shares. IRC §307(a).

4. Liquidation

"Liquidation" refers to the death or dissolution of the business entity. Under most state statutes, the assets of the entity are sold and the proceeds are used to pay off the entity's creditors. Any remaining proceeds are distributed proportionately to the owners. Instead of selling assets, liquidating entities may distribute assets to creditors and owners.

Unlike formation, liquidation is rarely painless from a tax perspective. Since a double tax has not been imposed on such assets (or, in the case of a sale, the proceeds), liquidating distributions to shareholders are taxable. IRC §331. Similarly, the corporation recognizes gain and loss upon a liquidating distribution. IRC §336. If a subsidiary corporation liquidates, there is a potential for a triple tax: once to the liquidating subsidiary, again to the parent corporation upon its liquidation, and finally to the shareholders of the parent corporation. To mitigate the adverse consequences attendant with these general rules, most subsidiary corporations may liquidate on a tax-free basis. IRC §332.

B. PLANNING OPPORTUNITIES WITH C CORPORATIONS

1. Reduced Rate on Gain from Sale of Qualified Small Business Stock

IRC §1202(a)(1) generally excludes half of the gain from the sale or exchange of qualified small business stock held for more than five years. The other half of such gain is subject to a preferential tax rate of 28 percent. IRC §§1(h)(1)(E); 1(h)(4); 1(h)(7). In effect, then, the entirety of such gain is taxed at a rate of 14 percent (half of the gain is taxed at 28 percent, half of the gain is not taxed at all).

Under the American Recovery and Reinvestment Act of 2009, the exclusion increased to 75 percent of the gain from the sale or exchange of qualified small business stock acquired after February 17, 2009, and before January 1, 2011. IRC §1202(a)(3). Where the special 75 percent exclusion applies, then, the effective rate of tax on the entire gain is only seven percent. The Creating Small Business Jobs Act of 2010, however, went one step further: qualified small business stock acquired from September 28, 2010, through December 31, 2010, was eligible for a 100-percent exclusion. The Tax Relief and Unemployment Insurance Reauthorization and Job Creation Act of 2010 extended the 100-percent exclusion for stock acquired through 2012, and the American Taxpayer Relief Act of 2012 further extended the 100-percent exclusion to stock acquired in 2013. It was extended again through 2014 by the Tax Increase Prevention Act of 2014. Finally, the Consolidated Appropriations Act of 2016 made the 100-percent exclusion permanent for stock acquired after September 27, 2010. The following example clarifies the mechanics of the exclusion based on the acquisition date of the qualified small business stock:

EXAMPLE: Taylor realized $100,000 of gain from the sale of qualified small business stock. Taylor held the stock for more than five years. The amount Taylor may exclude from gross income depends on when Taylor *acquired* the stock, not the date of the sale. Specifically:

If the stock was acquired…	The portion of the $100,000 gain excluded is…
On or before Feb. 17, 2009	$50,000
After Feb. 17, 2009 but before Sep. 28, 2010	$75,000
After Sep. 27, 2010	$100,000

Only C corporation stock can claim this benefit. Specifically, "qualified small business stock" is any stock in a domestic C corporation originally issued after August 10, 1993, but only if such stock was acquired by the shareholder either as compensation for services provided to the corporation or in exchange for money or other non-stock property, and only if the corporation is a qualified small business. IRC §1202(c)(1). A "qualified small business" is one with aggregate gross assets of $50 million or less at all times after August 10, 1993, and before the time immediately after the date of issuance. IRC §1202(d)(1). "Aggregate gross assets" is measured as the sum of cash plus the adjusted bases of all corporate assets (assuming that the basis of all contributed property is equal to its fair market value as of the date of contribution). IRC §1202(d)(2).

In addition to these requirements, the corporation must meet an "active business requirement" during substantially all of the shareholder's holding period in order for IRC §1202 to apply. IRC §1202(c)(2)(A). This requires that at least 80 percent of the value of the corporation's assets be used in the active conduct of a trade or business engaged in any activity *other than*: (1) professional services in health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or other business in which the principal asset is the reputation or skill of one or more of its employees; (2) banking, insurance, financing, leasing, investing, or similar business; (3) farming;

(4) extraction or production of natural resources eligible for percentage depletion; or (5) operation of hotels, motels, restaurants, or similar businesses. IRC §1202(e).

Depending on the applicable percentage exclusion (based on when the stock was acquired), the benefit of IRC §1202 exclusion may be significant. If IRC §1202 does not apply but the client holds the stock for more than one year, the gain will be long-term capital gain subject to a preferential tax rate generally ranging from zero to 23.8 percent. In case of IRC §1202 stock acquired before February 17, 2009, the cost of losing the 14 percent rate applicable to IRC §1202 stock may not be very significant. To the extent a client can save much more than this additional tax amount by making a subchapter S election or otherwise operating the business in a more profitable or tax-savvy manner that sacrifices the IRC §1202 exclusion, a planner should not be afraid to recommend such action. Of course, where the seven percent (or zero percent) preferential tax rate applies, the comparative benefit of IRC §1202 is stronger; depending on the amount of gain at issue, foregoing pass-through taxation or similar strategies might be desirable.

2. Like-Kind Exchange of Qualified Small Business Stock

One less heralded benefit of owning IRC §1202 stock is the ability to engage in a tax-deferred like-kind exchange under IRC §1045(a). As long as the selling shareholder purchases stock in another qualified small business within 60 days of the sale, he or she can elect to defer all non-recapture gain from the sale (provided the new stock costs at least as much as the amount realized from the sale of the old stock). The shareholder's basis in the new small business stock is reduced by the amount of gain deferred by the election. IRC §1045(b)(3).

EXAMPLE: Troy sells qualified small business stock in X Corporation with a basis of $13,000 to an unrelated buyer for $20,000. Within 60 days of this sale, Troy purchases qualified small business stock in Y Corporation from an unrelated seller for $20,000. Troy does not recognize any gain from the sale of the X Corporation shares but Troy's basis in the Y Corporation shares is $13,000 ($20,000 cost less $7,000 gain deferred from the sale of X Corporation stock). If Troy spends only $5,000 for the Y Corporation shares, Troy must recognize the $7,000 gain from the sale of X Corporation stock. Troy's basis in the Y Corporation shares would be $5,000.

3. Ever Thought of an S Election?

If the C corporation qualifies as a small business corporation under IRC §1361(b), its shareholders may elect S corporation status to ameliorate the impact of the double tax on C corporation earnings. IRC §1362(a). The S election usually causes no immediate tax consequences to the corporation or the shareholders (but see IRC §1363(d) and discussion *infra*), although built-in gains on assets held by the C corporation at the time of its conversion to an S corporation may have to be recognized by the S corporation. IRC §1374. This is better than a conversion from C corporation to partnership because that requires a deemed liquidation of the corporation, a taxable event to the corporation and the shareholders. IRC §§ 331(a); 336(a).

The S election may have other benefits beyond avoiding the double tax. If the C corporation is unable to use the cash method of accounting (under IRC §448(b), a C corporation generally cannot use the cash method unless: (1) it is engaged in farming; (2) substantially all of its activities consists of the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting; or (3) its average annual gross receipts for the three prior taxable years does not exceed $25 million), conversion to S corporation status will permit the entity to use the cash method unless the S corporation is a "tax shelter." IRC §448(a). A tax shelter is any "syndicate" within the meaning of IRC §1256(e)(3)(B) or a "tax shelter" as defined in IRC §6662(d)(2)(C)(iii) (yes, a "tax shelter" means "a syndicate or a tax shelter"). IRC §§448(d)(3); 461(i)(3).

If the C corporation is currently paying or may soon face liability for the personal holding company penalty tax in IRC §541, conversion to S corporation status will eliminate the penalty tax. IRC §1363(a).

COMMENT: A C corporation is a personal holding company if: (1) at least 60 percent of its "adjusted ordinary gross income" for the taxable year is "personal holding company income," and (2) at any time during the last half of the taxable year not more than five individuals own (directly or indirectly) more than 50 percent in value of the corporation's stock. IRC §542(a). Personal holding company income includes dividends, interest, royalties, annuities, rents, compensation for the use of corporate property by shareholders, and income from estates and trusts. IRC §543(a).

4. Other Chances to Minimize Double Taxation

Most C corporations can lessen the impact of the double tax by transferring earnings and profits into deductible payments of compensation, rent, or interest. While this is helpful to the corporation, it is generally worse for the shareholders in that these disguised distributions are ordinary income potentially subject to tax at rates far in excess of the preferential rate applicable to qualified dividend income. IRC §1(h)(11). One might expect that the competing interests of corporations and their shareholders might offset each other to the point that the Service might not care whether payments from corporations to shareholders are characterized as nondeductible (but tax-preferred) dividends or deductible (but fully taxable) forms of ordinary income. But in some cases these strategies are effective in reducing the total tax bite to corporation and shareholder.

EXAMPLE: Adam owns all of the stock in *Corp*, a C corporation. *Corp* has taxable income in Year One of $100,000. *Corp* will pay $21,000 in tax on this income (flat tax of 21 percent), leaving $79,000 of after-tax earnings. If *Corp* distributes the $79,000 as a dividend to Adam in Year Two, *Corp* gets no deduction, but Adam will pay tax of only $18,802 on the dividend (23.8 percent), leaving *A* with $60,198 after tax. If *Corp*'s taxable income in Year Two is also $100,000, it will

again have $79,000 of after-tax earnings. So after two years, the combined after-tax income from Year One ($60,198) and Year Two ($79,000) is $139,198.

If *Corp* makes no distribution but pays Adam rent in the amount of $79,000 for Year Two, *Corp* would get a $79,000 deduction for Year Two but Adam would have to include this amount in gross income. Assuming Adam can deduct 20 percent of this amount under §199A as qualified business income, Adam will pay 37 percent tax on $63,200, or $23,384. After tax, then, Adam will have $55,616, a result worse for him than when the $79,000 is paid in the form of a dividend. But *Corp* gets to reduce its Year Two taxable income to $21,000, which in turn results in a tax liability of $4,410 (21 percent of $21,000). That leaves *Corp* will $95,590 after tax, meaning *Corp* comes out way ahead. The combined after-tax income from both years is $151,206 ($55,616 from Year One and $95,590 from Year Two), a better result than what is achieved with a dividend distribution.

Even if Adam cannot claim the §199A deduction, and thus pays $29,230 tax on the $79,000 of rents (37 percent), the combined after-tax result ($145,360) still beats the combined result of a dividend distribution of the same amount.

Making deductible payments in lieu of a distribution will not always result in less tax, however, as this next example shows.

EXAMPLE: Assume the same facts from the prior Example as regards Year One. Recall from that Example that after two years, the combined after-tax income from Year One ($60,198) and Year Two ($79,000) is $139,198.

If *Corp* makes no distribution but pays Adam a $79,000 salary in Year Two, *Corp* would get a $79,000 deduction for Year Two but Adam would have to pay tax of $35,273.50 on the compensation (assuming Adam is in the 37-percent bracket and pays his share of employment taxes), leaving Adam with $43,726.50 after tax. This is a worse result for Adam than the dividend distribution (treating the amount received from *Corp* as compensation reduces the after-tax amount by over $16,000) but a better result for *Corp* (the compensation deduction reduces *Corp*'s taxable income to $21,000, which in turn results in a tax liability—$4,410—that is over $14,000 less than would otherwise result). Even when one factors in the employment taxes paid by *Corp* in Year Two (just over $6,000), *Corp* comes out ahead. But on these numbers notice that the combined after-tax income from both years ($133,273, which represents $43,726.50 from Year One and $89,546.50 from Year Two) is less than is the case when the corporation pays a dividend instead of salary.

The lesson here, then, is that one must run the numbers to determine whether a corporate deduction will offset the added tax hit to the shareholder. In some but not all cases, paying deductible rent, interest, or compensation will yield a better result than paying a dividend.

5. Redemptions to Pay "Death Taxes"

If the estate tax value of the decedent's stock in a corporation (C or S) comprises more than 35 percent of what we might call the decedent's "adjusted gross estate," IRC §303(a) treats the redemption of an estate's interest in a closely-held corporation as a sale of the stock (even if the transaction would otherwise be treated as a distribution with respect to the stock under IRC §302) to the extent the redemption proceeds do not exceed the sum of all estate, inheritance, legacy, and succession taxes imposed by reason of death plus funeral and administrative expenses deductible under IRC §2053. The redemption must occur within the estate tax return's assessment period to qualify for this benefit. IRC §303(b)(1).

The statute does not use the term "adjusted gross estate." It's just shorthand for the base used by IRC §303(b)(2), namely the value of the gross estate less the amounts deductible under IRC §§2053 (administrative expenses) and 2054 (casualty losses during administration).

C. PLANNING CHALLENGES WITH C CORPORATIONS

1. Penalties on Excessive Retained Earnings

Congress worries that the shareholders of a closely-held corporation prefer for the corporation to accumulate and retain its net earnings instead of paying dividends. Distributions of after-tax earnings are taxable to the shareholders. But if the corporation retains its after-tax earnings, the value of the corporation's stock increases without current taxation to the shareholders. The shareholders can thus defer the double tax on their shares of after-tax earnings until they either sell the stock (at an inflated price because of the retained surplus) or liquidate the corporation (at which point the retained earnings would finally be distributed). To thwart this deferral strategy, IRC §§531-537 impose an "accumulated earnings tax," a surtax levied on retained earnings in excess of the reasonable needs of the business where such retention has the purpose of avoiding income tax to the shareholders.

Prior to 2003, dividends were taxed at a higher rate than net capital gain. In those days, shareholders had even more incentive to keep after-tax earnings inside the corporation and then sell the stock at an inflated price because of the retained earnings. Absent the accumulated earnings tax, the shareholders could achieve tax alchemy by converting ordinary income into net capital gain. Now that most dividend distributions are taxed at the same rate as net capital gains, part of the incentive to avoid dividend distributions is lost. But the accumulated earnings tax remains. Sure, shareholders would still benefit from deferral of the double tax if the accumulated earnings tax did not exist, but deferral alone is hardly a grave sin.

A corporation's accumulated earnings tax is equal to 15 percent of its "accumulated taxable income." IRC §531. The accumulated taxable income figure roughly represents the corporation's undistributed taxable income (computed with some adjustments) in excess of amounts retained for the reasonable needs of the business. IRC §535(a). Note that the tax is

imposed only with respect to the corporation's earnings in a single taxable year. Those earnings are not again subject to tax in later years as they continue to be retained.

Accumulations of $250,000 or less are deemed to be retained for the reasonable needs of the business (in the case of a personal service corporation, i.e., one engaged in any of the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts or consulting, where the owners provide the services, the threshold is reduced to $150,000). IRC §535(c)(2). So if a corporation's retained earnings are within this threshold, there is no accumulated earnings tax exposure.

The tax is not self-assessed; rather it is a penalty imposed by the Internal Revenue Service. The Service initiates the issue by sending a notice to the corporation that all or part of a proposed notice of deficiency includes the accumulated earnings tax. At that point, the burden of proof shifts to the corporation to prove it is not liable for the tax. IRC §534.

In reviewing the financial statements for a client's corporation, the planner should consider whether the corporation is vulnerable to the accumulated earnings tax. Annual retained earnings in excess of the applicable threshold described above should be a red flag. If there is exposure, the planner should consider any of a number of possible solutions, including: (1) paying higher salaries to the owners in order to reduce retained earnings in a deductible way; (2) documenting the corporation's long-term capital-intensive plans that require accumulation of after-tax earnings; and (3) making a subchapter S election, if possible.

2. Funding the Buy-Sell Agreement

Shareholders of a closely-held C corporation may prefer that the corporation redeem the shares of a retiring or deceased shareholder (a "redemption agreement"), as opposed to having the surviving shareholders to purchase the shares directly (a "cross-purchase agreement"). Using entity funds to purchase the stock offers centralized funding (together with increased certainty of funding, for it is easier to monitor the reserves of the corporation than to continually police the saving habits of the other shareholders). In addition, where insurance will be used to fund the purchase, the C corporation needs fewer pre-tax dollars to fund premium payments to the extent the corporation is in a lower tax bracket than the shareholders.

But a redemption agreement carries some risks when the business operates as a C corporation. *First*, payments to the retiring shareholder may be treated as dividends, and while the preferential tax rate applicable to qualified dividend income helps it does not substitute for the lack of stock basis that could be used to reduce the tax bite. *Second*, to the extent there is net buildup in the value of life insurance contracts funding the C corporation's payment obligation, there is increased risk of alternative minimum tax. IRC §56(g)(4)(B)(ii). *Third*, if the C corporation uses a sinking fund or similar reserve to save up for a future redemption, there is additional risk that the Service will assert liability for accumulated earnings tax. While the corporation should be successful in proving that an accumulation of earnings to fund a

redemption agreement is a reasonable business need, the corporation still faces the hassle of having to make this showing. *Finally*, corporate-owned life insurance is an asset of the corporation that, in turn, drives up the estate tax value of the corporation's stock when a shareholder dies. See Treas. Reg. §§20.2031-2(f); 20.2042-1(c)(6). Together these risks may not outweigh the benefits of centralized funding, but they should be factored in to the decision of whether to use a redemption agreement.

III. S CORPORATIONS

A. THE BASIC MECHANICS

1. Formation

Unless a specific provision in subchapter S applies, the rules applicable to C corporations also apply to S corporations. IRC §1371. Because subchapter S is silent as to incorporation issues, the rules previously described for C corporations apply to S corporations. The only wrinkles upon formation of an S corporation pertain to the *eligibility* requirements to be an S corporation and the *timing* rules applicable to the subchapter S election.

a. Eligibility Rules

Not every corporation can elect to be treated as an S corporation. There are limits as to the number and types of shareholders that a corporation may have, although these limits are easily circumvented in most cases. There is also a limit as to the corporation's capital structure, a limit intended to ensure that the pass-thru of tax items remains relatively easy to administer.

As a threshold matter, **only domestic corporations** can elect to be treated as S corporations. IRC §1361(b)(1). A domestic corporation is any corporation organized in the United States or under the law of the United States or any particular state. IRC §7701(a)(4). A corporation organized in both the United States and a foreign country qualifies as a domestic corporation. Treas. Reg. §301.7701-5(a). See also PLR 9512001 (corporation organized in United States and in foreign country is eligible to make S election and will not be treated as having two classes of stock).

An S corporation can have **no more than 100 shareholders**. (From 1997 through 2004, there was a 75-shareholder limit.) With some exceptions, every person holding stock in an S corporation counts toward the 100-shareholder limitation. Rev. Rul. 59-187, 1959-1 C.B. 224. Spouses and their estates are treated as one shareholder for purposes of applying the limitation, IRC §1361(c)(1), regardless whether the spouses own shares jointly or separately or solely by operation of community property laws. Furthermore, all "members of a family" are treated as one shareholder for purposes of the 100-shareholder limitation. IRC §1361(c)(1)(A)(ii). Members of a family are the common ancestor, the lineal descendants of the common ancestor (up to a maximum of six (!) generations), and the current *and former* spouses of the lineal descendants

or the common ancestor. IRC §1361(c)(1)(B). This effectively eviscerates the 100-shareholder limitation. (The determination of whether there is more than six generations separating the common ancestor from the youngest generation of shareholders is made on the latest of: (1) the date the S election is made; (2) the first date on which the common ancestor or a lineal descendant (or spouse) owns stock in the S corporation; and (3) October 22, 2004 (the date of enactment for the American Jobs Creation Act of 2004).)

Very generally, subchapter S welcomes most individual shareholders (and their estates, see IRC §1361(b)(1)(B)) but exhibits hostility toward entity shareholders. A discussion of **trusts as shareholders** of S corporation stock appears later in these materials.

COMMENT: There is no limitation as to how long an estate may hold S corporation stock. This is not the case for testamentary trusts, which, as discussed *infra*, must distribute S corporation stock or otherwise qualify as a permissible S corporation shareholder within two years.

Most individuals are eligible S corporation shareholders. In Revenue Ruling 2004-50, 2004-1 C.B. 977, the Service ruled that a federally recognized Indian tribal government is not an eligible S corporation shareholder, meaning that the corporation in which the tribe owns shares cannot make a subchapter S election. The Service noted that only individuals and certain estate and trusts can hold S corporation shares under IRC §1361(b)(1). Since the Indian tribe is exempt from taxation under established authorities, and because the tribe is not subject to federal income tax as an individual under IRC §1, the Service determined that the tribe was not an "individual" for purposes of qualifying the corporation for election to subchapter S status.

But a corporation cannot make an S election if it has a **nonresident alien** shareholder, IRC §1361(b)(1)(C), and if a nonresident alien individual becomes a shareholder in an S corporation, the corporation will lose its S election, IRC §1362(d)(2)(A), and will generally be precluded from re-electing S status for five years. IRC §1362(g). A nonresident alien individual is an individual that is neither a citizen of the United States nor a resident of the United States. IRC §7701(b)(1)(B).

An individual is a resident of the United States if he or she meets either the "green card test" or the "substantial presence test." Both of these tests are objective; the intent of the individual and other such subjective measures (like domicile) are irrelevant. An individual meets the green card test if he or she is a lawful permanent resident of the United States at any time during the calendar year. IRC §7701(b)(1)(A)(i). An individual meets the substantial presence test if he or she is present in the United States on at least 31 days of the current year and at least 183 total days of the current and two preceding calendar years. IRC §§7701(b)(1)(A)(ii); 7701(b)(3)(A). Presence, for these purposes, is determined using a composite, weighted measure of the days of physical presence over a three-year period. All days in the current calendar year are added to one-third of the days in the first preceding calendar year and to one-sixth of the days in the second preceding calendar year.

If a current S corporation (or a C corporation or a partnership whose owners wish to make an S election) wants to pass shares to a nonresident alien individual, the S corporation and the nonresident alien should form a partnership or other pass-thru entity for federal income tax purposes. This preserves the S election while permitting the nonresident to participate in the profits and losses of the enterprise. See Michael Schlesinger, S CORPORATIONS: TAX PLANNING AND ANALYSIS 12 (CCH 2000). Schlesinger notes that this structure would survive scrutiny under the partnership anti-abuse rules in Regulation §1.701-2 because the S corporation's shareholders are taxed on their shares of the S corporation's income while the nonresident alien is taxed on his or her share of the partnership's profits.

EXAMPLE: Adam and Beth each own 10 shares in an S Corporation. Evita, a nonresident alien individual, wants to join Adam and Beth as an equal stakeholder, and both of the existing owners want Evita involved in the business. To protect the corporation's S election, the corporation and Evita form a limited liability company to be taxed as a partnership for United States income tax purposes. The corporation contributes all of its business assets to the LLC in exchange for two-thirds of the membership interests in the LLC, while Evita makes proportionate contributions of cash and/or property in exchange for a one-third interest in the LLC. The LLC's operating agreement provides that all tax items shall be allocated according to the membership interests, meaning the S corporation is taxed on two-thirds of the LLC's taxable income and that Evita is taxed on one-third of the LLC's taxable income. The share allocable to the S corporation passes through in equal shares to Adam and Beth. This structure should accomplish the objectives of Adam, Beth, and Evita without sacrificing the S election.

COMMENT: In the above example, if the LLC distributes some of the assets contributed by Evita to the S corporation (or if the LLC distributes some of the assets contributed by the S corporation to Evita) within seven years of their transfer to the LLC, the parties may have to recognize gain under the disguised sale rules in subchapter K. See IRC §§ 704(c)(1)(B); 707; 737.

Planners in community property states need to pay special attention to the nonresident alien prohibition. If an employee of an S corporation is married to a nonresident alien, the non-employee spouse may have a community property interest in any shares acquired by the employee as compensation. This would terminate the S election. Even if the shareholder-employee holds the S corporation shares as separate property, it may be possible for the non-employee spouse to acquire a community property interest in the shares to the extent the employee-shareholder otherwise receives inadequate compensation for the services he or she performs on behalf of the corporation. See William C. Staley, *S Corporations and Estate Planning*, at 6 (Glendale Estate Planning Council, Nov. 15, 2005).

Corporations, partnerships, limited liability companies, and other **business entities are not eligible to be shareholders** of S corporation stock. IRC §1361(b)(1)(B). Disregarded entities (such as single-member limited liability companies) are permissible shareholders if their owners are eligible S corporation shareholders. The Service will often ignore transitory ownership of S

corporation stock by a partnership in the process of converting to an S corporation, even though there is no Code or regulation authority to forgive momentary ownership by an ineligible entity. See, e.g., PLRs 200237014, 200237011, 9010042, and 8934020.

Since 1998, organizations described in IRC §401(a) or IRC §501(c)(3) that are exempt from tax under IRC §501(a) can be S corporation shareholders. IRC §1361(c)(6). Translation? Employee stock ownership plans (ESOPs) and certain charitable organizations can hold S corporation stock. For eligible exempt organizations other than ESOPs, tax items from the S corporation pass through as unrelated business taxable income (UBTI). IRC §512(e).

An S corporation can only have **one class of stock**. IRC §1361(b)(1)(D). For this purpose, differences in voting rights among shares of common stock are disregarded. IRC §1361(c)(4). Estate planners like to see S corporations with voting and nonvoting shares, because nonvoting shares in a closely-held business make ideal assets for gifts and other wealth transfers from a discount planning perspective. An S corporation has a single class of stock if all shares have equal rights to distributions and liquidation proceeds. Treas. Reg. §1.1361-1(l)(1). Whether all shares have equal economic rights is determined with reference to what the regulations call the corporation's "governing provisions." Treas. Reg. §1.1361-1(l)(2)(i). These include the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements related to distributions and liquidation.

b. Election

All shareholders must consent to make a subchapter S election. IRC §1362(a). An election is effective for the taxable year following the year of election, except that an election made in the first two and a half months of a taxable year is effective as of the first day of the taxable year. IRC §1362(b). The Service will consider requests for relief from the effects of a late election. Unless a special situation applies, however, the corporation usually must request relief through a private letter ruling that will require payment of a user fee. See Rev. Proc. 2014-1, 2014-1 I.R.B. 1. The Service has identified a number of special situations:

• *A partnership, LLC, or other noncorporate eligible entity failed to timely file the Form 2553 and has not elected to be treated as a corporation.* If the entity can show reasonable cause for its failure to timely file the S corporation election (and the entity classification election on Form 8832), then requests for relief made within six months after the due date for the tax return for the first year the entity intended to be an S corporation will be honored and the entity will be given additional time to make the required elections. Rev. Proc. 2004-48, 2004-1 C.B. 172.

• *A corporation failed to timely file the Form 2553 but has reasonable cause for its failure to do so*. Requests for relief made within two years of the original due date for the S election will be considered by the Service provided either: (1) the corporation has not yet filed a return for the first year in which the election was intended and the request for relief comes within six months of the due date for that return; or (2) the corporation did file a return for the first year in

which the election was intended and all of the shareholders have reported consistently with an S election on all of their affected returns for the year(s) in which the election was intended. Rev. Proc. 2003-43, 2003-1 C.B. 998.

• *The corporation filed a Form 1120S and, within six months, the Service did not notify the corporation or any shareholder of any problem with S corporation status*. If the shareholders reported their income consistent with S corporation status for the year(s) in which the S election was intended, then the corporation qualifies for automatic relief. Rev. Proc. 97-48, 1997-2 C.B. 521. To claim the relief, a completed Form 2553 must be filed with the words "FILED PURSUANT TO REV. PROC. 97-48" printed at the top of the Form.

2. Operation

In general, an S corporation will not pay income tax, since items of income, gain, loss, deduction, and credit pass through to the shareholders on a "per share" or "pro rata" basis. IRC §1366. Thus, if an S corporation has two equal shareholders, each must include one-half of the corporation's tax items on his or her own individual income tax return. The ultimate treatment of a tax item (as capital gain or ordinary income, for example) will depend upon the particular shareholder; consequently, some items pass through separately, while others are "netted" at the corporate level before passing through to the shareholders.

At the close of each taxable year, an S corporation shareholder's stock basis is adjusted to reflect both the shareholder's pro rata share of the S corporation's pass-through items and any distributions made during the year. IRC §1367(a). The adjustments to basis occur in this order (Treas. Reg. §1.1367-1(f)): (1) increase stock basis by the shareholder's share of income items; then (2) decrease stock basis by the amount of nontaxable distributions; then (3) decrease stock basis by the shareholder's share of noncapitalized, nondeductible expenses; then finally (4) decrease stock basis by the shareholder's share of loss and deduction items.

COMMENT: Examples of noncapital, nondeductible expenses include illegal bribes, fines, penalties, expenses related to tax-exempt income, disallowed losses under IRC §267, and the disallowed portion of meal and entertainment expenses under IRC §274.

3. Distributions

The tax treatment of distributions from S corporations depends upon whether the S corporation has accumulated earnings and profits. Only C corporations can have "earnings and profits." IRC §312. Corporations that have always been S corporations do not have accumulated earnings and profits.

Distributions from "pure" S corporations (those that have never been C corporations) are tax-free to the extent of the shareholder's stock basis. IRC §1368(b)(1). Any distributions in excess of a shareholder's basis is treated as gain from the sale or exchange of property (i.e., as long-

term capital gain if the stock has been held for more than one year, or short-term capital gain if the stock has been held for one year or less). IRC §1368(b)(2). Whether a shareholder has sufficient stock basis to absorb a distribution is tested at the end of the year, after all items of income and other increases to basis occur, but before any reductions to stock basis due to losses, deductions, and nondeductible expenses. Treas. Reg. §1.1367-1(f). This ordering rule maximizes the chances that any particular distribution will be tax-free. If an S corporation distributes appreciated property instead of cash, the distribution triggers gain to the corporation. IRC §§1371(a); 311(b). Like any gain, it passes through pro rata to the shareholders, with resulting increases to stock basis.

If an S corporation has accumulated earnings and profits, the distribution rules are slightly more complicated. A three-tier regime applies to such distributions. *First*, that portion of the distribution not in excess of the corporation's "accumulated adjustments account" ("AAA") is taxed under the rules applicable to distributions from S corporations without earnings and profits (i.e., tax-free to the extent of stock basis, with any excess treated as capital gain). IRC §1368(c)(1). If an S corporation makes more than one distribution during the taxable year, and if the total amount of such distributions exceeds the positive balance in the corporation's AAA, the AAA is allocated proportionately to all of the distributions. Treas. Reg. §1.1368-2(b).

Second, the remainder of the distribution is treated as a dividend to the extent of the corporation's accumulated earnings and profits. IRC §1368(c)(2).

Third, if the distribution exceeds accumulated earnings and profits, the balance is treated under the rules applicable to distributions from S corporations without earnings and profits. IRC §1368(c)(3).

The AAA is an entity-level account that begins at zero when the corporation's S election takes effect. Treas. Reg. §1.1368-2(a)(1). It is then adjusted upward and downward, generally by the same items that adjust a shareholder's basis under IRC §1367. IRC §1368(e)(1)(A); Treas. Reg. §§1.1368-2(a)(2), -2(a)(3). There are some differences, however, between the adjustments to the AAA and the adjustments to stock basis. For one thing, the AAA can go below zero. IRC §1368(e)(1)(A). And, importantly, no adjustment is made to the AAA for tax-exempt income or for expenses related to tax-exempt income. Thus, for example, death benefits received by an S corporation generally do not affect AAA even though the corporation has an increase in cash because the death benefits are excluded from gross income under IRC §101(a). Likewise, premium payments on life insurance policies should not affect AAA if the corporation will receive the death benefits on a tax-free basis.

Also, taxes paid by the corporation for years attributable to the corporation's period as a C corporation can adjust stock basis but such amounts do not affect the AAA. As these exceptions suggest, AAA is generally a reflection of the S corporation's items of income and deduction of tax consequence that have been passed through to the shareholders (in other words, perhaps, the corporation's previously taxed income).

Redemptions carry out a ratable share of the corporation's AAA if the redemption is treated as a sale or exchange under either IRC §302(a) or IRC §303(a). Treas. Reg. §1.1368-2(d)(1)(i). If the corporation makes both regular distributions and redemption distributions in the same taxable year, the AAA is adjusted first for ordinary distributions and then for any redemption distributions. Treas. Reg. §1.1368-2(d)(1)(ii).

Shareholders seeking to avoid the complexity of IRC §1368(c) may consider distributing the entire amount of the corporation's accumulated earnings and profits. This "purging" distribution permits future distributions to be tested under the simpler regime of IRC §1368(b). There are two ways to make a purging distribution. First, the corporation can elect to treat any distributions as coming first from accumulated earnings and profits and then from the AAA. Treas. Reg. §§1.1368-1(f)(1)(i); 1.1368-1(f)(2)(i). In effect, this election swaps the first two tiers of the three-tier regime. The practical effect of this election is that distributions are includible as dividends to the extent of earning and profits and *then* tax-free to the extent of stock basis. If one expects the preferential rates for qualified dividend income to expire in the near future, the election might be beneficial to the distributee-shareholders in the long term. At the same time, the election can be beneficial to the other shareholders.

The second way to make a purging distribution is for the corporation to elect a deemed dividend distribution. Under this approach, the corporation makes no actual distributions but the shareholders are taxed as though the corporation made a pro rata distribution of its accumulated earnings and profits at a time when its AAA is zero, followed by the shareholders' contribution of those same dollars back to the corporation, all on the last day of the taxable year. Treas. Reg. §§1.1368-1(f)(1)(ii); 1.1368-1(f)(3). This alternative keeps capital within the corporation's hands but may leave the shareholders without the dollars required to pay the tax associated with the deemed dividend.

4. Liquidation

The rules applicable to C corporation liquidations apply to S corporation liquidations. Thus, the corporation realizes gain and loss upon the distribution of assets to shareholders, and such gains and losses pass through to the shareholders like other income and deduction items. These gains and losses affect a shareholder's stock basis like other pass-through items.

B. PLANNING OPPORTUNITIES WITH S CORPORATIONS

1. Leverage the Purchase of Additional Shares

Normally, interest paid on debt incurred to purchase investment property ("investment interest") is deductible by the borrower only to the extent of his or her "net investment income." IRC §163(d)(1). This limitation does not apply to interest paid on debt incurred to purchase stock in an S corporation or a partnership. Instead, such interest is deemed to be paid on debt incurred

to purchase the pass-through entity's inside assets. Reg. §1.163-8T. Accordingly, if all of the entity's assets are used in the conduct of a trade or business, the interest paid on debt incurred to buy stock in the S corporation or partnership will be considered business interest. That's good news because business interest is not subject to the same limitation applicable to investment interest (in other words, business interest is deductible without regard to the currently taxable income generated by the entity's business). IRC §§163(a); 163(h)(2)(A). So if the client is thinking about purchasing additional shares (or if the client wants to help another to purchase the client's shares in the S corporation), this benefit is worth keeping in mind when running the numbers.

2. The Employment Tax Loophole for Sole-Shareholder S Corporations

While all of the operating profits of a disregarded single-member LLC or sole proprietorship are subject to employment taxes, only the salary paid to the sole shareholder of an S corporation is considered "wages" subject to employment taxes. Rev. Rul. 73-361, 1971-2 C.B. 331. Operating income of an S corporation not distributed in the form of salary is not self-employment income. Rev. Rul. 59-221, 1959-1 C.B. 225. See also IRS Publication 533. As a result, sole shareholders of S corporations have an incentive to receive no salary from their S corporations and take all of their incomes in the form of distributions.

Of course, if an S corporation pays no salary to its sole shareholder-employee, the Service may recharacterize some portion of the corporation's distributions as wages for employment tax purposes. Rev. Rul. 74-44, 1974-1 C.B. 287. There are many cases in which the Service has been successful in converting a portion of S corporation distributions into wages for purposes of employment taxes. See, e.g., *Mike J. Graham Trucking, Inc. v. Commissioner,* T.C. Memo 2003-49, affd in unpublished opinion (3d Cir. 2004); *Veterinary Surgical Consultants v. Commissioner*, 117 T.C. 141 (2001), affd in unpublished opinion (3d Cir. 2004). The taxpayers in both *Graham Trucking* and *VSC* argued that distributions from S corporations could not be treated as compensation because §530 of the Revenue Act of 1978 states that employment taxes do not apply if the S corporation has never treated the shareholder-employee as an employee for any period and if all filed returns are consistent with this assumption. The taxpayers conveniently forgot the language in §530 that says that employment tax relief does not apply if the corporation "had no reasonable basis for not treating such individual as an employee." The courts in both cases held that there was no precedent for treating the shareholder-employees as contractors or non-employees within their respective industries, and there were no audits of the corporations that upheld such treatment by the corporations. Accordingly, there was no basis for the corporations not to treat the taxpayers as employees, so some portion of the corporations' distributions must be treated as wages. See James A. Fellows and John F. Jewell, *S Corporations and Salary Payments to Shareholders: A Major Issue for the IRS*, 2006 THE CPA J. 46 (May 2006) (available at http://www.nysscpa.org/cpajournal/2006/506/essentials/p46.html).

Still, it appears the Service is not exercising its recharacterization power as much as it could: nearly a decade ago, a report of the Treasury Inspector General for Tax Administration claimed that some 36,000 sole shareholder-employees received no salaries from their S

corporations. Statement of J. Russell George, Inspector General, Treasury Inspector General for Tax Administration before the Senate Finance Committee (May 25, 2005), available at http://www.treas.gov/tigta/congress/congress_05252005. htm. See also Joint Committee on Taxation, *Options to Improve Tax Compliance and Reform Tax Expenditures* (JCS-02-05) (2005) at 426 (estimating that treating all net income from partnerships and S corporations as self-employment income could increase revenues by $57.4 billion over the nine-year period from 2006 to 2014); Tony Nitti, *S Corporation Shareholder Compensation: How Much is Enough?*, AICPA THE TAX ADVISER (August 1, 2011). The same report indicated that the percentage of S corporation profits paid to their sole shareholder-employees dropped from 47.1 percent in 1994 to 41.5 percent in 2001. To the extent sole proprietors and owners of disregarded entities have 100 percent of the business profits subject to employment taxes, there remains an advantage to keeping salaries modest and maximizing distributions from an S corporation.

The question becomes how much salary to pay to the sole shareholder-employee of an S corporation. The cautious approach is for the S corporation to pay its shareholder-employee the same salary that he or she would require if the shareholder-employee were only an employee of the entity. See Richard B. Robinson, *Tax Audit Issues for S Corporations*, in 41ST ANNUAL SOUTHERN FEDERAL TAX INSTITUTE MATERIALS at J-3 (2006). More aggressive clients may prefer the lemming approach: keep salaries to about 41 – 47 percent of the S corporation's net profits so as to be consistent with other S corporations, even if a non-shareholder-employee would insist upon a higher salary from the corporation.

3. Shift Built-in Gains to Your Low-Bracket (or Idiot) Co-Owners

When a shareholder contributes property with a value in excess of its adjusted basis to an S corporation, the corporation generally takes the contributing shareholder's basis in the property. IRC §362(a). When the S corporation subsequently sells the appreciated property, the gain from the sale, like any gain, is apportioned proportionately among the shareholders. The built-in gain is not allocated automatically to the contributing shareholder, which is not the case for a partnership. IRC §704(c)(1)(A). See discussion *infra* on partnerships. This provides contributing partners with an opportunity to shift gain to other, lower-bracket taxpayers without having to worry about the assignment of income doctrine.

EXAMPLE: *A* and *B* form an S corporation when *A* contributes inventory worth $100,000 (in which *A*'s basis is $10,000) and *B* contributes $100,000 cash. *A* and *B* are given equal shares in the corporation's single class of stock. If the corporation sells the inventory for $100,000 to an unrelated party, the corporation's $90,000 gain (ordinary income if the property is inventory in the hands of the corporation) will be allocated equally among *A* and *B*. Notice that $45,000 of the gain attributable to the period during which *A* held Blackacre is effectively shifted to *B*. If *B* is related to *A* and is in a lower tax bracket than *A*, this could be a beneficial result. Of course, *B* may not see it that way, so an "opportunity" for *A* is a "challenge" for *B*.

4. Manufacturing Basis to Claim Net Losses

An S corporation shareholder may deduct his or her proportionate share of the corporation's losses to the extent of the shareholder's stock basis and any basis in debt owed by the corporation to the shareholder. IRC §1366(d)(1). Losses in excess of these basis limitations are carried forward to subsequent taxable years, IRC §1366(d)(2), but time value of money considerations suggest we should do what we can to give the shareholder enough basis in the year the loss passes through to the shareholder.

If a client's share of an S corporation loss exceeds the client's stock basis and debt basis, the planner should explore techniques to give the client sufficient basis to claim the loss currently. A simple solution is for the client to make a loan or capital contribution to the S corporation, but the client may not have the dollars immediately available or may want to get basis now but pay later. It is not enough for the client to contribute a promise to pay to the corporation; there is no basis credit for the client's own note until actual payments are made on the note. But if the corporation has another shareholder, the client could consider giving a note to the other shareholder in exchange for some or all of the other shareholder's stock. Paying for stock with a note gives the client immediate stock basis that can be used to claim the loss flowing from the S corporation, while deferring the actual out-of-pocket cost to the client. See Jeanne E. Sullivan, *Structure and Techniques for S Corporations for 2007 and Beyond*, 31ST ANNUAL AMERICAN INSTITUTE ON FEDERAL TAXATION, Outline 11 (2007) at 61.

C. PLANNING CHALLENGES WITH S CORPORATIONS

1. Beware the Interests Given to Employees

If an employee of an S corporation owns more than two percent of the corporation's outstanding stock (or more than two percent of the total combined voting power of the corporation's stock) on any day of the taxable year, the employee is no longer eligible to receive "employee fringe benefits" on a tax-free basis. IRC §1372(a); Reg. §1.707-1(c). If the majority shareholder seeks to reward key employees with stock, it might have the unintended consequence of forfeiting some of these important benefits.

To be more precise, IRC §1372(a) states that so-called "2-percent shareholders" of an S corporation are to be treated as partners in a partnership for purposes of applying Code provisions related to employee fringe benefits. Regulation §1.707-1(c) treats fringe benefits paid to employee-partners as "guaranteed payments" because they are paid without regard to the partnership's income for services rendered. The same regulation states that a partner who receives guaranteed payments is not, by virtue of the payments, regarded as an employee of the partnership. Accordingly, the value of a fringe benefit "is not excludible from the partner's gross income under the general fringe benefit rules (except to the extent the Code provision allowing exclusion of a fringe benefit specifically provides that it applies to partners) because the benefit is treated as a distributive share of partnership income … for purposes of all Code sections other

than sections 61(a) and 162(a), and a partner is treated as self-employed to the extent of his or her distributive share of income." Rev. Rul. 91-26, 1991-1 C.B. 184. See also Albert B. Ellentuck, *S Corporation's Treatment of Employee-Shareholder Fringe Benefits*, THE TAX ADVISER (May 2003).

Examples of benefits not excludable by so-called "2-percent shareholders" are: (1) the cost of accident and health insurance plans under IRC §§105 and 106; (2) meals and lodging furnished on the business premises for the convenience of the employer under IRC §119; (3) the cost of group-term life insurance coverage under IRC § 79; and (4) cafeteria plans under IRC §125. When a 2-percent shareholder receives one of these taxable fringe benefits, it is to be treated as additional compensation subject to Federal withholding and employment taxes. Rev. Rul. 91-26, 1991-1 C.B. 184. That means the S corporation likely gets a deduction for the extra compensation, and this deduction will pass through to the shareholders *pro rata* like any other deduction item.

Not all fringe benefits excluded from the gross incomes of employees are lost; benefits that remain excludable include: (1) dependent care assistance under IRC §129 (IRC §129(e)(3) provides that the exclusion is available to self-employed individuals as well as employees; because partners in a partnership and 2-percent shareholders in an S corporation are deemed to be self-employed, as discussed *supra*, the exclusion is available to partners and 2-percent shareholders in an S corporation); (2) educational assistance programs under IRC §127, IRC §127(c)(2); and (3) several of the fringe benefits listed in IRC §132, including no-additional-cost services, qualified employee discounts, de minimis fringes, working condition fringes, and on-premises athletic facilities. Reg. §§1.132-1(b)(1); 1.132-1(b)(2)(ii); 1.132-1(b)(3); 1.132-1(b)(4).

2. Getting Basis Credit for Entity Debt

As mentioned above, S corporation shareholders need basis (either stock basis or debt basis) in order to claim their shares of the corporation's net losses. While partners in a partnership are entitled to basis credit for their shares of the partnership's debts, the same is not true for shareholders of an S corporation. It is not sufficient for a shareholder to guarantee the S corporation's debt in order to give the shareholder basis credit for the debt. (If the shareholder makes an actual payment on the guarantee, he or she gets basis credit for the amount paid.)

The preferred approach is for the lender to make the loan to the shareholder who then loans those proceeds to the S corporation. By structuring the loan arrangement in this fashion, the shareholder makes a loan to the corporation, which expressly entitles the shareholder to basis credit. In fact, as long as proper formalities are observed and the shareholder in fact assumes liability for servicing the debt, the refinancing of an entity debt into a shareholder debt can give the shareholder debt basis. See *Miller v. Commissioner*, T.C. Memo. 2006-125 (restructuring of corporation's line of credit under which shareholder assumed the debt gave shareholder basis credit to the extent of the shareholder's liability). As the *Miller* court observed, "The same result as a 'back to back' loan is reached where a shareholder substitutes his own note for the note of his S corporation on which he was a guarantor, thereby becoming the sole obligor on the new indebtedness. In such 'note substitution' scenarios, so long as the S corporation's

indebtedness to the third-party lender is extinguished, so that the shareholder becomes the sole obligor to the lender, the shareholder's assumption of what was formerly the S corporation's legal burden serves as a constructive furnishing of funds to the S corporation for which the S corporation becomes indebted to repay to the shareholder."

It is worth noting that to the extent the shareholder incurs personal liability in order to have the loan structured in such a way as to give the shareholder basis credit for the debt, the shareholder bears a genuine risk that a direct loan to the corporation would not present. But since many loan arrangements with closely-held S corporations require personal guarantees from the shareholders already, structuring the loan to pass through the shareholder may not affect the shareholder's liability for repayment.

3. Debt as a Second Class of Stock

Speaking of debt, planners have to tread carefully here. Shareholder loans to an S corporation may be recharacterized as equity, which would give the S corporation an impermissible second class of stock. A loan to an S corporation will be treated as stock if the transaction constitutes equity under general principles of federal tax law or if the principal purpose of the transaction is to circumvent the single-class-of-stock or eligible-shareholder rules. Treas. Reg. §1.1361-1(l)(4)(ii)(A). To be safe, all loan arrangements from shareholders to S corporations should come within one of the three safe harbors outlined in the regulations: (1) short-term unwritten advances that never exceed $10,000 in the aggregate (Treas. Reg. §1.1361-1(l)(4)(ii)(B)(1)); (2) debts owed solely to the shareholders and in proportion to their stock holdings (Treas. Reg. §1.1361-1(l)(4)(ii)(B)(2)); and (3) "straight debt." Straight debt is a written, unconditional obligation to pay a sum certain (on demand or on a specified due date) held by a United States citizen or resident, an estate, or an eligible trust shareholder and which does not provide for contingent interest (that is, interest computed or payable that is contingent on corporate profits, the borrower's discretion, the payment of dividends, or similar factors) and is not convertible to into stock. Treas. Reg. §1.1361-1(l)(5)(i).

The debt-as-second-class-of-stock problem can arise in situations planners may not expect. For example, if an S corporation redeems a portion of the shares of a retiring or deceased shareholder, the applicable buy-sell agreement usually permits the S corporation to pay the purchase price in installments. If the buy-sell agreement requires the S corporation to pay interest on the deferred payments, the obligation may create a second class of stock unless it qualifies under straight debt safe harbor. Planners should review the provisions of a buy-sell agreement involving S corporation stock to make sure this situation does not arise by accident.

4. The Perils of Former C Corporations

If an S corporation used to be a C corporation, the planner has to proceed carefully. Three separate Code provisions come into play for former C corporations, although the last two are

more significant because they continue to haunt the former C corporation for quite a while following the subchapter S election.

The first provision is IRC §1363(d), which forces a corporation using the LIFO method of inventory valuation to recapture as gross income the excess of the FIFO value of its inventory over the LIFO value of its inventory at the close of the corporation's last taxable year as a C corporation. The recapture amount is treated as gross income in such last taxable year, but the increase in tax caused by this recapture is payable in four equal annual installments without interest. Unless the planner is helping the business to elect S corporation status, the planner will likely not have to address this issue.

The second provision is IRC §1374, proof that the S election does not provide a perfect conduit for former C corporations. This provision imposes a tax on the disposition of "built-in gains." It is the S corporation that is liable for payment of this tax. The basic theme behind the IRC §1374 tax on built-in gains is that gains and losses attributable to taxable years prior to the S election should be taxed as though the corporation were still subject to subchapter C.

EXAMPLE: *X* Corporation purchased raw land for $100 three years ago. Today, the land is worth $500, and the corporation wants to sell the land to an unrelated purchaser. If *X* sells the land, *X* will be taxed on the $400 gain. If *X* then distributes the after-tax proceeds of the sale to its shareholders (as a dividend), the after-tax profit will be taxed again. The shareholders of *X* thus have an incentive to make the S election prior to the sale. If *X* makes an S election prior to the sale, the $400 gain will pass to the shareholders under IRC §1366, and subsequent distribution of the proceeds will be tax-free under IRC §1368. In effect, the election allows *X* to convert two levels of tax into one level of tax.

Congress reacted to this situation by enacting IRC §1374. Now, when the gain occurs during years in which the corporation was subject to two layers of tax, it is appropriate to tax that gain twice even though the entity is currently a valid S corporation.

The IRC §1374 tax applies to any "net recognized built-in gains" during each of the first several years following the former C corporation's subchapter S election (known as the "recognition period"). Legislation in 2009 shortened the recognition period to seven years for 2009 and 2010 only. IRC §1374(d)(7)(B). Under the Creating Small Business Jobs Act of 2010, the recognition period for taxable years beginning in 2011 only was shortened to five years, and the American Taxpayer Relief Act of 2012 extended the five-year recognition period through 2013. The Tax Increase Prevention Act of 2014 extended the five-year recognition period through 2014. Finally, the Consolidated Appropriations Act of 2016 made the five-year recognition period permanent.

The tax is computed by applying the highest rate under IRC §11 (now 21 percent) to the net recognized built-in gain for the taxable year or, if less, the corporation's taxable income for the taxable year. IRC §§1374(b)(1); 1374(d)(2)(A). The cumulative amount of net recognized built-

in gains during the recognition period cannot exceed the corporation's "net unrealized built-in gain" as of the date of the S election. IRC §1374(c)(2). Note that the tax applies to any disposition that results in a recognized built-in gain, whether in the form of a sale or a distribution to the shareholders. IRC §§311(b); 1374(d)(3).

The tax imposed under IRC §1374 passes through to the S corporation's shareholders as a loss with the same character as the corresponding gain giving rise to the tax. IRC §1366(f)(2). This lessens the impact of the double tax to some extent.

There are several ways to avoid or lessen the burden of the IRC §1374 tax. Perhaps the most common solution is to wait out the recognition period: the tax does not apply to dispositions of built-in gain property that occur after the recognition period expires. The tax can be deferred if the corporation effects a like-kind exchange of the built-in gain property under IRC §1031, although the IRC §1374 taint is preserved in the asset(s) received in the like-kind exchange. IRC §1374(d)(6). Regulations provide that if an S corporation acquires some asset before or during the recognition period with a principal purpose of reducing or eliminating the IRC §1374 tax (because the asset will generate a loss, deduction, or credit that can be used to reduce the corporation's taxable income below the amount of net recognized built-in gain), such loss, deduction or credit shall be ignored for purposes of computing the IRC §1374 tax. Treas. Reg. §1.1374-9. Finally, one could consider a charitable contribution of the built-in gain property. The S corporation does not recognize gain upon making the gift to charity (so the IRC §1374 tax cannot apply), and the deduction flows through to the shareholders. The shareholders reduce their stock bases by their shares of the corporation's adjusted basis in the contributed property, which insures that the lurking gain is not later taxed upon sale of the shares or liquidation of the corporation. IRC §1367(a). First introduced in 2006, this rule expired four times before being made permanent by the Protecting Americans from Tax Hikes Act of 2015.

The third provision is IRC §1375, which imposes a penalty tax at the entity level when two conditions exist: (1) an S corporation has "accumulated earnings and profits" (which by definition only applies if the S corporation was formerly a C corporation), and (2) the S corporation's "passive investment income" exceeds 25 percent of its total gross receipts. If the IRC §1375 tax is imposed for three consecutive years, the corporation will face the "death penalty": its S election is terminated and the corporation will revert to C corporation status. IRC §1362(d)(3).

Why the concern with the amount of passive income generated by a corporation? One treatise explains the policy of these rules as follows:

> These statutory measures restrict attempts to use S corporations as incorporated pocketbooks for their shareholders by investing the corporations' retained earnings in marketable securities and other passive investments of a type that the shareholders would have purchased had the earnings been paid out as dividends. This ploy is particularly likely to happen when the C corporation has liquidated its business assets. The passive-investment-income limitation can also be viewed as a rough-and-ready offset to the fact that a C

corporation can be converted to S status without subjecting its accumulated earnings to tax at the shareholder level as if the earnings were distributed in a quasi-liquidation.

Boris I. Bittker & James S. Eustice, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS (7th student ed. 2000) at 6-19. Basically, Congress wants to limit the benefits of subchapter S to corporations engaged in active businesses.

The mechanics of the IRC §1375 tax are relatively simple. The corporation's "excess net passive income" is multiplied by the highest rate of tax under IRC §11 (21 percent). IRC §1375(a). Excess net passive income is computed under this formula:

$$\frac{(PII) - (25\% \text{ of } GR)}{(PII)} \times (NPI) = \text{Excess Net Passive Income}$$

PII = **passive investment income** (royalties, rents, dividends, interest, annuities, and gains from sales or exchanges of securities). See IRC §§1362(d)(3)(C)(i); 1375(b)(3).
GR = **gross receipts** (the total amount received or accrued under the corporation's accounting method). See Treas. Reg. §1.1362-2(c)(4)(i).
NPI = **net passive income** (passive investment income less those deduction directly connected with the production of passive investment income other than net operating loss carryovers and dividends-received deductions). See IRC §1375(b)(2).

The corporate-level taxes are coordinated because built-in gains and losses are taken out of the definition of passive investment income. IRC §1375(b)(4). Instead of passing through as a loss, the amount of IRC §1375 tax serves to reduce the amount of each item of passive investment income passing through to the shareholders. IRC §1366(f)(3).

There are some planning suggestions for minimizing exposure to the IRC §1375 tax. If the corporation had relatively little earnings and profits at the time of the S election, it may be advisable to distribute the subchapter C earnings and profits to the shareholders, especially since those earnings will be taxed at preferential tax rates to the shareholders in the hopes of avoiding a 21 percent tax imposed on the corporation. IRC §1368(e)(3) permits the shareholders to declare that distributions come first from subchapter C earnings and profits and then from subchapter S earnings (the accumulated adjustments account), although the default distribution rules apply the opposite assumption. Once the subchapter C earnings and profits are gone, the IRC §1375 tax (and the risk of the death penalty under IRC §1362(d)(3)) cannot apply. Alternatively, the shareholders can try their very best to manage gross receipts so that the amount of passive income does not cross the 25 percent threshold.

5. Beware Trusts Holding S Corporation Stock

Only certain domestic trusts qualify as S corporation shareholders. If S corporation falls into the hands of an "ineligible" shareholder, the S election is lost and the corporation becomes a C corporation unable to elect S corporation status for five years unless it successfully obtains discretionary relief from an inadvertent termination of the S election. Although many trusts qualify as eligible shareholders of S corporation stock, some common trust arrangements do not qualify. For instance, a charitable remainder trust is not an eligible shareholder of S corporation stock. Planners should therefore not advise clients to fund charitable remainder trusts with S corporation stock because doing so would sacrifice the S election.

Generally there are five kinds of trusts that qualify as S corporation shareholders.

The first is the **qualified subchapter S trust**, or QSST. IRC §1361(d). Among other things, a QSST must be a domestic trust. See IRC §§7701(a)(30)(E); 7701(a)(31)(B). Under these rules, a trust is a domestic trust only if: (a) a court within the United States has primary supervision over the administration of the trust, and (b) one or more United States fiduciaries control all substantial decisions of the trust. The regulations give some examples of the "substantial decisions" related to a trust that a fiduciary may have. Treas. Reg. §301.7701-7(d)(1)(ii). These include, among others: (1) whether and when to make distributions of income and principal; (2) the amount of distributions; (3) whether a receipt is allocated to income or principal; (4) the selection of a beneficiary; and (5) whether to appoint a successor trustee to succeed another trustee that is unable or willing to serve or continue to serve.

Further, the QSST may have only one income beneficiary during that beneficiary's life (unless each beneficiary has a separate share of the trust, see IRC §663(c)) who is a United States citizen or resident. Spouses are treated as one current income beneficiary if they file jointly and each is a United States citizen or resident. The trust instrument must require that all income be distributed currently (or such income must in fact be paid at least annually to the current income beneficiary). A QSST may permit distributions of principal only to the current income beneficiary during his or her life. No one else may be entitled to distributions of income or principal during the trust term, and no payments can be made from the trust that discharge someone else's obligation to support the current income beneficiary. The trust instrument must provide that the current income beneficiary's income interest terminates at his or her death or, if earlier, upon expiration of a fixed term. If a QSST terminates during the current income beneficiary's life, all assets must be distributed to him or her.

To become a QSST, the current income beneficiary must make a QSST election. If the corporation loses its S election solely because the current income beneficiary of an otherwise valid QSST fails to make a QSST election, the S election may be preserved if a QSST election is filed within two years of its original due date. See Rev. Proc. 2003-43, 2003-1 C.B. 998.

In the case of a trust owning shares in a C corporation that becomes an S corporation, the QSST election is made on Part III of the Form 2553, Election by a Small Business Corporation. If the corporation's S election is already in effect when the trust receives the shares, the QSST election is made by signing and filing a statement with the service center where the corporation files its income tax return. Treas. Reg. §1.1361-1(j)(6)(ii). The statement must: contain the name, address, and taxpayer identification number of the current income beneficiary, the trust, and the corporation; identify the election as one made under IRC §1361(d)(2); specify the date on which the election is to become effective (cannot be more than 2 months and 15 days before the date the election is filed); specify the date(s) on which stock was transferred to the trust; and provide all information required to prove that the trust meets the requirements of a QSST.

The current income beneficiary reports all S corporation items attributable to the stock held by the QSST on his or her personal tax return. If the trust sells the S corporation stock, gain or loss is recognized by the trust (although the sale is considered to have been made by the current income beneficiary for purposes of the at-risk rules in IRC §465 and the passive loss rules in IRC §469). See IRC §1361(d)(1)(C).

For purposes of the 100-shareholder limitation, the current income beneficiary is treated as the shareholder of the stock. IRC §1361(c)(2)(B)(i).

The second is the **electing small business trust**, or ESBT. See IRC §1361(e). A trust can qualify as an ESBT if it has only individuals, estates, and/or qualified exempt organizations (any organization described in IRC §170(c)(2) – (5) is a qualified exempt organization, as is any IRC §170(c)(1) organization that holds a contingent interest and is not a potential current beneficiary) as present, remainder, or reversionary beneficiaries. A person who may take under the exercise of a power of appointment is not considered a beneficiary of the trust for this purpose unless such power is actually exercised in that person's favor.

A trust cannot qualify as an ESBT if any person has acquired an interest in the trust by purchase. A purchase includes any transaction in which the basis of the acquired property is its cost. IRC §1361(e)(1)(C). In addition, each "potential current beneficiary" of the trust must be an eligible shareholder of S corporation stock if the trust is to qualify as an ESBT. A potential current beneficiary is one entitled to (or who may currently) receive distributions of income or principal from the trust. IRC §1361(e)(2). The trust cannot be a charitable remainder trust or otherwise exempt from federal income tax.

An eligible trust becomes an ESBT when the trustee(s) with authority to legally bind the trust sign and file an election statement with the service center where the corporation files its income tax return. Treas. Reg. §1.1361-1(m)(2)(i). The statement must include: the name, address, and taxpayer identification number of the trust, the potential current beneficiaries, and the corporation; a statement that an ESBT election pursuant to IRC §1361(e)(3) is being made; the date when the trust first owned stock in the corporation; the date the election is to take effect (cannot be more than 2 months and 15 days before the date the election is filed); and

representations that the trust meets all of the requirements of an ESBT and that all potential current beneficiaries are eligible shareholders of S corporation stock.

While the requirements for an ESBT are easier to meet than the requirements for a QSST, the price for ease lies in the taxation of the trust's income. The trust itself must pay a flat tax equal to the highest rate applicable to trusts and estates under IRC §1(e) (currently 37 percent) on the trust's taxable income attributable to the S corporation items, the exemption amount for alternative minimum tax purposes is reduced to zero, and no capital loss carryovers are permitted. IRC §641(c). The trust continues to pay tax at the slightly progressive rates of IRC §1(e) on income attributable to other assets.

For purposes of the 100-shareholder limitation, each potential current beneficiary is counted as a shareholder. IRC §1361(c)(2)(B)(v). During any period that there is no potential current beneficiary of an ESBT, the trust itself is treated as the shareholder for purposes of applying the 100-shareholder limitation.

In computing an ESBT's income attributable to the S corporation, the only items taken into account are: (1) the trust's shares of the S corporation's item of income, gain, loss, deduction, and credit; (2) gain or loss from the trust's sale of the S corporation stock; (3) state or local income taxes and administrative expenses allocable to the S corporation stock; and (4) interest paid or accrued on debt used to acquire stock in the S corporation. IRC §641(c)(2)(C).

The third kind of trust eligible to be an S corporation shareholder is a good, old-fashioned **grantor trust**. IRC §1361(c)(2)(A)(i). A grantor trust is any trust that is deemed to be owned by the grantor or another person under any of IRC §§671-678. For more on the use of grantor trusts in estate planning, see (ahem) Samuel A. Donaldson, *Understanding Grantor Trusts*, *in* 40 HECKERLING INSTITUTE ON ESTATE PLANNING 2-1 (Tina Portuando ed., 2006).

A grantor trust is effectively disregarded for federal income tax purposes because all of the trust's tax items are reported by the deemed owner. Accordingly, if the deemed owner is an eligible shareholder of S corporation stock, transfers of S corporation stock to a grantor trust will not jeopardize the company's S election. For purposes of the 100-shareholder limitation, the deemed owner is counted as the shareholder. IRC §1361(c)(2)(B)(i). This is true even where the trust contains *Crummey* powers that give the beneficiaries a power to withdraw some or all of the amounts contributed to the trust so that a gift of S corporation stock to the trust qualifies for the federal gift tax annual exclusion. See, e.g., PLR 200732010 (grantor trust with *Crummey* powers is an eligible shareholder of S corporation stock because the grantor's ownership of the trust under IRC §674 trumped the beneficiaries' ownership of the trust under IRC §678(a).

The fourth kind of eligible trust is a **former grantor trust**. IRC §1361(c)(2)(A)(ii). As its name implies, a former grantor trust is a trust that was a grantor trust (with a United States citizen or resident as the deemed owner) immediately before the deemed owner's death and that continues after such death. Although the trust is no longer a grantor trust because of the

deemed owner's demise, the trust itself remains an eligible S corporation shareholder regardless of its dispositive scheme until the day before the second anniversary of the deemed owners death. After such time, the trust will need to qualify as a QSST, ESBT, or grantor trust if the S election is to continue. The estate of the deemed owner is counted as the shareholder for purposes of the 100-shareholder limitation. If no one is the deemed owner of the trust, the trust itself pays the tax on the items of income, gain, loss, deduction, and credit attributable to its share of the S corporation's stock.

The final kind of eligible trust is a **testamentary trust**. All testamentary trusts are permitted S corporation shareholders for a two-year period beginning on the date the stock is transferred to the trust. IRC §1361(c)(2)(A)(iii). After such time, the trust will need to qualify as a QSST, ESBT, or grantor trust if the S election is to continue. During the two-year grace period, the trust itself pays the tax on the items of income, gain, loss, deduction, and credit attributable to its share of the S corporation's stock if no one is the deemed owner of the trust. The testator is treated as the shareholder for purposes of applying the 100-shareholder limitation.

IV. PARTNERSHIPS

A. THE BASIC MECHANICS

1. Formation

Like a corporation, formation of a partnership is also a painless event. A partner will not recognize gain or loss upon a transfer to the partnership in exchange for an interest unless the contribution consists of services. IRC §721. Note that a partner does not need to be an 80-percent owner to achieve non-recognition, as does the shareholder of a corporation. To preserve any gain or loss not recognized, the partner's basis in the partnership interest equals the sum of the bases of the properties transferred to the partnership in exchange for the interest. IRC §722. The partnership also takes a carry-over basis in the property received from the partner. IRC §723.

2. Operation

The tax items of a partnership pass through to the partners. IRC §§701; 702. Unlike an S corporation, however, the partners of a partnership are generally free to allocate these tax items among the partners as they wish, so long as these allocations have "substantial economic effect." IRC §704(b). Thus, equal partners in a partnership may agree to allocate all losses to one partner and all tax-exempt income to the other partner, so long as the allocations have "substantial economic effect." The flexible tax allocations make the partnership a more attractive business vehicle to most business owners.

Allocations have "economic effect" if the partnership agreement requires, for the full term of the partnership, that: (1) capital accounts be created and maintained in the manner set forth in the regulations (see Treas. Reg. §1.704-1(b)(2)(iv)); (2) liquidating distributions be made

in accordance with the partners' positive capital account balances; and (3) any partner with a deficit balance in his or her capital account following liquidation of the partnership be unconditionally obligated to restore the amount of the deficit (see Treas. Reg. §1.704-1(b)(2)(ii)(b)). A partner's capital account balance is the amount he or she would be entitled to receive upon liquidation of the partnership. A capital account is increased by the net value of any contributed cash or property and the partner's share of partnership income items. It is decreased by the value of any distributions to the partner and the partner's share of partnership loss and deduction items

If the partnership agreement complies with the first two requirements but does not comply with the third requirement, the allocation can still have economic effect under an alternate test. See Treas. Reg. §1.704-1(b)(2)(ii)(d). Assuming the economic effect test is met, an allocation will be respected if it is **substantial**. While various standards for substantiality are provided in the regulations—a general rule as well as a rule for shifting and transitory allocations—the focus is whether the allocation will affect substantially the dollar amounts to be received by the partners from the partnership. See Treas. Reg. §1.704-1(b)(2)(iii).

3. Distributions

As you would expect, distributions from a partnership are generally tax-free since the partners have already taken the partnership's tax items into account on their own income tax returns. No gain is recognized upon a distribution to a partner except to the extent the amount of cash distributed exceeds the partner's outside basis immediately before the distribution. IRC §731(a)(1). No gain or loss is recognized by the partnership. IRC §731(b). If a partner receives cash or property regardless of the partnership's profitability, however, the distribution may constitute a "guaranteed payment" that will be treated as compensation income. IRC §707. Further discussion of the partnership distribution rules appears later in these materials.

4. Liquidation

The basis of property (other than money) distributed to a partner in liquidation of the partner's interest in the partnership is an amount equal to the partner's basis in the partnership interest reduced by any money distributed in the same transaction. IRC §732(b). Liquidation of a partner's interest is defined as the termination of the partner's entire interest in the partnership by means of a distribution or series of distributions. See IRC §761(d). Loss is not recognized by a partner upon a distribution *except* that loss *is* recognized on a distribution in liquidation of a partner's interest where no property other than cash, unrealized receivables, and inventory items are received by the partner. IRC §731(a)(2). The amount of the loss (which is considered to be loss from the sale or exchange of the partnership interest) is equal to the excess of the partner's basis in the partnership interest over the sum of the cash distributed to the partner and the adjusted basis of the distributed property under IRC §732.

B. PLANNING OPPORTUNITIES WITH PARTNERSHIPS

1. The IRC §754 Election and the Adjustment to Inside Basis

If the partnership makes an election under IRC §754, the partnership's basis in its assets ("inside basis") will be adjusted, but only with respect to the transferee partner. Specifically, the entity will increase its inside basis by the excess of the transferee partner's outside basis (freshly stepped-up under IRC §1014, remember) over his or her share of the partnership's inside basis. Alternatively, if the transferee partner's outside basis was stepped-*down* under IRC §1014, the entity will reduce its inside basis by the excess of the transferee partner's share of inside basis over his or her outside basis. This adjustment to inside basis affects not just the allocation of gain and loss to the transferee partner upon a disposition of a partnership asset. It determines the partner's share of inside basis for purposes of depreciation deductions and distributions, as well.

Notice that if the estate planner succeeds in claiming a significant valuation discount for the value of the partnership interest included in the deceased partner's gross estate, there is an adverse effect on the adjustment to inside basis (though usually not to such an extent that the valuation discounts have no net value).

EXAMPLE: Mom dies holding a five percent general partner interest and a 20 percent limited partner interest in a partnership. The partnership's assets have a combined liquidation value of $1,000,000 and an aggregate inside basis of $200,000. Mom's estate values the five percent general partner interest at $40,000 (assuming a 20 percent blended valuation discount against the $50,000 liquidation value attributable to the general partner interest) and it values the 20 percent limited partner interest at $120,000 (assuming a 40 percent blended valuation discount against the $200,000 liquidation value attributable to the limited partner interest). Both interests pass to Son. Son's aggregate outside basis is $160,000, the sum of the date-of-death values of the general and limited partner interests included in Mom's gross estate.

If the partnership has a valid IRC §754 election in effect, the $50,000 of aggregate inside basis (that portion of the inside basis attributable to Mom's interests) is increased to $160,000, *not* to its $250,000 liquidation value. Thus, while the IRC §754 election eliminates the disparity between inside and outside bases with respect to Son, the election does not completely eliminate the inherent gain attributable to the interests now held by Son; if the partnership sells all of its assets, $90,000 of gain will be allocable to Son. Of course, this beats the $200,000 gain that would have been allocable to Son had no IRC §754 election been made. And the estate tax savings from an aggregate $90,000 discount likely exceeds the income tax burden from $90,000 of extra gain. But it shows that the higher the discount, the less beneficial the IRC §754 election becomes to the decedent's successor in interest.

Note that if the deceased partner's surviving spouse is also a partner in the partnership, and if the spouses owned their interests as community property, the surviving spouse's interest in the partnership also triggers an adjustment to inside basis if the IRC §754 election is in effect.

2. S Corporation Election

Unincorporated domestic entities (like partnerships) can elect to be treated as corporations for federal tax purposes. Treas. Reg. §301.7701-3. Any such organization that elects status as a corporation can also elect to be taxed as an S corporation. See, e.g., Priv. Ltr. Rul. 199942017. To the extent a partnership wants to avail itself of the benefits of S corporation status, the partners can simply make this two-step election to achieve the desired status.

The key obstacle, of course, is that an electing unincorporated entity must meet the eligibility requirements of an S corporation in order for the S election to become effective. The entity, for example, cannot have more than 100 owners and no owner may be a nonresident alien individual. See IRC §1361(b)(1)(A), (b)(1)(C). These are easy enough to spot, but the "single-class-of-stock" requirement for S corporations under IRC §1361(b)(1)(D) can be harder to police. The Service will not issue rulings as to whether a limited partnership qualifies as a small business corporation eligible to elect S corporation status. Rev. Proc. 2011-3, 2011-1 I.R.B. 111, §5.11. No doubt this is because the varying rights and obligations of general and limited partners may well constitute a second class of stock. See Rev. Proc. 99-51, 1999-2 C.B. 760. We know that a limited partnership agreement does not create a second class of stock as long as distributions to the partners are to be made in accordance with the partners' respective cumulative interests. See, e.g., Priv. Ltr. Ruls. 200326023, 200326024, and 200326025. In the last of these private rulings, the shareholders of an S corporation (S1) formed a limited liability partnership (LLP) that made a double-election to be treated as an S corporation. The shareholders then contributed their S1 stock to LLP and S1 elected to be treated as a qualified subchapter S subsidiary corporation (or "Q-Sub"). LLP then created a wholly-owned limited liability company (LLC) that is disregarded for federal tax purposes as an unincorporated organization with only one owner. LLP transferred some of its S1 stock to LLC. Because LLC is disregarded, S1's Q-Sub election is not lost. S1 then converted to a limited partnership, with LLC as the general partner and LLP as the limited partner. As a limited partnership, S1 made a triple-election (electing to be a corporation, an S corporation, and a Q-Sub). At the end of the day, then, the shareholders owned all of the interests in LLP (an S corporation for tax purposes) which in turn held all of the limited partner interests (and, through a disregarded entity, all of the general partner interests) in a limited partnership (a Q-Sub for tax purposes). The Service approved this transaction in the ruling.

If the partnership agreement requires distributions in accordance with positive capital account balances and such capital accounts are not in proportion to the partners' percentage interests, however, the partnership likely has more than one class of stock, making the S election unavailable. See Richard B. Robinson, *Tax Audit Issues for S Corporations*, in 41ST ANNUAL SOUTHERN FEDERAL TAX INSTITUTE MATERIALS at J-7 (2006). Disproportionate operating distributions from the partnership should not create a second class of stock provided the entity makes corrective distributions to make distributions proportionate. See, e.g., Priv. Ltr. Rul. 200524020.

3. Allocating Items in the Year of a Partner's Death

Upon the death of a partner, IRC §706(c)(2)(A) provides that the taxable year of the partnership closes with respect to the deceased partner. The deceased partner's final income tax return includes all pass-through items for the short taxable year ending at death, either through an interim closing of the books or through a *pro rata* allocation based on the number of days in each period. Treas. Reg. § 1.706-1(c)(2)(ii).

EXAMPLE: *A*, *B*, and *C* are equal general and limited partners in a partnership. *A* dies on July 1, Year One. The partnership's income for Year One consists of two gains: a $900 gain in March and a $300 gain in November. If the partnership makes an election to close its books on July 1, the proportionate shares of the partners would be as follows:

Partner	March Gain Share	November Gain Share
A	$300	zero
B	$300	$150
C	$300	$150

If, on the other hand, the partnership does not close its books, the proportionate shares of the partners for Year One would be as follows:

Partner	March Gain Share	November Gain Share
A	$150	$50
B	$375	$125
C	$375	$125

In this example, *B* and *C* are inclined to close the books, for their proportionate shares under a closing of the books ($450) is less than their shares if no such election is made ($500). Of course, if the November gain were larger than the March gain, the incentive would be the opposite.

The point is that the fiduciary and the surviving partners should work together to determine which approach is better. The same is generally true of S corporations. IRC §1377(a), presumes that S corporation items will be allocated *pro rata* on a daily basis unless the surviving shareholders agree to an interim closing of the books.

C. PLANNING CHALLENGES PRESENTED BY PARTNERSHIPS

1. The Estate Planning Drawbacks of Special Allocations

Partners are generally free to allocate the income, gain, loss, deduction, and credit items of the partnership among themselves however they may agree, subject to the constraint in IRC §704(b) that such allocations have "substantial economic effect." Detailed regulations give guidance for ensuring that allocations meet this amorphous standard. The regulations provide

two safe harbors under which an allocation will be deemed to have "economic effect." Treas. Reg. § 1.704-1(b)(2)(ii). The first safe harbor applies where the partnership agreement requires: (1) the determination and maintenance of capital accounts in accordance with specific rules provided elsewhere in the regulations; (2) that liquidating distributions be made in accordance with the positive capital account balances of the partners; and (3) that any partner with a deficit balance in his or her capital account at liquidation be required to restore the deficit balance to the partnership within a stated period. Treas. Reg. § 1.704-1(b)(2)(ii)(b). The second safe harbor applies where the partnership agreement requires: (1) both of the first two conditions of the first safe harbor (maintenance of capital accounts according to specific rules and liquidating distributions according to positive capital account balances); (2) the operation of a "qualified income offset" provision; and (3) that no allocation to a partner may cause or increase a deficit balance to that partner's capital account in an amount greater than the amount that partner is obligated to restore upon liquidation of the entity. Treas. Reg. § 1.704-1(b)(2)(ii)(d).

Both safe harbors require the partnership to maintain capital accounts using specific accounting rules set forth in the regulations. Treas. Reg. § 1.704-1(b)(2)(iv). In some cases, compliance with these accounting rules proves to be difficult (i.e., expensive).

Special allocations of partnership income and deduction items are common in partnerships that conduct an active trade or business in which the partners participate. From an estate planning perspective, however, they may pose two problems. First, the use of special allocations might run afoul of IRC §2701. Section 2701 values certain retained interests in a partnership at zero for purposes of valuing subordinate equity interests transferred to certain family members. If all interests in a partnership have identical distribution and liquidation rights, IRC §2701 does not apply. Accordingly, estate planners usually advise the partners to make sure all income and deduction allocations are made according to the partners' interests in the partnership, regardless of whether such interests have voting or management rights. Differences in voting and management rights (as well as differences in liability for entity debts) do not by themselves create subordinate equity interests, so creating voting and nonvoting partnership interests does not trigger application of IRC §2701's zero-value rule. Treas. Reg. § 25.2701-1(c)(3).

Second, where the planner intends to have a partner give some portion of his or her partnership interest to a donee, the planner must be cognizant of IRC §704(e)(2). It states that where there has been a gift of a limited partner interest in a partnership, the recipient's distributive share of the partnership's income is limited in two ways. *First*, the donor must be adequately compensated for any services rendered to the FLP. In other words, the donor cannot perform services at no charge for the partnership and pass along the savings to the recipient. For example, suppose Parent gives Child a 40 percent limited partner interest in a partnership, retaining a ten percent general partner interest and a 50 percent limited partner interest. The partnership's taxable income for the year is $100,000. In that same year, Parent performed services for the partnership valued at $40,000. An allocation of $40,000 of the $100,000 taxable income to Child would violate IRC §704(e)(2) because it does not consider the services performed by Parent. Instead, the $40,000 in services should be treated as compensation to Parent, leaving

$60,000 to be allocated according to the partners' interests in the partnership. In sum, Parent would be allocated income totaling $76,000 ($40,000 for Parent's services plus 60 percent of the partnership's remaining $60,000 income, or $36,000), while Child would be allocated $24,000 of income (40 percent of the partnership's $60,000 income after services).

Second, if the recipient's interest was funded with donated capital, the donor and the recipient must be allocated income in proportion to the donated capital. In effect, the maximum income allocable to a recipient partner is the income allocable to the recipient partner's interest in partnership capital. Thus, if Mom and Dad form a partnership with contributed capital and gift a 20 percent limited partner interest to Child, Child must report 20 percent of the partnership's income attributable to the contributed capital. Combining the two rules under IRC §704(e)(2), the regulations state that family partnership income must be distributed proportionate to capital interests after distributing reasonable compensation to the donor for services rendered to the partnership. Treas. Reg. § 1.704-1(e)(3).

If the partnership is a holding company (one not actively conducting a trade or business), it is rare to see special income or deduction allocations. Given the risks described above, it might be better *not* to follow the capital account rules in the regulations, provided the partnership agreement requires all allocations to be in accordance with the partners' interests in the partnership. Remember: failure to fall within one of the two safe harbors for economic effect means only that the Service can reallocate items if it determines that an allocation with not made in accordance with the partners' interests in the partnership. It does not mean that all allocations are *per se* invalid.

2. Distributions within Seven Years of Capital Contributions

Normally, property distributions from a partnership are tax-free. IRC §731(a). Cash distributions from a partnership are taxable to the extent the cash distributed exceeds the recipient partner's basis in the partnership interest immediately prior to the distribution. IRC §731(a)(1). But if the partnership liquidates within seven years of a partner's contribution of property to the partnership, two Code provisions can convert a tax-free liquidation into a taxable one. For more on the federal income tax aspects of liquidating a partnership formed for estate planning purposes, see Samuel A. Donaldson, *Super-Recognition and the Return-to-Sender Exception: The Federal Income Tax Problems of Liquidating the Family Limited Partnership*, 35 CAP. U. L. REV. 15 (2006). Look, *someone* has to cite my works.

First, IRC §704(c)(1)(B) provides that if property distributed to one partner was contributed to the partnership by another partner within seven years of the distribution, and if that property had built-in gain or loss at the time of contribution, then the contributing partner must recognize the built-in gain or loss at the time of the distribution.

EXAMPLE: *A* and *B* formed a partnership in Year One when *A* contributed farmland worth $500,000 and with an adjusted basis of $300,000 in exchange for a five percent general partner

interest and a 45 percent limited partner interest, and *B* contributed cash in the amount of $500,000 for a 50 percent limited partner interest. In Year Five, the partnership distributed the farmland to *B*. Assuming the value of the land has not changed since contribution, *A* must recognize *A*'s $200,000 built-in gain from the farmland in Year Five.

Recognition of the built-in gain is avoided if the property is distributed back to the contributing partner. For this purpose, any assignee or successor to the contributing partner's interest is treated as the contributing partner to the extent of the built-in gain allocable to the assignee-successor's interest. Treas. Reg. § 1.704-4(d)(2).

EXAMPLE: Assume the same facts from the prior example, If in Year Four *A* gave *A*'s general and limited partner interest to *C*, and if in Year Five the partnership distributed the farmland to *C*, neither *A* nor *C* recognizes gain from this distribution under IRC §704(c)(1)(B) since *C* was *A*'s successor in interest.

Second, IRC §737 generally provides that if a partner contributes appreciated property to the partnership and, within seven years of such contribution, receives a distribution of non-cash property, the contributing partner must recognize the IRC §704(c) built-in gain (or, if less, the excess of the distributed property's value over the partner's outside basis immediately prior to the distribution minus any cash received in the same distribution).

EXAMPLE: Assume the facts from the example involving *A* and *B* and the formation of their partnership in Year One. The partnership used the cash contributed by *B* to acquire a small parcel of vacant land in the suburbs. In Year Five, the partnership distributed the suburban land to *A*. Assuming the value of the contributed properties has not changed since contribution, *A* must recognize the $200,000 built-in gain from the farmland in Year Five.

As was the case with IRC §704(c)(1)(B), an assignee-successor to a contributing partner's interest is treated as a contributing partner for purposes of IRC §737's general rule. Treas. Reg. § 1.737-1(c)(2)(iii).

EXAMPLE: Assume the same facts from the prior example. If *A* gifted *A*'s general and limited partner interests to *C* in Year Four and the partnership distributed the suburban land to *C* in Year Five, *C* "steps into *A*'s shoes" and must recognize in Year Five the $200,000 built-in gain from *A*'s contribution of the farmland in Year One.

On its face, § 737 would apply if the contributing partner received back from the partnership the appreciated property originally contributed to the partnership. Regulations recognize that because such a "return-to-sender" distribution is not taxable under IRC §704(c)(1)(B), IRC §737 does not apply if the contributing partner receives the property he or she originally contributed to the partnership. Treas. Reg. § 1.737-2(d)(1). Oddly, however, there is no rule providing that an assignee-successor to the contributing partner's interest likewise qualifies

for this exception. It is therefore possible that an assignee-successor must recognize gain under IRC §737 upon receipt of property originally contributed to the partnership by the assignee-successor's predecessor in interest—even though the receipt of the contributed property by the same party is expressly *not* subject to IRC §704(c)(1)(B). For a contrary view, *see* Ellen K. Harrison and Brian M. Blum, *Another View: Responding to Richard Robinson's 'Don't Nothing Last Forever'—Unwinding the FLP to the Haunting Melodies of Subchapter K*, 28 ACTEC J. 313, 315 (2003).

The moral of the story here is to postpone any distributions of IRC §704(c) property until the partnership has held such property for seven years, as IRC §§704(c)(1)(B) and 737 only apply to distributions made within seven years of contribution.

3. Distributions of Marketable Securities Treated as Cash Distributions

Under IRC §731(a)(1), no gain is generally recognized upon a distribution from a partnership except to the extent that any cash received in the distribution exceeds the recipient partner's outside basis immediately prior to the distribution. For purposes of this rule, however, IRC §731(c) provides that marketable securities are treated as cash (valued at fair market value as of the date of distribution). That, of course, creates the risk that a distribution of marketable securities will be a taxable event to the recipient partner.

EXAMPLE: *A* and *B* formed a partnership when *A* contributed a collectible with a value of $100,000 and a basis of $20,000 and *B* contributed $100,000 cash. The partnership used $50,000 of the cash to purchase Microsoft stock. The partnership then distributed the Microsoft stock to *A*. Under IRC §731(c), the stock distribution is treated as a cash distribution in the amount of $50,000, the value of the Microsoft shares distributed. *A* recognizes gain of $30,000 because the amount of deemed cash distributed exceeds *A*'s $20,000 outside basis.

By its terms, IRC §731(c) does not apply if: (a) the marketable securities received by the partner were those contributed by the same partner; (b) subject to some limitations, the marketable securities distributed were acquired by the partnership in a nonrecognition transaction (provided the total cash and marketable securities acquired by the partnership in the nonrecognition transaction is less than 20 percent of the value of the assets transferred by the partnership in such transaction and further provided that the distribution of the marketable securities occurs within five years of the partnership's acquisition of the securities (or, if later, within five years of the date when the securities became marketable)); (c) the distributed securities were not marketable when first acquired by the partnership and did not become marketable for at least six months (the partnership must distribute the securities within five years of the date upon which they became marketable and the issuer of the securities must not have issued any marketable securities prior to the time the partnership first acquired the distributed securities); or (d) the partnership is an "investment partnership" and is making a distribution to an "eligible partner."

This last exception requires elaboration. A partnership will qualify as an investment partnership if it has never been engaged in a trade or business and 90 percent or more of its assets, measured by value, have always consisted of portfolio assets. Treas. Reg. § 1.731-2(c)(3)(i). And an eligible partner is any partner that contributed nothing but such portfolio assets to the partnership. Treas. Reg. § 1.731-2(e)(2)(i).

Now let's return to the first exception: marketable securities will not be treated as cash for purposes of IRC §731 if they are distributed to the same partner that contributed them to the partnership. This is consistent with the "return-to-sender" exceptions under IRC §§704(c)(1)(B) and 737 described above. But here, as with IRC §737, there is no rule extending the exception to a distribution of marketable securities to an assignee-successor to the contributing partner's partnership interest. Regulation § 1.731-2(d)(1) states, in relevant part that "section 731(c) and this section do not apply to the distribution of a marketable security if-(i) the security was contributed to the partnership by the distributee partner…." No mention is made of a successor in interest here.

In short, then, those who receive a partnership interest by gift may have to recognize gain upon a distribution of marketable securities from the partnership even if those securities were contributed to the partnership by the donor. And the application of this rule does not expire after seven years.

One solution is to effect a proportionate distribution of any marketable securities. By doing so, one makes better use of the limitation in IRC §731(c)(3)(B), which reduces the amount of the deemed cash distribution by the recipient partner's share of gain on the distributed securities.

EXAMPLE: In Year One, *A*, *B*, and *C* formed a partnership when *A* contributed stock in Starbucks Corporation worth $900,000 (in which *A* had a basis of $720,000) in exchange for a four percent general partner interest and an 86 percent limited partner interest, while *B* and *C* contributed their undivided, one-half interests in a parcel of raw land worth a total of $100,000 (in which each had a basis of $20,000) in exchange for a ten percent limited partner interest (five percent held by *B* and five percent held by *C*. *A* died in Year Ten, leaving *A*'s general and limited partner interests in equal shares to *B* and *C*. At the date of *A*'s death, the Starbucks stock is worth $1.5 million, and the raw land is worth $500,000. *A*'s estate claims a 50 percent combined discount on the value of the partnership interests passing to *B* and *C*, reporting a combined value of $900,000 on *A*'s federal estate tax return (90 percent interest in a total liquidation value of $2 million, less 50 percent). Each beneficiary's aggregate outside basis in FLP is now $470,000 ($450,000 attributable to the 90 percent interest from *A* that was stepped-up under IRC §1014 plus $20,000 attributable to the ten percent interest acquired through their contribution).

If the partnership distributes the Starbucks stock in equal shares to *B* and *C*, each is deemed to receive a cash distribution of only $360,000 (not $750,000), because the $390,000 gain that would be allocated to each child from partnership's sale of the stock reduces the deemed cash

distribution pursuant to IRC §731(c)(3)(B). (For convenience, this example assumes no IRC §754 election is in place.) This deemed distribution is not taxable to either *B* or *C* because each has an outside basis in excess of the deemed distribution amount. The distribution will reduce each of *B*'s and *C*'s outside basis to $110,000 ($470,000 minus $360,000 deemed cash). Note that IRC §704(c)(1)(B) does not apply in this example because the distribution occurs after the seven-year period during which IRC §704(c)(1)(B) is alive.

If, instead, the partnership distributes the raw land plus $500,000 of the Starbucks stock to *B* ($1 million total) and the remaining $1 million of Starbucks stock to *C*, the result changes. *C* is deemed to receive a cash distribution of $610,000 (not $1 million), because the $390,000 gain that would be allocated to *C* from the partnership's sale of the stock reduced the deemed cash distribution under IRC §731(c)(3)(B). Because *C*'s outside basis immediately prior to the distribution is $470,000, *C* must recognize $140,000 of gain thanks to the deemed cash distribution. The disproportionate distribution of the Starbucks stock to *C* in this case forced the recognition of gain that would not have occurred in a proportionate distribution of the stock. Notice here that the IRC §754 election might be detrimental to the successors in interest. An increase in inside basis lessens the benefit of the IRC §731(c)(3)(B) reduction for the distributee's distributive share of gain on the property. If the partnership would realize no gain if it sold the distributed property, there is no reduction in the amount of the deemed cash distribution. Thus, while the IRC §754 election is generally beneficial in the context of IRC §§704(c)(1)(B) and 737, it can be disadvantageous for purposes of IRC §731(c).

The IRC §731(c)(3)(B) gain limitation is handy where the partnership distributes marketable securities with a low inside basis. Partners should therefore be reluctant to distribute freshly-purchased marketable securities with an inside basis (nearly) equal to their value. Likewise, marketable securities that have recently declined in value are less attractive candidates for distribution to donee-partners.

While a proportionate distribution of marketable securities may be helpful in avoiding IRC §731(c), it presents problems outside of the tax realm. Beneficiaries are often reluctant to hold assets as tenants in common (proof that the minority interest discount and, to a greater extent, the marketability discount are quite real). If so, then perhaps the best solution to the IRC §731(c) problem lies back in the exceptions: where possible, a partnership holding a substantial amount of marketable securities should own only portfolio assets at all times and care should be taken to make sure each partner is an "eligible partner." One *bad* solution would be to reallocate the partnership's gain to the distribute partner in an effort to maximize use of the IRC §731(c)(3)(B) gain limitation. Regulations give the Service the power to disregard a blatant attempt to avoid IRC §731(c)(1) through a change in partnership allocations. Treas. Reg. § 1.731-2(h)(1).

4. Sales of Partnership Interests Can Yield Ordinary Income

Subchapter K uses a hybrid aggregate-entity approach for the sale of an interest in a partnership. Generally, the sale gives rise to capital gain or loss because the selling partner is

disposing of a capital asset. IRC §741. But the portion of the gain or loss allocable to "unrealized receivables" or "inventory items" will be treated as ordinary income or loss. IRC §751(a). This rule applies no matter whether the partner sells all or part of the partner's interest.

Unrealized receivables are any rights to payments for goods or services that have not previously been included in the partnership's gross income. The term also includes any gain attributable to assets the sale of which would give rise to ordinary income. IRC §751(c). **Inventory items** are any assets that are neither capital assets nor IRC §1231 assets. IRC §751(d). Accordingly, "inventory" means not only inventory but also, for example, supplies used in the partnership's business and gains from hedging transactions.

EXAMPLE: *A* owns a one-third interest in the *ABC* Partnership, a cash method partnership that develops real estate. *ABC* both constructs buildings for sale to customers and holds real estate for rental purposes. On January 1, *A* sells her partnership interest to *D* for $180,000 cash. *ABC*'s balance sheet at the time of the sale is as follows:

Asset	Basis	Value	Capital	Basis	Value
Cash	$ 45,000	$ 45,000	*A*	$110,000	$180,000
Accounts Receivable	$ 0	$ 60,000	*B*	$110,000	$180,000
Building for sale	$150,000	$180,000	*C*	$110,000	$180,000
Building for rent	$135,000	$240,000			
Goodwill	$ 0	$ 15,000			
	$330,000	$540,000		$330,000	$540,000

A's realized gain from the sale is $70,000. To determine the character of this gain, we must pretend *ABC* sold *A*'s share of all partnership assets for fair market value. Treas. Reg. §1.751-1(a)(2). The accounts receivable are "unrealized receivables" under IRC §751(c), and *A*'s share of the $60,000 partnership gain from a sale of the receivables is $20,000. In addition, the building held for sale is an inventory item of the partnership under IRC §751(d), and *A*'s share of the $30,000 gain to the partnership is $10,000. Accordingly, *A* must recognize $30,000 of ordinary income from the sale of her partnership interest ($20,000 from the receivables and $10,000 from the building for sale). The building held for rent is not IRC §751(a) property because it is not held for sale to customers. The property qualifies as IRC §1231 property under IRC §1231(b), so it is not an "inventory item" of the partnership. The remaining $40,000 of *A*'s $70,000 realized gain may be long-term capital gain, provided *A* held her partnership interest for more than one year.

5. No Tax-Free Mergers with Corporations

Only corporations can participate in tax-free reorganizations with other corporations. A merger between a partnership and a corporation is treated as a taxable exchange. If the partners anticipate selling their business to a corporation and wish to participate in a tax-free reorganization transaction, they may be tempted to "check the box" so that the partnership is taxed as a corporation. But if the partners make the election only shortly before engaging in the

reorganization, there is a high risk that the transaction will not qualify for nonrecognition. This risk arises under the common law step transaction doctrine, where a proposed reorganization planned prior to the formation of a target corporation can be deemed a taxable exchange because there is no other business purpose for the corporation and because the transaction is, in substance, a taxable exchange. *West Coast Marketing Corp. v. Commissioner*, 46 TC 32 (1966).

There is no magic amount of time after electing corporate status that a former partnership should wait before the reorganization occurs. Instead, the principal focus should be on making sure there is some separate business purpose for converting the partnership to a corporation beyond qualifying the exchange for nonrecognition. See Robert R. Keatinge, *Tax Considerations in Choice of Business Entity*, 31ST ANNUAL AMERICAN INSTITUTE ON FEDERAL TAXATION, Outline 9, at 71 (2007). If the partners anticipate that the business might be acquired by a corporation, it is a good idea to create a corporation well in advance of discussions with a particular buyer. The partners can then move the business assets from the partnership to the corporation as discussions become serious. There is authority to suggest that funding a shell corporation followed shortly by the shell's acquisition by another corporation can qualify as a tax-free reorganization. *Weikel v. Commissioner*, T.C. Memo. 1986-58. *Weikel* has been criticized by other courts. See *Long Term Capital Holdings v. U.S.*, 330 F. Supp. 2d 122 (D. Conn. 2004); *Associated Wholesale Grocers v. U.S.*, 927 F.2d 1517 (10th Cir. 1990). Both of these cases observe that courts can still apply the step transaction doctrine to transactions even where the business purpose for the entity is established.

It is important to note that no such risk exists where the partners wish to take the business public instead of selling it to an acquiring corporation. A last-minute conversion or incorporation of the business on the eve of a public offering does not disqualify the conversion from nonrecognition. This is because the conversion qualifies for nonrecognition under IRC §351, which does not have a continuity of interest requirement that applies to reorganizations under IRC §368(a).

6. The Built-in Gain Problem Under IRC §704(c)

If a partner contributes "built-in gain property" to the partnership, subchapter K and corresponding regulations insure that the contributing partner's built-in gain cannot be shifted to another partner. Built-in gain property is property which, on the date of contribution to the partnership, has a fair market value greater than its tax basis. IRC §704(c)(1)(A); Treas. Reg. §1.704-4. When the partnership disposes of the built-in gain property, the built-in gain *must* be allocated to the contributing partner. IRC §704(c)(1)(A).

Dealing with Uncle Sam: Everyone's Least Favorite Relative in the Family Business

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The Three Entities

C CORPORATIONS

S CORPORATIONS

PARTNERSHIPS

1

C Corporations

The Roach Motel of Business Entities

C Corporations

TAX-FREE FORMATION

- transfer of **property** to corporation
- **solely** in exchange for
- **80%+** of stock
- (unless **debt exceeds basis**)

TAXATION OF OPERATIONS – Flat 21% tax

C Corporations

TAXATION OF DISTRIBUTIONS

- "Dividends" taxed at preferential rates
- Property distributions taxable to company
- Stock distributions rarely taxable

LIQUIDATION – taxable event

C Corporations – Planning Opportunities

- §1202 stock exclusion

  - Stock in domestic C corporation
  - Originally issued after 8/10/1993
  - Acquired as compensation or in exchange for cash or property
  - Company's aggregate gross assets don't exceed $50 million
  - 80% of assets used in active conduct of business (not specified service business)

- Like-kind exchanges of §1202 stock
- S election
- Pay generous rents to shareholder-landlord

C Corporations – Planning Challenges

- Double taxation of corporate income
- Accumulated earnings tax
- Funding a buy-sell agreement

S corporations

The “S” is for “Small,” “Simple,” and “Strict”

S Corporations

ELIGIBILITY RULES

- Domestic corporation
- No more than 100 shareholders
- No nonresident alien shareholders
- No entity shareholders
- One class of stock

TAXATION OF OPERATIONS – “pass-through” regime

S Corporations

DISTRIBUTIONS

- If always S corp, distributions tax-free to extent of shareholder's stock basis
- If former C corp, distributions consist first of S corp earnings, then C corp earnings

S Corporations – Planning Opportunities

- Borrowing to Buy Shares
- Employment Tax Loophole
- Shifting Gain to Co-Owners
- Get Basis Now, Pay Later

S Corporations – Planning Challenges

- Employees that are "2%-Shareholders"
- Getting Basis Credit for Entity Debt
- Debt as Potential Second Class of Stock
- Problems for Former C Corporations
  - LIFO recapture at conversion
  - Tax on "built-in gains"
  - Tax on "excess passive income"

S Corporations – Trusts Holding S Corp. Stock

QUALIFIED SUBCHAPTER S TRUST

ELECTING SMALL BUSINESS TRUST

GRANTOR TRUST

FORMER GRANTOR TRUST or TESTATMEN-TARY TRUST

Partnerships

All unincoporated entities with 2+ owners

Partnerships

FORMATION

- §721 → tax-free
- §722 → partner takes carryover basis
- §723 → partnership takes partner's basis

OPERATION – "pass-through," but flexible

DISTRIBUTIONS

- Cash tax-free to extent of basis
- Property distributions tax-free, but carryover basis

Partnerships – Planning Opportunities

- §754 Election
- S Corporation Election
- Allocations at Partner Death

Partnerships – Planning Challenges

- Special Allocations May Have Estate Tax Consequence
- Distributions within 7 Years of Contribution
- Distributions of Marketable Securities
- Ordinary Income on Sale of Partnership Interest

Thanks!

Any questions?

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