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# ESTATE PLANNING UPDATE

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ESTATE PLANNING UPDATE

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Preface


The 2012 Tax Act retained the existing $5,000,000 exemption (adjusted for inflation from 2010) for estate tax, gift tax and generation-skipping transfer (“GST”) tax purposes, and increased the maximum tax rate for all such purposes from 35% to 40%. In addition, the 2012 Tax Act made “permanent” (absent any further legislation) the federal transfer tax changes made to the Internal Revenue Code1 by the Tax Relief, Unemployment Insurance Reauthorization, and the Job Creation Act of 2010 (the “2010 Tax Act”) and many of the changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”). Further, the 2012 Tax Act increased the maximum income tax rate from 35% to 39.6% for high income persons, and increased the maximum income tax rate on dividends and long-term capital gains from 15% to 20%. Part I of this outline describes the important transfer tax aspects of the 2012 Tax Act.


1 All references to the Code and to the Internal Revenue Code of 1986, as amended.

IRS CIRCULAR 230 DISCLOSURE: To ensure compliance with Treasury Department regulations, we inform you that any U.S. federal tax advice contained in this outline (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties that may be imposed under the U.S. Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.
and state transfer tax considerations resulting from certain changes in the federal transfer tax laws.

The remaining parts of this outline discuss other important federal and state tax developments, and important non-tax developments, regarding estates and trusts.

I. THE AMERICAN TAXPAYER RELIEF ACT OF 2012


The 2012 Tax Act retains the $5,000,000 exemption, indexed for inflation since 2010, for transfers occurring, and for estates of persons dying, in 2013 and thereafter, for estate tax, gift tax and GST tax purposes, and increases the maximum tax rate for all such purposes from 35% to 40%. The inflation adjusted exemption for 2013 is $5,250,000.

In addition, the 2012 Tax Act continues the “portability” provisions that allow a surviving spouse to use the unused portion of the gift tax and estate tax exemption of the last deceased spouse of the surviving spouse. The surviving spouse can use such unused portion for both gift tax and estate tax purposes, but not for GST tax purposes. The executor of the estate of the first spouse to die must elect “portability” on a timely filed federal estate tax return for such deceased spouse’s estate, for the surviving spouse to be able to use such deceased spouse’s unused estate tax exemption, even if a federal estate tax return for such deceased spouse’s estate is not otherwise required to be filed.

Very importantly, the 2012 Tax Act does not contain any so-called “sunset” provision regarding these changes. Therefore, these federal transfer tax changes are “permanent”, absent any further legislation (unlike EGTRRA and the 2010 Tax Act, both of which contained “sunset” provisions).

It also is important to note that the 2012 Tax Act does not contain any provisions requiring a minimum term for grantor retained annuity trusts (GRATs), any provisions regarding valuation discounts for gift tax and estate tax purposes (which generally would be applicable in the case of family limited partnerships), or any provisions requiring the includibility in a person’s gross estate for estate tax purposes of so-called “grantor” trusts. As a result, all of these techniques continue to be important estate planning tools, as in the past.

As a result of the 2012 Tax Act, the federal transfer tax laws for 2013 and thereafter have achieved a degree of permanence that did not previously exist.

Practitioners may well want to send a mailing to their estate planning clients, if they have not already done so, alerting their clients to the changes in the law as a result of the 2012 Tax Act. A copy of such mailing which the authors of this outline have sent to their estate planning clients, and others, is attached to this outline as Exhibit “A”.


The 2012 Tax Act increased the maximum income tax rate from 35% to 39.6% for taxable income in excess $450,000 for married persons filing jointly, and $400,000 for an
unmarried individual; reinstated the previously existing “phase-out” of personal exemptions (the “PEP” provision) for individuals with adjusted gross income in excess of $300,000 for married persons filing jointly, and $250,000 for an unmarried individual; reinstated the previously existing limitation on itemized deductions (the “Pease provision”) for individuals with adjusted gross income in excess of $300,000 for married persons filing jointly, and $250,000 for an unmarried individual; increased the maximum income tax rate for qualified dividends and long-term capital gains from 15% to 20% for married persons filing jointly having taxable income over $450,000, and for single taxpayers having taxable income over $400,000; made alternative minimum tax relief permanent; and extended the income tax deduction for state and local sales taxes only for 2012 and 2013.

In addition, the 2012 Tax Act extends for 2013 the ability of a person who is older than 70-1/2 to make a direct contribution to charity of up to $100,000 from the person’s Individual Retirement Account, without the contribution being included in the person’s income.

II. THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010


Prior to the 2010 Tax Act, the applicable exclusion amount (i.e., the exemption) for estate tax purposes was $3,500,000 in 2009, and the maximum estate tax rate was 45% in 2009. Prior law also provided that there would be no estate tax for estates of persons dying in 2010, although such estates would be subject to a modified carryover basis regime for the decedent’s assets, rather than having an income tax cost basis for those assets equal to the federal estate tax values of such assets.

Pursuant to the 2010 Tax Act, the estate of a person dying in 2010 or thereafter would have an applicable exclusion amount of $5,000,000 (indexed for inflation from 2010, but starting in 2012) for estate tax purposes, the maximum estate tax rate would be 35% in 2010 and thereafter, and all such estates would have a basis for income tax purposes with respect to the assets acquired from the decedent equal to the federal estate tax values of such assets.

However, the 2010 Tax Act also permitted the estate of a person who died in 2010 to instead elect not to be subject to any federal estate tax, but to be subject to the modified carryover basis regime that existed under prior law. Under this modified carryover basis regime, for income tax purposes the income tax cost basis of assets that are inherited would be the lesser of the decedent’s income tax cost basis of those assets, or the value of those assets at the date of the decedent’s death, except that such estate could increase the basis of the decedent’s assets to the extent of $1,300,000, and could also increase the basis of assets bequeathed to the decedent’s surviving spouse outright, or bequeathed to a trust for the benefit of the decedent’s spouse for which the estate receives an estate tax marital deduction (i.e., generally a QTIP trust), to the extent of $3,000,000.
The estate of a person dying in 2010 who had a gross estate of less than the applicable exclusion amount of $5,000,000 would generally not opt out of the estate tax regime, since such estate would not be required to pay any estate taxes, due to the $5,000,000 applicable exclusion amount, and would obtain an income tax basis for the assets passing from the decedent equal to the federal estate tax values of such assets. On the other hand, the estate of a person dying in 2010 that had a value in excess of the $5,000,000 applicable exclusion amount might instead elect to not have the estate tax regime apply, and to have the modified carryover basis rules apply. However, in deciding whether or not to make such election, the executors of such estates would have to consider all the relevant factors, including the amount of income that the estate or its beneficiaries are likely to realize upon the eventual disposition of the inherited assets and when and at what rates they are likely to be required to pay income taxes on such income.

The election to opt out of the estate tax regime and to instead be subject to the modified carryover basis regime was made on Form 8939, entitled Allocation of Increase in Basis for Property Acquired From a Decedent, that was issued by the Internal Revenue Service (the “Service”).

As stated above, the estates of persons dying in 2011 and 2012 would have an applicable exclusion amount of $5,000,000 (indexed for inflation, as stated above) and would be subject to an estate tax with a maximum tax rate of 35%.

The 2010 Tax Act also restored the federal estate tax deduction (not the credit) for state death taxes paid by the estate.

THE FEDERAL ESTATE TAX DEDUCTION (NOT THE CREDIT) FOR STATE DEATH TAXES PAID BY THE ESTATE WAS MADE PERMANENT BY THE 2012 TAX ACT.

The due date for the estate tax return and for the payment of any estate tax that may be due with respect to the estate of a person who died in 2010 and prior to the enactment of the 2010 Tax Act was extended to not earlier than nine months after the date of the enactment of such Act. As the 2010 Tax Act was enacted on December 17, 2010, the corresponding date which is nine months later was September 17, 2011. However, as September 17, 2011 was a Saturday, such due date was the next following Monday, or September 19, 2011.

The 2010 Tax Act also provided that the time within which a beneficiary of an estate of a person who died in 2010 and prior to the enactment of such Act must make a qualified disclaimer under Code Section 2518 was extended to not earlier than nine months after the date of the enactment of the 2010 Tax Act. Thus, such extended due date also was September 19, 2011. In this regard, issues may arise as to whether a beneficiary of inherited property could make a qualified disclaimer if the beneficiary already accepted benefits from such property, or if applicable state law did not similarly extend the period in which a qualified disclaimer may be made.

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2 See Part II, Section C, of this Outline for a full discussion of Form 8939.
It is noted that Wills and other documents that serve as testamentary substitutes may utilize a formula clause for dividing a decedent’s estate between the portion of the estate that qualifies for the federal estate tax marital deduction and the balance of the estate, which may be bequeathed to or in trust for persons other than the decedent’s surviving spouse. The changes in the applicable exclusion amount could cause an unintentional shift in beneficial interests under estate planning documents.

For example, a possible consequence (prior to the enactment of the 2010 Tax Act) of the temporary repeal of the estate tax for decedents dying in 2010 was that certain beneficiaries may be unintentionally disinherited. For example, a formula clause which gives the decedent’s children the maximum amount of the estate which is exempt from the federal estate tax and leaves the remainder of the estate to the surviving spouse could result in the decedent’s children receiving the entire estate, since no portion of an estate of a decedent dying in 2010 was subject to federal estate tax. On the other hand, if the formula language directed that the decedent’s children receive the applicable exclusion amount and that the remainder of the estate passes to the surviving spouse, then the decedent’s children might be disinherited. As a result, several states enacted legislation to address these unintended consequences. Virginia enacted legislation which would interpret a formula in a will or a trust of a decedent dying in 2010 as though it refers to the federal estate tax laws of 2009 and gives the estate’s executor or any beneficiary the right to commence a judicial proceeding to determine whether the decedent intended for the formula clause to apply to the federal estate tax law as it existed in 2010. Similar legislation was enacted in Delaware, Georgia, Idaho, Indiana, Maine, Maryland, Michigan, Minnesota, Nebraska, New York, North Carolina, Pennsylvania, South Dakota, Tennessee, Utah, Washington, D.C., Washington State and Wisconsin. Florida enacted legislation which permits the trustees or beneficiaries of irrevocable trusts, and the personal representatives or beneficiaries of Wills, to commence a judicial proceeding to request that certain formula clauses be interpreted in accordance with the grantor’s or testator's likely intent. Similarly, South Carolina enacted legislation which permits a personal representative, trustee, or any affected beneficiary to bring a proceeding to determine the decedent’s intent when the dispositive instrument contains a formula based on the federal estate tax or the GST tax.

In addition, the application of such a formula with the advent of a $5,000,000 applicable exclusion amount for estate tax purposes may result in a bequest of the first $5,000,000 of the decedent’s assets to or for the benefit of persons other than the decedent’s surviving spouse, such as the decedent’s children and more remote descendants, or to a trust of which the decedent’s spouse is not the sole beneficiary. This dispositive result may be different from the disposition that the testator had intended by using such a formula clause in an instrument executed when the applicable exclusion amount for estate tax purposes was substantially less than $5,000,000.

In 2011 legislation was enacted in Virginia to clarify that a formula clause in an instrument of a decedent dying in 2010 is deemed to refer to federal laws applicable to decedents dying in 2010, regardless of the election to opt out of the federal estate tax regime. Thus, in Virginia formula clauses would be construed to refer to a $5,000,000 estate tax exemption, regardless of whether the estate is subject to the federal estate tax regime or the modified carryover basis regime. Similar legislation was enacted in Delaware, Idaho, New York, Minnesota, South Dakota and Washington State.
Therefore, it is advisable to review estate planning documents to determine whether the dispositive plan in those documents, taking into account the provisions of the 2010 Tax Act, the 2012 Tax Act and applicable state laws, continue to reflect the testator’s estate planning goals.

2. **Federal Gift Tax Provisions**

Prior to the 2010 Tax Act, the applicable exclusion amount (i.e., the exemption) for gift tax purposes was $1,000,000 in 2010, and the maximum gift tax rate was 35% in 2010.

The 2010 Tax Act did not change the applicable exclusion amount of $1,000,000 for gift tax purposes with respect to gifts made in 2010, and such Act continued the maximum gift tax rate of 35% for gifts made in 2010 and thereafter. However, the 2010 Tax Act provided that after 2010 donors of gifts would have an applicable exclusion amount for gift tax purposes of $5,000,000 (adjusted for inflation from 2010, but commencing in 2012).

Thus, a person who made gifts in 2010 would have an applicable exclusion amount of $1,000,000 with respect to such gifts, and such person’s taxable gifts would be subject to a maximum gift tax rate of 35%. As a result, it generally would have been preferable to make gifts in excess of $1,000,000 in 2011, when the gift tax applicable exclusion amount was increased to $5,000,000, rather than in 2010, when the gift tax applicable exclusion amount was limited to $1,000,000.

It is noted that, as in the past, previously made gifts will “consume” part of this $5,000,000 applicable exclusion amount, but at gift tax rates imposed at the time of the currently made gift. Thus, if a person previously made a gift of $1,000,000 at a time when the maximum gift tax rate was 45%, rather than 35%, the person should still be able to make $4,000,000 of additional gifts after 2010 and have such additional gifts “sheltered” from gift tax by the remaining $4,000,000 of the person’s applicable exclusion amount.

It is also noted that, as of this writing, only Connecticut and Minnesota impose a state gift tax, as Minnesota enacted a gift tax on May 23, 2013 effective on July 1, 2013. Tennessee enacted legislation on May 21, 2012 repealing its gift tax effective as of January 1, 2012.

3. **Federal Generation-Skipping Transfer Tax Provisions**

Prior to the 2010 Tax Act, there was no GST tax imposed on generation-skipping transfers that occurred in 2010.

The 2010 Tax Act created an exemption of $5,000,000 (indexed for inflation from 2010, but commencing in 2012) for GST tax purposes, commencing in 2010; provided that the GST tax rate for generation-skipping transfers occurring in 2010 was zero; and provided that the maximum tax rate for GST tax purposes was 35% for generation-skipping transfers that occur after 2010.
The previously existing rules regarding the identification of the “transferor” of a transfer, and the automatic allocation rules regarding the allocation of the transferor’s GST tax exemption, continued to apply, with respect to transfers made in 2010 and thereafter.

The GST tax exemption of $5,000,000 (indexed for inflation, as stated above) was available for the estate of a person who died in 2010, whether or not such person’s estate elected out of the estate tax regime for estate tax purposes.

As a result of these rules, a person in 2010 could make a gift in an unlimited amount outright and free of trust to a grandchild or more remote descendant without incurring a GST tax, although the amount of the gift that exceeded the unused portion of the donor’s $1,000,000 applicable exclusion amount for gift tax purposes would be subject to the payment of gift taxes.

In addition, a person could make a gift in 2010 in trust for the benefit of the person’s grandchild and more remote descendants, and no GST tax would be immediately imposed at the time of such transfer, as the transfer was a “direct skip” for GST tax purposes but the GST tax rate with respect to such transfer was zero. After the transfer, the donor, who is the “transferor” for GST tax purposes, will be treated as “moving down” one generation, so that the generation assignment of the donor’s grandchild will only be one generation below that of the transferor. As a result, distributions by the trust to the grandchild after 2010 will not be generation-skipping transfers, and no GST tax will be payable on account of such transfers. However, if the trust also provides for the eventual distribution of the trust property to the donor’s great grandchildren, then the death of the donor’s grandchild after 2010 will be a taxable termination, and the GST tax will be due at that time, unless the value of the trust remaining at the grandchild’s death is includible in the grandchild’s estate for estate tax purposes, or if such value is not so includible, unless the trust is exempt from GST taxes as a result of the donor having allocated his or her GST tax exemption to the gift that he or she made to the trust.


THE PORTABILITY PROVISIONS IN THE 2010 TAX ACT WERE MADE PERMANENT BY THE 2012 TAX ACT.

(a) General

The 2010 Tax Act provided that the unused applicable exclusion amount of the last deceased spouse of a person can be used by such a person for gift tax and/or estate tax purposes. However, these portability provisions do not apply to a person’s GST tax exemption.

It is important to note that these provisions apply only if the death of the first spouse to die occurs after 2010. Thus, both spouses must have died after 2010 and before 2013 for these provisions to apply to the estate of the second to die.

For example, if a husband died in 2011 and he and his estate have used only $3,000,000 of his $5,000,000 estate tax applicable exclusion amount, then his surviving wife will have an aggregate applicable exclusion amount of $7,000,000 (i.e., her own $5,000,000...
applicable exclusion amount, plus the unused $2,000,000 of her deceased husband’s applicable exclusion amount), assuming the widow does not remarry and she died before 2013.

Importantly, the 2010 Tax Act permitted a person to use the unused portion of the applicable exclusion amount of only such person’s last deceased spouse. Thus, a person cannot accumulate the unused portion of the applicable exclusion amount of more than one deceased spouse.

However, on March 23, 2011 the Congressional Joint Committee on Taxation issued an errata to the General Explanation of the 2010 Tax Act, suggesting a technical correction to the 2010 Tax Act regarding the portability exemption that could increase the unused exclusion amount of a deceased spouse (i.e., W) that her or his surviving spouse (i.e., H-2) could use to include the portion of the exclusion amount that such deceased spouse’s (i.e., W’s) previously deceased spouse (i.e., H-1) did not use and that the deceased spouse (i.e., W) did not use.

THE 2012 TAX ACT INCLUDES THIS TECHNICAL CORRECTION.

In addition, the unused portion of the applicable exclusion amount of the deceased spouse that can be used by the surviving spouse is not itself indexed for inflation; only the applicable exclusion amount of the surviving spouse is indexed for inflation, as described above.

To apply such portability provisions, the estate of the first spouse to die must elect to do so on a timely filed federal estate tax return. Thus, the estate of the first spouse to die must file such return, even if that person’s gross estate is less than that person’s applicable exclusion amount, if the person’s estate wants to apply these portability provisions.


The Notice stated that:

- To elect portability, the executor must file a complete estate tax return (Form 706) on a timely basis, including extensions, whether or not the value of the gross estate exceeds the exclusion amount, and whether or not the executor is otherwise obligated to file an estate tax return.

- An estate will be deemed to make the portability election by timely filing a complete estate tax return without the need to make an affirmative statement, check a box, or otherwise affirmatively elect to make the election.

- Until the Service revises Form 706 to expressly contain the computation of the deceased spousal unused exclusion amount, a complete and properly prepared Form 706 will be deemed to contain the computation of the deceased spousal unused exclusion amount.

- To not make the portability election:
• The executor must follow the instructions for Form 706 describing the steps to do so. The instructions for the 2011 Form 706 state that to opt out of the portability election, a statement should be attached to Form 706 indicating that the estate is not making the election under Code Section 2010(c)(5), or “No Election under Section 2010(c)(5)” should be entered across the top of the first page of Form 706.

• Not timely filing a Form 706 effectively prevents making the election.

• As the portability election is not available to the estate of a decedent dying on or before December 31, 2010, any attempt to make a portability election on a Form 706 for such estate will be ineffective.

• The Service intends to issue regulations regarding portability and invites comments on the following issues:

  • The determination in various circumstances of the deceased spousal unused exclusion amount and the applicable exclusion amount.

  • The order in which exclusions are deemed to be used.

  • The effect of the last predeceasing spouse limitation.

  • The scope of the Service’s right to examine a return of the first spouse to die without regard to the period of the statute of limitations.

  • Any additional issues that should be considered for inclusion in the proposed regulations.

On February 18, 2012, in order to enable estates to make the portability election, the Service issued Notice 2012-21 granting a six-month extension of time to file the federal estate tax return for the estate of a decedent who is a United States citizen or resident and who dies after December 31, 2010 and before July 1, 2011, if the decedent is survived by a spouse, the fair market value of the decedent’s gross estate does not exceed $5,000,000, the decedent’s estate did not request a six-month extension of time to file the return by timely filing Form 4768 requesting such extension, and if the executor files such Form 4768 within 15 months after the decedent’s death (which may be filed simultaneously with the filing of the estate tax return).

The Notice also stated that if, prior to the issuance of the Notice, an executor of such an estate files an estate tax return after its due date, but before 15 months after the decedent’s death, without having timely requested an automatic six-month extension of the time to file the estate tax return, the executor can file Form 4768 pursuant to the Notice and the extension will relate back to the due date of the estate tax return.

On June 15, 2012 the Service released proposed temporary regulations (REG-141832-11, T.D. 9593) regarding the portability provisions in the 2010 Tax Act. A full discussion of these regulations is contained in an article written by the authors of this outline and published by Commerce Clearing House in Financial and Estate Planning. A copy of that article is attached hereto as Exhibit “B”.

On May 11, 2013 a representative of the Service advised that it is considering granting so-called Code Section 9100 relief to estates that failed to elect portability by the required deadline.
Members of the American College of Trust and Estate Counsel are attempting to persuade the Service to clarify that under Rev. Proc. 2001-38, which treats certain QTIP elections as a nullity if the election is not required to reduce the estate tax, estates of less than the amount of the estate tax exemption are allowed to qualify for the federal estate tax marital deduction using a QTIP trust and electing portability. The Service’s Priority Guidance Plan for 2013-2014 includes the preparation of a Revenue Procedure regarding this issue.\(^3\)

(b) **Portability and the Future of Bypass Trusts\(^4\)**

Estate planning documents for spouses having combined assets of more than the basic exclusion amount of one person traditionally would commonly contain provisions under which the estate of the first spouse to die would create a so called “bypass” trust for the benefit of the surviving spouse, in order to effectively utilize the basic exclusion amount of both spouses, rather than provisions under which the first spouse to die would leave his or her entire estate to the surviving spouse, outright and free of trust. Some proponents of portability have contended that where the combined assets of a married couple are less than $10,500,000, then the necessity of the first spouse to die to create a bypass trust for the benefit of the surviving spouse is eliminated, thereby simplifying the estate planning documents for such persons. However, significant reasons continue to exist for the use of bypass trusts, even in cases where the value of the combined assets of a married couple is less than $10,500,000.

First, as noted above, the portability provisions of the 2010 Tax Act were made “permanent” by the 2012 Tax Act. However, it is always possible that portability could be repealed by future legislation.

Second, the first spouse to die, by creating a bypass trust for the surviving spouse, can ensure that the balance in such trust remaining at the death of the surviving spouse will pass to the person or persons whom the first spouse to die wants to inherit such remaining balance, rather than giving the surviving spouse the opportunity to bequeath such assets to other persons.

Third, a bypass trust affords a degree of creditor protection for the assets in the bypass trust that the surviving spouse would not have with respect such assets if they were bequeathed to the surviving spouse, outright and free to trust.

Fourth, the appreciation in value of the assets bequeathed to a bypass trust will not be subject to estate tax in the estate of the second spouse to die, whereas the appreciation in value of assets bequeathed to a surviving spouse, outright and free of trust, will be subject to estate tax on the death of the surviving spouse.

Therefore, many sound reasons exist for the continued use of bypass trusts, even where the combined wealth of a married couple is less than $10,500,000.

\(^3\) See Part IV, Section V for a discussion of the Service’s Priority Guidance Plan.

\(^4\) This subsection of the Outline is adapted from a portion of an article that the authors of this Outline wrote and that was published in Estate Planning Review – The Journal, a Wolters Kluwer Business.
However, there are other tax considerations that must be taken into account in deciding whether or not to use a bypass trust.

First, the assets in a bypass trust will not receive a so called “stepped-up” basis at the death of the surviving spouse, whereas the assets that the surviving owns at his or her death will receive a “stepped-up” basis at that time.

Second, if the state in which the decedent resided at his or her death has “decoupled” its estate tax from the federal estate tax regime, and if the state estate tax exemption is less than the federal estate tax exemption, then the use of a bypass trust could result in the payment of state estate taxes, even though no federal estate taxes would be due, whereas such state estate taxes could be avoided if the estate instead elects portability and does not use a bypass trust.\(^5\)

These tax considerations should be taken into account in deciding whether or not to use a bypass trust.

(c) **Portability and Prenuptial Agreements**\(^6\)

When negotiating and drafting a prenuptial agreement, consideration should be given to the desirability of including a section in such agreement regarding portability.

Assume, for example, that one party to the intended marriage owns assets that have a value substantially in excess of the applicable exclusion amount and that the other party owns assets having a value significantly less than such amount. In such case, the wealthier party may want a provision in the agreement that requires the executor of the estate of the less wealthy party, if the wealthier party survives the less wealthy party, to timely file a federal estate tax return for the estate of the less wealthy party and to elect on that return to permit the wealthier party, as the surviving spouse, to use the unused portion of the exclusion amount of the less wealthy party. Such a provision could provide a substantial tax benefit to the wealthier party, if he or she survives the less wealthy party.

Note, however, that in such case the executor of the estate of the less wealthy party will be required to prepare and file a federal estate tax return for such estate, even though the amount of the gross estate of the less wealthy party is less than the minimum filing requirement for such tax return, in order to make the required election.

5. **Other Provisions**

As a result of the 2010 Tax Act, many of the other provisions of prior law would continue to be effective for 2011 and 2012, including the provisions regarding modifications for GST tax purposes, the automatic allocation of the GST tax exemption, the retroactive allocation

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\(^5\) See Part II, Section D, of this Outline for a fuller discussion of “decoupling”.

\(^6\) This subsection of the Outline is adapted from a portion of an article that the authors of this Outline wrote and that was published in Estate Planning Review – The Journal, a Wolters Kluwer Business.
of the GST tax exemption, qualified severances, 9100 relief for GST tax purposes, and the relaxation of the requirements for the deferral of estate tax payments under Code Section 6166.

**THESE PROVISIONS ARE MADE “PERMANENT” BY THE 2012 TAX ACT.**

6. **Summary Chart**

The following chart summarizes the changes made by the 2010 Tax Act and the 2012 Tax Act:

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<thead>
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<tbody>
<tr>
<td>Estate Tax Exemption</td>
<td>Election between $5,000,000 exemption, or no estate tax and modified carryover basis</td>
<td>$5,000,000 and portability</td>
<td>$5,000,000 indexed for inflation since 2010 and portability</td>
<td>$5,000,000 indexed for inflation since 2010 and portability</td>
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<tr>
<td>Maximum Estate Tax Rate</td>
<td>35%</td>
<td>35%</td>
<td>35%</td>
<td>40%</td>
</tr>
<tr>
<td>Step-up in Income Tax Cost Basis at Death</td>
<td>Unlimited with estate tax, or modified carryover basis without estate tax</td>
<td>Unlimited</td>
<td>Unlimited</td>
<td>Unlimited</td>
</tr>
<tr>
<td>Lifetime Gift Tax Exemption</td>
<td>$1,000,000</td>
<td>$5,000,000 and portability</td>
<td>$5,000,000 indexed for inflation since 2010 and portability</td>
<td>$5,000,000 indexed for inflation since 2010 and portability</td>
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<tr>
<td>Maximum Gift Tax Rate</td>
<td>35%</td>
<td>35%</td>
<td>35%</td>
<td>40%</td>
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<tr>
<td>Lifetime Generation-Skipping Transfer Tax Exemption</td>
<td>$5,000,000 and no portability</td>
<td>$5,000,000 indexed for inflation since 2010 and no portability</td>
<td>$5,000,000 indexed for inflation since 2010 and no portability</td>
<td>$5,000,000 indexed for inflation since 2010 and no portability</td>
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<tr>
<td>Maximum Generation-Skipping Transfer Tax Rate</td>
<td>-0-</td>
<td>35%</td>
<td>35%</td>
<td>40%</td>
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</table>
7. **Omitted Transfer Tax Provisions**

The 2010 Tax Act did not contain any provisions requiring a minimum term for grantor retained annuity trusts (“GRATs”), as had been included in the President’s Budget Proposal for the prior two years and in prior legislative proposals. Thus, short term GRATs continued to be a viable estate planning tool.

In addition, the 2010 Tax Act did not contain any provisions restricting valuation discounts for transfer tax purposes. As a result, valuation discounts for family limited partnerships continued to apply for transfer tax purposes, as in the past.

**THESE PROVISIONS THAT WERE OMITTED FROM THE 2010 TAX ACT WERE ALSO OMITTED FROM THE 2012 TAX ACT.**

8. **IRS Publication 950**

In October 2011 the Service released a revised version of Publication 950, Introduction to Estate and Gift Taxes, highlighting the changes to the estate tax, gift tax and GST tax as a result of the 2010 Tax Act.


The 2010 Tax Act extended many of the Bush-era income tax cuts through 2012. Thus, for two more years the maximum income tax rate on ordinary income would remain at 35%, and the maximum income tax rate on long term capital gains and qualified dividends would remain at 15%.

**THE 2012 TAX ACT MADE “PERMANENT” MANY OF THE BUSH-ERA INCOME TAX CUTS, BUT INCREASED THE MAXIMUM INCOME TAX RATE FROM 35% TO 39.6% FOR HIGH INCOME PERSONS.**

In addition, the 2010 Tax Act extended for 2010 and 2011 the ability of a person who is at least 70-1/2 years old to make a direct contribution to charity of up to $100,000 from the person’s Individual Retirement Account, without the contribution being included in the person’s income. Moreover, the 2010 Tax Act permitted a person to make such a contribution in January 2011 and to treat the contribution as having been made on December 31, 2010.

**THE 2012 TAX ACT EXTENDED THESE PROVISIONS REGARDING DIRECT CONTRIBUTIONS TO CHARITY ONLY FOR 2012 AND 2013.**

C. **Estates of 2010 Decedents, Form 8939 and 2010 Transfers**

In January 2011 the Service released a draft Form 8939 to report carryover basis for the estates of decedents dying in 2010 that opt out of the estate tax regime. At the same time, the Service advised that an estate would not be required to file Form 8939 until at least 90 days after the final version of the form is released.
On March 31, 2011 (IR-2011-33) the Service announced that Form 8939 would not be due on April 18, 2011 and that it should not be filed with the decedent’s final Form 1040; that the Service would issue future guidance providing a deadline for filing such form and for the manner in which an executor of an estate of a person who died in 2010 can opt out of the estate tax; and that a reasonable period of time for the preparation and filing would be given between the issuance of that guidance and the deadline for filing Form 8939 and for electing to have the estate tax not apply.

On October 6, 2011 the Service released Form 8939.


On August 5, 2011 the Service issued Notice 2011-66, IRB 2011-35, providing guidance as to (a) the time and manner for the executor of the estate of a decedent who died in 2010 to elect to have the estate tax not apply and to instead have the modified carryover basis rules in Code Section 1022 apply to property transferred as a result of the decedent's death, (b) how a donor may elect out of the automatic allocation of the GST tax exemption to direct skips that occurred in 2010, (c) the due dates for certain tax returns for 2010 that report a generation-skipping transfer, that allocate the GST tax exemption, or that opt out of the automatic allocation of the GST tax exemption, (d) the application of the GST tax to testamentary transfers that occurred in 2010, and (e) certain other related issues. On the same date, the Service issued Rev. Proc. 2011-41, IRB 2011-35, providing optional safe harbor guidance regarding the allocation of additional basis under Code Section 1022 to property owned by and acquired from a decedent who died in 2010 where the executor of the decedent's estate opted out of the estate tax regime for such estate.

(a) Electing the Carryover Basis Regime

The Notice stated that the executor of the estate of a decedent who died in 2010 elects to have the modified carryover basis regime under Code Section 1022 apply (and therefore elects to opt out of the estate tax regime) by timely filing Internal Revenue Service Form 8939 (Allocation of Increase in Basis for Property Acquired from a Decedent) on or before November 15, 2011. The Notice further stated that:

- If an executor has not been appointed for a decedent’s estate, any person in actual or constructive possession of the decedent’s property may file a Form 8939 for the property that such person actively or constructively possesses.
- The election, once made, is irrevocable, except as provided below.
- Prior filings purporting to make such election must be replaced with a timely filed Form 8939.
- A timely filed Form 8939 may be amended or revoked, but only on a subsequent Form 8939 filed on or before November 15, 2011.
- The Service will not grant extensions of time to file Form 8939 and will not accept a Form 8939 or an amended Form 8939 filed after the due date, except as provided below.
If for the same decedent the Service receives a Form 8939 and either an estate tax return (Form 706) or an estate tax return for a nonresident alien (Form 706-NA), the Service will send a letter to each person filing such a form. All such persons must sign and file either a restated Form 8939 or a restated Form 706 (or Form 706-NA) within 90 days. If such restated Form is not timely filed, the Service will determine whether or not the executor has made an election to have Code Section 1022 apply to the estate.

If the Service receives multiple Forms 8939 that collectively purport to allocate increases in basis in an amount greater than the available amount of such increases, the Service will send a letter to each person who filed such a form. Such persons must sign and file a single, restated Form 8939 allocating the available increase in basis to make the election under Code Section 1022. The restated Form 8939 must be filed within 90 days of the date of the Service’s letters to such persons. If no restated Form 8939 is timely filed, the Service will allocate the available increase in basis.

An executor may not file an estate tax return and a conditional Form 8939 that would be effective only if an estate tax audit results in an increase in the gross estate above the estate tax exemption.

The basis of a person receiving a particular property (including the increase in basis allocated to that property) is subject to adjustment by the Service on its examination of any tax return reporting a value dependent upon such property’s basis (including without limitation the property’s depreciation, sale or other disposition that results in gain or loss).

(b) Relief Provisions for Form 8939

The Notice stated that:

An executor can file an amended Form 8939 after November 15, 2011 for the sole purpose of allocating the $3,000,000 available increase in the basis of property passing to the decedent’s surviving spouse, provided that (a) Form 8939 was timely filed and complete when filed except for the allocation of the full amount of such basis increase, and (b) each such amended Form 8939 must be filed within 90 days after the distribution of the property to which such basis increase is allocated on the amended Form 8939.

If an executor timely filed a Form 8939, the executor can file an amended Form 8939 under the provisions of Treas. Reg. Section 301.9100-2(b) on or before May 15, 2012 for any purpose except to make or revoke an election under Code Section 1022. In general, such regulation grants an automatic six month extension to make regulatory or statutory elections if the taxpayer timely filed the tax return for the year the election should have been made and the taxpayer takes the necessary corrective action as prescribed by such regulation within that six month period.

An executor may apply under Treas. Reg. Section 301.9100-3 for an extension of time to supplement a timely filed Form 8939 in order to allocate any increase in basis that had not previously been validly allocated, if (a) after filing Form 8939, the executor discovers additional property to which the remaining available increase in basis could be allocated, and/or (b) the fair market value of a property reported on Form 8939 is adjusted as a result of the Service’s examination or inquiry. Such relief will not be granted to reduce an
allocation of basis increase that had been made on a timely filed Form 8939. In general, such regulation authorizes the Service to grant an extension for regulatory elections that do not meet the requirements of Treas. Reg. Section 301.9100-2 if the taxpayer acted reasonably and in good faith and if granting that relief would not prejudice the government's interests.

- An executor may also apply under Treas. Reg. Section 301.9100-3 for an extension of time to file Form 8939, which requires the executor to demonstrate that he or she acted reasonably and in good faith and that granting the relief would not prejudice the government’s interests.

- The due date for filing Form 8939 for persons qualifying under Code Section 7508 (i.e., persons serving in combat zones) or Code Section 7508A (i.e., persons residing in a federally declared disaster area) is extended as provided in those sections.

In PLR 201322019 (February 26, 2013) the Service granted a 120-day extension of time to file Form 8939 and allocate the additional basis to eligible property pursuant to Code Section 1022.

In each of PLR 201231003 (April 16, 2012) and PLR 201238012 (Sept. 21, 2012), where the executrix of the estate of a decedent who died in 2010 retained a qualified tax professional to prepare the estate’s Form 8939 to elect carryover basis, the Service granted the executrix a 120-day extension pursuant to Treas. Reg. Section 301.9100-3 to file Form 8939, as the Service concluded that the executrix acted reasonably in her reliance on such tax professional and that the interests of the government would not be prejudiced by granting such extension.

(c) Amount of Basis Increase

In general, the Revenue Procedure stated that the amount that can be allocated to increase basis is (a) the sum of $1,300,000, plus the amount of any capital loss carryovers that would (but for the decedent’s death) have been carried from the decedent’s last taxable year to a later taxable year, the amount of any net operating loss carryovers that would (but for the decedent’s death) have been carried from the decedent’s last taxable year to a later taxable year, and the amount of unrealized losses that would have been allowable under Code Section 165 if the property acquired from the decedent had been sold at fair market value immediately prior to the decedent’s death, which sum can be allocated to property without regard to who inherits such property; and (b) $3,000,000, which may be allocated to any property owned by and acquired from the decedent by the decedent’s surviving spouse either outright or as qualified terminable interest property (whether or not a QTIP election is made under Code Section 2056(b)(7) with respect to such property).

The Revenue Procedure stated that in the case of a nonresident alien decedent, the available basis increase described above of $1,300,000, with the adjustments described above, is limited to $60,000. However, the $3,000,000 available basis increase described above for property passing to or for the benefit of the decedent’s surviving spouse is available in the case of a nonresident alien decedent.
(d) **Allocating Increases in Basis**

The Notice stated that the executor must allocate the increases in basis under Code Section 1022 on Form 8939 and that:

- The executor must report and value on such form all property (excluding cash and income in respect of a decedent) acquired from the decedent.

- The executor must report on such form all appreciated property acquired from the decedent, valued as of the decedent’s death, that would be required to be included on the donor’s gift tax return (Form 709), if such property was acquired by the decedent by gift or by inter vivos transfer for less than adequate and full consideration during the three-year period ending on the date of the decedent’s death (except property transferred to the decedent by the decedent’s spouse, who had not acquired the property in whole or in part by gift or by inter vivos transfer for less than adequate and full consideration during such three-year period).

- In a case of a deceased nonresident alien, the reported property is limited to tangible property located in the United States that is acquired from the decedent and any other property acquired from the decedent by a United States person.

- Form 8939 must include any other information and supporting documents required to be furnished pursuant to the instructions to such Form or in any Internal Revenue Bulletin.

The Revenue Procedure provided optional safe harbor guidance for allocating basis increase under Code Section 1022. Preliminarily, the Revenue Procedure states that if the executor of an estate who died in 2010 opts out of the estate tax regime and instead elects to have Code Section 1022 apply, then Code Section 1022 will determine a recipient’s basis in all property acquired from such decedent, regardless of the year the property is sold or distributed. In addition, the Revenue Procedure notes that an asset’s total basis (including an increase in basis allocated to such asset by the executor) cannot exceed such asset’s fair market value on the date of the decedent’s death.

The Revenue Procedure stated that basis increase can only be allocated to property that is acquired from the decedent, which is property acquired by bequest, devise or inheritance, or by the decedent’s estate from the decedent.

- Such property does not include income in respect of a decedent (including annuities subject to income tax under Code Section 72).

- Such property includes property transferred by the decedent during his or her life (a) to a qualified revocable trust as defined in Code Section 645, regardless of whether or not the election under Code Section 645 is made for such trust, and (b) any other trust as to which the decedent reserved the right to make any change in the enjoyment of it through the exercise of a power to alter, amend, or terminate the trust (which for such purpose is deemed to include a retained reversionary interest in the trust on death and trust property subject to any retained power of appointment).

- Such property includes any other property passing from the decedent by reason of death to the extent that such property passes without consideration, including without
limitation (a) any property transferred at the decedent’s death by reason of the decedent having or exercising a general power of appointment with respect to such property if the power was not created by the decedent, (b) property held by the decedent and another person as joint tenants with right of survivorship or as tenants by the entirety, and (c) the surviving spouse’s one-half interest in community property.

- Such property does not include a decedent’s interest in a QTIP trust. Thus, the basis of the recipient of such property will not be determined under Code Section 1022.

Property acquired from the decedent must also be owned by the decedent at death to qualify for the allocation of basis increase under Code Section 1022. Property owned by the decedent at death includes:

- Any property legally titled in the name of the decedent at death.
- Jointly owned property, whether owned with rights of survivorship, to the extent described in Code Section 1022(d)(1)(B)(i), or owned as tenants in common.
- Property transferred by the decedent during life to a qualified revocable trust as defined in Code Section 645, whether or not the election under Code Section 645 is made for that trust.
- The surviving spouse's share of community property owned by the decedent and the surviving spouse.

Property not owned by the decedent at death includes:

- Property over which the decedent holds any power of appointment.
- Property transferred to a trust by the decedent during life in which the decedent retained a power to alter, amend, or terminate the trust (excluding a trust which the decedent had the right to revoke).
- Property transferred to a trust by the decedent during life in which the decedent retained an income interest.
- Property transferred by a United States grantor to a foreign trust, even though the grantor may be treated as the owner of at least a portion of that trust for income tax purposes under Code Section 679.
- An interest in a QTIP trust created for the decedent’s benefit by a predeceased spouse of the decedent.

The Revenue Procedure stated that an executor cannot allocate an increase in basis to property that is acquired by the decedent by gift or by inter vivos transfer for less than adequate and full consideration during the three-year period ending on the decedent’s death (except property acquired by the decedent from the decedent’s spouse, if the property had not been transferred to the spouse during such three-year period in whole or in part by gift or by inter vivos transfer for less than adequate and full consideration), or to securities of a foreign personal holding company, a DISC or former DISC, a foreign investment company, or a foreign passive investment company, unless such company is a qualified electing fund as defined in Code
Section 1295 with respect to the decedent, even though such property may have been owned by or acquired from the decedent.

The Revenue Procedure stated that in allocating basis increase:

- The executor can do so on a property-by-property basis. Thus, the executor can allocate basis increase to one or more shares of stock or to a particular block of stock, rather than to the decedent’s entire holding of such stock.
- In general, basis increase may be allocated to property even after the executor has disposed of or distributed the property.
- An executor cannot allocate any basis increase to increases in value occurring after the decedent’s death.
- An executor may allocate basis increase to some or all of the interests in property owned by the decedent at death, but cannot do so with respect to property that is divided as a result of or after the decedent’s death into different interests that are not undivided portions or fractional interests in such property.
- The fair market value of property acquired from the decedent who died in 2010 is determined in the same manner for purposes of Code Section 1022 as for purposes of the estate tax. Thus, any appraisals that would be required by the regulations under Code Section 2031 to determine the fair market value of property includable in a decedent’s gross estate for federal estate tax purposes are also required to determine the fair market value of property acquired from the decedent under Code Section 1022, and must be attached to Form 8939.
- The fair market value of an undivided portion of a decedent’s property is the fractional share of the fair market value of such property at death, without regard to any discounts that otherwise might apply in the case of, and due to, such fractional interest.

As to the allocation of the $3,000,000 increase in basis to property passing to or for the benefit of the decedent’s surviving spouse, the Revenue Procedure further states that:

- The executor may allocate such amount to property that already has been distributed to or for the benefit of the surviving spouse.
- The executor may allocate such amount to property that is sold (whether before or after such allocation) prior to the distribution of such property, if the executor (a) certifies on Form 8939 that the net proceeds from the sale of such property will be distributed to or for the benefit of decedent’s surviving spouse in a qualifying manner, and (b) attaches to Form 8939 each document providing a bequest or devise to the surviving spouse.
- The executor may allocate such amount to property held by a testamentary charitable remainder trust if the surviving spouse is the sole non-charitable beneficiary of such trust and such trust would have qualified for the marital deduction under Code Section 2056(b)(8) if the executor had not opted out of the estate tax regime.

(e) Reporting to Beneficiaries

The Notice stated that the executor must provide a statement to each person acquiring property reported on Form 8939 within 30 days after the executor files such form,
setting forth the name and tax identification number of the recipient of such property, an accurate
description of such property, the adjusted basis of such property in the decedent’s hands and its
fair market value at the decedent’s death, the decedent’s holding period for such property,
sufficient information to determine whether or not any gain on the sale of such property would
be treated as ordinary income, the amount of basis increase allocated to such property under
Code Section 1022 and, if an adjustment is made to the basis of property reported on a Form
8939, the executor must provide updated statements to each recipient of property that is affected
by such adjustment within 30 days after making the adjustment or receiving notice of the
adjustment from the Service.

(f) Coordination With Other Income Tax Provisions

The Revenue Procedure and Notice included the following statements regarding
Code Section 1022 and certain other income tax provisions:

- The holding period of property inherited from a decedent includes the
  period during which the decedent held the property, to the extent that the recipient’s basis of
  such property is determined under Code Section 1022, whether or not the executor of the
  decedent’s estate allocates any basis increase to such property.

- For purposes of computing the applicable percentage under Code Section
  1250 to determine the amount of ordinary gain on the sale of Section 1250 property, the
  recipient’s holding period of such property includes the period during which the property was
  held by the decedent, if the recipient’s basis in such property is determined under Code Section
  1022, whether or not the executor allocates any basis increase to such property.

- The tax character of property acquired by a person from the estate of a
  decedent whose executor opted out of the estate tax regime is the same as it was in the hands of
  the decedent.

- In general, the recipient of property from the estate of a decedent whose
  executor opted out of the estate tax regime is treated for depreciation purposes as the decedent
  for the portion of the recipient’s basis in the property equal to the decedent’s adjusted basis in
  that property.

- In the case of an interest in a passive activity that is transferred by the
  reason of the decedent’s death, where the executor opted out of the estate tax regime, the
  suspended passive losses at the decedent’s death increase the basis of such property to the
  recipient and may not be deducted for any taxable year.

- If the executor of a decedent’s estate opts out of the estate tax regime, the
term “applicable date” in Code Section 645, for purposes of determining the period during which
the qualified revocable trust will be treated as part of the decedent’s estate for income tax
purposes, will mean the date that is two years after the date of the decedent’s death.

- The rules in Code Section 1040, regarding the recognition of gain on the
distribution of appreciated property to satisfy a pecuniary bequest, will apply to qualified
revocable trusts as defined in Code Section 645, and to trusts that would have been included in
the decedent’s gross estate for federal estate tax purposes under Code Section 2036, 2037 or
2038 if the decedent’s executor had not opted out of the estate tax regime.
A testamentary charitable remainder trust that otherwise would qualify as a charitable remainder trust under Code Section 664, but fails to meet the requirement that a deduction is allowable under Code Section 2055 solely by reason of the executor opting out of the estate tax regime, nonetheless will qualify as a charitable remainder trust under Code Section 664.

(g) **GST Tax in 2010**

The Notice also provided guidance as to GST tax elections with respect to decedents who died in 2010 and inter vivos direct skips that occurred in 2010.

As to a decedent who died in 2010 whose executor opts out of the estate tax regime, the executor allocates the decedent’s available GST tax exemption on Schedule R of a timely filed Form 8939 for the decedent’s estate.

As to an inter vivos direct skip that occurred in 2010, the donor would not want to allocate any of his or her available GST tax exemption to such transfer, since the GST tax rate in 2010 is zero. The Notice stated that such a donor may elect out of the automatic allocation of the GST tax exemption either by affirmatively doing so on a timely filed gift tax return (Form 709), or as to an inter vivos transfer that is a direct skip not in trust, by timely filing a gift tax return (Form 709) reporting such transfer.

The Notice stated that the provisions of the 2010 Tax Act, which extend the due date for filing certain tax returns to September 17, 2011 (and therefore to September 19, 2011, as September 17, 2011 is a Saturday), do not apply to a Schedule R attached to Form 8939, which is due by November 15, 2011. Further, the Notice stated that such provisions of the 2010 Tax Act do not extend the due dates for returns relating to an indirect skip, or to a post-December 16, 2010 direct skip. Thus, the due date for filing a gift tax return (Form 709) that does not report a GST transfer or that reports a GST transfer occurring after December 17, 2010 through December 31, 2010, was April 18, 2011, including extensions. In addition, the due date for filing a gift tax return (Form 709) to elect to treat a trust as a GST trust or to allocate GST tax exemption to a transfer occurring during 2010 was April 18, 2011, including extensions.

2. **Notice 2011-76 and IR-2011-91**

On September 13, 2011 the Service released Notice 2011-76 with IR-2011-91, providing rules regarding an automatic six month extension of time to file the federal estate tax return and to pay the federal estate tax for 2010 decedents, extending the due date for Form 8939 to January 17, 2012, providing additional rules regarding the allocation of the GST tax exemption for 2010 decedents, and providing certain penalty relief regarding the 2010 income tax of a recipient of property inherited from a 2010 decedent.

(a) **Estate Tax Return Extensions**

The Notice granted an automatic six month extension of time to file the federal estate tax return (for both Form 706 and Form 706-NA) and of the time to pay the estate tax, if the extension application (Form 4768) is timely filed. Thus, for estates of decedents who died after December 31, 2009 and before December 17, 2010, the extension application must be filed
by the due date of the estate tax return, which is September 19, 2011, and the automatic six month extension runs until March 19, 2012. For estates of decedents who died after December 16, 2010 and before January 1, 2011, the extension application must be filed by the due date of the estate tax return, which is nine months after the date of death, and the six month extension runs from such due date of the return.

The Notice also stated that:

- The executor is not required to provide a reason for the requested extension with Form 4768.
- Interest on the estate tax will accrue from the original due date of the tax return (excluding extensions).
- The Service will not grant any further extensions of time to file, unless the executor is abroad.
- The executor can apply for additional extensions of time to pay the tax under Code Section 6161.
- For estates of decedents who died after December 31, 2009 and before December 17, 2010, no late filing penalties and no late payment penalties will be imposed, if the extension application is timely filed by September 19, 2011 and if the estate tax is paid and the estate tax return is filed by March 19, 2012.
- For estates of decedents who died after December 16, 2010 and before January 1, 2011, no late filing penalties or late payment penalties will be imposed if the extension application is timely filed and if the estate tax is paid and the estate tax return is filed within 15 months after the date of death.

(b) Form 8939

The Notice changed the due date for Form 8939 from November 15, 2011 to January 17, 2012, and stated that the Service will not grant any further extensions of time to file Form 8939, except as previously provided in Notice 2011-66. In addition, the Notice stated that penalties under Code Section 6716 for failure to file Form 8939 and for failure to furnish information to beneficiaries regarding certain transfers at death will not apply if Form 8939 is filed on or before January 17, 2012 and if the statement required to be furnished to beneficiaries is provided by February 17, 2012.

(c) GST Taxes

The Notice stated that if Form 8939 is filed on or before January 17, 2012, and if the GST tax exemption is allocated on an attached Schedule R or R-1, the allocation will be timely and effective as of the date of the decedent's death. In addition, the Notice stated that the automatic allocation rules will apply if Form 8939 is timely filed without a Schedule R or R-1. Further, the Notice stated that if no Code Section 1022 election is made, then the automatic allocation rules will apply unless the executor timely files an estate tax return (Form 706) with Schedule R or R-1 attached.
(d) **Income Tax Returns and Gift Tax Returns**

The Notice stated that it is not extending the due date to file any income tax return for an individual, an estate or a trust, or to pay any income tax; that it is not extending the due date to file any gift tax return or to pay any gift tax; and that it is not extending the time to file any state death tax return or to pay any state death tax.

(e) **Penalty Relief**

The Notice and the IR stated that if a recipient of property that is inherited from a 2010 decedent disposes of such property in 2010, and if the recipient’s 2010 income tax is increased due to Code Section 1022, the recipient's reasonable cause and good faith will be presumed, and the Service will not impose a failure to pay penalty or a penalty for negligence, disregard of rules or substantial understatement of income tax.

D. **State Transfer Tax Considerations**

EGTRRA repealed the federal estate tax credit for state death taxes paid, for estates of decedents dying after 2004, and replaced such credit with a federal estate tax deduction for state death taxes paid. However, most states and the District of Columbia previously had the “sop” or pick-up tax as their estate tax, although numerous states also have an inheritance tax. The estate tax in a majority of these states automatically conformed to changes in the federal estate tax, and therefore the economic effect of the elimination of the state death credit had an impact on revenue from the credit. As a result, many states enacted estate, inheritance and/or succession taxes to make up for the revenue loss due to the elimination of the credit; thus, they “decoupled” from the changes in the federal tax code. However, different states decoupled based upon different pre-EGTRRA applicable exclusion amounts, and different states have different exemption amounts. The elimination of the federal estate tax credit for state death taxes paid, the existing federal estate tax deduction for state death taxes paid, and the “decoupling” by many states of their estate tax from the federal estate tax regime, requires the consideration of the state estate tax planning implications of these changes. A discussion of actions taken by certain of these states is contained below in this Section.

(a) **New York**

In the instance where a state statute does not automatically follow changes made to the federal estate tax, such as the New York State Tax Law, its residents may find themselves with a larger estate tax burden. The estates of New York decedents are subject to a New York estate tax that is based on the federal estate tax death credit that was in effect on July 22, 1998. This occurs as a result of the provisions of Section 951(a) of the New York State Tax Law, which states that for the purposes of Article 26 (the estate tax provisions) “any reference to the Internal Revenue Code means the United States Internal Revenue Code of 1986, with all amendments enacted on or before July twenty-second, nineteen hundred ninety-eight . . . .” In addition, the unified credit for New York State estate tax purposes for those dying in 2002 and thereafter is $345,800, which is an amount equal to the estate tax due on a taxable estate of $1 million.
Thus, a New York decedent dying in 2013 is subject to the 16% top rate for the state death tax credit, as reflected in the following chart:

<table>
<thead>
<tr>
<th>Year of Death</th>
<th>Actual Federal Tax Rate</th>
<th>Federal State Death Tax Credit</th>
<th>Additional Tax To New York State</th>
<th>Federal Tax Rate</th>
<th>Combined Federal and New York State Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>0%</td>
<td>16%</td>
<td>35%</td>
<td>45.4%</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>0%</td>
<td>16%</td>
<td>35%</td>
<td>45.4%</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>0%</td>
<td>16%</td>
<td>35%</td>
<td>45.4%</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>0%</td>
<td>16%</td>
<td>40%</td>
<td>49.6%</td>
<td></td>
</tr>
</tbody>
</table>

As a result of these changes, a credit shelter disposition upon the death of the first spouse to die of the maximum federal applicable exclusion amount will result in the imposition of New York estate taxes of $405,200 for decedents dying in 2012, and $420,800 for decedents dying in 2013, even though no federal estate tax would be owed. Practitioners should now advise estate planning clients to consider whether to have a maximum credit shelter disposition on the death of the first spouse to die, in order to minimize the federal estate taxes payable by the estate of the second spouse to die, with the attendant cost to the estate of the first spouse to die having to pay New York estate taxes, or alternatively whether to have a credit shelter disposition of only $1 million in the estate of the first spouse to die, in order to avoid the payment of New York estate taxes by that estate, but with the attendant increase in federal estate taxes payable by the estate of the second spouse to die. A major consideration which clients should take into account in making this decision is how important it will be to maximize the value in the estate of the first spouse to die which will be available for the support of the surviving spouse.

Possible Planning Technique: If the New York estate tax is paid from the credit shelter disposition, the amount of the New York estate tax imposed on the estate as described in the preceding paragraph will apply. However, paying the New York estate tax from the credit shelter disposition will reduce the net after-tax amount of that disposition, and correspondingly increase the amount of the marital deduction disposition, causing an increase in the amount of the federal estate tax payable on the death of the second spouse to die. Instead, practitioners should consider having the New York estate tax payable from the marital deduction disposition (which will not cause a federal estate tax to be payable, since the New York estate tax is deductible for federal estate tax purposes), in order to maximize the amount of the credit shelter disposition and avoid such increase in the amount of the federal estate tax payable on the death of the second spouse to die. Note, however, that paying the New York estate tax from the marital deduction disposition will cause the amount of the New York estate tax to increase from $420,800 to $478,182 for decedents dying in 2013.

The New York GST tax is equal to the maximum federal credit against the federal GST tax for state GST taxes paid. The federal GST tax rate is equal to the maximum federal

7 Taking into account the deduction for state estate taxes for decedents dying after December 31, 2004.
estate tax rate, and for this purpose New York assumes that the maximum federal estate tax rate is the maximum rate which was in effect in 2001. Thus, since that maximum credit is 5%, and the assumed maximum federal estate tax rate is 55%, the New York GST tax rate is 2.75%. Furthermore, for New York purposes, the maximum GST tax exemption is $1,000,000, adjusted for inflation. For 2012, the inflation adjusted New York GST tax exemption is $1,390,000. The New York State Department of Taxation and Finance has not yet released the inflation adjusted amount of such exemption for 2013. As a result, a trust’s inclusion ratio may be different for New York GST tax purposes than for federal GST tax purposes.

For purposes of the New York GST tax, property is deemed to be New York property if it is real property or tangible personal property located in New York, intangible personal property located in New York that is used in carrying on a trade or business or occupation in New York, or intangible personal property if the transferor was a New York resident at the time of the original transfer.

(b) Connecticut

On May 4, 2011, as part of the budget legislation (CGA Bill No. 1239), Connecticut lowered the Connecticut estate tax and gift tax thresholds from $3,500,000 to $2,000,000 applicable retroactively to estates of decedents dying on or after January 1, 2011 and gifts made on or after January 1, 2011. The tax for estates and gifts of more than $2,000,000 will be based on graduated rates, starting at a rate of 7.2%, and the maximum tax rate will be 12% (on the excess over $10,100,000).

As a result, the estate of a person who dies in 2013 a resident of Connecticut with a taxable estate of $5,250,000 would be required to pay Connecticut estate taxes of $251,700, even though such estate would not be required to pay any federal estate taxes.

(c) New Jersey

New Jersey, by affirmative legislation, on July 1, 2002 enacted an estate tax (P.L. 2002, Chapter 31) on the estate of every resident decedent dying after December 31, 2001 which would have been subject to an estate tax payable to the United States under the provisions of the Internal Revenue Code in effect on December 31, 2001. The amount of the New Jersey tax is the maximum state death tax credit that would have been allowable under the Code as in effect on December 31, 2001. For example, if the unified credit bequest equaled $1,000,000, there would be a New Jersey estate tax due of $33,200. On February 27, 2008, in the case of Oberhand v. Director, Division of Taxation, 193 N.J. 558, 9420 A.2d 1202 (2008), the Supreme Court of New Jersey found that the amendment was constitutional but that the application retroactive to December 31, 2001 violated the doctrine of “manifest injustice”. There is an alternative to this method which is the amount determined using a “simplified tax system” based on the $675,000 unified estate and gift tax applicable exclusion amount provided in the Internal Revenue Code, but the simplified method cannot be used if the taxpayer files or is required to file a Federal return. The legislation was implemented by rule amendments published on April 7, 2003. The amendment provides that a New Jersey estate tax return must be filed whenever the gross estate as determined in accordance with the provisions of the Code in effect on December 31, 2001 exceeds $675,000.
As a result, the estate of a person who dies in 2013 a resident of New Jersey with a taxable estate of $5,250,000 would be required to pay New Jersey estate taxes of $420,800, even though such estate would not be required to pay any federal estate taxes.

In *Estate of Stevenson v. Director*, 008300-07 (N.J. Tax February 19, 2008), the New Jersey Tax Court held that when calculating the New Jersey estate tax where a marital disposition was burdened with estate taxes, creating an interrelated computation, the marital deduction must be reduced not only by the actual New Jersey estate tax, but also by the hypothetical federal estate tax that would have been payable if the decedent had died in 2001.

(d) Pennsylvania

On July 29, 2002, Pennsylvania decoupled from the federal phase-out (Act 89 of 2002), applicable to estates of decedents who die after June 30, 2002. However, the Pennsylvania Courts held that the decoupling violated the Pennsylvania Constitution, and Pennsylvania’s estate tax was recoupled retroactively to the date of its decoupling. As a result of the phase-out of the federal state death tax credit, there is no Pennsylvania estate tax for estates of decedents who die after December 31, 2004. Thus, the Pennsylvania estate tax would resurrect itself on January 1, 2013 absent a change in federal law to that credit. However, Pennsylvania still has an inheritance tax, which is independent of the federal state death tax credit and the phase-out of that credit.

(e) Florida

In certain states, there are additional barriers to decoupling. For example, in Florida, a constitutional provision restricting the amount of estate tax levied would likely need to be altered. Therefore, since the complete phase-out of the state death tax credit in 2005, Florida has not been able to collect any estate tax from its residents.

Attached hereto as Exhibit “C” is a chart showing a comparison of the state estate taxes after the 2012 Tax Act of New York, New Jersey, Florida and Connecticut.

(f) Delaware

Delaware reinstated its estate tax for decedents dying after June 30, 2009. The amount of the estate tax is equal to the credit against federal estate taxes for state death taxes paid by the estate, as such credit was in effect as of January 1, 2001.

(g) Other States

Attached hereto as Exhibit “D” is a chart showing the effect as of July 24, 2013 of EGTRRA on the “pick-up” tax of each state and the status as of that date of any death tax legislation in each state.

(h) State QTIP Elections

In states which have decoupled and which have a separate qualified terminable interest property (“QTIP”) election for state estate tax purposes, practitioners should consider...
drafting testamentary documents with a separate QTIP trust for that election. As of this writing, Connecticut (only if no federal QTIP election is made), Illinois, Indiana, Kansas, Kentucky, Maryland, Massachusetts, Maine, New Jersey (only if a federal estate tax return is not required to be filed), Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee and Washington have such an election. In New York, on March 16, 2010 the New York State Department of Taxation and Finance issued TSB-M-10(1)M clarifying that an executor can elect QTIP treatment for New York estate tax purposes in 2010, even though no federal estate tax return is required to be filed in view of the repeal of the federal estate tax. The election must be made on a pro-forma federal estate tax return (as used for 2009 dates of death) attached to the New York estate tax return. The announcement also provides that the value of the QTIP property for which the election is made for New York estate tax purposes must be includible in the estate of the surviving spouse for such purpose. On March 1, 2011 the New York State Department of Taxation and Finance by a letter to a practitioner advised that an executor can elect QTIP treatment for New York estate tax purposes for the estate of a decedent who died in 2010, even though no federal estate tax return is required to be filed because the executor opted out of the federal estate tax regime. The New York legislature also is currently considering enacting legislation which would allow a separate QTIP election for New York estate tax purposes. With regard to Connecticut, the Department of Revenue Services, by special notice, has taken the position that if the federal QTIP election is made, a state election must also be made for the same amount, although this is not in accord with the underlying statute. If no federal election is made, a state-only QTIP election may be made. With regard to New Jersey, NJAC 26:18-3A.8(d) provides that the New Jersey estate tax return must be consistent with the federal return. Accordingly, if a federal QTIP election is made, it must also be made for New Jersey in the same amount. However, if a federal QTIP election would not reduce the federal estate tax liability, such an election will not be given effect for New Jersey estate tax purposes.

Since both New York and New Jersey take the position that, even if a federal estate tax return is filed solely for the purpose of electing portability, the same QTIP election that is made on such federal return must also be made for state estate tax purposes. If a QTIP election is not made on the federal estate tax return, then it may not be made for state estate tax purposes. Thus, the executors in such states may have to choose between a state QTIP election and portability.

E. Obama Administration and Congressional 2013 Proposals

President Obama’s April 2013 budget request for the fiscal year ending September 30, 2014 (the “Green Book”) includes:

- A proposal to make permanent the estate tax, gift tax and GST tax exemptions and rates as they applied during 2009 (i.e., an estate tax and GST tax exemption of $3,500,000, a gift tax exemption of $1,000,000, and a maximum tax rate of 45%), effective for the estates of decedents dying, and for transfers made, after December 31, 2017.

- A consistency requirement in the value of property for transfer tax and income tax purposes, under which the basis of property received by reason of death under Code Section 1014 must equal the value of the property for estate tax purposes, the basis of property acquired from a decedent whose estate elected the modified carryover basis regime is the basis of
that property, including any additional basis allocated to that property by the executor, as reported on Form 8939, and the basis of property received by gift must equal the donor’s basis, and a reporting requirement with respect thereto.

- A requirement that a GRAT have a minimum term of 10 years and a maximum term of the life expectancy of the annuitant plus 10 years.
- A requirement that the remainder interest in a GRAT have a value greater than zero at the time the interest is created.
- A prohibition on any decrease in a GRAT annuity during the GRAT term.
- A limitation of 90 years of the time during which a trust could be exempt for GST tax purposes.
- As to grantor trusts, if the deemed owner of a trust engages in a transaction with that trust that constitutes a sale, exchange or comparable transaction that is disregarded for income tax purposes by reason of the grantor trust rules, a proposal that the portion of the trust attributable to the property received by the trust in that transaction will be subject to estate tax as a part of the grantor’s gross estate, will be subject to gift tax at any time during the grantor’s life when his or her treatment as the grantor of the trust is terminated, and will be treated as a gift by the grantor to the extent any distribution is made to another person during the grantor’s life.
- If an estate elects to pay estate taxes in installments under Code Section 6166, a proposal to extend the 10 year estate tax lien under Code Section 6324(a)(1) for the entire Code Section 6166 deferral period;
- A proposal to limit the income tax value of specified deductions or exclusions from adjusted gross income and all itemized deduction to 28% of the specified exclusions and deductions that would otherwise reduce taxable income in the 33%, 35% or 39.6% income tax brackets.
- A new minimum tax, called the Fair Share Tax, on high income taxpayers to be phased in linearly starting at $1,000,000 of adjusted gross income, or $500,000 in the case of a married person filing a separate return.
- A proposal to clarify that the exclusion from the definition of a generation-skipping transfer under Code Section 2611(b)(1) applies only to a payment by a donor directly to the provider of medical care or to the school in payment of tuition and not to trust distributions, even if for those same purposes.
- A proposal requiring non-spouse beneficiaries of retirement plans and IRAs in general to take distributions over no more than five years.
- A proposal prohibiting a participant in a tax-favored retirement system from making additional contributions or receiving additional accruals under those arrangements, if the participant has accumulated amounts in such system in excess of the amount necessary to provide the maximum annuity permitted for a tax-qualified defined benefit plan under current law (which currently is an annual benefit of $205,000 payable in the form of a joint and 100% survivor benefit commencing at age 62 and continuing each year for the life of the participant and, if later, the life of the participant’s spouse).
On June 19, 2013 companion bills (S. 1183, H.R. 2429) were introduced in the Senate and the House of Representatives, respectively, to permanently repeal the federal estate tax.

III. MEDICARE TAX ON ESTATES, TRUSTS AND INDIVIDUALS

The Health Care and Education Reconciliation Act of 2010 enacted new Code Section 1411, which imposes a 3.8% unearned income Medicare contribution tax, starting in 2013. As to estates and trusts, the tax is imposed on the lesser of (1) undistributed net investment income for the tax year, or (2) any excess of adjusted gross income over the dollar amount at which the highest tax bracket for estates and trusts begins for the applicable tax year, which for 2012 is $11,650, subject to inflation adjustments each year. Trusts all of the unexpired interests in which are devoted to charitable purposes are exempt from this tax. As to individuals, the tax is imposed on the lesser of (1) the taxpayer’s net investment income for the tax year, or (2) any excess of the taxpayer’s modified adjusted gross income for the tax year, over $250,000, in the case of a taxpayer filing a joint return, or over $200,000, in the case of an unmarried taxpayer.

On November 30, 2012 the Service issued proposed regulations regarding such tax (REG-130507-11). The proposed regulations provide that any net investment income recognized by a charitable remainder trust before the end of 2012 is not included in such trust’s accumulated net investment income when a subsequent distribution is made after 2012. Pursuant to Proposed Reg. Section 1.1411-3, the 3.8% tax on the net investment income of an individual, estate or trust pursuant to Code Section 1411 is imposed on the lesser of (1) the taxpayer’s undistributed net income, or (2) the excess, if any, of its adjusted gross income over the threshold for the highest tax bracket under Code Section 1(e), which is $11,950 in 2013 for trusts.

As the tax applies with respect to tax years beginning after December 31, 2012, the estate of a decedent who died in 2012 and that selects a fiscal year ending on or before November 30, 2012 can avoid such tax on the estate’s net investment income for such fiscal year and also for the next following fiscal year.

IV. IMPORTANT IRS REGULATIONS, ANNOUNCEMENTS AND COURT DECISIONS

A. 2013 Inflation Adjustments


The inflation-adjusted annual gift tax exclusion is $14,000, increased from $13,000 in 2012; the annual gift tax exclusion for non-citizen spouses is $143,000, increased from $139,000 in 2012; the basic exclusion amount is $5,250,000, increased from $5,120,000 in 2012, for determining the amount of the unified credit against the estate tax and gift tax; the amount used to calculate the 2% portion for purposes of Code Section 6166 is
$1,430,000, increased from $1,390,000 in 2012; for executors electing to use the special use valuation method under Code Section 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use Code Section 2032A that is taken into account for purposes of the estate tax may not exceed $1,070,000, increased from $1,040,000 in 2012.

In addition, Rev. Proc. 2013-5 announced the following 2013 inflation-adjusted income tax rate brackets: for joint filers, the top bracket will start at $450,000; for single filers the top bracket will start at $400,000; and for estates and trusts, the top bracket will start at $11,950.

Beginning in 2004, the GST tax exemption became tied to the applicable exclusion amount under Code Section 2010(c). Pursuant to the 2010 Tax Act, this exemption was increased to $5,000,000, starting in 2010. Starting in 2012, this exemption is indexed for inflation from 2010, and the inflation-adjusted amount of this exemption is $5,250,000 in 2013.

B. Tax Returns

1. Draft Form 8690

On August 8, 2013 the Service released draft Form 8960 regarding the 3.8% Medicare Contribution Tax on unearned income for individuals, estates and trusts under Code Section 1411.

2. Estate Tax Returns for 2012 Decedents

On October 4, 2012 the Service released the estate tax (and generation-skipping transfer tax) return for the estates of decedents dying in 2012. The return includes a check-the-box feature for executors to opt out of electing portability of a spouse’s unused gift tax and estate tax exclusion amount. In addition, the return includes a new section regarding protective claims for refund dealing with contingent or contested claims against the estate.

3. 2012 Gift Tax Returns

On November 20, 2012 the Service released the gift tax return to report gifts made in 2012.

4. Estate Tax Returns for 2011 Decedents

On September 20, 2010, the Service released the estate tax (and generation-skipping transfer tax) return for the estates of decedents dying in 2011. On November 8, 2011 the Service issued final instructions for Form 706 to be used for estates of decedents dying in 2011.
5. **2011 Gift Tax Returns**

   On December 19, 2011 the Service released the gift tax return (Form 709) to be used to report gifts made in 2011.

6. **2011 Generation-Skipping Transfer Tax Forms**

   In December 2011 the Service issued a revised Form 706-GS(D) and a revised Form 706-GS(T) to report taxable distributions and taxable transfers, respectively, that occurred in 2011 for GST tax purposes.

7. **Estate Tax Returns for 2010 Decedents**

   On September 27, 2011 the Service released the estate tax (and generation-skipping transfer tax) return for decedents dying in 2010. The due date for the estate tax return and for the payment of any estate tax that may be due with respect to the estate of a person who died in 2010 and prior to the enactment of the 2010 Tax Act is extended to nine months after the date of the enactment of such Act. As the 2010 Tax Act was enacted on December 17, 2010, the corresponding date which is nine months later is September 17, 2011. However, as September 17, 2011 is a Saturday, such due date will be the next following Monday, or September 19, 2011.\(^8\)

8. **2010 Gift Tax Return**

   On March 15, 2011 the Service released the gift tax return (Form 709) to be used to report gifts made in 2010.

9. **2010 Generation-Skipping Transfer Tax Forms**

   In February 2011 the Service issued a revised Form 706-GS(D) to report taxable distributions that occurred in 2010 for GST tax purposes.

C. **Estate Tax and Gift Tax Audits and Collections**

   In *United States v. Mangiardi*, S.D. Fla., No. 9:13-cv-80256 (July 22, 2013), the Court held that the 10-year statute of limitations under Code Section 6324, rather than the four year statute of limitations under Code Section 6901, applies to the collection of unpaid federal estate taxes from a transferee.

   In *Estate of Liftin v. United States*, Fed Cl No. 10-589 (2013), where the executor of the decedent’s estate, on the advice of counsel, did not file the federal estate tax return by the extended due date, in order to wait until the naturalization process for the surviving spouse was completed, to take full advantage of the estate tax marital deduction, and where the executor filed the estate tax return after the extended due date and nine months after the surviving spouse obtained her United States citizenship, the Court held that the executor’s failure to file the return

\(^8\) See Part I, Section C, Subsection 2 for further extensions provided by Notice 2011-76.
until after the surviving spouse obtained her citizenship was due to a reasonable reliance of the erroneous advice of the estate’s attorney, because the advice related directly to the filing date, but that the nine month delay in filing the return after the surviving spouse obtained her citizenship was not reasonable. As a result, the Court sustained the Service’s imposition of the penalty for failure to timely file the tax return.

In Knappe v. United States, No. 10-56904 (9th Cir. 2013), where the executor of the decedent’s estate, in reliance on the erroneous advice of the estate’s accountant, believed that the automatic six month extension of the time to file the estate tax return was a one year extension, and the executor filed the estate tax return after the six month extension period, the Court sustained the late filing penalty on the grounds that there is reasonable cause to abate a penalty resulting from a taxpayer’s erroneous advice only when the advice is in regard to a substantive tax law issue, which in effect means an issue arising from an ambiguous tax provision, but that there was no ambiguity as to the extended due date for filing the tax return.

In CCA 201249015 (August 14, 2012) the Service advised that interest is assessed on gift taxes for an unreported gift from the date on which the gift tax return should have been filed to report such gift, even though such gift was reported on the estate tax return for the decedent’s estate.

In CCA 201214031 (March 15, 2012) the Service advised that Code Section 6423(a)(2) imposed personal liability for the payment of estate taxes on the transferees of nonprobate property of the decedent, and that bringing an action under Code Section 6901 to enforce such liability would result in assessments against the transferees and liens against the transferees’ property, although the nonprobate property was not encumbered by an estate tax lien under Code Section 6423(a)(1), as the transferees did not receive such property from the decedent’s estate.

In T. Gaughen, D.C. Pa., 2012 U.S. Dist. LEXIS 11662 (January 31, 2012), the Court, denying the taxpayer’s summary judgment motion for a refund of a fraud penalty relating to the understatement of the value of real estate for gift tax purposes, found that there was sufficient evidence to find that the donor had intentionally undervalued the properties, where a large difference existed between the values claimed on the gift tax return and the values claimed by the Service at trial, a substantial difference existed between the values of the properties reported for gift tax purposes and the County tax assessments of the value of such properties, prior contracts to sell certain of the properties were for almost 10 times the reported gift tax values of such properties, and the appraisal on which the taxpayer based the gift tax values of such properties could be found to directly reflect the values suggested by the donor to the appraiser. On December 1, 2011 the Service posted on its website an amendment to the Service’s Manual regarding the treatment of the gift tax statute of limitations in estate tax and gift tax examinations. The provision states that if an examiner determines that a gift has not been adequately disclosed on a gift tax return prior to the expiration of the statute of limitations, examiner must obtain the taxpayer’s consent to extend the limitations period on the entire return, but that if the examiner is unable to obtain that consent, then the examiner may allow the limitations period to expire if the examiner obtains written approval of his or her manager to do so.
The Service has been searching for and examining taxpayers who have made gifts of real property to family members and who have failed to report the transfers for gift tax purposes. The Service is working with representatives in Connecticut, Florida, Hawaii, Nebraska, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Texas, Virginia, Washington and Wisconsin to locate such taxpayers. In this regard, in In re: The Tax Liabilities of John Does, E.D. Cal., No. 2:10-mc-00130-MCE-EFB (May 23, 2011), the Court rejected the Service’s request for leave to serve a “John Doe” summons on the California Board of Equalization requiring the Board to give the Service the records of transfers of real property for little or no consideration, on the grounds that the Service failed to demonstrate that the information was not available through other sources. However, the Court thereafter allowed the Service to resubmit its petition to address its previous shortcomings, and on December 15, 2011 the Court (WL 6302284) granted a John Doe summons requiring the State of California to turn over information on property transfers in which the parties may not have paid federal gift taxes.

On January 27, 2011 the Service issued a memorandum (SBSE-04-0111-008) directing its tax examiners to refer to the Service’s Art Advisory Panel works of art with a reported value of $50,000 or more, rather than the prior threshold of $20,000 or more.

In Estate of Adelina Cheng Van v. Commissioner, T.C. Memo 2011-22 (January 26, 2011), the Court held that a residence purchased by the taxpayer was includible in her gross estate for federal estate tax purposes under Code Section 2036, where the taxpayer had purchased the residence for her daughter’s family, the taxpayer signed the purchase documents, including the sales agreement and a secured promissory note, members of the family of the taxpayer’s daughter paid the down payment for the purchase and the ongoing promissory note payments, the taxpayer subsequently conveyed the residence to a revocable trust that she created for the benefit of her daughter and grandchildren, and the taxpayer resided in the residence from the time of its purchase until her death.

In Estate of Le Caer v. Commissioner, 135 T.C. No. 14 (September 7, 2010), where a wife’s estate claimed a credit for prior transfers under Code Section 2013 for federal estate taxes and state estate taxes paid by estate of the decedent’s husband, who had predeceased the decedent by three months, the Court held that the wife’s estate can claim the credit for the federal estate taxes (but not the state estate taxes) paid by the husband’s estate, but subject to the limitations set forth in Code Sections 2013(b) and (c), and that in calculating the amount of the husband’s taxable estate for purposes of Code Section 2013(b), it is not reduced by the applicable exclusion amount.

In Estate of Thompson v. Commissioner, No. 09-3601-ag (March 17, 2010), the Court of Appeals for the Second Circuit, in an unpublished opinion, affirmed a Tax Court decision which declined to impose accuracy-related penalties on an estate pursuant to Code Section 6662, where the Tax Court found that the estate’s reliance on its experts was reasonable and in good faith, even though the two individual experts were inexperienced in valuing large companies.

In R. Cederloff Estate, 2010-2 USTC ¶ 60,604 (DC Md. 2010), the United States District Court in Maryland held that an estate was liable for a late filing penalty with respect to a
federal estate tax return, where the executor obtained a six-month extension of time to file the return, thereafter requested a second one-month extension of time to file, the Service informed the executor that it was prohibited by law from granting an extension of time to file beyond six months, and the executor filed the return almost a year after the extended due date.

In Estate of J. Fuertes, 2009-2 USTC ¶60,581 (U.S. Dist. Ct. Tex. 2009), the Court refused to grant the estate’s request for a refund of late filing penalties and late payment penalties assessed with respect to the late filing of the federal estate tax return and the late payment of the federal estate tax, where the executrix’s counsel acknowledged responsibility for the late filing and the late payment, finding that the executrix’s reliance on her counsel to file the return and to pay the tax was a delegation of her unambiguous duty to timely file the return under Code Section 6075(a) and did not constitute reliance on legal advice.

D. Request for Discharge From Personal Liability – Form 5495

An executor of a decedent’s estate may file Form 5495, Request for Discharge From Personal Liability Under Internal Revenue Code Section 2204 or 6905, with the Service to be discharged from personal liability for the estate taxes payable with respect to the decedent’s estate (Code Section 2204) and for income taxes and gift taxes payable by the decedent (Code Section 6905). The Service recently requested comments regarding such Form as part of the Service’s continuing efforts to reduce paperwork.

E. Form 990 and Form 8940

On June 24, 2011 the Service informed practitioners that tax exempt organizations will no longer be required to obtain approval from the board of directors to adopt whistleblower, conflict of interest and other governance policies for the 2010 Form 990. Instead, the Service will permit a committee of the board of directors to adopt the policy if it is adopted by the end of the tax year.

On August 8, 2011 the Service released a new one-page Form 8940, Request for Miscellaneous Determination, to be used to obtain advance approval from the Service of certain activities and exemption from Form 990 filing requirements. Form 8940 can be used to make requests for advance approval of certain private foundation set-asides; advance approval of private foundation voter registration activities; advance approval of private foundation scholarship procedures; exemption from Form 990 filing requirements; advance determination that a potential grant or contribution is an unusual grant, excluded from certain public support calculations; change in (or initial determination of) the type of a Code Section 509(a)(3) supporting organization; reclassification of foundation status, including a voluntary request from a public charity for private foundation status; termination of private foundation status under Code Section 507(b)(1)(B) (advanced ruling request); and termination of private foundation status under Code Section 507(b)(1)(B) (60-month period ended).

On September 7, 2011 the Service issued final rules (T.D. 9549) implementing the revised Form 990, eliminating the advanced ruling process for new organizations, changing the public support computation period for publicly supported organizations to five years, and clarifying that support must be reported using the organization’s overall method of accounting.
On November 17, 2011 a representative of the Service announced at a conference that the names of split-interest trusts will not have to be disclosed on the 2011 Form 990 Schedule R.

F. Qualified Personal Residence Trusts

In Riese v. Commissioner, T.C. Memo 2011-60 (March 15 2011), where the decedent had transferred her residence to a qualified personal residence trust ("QPRT") and continued to reside in the residence for approximately six months after the end of the term of the QPRT until her death without paying any rent, the Tax Court found that there was an agreement among the parties that the decedent would pay rent after the end of the QPRT term, even though there was no written lease and she had not paid any rent prior to her death, and the Court therefore held that the residence was not includible in the decedent’s gross estate for estate tax purposes under Code Section 2036. The Court also held that the estate was entitled to an estate tax deduction under Code Section 2053(a)(3) for the rent due for the period from the end of the QPRT to the date of the decedent’s death as a claim against the estate.

In PLR 200920033 (February 3, 2009), the Service ruled that a “Reverse QPRT”, under which the taxpayer transferred a residence to a QPRT which gave his parents the right to use the residence for a term of years, with the son retaining the reversion interest, qualified as a QPRT under Code Section 2702. Since the taxpayer had received the residence at the expiration of a QPRT created by his father with the same residence, the ruling noted that the Service was not expressing any opinion as to whether the residence would be included in his father’s gross estate under Code Section 2036, reserving the right to claim that the parties had an express or implied agreement that, after the first QPRT term ended, the son would retransfer the home to the reverse QPRT so that his father could continue to use it for his life.

On May 9, 2003, the Service in Rev. Proc. 2003-42 issued a sample declaration of trust that meets the requirements of the Code for a qualified personal residence trust with one term holder and provides samples of certain alternative provisions concerning additions to the trust to purchase a personal residence and disposition of trust assets on cessation of its qualification as a QPRT.

G. Private Trust Companies and Family Offices

In Notice 2008-63, IRB 2008-31 (August 4, 2008), the Service issued a proposed revenue ruling concerning the income, estate, gift and GST tax consequences of creating a private trust company to serve as the trustee of trusts having family members as grantors and beneficiaries. The private trust companies’ governing documents create a committee having exclusive authority regarding discretionary distributions from each trust. No member of the committee can participate in matters concerning any trust of which that member or his or her spouse is a grantor or a beneficiary or having a beneficiary to whom the member or his or her spouse who is a support obligation. Furthermore, no family member can have any express or implied reciprocal agreement with another family member regarding distributions. The Service ruled that a trust would not be includible in the grantor’s gross estate under Code Section 2036(a) or Code Section 2038(a) by reason of the trust company service as trustee, the grantor’s interest in the trust company, or the grantor’s service as an officer, director, manager, employee or
member of the distribution committee of the trust company. The Service also ruled that the service by a grantor on the distribution committee would not cause the grantor to be liable for gift taxes on discretionary distributions from the trust of which such person is the grantor, since the grantor cannot participate in distribution decisions. Furthermore, the Service ruled that the trust company serving as trustee, by itself, would not cause any grantor or beneficiary of that trust to be treated as the trust’s owner for income tax purposes.

On June 22, 2011 the Securities and Exchange Commission issued its final Rule 202(a)(11)(G)-1 exempting family offices from registration requirements under the Investment Advisers Act of 1940. The Rule stated that in order to qualify for the exemption, a family office adviser must only advise “family clients” with respect to securities, be wholly-owned by “family clients” and exclusively controlled by “family members”, and not hold itself out to the public as an investment adviser.

H. Restricted Management Accounts

On October 9, 2009 the Service determined in Chief Counsel Advice 200941016 that a restricted management account creates a principal/agent relationship and, therefore, that the only discount allowable for purposes of estate tax and gift tax valuation would be a discount for potential damages for breach of contract, which ordinarily would be significantly less than discounts for lack of control and lack of marketability.

In Rev. Rul. 2008-35, IRB 2008-29 (July 21, 2008), the Service ruled that for estate and gift tax purposes, the fair market value of a restricted management account is the actual value of the cash and marketable securities in the account without any restrictions or discounts, where the account was managed by a bank which had complete discretion regarding the investments, all dividends, interest and other earned income during the five-year term of the account would be reinvested, and no distribution would be made until the end of the term, except as permitted in the agreement. After one year and pursuant to the terms of the agreement, the decedent assigned the appreciation of the account assets to a child. The Service ruled that the assets remaining in the account were includible in the decedent's gross estate under Code Section 2036(a), finding that the decedent had always retained a property interest in the account’s assets. Moreover, the Service ruled that the account restrictions did not reduce the fair market value of the account’s assets for estate tax or gift tax purposes under Code Sections 2031 and 2512.

I. Estate Tax Deductions for Claims and Expenses - Section 2053

On October 16, 2009 the Service finalized previously proposed regulations regarding the determination of the amount deductible from a decedent’s gross estate for claims under Code Section 2053(a)(3). The final regulations generally provide that a deduction for any claim or expense described in Code Section 2053 is limited to the amount actually paid in settlement or satisfaction of the claim or expense. The final regulations provide exceptions for claims against an estate as to which there is a claim or asset includible in the gross estate that is substantially related to the claim against the estate, and for claims against the estate which in the aggregate do not exceed $500,000. These regulations generally apply to the estates of decedents dying on or after October 20, 2009.

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The Service also issued Notice 2009-84, IRB 2009-44 (November 2, 2009), which provides that if an estate timely files a protective claim for refund based on a Code Section 2053 deduction, the Service will limit its review of the estate tax return to such deduction if the claim becomes ready for consideration after the expiration of the period of limitations for the assessment of additional estate taxes against the estate, rather than examining the entire estate tax return. However, this exception does not apply when the Service is considering a protective refund claim based on a Code Section 2053 deduction and, in the same estate, is considering a refund claim that is not based on a protective claim regarding a Code Section 2053 deduction. This Notice applies to protective refund claims filed on behalf of estates of decedents dying on or after October 20, 2009.

On October 17, 2011 the Service issued Rev. Proc. 2011-48, IRB 2011-42, providing guidance regarding protective estate tax refund claims under Code Section 2053, applicable with respect to protective refund claims filed on behalf of estates of decedents dying on or after October 20, 2009. The Revenue Procedure provides in part that the claim may be filed at any time before the expiration of the statute of limitations, must describe the reasons and contingencies delaying the actual payment of the claim or expense, must set forth each ground upon which the claimed refund is based and facts sufficient to apprise the Service of the exact basis of the claim, and may be filed using Form 843 (Claim for Refund and Request for Abatement). The Revenue Procedure states that filing such a claim will not cause the Service to reopen issues on the estate tax return other than those that pertain to the claimed refund.

In J. Smith Exr., 2008-2 USTC ¶ 60,566, the Court of Appeals for the Fifth Circuit held that the Service was entitled to deduct the remaining obligation of an estate for unpaid underpayment interest against an overpayment of the estate tax and refund the balance of the overpayment to the estate.

In Estate of Malkin v. Commissioner, T.C. Memo 2009-212 (2009), the Tax Court held that the deductions claimed by the decedent’s estate under Code Section 2053 could not exceed the value of the estate property which was subject to claims.

In Estate of Black v. Commissioner, 133 T.C. No. 15 (December 14, 2009), the Tax Court held that a loan from a family limited partnership to the decedent’s estate, which the estate used to pay its tax liabilities and expenses, was not necessarily incurred by the estate and, therefore, that the interest paid by the estate in connection with the loan was not a deductible administration expense under Code Section 2053(a)(2).

In Stick v. Commissioner, T.C. Memo 2010-192 (September 1, 2010), the Tax Court held that the decedent’s estate could not deduct interest for estate tax purposes as an administration expense under Code Section 2053, where the interest was incurred on a loan made by the trust which was the residuary beneficiary of the estate, and the loan was used to pay the decedent’s estate taxes, where the estate failed to establish that the loan was required to enable the estate to pay such taxes.

In Keller v. United States, S.D. Tex., No.V-02-62 (September 15, 2010), the United States District Court for the Southern District of Texas held that the decedent's estate could deduct for estate tax purposes interest on a loan from an investment partnership established
by the decedent's financial advisors to two trusts which the decedent controlled, disallowed the 
estate tax deduction of a contingency fee paid to a law firm as not necessary to the administration 
of the estate, and allowed the estate to deduct for estate tax purposes fees paid to only one of the 
four executors (but not the fees paid to the three other executors), finding that only such one 
person actually performed the role of the executor of the estate.

In Duncan v. Commissioner, T.C. Memo 2011-255 (October 31, 2011), where the 
decedent’s estate borrowed funds from a trust that was the residuary beneficiary of the estate and 
the assets of which were includible in the decedent’s gross estate, in order to pay federal estate 
taxes, the Court held that the interest payable by the estate with respect to such loan was 
deductible for federal estate tax purposes as an administration expense under Code Section 2053, 
as the Court found that the loan at issue was a bona fide debt, the interest expense was actually 
and necessarily incurred in the administration of the estate, and the amount of interest was 
ascertainable with reasonable certainty.

In Naify v. United States, No. 3:09-cv-01604 (September 8, 2010), aff’d., 9th Cir. 
No. 10-17358 (2012) the District Court for the Northern District of California held that the 
decedent's estate, which had claimed an estate tax deduction of $62,000,000 for income taxes 
owed by the decedent to the State of California, could only deduct $26,000,000, which is the 
amount for which the estate settled that claim after the decedent's death.

In Saunders v. Commissioner, 136 T.C. No. 18 (2011), the Tax Court held that the 
decedent’s estate could claim an estate tax deduction under Code Section 2053 for the amount of 
a claim against the decedent that was actually paid during the administration of the estate, but not 
for the more substantial amount for which such claim was appraised as of the date of the 
decedent’s death because the value was not ascertainable with reasonable certainty.

In Gill v. Commissioner, T.C. Memo, 2012-7 (January 9, 2012), the Court held 
that an amount paid by an estate as legal fees under a settlement agreement to reimburse the 
decedent’s children for legal fees they incurred in an undue influence litigation regarding the 
decedent’s will are a deductible administration expense of the estate for federal estate tax 
purposes.

In Estate of Koons v. Commissioner, T.C. Memo 2013-94 (2013), where the 
decedent’s revocable trust owned a majority interest in a limited liability company having assets 
consisting largely of liquid securities, the Court denied an estate tax deduction for interest with 
respect to a loan from the limited liability company to such trust, noting that the loan was not 
necessary to the administration of the estate, as the trust could have caused the company to make 
a distribution of the required funds, rather than a loan.

J. Section 6166 Court Decisions and Announcements

On January 25, 2013 the Service issued CCA 201304006, advising that where an 
estate makes a Code Section 6166 election for part of a closely held business interest, and a 
deficiency is subsequently assessed, the portion of the deficiency that is attributable to the 
business will be prorated to the installments payable pursuant to the original election, but that a
deficiency that is unrelated to the value of the portion of such interest as to which the estate originally made the election cannot be used to expand such election.

In United States v. Johnson, 2012 U.S. Dist. LEXIS 72194 (D. Ct. Utah 2012), the executors of the decedent’s estate elected to pay estate taxes in installments pursuant to Code Section 6166, the decedent bequeathed the residue of her estate to an existing trust, the executors distributed such residue to that trust, and such trust distributed those assets to the trust’s beneficiaries pursuant to an agreement under which the beneficiaries agreed to pay the remaining estate tax due. The Court held that the trust’s beneficiaries were not liable for the remaining estate tax as transferees, as such beneficiaries did not receive assets directly from the decedent’s gross estate. However, the Court also held that such beneficiaries were liable for the estate tax as beneficiaries of life insurance policies insuring the decedent’s life, to the extent of the benefit that they received from such policies. Further, the Court held that the trustees of the trust were transferees of the estate, and that the trustees, as well as the estate’s executors, were personally liable for the estate tax.

It is noteworthy that the portion of the deferred tax that bears interest at the rate of 2% per year is currently being subjected to a higher rate of interest than the floating interest rate that generally is applicable to the underpayment of estate taxes.

On October 21, 2011 the Service issued CCA 201142025, which advised that a distribution by gift of 51% of the Code Section 6166 property to other family members was an accelerating event for purposes of Code Section 6166(g), thereby causing the Code Section 6166 election to cease to apply.

On October 21, 2011 the Service issued CCA 201142024, advising that a change in the form of the business that holds the property for which the Code Section 6166 election was made would not constitute a divestment of the interest in that property for purposes of Code Section 6166(g).

In CCA 201144027, dealing with an election to pay estate taxes in installments pursuant to Code Section 6166, and the holding company election under Code Section 6166(b)(8), the Service advised that an estate may not make a bifurcated Code Section 6166(b)(8) election with respect to the holding company stock, but that the estate may either apply Code Section 6166(b)(8) and forgo the deferral option under Code Section 6166(a)(3), or not make the Code Section 6166(b)(8) election.

In United States v. Kulhanek, 2010 U.S. Dist. LEXIS 130039 (W.D. PA., December 8, 2010), where there was an election to defer the payment of estate taxes under Code Section 6166, the Court held that the 10 year statute of limitations for the collection of unpaid estate taxes under Code Section 6324(a)(1) is suspended and does not begin to run until the disposition of the closely held stock.

In PLR 200939003 (June 23, 2009), the Service ruled that the GST tax payable on a taxable termination is not eligible to be paid in installments under Code Section 6166. Note, however, that the installment payment election is applicable to the GST tax imposed on direct skips occurring on the death of the transferor.
In Carroll v. United States, 2009-2 USTC ¶ 60,577 (N.D. Ala. July 29, 2009), the Court held that where executors are personally liable for the payment of estate taxes as a result of electing to pay such taxes in installments under Code Section 6166 and then distributing the estate assets to themselves as beneficiaries of the estate before paying all such installments, a co-executor could not discharge such liability in a bankruptcy proceeding, holding that the tax debt was excepted from discharge since the co-executor before the Court willfully evaded the payment of the estate tax debt, even though tax debts generally are dischargeable through bankruptcy.

In Chief Counsel Memorandum POSTS – 113182-07 (February 25, 2009), the Service advised that, in connection with an election to pay estate taxes in installments under Code Section 6166, the Service may require the estate to provide a bond or a lien in an amount including not only the deferred estate tax but also the aggregate amount of interest to be paid over the deferral period, provided that the amount of interest does not exceed the amount of the deferred tax; that the Service may accept a bond or a lien in a lesser amount on a case-by-case basis after examining all the relevant facts and circumstances; that the value of the property offered by the estate for the lien may or may not be the same as its value as reported on the federal estate tax return; that if an interest in a family limited partnership is being pledged as security, the federal estate tax discount used to value that interest should also be used in valuing it for purposes of the lien; and that if mortgaged property is used for purposes of the lien, such property should be valued based on its net equity.

On June 12, 2009 the Service issued a memorandum (SB/SE-05-0609-010) stating that, effective immediately, the Estate Tax Advisory Group of the Service will determine on a case by case basis whether a bond or the special estate tax lien under Code Section 6324A is required in all cases in which estates elect to pay estate taxes in installments pursuant to Code Section 6166 and will negotiate the bond or special lien, after the Service’s Estate and Gift Tax Section has determined that the estate qualifies for the election. The memorandum states that prior to making a determination as to whether to require a bond or a special estate tax lien, the Advisory Estate Tax Group will first request the estate to voluntarily provide a bond or special estate tax lien. If the estate declines to do so, the Advisory Estate Tax Group will make its determination based on a list of non-exclusive factors, which are the duration and stability of the business, the perceived ability to pay the installments of tax and interest on a timely basis, and the tax compliance history of the business, the estate and the decedent. After such determination, the estate will be given the right to appeal.

In CCA 200848004 (2008), the Service’s Office of Chief Counsel stated that a Code Section 6166 election can only be made by attaching a notice of election to a timely filed federal estate tax return.

In PLR 200842012, the Service ruled that the closely held company in which the decedent had an interest carried on an “active trade or business” for purposes of Code Section 6166, where the corporation owned, developed, managed and leased commercial property, the employees of the corporation were involved in all aspects of the business, and a separate facilities team was responsible for day-to-day repairs, maintenance and other tasks in connection with the properties.
In Roski v. Commissioner, 128 T.C. No. 10 (April 12, 2007), the Tax Court held that the Service does not have the authority to require a bond or a special lien for every estate that elects to defer the payment of estate taxes under Code Section 6166. Moreover, the Court stated that the Service must exercise its discretion as to whether or not to require a bond or a special lien in each case by reviewing the applicable facts and cannot arbitrarily rely on a standard which in effect precludes that exercise of discretion.

On November 13, 2007, as a result of the Court’s decisions in Roski, the Service announced a change in its policy and provided interim guidance for estates making a Section 6166 election (Notice 2007-90). The Service will now determine on a case-by-case basis whether security is required when a qualifying estate elects under Section 6166 to pay all or part of the estate tax in installments. The Treasury Department and the Service are in the process of establishing standards to apply and until such regulations are issued, the Service will evaluate three factors to determine whether at any time and occasionally during the deferral period the government’s interest in the estate tax and the interest is sufficiently at risk to justify the requirements of a bond or special lien. The factors are (1) the duration and stability of the closely held business on which the estate tax is deferred; (2) the estate’s ability to timely pay installments of tax and interest; and (3) the estate’s compliance history.

The Chief Counsel’s office of the Service in C.C.A. 200645027 has advised that when an estate elects to pay estate taxes in installments pursuant to Code Section 6166 and gives the Service the special estate tax lien provided for in Code Section 6324A with respect to the Code Section 6166 assets of the estate, that special lien does not divest the balance of the assets of the gross estate from the estate tax lien provided for in Code Section 6324.

The Chief Counsel’s office of the Service addressed questions regarding the acceptance of stock in a closely held corporation as collateral for a lien under Section 6324A for estate tax deferred under Section 6166 (C.C.A. 200747019). The Service said that stock in a closely held corporation qualifies as “other property” acceptable as collateral for such a lien if three statutory requirements are met: (1) the stock must first be expected to survive the deferral period and retain its value, based on the Service’s valuation; (2) the stock must be identified in the written agreement described under Section 6324A(b)(1)(B) which must show all persons having an interest in the stock agree to the creation of the special lien; and (3) the value of the stock as of the agreement date must be sufficient to pay the deferred taxes plus required interest. The Service noted that the principles in the C.C.A. are equally applicable to interests in a limited liability company or a partnership. In order to secure the Service’s interest in the stock, a Notice of Federal Tax Lien should be filed and the Service may hold the stock certificates to prevent their sale to third parties.

In addition, the Chief Counsel’s office in C.C.A. 200803016 has provided advice on whether the Service is required to accept an interest in a limited liability company as collateral under Section 6324A. As with the sufficiency of stock in a closely held corporation, the Chief Counsel explained that if the three requirements [i.e., (1) the interest has to be expected to survive the deferral period; (2) the interest has to be identified in the written agreement described under Section 6324A(b)(1)(B); and (3) the value of the interest has to be sufficient to pay the deferred taxes plus required interest] under Section 6324A are met, the special lien arises and the collateral offered by the estate has to be accepted by the Service. In the case of an LLC,
the Chief Counsel observed that the Service was required to file a Notice of Federal Tax Lien for
the special estate tax lien against the LLC.

In Rev. Rul. 2006-34, 2006-1 Cum. Bull. 1171, the Service set forth a non-
exclusive list of factors which the Service would use to determine whether a decedent’s real
estate activities were sufficiently active to qualify the real estate interest as a closely held
business interest for purposes of allowing the decedent’s estate to defer the payment of estate
taxes under Code Section 6166. The Service stated that, to determine whether the decedent’s
interest is an asset used in the active conduct of a trade or business, the Service will consider the
amount of time the decedent devoted to the trade or business, whether an office was maintained
from which the decedent’s activities were conducted or coordinated and whether the decedent
maintained regular business hours for that purpose, the extent to which the decedent was actively
involved in finding new tenants and negotiating and executing leases, the extent to which the
decedent provided landscaping, grounds care or other services beyond the mere furnishing of
leased premises, the extent to which the decedent personally made, arranged for, performed or
supervised repairs and maintenance to the property, and the extent to which the decedent handled
tenant repair requests and complaints. The Ruling further stated that no single factor would be
determinative.

K. 2% Floor for Miscellaneous Itemized Deductions

In Rudkin v. Commissioner, sub nom, Knight v. Commissioner, 552 U.S. 181
(2008), the Court unanimously held that deductions for investment advisory fees paid by a trust
are subject to the 2% floor on miscellaneous itemized deductions under Code §67(a). The Court
rejected the approach which asked whether the cost at issue “could” have been incurred by an
individual. Instead, the Court adopted the test which asked whether the costs incurred would not
“commonly” or “customarily” be incurred by individuals, holding that Code §67(e)(1) excepts
from the 2% floor only those fees that would be uncommon, unusual or unlikely for such a
hypothetical individual to incur.

On February 27, 2008, and in light of the U.S. Supreme Court’s decision in
Knight, id., the Service issued Notice 2008-32 to provide interim guidance on the treatment
under Code Section 67 of investment advisory costs and other costs subject to the 2% floor.
Taxpayers will not be required to determine the portion of a bundled fiduciary fee that is subject
to the 2% floor for any tax year prior to January 1, 2008. The proposed regulations from July,
2007 were based on reasoning that was specifically rejected by the Supreme Court in Knight.
Accordingly, the Notice indicates that the Service will issue final regulations that conform to
Knight and anticipates that final regulations under §1.67-4 will be published after the extended
comment period which ends May 27, 2008. On December 11, 2008 the Service issued Notice
2008-116 extending the application of Notice 2008-32 to tax years beginning before January 1,
2009. On April 1, 2010 the Service issued Notice 2010-32, 2010-16 IRB 594, further extending
the application of Notice 2008-32 to tax years beginning before January 1, 2010. On April 13,
2011 the Service issued Notice 2011-37 extending the application of Notice 2008-32 to tax years
that begin before the date that final regulations regarding this issue are published in the Federal
Register.
On September 6, 2011 the Service issued proposed regulations (REG-128244-06) as to which expenses that are incurred by estates and trusts other than grantor trusts are subject to the two-percent floor for miscellaneous itemized deductions under Code Section 67(a). These proposed regulations provide that:

- In general, an administration expense is subject to the two-percent floor if the expense would be “commonly” or “customarily” incurred by a hypothetical individual owning the same property as the property owned by the estate or the non-grantor trust.

- In determining whether an expense is “commonly” or “customarily” incurred by a hypothetical individual owning the same property, the determining factor is the type of product or service that the estate or the non-grantor trust purchases, rather than the description of the cost of that product or service. In addition, expenses that do not depend on the identity of the payor generally are expenses that are “commonly” or “customarily” incurred by an individual, including without limitation expenses incurred in the defense of a claim against the estate, the decedent or a non-grantor trust that are no related to the existence, validity or administration of such estate or trust.

- Ownership costs, which are costs that are chargeable to or incurred by an owner of property merely by reason of owning such property, are subject to the two-percent floor. Such costs include condominium fees, real estate taxes, insurance premiums, maintenance and lawn services, automobile registration and insurance costs, and partnership costs that are passed through to and reportable by the estate or the trust as a partner.

- The cost of preparing estate tax returns, GST tax returns, fiduciary income tax returns and a decedent’s final individual income tax returns are not subject to the two-percent floor. However, the cost of preparing other individual income tax returns, gift tax returns and returns of a sole proprietorship or a retirement plan are subject to the two-percent floor.

- Investment advisory fees generally are subject to the two-percent floor.

- Generally, “bundled” fees must be allocated between costs that are subject to the two-percent floor and costs that are not subject to such floor. However, if a “bundled fee” is not computed on an hourly rate basis, then only the portion of such fee that is attributable to investment advice is subject to the two-percent floor, except that payments from a “bundled” fee to third parties that would have been subject to the two-percent floor if they had been paid directly by the estate or the trust are subject to such floor, and except that any fees or expenses that are separately assessed by the fiduciary or other payee, that are in addition to the usual or basic “bundled” fee and that are “commonly” or “customarily” incurred by an individual, are subject to the two-percent floor.

- The allocation of the portion of the “bundled” fee that is subject to the two-percent floor may be made by any “reasonable” method.

- The proposed regulations apply to tax years of an estate or a non-grantor trust that begin on or after the date that such regulations are published as final regulations in the Federal Register.
L. Alternate Valuation Date Election

In PLR 201109014 (March 4, 2011), rescinding PLR 201033023 (August 20, 2010), the Service granted an estate additional time to make the alternate valuation date election for federal estate tax purposes, where the estate had timely filed a federal estate tax return valuing the decedent’s assets on the date of the decedent’s death and, more than 18 months after the due date of that return, the executors asked the Service to grant additional time to make such election.

On November 18, 2011 the Service released new proposed regulations under Code Section 2032 (REG-112196-07) regarding the alternate valuation date election and withdrew previously proposed regulations regarding that election that were released in April 2008. The new proposed regulations provide that:

- If an interest in a corporation, a partnership or any other entity that is includible in a decedent’s gross estate is exchanged for one or more different interests in the same entity, or in an acquiring or resulting entity, the transaction will not constitute a “disposition” for purposes of such election, if, on the date of the exchange, the value of the interest surrendered equals the value of the acquired interest.

- In determining whether or not the exchanged properties have the same fair market value, a difference in value that is equal to or less than 5% of the value of the surrendered property as of the transaction date will be ignored.

- If the decedent’s estate receives a distribution or a disbursement from a partnership, a corporation, a trust (including an Individual Retirement Account, a Roth IRA, or other deferred compensation plans), the distribution or disbursement will not constitute a “distribution” of the asset for purposes of such election, if on the date of the distribution or disbursement the value of the decedent’s interest in such property before the distribution or disbursement equals the sum of the value of the distribution or disbursement received and the value of such property after that distribution or disbursement.

- If the estate disposes of only a portion of the decedent’s interest in an asset and retains the other portion on the six-month date, or if an estate disposes of a decedent’s entire interest in an asset in two or more transactions prior to the end of the six-month date, the value of each portion of the asset is determined by multiplying the value of the decedent’s entire interest by a fraction, the numerator of which is the portion of the interest in the asset that is disposed of, and the denominator of which is the decedent’s entire interest in the asset.

- An asset owned by the decedent at his death is not considered to be “distributed” merely because it passes directly to another person at the decedent’s death as a result of a beneficiary designation, or other contractual arrangement, or by operation of law.

- Factors such as economic or market conditions, occurrences described in Section 2054 of the Code (i.e., losses arising from fires, storms, shipwrecks, other casualties, or theft, that are not compensated for by insurance or otherwise) can be taken into account in determining the value of an asset for purposes of such election.
Management decisions made in the ordinary course of operating a business generally are taken into account as occurrences relating to economic or market conditions.

Changes in value due to the mere lapse of time generally are not taken into account in determining the value of an asset for purposes of such election.

As to the value of a life estate, remainder interest or term interest for purposes of such election, the value of the interest as of the alternate valuation date is determined by applying the age, at the decedent’s death, of each person whose life expectancy may affect the value of that interest, and the value of the property and the applicable interest rate under Section 7520 of the Code shall be determined using values that apply on the alternate valuation date.

M. Generation-Skipping Transfer Taxes

1. Exercise or Lapse of Power of Appointment

Conflict continues among the Courts in regard to the “grandfather” exception to GST taxes for trusts that were irrevocable before September 25, 1985 where a general power of appointment is not exercised. The issue is whether the lapse of the general power of appointment is an “addition” to the corpus of a trust which thereby subjects the trust to the GST tax even though it would otherwise not be subject to the GST tax because of the “grandfather” exception.

In Peterson Marital Trust v. Commissioner, 78 F.3d 795 (2d Cir. 1996), the Court held that (1) the lapse of the surviving spouse’s general power of appointment was a “constructive addition” to the marital trust under Temporary Regulation Section 26.2601-1(b), and (2) since the lapse occurred after 1985, the entire trust, which was payable to the settlor’s grandchildren, was subject to the GST tax.

However, in Simpson v. United States, 183 F.3d 812 (8th Cir. 1999), the Court held that the 1993 transfer of trust corpus to the settlor’s widow’s grandchildren, pursuant to the widow’s failure to exercise a general power of appointment under the settlor’s testamentary trust, which became irrevocable upon his death in 1966, came within the “grandfather” provision, making the GST tax inapplicable to any generation skipping transfer under the trust.

In the Estate of Gerson, 2007-2 USTC ¶ 60,551 (6th Cir. 2007), the Sixth Circuit Court of Appeals affirmed the Tax Court finding that a decedent’s exercise of her testamentary general power of appointment in favor of her grandchildren with respect to an irrevocable trust created by her deceased husband prior to September 25, 1985, was subject to the GST tax under Reg. Section 26.2601-1(b)(1)(i). The Court of Appeals found that the regulation was a valid interpretation of language in the effective date rule of Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (which provided a grandfather exception for trusts that were irrevocable before September 25, 1985 but only to the extent that such transfer is not made out of corpus added to the trust after that date). The Tax Court’s opinion agreed with the Second Circuit’s ruling in Peterson Marital Trust v. Commissioner, supra., that the words of TRA ‘86 Section 1433(b)(2)(A) can only be given meaning in a particular context. The Tax Court’s ruling was at odds with decisions from the Eighth and Ninth Circuits (see, Simpson, supra., and R. Belcher, 281 F.3d 1078 (9th Cir. 2002)), which have allowed such transfers. On May 27, 2008 the United
States Supreme Court denied certiorari in Gerson (sub nom Kleinman v. Commissioner, No. 07-1064).

In Estate of Timken v. United States, 630 F. Supp. 2d 823 (U.S. Dist. Ct., N.D. Ohio 2009), the Court held that a lapse of a general power of appointment under a trust is a constructive addition to the trust for GST tax purposes, finding that Treas. Reg. Section 26.2601-1(b)(1)(v)(A) which, so provides, is valid as a permissible construction of the effective date provisions of the GST tax. The Court of Appeals for the Sixth Circuit (Case No. 09-3650, April 2, 2010) affirmed the District Court decision. On January 10, 2011 the United States Supreme Court (U.S. No. 10-363) denied a petition for certiorari.

2. Qualified Severances

Final regulations (NPRM-REG-128843-05) with regard to a qualified severance for GST tax purposes were effective on August 2, 2007. For severances made after December 31, 2000 and before August 2, 2007, taxpayers may rely on any reasonable interpretation of Sec. 2642(a)(3), provided that reasonable notice of the severance has been given to the Service. Although the proposed regulations posited that the severance rules of Reg. Section 26.2654-1(b) were superseded by Sec. 2642(a)(3), the final regulations note that the provisions address different circumstances. Therefore, Reg. Section 26.2654-1(b) is not superseded by the final regulations. While the non pro rata funding of trusts resulting from a qualified severance is still permitted, the final regulations provide that such funding must be achieved by applying the appropriate fraction or percentage to the total value of the trust assets as of the “date of severance”. The “date of severance” is defined as the date selected for determining the value of trust assets, either on a discretionary basis or by court order, so long as funding is begun immediately and occurs within a reasonable time (not more than 90 days) after the selected date of severance.

In addition, the final regulations also address the qualified severance of a trust that was irrevocable prior to September 25, 1985, but to which an addition was made after that date. The regulations explain that, while the reporting provision of the regulations is not a requirement for qualified severance status, a severance should be reported to the Service to ensure the proper application of the GST tax. Notification of a qualified severance must be made by marking “Qualified Severance” at the top of Form 706-GS(T) and attaching a “Notice of Qualified Severance” to the return.

Proposed amendments to Reg. Sections 26.2642-6 and 26.2654-1 were issued contemporaneously with the final regulations (T.D. 9348 (FEGT ¶43,113)) and address the situation where the trusts resulting from a severance do not meet the requirements of a qualified severance. In such case, the new trusts will be treated as separate trusts for GST tax purposes as long as the resulting trusts are recognized under applicable state law. However, each trust will have the same inclusion ratio immediately after the severance as the original trust had prior to the severance. In addition, an additional type of qualified severance is proposed (as authorized by Section 2642(a)(3)(B)(ii)): the severance of a trust with an inclusion ratio between zero and one into two or more new trusts. The proposed regulations clarify Reg. Section 26.2642-6(d)(4) by providing that no discount or reduction from value of an asset owned by the original trust arising as a result of the division of the original trust’s interest in the assets between the resulting trusts.
is allowed in funding the new trusts. This clarification is proposed to be effective with respect to severances occurring on or after August 2, 2007.

Effective July 31, 2008, the Service published final rules (T.D. 9421) regarding qualified severances of trusts for GST tax purposes. The final rules rejected a recommendation of an alternative funding rule for qualified severances of trusts in relation to the GST tax and clarified that, for the requirements of a qualified severance, regardless of whether the funding is done on a pro rata basis, the cumulative value of the resulting trusts equals the value of the original trust. The Service stated that "this funding rule produces a bright line test, the same result whether or not the trust assets are divided on a pro rata basis, and recognizes that in many circumstances, where a trust is severed for tax purposes into two identical trusts with the same or related beneficiaries, any closely held stock or partnership units divided between the two resulting trusts are likely to be sold as a unit without any actual reduction in value that may be reflected in the claimed discounts." In addition, the final rules added cautionary language to Example 3 of Reg. Section 26.2642-6(j) to the effect that a GST taxable event will result as a consequence of a nonqualified severance and added a new example to confirm that a trust resulting from a nonqualified severance may subsequently be severed in a qualified severance.

3. Allocation of GST Tax Exemption

On April 16, 2008, the Service issued proposed regulations (REG-147775-06) that describe the circumstances and procedures under which an extension of time will be granted to make a late allocation of a GST tax exemption to a transfer, to make a late election out of an automatic allocation of that exemption to a transfer, and to elect to have the deemed allocation of a GST exemption apply to a direct skip. The proposed regulations would replace Treas. Regs. Section 301.9100-3 regarding relief under Code Section 2642(g)(1).

Requests for relief under Code Section 2642 will be granted when the taxpayer establishes to the Service’s satisfaction that the taxpayer acted reasonably and in good faith and that the grant of relief will not prejudice the interests of the government. Factors such as the intent of the transferor to timely allocate the GST tax exemption or to timely make an election under Code Section 2632 will be used to determine whether the taxpayer acted reasonably and in good faith.

In the event an extension of time to allocate a GST tax exemption is granted under Code Section 2642, the allocation will be considered effective as of the date of the transfer and the value of the property transferred will determine the amount of the GST tax exemption allocated. If an extension of time to elect out of the automatic allocation of the GST tax exemption is granted under Code Section 2632, the election will be considered effective as of the date of the transfer. If an extension of time to treat any trust as a GST trust under Code Section 2632 is granted, the election will be considered effective as of the first (or each) transfer covered by the election. If an extension is granted under Code Section 2642, the amount of the exemption is limited to the amount of the transferor’s unused GST tax exemption under Code Section 2631. If an amount of the GST tax exemption has increased since the date of the transfer, no portion of the increased amount can be applied because the grant of relief is to a transfer taking place in an earlier year and prior to the effective date of that increase. The
proposed regulations apply to requests for relief filed on or after the date of publication of the Treasury decision adopting these rules as final regulations.

4. **Transactions of Interest**

On November 14, 2011 the Service published final regulations (T.D. 9556) containing rules giving material advisors to reportable tax shelter transactions involving GST taxes 30 days to prepare a list of advisees that must be disclosed to the Service.

On September 11, 2009 the Service issued Proposed Reg. Section 26.6011-4 (REG-136563-07), which would require the disclosure under Code Section 6011 of certain listed transactions and transactions of interest regarding the GST tax. However, the Service has not yet identified any such transactions, pending the proposal of the relevant regulations.

5. **GST Taxes and Code Section 6166**

In PLR 200939003 (June 23, 2009), the Service ruled that the GST tax payable on a taxable termination is not eligible to be paid in installments under Code Section 6166. Note, however, that the installment payment election is applicable to the GST tax imposed on direct skips occurring on the death of the transferor.

N. **Intentionally Defective Grantor Trusts**

In Adams v. Commissioner, T.C. Memo 2010-72 (April 13, 2010), the Tax Court held that a beneficiary of a grantor trust that owned real property was entitled to claim a mortgage interest deduction on the trust property where the beneficiary had the duty to maintain and repair the property, the beneficiary paid the taxes attributable to the property and the beneficiary had a right of first refusal to purchase the property.

In Rev. Rul. 2011-28, IRB 2011-49 (Dec. 5, 2011), the Service ruled that the retention by a trust’s grantor of a non-fiduciary power to acquire an insurance policy held in the trust by substituting other assets of equivalent value will not, by itself, cause the value of the policy to be includible in the grantor’s gross estate under Code Section 2042 if the trustee has a fiduciary obligation (either under applicable local law or in the trust instrument) to ensure that the substitute property is of equivalent value and the substitution power cannot be exercised in a manner that shifts benefits among trust beneficiaries.

In Rev. Rul. 2008-22, 2008-16 IRB 796 (April 21, 2008), the Service ruled that an inter vivos trust will not be included in a grantor’s taxable estate under Code Sections 2036 or 2038 solely because the grantor retains a nonfiduciary power to substitute property of equivalent value. The Service was presented with a trust instrument where the grantor had created and funded an irrevocable inter vivos trust for the benefit of his descendants. The trust instrument prohibited the grantor from serving as a trustee but provided the grantor with the power, exercisable in a nonfiduciary capacity, at any time, to reacquire trust property by substituting other property of equivalent value. Approval of such action was not required by any third party. The grantor was required to certify in writing that the original and substituted properties were of equivalent value. Under local law, a trustee had the obligation to ensure that the original and substituted properties were of equivalent value. Based on these facts, the Service concluded that
as long as the trust instrument or local law provide that the trustee has a fiduciary obligation to ensure that the original and substituted properties are of equivalent property, then such a retained power exercisable in a nonfiduciary capacity will not cause the trust corpus to be included in the grantor's gross taxable estate under either Code Section 2036 or Section 2038, "provided that the power is not exercised in a manner that can shift benefits if (a) the trustee has both the power (under local law or the trust instrument) to re-invest the trust corpus and a duty of impartiality with respect to trust beneficiaries or (b) the nature of the trust investments or the level of income produced by any or all of the trust's investments does not impact the respective interests of the beneficiaries, such as when the trust is administered as a unitrust ... or when distributions from the trust are limited to discretionary distributions of principal and income."

In PLR 200944002 the Service ruled that the retention by the grantor of an irrevocable trust of the power to substitute trust assets with other property of equal value did not cause the trust property to be included in the grantor’s gross estate for estate tax purposes, where the trustee was prohibited from distributing trust funds to the grantor or the grantor’s estate to satisfy the grantor’s income tax liabilities.

In PLR 200848006, PLR 200848015, PLR 200848016 and PLR 200848017, the Service refused to rule as to whether a plan to modify a trust to give the grantor the power, exercisable solely in a non-fiduciary, to reacquire trust property by substituting other property of equivalent value would cause the trust to be treated as a grantor trust for income tax purposes, advising that this is a fact question to be determined after the federal income tax returns for the relevant parties have been filed and examined.

In Karmazin v. Commissioner, Tax Court Docket No. 2127-03 (2003), in a gift tax audit resulting in the taxpayer filing a petition in Tax Court, the Service issued an unagreed report and a 90-day tax deficiency letter in which the Service viewed an installment note, issued by an intentionally defective grantor trust in exchange for the assets, as equity rather than debt. If this characterization was sustained, it would result in the note having a value of zero (pursuant to the rules of Code Chapter 14) and the taxpayer being burdened with a sizable gift tax obligation. The Service claimed that the notes, as equity, constitute an “applicable retained interest” and must be valued at zero for gift tax purposes. The Service’s conclusion that the notes constitute equity was based on a number of factors, including a low equity-to-debt ratio (which nevertheless was in excess of the 10% equity requirement often cited as sufficient), the fact that the only assets supporting the “debt” were the FLP interests transferred to the family trusts and the fact that the debt was non-recourse as to the trust beneficiaries. In the alternative, the Service also took the position that the FLP should be disregarded for transfer tax purposes because it lacked economic substance and had no valid business purposes, or Code Section 2703(a)(2) applies to disregard the FLP for transfer tax purposes, since the limited partnership form itself constitutes a restriction on the right to sell or use the underlying assets. The Service stated that although no discount was applicable, if one was determined to apply it should be limited to 3% and no annual exclusions may be claimed, citing Hackl v. Commr.. The Service is reported to have withdrawn its position that the sale of limited partnership interests to an intentionally defective grantor trust in exchange for a note was not a bona fide transaction under Code Sections 2701 and 2702.
In Rev. Rul. 2004-64, 2004-2 Cum. Bull. 7, the Service addressed the gift and estate tax issues involved in a grantor trust where neither applicable state law nor the trust instrument contains any provision requiring or permitting the trustee to reimburse the grantor for income taxes payable by the grantor with respect to trust income, or where applicable state law or the governing instrument requires the trustee to do so, or where applicable state law or the governing instrument merely gives the trustee discretion to do so. As to the gift tax consequences, the Service held that the grantor’s payment of those income taxes does not constitute a gift by the grantor to the trust beneficiaries in any of those situations because the grantor, rather than the trust, is liable for the payment of the taxes. In addition, the Service held that the trust’s reimbursement of the grantor for the payment of those taxes, whether that reimbursement is permitted or required, is not a gift by the trust beneficiaries to the grantor.

As to the estate tax consequences, the Service held that no portion of the trust is includible in grantor’s gross estate under Code Section 2036 where neither applicable state law nor the trust instrument contains any provision requiring or permitting the trustee to reimburse the grantor, since the grantor did not retain the right to have the trust property used to discharge his legal obligation to pay the income tax. However, where the trust instrument requires the trustee to reimburse the grantor, or where state law requires the trustee to reimburse the grantor (unless the trust instrument provides otherwise), the full value of the trust’s assets will be includible in the grantor’s gross estate under Code Section 2036(a)(1), but the Service will not adversely apply this estate tax holding to a grantor’s estate with respect to any trust that was created prior to October 4, 2004. As to a trust instrument which gives the trustee discretion to reimburse the grantor, the Service held that this discretionary reimbursement power (whether granted in the trust instrument or under state law), by itself, will not cause the trust assets to be includible in the grantor’s gross estate, whether or not the trustee actually reimburses the grantor. However, the Service noted that the trustee’s discretion combined with other facts such as an expressed or implied understanding between the grantor and the trustee regarding the trustee’s exercise of that discretion could cause inclusion of the trust assets in the grantor’s gross estate tax purposes.

O. GRATs and GRITs

On November 7, 2011 the Service issued final regulations under Code Section 2036 regarding the value of property transferred in trust that is includable in the transferor’s gross estate for estate tax purposes where the transferor retained an interest in such property. The regulations provide that: If the decedent and another individual were joint income beneficiaries of the trust, the decedent’s estate includes (a) one-half of the value of the trust property, plus (b) the value of the other half of the trust property reduced by the value, as of the decedent’s death, of the present value of the survivor’s interest. Where the grantor’s beneficial interest succeeds another individual’s interest, the includable amount is the value of the trust property necessary to produce the grantor’s annuity or unitrust payment had he survived the current recipient, less the present value of the current recipient’s remaining interest, except that the includable amount cannot be less than the amount of the trust property required to produce the annuity or unitrust payment to which the decedent was entitled in the year of his death. Where the decedent is entitled to increasing payments, the includable amount is (a) the value of the trust property necessary to produce the decedent’s annuity or unitrust payment for the year of death, plus the value of the trust necessary to produce the incremental amount resulting from the
increased annuity in each of the future years, discounted to reflect the delay in the decedent receiving this additional amount. The regulations also provide that if Code Section 2036 applies to include the value of trust property in the decedent’s estate, any payments payable to such estate after the decedent’s death will not also be includable under Code Section 2033.

On July 14, 2008, the Service adopted amendments and revisions to Treas. Reg. Sections 20.2036-1 and 20.2039-1 relating to a grantor's retained interest in a trust. The final regulations incorporate guidance provided in Rev. Rul. 82-105, 1982-1 C.B. 133 and Rev. Rul. 76-273, 1976-2 C.B. 268 regarding the portion of a trust which is includible in a grantor's gross estate under Code Section 2036 if the grantor retained the right to use trust property or the right to receive an annuity, unitrust, or other income payment for the grantor's life, for any period not ascertainable without reference to the grantor's death or for any period that does not end before the grantor's death. The covered trusts include grantor retained annuity trusts, charitable remainder trusts and qualified personal residence trusts, among others. Pursuant to amended Treas. Reg. Section 20.2036-1, if a grantor retained the right to use the trust property, the portion of the trust corpus includible in the grantor's gross estate is that portion of corpus, valued as of the grantor's date of death or alternate valuation date, necessary to yield the annual payment using the then applicable Code Section 7520 rate. In addition, as to pooled income funds, the retained interest is the right to all the income. Thus, the entire share of the fund's corpus attributable to the transferor is includible in the transferor's gross estate. The amendments clarify that although Code Section 2039 may also have implications on the issue of includibility in the grantor's gross estate, only Code Section 2036 will apply to an annuity, unitrust or other payment retained by a deceased grantor in a CRT or GRAT. The amended regulations are effective with respect of decedents for which the valuation date of the gross estate is on or after July 14, 2008.

In Walton v. Commissioner, 115 T.C. No. 41 (Dec. 22, 2000), the grantor funded two substantially identical GRATs with common stock worth approximately $100 million. Each GRAT had a term of two years and, in the event of the grantor’s death, the annuity amounts were to be paid to her estate. At the end of the two year term, the remaining value of each trust was to be distributed to the grantor’s daughters. The Tax Court determined that for purposes of valuing the gift to the grantor’s daughters upon the creation of the GRATs under Code Section 2702, the retained qualified annuity should have been valued as an annuity for a specified term of years, rather than as an annuity for the shorter of a term certain or the period ending upon the grantor’s death. The Court also determined that the grantor retained all interests in the annuities set forth in the GRATs because she could not, as a matter of law, make a gift of the property to herself or her estate. Finally, the Court reviewed Example (5) of Treasury Regulation Section 25.2702-3(e) which the Service relied upon in arguing that the value of the annuity payable for the shorter of two years or the period ending upon the grantor’s death could be subtracted from the fair market value of the gifted stock. The Court rejected the Service’s argument and held that Example 5 was an invalid interpretation of Code Section 2702 because it was inconsistent with the statutory text, the policy objectives which motivated the statute’s enactment, and the approach taken in the comparable context of valuing split-interest gifts to charities. The Service in Notice 2003-72 announced its acquiescence in the Court’s decision. In that Notice, the Service also announced that it would change the regulations to allow treatment of a retained unitrust interest payable to a donor or his or her estate as a qualified interest. On July 23, 2004, the Service issued those Proposed Regulations (Reg-163679-02) which clarify that a unitrust amount or annuity payable to a grantor, or the grantor’s estate if the grantor dies prior to the expiration of the term, is a
qualified interest for the specified term. On February 24, 2005, the Service adopted the proposed regulations.

In Cook v. Commissioner, 269 F.3d 854 (7th Cir. Oct. 22, 2001), the Seventh Circuit affirmed the Tax Court’s holding that a husband and wife who each created two GRATs must determine the value of the remainder interest in the GRATs using the factor for single-life annuities not a dual-life annuity, because the spousal interests in each trust were not fixed and ascertainable and because the retained interests in each GRAT may extend beyond the shorter of a term of years or the period ending upon the death of the grantor. The couple were co-trustees for each GRAT and funded them with shares of stock in their closely-held family company. The grantors each transferred the shares into a retained annuity for a fixed number of years or until the grantor’s death; if the grantor died prior to the expiration of the annuity, the annuity would be paid to the surviving grantor until the earliest of the death of the surviving grantor or an additional specified term and each grantor retained the right to revoke the other grantor’s interest.

In Schott v. Commissioner, T.C. Memo 2001-110 (2001), a case with nearly identical facts as Cook v. Commissioner, the Tax Court held that a successor annuity interest of a spouse in a retained two-life annuity is not a qualified interest that is subject to valuation under Code Section 2702. Under the terms of the GRAT, the grantor retained an annuity interest for 15 years or, if sooner, until the grantor’s death. If the grantor died prior to the expiration of the annuity term, the annuity was to be paid to the spouse. If the spouse did not survive the grantor or the grantor revoked the interest, the annuity payments ceased. The Court held that this contingent spousal interest was distinguishable from the fixed, noncontingent spousal interest for a fixed term of years in both Example (6) and Example (7) of Treasury Regulation Section 25.2702-2(d)(1). Finally, the Court noted that the legislative intent to conform qualified interests in valuing GRATs with charitable split interest trusts did not include dual-life annuities. Accord: Tech. Adv. Mem. 2002-30003 (July 26, 2002), where the spousal interests were nearly the same as those in Cook and Schott, as the spousal interests were contingent, rather than fixed and ascertainable, because it was possible that they would never vest. The Service concluded that the spousal interests were not qualified interests and were valued at zero in determining the value of the grantors’ gifts to the GRATs. The Service rejected the grantors’ argument that the GRATs were of the “fixed” term variety considered in A. Walton, supra. The Service further determined that the fact that the spousal interests were payable to the spouse’s estate if the spouse died before the end of the annuity term did not alter the contingent nature of the spousal interests. The Ninth Circuit reversed the Tax Court’s judgment in Schott v. Commissioner, 81 TCM (CCH) 600, rev’d 319 F.3d 1203 (9th Cir. 2003) and distinguished the Seventh Circuit Cook decision (Cook v. Commissioner, 269 F.3d 854 (7th Cir. 2001). The Ninth Circuit held that the two-life annuity retained by the Schotts in their GRATs is an interest which is qualified under Code Section 2702 and therefore is to be subtracted from the value of the gift. The Court stated that the Commissioner’s interpretation of Example 7 in 20 CFR Sec. 25.2702-2(d) to exclude the contingency of the spouse being alive at the time her annuity begins is unreasonable and invalid; the annuity created by each Schott trust for the lives of the grantor and spouse or 15 years is as qualified as the annuity in Example 7 paying a fixed amount for 10 years to the grantor, then to the spouse if living. The Court held that a two-life annuity, based on the lives of the grantor and spouse with a limit of 15 years, falls within the class of easily valued rights that Congress meant
to qualify under Code Section 2702. The Ninth Circuit distinguished Cook on the basis of the requirement in Cook that the parties be married at the date the survivor annuity begins.

In response to the decision in Schott, on July 23, 2004 the Service issued Proposed Regulations (REG -163679-02) that clarify when a revocable spousal interest is a qualified interest. The Proposed Regulations provide that the qualified interest must be for a fixed term and payment cannot be contingent on an event other than survival of the term holder (subject to the transferor’s retained right of revocation). A revocable spousal interest is contingent, and therefore not a qualified interest, if the spouse will not receive any payments if the transferor survives the fixed term during which the transferor is the holder. These regulations clarify that the revocable spousal interest is a qualified interest only if the spouse’s interest, standing alone, would constitute a qualified interest but for the grantor’s revocation power. On February 24, 2005 the Service adopted the proposed regulations and added new Example 8 in Reg. §25.2702-3(e) to clarify that the grantor makes a completed gift to the spouse when the revocation right lapses on the expiration of the grantor’s retained term.

The final regulations amending Reg. §2702-2 and Reg. §2702-3 apply to trusts created on after July 26, 2004, but the Service will not challenge any prior application of the changes to Example 5 and Example 6 in Reg. §25.2702-3(e).

P. Gifts, Gift Tax, and Estate Tax Includibility of Gift Tax

In V. Kite Estate, TCM 2013-43, the decedent appointed her children as trustees of certain trusts, including QTIP trusts. The children then terminated such trusts, with the assets passing to the decedent’s revocable trust. The assets consisted entirely of interests in a family limited partnership, and the decedent’s revocable trust then sold its interest in the partnership to the decedent’s children in exchange for deferred private annuities. The Tax Court held that the sale was for full and adequate consideration and, therefore, not subject to gift tax. However, the Court also held that the termination of the QTIP trusts and the sale of the decedent’s interest in the partnership disregarded the Code Section 2519 QTIP rules and, therefore, was subject to gift tax, noting that the disposition of the QTIP trusts was part of a prearranged and simultaneous transfer.

In Sommers v Commissioner, T.C. No. 9305-07, T.C. Memo 2013-8 (January 10, 2013), where the decedent transferred his art collection during his life to a limited liability company and made gifts of units in the company to his nieces, and where state court cases held that such gifts were valid and complete, the Tax Court held that the estate was collaterally estopped by such state court decisions from arguing that the gifts were not gifts for federal gift tax purposes, and from arguing that the decedent retained a power to alter, amend, revoke or terminate the gifts.

In PLR 201310002 (2013) and PLR 201310006 (2013) the Service ruled with respect to Delaware incomplete non-grantor trusts (i.e., so-called “DING” trusts), where there was a corporate trustee that was required to distribute income or principal to the grantor or his issue at the direction of a distribution committee consisting of the grantor and his four children, or must make distributions of principal to the grantor’s issue at the grantor’s direction pursuant to an ascertainable standard, the Service ruled that the trusts are not grantor trusts, that the
The grantor did not make completed gifts on the creation of the trusts, and that the distribution committee members did not make completed gifts upon making distributions to the grantor or to persons other than the grantor.

In CCA 201208026 dated September 28, 2011 the Service advised that a transfer to an irrevocable trust as to which the donor retains a testamentary limited power of appointment is a completed gift of the term interest in the trust, and the value of the term interest for gift tax purposes is 100% of the amount transferred to the trust due to the application of Chapter 14 of the Code. On August 21, 2012 officials of Bessemer Trust Company advised the Real Property, Trust and Estate Law Section of the American Bar Association that using a retained testamentary limited power of appointment is no longer an absolute way of avoiding having a transfer to a trust treated as a completed gift if the grantor is not the sole beneficiary of the trust.

On June 18, 2010 the Service issued a Chief Counsel Advice Memorandum (CCA 201024059) advising that the gift tax imposed on the transfer of closely held stock could be assessed at any time where the donor failed to disclose on the gift tax return the method used to value the stock and a description of the discounts taken in valuing the stocks, thereby failing to comply with the requirement that the transfer must be “adequately disclosed” for the statute of limitations to begin to run.

On May 21, 2010 the Service issued a Chief Counsel Advice Memorandum (CCA 201020009), advising that Code Section 2035(b), which includes in the gross estate of a decedent the amount of any gift tax paid on gifts made within three years of death, does not apply to the payment of gift tax made by a non-resident non-U.S. citizen.

In Estate of Morgens v. Commissioner, 133 T.C. No. 17 (December 21, 2009), where the income beneficiary of QTIP trusts, within three years of her death, made a gift of her income interests in the trusts to the remainder beneficiaries of the trusts, thereby causing a gift of the trusts’ remainder interests under Code Section 2519, the Tax Court held that the income beneficiary was liable for the payment of the gift tax, resulting in the includibility of that gift tax in the income beneficiary’s gross estate for estate tax purposes pursuant to Code Section 2035(b), even though the remainder beneficiaries had agreed to indemnify the income beneficiary for any gift tax payable by reason of the gift. On May 3, 2012 the Court of Appeals affirmed the Tax Court decision (109 AFTR2d 2006, 9th Cir. 2012), and held that the gift taxes paid must be included in the transferor’s gross estate under Code Section 2035(b).

In E. Barnett, Admr., 2009-2 USTC ¶ 60,576, the District Court in Pennsylvania held that checks issued by the decedent’s agent to make gifts pursuant to a power of attorney which did not specifically authorize the agent to make gifts were not valid gifts and were includible in the decedent’s gross estate for estate tax purposes.

On September 9, 2009 the Service issued final regulations under Code Section 7477 (Treas. Reg. §301.7477-1) as to when a donor may file a Tax Court petition seeking a declaratory judgment as to the gift tax value of a gift. The regulations provide that a donor may file such a petition if (1) the transfer is shown or disclosed on a gift tax return, (2) the Service has made a determination regarding the gift tax treatment of the transfer that results in an “actual controversy”, (3) the donor has exhausted all available administrative remedies, and (4) the
donor files the Tax Court petition requesting a declaratory judgment under Code Section 7477 within 91 days of the Service’s notice of proposed adjustment. The final regulations apply to civil proceedings described in Code Section 7477 which are filed in the Tax Court on or after September 9, 2009.

In CCA 201330033 (February 24, 2012) the Service advised as to the gift tax and estate tax consequences of transfers of stock to grantor trusts in exchange for self-cancelling notes that provided only for the payment of interest during their term, with a balloon payment of principal at the end of the term, where the transferor died in the year after the transfer and before the notes matured. The Service stated that the fair market value of the notes is to be determined pursuant to the willing buyer, willing seller standard in Treas. Reg. Section 25.2512-8, rather than based on the Code Section 7520 mortality tables, and that if the value of the notes is less than the value of the stock, measured at the time of the transfer, then there is a deemed gift by the transferor of the difference. The Service stated that in the instant case the notes lacked the indicia of genuine debt, which requires a reasonable expectation of payment, since it was unclear as to whether or not the trusts were adequately funded to be able to pay the notes. As a result, the Service concluded that notes were worth significantly less than the value of the stock and that the difference was a gift. The Service also advised that there were no estate tax consequences as a result of the cancellation of the notes at the transferor’s death.

Q. Same-Sex Marriages

In United States v. Windsor, 570 U.S. _____ (2013), the United States Supreme Court held that Section 3 of the Defense of Marriage Act was unconstitutional and that the estate of a same-sex spouse was entitled to a federal estate tax marital deduction for the bequest to the surviving same-sex spouse.

In Hollingsworth v. Perry, 570 U.S. _______ (2013), the United States Supreme Court also held that the proponents of Proposition 8, which was California’s ban of same-sex marriage, lacked standing to appeal a Federal District Judge’s ruling that Proposition 8 violated the Constitution.

In Cozen O’Connor, P.C. v.Tobits, E.D. Pa., No. 2:11-cv-00045-CDJ (2013), the Court held that the same-sex spouse of a deceased participant in a profit sharing plan, which provided that death benefits would be paid to the participant’s surviving spouse, was entitled to the spousal death benefits under the plan and under the Employee Retirement Income Security Act (“ERISA”).

In Rev. Rul. 2013-17, IRB 2013-38, the Service ruled that a same-sex couple that is legally married in a jurisdiction that recognizes such marriages will be treated as married for federal tax purposes, whether or not the couple resides in a jurisdiction that recognizes same-sex marriages.

R. IRAs and Qualified Retirement Plans

In Chilton v. Moser, 2012 U.S. App. LEXIS 5140 (5th Cir. Tex. 2012), the Court held that an inherited IRA qualifies as retirement funds that are exempt from the bankruptcy
estate, even though the distribution rules that applied to the owner of the original IRA were different from the distribution rules that applied to the beneficiary of the original IRA.

In In re Stephenson, E.D. Mich., No. 4:11-cv-10848-MAG-MAR (Dec. 12, 2011), the Court held that whether or not inherited IRAs are exempt from the bankruptcy estate, which exempts retirement accounts from creditors’ claims, is an issue to be decided by the trial court.

In PLR 201125009 (June 24, 2011), the Service ruled that the executor of the estate of a surviving spouse could disclaim the undistributed portion in a retirement account, even though required minimum distributions had already been made from such account to the estate’s account.

In In re Wachovia Corp. ERISA Litigation, W.D.N.C., No. 3:09-cv-00262-MR (October 24, 2011), the Court approved a settlement of $12,350,000, plus attorney’s fees, in an action by Code Section 401(k) plan participants against Wachovia Corp., where Wachovia allegedly breached its fiduciary duties by permitting substantial investment of the plan assets in Wachovia’s common stock when it was not prudent to do so.

ROTH IRA CONVERSIONS: For tax years beginning after 2009, an individual can convert a traditional IRA into a Roth IRA without regard to the amount of the individual’s adjusted gross income, thereby avoiding income tax on all future income and appreciation in the IRA, whereas prior to 2010 an individual could do so only if his or her modified adjusted gross income was not more than $100,000. A taxpayer who made such a conversion in 2010 can elect to recognize the conversion ratably in 2011 and 2012.

In Notice 2009-75, IRB 2009-39 (September 28, 2009), the Service stated that a Roth IRA conversion made directly from a non-IRA account will be treated as though it first passed through a traditional IRA, so that special tax rules, such as those applicable to net unrealized depreciation on employer securities, which otherwise would require the payment of current income tax only on the amount of the stock’s cost basis until the participant later sells the stock, would not be applicable, with the result that the participant will be required to pay income tax on the entire amount.

In Paschall v. Commissioner, 137 T.C. No. 2 (2011), and Swanson v. Commissioner, T.C. Memo 2011-156 (2011), the Tax Court held that taxpayers who utilized a Roth IRA conversion tax shelter were liable for excise taxes due to excess contributions to the Roth IRA and were liable failure to file penalties for relying on the tax advice of the tax shelter promoter.

In Strong v. Dubin, NY Slip Op 04121 (May 13, 2010), the Appellate Division, First Department, held that a prenuptial waiver of equitable distribution rights to retirement assets is valid, distinguishing the requirement under ERISA that a waiver of survivorship rights to retirement assets can only be validly accomplished by a spouse.

In Hess v. Wojcik-Hess, 1:08-cv-789 (January 26, 2010), the District Court for the Northern District of New York held that the decedent’s employee benefit plans were governed by ERISA, which required that the Court must apply the terms of the plans in determining the eligible beneficiary, thereby entitling the decedent’s separated spouse to the
benefits under those plans, notwithstanding a separation agreement between the decedent and his spouse in which the spouse waived any claim which she may have in those plans.

In **Diversified Investment Advisors Inc. v. Baruch**, N.Y.L.J. June 30, 2011, the United States District Court for the Eastern District of New York held that the waiver by the surviving spouse of the decedent’s pension benefits or non-wage compensation benefits during his years of employment for the New York State Teachers Retirement System was an enforceable waiver with respect to the decedent’s participation in an annuity pension plan regulated by state and federal law, as the waiver was explicit, voluntary and made in good faith.

In **Kesinger v. URL Pharma Inc.**, No. 09-cv-06510 (D. Ct. New Jersey, March 20, 2012), where the decedent’s wife waived her right to the proceeds of the decedent’s 401(k) plan as part of their divorce decree, but the decedent failed to change the designated beneficiary of his plan benefits prior to his death, the Court held that the plan administrator is obligated to pay the plan proceeds to the decedent’s former wife, as the designated beneficiary, but that the decedent’s estate could sue the decedent’s former wife to enforce her waiver of her right to receive the plan proceeds and to recover such proceeds for the decedent’s estate.

In **Charles Schwab & Co. v. Debickero**, 593 F.3d 916 (January 22, 2010), the Ninth Circuit Court of Appeals affirmed a District Court decision that automatic protections provided by ERISA for a surviving spouse which are applicable to pension plans do not apply to IRAs, even though some of the funds in the IRA originated in an ERISA-protected pension plan before being rolled over to the IRA.

In **Prudential Insurance Co. of America v. Glacobbe**, No. 3:07-cv-04113-AET-TJB (October 30, 2009), the District Court in New Jersey, in an unpublished decision, held that, where the decedent attempted to change the beneficiary designation of a life insurance policy held in a welfare benefit plan which was governed by ERISA, but omitted the Social Security numbers of the new beneficiaries, the plan was required to be administered in accordance with the plan documents and that the decedent had failed to “substantially comply” with the plan’s requirements by not including those Social Security numbers on the beneficiary designation form.

In **PLR 200944059** (August 3, 2009), the Service ruled that where the decedent named a trust as the beneficiary of his IRA and the lifetime beneficiary of the trust was the decedent's wife and the remainderman was his son, the wife was not treated as the payee of the IRA and, therefore, she could not roll the decedent's IRA into an IRA in her own name.

In **PLR 201011036** (December 14, 2009), the Service ruled that a taxpayer who suffered from multiple sclerosis and was unable to engage in any substantial gainful employment by reason of his illness was disabled and, therefore, was not subject to the 10% early distribution penalty for early distributions from his IRA.

The Department of Labor in Advisory Opinion 2009-02A (September 28, 2009) stated that benefit distributions from an IRA to a trust, when the IRA’s owner’s grandson is the sole beneficiary, the IRA owner is the trustee and the owner’s son is the designated successor trustee, would not constitute a prohibited transaction for purposes of Code Section 4975, even...
though the trust is a “disqualified person” under Code Section 4975, since ordinary benefit distributions are not prohibited transactions if the benefit is computed and paid on a basis consistent with the terms of the plan and is applied to all other participants and beneficiaries.

In Hallingby v. Hallingby, No. 08-1866-cv (2009), the United States Court of Appeals for the Second Circuit held that commercial annuities purchased for retirement plan participants in connection with the termination of such plan are not subject to ERISA, since ERISA allows an employee benefit plan to be terminated under stated conditions, including by the purchase of commercial annuities for the plan participants, notwithstanding that ERISA requires a pension plan to prohibit the assignment of plan benefits. The Court of Appeals remanded the case to the District Court for the Southern District of New York to decide in accordance with state law whether the decedent’s final wife is entitled to the survivor benefit payments under the annuity contract, or whether a prior wife of the decedent who had waived all rights to any retirement benefits in her divorce settlement with the decedent was entitled to such survivor benefit payments.

In McCauley v New York State and Local Employees’ Retirement System, 2012 N.Y. Slip Op 22283 (Sup. Ct. August 13, 2012), the Court held that the dissolution of the plan participant’s marriage revoked his beneficiary designation that he executed prior to his death.

In In re Estate of Sauers, 971 A.2d 1265 (Pa. Super. Ct. 2009), the Superior Court of Pennsylvania held that the decedent’s ex-wife, who received the death benefit payable under a life insurance policy insuring the decedent’s life as the policy’s beneficiary, where the policy was part of an employee benefit plan subject to ERISA and the insured did not change the policy beneficiary after his divorce, was required to transfer the policy proceeds to the contingent beneficiary under the policy, on the grounds that the Pennsylvania revocation-on-divorce statute did not affect the administration of the Plan and, therefore, ERISA did not preempt such Pennsylvania statute.

In Kennedy v. Plan Administrator for Dupont Savings and Investment Plan, 129 S. Ct. 865 (2009), the United States Supreme Court held that the Plan Administrator properly paid the death benefit payable under the company’s savings and investment plan to the decedent’s former wife, whom the decedent had properly designated as the beneficiary of that benefit when the decedent was married to her, even though the decree divorcing the decedent and his former wife divested her of her rights under that plan, since the decedent had not executed another beneficiary designation form after his divorce, where the plan required that beneficiary designations must be made as required by the Plan Administrator using the specific forms the Administrator had created for that purpose. However, the Court expressly refused to decide whether the decedent’s estate (to whom the plan benefit would have been payable in the absence of a valid beneficiary designation) would have a valid federal or state contract claim against the decedent’s former spouse and whether federal law would preempt any such state law claim.

In Egelhoff v. Egelhoff, 532 U.S. 141, 121 S. Ct. 1322 (2001) the United States Supreme Court held that ERISA preempts state laws that automatically revoke group-term life insurance and pension plan beneficiary designations upon the participant’s divorce because such state laws directly relate to the administration of ERISA plans. A decedent’s children sought to have the decedent’s group-term life insurance proceeds and pension benefits paid to them under
Washington state law rather than the decedent’s ex-wife who was still the named beneficiary for the plans. Under Washington law, and many other state laws, beneficiary designations for nonprobate assets are automatically revoked upon divorce as a matter of law. The Court reasoned that ERISA’s broad preemption clause was intended to ensure uniform administration of employee benefit plans. The Supreme Court decision does not, however, preclude plan sponsors from choosing to include automatic beneficiary designation revocation as part of the plan design to the extent permitted under the Code and ERISA.

In McGowan v. NJR Service Corp., 423 F.3d 241 (3d Cir. 2005), a divided panel of the United States Court of Appeals for the Third Circuit held that, in the absence of a qualified domestic relations order, an Employee Retirement Income Security Act benefits plan administrator is not required to recognize a non-participant beneficiary’s waiver of benefits. The Court stated that the explicit prohibition against alienation or assignment of benefits in ERISA Section 206(d) applies to invalidate the waiver by the participant’s former spouse in a divorce settlement.

In Silber v. Silber, 99 N.Y.2d 395 (Ct. App. 2003), the New York Court of Appeals held that a qualified domestic relations order (“QDRO”) may serve as a qualified deferred compensation plan document that changes the beneficiary designation of a plan governed by ERISA in the absence of the filing of a plan beneficiary designation form, even though the QDRO in question only constituted a waiver of the claimant’s rights to the plan benefit and did not specifically designate a beneficiary of that benefit.

In a PLR 200826008 (June 30, 2008), the Service considered the income tax consequences of a sale of an IRA to a trust created for the benefit of the IRA's beneficiary. A decedent left his IRA to his two children, one of whom was a minor. The minor child's conservator proposed to create a trust for the sole benefit of the child, from which the child could withdraw increasing portions as he attained certain ages, eventually having the power to withdraw the trust's entire balance. At the child's death, any remaining property would pass as he designates under a general power of appointment. Code Section 691(a)(1) generally provides that when a person inherits a right to income in respect of a decedent (such as an IRA) and then transfer this right, that person must include in gross income the fair market value of this right at the time of transfer, plus any amount by which any consideration for the transfer exceeds the fair market value. Citing Rev. Rul. 85-13, 1985-1 C.B. 184, the Service concluded that, because the proposed trust would be a grantor trust to the beneficiary, a sale of the IRA would be disregarded for income tax purposes, and assuming the transfer would not constitute a completed gift by the beneficiary, the transfer of the IRA would not be a sale or disposition of the IRA for federal income tax purposes or a transfer for purposes of Code Section 691(a)(2).

In Tech. Adv. Memo 2002-47-001, the National Office ruled that the value of decedent’s IRAs holding marketable securities should not be discounted for estate tax purposes to reflect income taxes that will be payable by the beneficiaries upon receipt of distributions from the IRAs, or for lack of marketability. The ruling follows the rationale in Estate of Robinson v. Commissioner, 69 T.C. 222 (1977), which held that the fact that the assets are subject to income tax on distribution should not impact on the application of the “willing buyer - willing seller” standard because the IRA distributee can sell the underlying assets at market price without any discount. With respect to the lack of marketability, the ruling stated that “while §
408(e) imposes penalties on the transfer or assignment of the IRA there are no restrictions preventing the distribution of assets to the beneficiaries after the decedent’s death and short administrative delays in processing the beneficiaries’ request for distribution should not warrant a discount.” The Service declined to treat an IRA as a separate entity like a corporation, viewing it as merely a custodial arrangement with the assets held in the IRA as being no different from securities held in a brokerage account. The Service also noted that the Code provides for an income tax deduction for the estate tax attributable to the income tax inherent in the IRA and that this deduction is intended to operate in lieu of a valuation discount for estate tax purposes.

In L. Smith Est., 300 F. Supp. 2d 474 (D. Ct. Texas 2004), the Court held that the value of a decedent's retirement accounts for estate tax purposes could not be discounted to reflect the income tax liability to be incurred by the accounts' beneficiaries when the accounts are distributed and noted that Congress alleviated the impact of the double taxation of income in respect of a decedent by allowing the recipient of that income to deduct the estate tax attributable to it pursuant to Code Section 691(c). On November 15, 2004, the Court of Appeals for the Fifth Circuit (391 F.3d 621) affirmed the District Court decision.

Furthermore, on June 21, 2004 the National Office ruled in Tech. Adv. Memo 2004-44-021 that income taxes paid by a decedent’s estate on distributions from IRAs were not deductible for federal estate tax purposes under Code Sec. 2053 as administration expenses or as claims against the estate.

In Estate of Kahn v. Commissioner, 125 T.C. No.11 (2005), the Tax Court held that the decedent’s estate could not reduce the value of the decedent’s individual retirement accounts owned at her death by the anticipated amount of federal income taxes which the beneficiaries of the accounts would pay when they received distributions from the accounts. Instead, the Court held that the estate had to report the accounts for estate tax purposes at the net aggregate value of the assets in the accounts. On April 4, 2005, the United States Supreme Court in Rousey v. Jacoway, 544 U.S. 320, held that an IRA is exempt from the reach of creditors in bankruptcy pursuant to §522(d)(10)(E) of the Bankruptcy Code, which exempts certain assets from the debtor’s bankruptcy estate. The Court stated that the 10% penalty imposed on withdrawals from an IRA before the accountholder is 59-1/2 years old, and the elimination of this penalty for withdrawals after the accountholder attains that age, indicates that the accountholder’s right to receive payments from the IRA is a right to payment "on account of age" for purposes of that section of the Bankruptcy Code, which exempts payments under certain types of plans on account of age, as well as on account of other specified factors.

In Rev. Rul. 2005-36, 2005-1 Cum. Bull. 1368, the Service ruled that a beneficiary’s receipt from a decedent’s individual retirement account of the required minimum distribution for the year of the decedent’s death does not prevent the beneficiary from making a qualified disclaimer of her beneficial interest in the IRA.

S. Special Valuation Rules – Chapter 14

In Rankin v. Smith, 109 A.F.T.R.2d 987 (Fed. Ct. Cl. 2012), where the decedent owned stock that was required to be converted at his death into another class of stock that would have fewer voting rights than the original stock, the Court held that Code Section 2704 required
the lapsed voting rights of the pre-converted stock to be disregarded in determining the estate tax value of such stock, as the decedent and his family controlled the corporation both before and after the conversion.

T. Ruling Procedures


U. No Ruling Areas

On January 3, 2013 the Service published Rev. Proc. 2013-3, IRB 2013-1, containing a revised list of areas in which the Service will not, or ordinarily will not, issue letter rulings or determination letters. The areas in which the Service will not issue letter rulings include:

1. Whether there has been a transfer for value for purposes of Code Section 101(a) in situations involving a grantor and 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 Code Sections 673 to 677.

2. Whether a transfer is a gift within the meaning of Code Section 102(a).

3. Whether property qualifies as a taxpayer’s principal residence for purposes of Code Section 121.

4. Whether a charitable contribution deduction under Code Section 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 Code Section 170(c).

5. 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.
6. Whether the period of administration or settlement of an estate or a trust (other than a trust described in Code Section 664) is reasonable or unduly prolonged.

7. Allowance of an unlimited deduction under Code Section 642(c) 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.

8. Whether the settlement of a charitable remainder trust upon the termination of the noncharitable interest is made within a reasonable period of time.

9. 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 Code Sections 673 to 677.

10. Matters relating to the validity of a family partnership when capital is not a material income producing factor.

11. Actuarial factors for valuing interests in the prospective gross estate of a living person.

12. Whether a charitable contribution deduction under Code Section 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 Code Section 2055(a).

13. Actuarial factors for valuing prospective or hypothetical gifts of a donor.

14. Whether a charitable contribution deduction under Code Section 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 Code Section 2522(a)

15. Whether a trust exempt from GST tax under Section 26.2601-1(b)(1),(2), or (3) of the GST tax regulations will retain its GST tax exempt status when there is a modification of a trust, a 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 Section 26.2601-1(b)(4)(i)(E).

16. Requests involving Code Section 6166 where there is no decedent.

17. Whether a taxpayer is liable for tax as a transferee.

In addition, the areas in which the Service ordinarily will not issue letter rulings or determination letters include:
1. Whether a transfer to a pooled income fund described in Code Section 642(c)(5) qualifies for a charitable contribution deduction under Code Section 170(f)(2)(A).

2. 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.

3. Whether a transfer to a charitable remainder trust described in Code Section 664 that provides for annuity or unitrust payments for one or two measuring lives qualifies for a charitable deduction under Code Section 170(f)(2)(A).

4. Whether a pooled income fund satisfies the requirements described in Code Section 642(c)(5).

5. Whether a charitable remainder trust that provides for annuity or unitrust payments for one or two measuring lives or for annuity or unitrust payments for a term of years satisfies the requirements described in Code Section 664.

6. 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 Code Sections 673 to 677.

7. If the beneficiaries of a trust permit a power of withdrawal to lapse, whether Code Section 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 Code Sections 673 to 677.

8. Whether a transfer to a pooled income fund described in Code Section 642(c)(5) qualifies for a charitable deduction under Code Section 2522(c)(2)(A).

9. Whether a trust that is exempt from the application of the GST 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.
10. Whether annuity interests are qualified annuity interests under Code Section 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 Code Section 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.

11. Whether a trust with one term holder satisfies the requirements of Code Section 2702(a)(3)(A) and Treas. Reg. Section 25.2702-5(c) to be a qualified personal residence trust.

12. Whether a trust that calculates the unitrust amount under Code Section 664(d)(3) qualifies as a Code Section 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 Code Section 643(b) and income for federal income tax purposes for the benefit of the unitrust recipient.

13. Whether the termination of a charitable remainder trust before the end the trust term, in a transaction in which the trust beneficiaries receive their actuarial share of the value of the trust assets, causes the trust to cease to qualify as a charitable remainder trust under Code Section 664, and whether such termination is treated as a sale or other disposition by the beneficiaries of their trust interests.

14. Whether trust assets are includable in a trust beneficiary’s gross estate under Code Sections 2035, 2036, 2037, 2038 or 2042 if the beneficiary sells property (including life insurance policies) to the trust or dies within three years of selling such property to the trust, and (a) the beneficiary has a power to withdraw the trust property, other than a general power of appointment, (b) the trust purchases the property with a note, and (c) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

15. Whether the sale of property (including life insurance policies) to a trust by a trust beneficiary is subject to Code Section 2702 if (a) the beneficiary has a power to withdraw the trust property, other than a general power of appointment, (b) the trust purchases the property with a note, and (c) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

16. Whether a person will be treated of the owner of a trust under which such person has a power of withdrawal, other than a general power of appointment, if the trust purchases property from such person with a note and the value of the assets with which the trust was funded by such person is nominal compared to the value of the property purchased.
Rev. Proc. 2012-3 also states that the Service will not issue letter rulings or determination letters as to the following issues until the Service resolves the issues through the publication of a revenue ruling, a revenue procedure, regulations or otherwise:

1. Whether the corpus of a trust will be included in a grantor’s estate under any of Code Sections 2036, 2038 or 2041 when the trustee of the trust is a private trust company owned partially or entirely by members of the grantor’s family.

2. Certain income tax, gift tax and GST tax aspects of the distribution from one irrevocable trust to another irrevocable trust (i.e., "decanting").

V. Priority Guidance Plan

On August 9, 2013 the Service issued its 2013-2014 Priority Guidance Plan, listing projects to be completed through June 2014. The proposed projects include final regulations concerning restrictions on estate assets during the six-month alternate valuation period (Code Section 2032); guidance regarding personal guarantees and the application of present value concepts in determining the deductible amount of administrative expenses and claims against the estate (Code Section 2053); regulations under Code Section 2642 concerning the allocation of GST exemption to a pour-over trust at the end of the estate tax inclusion period (ETIP); final regulations with respect to extensions of time to allocate the GST tax exemption (Code Section 2642); restrictions on the liquidation of an interest in a corporation or partnership (Code Section 2704); guidance concerning private trusts companies; guidance concerning the tax on covered gifts and bequests from expatriates under Code Section 2801; guidance regarding uniform basis rules for trusts (Code Section 1014); guidance regarding updates to the sample charitable remainder trust forms under Code Section 664; regulations concerning itemized deductions of a trust or estate (Code Section 67); and a Revenue Procedure regarding the validity of a QTIP election on an estate tax return filed only to elect portability (Code Section 2010(c)).

W. Basis Reporting Requirements

On February 1, 2010 the Service issued proposed regulations (REG-101896-09) requiring brokers, mutual funds and others to report the basis of stock and to classify capital gains and losses as long-term or short-term, explaining how to compute average stock basis, and requiring stock issuers to report corporate actions that affect stock basis. Brokers reporting gross proceeds from the sale of a security will be required to report the adjusted basis and type of gain for most stock acquired on or after January 1, 2011, for stock in a mutual fund or a dividend reinvestment plan acquired on or after January 1, 2010, and for other securities and options acquired on or after January 1, 2013.

X. Change of Address Notification

In Rev. Proc. 2010-16, IRB 2010-19 (May 10, 2010), the Service updated its procedures for taxpayers to notify the Service of a change of address. Generally, the Service uses the address on a taxpayer’s most recently filed and properly processed return as the taxpayer’s address of record. In addition, a taxpayer can file Form 8822, Change of Address, to properly notify the Service of the taxpayer’s change of address. The Revenue Procedure noted that a taxpayer’s new address listed on an application (Form 4868) for an automatic extension of time
to file the taxpayer’s income tax return, or a power of attorney and declaration of representative (Form 2848), will not be used by the Service to automatically update a taxpayer’s address.

Y. Circular 230

On September 14, 2012 the Service issued proposed regulations (REG-138367-06) regarding Circular 230 that would eliminate the current requirements under Section 10.35 of Circular 230 governing “covered opinions” that are provided to clients. The proposed regulations eliminate the requirement that practitioners fully describe the relevant facts and the application of the law to the facts in the written advice itself, and the use of the Circular 230 disclaimers in documents and transmissions, including emails. Section 10.35 of Circular 230 would be replaced with a proposed Section 10.37 that would require only that practitioners base all written advice on factual and legal assumptions, exercise reasonable reliance, and consider all relevant facts that the practitioner knows or should know.

Z. Internal Revenue Bulletins and Cumulative Bulletins

In Ann. 2013-12, the Service announced that it will cut costs by suspending the printing of paper copies of the Internal Revenue Bulletin and that it has eliminated the Cumulative Bulletin for editions after the 2008-2 edition.

V. DIGITAL ASSETS

As a result of the advent of the technology age, estate planning documents should expressly provide for the marshaling, access, administration and disposition of a person’s technological assets, which are commonly referred to as “digital assets”.

Digital assets include tangible digital devices, such as a computer, an Ipod, an Ipad and a blackberry; digital information, such as email, which may be stored in a tangible digital device, on a service provider’s platform, or generally on the internet; on-line accounts, including social media accounts, such as Facebook and Twitter; and “clouds”, which generally refer to the storage of digital information on the internet. Estate planning documents, such as a Will and a Power of Attorney, should provide specific authority regarding the digital assets of the decedent or principal. In addition, consideration should be given to the appointment by Will of a “Digital Executor”, who would have the authority to deal with digital assets.

Accessing a person’s digital assets after the person becomes incompetent, or after the person dies, may require applicable passwords. Thus, clients should be encouraged to prepare and maintain a current inventory of digital assets, including applicable passwords, so that such assets can be readily identified and accessed as needed. In addition, digital service providers may have policies and contractual provisions regarding the accessibility of the digital information that they provide. Accordingly, a person’s designated agent pursuant to a Power of Attorney, or the Executor of an estate of a deceased person, may be required to review and comply with such policies and contractual provisions in order to access digital information.
A few states, including Connecticut, Idaho, Indiana, Oklahoma and Rhode Island, have enacted legislation specifically authorizing the personal representative of a decedent’s estate to obtain the decedent’s digital information.

Attached hereto as Exhibit “E” are sample Will provisions regarding the appointment of a Digital Executor, the definition of digital assets, and the administration and disposition of such assets in a decedent’s estate, and sample provisions for a Power of Attorney authorizing the principal’s agent to act with respect to the principal’s digital assets.

VI. FDIC INSURANCE INCREASES

The Federal Deposit Insurance Corporation (“FDIC”) has increased its insurance coverage for deposits from the existing limit of $100,000. The new coverage limitation for single accounts owned by one person is $250,000 per owner; for joint accounts owned by two or more persons is $250,000 for each co-owner; for IRAs and certain other retirement accounts is $250,000 per owner; for revocable trust accounts is $250,000 per owner per beneficiary, up to five beneficiaries; for corporations, partnerships and unincorporated associations is $250,000 per entity; for irrevocable trusts is $250,000 for the non-contingent, ascertainable interest of each trust beneficiary; for employee benefit plan accounts is $250,000 for the non-contingent, ascertainable interest of each plan participant; and for government accounts is $250,000 per official custodian. The increased coverage was scheduled to expire on December 31, 2009, after which the standard coverage limit would return to $100,000 for all deposit categories except IRAs and certain other retirement accounts, which would continue to be insured up to $250,000 per owner. The Helping Families Save Their Homes Act, which was signed by President Obama on May 20, 2009, extends this increased insurance coverage through December 31, 2013.

VII. SIGNIFICANT FLORIDA LEGISLATION AND CASE LAW DEVELOPMENTS

In recent years, the Florida Legislature has enacted significant new legislation regarding Florida taxes, estates and trusts. The following are the highlights of some aspects of this new legislation, as well as certain case law developments:

A. Repeal of Florida's Intangible Tax

Effective January 1, 2007, the tax was repealed in its entirety.

B. Creation of Dynasty Trusts

The length of time that a trust can exist before being terminated by law has been extended in Florida to a term of 360 years. This changes the prior rule against perpetuities, which normally forced a trust to terminate after approximately 90 years.

Accordingly, it is now possible to establish "dynasty" trusts in Florida. These trusts, when funded with not more than an amount equal to the GST tax exemption available to an individual, can continue for up to 360 years without the payment of any GST tax.
C. **Intestate Shares**

   In *Astrue v. Capato*, 132 S.Ct. 2021 (2012), the United States Supreme Court held that twins conceived through in vitro fertilization after their father’s death in Florida did not qualify for Social Security Survivors’ benefits as Florida intestacy law permits children who are born posthumously to inherit only if conceived during the decedent’s lifetime.

   In 2011 Florida enacted legislation, Fla. Stat. Section 732.102, effective October 1, 2011, changing the intestate share of a surviving spouse to the entire intestate estate of the deceased spouse if all of the decedent’s descendants are also descendants of the surviving spouse and the surviving spouse does not have any other descendants. If the decedent has one or more surviving descendants who are not descendants of the surviving spouse, the intestate share of the surviving spouse is one-half of the decedent’s intestate estate. If there are one or more surviving descendants of the decedent, all of whom are also descendants of the surviving spouse, and if the surviving spouse also has one or more descendants who are not descendants of the decedent, the surviving spouse receives one-half of the decedent's intestate estate.

D. **Separate Writings**

   Effective January 1, 2002, even though a testator may still refer to a separate writing in his will for purposes of disposing of tangible personal property, a testator may not dispose of property used in a trade or business. If there are conflicts, the provisions of the most recent writing shall control.

E. **Chapter 738: Principal and Income Act**

   On March 20, 2002, the Florida Legislature enacted an entirely new Principal and Income Act under Chapter 738, Florida Statutes. Section 738.804 provides that the new Act will apply to any receipt or expense received or incurred and any disbursement made after January 1, 2003.

   The new sections of the Principal and Income adopt the basic concepts of the Uniform Act, but also contain Florida-specific provisions. Most significant is that the Trustee is given a power to adjust between principal and income and power to convert an income to a total return trust, or vice versa.

F. **UTMA Transfers**

   In 2005, the Florida legislature enacted a statute that allows a custodian under the Uniform Transfers to Minors Act to transfer custodial assets to a trustee of a Code Section 2503(c) trust.

G. **Uniform Disclaimer of Property Interests Act**

   In 2005, Florida enacted The Florida Uniform Disclaimer of Property Interests Act. The Act contains broad powers to disclaim, including the right to disclaim a survivorship interest in jointly held property, the right to disclaim property held as a tenancy by the entirety, the right to disclaim a power of appointment, the right to disclaim by an appointee, object or
taker in default of the exercise of a power of appointment, and the right of a fiduciary to disclaim a power held in a fiduciary capacity. In addition, the Act authorizes a fiduciary to disclaim any interest in or power over property, without court approval, if and to the extent that the instrument creating the fiduciary relationship expressly gives the fiduciary the right to do so. In the absence of that grant of authority in the governing instrument, a fiduciary can disclaim an interest in or power over property with court approval.

H. **Anatomical Gift Law**

Florida adopted revisions to its anatomical gift law (Fla. Statutes Sections 765.511, et seq.), effective July 1, 2009, to incorporate certain provisions from the Revised Uniform Anatomical Gift Act of 2006 (Fla. Sess. Law Serv. Ch. 2009-218). The Act limits the authorized donee of an anatomical gift to (1) any procurement organization (which is defined as an entity that is designated as an organ procurement organization by the Secretary of the United States Department of Health and Human Services and that engages in the retrieval, screening, testing, processing, storage or distribution of human organs), (2) any accredited medical or dental school, college or university for education, research, therapy or transplantation, or (3) any individual specified by name for therapy or transplantation needed by such individual.

I. **Fiduciary Responsibility for Life Insurance**

In 2009 Florida enacted legislation (Title XXXIII, Section 518.112) permitting a trustee of a life insurance trust, after written notice to the beneficiaries, to delegate investment management of life insurance to others, including the grantor of the trust or the trust beneficiary, thereby eliminating trustee responsibility for the investment decisions or actions or omissions of the selected agent, if all the requirements of the legislation are satisfied.

In 2010 Florida enacted legislation (Title XLII, Section 736.0902), effective July 1, 2010, under which a trustee of a trust will have no duty to ensure that the trust has an insurable interest in a life insurance policy if:

1. The trust owns insurance on the life of a person who is the insured, a proposed insured, or such person's spouse, and any such person has furnished the trustee with the funds used to acquire or pay premiums on the policy insuring the life of any such person;

2. The trust agreement does not opt out of the statute’s application;

3. The insurance policy is not purchased from a trustee affiliate, and neither the trustee nor any trustee affiliate receives commissions regarding the policy’s purchase unless the trustee’s investment duties were delegated to another person;

4. The trustee did not know that the beneficiaries lacked an insurable interest when the policy was purchased; and
The trustee did not have knowledge of a stranger-owned life insurance arrangement.

The statute also provides that a trustee has no duty to determine whether the life insurance policy is a proper trust investment, to diversify with respect to any such policy, to investigate the financial strength of the issuing company, to decide whether to exercise any policy options, or to examine the financial and physical health of the insured, if the statements in clauses (1), (2) and (3) in the preceding sentence apply, and if either:

(a) The trust agreement affirmatively opts into the application of the statute; or

(b) The trustee gives notice to the trust beneficiaries of the trustee’s intention to opt into the statute and no beneficiary objects within 30 days of receipt of that notice or any written objections are withdrawn.

J. Avoiding Unintended Consequences of Estate Tax Repeal

In 2010, Florida enacted legislation (Chapter 122 and 132, Laws of 2010) which permits the trustees or beneficiaries of irrevocable trusts, and the personal representatives or beneficiaries of Wills, to commence a judicial proceeding to request that certain formula clauses be interpreted in accordance with the grantor’s or testator’s likely intent to avoid unintended consequences which may result from the repeal of the federal estate tax for decedents dying in 2010.

K. Creditors’ Claims

In Miller v. Kresser, 34 So.3d 172 (Fla. 4th DCA, May 5, 2010), the Court held that a creditor cannot invalidate the spendthrift provision of a trust, even where the trustee had completely turned over management of the trust to the beneficiary, provided that the language of the trust meets certain statutory requirements.

In Olmstead v. Fed. Trade Commission, No. SC08-1009 (June 24, 2010), the Florida Supreme Court held that a Court may require an owner of a single member Florida limited liability company to surrender his ownership interest in the company to satisfy an outstanding judgment against the member.

In 2011 Florida enacted legislation which amended Florida Statutes Section 608.433 to clarify the decision in Olmstead by expressly providing that a charging order is the “sole and exclusive remedy” against limited liability company membership interests, except that a charging order is not the sole and exclusive remedy in the context of a single member limited liability company if the judgment creditor can establish that distributions under a charging order will not satisfy the judgment within a reasonable amount of time.
In 2011 Florida enacted legislation to amend Florida Statutes Section 222.21(c) to provide that inherited IRAs are exempt from the claims of creditors of the owner, beneficiary or participant of the inherited IRA. The statute applies retroactively to all inherited IRA accounts regardless of the date on which the account was created.

L. Homestead Law

The Florida Constitution and related statutes restrict the ability of a homestead owner to devise the homestead if survived by a spouse or minor children and also impose certain restrictions on the lifetime transfer of such property. A series of Florida statutes, effective on October 1, 2010, permit greater flexibility with respect to the transfer of such property.

- FS 732.4015(3) provides that if a homestead property is validly devised (for example, an owner with no minor children devises the homestead to his or her surviving spouse outright), the surviving spouse's disclaimer of the devise will cause the disclaimed homestead to pass to the specified takers in default, rather than pursuant to the restrictions on the devise of homestead property that otherwise would apply.

- FS 372.401(4) provides that if a homestead property is invalidly devised (for example, if one spouse devises the homestead property to one of several children, and the devising spouse has a surviving spouse), a disclaimer by the surviving spouse will not correct the invalid devise.

- FS 732.4017 permits an inter vivos transfer of homestead property to an irrevocable trust without post-death devise restrictions, even if the transferor retains certain interests in the property, without invoking the restrictions on the devise of homestead property that otherwise would apply.

In addition, as to the estates of decedents dying after October 1, 2010, if homestead property is invalidly devised, FS 732.401(2) gives the surviving spouse an election to take a one-half interest as a tenant in common in the devised property, instead of a life estate in such property, as would have applied prior to such statute.

In Habeeb v. Linder, 3D 10-1532 (FL. 3d DCA 2011), the Court held that a husband and wife had waived their post-death homestead rights by signing a joint warranty deed transferring the homestead property to the wife. However, the Court subsequently withdrew its decision, leaving open the possibility of future litigation regarding this issue.

In Grisolia v. Pfeffer, 2011 WL 5864806 (Fla. 3d DCA 2011), where the decedent and his wife were registered aliens and the decedent had purchased an apartment for his family in Florida, the Court held that, despite the decedent’s immigration status at the time of his death, his intention to make the condominium his family’s permanent residence caused the condominium to be homestead property, which could not be subject to a forced sale to pay the decedent’s debts.
M. Attorney-Client Privilege

In 2011 Florida enacted legislation, Fla. Stat. Section 90.5021, providing that the attorney-client privilege applies between a fiduciary and an attorney employed by the fiduciary. For this purpose, the term "fiduciary" includes without limitation personal representatives, trustees, guardians and attorneys-in-fact. The legislation requires a personal representative in a probate proceeding to include in the Notice of Administration a statement that the attorney-client privilege applies with respect to the personal representative and any attorney employed by the personal representative, and requires a trustee to include in the initial notice to qualified beneficiaries a statement that the attorney-client privilege applies with respect to the trustee and any attorney employed by the trustee.

N. Privity

In Hodge v. Cichon, Fla. Ct. App., No. 5D10-1852 (February 6, 2012), a case in which beneficiaries of a decedent’s estate sued the attorneys who prepared the decedent’s estate planning documents for legal malpractice, the Court held that the issue of whether or not the estate’s beneficiaries had standing to sue the attorneys raised an issue of material fact, as there may have been a conflict among the parties as to the identity of the estate’s beneficiaries.

O. Reformation and Construction of Wills

In 2011 Florida enacted legislation, Fla. Stat. Sections 733.615, 733.616 and 733.1061, effective July 1, 2011, permitting a Court to reform a will, even if the will is not ambiguous, to conform its terms to the testator’s intent if it is proven by clear and convincing evidence that both the accomplishment of the testator’s intent and the terms of the will were affected by a mistake. In addition, the legislation permits a Court to modify a will, with or without retroactive effect, to accomplish a testator’s tax objectives, if the modification is not contrary to the testator’s probable intent.

In Basil v. Aldrich, 2011 WL 3696309 (Fla. 1st DCA 2011), where the decedent's will did not have a residuary clause the Court held that property acquired by the decedent after the execution of the will should pass subject to Florida's intestate succession rules, rather than to the beneficiary of specific bequests named in the will.

P. Powers of Attorney

Florida amended its statute (FS Sections 709.2101-709.2402) regarding powers of attorney, effective on October 1, 2011, to provide that a power of attorney must be signed by the principal and by two subscribing witnesses and must be acknowledged by the principal before a notary public, effective for powers of attorney executed after September 30, 2011; that a power of attorney executed in another state which does not comply with such execution requirements is nonetheless valid if it complied with the execution requirements of the state in which it was executed at the time it was executed; that a third party who is asked to accept such a power of attorney may in good faith request, and rely upon without further investigation, an opinion of counsel as to any matter of law concerning the power of attorney; and that a power of attorney signed after September 30, 2011 cannot be contingent upon some future event, such as the principal’s incapacity. A power of attorney that is executed prior to October 1, 2011 that is
contingent on a future event is only exercisable upon delivery of an affidavit of a physician that must state that the physician is licensed to practice medicine under Florida law, that the physician is the primary physician who has responsibility for the treatment and care of the principal, and that the principal lacks the capacity to manage his or her property. The statute does not create a "statutory" form of power of attorney. The statute also provides that a power of attorney containing only a blanket grant of authority, or a power of attorney that contains incorporations by reference, executed after the amendment to the statute, are generally ineffective.

Q. Personal Representatives and Administrators

In Hill v. Davis, 2011 WL 3847252 (Fla. 2011), the Florida Supreme Court held that the statutory time limit for objecting to the qualifications of a personal representative of a decedent's estate bars an untimely objection, even when the personal representative was never qualified to serve as such person failed to meet the qualifications required for a nonresident, absent fraud, misrepresentation or misconduct.

In Naftel v. Pappas, 2011 WL 3678004 (Fla. 1st DCA 2011), where the Order appointing a personal representative of the decedent's estate was entered before the issuance of Letters of Administration, the Court held that the time within which an objectant could appeal such appointment commenced on the date of such Order, rather than on the later date of the issuance of the Letters of Administration.

In Long v. Willis, 2011 WL 3587411 (Fla. 2d, DCA 2011), where an unmarried decedent died intestate survived by three minor children, and where Florida law provides that the Administrator of the intestate estate, in the absence of a spouse, is to be selected by a majority in interest of the decedent's heirs, the votes of minor heirs are cast not by their surviving parent (i.e., the decedent's former wife) or natural guardian, but instead by the guardian of the property of such minor heirs, and that a guardian of the property of the decedent's minor children should be appointed so such children's vote, by such guardian, could be counted.

R. Standing to Contest Will or Challenge Trust Distributions

In Agee v. Brown, 2011 WL 5554833 (Fla. 4th DCA 2011), the Court held that an attorney who prepared the decedent’s prior will is an “interested person” under Fla. Stat. Section 733.109(1) who can seek to revoke the decedent’s last will, as such attorney was a beneficiary under the decedent’s prior will, even though the bequest to such attorney under the decedent’s prior will might be found to be improper and void.

In Siegel v. JP Morgan Chase Bank, 71 So. 3d 935 (Fla. 4th DCA 2011), the Court held that beneficiaries of the decedent’s inter vivos trust had standing to challenge distributions that the trustee of such trust made before the grantor’s death.

S. Enforcement of Alimony and Child Support Orders

In Jackmore v. Jackmore, 71 So. 3d 912 (Fla. 1st DCA 2011), the Court held that Florida does not have any limitations period for the enforcement for alimony or child support orders and that, pursuant to the Uniform Interstate Family Support Act, the law of the state with
the longer limitations period, which in such case is Florida, applies. However, the Court remanded the case and directed the trial court to determine whether or not the plaintiff’s claim should nonetheless be barred by laches or Florida’s two-year statute of non-claim under Fla. Stat. Section 733.710.

T. Waiver of Spousal Rights

In Steffens v. Evans, 70 So. 3d 758 (Fla. 4th DCA 2011), where the decedent had executed a will naming his wife as a beneficiary but thereafter entered into a post-nuptial agreement waiving all rights as to certain property of each other, the Court held that the post-nuptial agreement waived any benefits that would have passed to the decedent’s wife under his will, as the language of the agreement tracked the language of Fla. Stat. Section 732.702(1), regarding a waiver of rights of a surviving spouse, even though the agreement also provided that either party could transfer to the other party any property or interest, as the Court held that such provision referred to transfers of property after the execution of the agreement and would not preserve the rights of the decedent’s wife under the previously executed will.

U. Ademption of Bequests

In Melican v. Parker, 289 Ga. 420 (2011), where the decedent had devised his Florida condominium to the plaintiff but executed a contract to sell the condominium before he died and the closing of such sale occurred after the decedent’s death, the Court held that under Florida’s nonademption statute, Fla. Stat. Section 732.606(2)(a), which provides that a “specific devisee has the right to the remaining specifically devised property and …[a]ny balance of the purchase price owing from a purchaser to a testator at death because of the sale of the property”, the plaintiff was entitled to the sale proceeds as a specific devisee of the condominium.

V. Former Spouse and Non-Probate Assets

Pursuant to Fla. Stat. Sections 732.507(2) and 736.1105, designations of a former spouse as the beneficiary of a non-probate asset that would otherwise be transferred or paid to the spouse pursuant to such designation upon the death of a the decedent are void. The statute applies to all designations made by or on behalf of decedents dying on or after July 1, 2012, regardless of when the designation was made.

W. Gifts and Bequests to Clients’ Attorneys

In 2013 Florida enacted a statute (Section 732.806) that voids any part of a written instrument, including a will, a trust, a deed, a document exercising a power of appointment, or a beneficiary designation under a life insurance contract, that makes a gift to a lawyer or a person related to the lawyer, if the lawyer prepared or supervised the execution of the instrument, or solicited the gift, unless the lawyer or other recipient of the gift is related to the person making the gift.

X. Disposition of Decedents’ Wills

Pursuant to Fla. Stat. Section 732.901, a custodian of a will must deposit it with the clerk of the court within 10 days after receiving information that the testator died.

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Y. Florida Jurisdiction and Trusts

Pursuant to Fla. Stat. Section 732.0202, any beneficiary of a trust is subject to the jurisdiction of the Florida courts to the extent of the beneficiary’s interest in the trust; and any trustee, trust beneficiary or other person, whether or not a citizen or resident of Florida who personally or through an agent does any of the following acts related to a trust, submits to the jurisdiction of the Florida courts involving that trust:

- Accepts trusteeship of a trust with its principal place of administration in Florida at the time of acceptance.
- Moves the principal place of administration of a trust to Florida.
- Serves as trustee of a trust: (i) created by a settlor who was a resident of Florida at the time of creation; or (ii) having its principal place of administration in Florida.
- Accepts a delegation of powers/duties from the trustee of a trust with its principal place of administration in Florida.
- Commits a breach of trust in Florida or with respect to a trust with its principal place of administration in Florida at the time of the breach.
- Accepts compensation from a trust with its principal place of administration in Florida.
- Performs any act or service for a trust with its principal place of administration in Florida.
- Accepts a distribution from a trust with its principal place of administration in Florida with respect to any matter involving the distribution.

Z. Limited Liability Companies

On June 14, 2013 Florida enacted the Revised Limited Liability Company Act (Fla. Stat. Ch. 605), which makes substantial changes to the rules governing limited liability companies in Florida.

VIII. SIGNIFICANT NEW JERSEY LEGISLATION, REGULATIONS AND CASE LAW DEVELOPMENTS

A. Domestic Partnership Act

The Domestic Partnership Act was signed into law on January 12, 2004 and became effective on July 10, 2004. The Act establishes domestic partnerships for same sex and opposite sex (age 62 and older) nonrelated partners.

Under the Act, a domestic partnership is established when both persons have a common residence and are jointly responsible for each other’s common welfare as evidenced by
joint financial arrangements or joint ownership of real or personal property. Both persons must not be related by blood or affinity up to and including the fourth degree of consanguinity, be at least 18 years of age and of the same sex or of the opposite sex age 62 years or older. Both persons must agree to be jointly responsible for each other’s basic living expenses during the domestic partnership. Neither person can be in a marriage recognized by New Jersey law or can be a member of another domestic partnership.

The State of New Jersey recognizes domestic partnerships if both persons jointly file an Affidavit of Domestic Partnership with their local registrar. An Affidavit of Domestic Partnership is an affidavit that sets forth each party’s name and age, the parties’ common mailing address, and a statement that, at the time the affidavit is signed, both parties meet the requirements of the Act and wish to enter into a domestic partnership with each other. In order to file such affidavit, neither person can have been a partner in a domestic partnership that was terminated less than 180 days prior to the filing of the current Affidavit of Domestic Partnership, except that this prohibition does not apply if one of the partners died.

For New Jersey Gross Income tax purposes, the Domestic Partnership Act applies to the 2004 income tax year and provides that the meaning of “Dependent” includes a qualified domestic partner. Consequently, taxpayers are able to claim an additional $1,000 personal exemption for a qualified domestic partner that does not file a separate income tax return.

For New Jersey Transfer Inheritance Tax purposes, the Domestic Partnership Act applies to decedents dying on or after July 10, 2004. It exempts all transfers made by will, survivorship or contract to a surviving domestic partner. This includes a membership certificate or stock in a cooperative housing corporation and the value of any pension, annuity, retirement allowance or return of contributions.

B. Civil Unions and Same-Sex Marriage

A Bill allowing civil unions was signed into law on December 21, 2006.

To enter into a civil union, the persons must not be a party to another civil union, domestic partnership or marriage in New Jersey, must be of the same sex, and must be at least 18 years of age, unless they obtained the consent of their parents or guardian or, if under the age of 16, they obtain a consent of a family court judge. Since New Jersey does not have a residency requirement for marriage, a nonresident same-sex couple can enter into a civil union in New Jersey.

This legislation provides that no new domestic partnerships will be registered in New Jersey, except for same-sex and opposite-sex couples in which both partners are at least 62 years of age. Currently registered domestic partnerships will continue to be recognized with at least the rights, benefits and obligations provided under the Domestic Partnership Act.

Under the new legislation, the inheritance treatment, including intestacy rights, of a surviving spouse in a civil union are now equal to those of a similarly situated married couple under New Jersey law. In addition, for parties to a civil union, as in a marriage, the default form of joint property ownership is tenancy by the entirety. Moreover, a surviving partner of a civil
union will be considered as a Class A beneficiary for New Jersey inheritance tax purposes and, therefore, can inherit from his or her partner free from New Jersey inheritance taxes.

On February 16, 2007 the Attorney General of New Jersey issued a Formal Opinion to the state registrar of vital statistics containing guidelines for recognizing same sex relationships contracted out of state. The Opinion stated that such relationships which provide substantially all the rights and benefits of marriage are to be treated as civil unions in New Jersey.

On January 10, 2012 a bill was introduced in the New Jersey legislature to recognize same-sex marriages, in place of the civil union regime that is currently authorized under New Jersey law. The bill provides that civil union partners would have 60 days after the bill’s enactment to dissolve their civil union and, if they do not so, then the civil union partners would be deemed to be married. Both houses of the legislature passed the bill, but Governor Christie vetoed the legislation on February 17, 2012. On February 6, 2012 a resolution was introduced in the New Jersey legislature to amend the state constitution to authorize same-sex marriage, if approved by a referendum.

NJSA Section 37:2-38 and NJSA Section 37:2-32 have been amended, effective June 27, 2013, to remove provisions that invalidate a pre-civil union agreement if it is unconscionable at that time its enforcement is sought. As a result, whether or not such an agreement is unconscionable is to be determined at the time of its execution.

C. Domestic Partners

On January 11, 2006 New Jersey amended its probate law to give a domestic partner the same rights with respect to the estate of a deceased partner as a surviving spouse has with respect to the estate of a deceased spouse. Thus, a domestic partner can inherit as an intestate taker of a deceased partner, has a right of election with respect to the estate of a deceased partner, has priority to be appointed as the deceased partner’s personal representative, and has priority to make funeral arrangements for a deceased partner. The statute provides that these amendments are effective immediately.

D. Uniform Prudent Management of Institutional Funds Act

Effective on June 10, 2009, New Jersey adopted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") (NJ P.L. 2009, c. 64), replacing the 1975 Uniform Management of Institutional Funds Act ("UMIFA"). The UMIFA contained a general obligation to invest prudently using ordinary business care, and the UPMIFA updates that prudence standard to adopt more modern investment practices and provide greater guidance to boards by imposing the duty to:

1. Give primary consideration to the donor's intent as expressed in a gift instrument;

2. Act in good faith, with the care an ordinary prudent person would exercise;
3. Incur only reasonable costs in investing and managing institutional funds;

4. Make a reasonable effort to verify relevant facts;

5. Make decisions about each asset in the context of the portfolio of investments as part of an overall investment strategy;

6. Diversify investments, unless due to special circumstances, the purposes of the fund are better served without diversification;

7. Dispose of unsuitable assets; and

8. In general, develop an investment strategy appropriate for the fund and the institution.

The UPMIFA also contains provisions permitting the release and modification of donor restrictions on funds held by a charitable institution. Under both the UPMIFA and the UMIFA, a donor can release a restriction. Under the UPMIFA, if a board cannot obtain the donor's consent (e.g., the donor is deceased), an institution can petition a court to modify or release a restriction that has become impracticable, wasteful, impairs the management or investment of the fund, or, if because of circumstances unanticipated by the donor, the modification will further the purposes of the fund. The UPMIFA also applies cy pres and allows a change in a restriction if consistent with the charitable purpose of the institution or charitable intent of the donor.

The UPMIFA adds a new provision which enables an institution to modify restrictions without judicial approval on funds that are under $250,000 and have been established for at least 20 years, provided that the institution must continue to use the property in a manner consistent with the donor's charitable purpose expressed in the gift instrument. In such case, the institution must give 60 days' notice of the proposed modification to the New Jersey Attorney General.

E. New Jersey Estate Tax

On January 10, 2012 bills were introduced in the New Jersey Assembly and the New Jersey Senate (A 1096 and S 765, respectively) providing that a trustee’s discretion to reimburse the trust’s grantor for income taxes that the grantor pays with respect to the trust’s income is not a right that would subject the trust’s assets to the claims of the grantor’s creditors.

In Estate of Stevenson v. Director, 008300-07 (N.J. Tax February 19, 2008), the New Jersey Tax Court held that when calculating the New Jersey estate tax where a marital disposition was burdened with estate taxes, creating an interrelated computation, the marital deduction must be reduced not only by the actual New Jersey estate tax, but also by the hypothetical federal estate tax that would have been payable if the decedent had died in 2001.
The New Jersey Division of Taxation adopted new regulations (NJAC Section 188:26-3A.8), effective for decedents dying after April 5, 2008, providing that if an estate makes a QTIP election for federal estate tax purposes, the estate must make a QTIP election for New Jersey estate tax purposes, but if a federal QTIP election would not reduce the federal estate tax liability, such election would not be given effect for New Jersey estate tax purposes.

F. New Jersey Gross Income Tax

On June 17, 2013 legislation (S. 2532) was enacted that bars the New Jersey Division of Taxation from considering a person’s charitable contributions when determining whether or not the donor is a New Jersey resident for New Jersey gross income tax purposes.

On June 7, 2005 the New Jersey Division of Taxation issued a notice setting forth its policies for determining residency and changes in domicile for purposes of the New Jersey gross income tax. NJS §54A:1-2(m) defines a New Jersey resident as any individual domiciled in New Jersey, unless the individual does all of the following for entire year: maintains no permanent place of abode in New Jersey; maintains a permanent place of abode elsewhere; and spends no more than 30 days of the taxable year in New Jersey. The notice stated that domicile is regarded as “any place an individual regards as his or her permanent home” and that an individual’s domicile continues until he or she moves with the intent to establish a permanent home elsewhere. The notice also stated that it is the taxpayer’s burden to prove a change of domicile and that the Division of Taxation will no longer consider charitable contributions in determining an individual’s domicile.

G. New Jersey Resident Trusts

In Kassner v Division of Taxation, No. 000364-2010 (N.J. Tax Court, January 3, 2013), the Court held that the State of New Jersey cannot impose its income tax on the undistributed out-of-state income of a trust that is created under the will of a New Jersey domiciliary and that is administered outside of the State of New Jersey by a nonresident trustee, even though the trust owns stock in an S corporation that transacts business in New Jersey.

H. Perelman v. Cohen: Alleged Incompetence; Alleged Fraudulent Transfers and Undue Influence; Oral Promise to Make a Will; Gifts vs. Loans; and Sanctions for Frivolous Litigation

In Perelman v. Cohen, the Superior Court of New Jersey, Chancery Division, Bergen County (Docket No. C-134-08), in an action commenced by Ronald O. Perelman, the ex-husband and Executor of the Estate of his deceased former wife, Claudia Cohen, and by their daughter, Samantha Perelman, against Claudia’s father, Robert Cohen, and Robert Cohen’s son, James Cohen, the Court held in a series of decisions from 2008 through 2010 that:

1. Robert Cohen was competent and did not require a guardian ad litem to represent him in the action.

2. The plaintiffs failed to demonstrate an enforceable pre-1978 oral promise by Robert Cohen to bequeath a certain share of his Estate to his daughter, Claudia Cohen (after 1978, any such promise had to be in writing to be enforceable).
3. Plaintiffs’ claim that Robert Cohen’s Last Will and Testament was the product of undue influence is not cognizable by the Court where Robert Cohen is living and competent.

4. Various transfers by Robert Cohen to his son, James Cohen, were not fraudulent.

5. Transfers by Robert Cohen in the aggregate amount of $10,000,000 to his daughter, Claudia Cohen, were loans, rather than gifts, where Claudia had signed a loan document, but no interest was paid on the loans and Robert did not ask for the return of the funds when the loans came due, but only sought repayment after Claudia died.

6. The law firms representing the plaintiffs in the action were ordered to pay the defendants $1,960,000 as a sanction for filing frivolous litigation.

I. Support Trusts and Alimony

In Tannen v. Tannen, Nos. A-4185-07T1, A-4211-07T1 (N.J. App. Div., August 31, 2010), a divorce proceeding in which the wife was a beneficiary of a discretionary support trust created by her parents for her benefit, of which the wife and her parents were the trustees, the Court held that the trust was not an asset of the wife for purposes of the alimony statute and, therefore, that trust income should not be imputed to the wife for purposes of determining the amount of alimony payable by the husband to the wife, even though the Restatement (Third) of Trusts provides that the wife has an enforceable interest in the trust’s income, since no reported New Jersey appellate or New Jersey Supreme Court opinion has adopted such statement of the law as is contained the Restatement.

J. Trust Reimbursement of Settlor’s Income Taxes

On January 10, 2012 legislation was introduced in the New Jersey Assembly and Senate to provide that the trustee’s discretion to reimburse the trust settlor for income taxes paid with respect to trust income is not a right that would subject the trust assets to the claims of the settlor’s creditors.

K. Revised Uniform Limited Liability Company Act

On September 19, 2012 New Jersey enacted the “Revised Uniform Limited Liability Company Act” effective March 19, 2013 for all new LLCs and March 19, 2014 for all existing LLCs. The pertinent provisions of the Act are as follows:

- An LLC may have one or more members. A member may not be classified as an LLC’s agent solely by reason of being a member. However, an LLC may file a “statement of authority” indicating all persons authorized (1) to execute an instrument transferring real property held in the LLC’s name or (2) enter into other transactions on the LLC’s behalf.
• An LLC’s debts, obligations or other liabilities, whether arising in contract, tort or otherwise, are solely the LLC’s debts and do not become the debts of a member or manager solely by reason of the member acting as a member or manager acting as a manager.

• An LLC is member managed unless expressly provided otherwise in the operating agreement.

• Managers and members now have expressly stated fiduciary duties of care and loyalty as well as obligations of good faith and fair dealing.

• A purchaser of a transferable interest at a foreclosure sale does not thereby become a member.

L. Prenuptial Agreements

NJSA Section 37:2-38 and NJSA Section 37:2-32 have been amended, effective June 27, 2013, to remove provisions that invalidate a prenuptial agreement if it is unconscionable at that time its enforcement is sought. As a result, whether or not such an agreement is unconscionable is to be determined at the time of its execution.

IX. NEW YORK STATUTORY AND CASE LAW DEVELOPMENTS

A. Powers of Attorney

On January 27, 2009 Chapter 644 of the New York General Obligations Law, which changes the rules regarding the statutory short form power of attorney, was enacted. The legislation provides a new statutory short form power of attorney, which includes new optional provisions for the designation of a monitor and compensation of the agent. Both the principal and the agent must sign the power of attorney. In addition, the legislation provides that if a principal wants to authorize the agent to make gifts on the principal’s behalf, a new “Statutory Major Gifts Rider” must be completed, signed, acknowledged and witnessed. The legislation is effective September 1, 2009, and powers of attorney executed before that date will continue to be valid.

On August 13, 2010 New York State enacted technical corrections legislation to its powers of attorney statute. The technical corrections legislation is effective on September 12, 2010, applicable retroactively to powers of attorney executed on or after September 1, 2009. Pursuant to the legislation, (a) a revocation of a power of attorney will be valid, even if it is delivered only to the attorney-in-fact but not to a third party, (b) a power of attorney will not automatically revoke previously executed powers of attorney, unless the new power of attorney expressly so provides, (c) an attorney-in-fact having authority to make gifts customarily made by the principal cannot make aggregate gifts of more than $500 per year, unless the power of attorney authorizes more substantial gifts, and (d) forms of powers of attorney other than the statutorily prescribed form may be used.

In Perosi v. LiGreci, 98 A.D.3d 230 (2d Dep’t. 2012), where the grantor of a trust executed a statutory short-form power of attorney naming his daughter as his agent and granting her the authority to designate the trustee of any trust, and executed a statutory gift rider giving his daughter the authority to act as grantor and trustee, the Court held that the agent could amend
such trust to remove the original trustee and appoint a successor trustee, even though the power of attorney did not specifically authorize the agent to amend the trust, since the agent had the authority to do so as the “alter ego” of the principal.

In In the Matter of the Estate of George J. Ferrara, 7 N.Y. 3d 244 (2006), the New York Court of Appeals held that attorneys-in-fact acting pursuant to a New York statutory short form power of attorney, which had been modified to provide that the attorneys-in-fact could make gifts to themselves without limitation in amount, were nonetheless bound by the requirement in New York General Obligations Law Section 5-1502M that a gift made pursuant to a short form power of attorney must be made only for purposes which an attorney-in-fact "... reasonably deems to be in the best interest of the principal ...", since any additional language inserted in the power of attorney must be consistent with this constructional section of the statute.

In Matter of Mueller, 19 Misc.3d 536, 853 N.Y.S.2d 245 (Surr. Ct. Westchester County 2008), the Westchester County Surrogate rendered a decision regarding whether an exoneration clause in a power of attorney is enforceable. The decedent died intestate in 2002 at the age of 100. She was survived by her nephew as her sole distributee. Seventeen months before her death, the decedent, who was then 98 and living with an aide, executed a power of attorney prepared by her tenant. The power of attorney, given to the tenant, gave broad powers to him, including additional powers which allowed him to make gifts of the decedent's property to himself or to any of his family members, allowed him to transfer the decedent's bank accounts to other accounts in his name or to the name of any member of his family, exonerated him from accounting for his actions and exonerated him from liability to the decedent and/or her heirs. Using the power of attorney, the tenant transferred all of the decedent's bank accounts to himself and/or his mother and used the funds to pay off his credit card bills, buy a computer and, generally, to fund his lifestyle. Additionally, the tenant prepared a life tenancy agreement for himself and his mother, which he executed on behalf of the decedent, whereby he and his mother were granted the right to reside in the decedent's house for the remainder of their lives with the decedent paying all of the bills. On a motion for summary judgment, the Court held that the exoneration clause could not serve as a basis for exculpating the respondent from liability for his conduct. Applying the principles of the New York Estates, Powers & Trusts Law (“EPTL”) Section 11-1.7, and relying on Matter of Ferrara, the Court found that a clause in a power of attorney that seeks to exonerate an attorney-in-fact from any and all liability is void as against New York's public policy. The Court further ruled that fundamental to the fiduciary relationship is a duty to account and that such duty extends to an attorney-in-fact. The Court stated that "[a]bsent enforceability of the duty to account, neither a principal nor the beneficiaries of her estate would be able to protect their interests leaving an abusive attorney-in-fact in a position to act without fear of any adverse consequence."

In Matter of Francis, 2008 WL 586210 (Surr. Ct. Westchester County 2008), Surrogate Scarpino held that an exculpation clause in a power of attorney did not exonerate an attorney-in-fact from the duty to account, noting that the fundamental duty of every fiduciary to act in good faith and with undivided loyalty also applies to an attorney-in-fact.
B. Same Sex Couples

1. General

On June 24, 2011 New York State enacted the Marriage Equality Act, effective on July 24, 2011, legalizing same-sex marriage. Despite such legislation, same-sex couples will not achieve full equality until the Defense of Marriage Act is repealed, since they will not benefit from many of the federally based legal rights of married couples, including the right to file joint federal income tax returns, the right to the unlimited federal estate tax and gift tax marital deduction, the right to survivor and spousal Social Security benefits and the ability to take unpaid leave under the Family and Medical Leave Act. Additional issues exist with regard to the transfer of real estate interests between same-sex couples, the distribution of life insurance proceeds, a spousal rollover of an IRA and the right of children born to a same-sex couple to inherit from the non-biological parent.

In Matter of Ranftle, N.Y.L.J., February 25, 2011 (App. Div. 1st Dept., February 24, 2011), the Court held that the State of New York would recognize a same-sex marriage that was performed in Canada for New York probate law purposes, as such marriages do not violate the public policy of the State of New York.

In B.S. v. F.B., 25 Misc.3d 520 (Sup. Ct., Westchester Co. 2009), the New York Supreme Court held that it lacks jurisdiction over a proceeding to “divorce” the same-sex parties to a Vermont civil union, since a civil union is not a marriage, and the Court dismissed the action without prejudice to the plaintiff’s right to file a complaint for the dissolution of the Vermont civil union addressed to the Court’s general equitable jurisdiction.

In Godfrey v. DiNapoli, 22 Misc. 3d 249, 866 NYS 2d 844 (2008), the New York Supreme Court held that the New York State Comptroller acted legally in October 2004 when that office, applying the doctrine of comity, indicated that the State Retirement System would recognize the same sex marriage of a state employee entered into in Canada.

In Will of Alan Zwerling, N.Y.L.J. Sept. 9, 2008 (Queens Co. Surr. Nahman) the Court stated that although the decedent had been legally married in Canada, the “validity of same-sex marriage had not been definitely determined”, and the Court therefore required that the decedent’s parents be cited with notice of the probate proceeding. However, in Matter of the Estate of H. Kenneth Ranftle, N.Y.L.J. Feb. 2, 2009 (N.Y. Co. Surr. Glen), where the decedent similarly had been validly married in Canada in a same-sex marriage, the Court held that the man married to the decedent is the decedent’s surviving spouse and sole distributee and, therefore, that no citation in the probate proceeding need be issued to any other person as a distributee, thereby precluding family members of the decedent from objecting to the validity of the same-sex marriage.

In Beth R. v. Donna M., 19 Misc.3d 724, Sup. Ct., New York Co. 2008, the Supreme Court, New York County held that a marriage in Canada by a lesbian couple which is valid under Canadian law is valid under New York law and the New York courts therefore can hear an action brought by one of the spouses for divorce.
2. **New York Taxes**

On November 17, 2011 a representative of the Department of Taxation and Finance informally stated that same-sex marriages performed in jurisdictions other than New York would be recognized in New York for New York tax purposes, but that domestic partnerships would not qualify for recognition unless they take a form legally recognized as a marriage.

3. **New York Estate Tax**

On July 18, 2013 the New York State Department of Taxation and Finance issued Technical Memorandum TSB-M-13(9)M advising that, in view of the United States Supreme Court decision in *United States v. Windsor*, same-sex spouses may amend previously filed estate tax returns for spouses who die prior to July 24, 2011, if the statute of limitations to apply for a refund remains open.

On July 29, 2011 the New York State Department of Taxation and Finance issued Technical Memorandum TSB-M-11(8)M advising that, as a result of the legalization of same-sex marriage in the State of New York, the term “spouse” for New York State estate tax and gift tax purposes includes same-sex spouses and different-sex spouses, for the estates of persons dying on or after July 24, 2011. Thus, the estate of a same–sex spouse may claim a marital deduction for New York State estate tax purposes and may also make a QTIP election for New York State estate tax purposes. To do so, the decedent’s estate must file with the New York estate tax return a pro forma federal estate tax return showing the computation of the federal estate tax as though the marital deduction had been allowed for federal estate tax purposes, and a copy of the actual federal estate tax return filed with the Service, if such return is required to be filed. Similar rules apply with respect to the qualified joint interests owned by same-sex spouses and gift splitting between same-sex spouses.

4. **New York Income Tax**

On July 29, 2011 the New York State Department of Taxation and Finance issued Technical Memorandum TSB-M-11(8)C, (8)I, (7)M, (1)MCTMT, (1)R and (12)S providing guidance regarding New York State income taxes of same-sex married couples. The Memorandum provides that same-sex married couples must file New York personal income tax returns using a married filing status (e.g., married filing jointly, or married filing separately), even though they do not use a married filing status for federal income tax purposes. In order to compute their New York income tax, such persons must recompute their federal income tax as if they were married for federal tax purposes. As the legalization of same-sex marriages in the State of New York was effectively on July 24, 2011, same-sex married couples who are married as of December 31, 2011 will be considered as married for the entire year and must file their New York income tax returns using a married filing status starting in tax year 2011. Since the legalization of same-sex marriage is not retroactive, a same-sex married couple who were legally married in another state prior to July 24, 2011 is not treated as married for New York tax purposes until July 24, 2011, and may not use a married filing status prior to tax year 2011.
C. Other New York Estate Tax Changes

On September 26, 2012 the New York State Department of Taxation and Finance issued a Technical Memorandum (TSB-M-12(4)M) advising that where a federal estate tax return is filed solely to elect portability, the decedent’s estate must file with the New York estate tax return both a copy of the federal estate tax return, as filed with the Service, and a completed pro forma Part 5-Recapitulation (form 706) and all applicable schedules that report the actual date of death value of all property the value of which was only estimated for federal estate tax purposes.

On July 29, 2011 the New York State Department of Taxation and Finance issued TSB-M-11(9)M stating that if a federal estate tax return is filed solely to elect portability, any QTIP election that is made on such tax return must also be made for New York estate tax purposes. If a QTIP election is not made on such federal return, it may not be made for New York estate tax purposes.

On February 2, 2011 the New York State Department of Taxation and Finance issued a Technical Memorandum (TSB-M-11(1)(M)) advising that the amendments made by the 2010 Tax Act, including federal extensions, do not apply for New York purposes. Thus, the New York estate tax return for the estate of decedents dying in 2010 is due within nine months of the date of death, unless the estate has been granted an extension of time to file. In addition, since an estate must submit a federal estate tax return with the New York estate tax return, even if the state is not required to file a federal estate tax return, the Technical Memorandum states that for the estates of decedents dying in 2010, a federal estate tax return for 2010 may be used, if it is available before the due date for the filing of the New York estate tax return, or if it not so available, then the estate should use a 2009 federal estate tax form for the pro-forma filing requirement. Further, the Technical Memorandum states that, as the New York GST tax does not conform to the federal GST tax, skip person distributees and trustees must file the requisite New York GST tax forms by April 15, 2011 for generation-skipping distributions or taxable terminations.

The New York Department of Taxation and Finance has confirmed that if the modified carryover basis regime is elected for the estate of a New York decedent who died in 2010, the estate could be liable for both New York estate taxes and New York capital gains taxes, as the estate would be subject to New York estate taxes but would not receive a stepped up income tax basis at the decedent’s death.

On August 11, 2010 Section 951(a) of the New York Tax Law was amended to eliminate the reference in that Section to the federal unified credit in effect on the decedent’s date of death and to provide that such credit against the New York estate tax would be fixed at $1,000,000, effective with respect to the estates of decedents dying on or after January 1, 2010.

On October 12, 2011 the Department of Taxation and Finance issued Advisory Opinion TSB-A-11(1)M, stating that a non-resident’s revocable trust that owns an interest in a multiple member limited liability company or a partnership that owns an interest in New York real property, is an interest in an intangible asset that is not subject to New York estate tax.
On April 8, 2010 the New York State Department of Taxation and Finance, in Advisory Opinion (TSB-A-10(1)(M)), considered whether a non-resident decedent’s interest in a revocable trust, which owned interests in several multi-member New York limited liability companies that had elected to be treated as partnerships for federal income tax purposes, which in turn owned New York residential and commercial rental real property, is subject to New York estate tax. The Department concluded that the decedent’s interest in the trust was an intangible asset that was not subject to New York State estate tax.

On March 16, 2010 the New York State Department of Taxation and Finance issued TSB-M-10(1)(M) clarifying that an executor can elect QTIP treatment for New York estate tax purposes in 2010, even though no federal estate tax return is required to be filed in view of the repeal of the federal estate tax. The election must be made on a pro-forma federal estate tax return (as used for 2009 dates of death) attached to the New York estate tax return. The announcement also provides that the value of the QTIP property for which the election is made for New York estate tax purposes must be includible in the estate of the surviving spouse for such purpose. On March 1, 2011 the New York State Department of Taxation and Finance by a letter to a practitioner advised that an executor can elect QTIP treatment for New York estate tax purposes for the estate of a decedent who died in 2010, even though no federal estate tax return is required to be filed because the executor opted out of the federal estate tax regime.

On January 14, 2009 the Office of Counsel of the New York State Department of Taxation and Finance issued an informational statement (NYT-G-09(1)M) stating that an executor may elect to use alternate valuation for purposes of calculating the New York gross estate when no federal estate tax return is required to be filed, provided that the requirements for electing alternate valuation under Code Section 2032 (i.e., reduction of the gross estate and reduction of the estate tax and the GST tax liability) are met applying the provisions of the Code as it existed on July 22, 1998 and applying the limitations on the unified credit in Section 951(a) of the New York Tax Law.

On October 24, 2008 the New York State Department of Taxation and Finance published an advisory opinion (TSB-A-08(1)(M)), which considered whether an interest owned by a non-New York resident in an S corporation or in a single member limited liability company that owns real property located in New York constitutes intangible personal property, rather than real property, and therefore will not be included in the non-resident decedent’s New York gross estate. The advisory opinion concluded that an interest in an S corporation owning New York real property is considered an intangible and is not included in a non-resident decedent’s New York gross estate, unless the S corporation is not entitled to recognition under the Moline Properties test (Moline Props. v. Commissioner of Internal Revenue, 319 U.S. 436 (1943)). Under the Moline Properties test, a corporation’s separate existence would be recognized for tax purposes if its purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation. The advisory opinion also concluded that an interest in a single member limited liability company owning New York real property is considered an intangible and is not included in the non-resident decedent’s New York gross estate if the limited liability company elects to be treated as a corporation under the Service’s “check-the-box” regulations (Treas. Reg. Sections 301.7701-1 through 301.7701-3). Although the advisory opinion only referenced the Moline Properties test in its discussion regarding an S corporation, it is likely that...
New York would also apply such test with respect to a single member limited liability company for purposes of the advisory opinion.

D. Other New York Income Tax Changes

1. Modified Carryover Basis

On July 29, 2011 the New York State Department of Taxation and Finance issued TSB-M-11(9)M stating that the New York state personal income tax is based upon information reported on the taxpayer’s federal income tax return. Therefore, if the estate of a 2010 decedent elected the modified carryover basis regime, such modified carryover basis must be used to report for New York income tax purposes any gain or loss realized on the sale of the decedent’s assets after his or her death, with the result that both New York estate taxes and New York income taxes may be payable with respect to any appreciation in value with respect to such property that occurred prior to the decedent’s death.

2. New York Source Income

Retroactive to tax years beginning on or after January 1, 2007, when a nonresident sells stock in an S corporation doing business in New York State and makes a Code Section 338(h)(10) election, the sale will be treated as an asset sale, and the gain that passes through to the nonresident shareholder is subject to New York State income tax.

The statutory definition of New York source income from the sale of real property located in the state has been expanded to include gain or loss on the sale or exchange of an interest in an entity that owns real property in New York. The legislation applies to the sale or exchange of an interest in partnerships, limited liability companies, S corporations and non publicly traded C corporations with 100 or fewer shareholders, if the entity owns real property in New York with a fair market value of at least 50% of the fair market value of all the entity’s assets owned for at least two years. The amount of New York source income from the sale or exchange is determined by multiplying the amount of the federal gain or loss by a fraction, the numerator of which is the fair market value of the entity’s New York real property, and the denominator of which is the fair market value of all the entity’s assets. The legislation does not affect the treatment of gain or losses passed through to the taxpayer when the entity itself sells real property located in New York, or from the sale of an interest in an entity where the interest is employed in another business carried on in New York. The legislation applies to sales of an interest in an entity that occur on or after May 7, 2009.

3. Income Tax Rates

On March 20, 2013 Governor Cuomo and legislative leaders announced a bipartisan agreement to extend for three years the state’s highest income tax rate of 8.82%, which is applicable to income of more than $1,000,000 for individuals and more than $2,000,000 for married couples (commonly called the “millionaire’s tax”), which is scheduled to expire in 2014.

On December 6, 2011 Governor Cuomo and New York’s legislative leaders announced a bi-partisan agreement to lower personal income tax rates on middle-income
taxpayers and raise income tax rates on wealthy taxpayers, by lowering the maximum income tax rate from 6.85% to 6.45% for taxpayers earning between $40,000 and $150,000, by lowering the maximum income tax rate to 6.65% for taxpayers earning between $150,000 and $300,000, and by raising the maximum income tax rate to 8.82% for taxpayers earning more than $2,000,000. The proposal would also index the income tax brackets for inflation.

Effective January 1, 2011, New York City has a new maximum income tax rate of 3.876% on New York City income in excess of $500,000. The prior maximum rate of 3.648% continues in effect on income of more than $90,000 up to $500,000.

Effective for taxable years 2010 through 2012, the New York State itemized deduction for charitable donations is reduced from 50% to 25% for taxpayers with New York adjusted gross income in excess of $10,000,000.

On April 7, 2009, legislation was enacted, retroactive to January 1, 2009, increasing New York State income tax rates. The legislation increases the maximum tax rate to 8.97% on New York adjusted gross income in excess of $500,000, and increases the second highest rate to 7.85% for taxpayers filing jointly with New York adjusted gross income above $300,000, heads of households with New York adjusted gross income above $250,000 and single taxpayers with New York adjusted gross income above $200,000. In addition, the legislation eliminates all itemized deductions, other than 50% of charitable contributions, for taxpayers having New York adjusted gross income in excess of $1,000,000. Furthermore, in order to satisfy the “safe harbor” provision regarding the payment of estimated income taxes by paying 110% of the taxpayer’s prior year’s taxes, the taxpayer must pay estimated income taxes for 2009 based upon the taxpayer’s 2008 tax liability recalculated by applying these 2009 tax law changes to the taxpayer’s 2008 income.

4. Income Tax Return Extensions

New York Department of Taxation and Finance Regulation Section 157.2 provides that the automatic extension for a New York State partnership or fiduciary income tax return is now five months, although large partnerships which are allowed an automatic six-month extension for federal purposes also will be allowed an automatic six-month extension for New York partnership returns. The new rule is effective September 30, 2009 and applies to New York income tax returns for taxable years ending on or after December 31, 2009.

5. New York Residency

In In Re Cooke, N.Y. Div. of Tax Appeals, Administrative Law Judge Unit, DTA No. 823591 (2012), where the taxpayers had residences in New York City and in Bridgehampton, New York, and divided their time approximately equally between the two residences, the tribunal determined that the taxpayers had changed their domicile from New York City to Bridgehampton, New York by the fact that the overwhelming amount of family activities and general habit of life took place in Bridgehampton, rather than in New York City.

On September 11, 2012 the New York State Department of Taxation and Finance released TSB-A-12(4)I regarding a non-New York State resident who owned a one-eighth tenancy in common interest in one of the apartments in a private, member-owned residential club

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in New York City. Since the club awarded the use of such residence on a first-come, first-served basis, and since the taxpayer had a priority right to use the residence for only 45 days per year, the opinion stated that the taxpayer did not have free and continuous access to the apartment and, therefore, did not maintain a permanent place of abode in New York for New York State income tax purposes solely by reason of his ownership interest in the club.

In Matter of Michaels, DTA No. 823370, N.Y.S. Div. of Tax App., ALJ Unit, April 12, 2012, where the taxpayer contracted to sell her Connecticut residence on September 14, 2004, purchased a New York City condominium on November 9, 2004 and immediately began residing in such condominium, and closed on the sale of her Connecticut residence on November 29, 2004, the Administrative Law Judge of the Division of Tax Appeals found that the decedent’s sale of her Connecticut residence occurred on November 29, 2004, at which time the taxpayer was a New York resident, and held that the gain realized on the sale was subject to New York income tax.

On November 28, 2011 the Department of Taxation and Finance issued an advisory opinion regarding taxpayers who changed their domicile during 2010 from New York to Connecticut and had restricted access to their New York City residence prior to its sale. The opinion stated that the taxpayers should not be taxed as “resident” taxpayers for 2010, as they did not maintain a permanent place of abode in New York for substantially all of 2010, even though they spent more than 183 days in New York during 2010.

In Matter of Gaied, DTA No. 821727, State of New York-Tax Tribunal, 2011 N.Y. Tax LEXIS 136 (June 16, 2011), the New York State Tax Appeals Tribunal held that a New Jersey resident who worked in Staten Island and who purchased a residence in New York State for use by his parents was a New York State resident for New York State income tax purposes, even though the taxpayer stayed at the New York residence only when he visited his parents, as the taxpayer had not established that the property was maintained exclusively for his parents and had not established that the New York residence was solely an investment property, since the taxpayer did not collect rent from his parents. In Gaied v. New York, NY Slip Op. 09108 (App. Div., 3d Dept., 2012), the Appellate Division upheld the decision of the Tax Tribunal.

In In re Robertson, No. 822004 (September 23, 2010), the New York Tax Appeals Tribunal held that during 2000 the taxpayer was not physically present in New York City for more than 183 days, the number necessary for finding him a city resident, and that the taxpayer therefore did not owe New York City income taxes for such year, even though the taxpayer owned an apartment in New York City during such year.

In In re David Leiman, the New York Division of Tax Appeals, Nos. 822385, 822386 and 822387 (Feb. 4, 2010), held that the taxpayer’s ownership of a life estate in New York property that was owned by his daughter constitutes a permanent place of abode in New York for purposes of residency and, since the taxpayer failed to present any evidence as to his whereabouts during the tax year, the taxpayer was liable for New York personal income tax on his income from all sources.
On December 24, 2008 the New York Department of Taxation and Finance published 20 New York Codes, Rules and Regulations Section 105.20(e)(1), changing the rules regarding residency in New York for personal income tax purposes. The new regulations, which apply to tax years ending on or after December 31, 2008, provide that an individual who is not domiciled in New York is considered a New York resident if he or she maintains a “permanent place of abode” in New York and spends more than 183 days of the tax year in New York, even if the person maintains the place of abode in New York only during “a temporary stay” or for a “fixed and limited period” for the accomplishment of a “particular purpose”.

6. New York Resident Trusts

Currently, a “resident trust” is defined as a testamentary trust under the will of a decedent who is domiciled in the State of New York at his or her death, a trust (whether revocable or irrevocable) established by a person who is domiciled in New York at the time of the trust’s creation, or a revocable trust that later became irrevocable while the settlor was domiciled in New York. However, under current law even a New York resident trust would not be subject to any New York income taxes if all of the trustees are domiciled in a state other than New York, the entire corpus of the trust is located outside of New York, and the trust has no New York source income.

On June 8, 2010, the New York Department of Taxation and Finance issued Advisory Opinion No. TSB-10(4)I, which clarifies that a New York resident trust will become non-taxable for New York income tax purposes immediately upon satisfying the three conditions described above. Thus, in the year in which the trust changes its taxable status for New York income tax purposes, New York will only tax the trust income that accrued prior to the trust becoming non-taxable by New York State.

On July 23, 2010 the New York Technical Service Bureau issued memorandum TSB-M-10(5)I, requiring a New York resident trust that is exempt from paying New York fiduciary income tax because the Trust has no New York trustee and no New York source income, and all of its assets are located outside of New York, to nonetheless file both a New York fiduciary income tax return, but not pay New York income tax, and a Declaration confirming why the Trust is exempt from paying New York income tax. The policy stated in the Memorandum is effective for tax years beginning on or after January 1, 2010.

In 2010, New York released Form IT-205-C, the New York State Resident Trust Nontaxable Certification, which must be filed every year by a New York resident trust that meets the requirements described above so as not to be subject to New York State income tax.

On January 19, 2010 the Governor’s Budget Bill (A 9710) was introduced in the New York State Assembly, which in part would change the definition of a “resident trust” for New York State income tax purposes. Pursuant to the Bill, any testamentary trust established under the will of a decedent who at his or her death was domiciled in New York would be fully taxed as a “resident trust”; and any inter vivos trust (being either an irrevocable or a revocable trust established by a person who is domiciled in New York at the time of the trust’s creation, or a revocable trust that later became irrevocable while the settlor was domiciled in New York) would be fully taxable as a “resident trust”, unless (a) there are one or more nonresident
“ascertainable beneficiaries”, and (b) there is no income derived from or connected with New York sources. Subsequently, this portion of the Bill was stricken.

In Matter of William Rockefeller, N.Y.L.J., January 5, 2004, the New York County Surrogate’s Court considered an application to change the situs of a testamentary trust from New York to Delaware, where the New York corporate trustee was resigning in favor of a Delaware corporate trustee affiliated with a financial institution having its principal place of business in New York to enable the trust to avoid the application to it of New York income taxes. The trust was created under the will of a New York domiciliary which was probated in New York. The Court noted that the New York corporate trustee’s resignation would result in the trust no longer being taxable for New York income tax purposes, but denied the application to change the trust’s situs, noting that the change in the trust’s New York tax status was not inconsistent with the continuing supervision of the trust by the New York courts.

E. Statute of Limitations for Tax Collections

On September 9, 2011 the New York State Department of Taxation and Finance released guidance memorandum TSB-M-11(10)(C), explaining a new state law that took effect on August 17, 2011 limiting the 20-year statute of limitations for the collection of tax liabilities, by stating that such statute of limitations runs from the first date on which a warrant could be filed by the Department and that a payment by a taxpayer or an acknowledgment by the taxpayer of indebtedness in writing no longer extends such 20-year limit. The new statute of limitations applies to all taxes, fees, penalties, interest and special assessments administered by the Department. However, a taxpayer and the Department can agree in writing to extend the time period to collect a warrant.

F. Principal and Income Act

Principal and Income Act (Chapter 243, signed 9/4/01, S. 5531, A. 9050-A) which enacted a new Principal and Income Act, added a power of adjustment to the Prudent Investor Act (EPTL Section 11-2.3(b)(5)) and defines “net income” for a trust as a 4% unitrust amount if a trust elects to be treated as a unitrust unless the terms of the trust provide otherwise. This new form of trust has been approved by the Service in final regulations. It has been stated that this legislation would permit investing for the highest total return as payments to beneficiaries would come from a combination of growth in the trust’s equity as well as the income produced by the assets.

A new EPTL Section 11-2.3(b)(5) is enacted granting trustees the power to make adjustments between principal and income, and to change the amount which may be distributed to a beneficiary under a trust instrument referring to “income,” in order to balance the interests of trust income beneficiaries and remainder beneficiaries for all trusts covered by the new Principal and Income Act after January 1, 2002.

The trustee is authorized to make adjustments between income and principal under the prudent investor standard “to the extent, the trustee considers advisable to enable the trustee to make appropriate present and future distributions in accordance with clause (b)(3)(A)” (that is, the trustee’s pursuit of an overall investment strategy for total return). The trustee must
determine that such adjustments “would be fair and reasonable to all of the beneficiaries, so that current beneficiaries may be given such use of the trust property as is consistent with preservation of its value.”

The rules in EPTL Section 11-A really refer to the rules in EPTL Section 11-A-1.3, which are virtually identical to the Uniform Act and state:

Section 11-A-1.3. Fiduciary Duties:
General Principles

In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of (the act), a fiduciary:

- shall administer a trust or estate in accordance with the terms of the trust or the will, even if there is a different provision in this Article;
- may administer a trust or estate by the exercise of a discretionary power of administration given to the fiduciary by the terms of the trust or the will, even if the exercise of the power produces a result different from a result required or permitted by this Article;
- shall administer a trust or estate in accordance with this Article if the terms of the trust or the will do not contain a different provision or do not give the fiduciary a discretionary power of administration; and
- shall add a receipt or charge a disbursement to principal to the extent that the terms of the trust or the will and this Article do not provide a rule for allocating the receipt or disbursement to or between principal and income.

In exercising a discretionary power of administration regarding a matter within the scope of this Article, whether granted by the terms of the trust, a will, or this Article, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with the Article is presumed to be fair and reasonable to all the beneficiaries.

In deciding whether to exercise the power, the trustee is referred back to the original standards of the N.Y. Prudent Investor Act for the investment of trust assets, found in EPTL Sections 11-2.3(b)(3)(B) and (4)(B).

The trustee may, as well, consider the following factors, (taken from the Uniform Act) to the extent relevant:

- the intent of the settlor, as expressed in the governing instrument; the assets held in the trust; the extent to which they consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property; the extent to which an asset is used by a beneficiary; and whether an asset was purchased by the trustee or received from the settlor.
• the net amount allocated to income under Article 11-A and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available; and

• whether and to what extent the terms of the trust give the trustee power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income.

EPTL Section 11-2.3(b)(5)(c) prohibits trustees from, among other things, making an adjustment where doing so would result in adverse income or transfer tax consequences or would involve acts of self-dealing if the trustee is a beneficiary. Trustees are also prohibited from making adjustments that would increase or decrease the amount of a fixed annuity payment, jeopardize the marital deduction for a gift to a surviving spouse, or from any amount that is permanently set aside for charitable purposes unless the income therefrom is also permanently devoted to charitable purposes. The law also provides that a trustee may not make an adjustment if the trust is an irrevocable lifetime trust which provides income to be paid for life to the grantor, and possessing or exercising the power to make an adjustment would cause any public benefit program to consider the adjusted principal or income to be an available resource or available income and the principal or income or both would in each case not be considered as an available resource or income if the trustee did not possess the power to make an adjustment.

The Act provides: “A court shall not change a fiduciary’s decision to exercise or not to exercise an adjustment power . . . unless it determines that the decision was an abuse of the fiduciary’s discretion. A court shall not determine that a fiduciary abused his, her, or its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion.” The trustee may petition the court for guidance as to whether a proposed exercise of discretion is appropriate.

As stated above, EPTL Section 11-2.4 provides for an optional unitrust provision, whereby the net income of any trust to which this section applies will mean a unitrust amount equal to 4% of the fair market value of the assets held in the trust on the first business day in the current valuation year, or, if the trust has been in existence for four or more years, 4% of the average such fair market value for the current year and the prior two years. This section applies (I) if the governing instrument so provides; (ii) if, with respect to a trust in existence prior to January 1, 2002, the trustee, with consent on behalf of all persons interested in the trust or in the trustee’s discretion, elects to have this section apply on or before December 31, 2005; or (iii) if, with respect to a trust not in existence before January 1, 2002, the trustee so elects on or before the last day of the second full year of the trust beginning after assets first become subject to the trust. This change took effect January 1, 2002.

Pursuant to EPTL Section 11-2.4(b)(2), a “smoothing” rule applies to trusts in existence more than three years. The Statute provides that: “the ‘unitrust amount’ for a current valuation year of the trust shall mean an amount equal to four percent multiplied by a fraction, the numerator of which shall be the sum of (A) the net fair market values of the assets held in the trust on the first business day of the current valuation year and (B) the net fair market values of the assets held in the trust on the first business day of each prior valuation year, and the
denominator of which shall be three.” The effect of the smoothing rule is to even out the unitrust amounts, notwithstanding possible wide fluctuations in the value of the assets of the trust over a moving three year period.

Inasmuch as the unitrust amount is meant to reflect an appropriate return on the assets comprising the trust, if additional assets are transferred to a trust or distributions are made from the trust, the unitrust amount needs to be adjusted to reflect the increase or decrease in the value of the trust corpus. Accordingly, EPTL Section 11-2.4(b)(3) provides for the unitrust amount to be proportionately reduced in the case of any distributions (other than distributions of the unitrust amount) during the valuation year mandated by the terms of the trust. Similarly, the unitrust amount will be increased proportionately for the receipt of any additional property into the trust during the current valuation year, not including however any receipt that represents a return on investment. The net fair market value for each prior valuation year also must be adjusted to reflect the distributions from or additions to the trust in the prior valuation year.

Significant amendments to the power to adjust and to the unitrust provisions of the EPTL were enacted on August 5, 2008 and became effective immediately. Among its revisions, the law amended Section 1, Clauses (A), (C) and (D) of subparagraph (b) of Section 11-2.3 of the EPTL to add language regarding factors a trustee should consider in determining whether to make an adjustment, expressly including a trustee's investment decisions and the accounting income expected to be produced. The prohibitions on exercising the power to adjust remain if the trustee is a current beneficiary or a presumptive remainder person or the adjustment would benefit the trustee directly or indirectly. The amendments clarify that the adjustment's possible effect on a trustee's commission are not included in the determination of whether the adjustment would benefit the trustee directly or indirectly. In addition, the revisions provide that an adjustment otherwise prohibited by the terms of the statute may be made if the trust agreement expressly provides otherwise. EPTL Section 11-A-2.2(e) has been added to provide that a beneficiary’s share of estate income is subject to the fiduciary power to adjust.

The law also made significant revisions to Section 2, Paragraph (b) of Section 11-2.4 of the EPTL. Specifically, the "smoothing rule" to reduce market volatility which began in the fourth year of the trust now begins in the second year of the trust by averaging the first two years valuations for setting the second year payout. The full three year rolling average smoothing begins in the unitrust's third year. The new law differentiates between "material" and "non-material" incorrect payouts. Non-material adjustments must be made within eighteen months and material corrections require court approval. The law now provides that an election to opt into the unitrust regime can be made without court approval only for trusts created after January 1, 2002, if made within two years. All other trusts require court approval. As a result of the changes, the election date specified by a trustee (without court approval) must be within the year in which the election is made or the first day of the following year. The court can specify an election date, but the default effective date for a court decision is no longer the first year of the trust in which assets became subject to the trust. The law left unchanged a trustee's ability to opt into the unitrust regime if he is a beneficiary or would benefit from the election directly or indirectly. The revisions specify trusts to which the unitrust statute will not apply.

EPTL Section 11-2.4(c) has been amended to provide that the fair market value of an asset may be determined by any appropriate technique that is consistently applied, including
by valuing the asset as of the close of business of the previous business day, even if that day was in a prior year. The amendment clarifies that income distributed to the trust from a decedent’s estate or other source shall not be included in determining the fair market value of the assets, unless a determination has been made to accumulate and add such income to principal.

EPTL Section 11-2.4(d) has been amended to provide that when the interests of the current income beneficiaries terminate in favor of new beneficiaries, the trustee has the same two-year period to opt into unitrust treatment as existed at the beginning of the trust.

A new Section 11-2.4(f) of EPTL has been added to provide that the unitrust election shall not be available to a trust if the governing instrument so provides, if the trust is a pooled income fund, if the trust is a charitable remainder trust, or if the trust is an irrevocable lifetime trust providing for income to be paid for the life of the grantor, and such power would cause any public benefit program to consider the additional amounts of principal or income to be an available resource.

EPTL Section 11-A-4.11 has been entirely repealed and replaced with a new Section 11-A-4.11, effective August 5, 2008, which generally allocates receipts from minerals, water and other natural resources at 15% to principal and 85% to income.

In a case of first impression involving the newly effective New York unitrust legislation, the Court was asked to permit the conversion to a unitrust under EPTL Section 11-2.4(e)(2) of a testamentary trust for the benefit of the testator’s widow. Considering the factors enumerated in EPTL Section 11-2.4(e)(5)(A) for unitrust conversion, the Court found that the original trust, which provided a power of invasion for the petitioner’s support and maintenance, had been intended by the testator to benefit his wife. The Court further determined that EPTL Section 11-2.4(b)(2)’s “smoothing” rule did not apply to trusts established prior to its January 1, 2002 effective date. Therefore, the Court treated the trust as a new trust opting into unitrust as of January 1, 2002 and applied a three-year average to the smoothing rule with the average to be determined from the net fair market values of the trust assets on the first business days of 2002, 2003 and 2004, to apply in 2004. In Re Estate of Edward J. Ives, N.Y.L.J. July 29, 2002, p. 28, col. 3, Broome County, Surrogate Peckham.

In In re Estate of Jacob Heller, N.Y.L.J., January 23, 2004, the Westchester County Surrogate's Court held that whether a trustee abuses his discretion by electing unitrust status pursuant to Section 11-2.4 of the EPTL is an issue of fact, rather than an issue of law, to be decided based on the factors enumerated in that statute, and that a trustee could only elect unitrust status prospectively, no retroactively. On May 4, 2006 the Court of Appeals issued its opinion in Heller, (2006 WL 1193191, 2006 N.Y. Slip Op. 03469), holding that a trustee’s status as a remainder beneficiary by itself does not invalidate a unitrust election made by that trustee, and that a trustee may elect unitrust status retroactive to January 1, 2002, which was the effective date of EPTL Section 11-2.4.
EPTL Section 10-6.6 was amended (Chapter 204, signed August 20, 2001, S. 3751A/A.7699A) in relation to a trustee’s powers to invade the principal of a trust in further trust so as not to trigger the GST tax.

G. Attorney Engagement Letters


The rule (§1215.1) requires an attorney who undertakes to represent a client and enters an arrangement for, charges or collects any fee from a client, to provide to the client a written letter of engagement before commencing the representation, or within a reasonable time thereafter if otherwise impracticable, or if the scope of services cannot be determined at the time of the commencement of the representation. The letter of engagement must address the following matters: (1) the scope of the legal services to be provided; (2) an explanation of the attorney’s fees to be charged, as well as expenses and billing practices of counsel; and (3) where applicable, notice of the client’s rights to arbitration of fee disputes pursuant to Part 137 of the Rules of the Chief Administrator. In lieu of a written letter of engagement, a signed written retainer agreement addressing the matters to be contained in the written letter of engagement may be utilized.

Part 137 of the Rules of the Chief Administrator was issued in 2002 and mandates fee-dispute arbitration initiated by the client where the fees in issue are between $1,000 and $50,000. Arbitration is not mandated, but permitted at the attorney’s request, if the client agrees. If an attorney refuses to participate in mandatory arbitration, a referral will be made to the grievance committee.

Excluded from the rule are (1) representation of a client where the fee to be charged is expected to be less than $3,000; (2) representation where the attorney’s services are of the same general kind as previously rendered to and paid for by the client; or (3) representation in domestic relations matters subject to Part 1400 of the Joint Rules of the Appellate Division (22 NYCRR).

In Feder, Goldstein, Tanenbaum & D’Errico v. Ronan, N.Y.L.J. May 6, 2003, p. 21, col. 5 (Nassau Co. Dist. Ct. J. Pardes), a law firm’s failure to provide an engagement letter or retainer agreement precluded the recovery of attorney fees.

In Matter of Feroleto, 6 Misc. 3d 680, 2004 N.Y. Slip Op. 24495, Bronx County Surrogate Holzman allowed compensation to an attorney determined on a quantum meruit basis where the client had not signed a letter of engagement, but where the Court determined that the failure to comply with Rule §1215.1 was not willful and that the client knew that counsel was to be compensated for service rendered.

Similarly, in Seth Rubinstein, P.C. v. Ganea, 2007 NY Slip Op. 02923 (2d Dept. April 3, 2007), the Appellate Division allowed compensation to an attorney determined on a quantum meruit basis even though the lawyer failed the furnish the client with a written engagement letter, where the client had conceded that he did not believe that the legal services
would be rendered without charge and where the lawyer’s failure to comply with Rule §1215.1 was found to be unintentional.

Amendments to CPLR Section 4503 (Ch. 430, Laws of 2002) providing that for the purposes of the attorney-client privilege, if the client is a “personal representative”, as defined therein, and the attorney represents the personal representative in that capacity, then in the absence of an agreement to the contrary, no beneficiary of the estate shall be treated as a client of the attorney solely by reason of status as beneficiary, and the existence of a fiduciary relationship between the personal representative and a beneficiary of the estate does not constitute a waiver of the privilege. A technical corrections bill has been submitted to include SCPA Article 17 and 17-A guardians and lifetime trustees in the definition of personal representative.

In Lawrence v. Graubard Miller, 11 N.Y.3d 588 (2008), the law firm that represented the decedent's widow in a decades-long legal proceeding regarding the accounting of the administration of the decedent’s estate had been billing the widow on a straight time basis for legal services rendered, but changed the billing arrangement to a contingency fee shortly before the accounting proceeding was settled by the payment of the executor of the decedent’s estate of approximately $100,000,000 to the decedent’s widow and her children. In addition, the widow made gifts of approximately $5,000,000 to three members of the law firm which represented her in that accounting proceeding and paid approximately $2,700,000 in gift taxes with respect to such gifts. The Court held that more information was required to determine whether the contingency fee arrangement was unconscionable. On August 27, 2010, Hon. Howard A. Levine, a former New York Court of Appeals judge who had served as the referee in the contested accounting proceeding, issued a report to the New York County Surrogate’s Court recommending that the claimed fees of approximately $44,000,000 should be reduced to $15,840,000, which he determined by applying 40% to the first $10,000,000 of recovery, 30% to the next $10,000,000 of recovery and 10% to the remainder of the recovery. As to the gifts by the widow to her lawyers, Judge Levine found that the widow understood the implications of making the gifts, including her awareness that taxes would result from large gifts, and that she was not under any undue influence regarding the gifts, although he also found that the attorneys to whom the widow had made gifts had violated an ethical consideration contained in New York’s Disciplinary Rules which was in place at the time of the gifts by failing to advise the widow to seek independent counsel about making the gifts to her attorneys. In Estate of Sylvan Lawrence, N.Y.L.J. (Surr. Ct., N.Y. Co., September 8, 2010), the Court ordered counsel to return such gifts to their client and approved the portion of the referee’s report that preserved the contingent nature of the modified fee arrangement but resulted in a modified fee of approximately $16,000,000, rather than the $44,000,000 contingent fee sought by such counsel.

In Matter of Talbot, 84 A.D.3d 967 (2d Dep’t 2011), where a party executed an attorney retainer agreement under which the attorney would receive a $5,000 retainer and a contingent fee of $585,000 regarding a contested probate proceeding, the Court held that the Surrogate must consider not only whether a contingency fee retainer agreement was wrongfully procured, but also the reasonableness of the fee and the agreement itself.

In Matter of Benware, 86 A.D.3d 687 (3d Dep’t 2011), the Court held that , although the Surrogate was not bound by the attorney retainer agreement in setting the attorney’s
fee, the Surrogate could not award fees in excess of the amount agreed to in a valid retainer agreement.

H. Disclosure Requirements of Attorney-Fiduciaries

The Surrogate of Bronx County held that an SCPA Section 2307-a disclosure statement contained in the will, itself, rather than in a separate writing, was still valid and the designated executor, who also was the attorney who drafted the will, was entitled to a full executor’s commission. The testatrix designated her executor in the following language: “I hereby appoint Philip L. McGrory to be the executor of this my Last Will and Testament; I realize he is my attorney and would be entitled to a fee both as the executor and as the attorney for the estate but I wish him to serve as the executor because my sister has refused.” Surrogate Holzman declined to follow Surrogate Roth’s holdings in In re Pacanofsky and In re Hinkson, 186 Misc.2d 15, 714 N.Y.S.2d 433 (N.Y. County 2000). Those cases held that a disclosure statement, consisting of the general language of the statutory model and contained in the will, failed the requirements for a disclosure statement under SCPA Section 2307-a. Surrogate Holzman reasoned that even though the statute envisions the disclosure statement set forth as a separate writing, the statute does not contain an absolute prohibition against the disclosure being set forth in the will, itself. Addressing the language of the testatrix’s will, Surrogate Holzman thought the disclosure set forth in the will reflected a more meaningful discussion between the decedent and her attorney than could have been presumed to have occurred from the general language of a statutory model. Finally, the Court distinguished In re Pacanofsky and In re Hinkson on the grounds that in those cases, the disclosure statement contained within the will was the boilerplate language of the statutory model. In contrast, the language of the testatrix’s will reflected a meaningful conversation between the testatrix and her attorney. Estate of Winston, 186 Misc.2d 332, 714 N.Y.S.2d 879 (Bronx County Surr. Holzman, December 5, 2000).

Surrogate Riordan of Nassau County decided that an attorney/fiduciary was entitled to only one-half a statutory commission because a disclosure statement contained in a will did not meet the requirements of SCPA Section 2307-a. After reviewing the legislative history of SCPA Section 2307-a, Surrogate Riordan held that an acknowledgment in a Will stating that “I hereby appoint my friend and attorney . . . to be Executor of this, my Will . . . I direct that my Executor shall receive a full commission in addition to a legal fee notwithstanding any rules or laws which prohibit a full commission” was not sufficient to comply with Section 2307-a and the fiduciary/attorney was only entitled to one-half a statutory commission. See In re Estate of Bruder, N.Y. L.J. Mar. 15, 2001, p. 25, col. 3 (Nassau County Surr. Riordan). Accord In Re Estate of Katz, N.Y.L.J. March 26, 2001, p. 30, col. 2 (Kings Co. Surr. Feinberg); In Re Estate of McGarry, N.Y.L.J. June 10, 2002, p. 31 (Suffolk Co. Surr. Czygier).

Surrogate Radigan decided that a waiver of the SCPA 2307-a disclosure requirement was proper where a woman acknowledged her understanding that her attorney/fiduciary was entitled to both commissions and attorney’s fees and reaffirmed her will without signing a disclosure statement. The attorney/fiduciary named in the 1981 will had retired. In 1999, the attorney for the attorney/fiduciary visited the testatrix in the hospital to review her estate plan. At that time, the attorney for the attorney/fiduciary informed the testatrix that her attorney/fiduciary was entitled to both attorney’s fees and commissions which she
acknowledged. There appearing to be no immediate threat to the testatrix’s health, the disclosure statement was not obtained at that time. The testatrix suddenly died five days later without having signed a disclosure statement. Surrogate Radigan decided on these facts that waiver of the SCPA 2307-a disclosure requirements was proper. See In re Smith, N.Y. L.J., Nov. 28, 2000 p. 29, col. 3 (Nassau County Surr. Radigan).

Surrogate Czygier found good cause existed for waiver of the SCPA 2307-a disclosure provisions and allowed full statutory commissions. A Connecticut attorney drafted a Will in 1981 while the testator was domiciled in Connecticut where there was no comparable statute with such requirements and the attorney was not admitted to practice in New York. At the time of the preparation of the Will there was no anticipation that the decedent would reside in New York. The Court held that the requirements of SCPA 2307-a must be adhered to only if, at the time the Will was prepared, it was foreseeable that the Will would be probated in New York State. Matter of Newell, N.Y.L.J. June 6, 2002, p. 27, col. 4 (Suffolk Co. Surr. Czygier).

In Matter of Lustig, N.Y.L.J., February 7, 2005, p. 32 (App. Div. 1st Dept.), the Appellate Division confirmed the Order of Surrogate Roth, New York County Surrogate’s Court, directing that the executor’s commissions payable to the attorney-executor be limited to one-half of the statutory commissions to which he otherwise would have been entitled, since the testator failed to acknowledge in a writing separate from his will that the disclosure required by SCPA § 2307-a had been provided.

In Matter of Wagoner, 7 Misc. 3d 445 (Surr. Ct., Albany Co., Surr. Doyle, January 10, 2005), the Court considered a statutory disclosure statement under SCPA 2307-a, which was witnessed only by the testator’s attorney, where the testator designated the attorney’s paralegal as the testator’s executor. The paralegal informed the Court by affidavit that she was not a close friend of the decedent and that she became acquainted with the decedent as a result of her employment with the decedent’s attorney. The Court determined that the paralegal’s relationship with the attorney, combined with her lack of an independent relationship with the decedent, was such that a statutory disclosure statement was required, and held that the statement in question should not be treated as having been signed in the presence of "one witness other than the executor-designee." As a result, the Court held that the statement was null and void and limited the executor’s commissions to one-half of the statutory commissions. However, the Appellate Division (30 A.D. 3d 805, 3rd Dept., June 2006), reversed the Surrogate’s Court decision, holding that the statute is inapplicable to the instant case, since it only applies to attorneys who are named as executors and the nominated executrix is not an attorney.

In Matter of Karlan, N.Y.L.J., April 11, 2006, p. 19 (Surr. Ct., Nassau Co., Surr. Riordan), the Court held that the attorney who prepared the decedent’s will and who was named in the will as one of the decedent’s three executors could not receive more than one-half of one full executor’s commission, since the decedent did not execute a written acknowledgment of disclosure in the form set forth in SCPA 2307-a, even though the same attorney had prepared numerous prior wills for the decedent who had executed such disclosure statements in connection with those prior wills.

In In re Estate of Brokken, N.Y.L.J., March 28, 2006, p. 24 (New York Co., Surr. Roth), the Court held that the attorney-fiduciary could receive a full commission, even though
the testator did not execute the disclosure statement required by SCPA Section 2307-a, where the estate’s beneficiaries were fully informed of the statutory disclosure requirement and waived it.

In In re Estate of Tackley, N.Y.L.J., October 10, 2006, p. 33, (Surr. Ct., New York Co., Surr. Roth), the Court held that the disclosure statement in question failed to comply with the statutory requirements, since it did not state that the testator acknowledges that, absent disclosure, an attorney who serves as an executor shall be entitled to one-half the commissions which the executor otherwise would be entitled to receive.

In In re Estate of Wrobleski, N.Y.L.J., June 4, 2008, p. 41, an uncontested probate proceeding, the Kings County Surrogate's Court was presented with the issue of whether the acknowledgment of disclosure submitted by the nominated attorney-fiduciary was in compliance with the dictates of SCPA Section 2307-a. The petitioner submitted an acknowledgment executed by the decedent that did not comply with the current requirements of SCPA Section 2307-a but appeared to comply with those required by the statute at the time the acknowledgment was executed. However, the Court noted that the acknowledgment was missing the signature of the witness to the instrument. In an effort to cure this defect, the petitioner submitted an affidavit of the attorney who supervised the execution of the will and an affidavit of one of the attesting witnesses, both of which alleged that they witnessed the execution of the acknowledgment of disclosure with the other two attesting witnesses. The Court found that while substantial compliance with the model disclosure provided by the statute will entitle an attorney to full commissions, omission of any of the material requirements of the acknowledgment will deprive the attorney-fiduciary of the full statutory commission. The Court found further that the signature of a witness on the acknowledgment was a substantial component of the statutory requirement that could not be overlooked and could not be cured post-mortem by the affidavits of witnesses. Accordingly, the attorney-fiduciary's commissions would be reduced to one-half of the statutory rate.

IMPORTANT:

SCPA Section 2307-a was amended, effective November 16, 2004, to provide that the disclosure must be acknowledged in a document separate from the will, but which may be attached to the will, and to provide that the disclosure must state that the testator acknowledges or was informed that, absent the execution of the disclosure, an attorney who serves as an executor shall be entitled to one-half of the commissions which the attorney otherwise would be entitled to receive. The amendment did not address the issue of whether a disclosure statement executed before November 16, 2004, containing all the elements of disclosure required by the statute in effect at the time the statement was executed, but not containing the new disclosure provision describing the effect of the failure to execute a disclosure statement, will satisfy the new statutory requirement. However, In Matter of Griffen, 16 Misc. 3d 295 (Surr. Ct., Nassau Co., Surr. Radigan 5/2/07), the Court ruled that a disclosure statement executed prior to the effective date of an amendment (which added an additional requirement to the form of disclosure) but which conformed to the statute in effect on the date the disclosure statement was executed was in compliance with the statute and the attorney-executor was entitled to full statutory commissions.
In Matter of Gurnee, 16 Misc.3d 1113(A), 2007 N.Y. Slip. Op. 51408(U), (Surr. Ct. So. June 28, 2007), Surrogate Czygier of Suffolk County held that the attorney-executors were limited to one-half commissions pursuant to SCPA Section 2307-a, where the disclosure form failed to contain additional language required by the 2004 amendment to the statute. In addition, the Court stated that a valid disclosure form executed in connection with an earlier will of a testator cannot be utilized as proof of compliance with the statute with respect to a later will which does not contain the necessary disclosure statement.

In Matter of Moss, N.Y.L.J. Sept. 24, 2008, p. 40, col. 3 (Surr. Ct. New York Co. Surr. Roth), the Court held that where the testatrix signed a disclosure statement which complied with the then applicable requirements, her subsequent execution of a codicil after the 2004 amendment to SCPA Section 2307-a did not require the execution of a new disclosure statement, where the codicil did not involve a fiduciary appointment.

SCPA Section 2307-a was further amended, effective on August 31, 2007 and applicable to all wills executed on or after that date, to extend the disclosure provisions to include a nominated executor who is an employee of the attorney draftsperson or of a then affiliated attorney. In addition, the amendment provides that the testator must be informed that any person, including “the testator’s spouse, child, friend or associate, or an attorney” is eligible to serve as an executor. Furthermore, the amendment provides that in the absence of an executed disclosure acknowledgment by the testator, the attorney draftsperson, a then affiliated attorney, or an employee of the draftsperson or of a then affiliated attorney, who serves as an executor will be entitled to one-half of the commissions he or she otherwise would be entitled to receive. The amendment also modifies the statutory model disclosure forms to incorporate these changes.

In Matter of Hess, N.Y.L.J. Sept. 24, 2008, p. 40, col. 3 (Surr. Ct. New York Co. Surr. Roth), the Court held that a partner of the attorney-drafters is “affiliated” with the attorney-drafters within the meaning of the statute and, therefore, is ineligible to act as a witness to the disclosure statement.

In In Re Estate of Deener, 2008 N.Y. Slip. Op. 28470 (Surr. Ct. New York Co. Surr. Roth), the Court held that SCPA Section 2307-a applies even to an out-of-state attorney named as an executor in the will of a New York domiciliary.

In Matter of Winters, 25 Misc.3d 631 (Surr. Ct., Broome Co. 2009), the Court held that the 2007 amendment to SCPA Section 2307-a, to the effect that the disclosure provisions also apply to the employees of the attorney draftsperson, should not be applied retroactively to a will which was executed in 1994 and in which the decedent nominated as the executrix a legal secretary in the office of the attorney who prepared the will.

In Matter of Riley, 29 Misc.3d 1059 (Surr. Ct., Oneida Co., September 17, 2010), the Court held that the an attorney-executor was entitled to full commissions because the SCPA §2307-a disclosure statement executed by the decedent at the time the will was executed complied with the mandatory provisions then in effect even though it did not comply with the model disclosure statement.
In Estate of Carl Beybom, N.Y.L.J. (Surr. Ct., Suffolk Co., September 28, 2011), the Court held that the attorney disclosure form in question satisfied the statutory requirements, even though it did not bear the signature of a “witness” but instead bore signature and stamp of a notary who in effect acted as an attesting witness, and where the notary was an attorney affiliated with the draftsperson designated in the Will as the nominated executor.

In In re Estate of Mayer, N.Y.L.J., August 11, 2011, p. 27 (Surr. Ct., Bronx Co.), where the testator executed a disclosure statement containing only three of the four statutorily required disclosures but omitting the disclosure that absent execution of such statement the attorney-executor shall be entitled to only one-half of the commissions that he or she would otherwise be entitled to receive, the Court held that the disclosure statement failed to comply with the required statutory language and that the commissions of the attorney-executor were limited to one-half of the statutory commissions.

In Matter of Rafailovich, 2012 N.Y. Slip Op. 50522(U) (Surr. Ct., Bronx Co., March 23, 2012), where the decedent executed her will and an attorney disclosure statement in 2002, and such statement complied with the then existing requirements for such statements, but did not include the additional requirements that were added by the 2004 and 2007 amendments to SCPA Section 2307-a, the Court held that such additional requirements would not be applied retroactively and, therefore, that the attorney co-executor would be entitled to full statutory commissions.

In Matter of Restuccio, NY Slip Op. 22390 (Surr. Ct., Richmond Co., December 31, 2012) the Court held that disclosure requirements in SCPA 2307-a are not applicable to a will that was prepared for a non-New York domiciliary by a non-New York attorney who is named in the will as the executor, where the decedent died a New York domiciliary.

I. Relaxation of Strict Privity Doctrine

In Estate of Saul Schneider v. Finmann, No. 104 (June 17, 2010), the New York Court of Appeals relaxed the application of the strict privity doctrine to estate planning malpractice suits commenced by the personal representative of the decedent’s estate against the decedent’s attorney and held that “privity, or a relationship sufficiently approaching privity, exists between the personal representative of an estate and the estate planning attorney”, thereby allowing the personal representative to maintain the malpractice claim. However, the Court also stated that strict privity remains a bar against estate planning malpractice claims of beneficiaries of the estate or of third-party individuals against the estate planning attorney, in the absence of fraud or other circumstances.

In Leff v. Fulbright & Jaworski, L.L.P., 2010 NY Slip Op 08443 (App. Div. 1st Dep’t., November 18, 2010), the Court held that the decedent’s wife was not in privity with the attorneys who represented her deceased husband in connection with his estate planning and, therefore, that she could not maintain a legal malpractice proceeding against such attorneys, as the surviving spouse was never involved in the planning of the decedent’s estate and did not rely on any advice relating to that planning, notwithstanding that such attorneys also represented the surviving spouse in connection with her estate planning.

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In *Will of Seymour Schuman* (April 12, 2011) the New York County Surrogate’s Court, in a contested accounting proceeding regarding the accounting of the decedent’s surviving spouse as the executor of the decedent’s estate, where the objectants also asserted a legal malpractice claim against the attorneys who performed legal services for the executor, the Court held that there was no privity between such attorneys and such beneficiaries, and the Court therefore dismissed such claim.

On May 10, 2011 the New York State Bar Association Committee on Professional Ethics issued Opinion 865, stating that a lawyer who prepared an estate plan for a client can agree to act as counsel to the executor of the client’s estate if, before or during the representation of the executor, the lawyer does not perceive a “colorable claim” for legal malpractice arising out of the lawyer’s representation of the client in relation to doing the estate planning; and that if the lawyer does perceive such a claim, then the conflict is not consentable and the lawyer must decline or withdraw from the representation and must inform the executor of the facts giving rise to the claim.

In *Allmen v. Fox Rothschild LLP*, 2012 NY Slip Op. 30244(U) (NY Co. Sup. Ct., January 31, 2012), in which the executor of a decedent’s estate sued the law firm that drafted the decedent’s will for legal malpractice, the Court held that the “continuous representation” doctrine does not apply after the decedent’s death to toll the applicable statute of limitations.

J. No Fault Divorce

On August 15, 2010 New York enacted no-fault divorce (Domestic Relations Law Section 170.7), permitting a divorce where either spouse states under oath that the marital relationship has irretrievably broken down for at least six months, and all financial, child custody and visitation issues have been resolved. The statute is effective on October 14, 2010.

In *A.C. v. D.R.*, No. 10-202115, and *D.R.C. v. A.C.*, No. 10-203033 (April 2011), the New York State Supreme Court held that a spouse’s self-serving declaration about his or her state of mind, even though not based on any objective fact, is sufficient to meet the requirements of the no-fault divorce law that the relationship has irretrievably broken for the period of at least six months.

K. In Terrorem Clauses

In *Matter of Egerer*, 30 Misc.3d 1229A (2006), the Suffolk County Surrogate’s Court held that an in terrorem clause, to the extent that it could be interpreted as preventing the estate’s beneficiaries from objecting to the fiduciaries’ conduct, is void as against public policy.

In *Hallman v. Bosswick*, N.Y.L.J. March 11, 2009, p. 32, col. 5, the New York County Surrogate's Court construed a broadly worded in terrorem clause and held that a proceeding to set aside the fiduciary nominations in the decedent's Will of certain of the co-executors and co-trustees, based upon their alleged actions and inactions prior to the decedent's death, would trigger the in terrorem clause, but that neither a petition to reduce the executor's commissions of one of the co-executors by one-half for his alleged failure to comply with the SCPA 2307-a, nor a petition to revoke the letters testamentary and the letters of trusteeship issued to two of the co-executors, based on their alleged actions and omissions after the
decedent's death, would trigger that clause. The New York Supreme Court, Appellate Division, First Department, 72 A.D.3d 616 (2010), affirmed the Surrogate Court's determination that a proceeding to set aside the fiduciary nominations based upon alleged actions and inactions prior to the decedent's death would trigger the in terrorem clause.

In Matter of Baugher, N.Y.L.J. July 2, 2010, p. 25, c. 1 (Surr. Ct., Nassau Co.), where the decedent's will had not yet been admitted to probate, the Court granted a motion permitting the decedent's children, and the children of a predeceased child of the decedent, to depose the person nominated as the successor executor in the propounded will, and to depose the attorney draftsman of a prior instrument, prior to filing objections, the Court further held that it could not determine prior to the admission of the will to probate whether conducting those depositions violated the in terrorem clause in the will, and the Court warned such children and grandchildren that conducting such depositions might trigger the in terrorem clause.

EPTL Section 3-3.5(b)(3)(D), which provides that preliminary examination under SCPA Section 1404 of the witnesses to a Will, the person who prepared the Will, the nominated executors and the proponents in a probate proceeding, will not trigger an in terrorem clause in a Will, has been amended, effective as of August 3, 2011, to expand such classes of persons to include, upon the application to the Court based upon special circumstances, any person whose examination the Court determines may provide information with respect to the validity of the Will that is of substantial importance or relevance to a decision to file objections to the Will.

In In re Estate of Spiegel, N.Y.L.J. Oct. 31, 2011, p. 30 (Surr. Ct., Nassau Co.), where the Court allowed the pre-action deposition of the attorney-draftsman of the decedents’ wills for use in a construction proceeding regarding the instruments, the Court held that the deposition would not trigger the in terrorem clause in the wills, due to the safe harbor provisions of EPTL Section 3-3.5, as the deposition was relevant discovery for the construction proceeding.

In Estate of Weintraub, N.Y.L.J., July 19, 2013 (Surr. Ct., Nassau Co.), the Court held that an in terrorem clause would not be violated by a deposition of an associate of the attorney who drafted and supervised the execution of the decedent’s will as part of a SCPA Section 1404 examination, as special circumstances permitting such deposition without triggering the in terrorem clause existed where the decedent was diagnosed with Alzheimer’s disease before the execution of the will, and the hospital records indicated that the decedent was “confused” and “disoriented”.

L. Other Significant Legislation

1. Significant 2008 Legislation

(a) Small Estates

SCPA Section 1301 has been amended, effective January 1, 2009, to increase from $20,000 to $30,000 the maximum value of a small estate which can be settled without the formality of court administration.
(b) **Revocation of Incompetent’s Will**

Mental Hygiene Law Section 81.29(d) has been amended, effective July 7, 2008, to provide that an Article 81 proceeding for the appointment of a guardian for an incapacitated person shall not invalidate or revoke a will or codicil of that person during his or her lifetime.

(c) **Revocatory Effect of Divorce**

EPTL Section 5-1.4 dealing with the revocatory effect of a divorce was repealed and a new EPTL Section 5-1.4 was enacted in its place. Pursuant to the new statute, except as provided as by the express terms of a governing instrument, a divorce (including a judicial separation), or an annulment of a marriage, revokes any revocable disposition or appointment of property made by a divorced individual to or for the benefit of the former spouse, including a disposition or appointment by will, by a transfer on death security registration, by a beneficiary designation in a life insurance policy or in a pension or retirement benefits plan, or by a revocable trust, including a bank account in trust form. The new statute also provides that a divorce revokes a provision conferring a power of appointment or a power of disposition on the former spouse and the nomination of the former spouse to serve in any fiduciary or representative capacity, including as a personal representative, executor, trustee, conservator, guardian, agent or attorney-in-fact. This new statute is effective July 7, 2008 and applies if the divorce or death occurs after that date.

2. **Significant 2009 Legislation**

   (a) **Loss of Health Insurance Coverage in Divorce**

Sections 236(B)(5) and 236(B)(6) of the Domestic Relations Law have been amended, effective September 21, 2009, to include the loss of health insurance coverage and the cost of obtaining such coverage as a factor to be considered by the New York Courts in divorce proceedings when determining the equitable distribution of marital property and the award of maintenance.

   (b) **Simultaneous Deaths**

EPTL Section 2-1.6 has been repealed and replaced by a new Section 2-1.6, which provides that an individual who does not survive a decedent or an event by 120 hours is deemed to have predeceased the decedent, or died before the event, unless the governing instrument expressly provides otherwise.

   (c) **Sale of Life Insurance**

On November 19, 2009 New York enacted the Life Settlements Act establishing a comprehensive statutory framework to regulate the sale of life insurance policies by their owners. The Act requires the licensing of life settlement brokers, contains privacy protections for individual policyholders, requires disclosure to a policyholder of a full and complete description to all offers, counter-offers, acceptances and rejections related to a proposed life settlement, establishes standards of conduct which impose a fiduciary duty on a life settlement broker to the policyholder, and contains criminal provisions regarding fraudulent acts in
violation of the insurance law. The Act also prohibits life settlement providers and life settlement brokers from facilitating the issuance of a policy for the intended benefit of a person who has no insurable interest in the insured’s life. The legislative history of the Act makes clear that, in the case of a sale of a life insurance policy, where there was a prior plan or arrangement for the individual to purchase the policy for the purpose of selling it to a third party, it may be determined that there was no insurable interest at the inception of the policy. In addition, the Act prohibits a person from entering into a valid life settlement contract for two years after the issuance of a policy, with certain exceptions.

3. Significant 2010 Legislation

(a) Formula Bequests

On August 13, 2010 New York amended the EPTL by adding a new Section 2-1.13 to provide that a formula in a dispositive instrument executed prior to January 1, 2010 containing a bequest of the maximum amount that can pass free of federal estate taxes shall be construed under the Code as in effect for decedents dying on December 31, 2009, if the decedent dies after December 31, 2009, the decedent dies at a time when there is no federal estate tax in effect, and the decedent is survived by a spouse. The Section also provides that the federal estate tax is deemed to be in effect if it is legally restored retroactively to the date of the decedent’s death. In addition, the Section provides that a formula in a dispositive instrument executed prior to January 1, 2010 providing for a bequest of the decedent’s unused GST tax exemption shall be construed under the Code as in effect on December 31, 2009, if the decedent dies after that date and at a time when there is no federal GST tax in effect. The Section states that the federal GST tax is deemed to be in effect if it is legally restored to the date of the decedent’s death.

(b) Life Sustaining Measures

On March 16, 2010 New York enacted the Family Health Care Decisions Act ("FHCDA"), which expands the authority of family members and others close to a patient to withdraw or withhold life-sustaining measures in the absence of a health care proxy or living will. If there is no health care proxy, the FHCDA sets a priority list of individuals who can make such decisions for an incapacitated patient, as follows: a guardian authorized to make health care decisions pursuant to Article 81 of the Mental Hygiene Law, the spouse (if not legally separated) or the domestic partner, a child 18 years of age or older, a parent, a sibling 18 years of age or older or a close friend. Under the FHCDA, the patient is presumed capable to make health care decisions unless determined otherwise by procedures established in the FHCDA. The Act is effective June 1, 2010.

(c) Renunciations

On March 30, 2010 EPTL Section 2-1.11 was amended to provide that certain renunciations shall not necessarily constitute a qualified disclaimer for federal estate tax and gift tax purpose, unless the renunciation also satisfies the federal gift tax and estate tax requirements for a qualified disclaimer. The law also allows a beneficiary to renounce his or her survivorship interest in joint property or property held as a tenancy by the entirety to the extent that he or she
could make a "qualified disclaimer" under Code Section 2518. The law is effective on January 1, 2011.

(d) **Proof of Paternity**

On April 28, 2010 EPTL Section 4-1.2(a)(2)(D) was repealed and EPTL Section 4-1.2(a)(2)(C) was amended, to add that proof of paternity by clear and convincing evidence may include evidence derived from a genetic marker test, or evidence that the father openly and notoriously acknowledged the child as his own. The amendment is effective on April 28, 2010, applying to the estates of decedents dying on or after that date.

(e) **Pet Trusts**

EPTL Section 7-8.1 was amended to eliminate the 21 year limitation on the length of trusts for the benefit of pets. The amendment is effective on May 5, 2010.

In Matter of Rosenthal, File No. 2007/2968/A (Surr. Ct. N.Y. Cty., April 15, 2011), the New York County Surrogate's Court denied a motion filed by a number of animal welfare groups to intervene in a terminated proceeding involving the interpretation of a charitable trust established under a lifetime trust by Leona Helmsley. The movants sought a ruling that the trust be required to give “special emphasis” to dog welfare charities and claimed standing as potential beneficiaries with a “special interest” in the trust funds. The Court rejected the groups' theory of standing noting that “in more than 25 years since the Alco (referring to Alco Gravure Inc. v. Knapp Foundation, 64 N.Y.2d 458) decision, no New York court has found standing under the 'special interest' exception.”

(f) **Uniform Prudent Management of Institutional Funds Act**

On September 17, 2010 New York enacted its version of the Uniform Prudent Management of Institutional Funds Act. In general, the Act imposes standards regarding the investment of institutional funds, standards regarding the appropriation of endowment funds and standards for modifying restrictions imposed by the donor on the investment and use of institutional funds. Specifically, the Act, among other things, authorizes a donor of a restricted charitable transfer to designate an individual or an entity in the document making the transfer who or which will have the authority to enforce the terms of the transfer. Thus, absent such a designation, the transferor’s executors, heirs, successors, assigns, transferees or distributees will not have any such authority. The Act also requires that directors and officers make “a reasonable effort to verify facts relevant to the management and investment” of a fund in which the institutional fund invests its assets and creates a rebuttable presumption of imprudence for appropriations made from an endowment that is greater than 7% of the endowment’s market value, calculated over a five year period. In addition the Act creates a good faith prudent person care standard for the delegation of management or investment functions to an independent investment advisor or manager. Moreover, the Act provides that an investment delegee submits to the jurisdiction of the State of New York and that its contract can be terminated at any time without penalty on 60 days’ notice.
(g) **Family Exemption**

On August 30, 2010 EPTL Section 5-3.1 was amended, effective as of January 1, 2011, to modify the statute that enumerates certain items of a decedent’s property that vest in a surviving spouse (or in children under the age of 21 years, if there is no surviving spouse) and that are exempt from the claims of creditors. The amendment increases the monetary value of such property from $56,000 to $92,500; increases the amount of cash that the spouse or children are entitled to retain from $15,000 to $25,000; increases the exempt value of the automobile that the spouse or children are entitled to retain from $15,000 to $25,000; increases the value of furniture, clothing, computers and other household items that the spouse or children are entitled to retain from $10,000 to $20,000; increases the value of books, family pictures, DVDs, CDs, discs and software that the spouse or children are entitled to retain from $1,000 to $2,500; increases the value of farm animals and tractors that the spouse or children are entitled to retain from $15,000 to $20,000; and includes jewelry (unless specifically bequeathed in the decedent’s will) as household items.

4. **Significant 2011 Legislation**

(a) **Decanting**

On August 7, 2011 EPTL Section 10-6.6 was amended, effective immediately and applicable to all trusts created before and after the statute’s effective date, to broaden New York’s “decanting” statute. Under the new statute, if a trustee has unlimited discretion to distribute principal, the current and remainder beneficiaries of the new trust to which the appointed trust is decanted may be any one or more of the beneficiaries of the invaded trust, to the exclusion of other beneficiaries. In addition, a trustee may grant a discretionary power of appointment to any one or more of the beneficiaries of the appointed trust if such beneficiary could receive principal distributions outright from the invaded trust. If a trustee’s discretion is not unlimited, the trustee may appoint the principal of the invaded trust to a new trust only if the current and remainder beneficiaries of the appointed trust are the same as in the invaded trust. However, a trustee’s power to distribute cannot be used to limit, reduce or modify any beneficiary’s current right to receive mandatory distributions of income or principal, unless the newly created trust is a supplemental needs trust. Further, a trustee is not entitled to receive paying commissions for exercising the “decanting” power, and the “decanting” power cannot be exercised in a manner that violates the Rule Against Perpetuities.

(b) **Formula Bequests**

On September 23, 2011 New York amended EPTL Section 2-1.13 to provide that a formula bequest in a testamentary instrument of a person who died in 2010 is deemed to refer to the federal estate tax law as it applied with respect to persons dying in 2010, regardless of whether the decedent’s estate is subject to the federal estate tax regime or elects out of the federal estate tax regime and into the modified carryover basis regime; that its formula construction provisions also apply to all generation-skipping formula transfers; that its formula construction provisions apply to wills, trusts and beneficiary designations; and that the time to bring a construction proceeding regarding such matters is extended until the later of 24 months after the decedent’s death or six months after the date of enactment of such legislation.
5. Proposed Significant 2012 Legislation

(a) Uniform Trust Code

The New York Advisory Committee to the Legislature on the EPTL and the SCPA is issuing its Sixth Report, recommending that the Legislature consider enactment of a New York Uniform Trust Code, which would be incorporated within Article 7 of the EPTL as a new Article 7A. The new Article, which would be a default statute, would address jurisdictional and venue issues; virtual representation, trust validity, modification, reformation, termination, cy pres, decanting and combining trusts; under what circumstances lifetime trusts are irrevocable; the statute of limitations regarding a claim concerning the validity of an irrevocable trust; duties and powers of trustees, including the duty to maintain adequate records and keep trust property separate; trustees’ liability and computation of damages; and issues of exoneration of a trustee from liability.

(b) EPTL and SCPA Amendments to Conform to the Marriage Equality Act

On April 30, 2012, the New York State Bar Association Trusts and Estates Law Section, in response to the enactment of the Marriage Equality Act, issued a memorandum supporting amendments to Articles 4 and 6 of the EPTL and Articles 10, 13, and 17 of the SCPA, to make such statutes neutral as between different-sex and same-sex marriages.

(c) Trust Advisors and Protectors

On May 1, 2012 a bill (S7183-2011) was introduced in the New York legislature providing that if the governing instrument states that a fiduciary is to follow the direction of an advisor, and the fiduciary acts in accordance with the direction, then except in the case of willful misconduct, the fiduciary shall not be liable for any resulting loss. The bill further provides that if a fiduciary is required to follow the directions of an advisor with respect to investment decisions, distribution decisions, or other decisions, the fiduciary has no duty to monitor the conduct of the advisor, to provide advice to the advisor or to communicate with or warn any beneficiary or third party if the fiduciary would have exercised the fiduciary’s own discretion in a different manner. Persons given authority to direct fiduciaries are considered to be advisors and fiduciaries, unless the governing instrument otherwise provides. For this purpose, advisors are defined to include “protectors” whose powers may include the power to remove and appoint trustees, amend the governing instrument and modify a beneficiary’s power of appointment.

6. Significant 2013 Legislation

The New York Not-For-Profit Corporation Law was amended, generally effective July 1, 2014. The legislation made the following significant changes to New York’s Not-For-Profit Corporation Law:

- The replacement of four types of not-for-profit corporations with two: charitable corporations and non-charitable corporations.
• Changes regarding the procedures for amending a Certificate of Incorporation including the approval of the Attorney General of New York or of the Court to an amendment that changes or eliminate the need for a charitable purpose or power.

• A majority vote of the board or a board committee, rather than a two-thirds vote of the entire board, can approve non-substantial real estate transactions.

• Either the Attorney General of New York or a Court may approve a merger or consolidation where the existing or resulting not-for-profit corporation is charitable.

• A corporation with annual income in excess of $500,000 on or after July 1, 2014, in excess of $750,000 on or after July 1, 2017, and in excess of $1,000,000 on or after July 1, 2021, is required to obtain an independent CPA audit.

• All not-for-profit corporations must adopt a written conflict of interest policy.

• All not-for-profit corporations with 20 or more employees and annual revenue exceeding $1,000,000 must adopt a whistleblower policy.

7. Proposed Significant 2013 Legislation

(a) Interest on Bequests

The Trust and Estate Law Section of the New York State Bar Association has proposed amending EPTL Section 11-1.5, which provides for interest on legacies, to provide that such interest would be mandatory and would be payable from the residuary estate, accruing from seven months after preliminary or permanent letters are issued, that such interest paid in any calendar year would be set on the first business day of the year at the federal funds rate less 1%, but no lower than 0.5%, and that such interest would be treated as accounting income so the residuary estate could deduct it for income tax purposes; and

(b) “Small Estates”

The Trust and Estate Law Section of the New York State Bar Association has proposed amending the SCPA Section 1301(1) definition of a “small estate” to read “an estate worth $30,000 or less, exclusive of property required to be set off under EPTL 5-3.1(a)” which provides that a surviving spouse, or if there is none, minor children, are entitled to set off from the estate certain “exempt” property (which includes an automobile, domestic and farm animals, a computer, and household furnishings).

(c) Power to Adjust and Trustee’s Commissions

The Trust and Estate Law Section of the New York State Bar Association has proposed amending EPTL Section 11-2.3(b)(5), regarding the power to adjust, to clarify that any adjustment constitutes a re-characterization of the transferred assets for purposes of calculating trustee commissions.
M. Other Case Law Developments

1. Fiduciary Investments-Diversification and Self-Dealing

In Matter of the Accounting of Tydings, N.Y.L.J., July 7, 2011, p. 26 (Surr. Ct., Bronx Co.), where the grantor of an inter vivos trust transferred to the trust an interest-free loan previously made to the person who would be the trustee of the trust, where the trust authorized the trustee to retain an original investment for any length of time without liability, and where the trust authorized the trustee to act on behalf of the trust with regard to any transaction in which the trustee had an interest and exonerated the trustee from liability for any loss to the trust absent bad faith or fraud, the Court held that the trustee would not be liable for retaining such interest-free loan, but that the trustee would be liable for interest-free loans subsequently made by the trust to the trustee. The Court surcharged the trustee at the rate of 5% per year for the lost income on such loans made by the trust to the trustee. The Court also held that the exoneration clause in the trust did not bar the objectant from recovering lost profits attributable to the trustee’s use of trust funds, without consideration, to benefit an entity in which the trustee was personally interested. Further, the Court concluded that the trustee had exhibited indifference to the trustee’s duties and, therefore, sufficient malfeasance to warrant a denial of trustee’s commissions. Moreover, the Court held that the trustee and the objectant beneficiary should each, individually, pay such person’s own legal fees and expenses.

Although not a New York case, in In re Wachovia Corp. ERISA Litigation, W.D.N.C., No. 3:09-cv-00262-MR (October 24, 2011), the Court approved a settlement of $12,350,000, plus attorney’s fees, in an action by Code Section 401(k) plan participants against Wachovia Corp., where Wachovia allegedly breached its fiduciary duties by permitting substantial investment of the plan assets in Wachovia’s common stock when it was not prudent to do so.

In Matter of Knox, 2010 N.Y. Misc. LEXIS 6110 (Surr. Ct., Erie Co.), where the trust was initially funded with stock of Woolworth and Marine Midland Bank, N.A., the Court held that the trustee was liable for its failure to diversify the trust’s investments and that the proper method of calculating damages for the negligent retention of trust assets is the value of the lost capital to the trust, which is the value of the stock on the date on which it should have been sold, less the actually sale proceeds of the stock or, if the stock is still retained, less the value of the stock at the time of the accounting. However, the Appellate Division sub nom. Matter of HSBC Bank, USA, N.A., 98 A.D.3d 300 (4th Dept., 2012), reversed the Surrogate’s Court, holding that the trustee erred only in retaining the Woolworth stock beyond the date of the company’s final dividend payment, that the trustee had not negligently failed to diversify, that the lower court wrongly applied at 9% interest rate to damages prior to June 1981 when the statutory rate was 6%, and that there was no basis to award fees and expenses to the guardian and the attorney for the adult objectants, and the Court remanded the case for a re-accounting and a calculation of damages.

Although not a New York case, Merrill Lynch Trust Company, FSB v. Mary C. Campbell, et al., (Del Ch. Case # C.A. 1803-VCN 9/2/2009), the Delaware Chancery Court ruled that where a trust instrument placed sole discretion for investment decisions on the trustee, the
trustee’s exercise of discretion is not subject to the control of the court except where necessary to prevent an abuse of discretion.

In In re Carpenter, File No. 159626 (Surr. Ct. Nassau Co. 2009), the corporate co-trustee of a testamentary trust requested the Court’s advice and direction as to the need to diversify the trust’s assets. The trust directed the trustees to distribute the trust’s income to the individual co-trustee/income beneficiary for his life, required that the trustees act unanimously and contained no provisions authorizing the retention of specific assets. The Court directed that the trust assets be diversified, unless all the interested parties to the trust agree in writing to waive the co-trustees’ obligation to diversify, assent in writing and ratify the past and future retention of trust assets until the trustees agree to their disposition, and indemnify and absolve the corporate co-trustee from any and all liability for retaining the trust assets.

In Matter of the Final Accounting of Michael Duffy, 25 Misc.3d 901 (2009), the Monroe County Surrogate’s Court held that the executor’s failure to convert the estate’s stock portfolio to cash immediately after the September 11, 2001 terrorist attacks was not negligent and therefore did not violate EPTL Section 11-2.3, even though the stocks lost 40% in value between the time the executor was appointed and the date when the stock was transferred to the estate’s beneficiary, where the executor demonstrated that the decedent wanted to protect the long-term financial needs of the beneficiary by maintaining a diversified investment portfolio.

In Matter of Bloomingdale, 48 A.D.3d 559, 853 N.Y.S.2d 92 (2d Dept. 2008), the Appellate Division modified a decision of the Surrogate’s Court, Westchester County, which denied the petitioner's motion for summary judgment dismissing certain objections again him insofar as they related to the failure to diversify investments. The record revealed that the act complained of, in part, occurred during a period in time when the petitioner served as co-trustee with the two remaindermen (the objectants) of the trust. The Court held that "[w]here a fiduciary has the means to know of a cofiduciary's act, and has assented or acquiesced in them, the fiduciary is bound by those acts and jointly liable for them." Accordingly, as to the period of time during which the remaindermen were co-trustees with the petitioner, their objection was dismissed.

In Matter of Manufacturers and Traders Trust Co., N.Y.L.J. June 10, 2008, p. 25 (Onondaga Co. Surr. Wells), the Court held that the objectants failed to satisfy their burden of proof that any purchase or sale of any of the trust’s investments was unreasonable or outside the scope of the powers granted by the trust instrument to the trustee, where the trust instrument gave the trustee broad investment powers.

Although not a New York case, in Nelson v. First National Bank and Trust Co. of Williston, 543 F.3d 432 (October 1, 2008), the Court of Appeals for the 8th Circuit held that the trustee did not breach its fiduciary duty by failing to liquidate the trust’s stock within two months after the settlor’s death, where 90% of the trust’s marketable assets consisted of the stock of a single company and the terms of the trust expressly provided for retention of that stock despite any resulting lack of diversification.

In the case of In re Hyde, 845 N.Y.S. 2d 833 (N.Y. App. Div. 2007), the Court affirmed the dismissal of the beneficiaries objections to the trustee’s account that the trustee’s
lack of diversification violated the prudent investor rule. The Court found that the trustee’s retention of the common stock of a closely held business did not violate New York’s version of the prudent investor rule because the stock was particularly unmarketable given the capital structure of the corporation, the high dividend payout served the beneficiaries’ needs, the settlors used the trust as a device for insuring that ownership of the corporation remained in the family and the corporate co-trustee regularly explored selling the stock and kept well informed of the corporation’s financial situation.

In Estate of Charles Dumont, (Surrogate’s Court of Monroe County, New York, July 13, 2004), the Court held that the trustee of a testamentary trust violated its fiduciary duty to the trust and was liable to the trust, where the trust consisted overwhelmingly of the stock of one company, where the will expressly exonerated the trustee from losses caused by failure to diversify the trust’s assets and in fact barred the trustee from selling trust assets solely for the purpose of diversification, but where the trustee was authorized to sell the stock for a “compelling reason”, and where the trustee did not sell the stock, which declined significantly in value. In addition, the Court ruled that the trustee must return to the trust its commissions received since the stock declined in value. However, on February 3, 2006 the Appellate Division, Fourth Department (809 N.Y.S. 2d 360), reversed the Monroe County Surrogate’s Court judgment, holding that the Surrogate’s decision was impermissibly based on nothing more than hindsight and that there was no evidence that the trustee acted imprudently in failing to sell the stock in question. On April 28, 2006 the New York Court of Appeals denied a petition for appeal of the Appellate Division’s decision.

In two cases, the Appellate Division, Third Department decided matters relating to trustee’s investments. See N.Y.L.J. August 11, 2000. In In re Estate of Saxton, 274 A.D.2d 110 (2000) aff'g 179 Misc. 2d 681 (Broome Co. Surr. Thomas 1998), the Court held that the bank - trustee was liable for its failure to diversify investments held in the trust. The testamentary trust was established in 1958 and funded entirely with IBM stock worth $569,853. In 1959, the beneficiaries signed an “Investment Direction Agreement” which attempted to immunize the bank from liability. In 1986, the stock was valued at more than $7 million. The beneficiaries urged diversification but the trust officer resisted it. When the trust ended in 1993, the stock was worth only $2.9 million. The critical issue in the case was whether the trustee was shielded by the fact that the beneficiaries signed the “Investment Direction Agreement” stating that the investment would consist almost entirely of IBM stock, and that the bank would be held harmless in the event of a decrease in value. The Court unanimously held that the bank could not rely on the waiver to insulate it from liability where the waiver was not the result of an informed consent by the beneficiaries. The Court also held that in assessing damages the capital gains taxes that would have been paid had the stock been sold at the appropriate time must be deducted from the award and interest must be frontloaded and awarded based on the value of the trust had the stock been sold when it should have been sold. Surrogate Thomas had assessed a surcharge of $6,681,038 plus interest and return of all commissions; the surcharge being based on the difference between the amount that would have been in the trust if 90% of the IBM stock had been sold on September 10, 1987 (the date the market crashed) and the amount that was in the trust when the stock was actually distributed in July, 1993, minus dividends and other income. The Appellate Court ordered a recalculation of damages, holding that the damages should be reduced by the federal tax that the beneficiary would have had to pay if the stock had been sold and that interest should have been based on the full value of the stock at the time when
it should have been sold less the value at the time of distribution and dividends based on the methodology established in In re Janes, 90 N.Y. 2d 41 (1997). Finally, the Court held that absent a showing of self-dealing or fraud, there was no basis for a denial of commissions since the beneficiary was simply entitled to be put in the position she would have occupied if no breach of duty occurred.

In a second case, In re Estate of Rowe, 274 A.D.2d 87 (3d Dep’t Aug. 10, 2000) aff’g N.Y. L.J. Mar. 16, 1998 at 25 (Otsego Co. Surr. Ct. Judicial Hearing Officer Farley), the Third Department upheld the removal of a bank trustee for its negligent conduct in failing to diversify a charitable trust funded solely by 30,000 shares of IBM stock. The trust was funded with 30,000 shares of IBM, which was trading at about $117 per share when the trust was funded in September 1989. The charitable lead interest of the trust was payable for 15 years. Although the trustee/bank had sold approximately 8,000 shares of stock during the period of account, the record revealed that by the close of the accounting period it held 19,398 shares of stock valued at $74 per share. The market value of the trust assets over the course of the accounting period had dropped by $1.7 million. The Surrogate determined that from September 1989 to the end date of the accounting period, the trustee/bank was negligent, that it had violated its own policy manual and that, in January 1990, it should have diversified most of the trust’s holdings in IBM. The Third Department affirmed the removal, denial of commissions and surcharge, finding that the Surrogate’s Court properly followed the methodology established in In re Janes, 90 N.Y. 2d 41 (1997), and did not erroneously compute damages by adding compound interest to the value of the stock at the time it was sold or, if unsold, at the time of the accounting, rather than computing interest on the difference between the two values. Among the factors which the Appellate Division relied upon was the failure of the trustee/bank to adhere to its own internal protocol or to conduct more than routine reviews of the IBM stock.

The Southern District of New York, applying New York law, in Williams v. J.P. Morgan & Co., Inc., 199 F.2d 189 (S.D.N.Y. 2002), was faced with a situation where the remainderman of the trust and the trustee-bank respectively moved for summary judgment on the issue of the calculation of damages. The Bank had liquidated the trust’s stock portfolio in 1971 and reinvested the proceeds in cash and tax-exempt bonds, with the ratification of the income beneficiary and not the remaindermen, nor did it alter the 1970 trust investments at any time thereafter. Plaintiff did not claim that the trustee engaged in any fraud or self-dealing or misconduct apart from the negligent and imprudent failure to invest and/or diversify the trust assets. The Court held that under New York law as construed by the state Court of Appeals, the measure of damages for negligent and imprudent failure to invest and diversify is the value of the capital lost. See, Matter of Janes, 90 NYS2d 41. The methodology established by the Court of Appeals for establishing lost capital requires a determination of the value of the asset on the date on which it should have been sold and, then, subtracting either (a) the value of the asset at the time of the accounting or (b) the value of the asset at the time of the Court’s decision. The Court has the discretion to award interest, but must subtract therefrom any dividends or income attributable to the asset during the time the asset was retained. Finding that it was bound to apply the rule of law as enunciated by the highest court of the state, the Court concluded that the methodology established by Janes governed the calculation of damages should plaintiff prevail on liability. The Court rejected plaintiff’s arguments that a distinction should be drawn between investments in securities, as in Janes, as compared to investments in tax-exempt bonds, holding that it was a distinction without a difference, because both claims concerned inattentiveness and
inaction on the part of the trustee. Further, the Court rejected plaintiff’s application for lost
profits, concluding that, an award of appreciation damages or lost profits was inapplicable unless
the fiduciary’s conduct consisted of deliberate self-dealing and faithless transfers of trust
property.

In a non-New York case, the Court of Appeals for the First Appellate District of
reviewing the Trial Court’s decision in an action seeking to surcharge the trustee of a charitable
remainder unitrust for failing to properly diversify the trust’s assets, where the trust was funded
entirely with the stock of one company and the trust lost one-half of its value during its first year.
The Court of Appeals affirmed the Trial Court’s determination that the Ohio Attorney General
was a necessary party to the action, that authority in the trust document to retain assets
transferred by the grantor to the trust did not abrogate the trustee’s duty to diversify the trust
assets and that the trustee should be surcharged for the loss sustained by the trust.

2. Qualification and Removal of Fiduciaries

In the recent case of In re Huntington, 16 Misc. 3d 914, 839 N.Y.S.2d 909 (Sur.
Ct., Onondaga Co. 2007), a testator nominated a professional corporation as executor. The sole
shareholder of the corporation argued that it could be defined as a natural person and therefore
was eligible under SCPA 707. The Surrogate rejected the argument stating that the shareholder
“has elected to shield himself from individual liability by operating as a professional corporation
rather than as an individual” and was bound by that choice. Letters were ordered issued to the
successor nominated executor.

In Matter of Stewart, N.Y.L.J. December 23, 2011 (Surr. Ct. N.Y. Co.), the Court
accepted the Referee’s findings that the trustee of a trust was unfit to continue to serve, due to
her documented hostility to her co-trustee and to the trust’s beneficiaries which was of such
severity that it interfered with the administration of the trust, and the Court confirmed the
Referee’s report that the trustee should be removed.

In In re Marsloe, 88 A.D.3d 1003 (2d Dept. 2011), where the nominated executor
of the decedent’s will was one of two witnesses to the will, the Court determined that the
executorial appointment was not a beneficial disposition or an appointment of property for
purposes of EPTL Section 3-3.2, which voids a disposition to a beneficiary who serves as a
witness if there are not two other available witnesses who are not beneficiaries, and the Court
held that the nominated executor therefore could serve as such executor.

3. Right of Election

In In Re Berk, 20 Misc. 3d 691, 864 NYS 2d 710 (Surr. Ct., Kings Co. 2008), the
Court held that a decedent’s surviving spouse could claim her elective share of the decedent’s
estate under EPTL Section 5-1.1-A, even if the marriage had been voidable due to the decedent’s
alleged lack of competency to marry, or due to the marriage resulting from fraud, duress or force.

In In Re Oestrich, 21 Misc. 3d 499, 863 NYS 2d 531 (Surr. Ct., Broome Co.
2008), where the decedent’s surviving spouse had filed her right of election and then petitioned
to withdraw it, and where the decedent’s executor had distributed the residue of the estate to the
residuary beneficiaries, including the surviving spouse, the Court denied the surviving spouse’s petition to withdraw her election, since allowing the withdrawal of the election would prejudice the residuary beneficiaries, other than the surviving spouse, who would have to refund a portion of their distributions if the election was withdrawn. In addition, the Court held that the executor improperly distributed a portion of the residuary estate to the surviving spouse before the Court ruled on her request to revoke her election and surcharged the executor in the amount of the improper distribution, less any repayment by the surviving spouse.

In Campbell v. Thomas, NY Slip Op 02082 (2d Dept. 2010), the Appellate Division held that a right of election could not be exercised by the decedent’s surviving spouse, where the surviving spouse married the decedent shortly before his death when the decedent suffered from severe dementia and the marriage has been declared null and void, as such exercise would enable that spouse to profit from her own wrongdoing.

4. Jurisdiction and Charitable Trusts

In In re Fleet National Bank, 20 Misc. 3d 879, 864 NYS 2d 706 (Sup. Ct., Albany Co. 2008), the Court held that the Surrogate’s Court has jurisdiction over charitable inter vivos trusts, notwithstanding EPTL Section 8-1.1(c)(1), which appears to provide that only the Supreme Court has jurisdiction over such trusts.

5. Presumption Against Suicide

In Matter of Green v. William Penn Life Insurance Co. of N.Y., 2009 NY Slip Op. 3586 (May 9, 2009), the Court of Appeals held that the question of whether a person has committed suicide is a factual issue to be decided by a fact finder and that the Appellate Division had erred when it found, as a matter of law, that the insurer failed to rebut the presumption against suicide.

In Matter of Infante v. Dignan, 2009 NY Slip Op. 3587 (May 5, 2009), the Court of Appeals refused to allow the presumption against suicide to overrule a medical examiner’s determination that the decedent had committed suicide.

6. Forced Heirship and New York Property

In Matter of Meyer, 876 NYS 2d 7, N.Y. App. Div. (1st Dept. 2009), the Court considered whether forced heirship under French law applied to inter vivos gifts of New York property made by a person who was a French citizen, domiciled in Bermuda, who died in her New York residence and who had executed a New York will and two codicils directing that New York law should govern the testamentary disposition of her New York situs property. The Court held that inter vivos transfers of property are governed by the law of the state where the property was situated at the time of the transfer, regardless of the transferor’s domicile, even though neither the decedent’s New York will and codicils nor the EPTL governs inter vivos transfers, thereby denying the claim of the decedent’s son to such property based on forced heirship.
7. Executor’s Commissions and Trustee’s Commissions

In In re Ostrer, 23 Misc. 3d 246, 869 NYS 2d 894 (Surr. Ct., Nassau Co. 2008), the Court held that the executor of the estate was entitled to receive commissions, even though the testator’s will directed that no executor shall receive commissions, where all the beneficiaries consented to the payment of the commissions.

In Matter of Ralph P. Manny, 1992-1319/B, (Surr. Ct. Westchester Co., May 20, 2010), the Court held that the trustees of an inter vivos trust who received annual commissions from the trust, but who did not provide annual statements to the trust’s beneficiaries required by SCPA Sections 2309(4) and 2312(6), could retain the commissions they received, but would be required to pay the trust statutory interest at the rate of 9% per annum on such commissions, as they were improperly taken by the trustees.

8. Prenuptial and Postnuptial Agreements

In Galetta v. Galetta, 2013 NY Slip Op 03871, No. 94, the Court of Appeals held that the parties’ prenuptial agreement was invalid because the notarial acknowledgement failed to include the phrase “to me known and known to me” as required by the applicable statute, and because the notary’s affidavit intended to cure the error failed to describe a specific protocol that the notary repeatedly and invariably used to identify the signers of the document.

In Petracca v. Petracca, 101 AD3d 695 (2d Dept. 2012), the Court set aside a post nuptial agreement, in which the wife waived any rights to her husband’s business interests, the marital residence and her rights of inheritance, on the grounds that the husband’s assets as stated in the agreement were undervalued by at least $11,000,000 and that the terms of the agreement were manifestly unfair to the wife when the agreement was executed.

In Cioffi Petrakis v. Petrakis, 103 AD3d 766 (2d Dept. 2013), the Court sustained the wife’s claim that she was fraudulently induced to sign a prenuptial agreement and set aside the agreement, noting that the wife’s claim rested largely on the creditability of the parties and that the lower Court resolved the credibility issues in the wife’s favor, even though the agreement expressly stated that there were no oral representatives other than those set forth in the agreement, that the agreement set forth the “entire understanding” of the parties, and that neither party was relying on any promises that were not set forth in the agreement.

In Strong v. Dubin, NY Slip Op 04121 (May 13, 2010), the Appellate Division, First Department, held that a prenuptial waiver of equitable distribution rights to retirement assets is valid, distinguishing the requirement under ERISA that a waiver of survivorship rights to retirement assets can only be validly accomplished by a spouse.

9. Payment of Fiduciary's Attorney's Fees

In Matter of Hyde, 15 NY3d 179 (June 29, 2010), the New York Court of Appeals held that Surrogates have the discretion to order the payment of a fiduciary’s attorney’s fees from shares of individual estate beneficiaries, and not just from the estate as a whole. The Court stated that the factors which Surrogates may consider in exercising such discretion, none of which is determinative, include whether the beneficiaries who are objecting to the disposition of
an estate are acting solely on their own behalf, or on behalf of the common interest of the estate; the possible benefits to individual beneficiaries from the outcome of the proceeding; the extent of an individual beneficiary’s participation in the proceeding; the good faith or bad faith of the objecting beneficiary; whether or not there was justifiable doubt regarding the fiduciary’s conduct; the portions of interest in the estate held by the non-objecting beneficiaries relative to those of the objecting beneficiaries; and the future interests that could be affected by charging the counsel fees against the shares of individual beneficiaries rather than against the estate as a whole. On remand, the Court, 32 Misc.3d 661 (Surr. Ct., Warren Co. 2011), applied the Court of Appeals’ decision to the intermediate accountings of two trusts, each of which was for the benefit two families, both of whom had objected to both accountings. One of the families withdrew their objections to the accountings after discovery was completed and before trial. After trial, the Surrogate’s Court dismissed all of the objections. As to one of the two trusts, the Surrogate’s Court held that all litigation expenses that were incurred prior to the withdrawal by one of the families of its objections to the accounting should be paid from the trust, as until that point in time, both families were participating in the objections to the accounting of such trust. However, as to the litigation expenses that were incurred after the withdrawal of such objections by one of the families, the Surrogate’s Court held that one-half of such litigation expenses should be paid from the share of the trust attributable to the family that continued the litigation after discovery, and that the other half of such litigation expenses should be paid from the trust corpus. As to the other trust, the Surrogate’s Court assessed all of the litigation expenses relating to the objections to the accounting of such trust against that trust’s corpus, as only one member of one of the two families, who was the income beneficiary of the trust, had filed objections to such accounting.

In Matter of Lasdon, No. 703/93 (Surr. Ct. New York Co., November 19, 2010), where the trustee delayed the final distribution of trusts that had formally terminated, the Court held that the trustee should not be barred from having the trusts pay his attorneys’ fees and that the trustee should not be required to pay the legal expenses incurred by the objectants, even though the trustee was surcharged for losses occurring after the formal termination of the trusts. This portion of the holding in Lasdon was affirmed by the Appellate Division, First Department, 2013 NY Slip Op 02467 (2013).

In Matter of Benware, 86 A.D.3d 687 (3d Dep’t 2011), the Court held that the Surrogate properly assessed a portion of the fees paid by the estate to the executor’s attorney against the share of the residue of the estate distributable to one of the co-executors, as beneficiary, finding that such person’s behavior was responsible for some of the acrimony that characterized the administration of the estate, and the Court further held that, although the Surrogate was not bound by the retainer agreement in setting the fee, the Surrogate could not award fees in excess of the amount agreed to in a valid retainer agreement.

10. Loans vs. Gifts

In Bosswick v. Hallman, N.Y.L.J. May 6, 2009, p. 36, col. 2, a turnover proceeding seeking collection of promissory notes given by the decedent's daughter to the decedent, the New York County Surrogate’s Court granted petitioners' motion for summary judgment and denied respondent's motion for summary judgment, holding that the cash transfers from the decedent to his daughter which were evidenced by those promissory notes were loans,
rather than gifts, where the decedent's daughter, as a co-executor of the decedent's estate, included such transfers as assets of the estate on the estate's inventory filed with the Surrogate's Court, and on the federal estate tax return and the amended federal estate tax return filed by the estate with the Service, and did not include such transfers as gifts on gift tax returns of the decedent which the executors filed with the Internal Revenue Service. The New York Supreme Court, Appellate Division, First Department, 72 A.D.3d 617 (2010), affirmed the Surrogate Court's decision.

11. Health Care Proxies

In Stein v. County of Nassau, 642 F.Supp.2d 135 (E.D.N.Y. July 23, 2009), the Court held that a health care proxy signed pursuant to New York Public Health Law Section 2980 is valid in all locations, not merely in hospital-like settings, and that the health care agent must consult with one of the professionals specified in the proxy prior to being able to make a medical decision on behalf of the principal.

12. Statute of Limitations

In Williamson v. PricewaterhouseCoopers LLP, 9 N.Y.3d 1 (2007), the Court held that the “continuous representation” doctrine, which if applicable would toll the statute of limitations for accounting malpractice claims until the accountant-client relationship terminated, does not apply where an audit client entered into annual engagements with the accounting firm to provide separate and discrete audit services for each audit year.

13. Rule Against Perpetuities

In Bleecker Street Tenants Corp. v. Bleecker Jones LLC, 16 N.Y.3d 272 (2011), the Court held that the Rule against Perpetuities in EPTL Section 9-1.1(b) does not apply to options to renew a lease.

In TDNI Properties LLC v. Saratoga Glen Builders, LLC, 80 A.D.3d 852 (3d Dept. 2011), the Court held that options granted by a landowner to a builder to purchase lots in a subdivision are subject to the Rule against Perpetuities.

14. Surcharge Computations

In Matter of Lasdon, 2011 N.Y. Misc. LEXIS 4433 (Surr. Ct., N.Y. Co., August 22, 2011), where a trustee failed to timely distribute the trust assets to the remainder beneficiaries and the value of the trust declined between the time when such assets should have been distributed and when they were actually distributed, the Court, in computing the amount of the surcharge against the trustee, declined to impute a gains tax as a factor in the surcharge and declined to award 9% interest on the surcharge, instead awarding 6% interest, compounded annually, on the surcharge. In a subsequent opinion, N.Y.L.J. June 18, 2012, the Court held that interest should be imposed not on the lost capital, but instead should be imposed on the full value of the assets at that time they should have been sold, and then deducted the value of such assets when they were distributed to the beneficiaries, as well as the dividends and other income attributable to the improper retention by the trustee of such assets. In addition, the Court held that interest should be imposed to the date of the Court’s decision, on August 22, 2011, rather
than to the earlier date on which the trustee distributed the assets to the beneficiaries. The Appellate Division, First Department, 2013 NY Slip Op 02467 (2013), reversed the Surrogate Court’s imposition of a surcharge, stating that the petitioners did not demonstrate that the measure of damages is the difference in the value of the stock on the date such stock should have been distributed and the date such stock was actually distributed.

15. Exoneration of Fiduciaries

In JPMorgan Chase Bank v. Loutit, N.Y.L.J. February 21, 2013, involving trusts containing a choice of law provision requiring the application of Massachusetts law, the Supreme Court, Nassau County, held that Massachusetts law would apply, rather than New York law, that the exculpatory provisions in the trusts were valid under Massachusetts law, even though they would be invalid under New York law, and that the language of the guidelines for the trusts exonerate the trustee from any claim that the trustee violated such guideline terms by failing to sell a large concentration of stock sufficiently early in time.

In Matter of HSBC Bank, USA, N.A., 2012 NY Slip Op 4954 (App. Div. 4th Dept., June 19, 2012), where an inter vivos trust authorized the trustee to seek and rely without liability on the advice of “counsel”, the Court held that such provision was not the type of absolute exoneration from liability that is prohibited by Section 11-1.7 of the EPTL, which voids as contrary to public policy any attempt at exoneration from liability of an executor or a testamentary trustee for the failure to exercise reasonable care, diligence and prudence.

16. Slayer Inheritance

In Matter of Gleason, 36 Misc.3d 486 (Sur. Ct., Suffolk Co. 2012), where a husband had pleaded guilty to first-degree manslaughter for causing the death of his mother-in-law, the slayer’s wife was the sole beneficiary of her mother’s will, the slayer’s wife committed suicide 13 months after her mother’s death, and the slayer was the sole distributee of his wife’s estate, the Court held the slayer was disqualified from inheriting his wife’s estate, as her assets have been inherited by her from the victim.

17. Delaware Trusts

In In Re Ethel F. Peierls Charitable Lead Unitrust, C.M. No. 16811-N-VCL (2012), In Re The Peierls Family Inter Vivos Trusts, consolidated C.M. No. 16812-N-VCL (2012) and In Re the Peierls Family Testamentary Trusts, consolidated C.M. No. 16810-N-VCL (2012), the Delaware Court of Chancery refused to approve the resignations of individual trustees and the confirmation of the appointment of a Delaware trust company as successor corporate trustee, on the grounds that such resignations and appointment can be accomplished pursuant to the terms of the trust agreements, refused to hold that Delaware law would govern the administration of the trusts upon the appointment of a Delaware trustee, as such an order would be contrary to the choice of law provisions in the trust agreements, declined to confirm that Delaware was the situs of the trusts, as New York or New Jersey law applied to the administration of the trusts and must be followed in order to change the trust situs, denied a requested reformation of the trusts, since the question of whether or not the trusts could be
reformed was a matter of New York law or New Jersey law which the parties had not briefed, and denied the request that the Court accept jurisdiction over the trusts.

18. **Equitable Deviation**

In *Matter of Muir*, N.Y.L.J. June 6, 2013, the New York County Surrogate’s Court held that the doctrine of equitable deviation should apply to modify a requirement in the testator’s will that the assets of a testamentary trust should be invested solely in United States obligations, where the income from such obligations decreased to the point where it was no longer in the best interests of the trust’s beneficiaries to follow that investment restriction, and the court reformed the terms of the trust to permit the trustees to invest in a manner consistent with the Prudent Investor Act as set forth in EPTL Section 11-2.3.

X. **CONNECTICUT GIFT TAX, ESTATE TAX AND OTHER PERTINENT LEGISLATION**

In 2012 Connecticut enacted legislation (Conn. Gen. Stat. Section 45a-334a) requiring an electronic mail service provider to provide to the personal representative of a decedent’s estate who was domiciled in Connecticut at the time of his or her death access to or copies of the contents of the electronic mail account of the decedent.

On May 4, 2011, as part of the budget legislation (CGA Bill No. 1239), Connecticut lowered the Connecticut estate tax and gift tax thresholds from $3,500,000 to $2,000,000 applicable retroactively to estates of decedents dying on or after January 1, 2011 and gifts made on or after January 1, 2011. The tax for estates and gifts of more than $2,000,000 will be based on graduated rates, starting at a rate of 7.2%, and the maximum tax rate will be 12% (on the excess over $10,100,000). The Connecticut budget legislation also increased the marginal income tax rates for taxpayers by increasing the number of tax brackets from three to six and by increasing the maximum income tax rate from 6.5% to 6.7%.

On April 23, 2009 legislation was enacted in Connecticut approving same-sex marriage.

The Connecticut estate tax and gift tax statute was amended to treat parties to a same sex marriage in the same manner as parties to a heterosexual marriage for estate tax and gift tax purposes, effective April 23, 2009.

Connecticut enacted legislation (Conn. Legis. Serv. 09-169), effective October 1, 2009, which authorizes, either by a will or by an inter vivos trust, the creation of a trust which provides for the care of one or more specified animals which is or are alive during the testator’s or settlor’s life. Any such trust must terminate at the death of the last surviving animal or animals designated in the trust.

On June 24, 2005 Connecticut enacted legislation (Public Act No. 05-136) requiring an electronic mail service provider to provide the fiduciary of a decedent’s estate who is domiciled in Connecticut at the date of death access to or copies of the contents of the
decedent’s electronic mail account upon written request for same or an Order of the probate court having jurisdiction over the decedent’s estate.
January 9, 2013

TO: OUR CLIENTS, FRIENDS AND COLLEAGUES

SUBJECT: Federal Tax Alert

We are sending this notice to alert and update you with respect to the American Taxpayer Relief Act of 2012 (the “Act”), that was enacted on January 2, 2013. The Act changes federal tax laws regarding estate taxes, gift taxes and generation-skipping transfer taxes, and also makes significant changes regarding federal income tax laws.

I. Federal Estate Tax, Gift Tax and Generation-Skipping Transfer Tax

These changes in federal tax law may have an impact on your estate and tax planning and are discussed briefly below. If you would like to review with us the potential impact of these tax law changes on your estate plan, or if you would like to discuss questions in this regard, please contact us at your convenience so that we can follow up with you concerning your particular individual circumstances. The discussion in this notice of the changes in federal tax law is extremely general and should not be relied on as constituting legal advice applicable to any individual’s personal situation.

Preliminarily, we note that these changes made by the Act, that are described below, apply to transfers made, and to the estates of persons dying, on or after January 1, 2013. In addition, the Act does not contain a so-called “sunset” provision, as existed in the federal transfer tax legislation that was enacted in 2001 and 2010. Therefore, the federal transfer tax provisions of the Act are “permanent”, unless modified by subsequent legislation.

Estate Taxes

For the estates of persons dying in 2013 and thereafter, the Act imposes an estate tax on such estates, retains the prior estate tax exemption of $5,000,000 (indexed for inflation from 2010), but increases the maximum estate tax rate from 35% to 40%, and provides for a full step-up in basis for income tax purposes with respect to the assets acquired from the decedent. Pursuant to the Act, the amount of a decedent’s estate that exceeds the inflation adjusted exemption amount will be taxed at 40%. The inflation adjusted estate tax exemption for 2013 is $5,250,000.
It is important to note that although the Act retained the federal estate tax exemption of $5,000,000, as described above, the various states have their own laws regarding the imposition of state inheritance and estate taxes, and such state laws may not be “coupled” with the federal estate tax exemption. For example, each of New York and New Jersey would impose an estate tax of $420,800 on the estate of a person who dies in 2013 or thereafter a resident of such state with an estate of $5,250,000 (in the absence of a marital or charitable deduction), even though such estate would not be required to pay any federal estate tax. Similarly, the Connecticut estate tax on such an estate of a person dying in 2013 or thereafter a resident of Connecticut would be $251,700. Florida, on the other hand, would continue to have no estate tax, as has been the case since 2005.

Gift Taxes

The gift tax exemption and the maximum gift tax rate for gifts made in 2013 and thereafter continue to be “unified” with the federal estate tax exemption and the maximum federal estate tax rate applicable to the estates of persons dying in 2013 and thereafter. Thus, for gifts made in 2013 and thereafter, the gift tax exemption will be $5,000,000 (also indexed for inflation, as described above), and the maximum gift tax rate will be 40%. We note that Connecticut is the only State that has a gift tax, with a $2,000,000 exemption and gift tax rates ranging from 7.2% to 12%.

Generation-Skipping Transfer Taxes

The Act also retains the generation-skipping transfer tax exemption of $5,000,000 (also indexed for inflation, as described above) for 2013 and thereafter, and continues to apply the maximum federal estate tax rate (now 40%, as described above) to generation-skipping transfers that are made in 2013 and thereafter.

Portability Provisions

The Act also retains the “portability” provisions that allow a surviving spouse to use the unused portion of the estate tax exemption and the gift tax exemption of the last deceased spouse of the surviving spouse. The surviving spouse can use such unused portion for both gift tax and estate tax purposes, but not for generation-skipping transfer tax purposes.

For example, if a husband died in 2012 and his estate used only $3,000,000 of his $5,120,000 estate tax exemption, then his surviving wife will have an aggregate exemption of the sum of her own $5,000,000 exemption, adjusted for inflation as described above, plus the unused $2,120,000 of her deceased husband’s exemption, assuming that such deceased husband is the surviving spouse’s last deceased husband.

We note that the executor of the estate of the first spouse to die must elect “portability” on a timely filed federal estate tax return for such deceased spouse’s estate in order for the surviving spouse to be able to use such deceased spouse’s unused estate tax exemption, even if the amount of the estate of the deceased spouse is below the federal estate tax return filing threshold of $5,000,000 (adjusted for inflation, as noted above).
Omitted Provisions

Importantly, the Act does not contain any provisions requiring a minimum term for grantor retained annuity trusts (“GRATs”). Therefore, short term GRATs continue to be a valuable estate planning tool. In addition, the Act does not contain any provisions regarding valuation discounts for gift tax and estate tax purposes. As a result, estate planning techniques that involve such discounts, such as family limited partnerships, also continue to be an important estate planning tool, as in the past. Further, the Act does not contain any provisions that would require so-called “grantor trusts” to be includible in the grantor’s gross estate for estate tax purposes. Consequently, estate planning techniques that involve the use of grantor trusts also continue to be an important estate planning tool, as in the past.

II. Federal Income Tax

The Act also makes the following significant income tax changes for tax years beginning in 2013 (except as otherwise noted):

- The maximum income tax rate for individuals is increased from 35% to 39.6% for taxable income in excess of $450,000 for married persons filing jointly or a surviving spouse, $425,000 for a head of household, and $400,000 for an unmarried individual who is not a surviving spouse or a head of household.

- The previously existing “phase-out” of personal exemptions (the “PEP” provision) is reinstated for individuals with adjusted gross income in excess of $300,000 for married persons filing jointly or a surviving spouse, $275,000 for a head of household, and $250,000 for an unmarried individual who is not a surviving spouse or a head of household.

- The previously existing limitation on itemized deductions (the “Pease provision”) is reinstated for individuals with adjusted gross income in excess of $300,000 for married persons filing jointly or a surviving spouse, $275,000 for a head of household, and $250,000 for an unmarried individual who is not a surviving spouse or a head of household.

- The maximum income tax rate for qualified dividends and long-term capital gains is increased from 15% to 20% for married persons filing jointly having taxable income over $450,000 and for single taxpayers having taxable income over $400,000.

- Alternative minimum tax relief is made permanent by providing revised exemption amounts for 2012, indexed for inflation, of $78,750 for married persons filing jointly or a surviving spouse, $39,375 for a married person filing separately, and $50,600 for an unmarried person who is not a surviving spouse. The 2013 inflation adjusted exemption amounts are $80,800 for married persons filing jointly or a surviving spouse, $40,400 for a married person filing separately, and $51,900 for an unmarried person who is not a surviving spouse.
• The income tax deduction for state and local sales taxes is extended only for 2012 and 2013.

In addition, the Act extends for 2013 the ability of a person who is older than 70-1/2 to make a direct contribution to charity of up to $100,000 from the person’s Individual Retirement Account, without the contribution being included in the person’s income. Moreover, the Act permits a person to make such a contribution in January 2013 and to treat the contribution as having been made in 2012. In addition, a distribution from an Individual Retirement Account to the account holder in December 2012 can be treated as a qualified charitable distribution in 2012 if it is transferred in cash to charity before February 1, 2013.

Although not part of the Act, the 3.8% Medicare surtax on investment income, that was enacted as part of the Health Care and Education Reconciliation Act of 2010, and the 0.9% increased Medicare tax on FICA wages above certain threshold amounts, and on self-employment income above certain threshold amounts, that was enacted as part of the Patient Protection and Affordable Care Act of 2010, become effective in 2013.

As can be seen from the foregoing, the Act substantially changes the rules regarding federal estate taxes, gift taxes and generation-skipping transfer taxes. These changes may require a review of your estate and tax planning documents in certain instances.

BEST WISHES FOR THE NEW YEAR.
EXHIBIT “B”

Proposed Temporary Regulations Regarding Portability

By Sanford J. Schlesinger, Esq. and Martin R. Goodman, Esq.*

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This Article has been updated by the addition of the bracketed material.

On June 15, 2012 the Internal Revenue Service (IRS) released proposed temporary regulations (the regulations) (REG-141832-11, T.D. 9593) regarding the portability provisions in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Tax Relief Act). This analysis will review and discuss the regulations.

The regulations consist of estate tax regulations and gift tax regulations. The estate tax regulations are Temporary Reg. §20.2010-1T, which sets forth definitions and general rules regarding the unified credit against the estate tax, Temporary Reg. §20.2010-2T, which contains portability provisions that are applicable to the estate of a decedent who is survived by a spouse, and Temporary Reg. §20.2010-3T, which contains portability provisions that are applicable to the estate of the surviving spouse. The gift tax regulations consist of Temporary Reg. §25.2505-1T, which sets forth general rules regarding the unified credit against the gift tax, and Temporary Reg. §25.2505-2T, which contains provisions regarding lifetime gifts made by a surviving spouse who has a deceased spousal unused exclusion (DSUE, described below) amount available.

Preliminarily, it is noted that the regulations provide that their applicability will expire “on or before” June 15, 2015. This expiration date is required by Code Sec. 7805(e)(2), which provides that temporary regulations must expire within three years of the date issued.

Estate Tax Regulations

Temporary Reg. §20.2010-1T:

Temporary Reg. §20.2010-1T defines certain relevant terms and sets forth general rules regarding the unified credit against the estate tax.

This regulation begins by stating that the estate of every decedent is allowed a credit under Code Sec. 2010(a) known as the “applicable credit amount” (and which is sometimes referred to as the “unified credit”). The amount of this credit for the estate of a decedent who died in 2011 is
$1,730,800 as determined from an applicable exclusion amount of $5,000,000, and the amount of this credit for the estate of a decedent who dies after 2011 is determined based on an applicable exclusion amount of $5,000,000, as adjusted for inflation from 2010. For the estate of a decedent who dies in 2012, the applicable exclusion amount is adjusted for inflation to $5,120,000, which corresponds to an applicable credit amount of $1,772,800. The applicable credit is reduced by 20 percent of the portion of the gift tax exemption of $30,000 that was allowable prior to 1977 and that the decedent used with respect to gifts made after September 8, 1976 and before January 1, 1977. However, in any case the allowable credit may not be more than the amount of the tentative estate tax determined under Code Sec. 2001(c).

The regulation then defines the term “applicable exclusion amount” to be equal to the sum of the “basic exclusion amount” (defined below), and, with respect to the estate of a surviving spouse, the DSUE amount (also defined below). The basic exclusion amount (which is commonly referred to as the estate tax exemption) is defined as $5,000,000, for the estate of a decedent dying in 2011, and $5,000,000, adjusted for inflation from 2010, for the estate of a decedent dying after 2011.

The regulation states that the DSUE amount generally is the unused portion of a decedent’s applicable exclusion amount to the extent that such amount does not exceed the basic exclusion amount in effect in the year of the decedent’s death.

Finally, the regulation defines the term “last deceased spouse” as the most recently deceased individual who, at that individual’s death after December 31, 2010, was married to the surviving spouse.

**Temporary Reg. §20.2010-2T**

**Portability Election Requirements:**

Temporary Reg. §20.2010-2T(a) sets forth the requirements for a valid portability election.

The regulation states that the executor of a decedent’s estate must elect portability of the DSUE amount on a timely filed federal estate tax return (Form 706) to allow the decedent’s surviving spouse to take into account the decedent’s DSUE amount. The regulation provides that an estate that elects portability will be treated as an estate that is required to file an estate tax return under Code Sec. 6018(a), even if the estate otherwise would not be required to file an estate tax return. Therefore, the due date of an estate tax return that is filed to elect portability is nine months after the date of the decedent’s (not the surviving spouse’s) death, subject to any allowed extension of time to file such tax return, even if an estate tax return is not otherwise required to be filed for the estate.

The regulation further states that if an estate tax return is complete and properly prepared (as discussed below) and is timely filed, the executor of the estate of a decedent who is survived by a spouse will be treated as having elected portability of the decedent’s DSUE amount, unless the executor chooses not to elect portability. An executor will not be considered to have elected portability if the executor states affirmatively on a timely filed estate tax return, or in an
attachment to that return, that the executor is not electing portability under Code Sec. 2010(c)(5), or if the executor does not timely file an estate tax return. The regulation states that the manner in which the executor may make the above-described affirmative statement on the estate tax return will be set forth in the instructions issued for that tax return.

The regulation then states that the portability election, once made, becomes irrevocable after the due date of the estate tax return, including extensions actually granted. However, before a portability election becomes irrevocable, an executor may supersede a portability election previously made by timely filing another estate tax return reporting the decision not to make a portability election. The regulation provides that an executor of the estate of a decedent who is survived by a spouse may elect portability on behalf of the estate if the decedent died in 2011 or in a subsequent period in which portability is in effect. However, the regulation also provides that the executor of the estate of a nonresident decedent who was not a citizen of the United States at the time of his or her death may not elect portability on behalf of that decedent, and that the timely filing of an estate tax return for such decedent will not be deemed to make the portability election.

The regulation states that a duly appointed executor or administrator of the estate of a decedent, who is acting within the United States, can file the estate tax return for the decedent’s estate and elect portability, or elect not to have portability apply. Such regulation also provides that if no executor or administrator has been appointed for a decedent’s estate, then any person in actual or constructive possession of any property of the decedent (a non-appointed executor) can file the estate tax return for the decedent’s estate and elect portability, or can elect not to have portability apply. Such regulation further provides that a portability election so made cannot be superseded by a contrary election made by another non-appointed executor of that estate, unless such other non-appointed executor is the successor of the non-appointed executor who made the portability election.

In this regard, it is noted that circumstances may exist which cause the executor to be unwilling to elect portability. For example, the executor may be a child of the decedent from a former marriage who, due to animus, may not want to confer a tax benefit on the decedent’s surviving spouse by electing portability. However, the state in which the decedent’s Will is probated may authorize the appointment of an executor for a limited purpose, as the State of New York does pursuant the Section 702 of the New York Surrogate’s Court Procedure Act. In such a case, it may be possible for the surviving spouse to be appointed as the executor of the estate for the limited purpose of filing the estate tax return and making the portability election. In that event, presumably the surviving spouse, as such executor, would be the person who would have the authority to file the estate tax return for the decedent’s estate and to elect portability.

The regulation then sets forth the requirements for a complete and properly prepared estate tax return pursuant to which the executor may elect portability. The regulation provides that, in general, an estate tax return will be considered complete and properly prepared if it is prepared in accordance with the instructions issued by the IRS for the preparation of an estate tax return and if the requirements of Reg. §20.6018-2 (which, in general, contains additional provisions as to the person or persons required to file an estate tax return), Reg. §20.6018-3 (which sets forth the
requirements for the contents of an estate tax return), and Reg. §20.6018-4 (which sets forth certain requirements as to documents that must be filed with an estate tax return) are satisfied.

The regulation also sets forth a special rule regarding the reporting of the value of certain property of estates as to which the executor is not required to file an estate tax return other than for the purpose of making the portability election (i.e., an estate of a decedent whose gross estate and adjusted taxable gifts do not exceed the filing requirement threshold for the year of the decedent’s death). Pursuant to this special rule, an executor is not required to report a value for property that is includible in the decedent’s gross estate and that qualifies for either the estate tax marital deduction or the estate tax charitable deduction. Instead, the executor will only be required to report the description, ownership and/or beneficiary of such property, and all other information necessary to establish the right of the estate to the estate tax marital deduction or the estate tax charitable deduction for such property.

However, this special rule does not apply (a) if the value of such property relates to, affects or is needed to determine the value passing from the decedent to another recipient, (b) if the value of such property is needed to determine the estate’s eligibility for the provisions of Code Sec. 2032 (regarding the alternate valuation date election), Code Sec. 2032A (regarding the valuation of qualified real property), Code Sec. 6166 (regarding the election to pay the portion of the estate tax that is attributable to an interest in a closely held business in installments), or another provision of the Code, or (c) if less than the entire value of an interest in property that is includible in the decedent’s gross estate qualifies for the estate tax marital deduction or the estate tax charitable deduction, or if a partial disclaimer or a partial qualified terminable interest property (QTIP) election is made with respect to property that is includible in the decedent’s gross estate, part of which qualifies for the estate tax marital or charitable deduction. Thus, in any of these instances, an estate tax return that is filed solely to make the portability election, and that would not otherwise be required to be filed, will require all of the information and related documentation that would be required for an estate tax return for the estate of a decedent whose gross estate and adjusted taxable gifts exceeds the filing threshold, in order to be considered a complete and properly prepared estate tax return.

This special rule reducing the requirements for reporting the value of certain property that is includible in the decedent’s gross estate will apply only if the executor exercises due diligence to estimate the fair market value of the decedent’s gross estate, including the property that is includible in the decedent’s gross estate and that qualifies for the estate tax marital or charitable deduction. The regulation states that the instructions for the estate tax return will provide ranges of dollar values, and that the executor must identify on the estate tax return an amount corresponding to the particular range within which falls the executor’s best estimate of the total gross estate. The regulation further provides that until the form for the estate tax return that includes this estimate is issued, the executor must include his or her best estimate of the decedent’s gross estate, rounded to the nearest $250,000, on or attached to the estate tax return, and that it must be signed under penalties of perjury.

[The instructions for the United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706) for decedents who died in 2012 contains a “Table of Estimated Values” that provides ranges of dollar values for property as to which this reduced reporting]
requirement is applicable, and the amount that must be reported as includable in the
decedent’s gross estate for each range. The ranges are generally in increments of $250,000,
starting with a range from $0 to $250,000, and ending with a range of $5,000,000 to
$5,120,000 (as the inflation adjusted amount of the basic exclusion amount was $5,120,000
in 2012), and the includable amount for each range is the maximum amount of such range.
In addition, page 3, Part 5, Recapitulation, of such Form 706 includes line 10 thereof, for
the purpose of reporting the estimated value of such assets. The Table of Estimated Values
is reprinted below.

**TABLE OF ESTIMATED VALUES**

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It is noted that some practitioners have expressed disappointment at this regulation and have stated that they had hoped that the IRS would have permitted the filing of an even more simplified estate tax return in all cases in which an estate tax return is being filed solely to make the portability election and where such return would not otherwise be required to be filed.

This regulation contains examples illustrating its operation.
In Example 1, the gross estate of the first spouse to die consisted solely of assets owned jointly with the decedent’s surviving spouse, with right of survivorship, a life insurance policy payable to the surviving spouse, and a survivor annuity payable to the surviving spouse for her life. The decedent made no taxable gifts during his lifetime. The example states that an estate tax return that identifies these assets on a proper schedule, but provides no information with regard to the date of death value of such assets, that includes evidence verifying the title of each jointly held asset, confirming that the surviving spouse is the sole beneficiary of both the life insurance policy and the survivor annuity, and verifying that the annuity is exclusively for the surviving spouse’s life, and that contains the required certification of the executor’s best estimate, determined by exercising due diligence, of the fair market value of the decedent’s gross estate, is considered a complete and properly prepared estate tax return in which the executor has elected portability.

In Example 2, the decedent died testate, leaving a will in which he bequeaths his entire estate to a QTIP trust for his surviving wife. The decedent also had non-probate assets that are includible in his gross estate, consisting of a life insurance policy payable to his children and an individual retirement account (IRA) payable to his wife. The decedent made no taxable gifts during his lifetime. The executor of the decedent’s estate filed an estate tax return in which all of the assets that are includible in the decedent’s gross estate are identified on the proper schedule. As to the decedent’s probate assets and the IRA, no information is provided regarding the date of death value of such assets. The executor makes a QTIP election on the estate tax return, attaches a copy of the decedent’s will creating the QTIP trust, and describes each such asset and its ownership to establish the estate’s entitlement to the estate tax marital deduction for such assets. As to the life insurance policy payable to the decedent’s children, all of the regular estate tax return requirements apply, including reporting and establishing the fair market value of such asset, and obtaining Form 712 regarding such policy from the insurance company and attaching it to the estate tax return. The executor also provides the above-referenced certification as to the value of the decedent’s gross estate. This example states that the estate tax return is considered to be complete and properly prepared, and that the executor has elected portability. This example also states that if the above-recited facts are the same, except that there are no non-probate assets, and the executor elects to make only a partial QTIP election, then the regular return requirements will apply to all of the property includible in the decedent’s gross estate, and the special rule described above that waives such requirements will not apply.

In Example 3, the decedent died testate, and his will bequeathed 50 percent of his probate assets to a marital trust for the benefit of the decedent’s wife and the other 50 percent thereof to a trust for the benefit of the decedent’s wife and their descendants. This example states that, as the amount passing to the non-marital trust cannot be verified without knowledge of the full value of the property passing under the decedent’s will, the value of the property of the marital trust relates to or affects the value of the property passing to the non-marital trust, so that the general return requirements apply to all of the property includible in the decedent’s gross estate. Thus, in this example, the special rule described above waiving such requirements does not apply.

Temporary Reg. §20.2010-2T(b) provides that the executor of a decedent’s estate must include a computation of the DSUE amount on the decedent’s estate tax return to elect portability. However, this regulation also contains a transitional rule that provides that until the form for the
estate tax return that expressly includes a computation of such amount is issued, a complete and properly prepared estate tax return will be “deemed” to include the computation of such amount. This regulation further provides that after such revised form of estate tax return is issued, an executor that previously filed an estate tax return pursuant to this transitional rule will not be required to file a supplemental estate tax return using the revised form.

**Computation of the DSUE Amount:**

Temporary Reg. §20.2010-2T(c) contains provisions regarding the computation of the DSUE amount. This regulation provides that such amount generally is the lesser of the basic exclusion amount in effect for the year of the decedent’s death (i.e., $5,000,000, adjusted for inflation, as noted above), or the excess of the decedent’s applicable exclusion amount over the sum of the decedent’s taxable estate and the amount of the decedent’s adjusted taxable gifts as to which gift taxes were not paid.

Importantly, this regulation confirms that the term “basic exclusion amount” that is referred to in Code Sec. 2010(c)(4)(A) means such amount that is in effect in the year of the death of the decedent whose DSUE amount is being computed.

Perhaps most importantly, this regulation resolves in favor of the taxpayer an issue regarding the computation of the DSUE amount of a decedent, whose previously deceased spouse had elected portability. This issue was created by the provision in the Act that defines the DSUE amount as the lesser of (a) the basic exclusion amount, or (b) the excess of the basic exclusion amount (rather than the applicable exclusion amount) of the last deceased spouse of the surviving spouse over the amount with respect to which the tentative tax is determined under Code Sec. 2001(b)(1) on the estate of such deceased spouse.

The effect of such statutory formulation, and the effect of the regulatory interpretation of it, can be illustrated by the following example:

Assume that H-1 dies in 2011, having made taxable gifts during his life of $3,000,000 and having no taxable estate, that the executor of H-1’s estate files an estate tax return electing portability, that H-1’s surviving spouse, W, makes no taxable gifts during her life, and that W remarries H-2 and W predeceased H-2. Pursuant to the statutory formulation, after H-1’s death, W’s applicable exclusion amount is $7,000,000 (i.e., her $5,000,000 basic exclusion amount, plus the DSUE amount of $2,000,000 from H-1). W has a taxable estate of $3,000,000 at her death, and the executor of W’s estate files an estate tax return electing portability. Pursuant to the statutory formulation, W’s DSUE amount is the lesser of (a) W’s basic exclusion amount of $5,000,000, or (b) the excess of W’s basic exclusion amount of $5,000,000, over her taxable estate of $3,000,000, or $2,000,000. Thus, W’s DSUE amount is $2,000,000. Therefore, H-2’s applicable exclusion amount would be the sum of his own basic exclusion amount of $5,000,000, plus W’s DSUE amount of $2,000,000, or $7,000,000.

However, pursuant to this regulation, W’s DSUE amount is the lesser of (a) W’s basic exclusion amount (i.e., $5,000,000), or the (b) excess of W’s applicable exclusion amount, which is $7,000,000 (i.e., W’s $5,000,000 basic exclusion amount, plus the $2,000,000 DSUE amount

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from H-1), over the amount of the W’s taxable estate of $3,000,000, for an excess amount of
$4,000,000. Thus, pursuant to the regulation, W’s DSUE amount is $4,000,000, and the
applicable exclusion amount of H-2 is $9,000,000 (i.e., H-2’s basic exclusion amount of
$5,000,000, plus W’s DSUE amount of $4,000,000).

Consequently, this regulatory interpretation of the statute increases the applicable exclusion
amount of H-2 by $2,000,000.

Interestingly, the technical explanation of the Act prepared by the Joint Congressional
Committee on Taxation (JCX-55-10), in its discussion regarding the portability provisions of the
Act, included an example (Example 3) which in effect adopted the view regarding the
computation of the DSUE amount that is set forth in this regulation. In addition, on March 23,
2011, the same Committee issued an errata (JCX-20-11) to its “General Explanation of Tax
Legislation Enacted in the 111th Congress” (JCS-2-11) stating that the intent of the Act was to
calculate the DSUE amount of the wife in the above example in the same manner as it is
computed pursuant to this regulation, and further stating that a technical correction of the Act
may be necessary to replace the statutory reference to the “basic exclusion amount of the last
such deceased spouse of such surviving spouse” with a statutory reference to the “applicable
exclusion amount of the last such deceased spouse of such surviving spouse” to reflect this
intent. Apparently, no such statutory correction will be required, as this regulation adopts the
Joint Committee’s view regarding this issue.

The regulation also sets forth a special rule regarding portability in the case of property passing
to a qualified domestic trust (QDOT). Pursuant to Code Sec. 2056(d), the estate of a decedent is
not allowed an estate tax marital deduction for property passing from the decedent to a surviving
spouse who is not a United States citizen, unless the property passes to a QDOT. Pursuant to
Code Sec. 2056A, in general a QDOT is a trust that requires that at least one trustee shall be an
individual who is a United States citizen or a domestic corporation, who or which will pay the
estate tax with respect to such trust from any principal distribution of the trust before the death of
the surviving spouse, and from the value of the trust that is remaining on the death of the
surviving spouse. The regulation provides that in such case the DSUE amount of the decedent is
computed on the decedent’s estate tax return for the purpose of electing portability in the same
manner as such amount would otherwise be computed, but the decedent’s DSUE amount is
subject to subsequent adjustments. The regulation states that the DSUE amount of the decedent
must be redetermined upon the occurrence of the final distribution or other event (generally, the
death of the surviving spouse or the earlier termination of all QDOTs for that surviving spouse)
on which the estate tax is imposed. Thus, a surviving spouse cannot use any of the DSUE
amount received from the deceased spouse while a QDOT for the benefit of the surviving spouse
remains in effect. As a result of this rule, a non-citizen surviving spouse generally will not be
able to use the deceased spouse’s DSUE amount to make lifetime gifts.

The regulation contains three examples illustrating its application:

In Example 1, H makes a taxable gift of $1,000,000 in 2002, pays no gift tax due to the
applicable exclusion amount available to H of $1,000,000 in 2002, and dies in 2011 survived by
W. H’s taxable estate is $1,000,000, and the executor of H’s estate timely files an estate tax
return electing portability. The example states that H’s DSUE amount is $3,000,000 (the lesser of (a) the $5,000,000 basic exclusion amount in 2011, or (b) the excess of H’s $5,000,000 applicable exclusion amount over the sum of H’s $1,000,000 taxable estate and the $1,000,000 amount of adjusted taxable gifts that H made).

In Example 2, the facts are the same as in Example 1, except that the value of H’s taxable gift in 2002 is $2,000,000, as to which H paid a gift tax of $1,000,000. This example states that H’s DSUE amount is $3,000,000 (the lesser of (a) the $5,000,000 basic exclusion amount in 2011, or (b) the excess of H’s $5,000,000 applicable exclusion amount over the sum of the $1,000,000 taxable estate of H and the $1,000,000 adjusted taxable gift made by H as to which gift taxes were not paid).

In Example 3, H made a taxable gift of $1,000,000 in 2002 as to which no gift taxes were due, H dies in 2011 with a gross estate of $2,000,000 survived by W, who is a United States resident but not a United States citizen. H bequeathed the sum of $1,500,000 to a QDOT for the benefit of W. H’s executor timely filed an estate tax return making the QDOT election and electing portability. H’s taxable estate, after the marital deduction of $1,500,000, is $500,000. The preliminary DSUE amount of H is $3,500,000 (the lesser of (a) the $5,000,000 basic exclusion amount in 2011, or (b) the excess of H’s $5,000,000 applicable exclusion amount over the sum of H’s $500,000 taxable estate and the $1,000,000 adjusted taxable gift made by H). At W’s death in 2012, the value of the assets of the QDOT is $1,800,000. The example states that the DSUE amount is redetermined to be $1,700,000 (the lesser of (a) the $5,000,000 basic exclusion amount in 2011, or (b) the excess of H’s $5,000,000 applicable exclusion amount over $3,300,000 (the sum of the $500,000 taxable estate of H augmented by the $1,800,000 of QDOT assets and the $1,000,000 of adjusted taxable gifts)).

Interestingly, Temporary Reg. §20.2010-2T(c)(3) is reserved to provide future guidance as to whether or not the DSUE amount is determined before or after the application of other available credits, such as the credit for the estate tax on prior transfers pursuant to Code Sec. 2013, the credit for foreign death taxes pursuant to Code Sec. 2014, and the credit for death taxes on remainder interests pursuant to Code Sec. 2015. In this regard, the IRS requests comments regarding the appropriate rules to coordinate these credits with the portability rules.

Temporary Reg. §20.2010-2T(d) states that the IRS may examine the tax returns of a decedent to determine the decedent’s DSUE amount, regardless of whether or not the period of limitations on the assessment of additional taxes has expired for such tax return. However, as noted below regarding the gift tax regulations, the IRS cannot assess any additional taxes with respect to any such tax return after the expiration of the statute of limitations for such assessment.

**Temporary Reg. §20.2010-3T**

This regulation confirms that the DSUE amount of a decedent is included in determining the applicable exclusion amount of the decedent’s surviving spouse for estate tax purposes only if such decedent is the last deceased spouse of such surviving spouse on the date of the death of such surviving spouse, and only if the executor of the estate of such last deceased spouse elected portability. This regulation further states that the surviving spouse’s estate has no DSUE amount.
available if the last deceased spouse of such surviving spouse had no DSUE amount, or if the executor of the last deceased spouse’s estate did not make a portability election, even if the surviving spouse previously had a DSUE amount available from another decedent who, prior to the death of the last deceased spouse, was the last deceased spouse of such surviving spouse. For example, if H-1 and W are married, and if H-1 dies having a DSUE amount and the executor of his estate makes the portability election, but thereafter W marries H-2 who then dies having no DSUE amount, then on W’s death the DSUE amount from H-1 would not be available to the estate of W.

In addition, this regulation states that a decedent is the last deceased spouse of a surviving spouse even if, on the date of the death of such surviving spouse, the surviving spouse is married to another then living individual. Further, the regulation states that if a surviving spouse remarries and that marriage ends in a divorce or an annulment, the subsequent death of the divorced spouse does not end the status of the prior deceased spouse as the last deceased spouse of the surviving spouse. Since the divorced spouse, at his or her death, is not married to the surviving spouse, such divorced spouse is not the last deceased spouse of the surviving spouse.

The regulation provides a special rule to compute the DSUE amount of a surviving spouse for estate tax purposes where the surviving spouse previously applied the DSUE amount of one or more deceased spouses to lifetime taxable gifts. This rule states that, if a surviving spouse has applied the DSUE amount of one or more last deceased spouses to the surviving spouse’s lifetime gifts, and, if any of those last deceased spouses is not the surviving spouse’s last deceased spouse at the death of the surviving spouse, then the DSUE amount to be included in determining the applicable exclusion amount of the surviving spouse at the time of the surviving spouse’s death is the sum of the DSUE amount of the surviving spouse’s last deceased spouse, and the DSUE amount of each other deceased spouse of the surviving spouse, to the extent that such DSUE amount was applied to one or more taxable gifts of the surviving spouse.

This regulation contains the following example to illustrate the operation of this provision:

H-1 dies in 2011, survived by W, and neither of them has made any taxable gifts during H-1’s life. H-1’s executor elects portability of H-1’s DSUE amount, which is $5,000,000. On December 31, 2011 W makes taxable gifts of $2,000,000. Thereafter, W has a remaining applicable exclusion amount of $8,000,000, consisting of H-1’s $3,000,000 remaining DSUE amount, plus W’s own $5,000,000 basic exclusion amount. After H-1’s death, W marries H-2, who dies in June 2012. H-2’s executor elects portability of H-2’s DSUE amount, which is $2,000,000. W dies in October 2012. The example states that the DSUE amount to be included in determining the applicable exclusion amount available to W’s estate is $4,000,000, which is determined by adding the $2,000,000 DSUE amount of H-2 and the $2,000,000 DSUE amount of H-1 that was applied by W to W’s 2011 taxable gifts. Thus, W’s applicable exclusion amount is the sum of her own basic exclusion amount of $5,000,000, plus such DSUE amount of $4,000,000, for a total of $9,000,000.

The foregoing example is as set forth in the proposed regulations. It is noted that the regulation states that H-2’s DSUE amount is correctly computed to be $2,000,000. Thus, it would appear that H-2’s basic exclusion amount of $5,000,000, increased by the inflation adjustment to
$5,120,000, was used by his estate to the extent of $3,120,000, leaving an unused portion of such amount of $2,000,000. In addition, it appears that this example fails to reflect the fact that W’s own basic exclusion amount at her death in 2012 is increased from $5,000,000 to $5,120,000, as a result of the inflation adjustment. Thus, it appears that this example should state that W’s applicable exclusion amount is $9,120,000, rather than $9,000,000.

Therefore, this special rule in effect could permit a wealthy person to make a very large aggregate amount of lifetime gifts on a tax free basis, as long as portability remains in effect, by having serial marriages to individuals, each of whom predeceases such person, has a DSUE amount and elects portability, and by such person making a lifetime gift equal to such DSUE amount of each such deceased individual before the person remarries.

The regulation provides rules regarding the date as of which a decedent’s DSUE amount is to be taken into consideration by the surviving spouse. This regulation states that in general a portability election applies as of the date of the death of the person with respect to whom such election is made. Therefore, a decedent’s DSUE amount is included in the applicable exclusion amount of the decedent’s surviving spouse and will be applicable to transfers made by the surviving spouse after the death of the decedent. However, this regulation also states that even if the surviving spouse made a transfer in reliance on the availability or computation of the decedent’s DSUE amount, such DSUE amount will not be included in the applicable exclusion amount of the surviving spouse (a) if the executor of the decedent’s estate supersedes the portability election by timely filing a subsequent estate tax return in which no such election is made, or (b) to the extent that the DSUE amount is subsequently reduced by a valuation adjustment or a correction in the error in the computation of such amount, or (c) to the extent that the surviving spouse cannot substantiate the DSUE amount that is claimed on the surviving spouse’s tax return.

This regulation also provides a special rule when property passes from a decedent for the benefit of a surviving spouse in one or more QDOTs and the decedent’s executor elects portability. The regulation states that in such case the DSUE amount that is available to be included in the applicable exclusion amount of the surviving spouse is the DSUE amount of the decedent as redetermined (as previously described). Thus, the earliest date on which the decedent’s DSUE amount can be included in the applicable exclusion amount of the surviving spouse is the date of the occurrence of the final QDOT distribution or other final event (generally, the death of the surviving spouse or the earlier termination of all QDOTs for that surviving spouse) on which the estate tax is imposed. Thereafter, however, the decedent’s DSUE amount as so redetermined may be applied to taxable gifts of the surviving spouse.

The regulation provides that for the purpose of determining the DSUE amount that is included in the applicable exclusion amount of the surviving spouse for estate tax purposes, the IRS may examine the tax returns of each of the surviving spouse’s deceased spouses whose DSUE amount is claimed to be included in the surviving spouse’s applicable exclusion amount, whether or not the period of limitations for the assessment of additional taxes has expired for any such tax return. This regulation further states that the IRS, upon such examination, may adjust or even eliminate the DSUE amount reported on such a return, but that the IRS can assess additional
taxes on that return only if that tax is assessed within the applicable period of limitations regarding assessments.

The regulation provides that the estate of a nonresident surviving spouse who is not a United States citizen at the time of his or her death cannot take into account the DSUE amount of any deceased spouse of such surviving spouse, except to the extent allowed under any applicable treaty obligation of the United States.

**Gift Tax Regulations**

Temporary Reg. §25.2505-1T provides general rules regarding the application of the unified credit against the gift tax. These provisions are comparable to the provisions in the estate tax regulations described above regarding the general rules concerning the application of the unified credit against the estate tax.

Temporary Reg. §25.2505-2T sets forth rules regarding lifetime gifts made by a surviving spouse who has a DSUE amount available.

This regulation provides that a DSUE amount of a decedent is included in determining the surviving spouse’s applicable exclusion amount if (a) such decedent is the last deceased spouse of the surviving spouse at the time of the surviving spouse’s taxable gift, and (b) if the executor of the decedent’s estate elected portability. In addition, this regulation provides that if, on the date that the surviving spouse makes a taxable gift, the last deceased spouse of the surviving spouse had no DSUE amount, or if the executor of the estate of such last deceased spouse did not elect portability, then the surviving spouse has no DSUE amount available to determine his or her applicable exclusion amount, even if the surviving spouse previously had a DSUE amount available from another decedent who, prior to the death of the last deceased spouse, was the last deceased spouse of such surviving spouse (except as provided below).

Further, this regulation provides that a decedent is the last deceased spouse of a surviving spouse even if, on the date of the surviving spouse’s taxable gift, the surviving spouse is married to another individual who is then living. Moreover, if a surviving spouse remarries and that marriage ends in divorce or an annulment, the subsequent death of the divorced spouse does not end the status of the prior deceased spouse as the last deceased spouse of the surviving spouse, because the divorced spouse, at his or her death, was not married to the surviving spouse.

**Thus, a surviving spouse can bring a DSUE amount to a new marriage and can use it to make gifts while the new spouse is alive and can also use it to calculate the surviving spouse’s estate tax if the new spouse survives. In addition, if a surviving spouse makes taxable gifts, any DSUE amount is applied first to offset any gift tax that would otherwise be due (whether or not the surviving spouse is then married), but once the new spouse dies, that deceased spouse is the “last deceased spouse” and any DSUE amount from the first marriage is lost.**

This regulation contains a much needed ordering rule providing that if a surviving spouse makes a taxable gift and has a DSUE amount that is included in determining the surviving spouse’s
applicable exclusion amount, then the surviving spouse will be treated as applying such DSUE amount to the taxable gift before applying the surviving spouse’s own basic exclusion amount to such gift.

Very importantly, this regulation contains a special rule regarding multiple deceased spouses and a previously used DSUE amount that is available to a surviving spouse. This rule states, in general, that if a surviving spouse applied the DSUE amount of one or more last deceased spouses to the surviving spouse’s prior lifetime gifts, and if any of those last deceased spouses is different from the surviving spouse’s last deceased spouse at the time of the surviving spouse’s current taxable gift, then the DSUE amount to be included in determining the applicable exclusion amount of the surviving spouse that will apply at the time of the current taxable gift is the sum of (a) the DSUE amount of the surviving spouse’s last deceased spouse, and (b) the DSUE amount of each of the other deceased spouses of the surviving spouse to the extent that such amount was applied to one or more previous taxable gifts of the surviving spouse.

For example, H-1 dies on January 15, 2011, survived by W, and neither of them made any taxable gifts during H-1’s life. H-1’s executor elects portability. Assume that the DSUE amount of H-1 is $5,000,000. On December 31, 2011, W makes taxable gifts of $2,000,000. W is treated as having applied $2,000,000 of H-1’s DSUE amount to such gifts. Thereafter, W is considered to have a remaining applicable exclusion amount of $8,000,000, consisting of H-1’s $3,000,000 remaining DSUE amount, plus W’s own $5,000,000 basic exclusion amount. After H-1’s death, W marries H-2, and H-2 dies on June 30, 2012. H-2’s executor elects portability, and assume that H-2’s DSUE amount is $2,000,000. The DSUE amount to be included in determining the applicable exclusion amount available to W for gifts that she makes from July 1, 2012 through December 31, 2012 is $4,000,000, determined by adding the $2,000,000 DSUE amount of H-2 and the $2,000,000 DSUE amount of H-1 that was applied by W to W’s 2011 taxable gifts. Thus, W’s applicable exclusion amount for the second half of 2012 is $9,000,000, consisting of the sum of the two $2,000,000 DSUE amounts described above, plus W’s own basic exclusion amount of $5,000,000. Since the gift tax on any gifts that W makes during the second half of 2012 will be computed on both the amount of such gifts and the $2,000,000 of taxable gifts that W made on December 31, 2011, W in effect can make additional gifts of $7,000,000 during the second half of 2012 without having to pay any gift tax on account of such gifts.

The foregoing example is based upon an example in the proposed regulations. This example apparently fails to reflect the fact that W’s basic exclusion amount in 2012 is increased from $5,000,000 to $5,120,000 as a result of the inflation adjustment. Thus, it appears that the example should state that W’s applicable exclusion amount for the second half of 2012 is $9,120,000, rather than $9,000,000, that W’s basic exclusion amount for the second half of 2012 is $5,120,000, rather than $5,000,000, and that W can make additional gifts during the second half of 2012 of $7,120,000, rather than $7,000,000.

This regulation contains a special rule regarding the computation and redetermination of the DSUE amount for property passing to a QDOT for the benefit of a surviving spouse where the decedent’s executor elects portability that is similar to the comparable rule in the estate tax regulations discussed above. However, this regulation further states that the decedent’s DSUE
amount as so redetermined may be applied to the surviving spouse’s taxable gifts that are made in the year of the surviving spouse’s death, or if the terminating event occurs prior to the surviving spouse’s death, then in the year of that terminating event and/or in any subsequent year of the surviving spouse’s life.

Finally, this regulation contains provisions regarding the authority of the IRS to examine the tax returns of each of the surviving spouse’s deceased spouses whose DSUE amount is claimed to be included in the surviving spouse’s applicable exclusion amount, and rules regarding the inability of a nonresident surviving spouse who is not a citizen of the United States at the time that he or she makes a gift that is subject to gift taxes to take into account the DSUE amount of any deceased spouse, that are similar to the comparable rules in the estate tax regulations discussed above.

Conclusion

These proposed temporary regulations provide comprehensive guidance regarding the complex portability provisions that are set forth in the 2010 Tax Relief Act. As noted above, in certain important respects they are very favorable to the taxpayer, but there still remain areas that need clarification.

## EXHIBIT “C”
**STATE ESTATE TAX AFTER EGTRRA, THE 2010 TAX ACT AND THE 2012 TAX ACT ON A TAXABLE ESTATE EQUAL TO THE FEDERAL BASIC EXCLUSION AMOUNT**

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</table>

* New Jersey also imposes an inheritance tax. Transfers to surviving spouses, fathers, mothers, grandparents, children (both natural and adopted) and issue of children are exempt from tax.

** Prior to January 1, 2005, Connecticut also imposed an inheritance tax on property passing to beneficiaries other than spouse or descendants.
EXHIBIT “D”

STATE DEATH TAX LEGISLATION

AS OF JULY 24, 2013

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The American College of Trust and Estate Counsel

<table>
<thead>
<tr>
<th>State</th>
<th>Type of Tax</th>
<th>Effect of EGTRRA on Pick-up Tax and Size of Gross Estate</th>
<th>Legislation Affecting State Death Tax</th>
<th>2013 State Death Tax Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit. AL ST § 40-15-2.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Alaska</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit. AK ST § 43.31.011.</td>
<td></td>
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</tr>
<tr>
<td>Arizona</td>
<td>None</td>
<td>Tax was tied to federal state death tax credit. AZ ST §§ 42-4051; 42-4001(2), (12). On May 8, 2006, Governor Napolitano signed SB 1170 which permanently repeals Arizona’s state estate tax.</td>
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<tr>
<td>California</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit. CA REV &amp; TAX §§ 13302; 13411.</td>
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<tr>
<td>State</td>
<td>Type of Tax</td>
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</tr>
<tr>
<td>Colorado</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit. CO ST §§ 39-23.5-103; 39-23.5-102.</td>
<td></td>
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</tr>
<tr>
<td>Connecticut</td>
<td>Separate Estate Tax</td>
<td>As part of the two year budget which became law on September 8, 2009, the exemption for the separate estate and gift taxes was increased to $3.5 million, effective January 1, 2010, the tax rates were reduced to a spread of 7.2% to 12%, and effective for decedents dying on or after January 1, 2010, the Connecticut tax is due six months after the date of death. CT ST § 12-391. In May 2011, the threshold was lowered to $2 million retroactive to January 1, 2011</td>
<td>On March 28, 2013, the Governor signed HB 51 to eliminate the four year sunset provision that originally applied to the tax as enacted in June 2009.</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Delaware</td>
<td>Pick-up Only</td>
<td>For decedents dying after June 30, 2009. The federal deduction for state death taxes is not taken into account in calculating the state tax. DE ST TI 30 §§ 1502(c)(2)</td>
<td>On March 28, 2013, the Governor signed HB 51 to eliminate the four year sunset provision that originally applied to the tax as enacted in June 2009.</td>
<td>$5,250,000 (indexed for inflation)</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>Pick-up Only</td>
<td>Tax frozen at federal state death tax credit in effect on January 1, 2001. In 2003, tax imposed only on estates exceeding EGTRRA applicable exclusion amount. Thereafter, tax imposed on estates exceeding $1 million. DC CODE §§ 47-3702; 47-3701; approved by Mayor on June 20, 2003; effective retroactively to death occurring on and after January 1, 2003.</td>
<td></td>
<td>$1,000,000</td>
</tr>
<tr>
<td>State</td>
<td>Type of Tax</td>
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<tr>
<td>Florida</td>
<td>None</td>
<td>No separate state QTIP election. Tax is tied to federal state death tax credit.</td>
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</tr>
<tr>
<td>Georgia</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit.</td>
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</tr>
<tr>
<td>Hawaii</td>
<td>Modified</td>
<td>Tax was tied to federal state death tax credit. The Hawaii Legislature on April 30, 2010 overrode the Governor’s veto</td>
<td>On May 2, 2012, the Hawaii legislature passed HB 2328 which conforms the Hawaii estate tax exemption to</td>
<td>$5,250,000 (indexed for inflation) (for deaths occurring after January 25, 2012)</td>
</tr>
<tr>
<td></td>
<td>Pick-up Tax</td>
<td>of HB 2866 to impose a Hawaii estate tax on residents and also on the Hawaii assets of a non-resident, non US citizen.</td>
<td>the federal estate tax exemption for decedents dying after January 25, 2012.</td>
<td></td>
</tr>
<tr>
<td>Idaho</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit.</td>
<td></td>
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</tr>
<tr>
<td>Illinois</td>
<td>Modified</td>
<td>On January 13, 2011, Governor Quinn signed Public Act 096-1496 which increased Illinois’ individual and corporate income</td>
<td>$4,000,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Pick-up Only</td>
<td>tax rates. Included in the Act was the reinstatement of Illinois’ estate tax as of January 1, 2011 with a $2 million</td>
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<td>exemption. Senate Bill 397 passed both the Illinois House and Senate as part of the tax package for Sears and CME on</td>
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<td>December 13, 2011. It increases the exemption to $3.5 million for 2012 and $4</td>
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<tr>
<td>State</td>
<td>Type of Tax</td>
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<tr>
<td>Indiana</td>
<td>None</td>
<td>Pick-up tax is tied to federal state death tax credit. IN ST §§ 6-4.1-11-2; 6-4.1-1-4. Indiana has not decoupled but has a separate inheritance tax (IN ST § 6-4.1-2-1) and recognizes by administrative pronouncement a separate state QTIP election. On May 11, 2013, Governor Pence signed HB 1001 which repealed Indiana’s inheritance tax retroactively to January 1, 2013. This replaced Indiana’s prior law enacted in 2012 which phased out Indiana’s inheritance tax over nine years beginning in 2013 and ending on December 31, 2021 and increased the inheritance tax exemption amounts retroactive to January 1, 2012.</td>
<td></td>
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</tr>
</tbody>
</table>

million for 2013 and beyond. Governor Quinn signed the legislation on December 16, 2011. Illinois permits a separate state QTIP election, effective September 8, 2009. 35 ILCS 405/2(b-1). On May 11, 2013, Governor Pence signed HB 1001 which repealed Indiana’s inheritance tax retroactively to January 1, 2013. This replaced Indiana’s prior law enacted in 2012 which phased out Indiana’s inheritance tax over nine years beginning in 2013 and ending on December 31, 2021 and increased the inheritance tax exemption amounts retroactive to January 1, 2012.
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<th>2013 State Death Tax Threshold</th>
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</thead>
<tbody>
<tr>
<td>Kansas</td>
<td>None.</td>
<td>For decedents dying on or after January 1, 2007 and through December 31, 2009, Kansas had enacted a separate stand alone estate tax. KS ST § 79-15, 203.</td>
<td></td>
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<tr>
<td>Kentucky</td>
<td>Inheritance Tax</td>
<td>Pick-up tax is tied to federal state death tax credit. KT ST § 140.130.</td>
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<td>Kentucky has not decoupled but has a separate inheritance tax and recognizes by administrative pronouncement a separate state QTIP election.</td>
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<tr>
<td>Louisiana</td>
<td>None</td>
<td>Pick-up tax is tied to federal state death tax credit.</td>
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</tr>
<tr>
<td>Maine</td>
<td>Pick-up Only</td>
<td>For decedents dying after December 31, 2002, pick-up tax is frozen at pre-EGTRRA federal state death tax credit, and imposed on estates exceeding applicable exclusion amount in effect on December 31, 2000 (including scheduled increases under pre-EGTRRA law) (L.D. 1319; March 27, 2003).</td>
<td></td>
<td>$2,000,000</td>
</tr>
<tr>
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<td>On June 20, 2011, Maine’s governor signed Public Law Chapter 380 into law, which will increase the Maine estate tax exemption to $2 million in 2013 and beyond. The rates are also changed, effective January 1, 2013, to 0% for Maine estates up to $2 million, 8% for Maine estates between $2 million and $5 million, 10% between $5 million and $8 million and 12% for the excess over $8 million.</td>
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<tr>
<td>Maine</td>
<td></td>
<td>For estates of decedents dying after December 31, 2002, Sec. 2058 deduction is ignored in computing Maine tax and a separate state QTIP election is permitted. M.R.S. Title 36, Sec. 4062.</td>
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<td>A 2010 Tax Alert issued by the Maine Revenue Services department limits the amount of the state QTIP to $2,500,000 (the difference between Maine’s $1,000,000 threshold and the $3,500,000 federal exemption Maine recognizes in 2010).</td>
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<td>Maine also subjects real or tangible property located in Maine that is transferred to a trust, limited liability company or other pass-through entity to tax in a non resident’s estate. M.R.S. Title 36, Sec. 4064.</td>
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<td></td>
</tr>
<tr>
<td>Maryland</td>
<td>Pick-up Tax</td>
<td>Tax frozen at pre-EGTRRA federal state death tax credit. MD TAX GENERAL § 7-309.</td>
<td></td>
<td>$1,000,000</td>
</tr>
<tr>
<td></td>
<td>Inheritance Tax</td>
<td>Effective January 1, 2004, the threshold for Maryland tax is capped at $1 million. Senate Bill 508 signed by Governor Erlich on May 26, 2004.</td>
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<td>Effective January 1, 2005, federal deduction for state death taxes under Sec. 2058 is ignored in computing Maryland estate tax, thus eliminating a circular computation. Senate Bill 508 signed by Governor Erlich on May 26, 2004.</td>
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<td>MD TAX GENERAL §§ 7-304; 7-309, amended</td>
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<td>State</td>
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<tr>
<td>Maryland</td>
<td></td>
<td>May 2004.</td>
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<td>On May 2, 2006, Governor Erlich signed S.B. 2 which limits the amount of the federal credit used to calculate the Maryland estate tax to 16% of the amount by which the decedent’s taxable estate exceeds $1,000,000, unless the Section 2011 federal state death tax credit is then in effect. It also permits a state QTIP election. MD TAX GENERAL § 7-309</td>
<td></td>
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</tr>
<tr>
<td>Massachusetts</td>
<td>Pick-up Only</td>
<td>For decedents dying in 2002, pick-up tax is tied to federal state death tax credit. MA ST 65C §§ 2A.</td>
<td></td>
<td>$1,000,000</td>
</tr>
<tr>
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<td>For decedents dying on or after January 1, 2003, pick-up tax is frozen at federal state death tax credit in effect on December 31, 2000. MA ST 65C §§ 2A(a), as amended July 2002.</td>
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<td></td>
<td>Tax imposed on estates exceeding applicable exclusion amount in effect on December 31, 2000 (including scheduled increases under pre-EGTRRA law), even if that amount is below EGTRRA applicable exclusion amount.</td>
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<tr>
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<tr>
<td>Massachusetts</td>
<td></td>
<td>Massachusetts Department of Revenue has issued directive, pursuant to which separate Massachusetts QTIP election can be made when applying state’s new estate tax based upon pre-EGTRRA federal state death tax credit.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Michigan</td>
<td>None</td>
<td>Tax was tied to federal state death tax credit.</td>
<td>MI ST §§ 205.232; 205.256</td>
<td></td>
</tr>
<tr>
<td>Minnesota</td>
<td>Pick-up Only</td>
<td>Tax frozen at federal state death tax credit in effect on December 31, 2000, clarifying statute passed May 2002.</td>
<td>On May 23, 2013, the governor signed the Omnibus Tax Bill, HF0677. This bill includes the following provisions affecting the estate and gift taxes: 1. A new Minnesota gift tax imposed at a flat rate of 10% and a taxpayer has a lifetime credit against the tax of $100,000 (that credit would exclude $1,000,000 of cumulative taxable gifts). The effective date for the new Minnesota gift tax is July 1, 2013. The Minnesota definition of “taxable gifts” closely follows the federal concept of “taxable gifts,” including gift tax annual</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>State</td>
<td>Type of Tax</td>
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<td>exclusions, gift-splitting, charitable deductions, and marital deductions.</td>
<td>2. The Minnesota’s estate tax so that the tax is computed by including taxable gifts made within three years of death. This provision will generally apply retroactive to decedents dying after December 31, 2012.</td>
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<tr>
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<td>3. This bill changes Minnesota’s estate tax with respect to the situs of property owned by a pass-through entity (e.g., an LLC, partnership, or S corporation that owns Minnesota real property or tangible personal property). This change ignores the pass-through entity for purposes of applying the Minnesota estate tax to Minnesota real property or tangible personal property owned by the pass-through entity. This provision applies retroactively to decedents dying after December 31,</td>
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<tr>
<td>Mississippi</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit. MS ST § 27-9-5.</td>
<td>2012.</td>
<td></td>
</tr>
</tbody>
</table>

4. Although Minnesota’s state estate tax exclusion amount is currently $1 million, Minnesota allows an additional deduction in computing the Minnesota taxable estate of up to $4 million for “qualified small business property” or “qualified farm property”. This was enacted in 2011 and applies for decedents dying after June 30, 2011. This new Omnibus Tax Bill includes several clarifications to the rules for qualified small business property and qualified farm property (previously, Minnesota Revenue had applied a very strict reading of the requirements for these deductions, and this bill clarifies or relaxes those requirements). These revisions will apply retroactively to decedents dying after June 30, 2011.
<table>
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</thead>
<tbody>
<tr>
<td>Missouri</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit.</td>
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<td></td>
<td></td>
<td>MO ST §§ 145.011; 145.091.</td>
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<tr>
<td>Montana</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit.</td>
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<td></td>
<td>MT St § 72-16-904; 72-16-905.</td>
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<tr>
<td>Nebraska</td>
<td>County Inheritance Tax</td>
<td>Nebraska through 2006 imposed a pick-up tax at the state level. Counties impose and collect a separate inheritance tax.</td>
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<td>NEB REV ST. § 77-2101.01(1).</td>
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<tr>
<td>Nevada</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit.</td>
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<td>NV ST §§ 375A.025; 375A.100.</td>
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<tr>
<td>New Hampshire</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit.</td>
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<td></td>
<td>NH ST §§ 87:1; 87:7.</td>
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</tr>
<tr>
<td>New Jersey</td>
<td>Pick-up Tax</td>
<td>For decedents dying after December 31, 2002, pick-up tax frozen at federal state death tax credit in effect on December 31, 2001.</td>
<td></td>
<td>$675,000</td>
</tr>
<tr>
<td></td>
<td>Inheritance Tax</td>
<td>NJ ST §§ 54:38-1</td>
<td></td>
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</tr>
<tr>
<td></td>
<td></td>
<td>Pick-up tax imposed on estates exceeding federal applicable exclusion amount in effect December 31, 2001 ($675,000), not including scheduled increases under pre-EGTRRA law, even though that amount is below the lowest EGTRRA applicable exclusion amount.</td>
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<td>The executor has the option of paying the above</td>
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</tr>
<tr>
<td>New Mexico</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit.</td>
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</tr>
</tbody>
</table>

pick-up tax or a similar tax prescribed by the NJ Dir. Of Div. of Taxn. NJ St §§ 54:38-1; approved on July 1, 2002.

In Oberhand v. Director, Div. of Tax, 193 N.J. 558 (2008), the retroactive application of New Jersey's decoupled estate tax to the estate of a decedent dying prior to the enactment of the tax was declared "manifestly unjust", where the will included marital formula provisions.

In Estate of Stevenson v. Director, 008300-07 (N.J.Tax 2-19-2008) the NJ Tax Court held that in calculating the New Jersey estate tax where a marital disposition was burdened with estate tax, creating an interrelated computation, the marital deduction must be reduced not only by the actual NJ estate tax, but also by the hypothetical federal estate tax that would have been payable if the decedent had died in 2001.

New Jersey allows a separate state QTIP election when a federal estate tax return is not filed and is not required to be filed.

The New Jersey Administration Code also requires that if the federal and state QTIP election is made, they must be consistent. NJAC 18:26-3A.8(d)
<table>
<thead>
<tr>
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</thead>
<tbody>
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<td>New York</td>
<td>Pick-up Only</td>
<td>Tax frozen at federal state death tax credit in effect on July 22, 1998. NY TAX § 951. Governor signed S. 6060 in 2004 which applies New York Estate Tax on a <em>pro rata</em> basis to non-resident decedents with property subject to New York Estate Tax. On March 16, 2010, the New York Office of Tax Policy Analysis, Taxpayer Guidance Division issued a notice permitting a separate state QTIP election when no federal estate tax return is required to be filed such as in 2010 when there is no estate tax or when the value of the gross estate is too low to require the filing of a federal return. See TSB-M-10(1)M. Advisory Opinion (TSB-A-08(1)M (October 24, 2008) provides that an interest in an S Corporation owned by a non-resident and containing a condominium in New York is an intangible asset as long as the S Corporation has a real business purpose. If the S Corporation has no business purpose, it appears that New York would look through the S Corporation and subject the condominium to New York estate tax in the estate of the non-resident. There would likely be no business purpose if the sole reason for forming</td>
<td></td>
<td>$1,000,000</td>
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<tr>
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<td>the S Corporation was to own assets.</td>
<td>On July 23, 2013, the Governor signed HB 998 which repealed the North Carolina estate tax retroactively to January 1, 2013</td>
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<tr>
<td>North Carolina</td>
<td>None</td>
<td></td>
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</tr>
<tr>
<td>North Dakota</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit.</td>
<td>On June 30, 2011, Governor Kasich signed HB 153, the biannual budget bill, which contains a repeal of the Ohio state estate tax effective January 1, 2013.</td>
<td></td>
</tr>
<tr>
<td>Ohio</td>
<td>None</td>
<td>Governor Taft signed the budget bill, 2005 HB 66, repealing the Ohio estate (sponge) tax prospectively and granting credit for it retroactively. This was effective June 30, 2005 and killed the sponge tax.</td>
<td></td>
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</tr>
<tr>
<td>Oklahoma</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit.</td>
<td></td>
<td>$1,000,000</td>
</tr>
<tr>
<td>State</td>
<td>Type of Tax</td>
<td>Effect of EGTRRA on Pick-up Tax and Size of Gross Estate</td>
<td>Legislation Affecting State Death Tax</td>
<td>2013 State Death Tax Threshold</td>
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<td>The new tax has a $1 million threshold with rates increasing from ten percent to sixteen percent between $1 million and $9.5 million. Determination of the estate for Oregon estate tax purposes is based upon the federal taxable estate with adjustments.</td>
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</tr>
<tr>
<td>Pennsylvania</td>
<td>Inheritance Tax</td>
<td>Tax is tied to the federal state death tax credit to the extent that the available federal state death tax credit exceeds the state inheritance tax. Pennsylvania had decoupled its pick-up tax in 2002, but has now recoupled retroactively. The recoupling does not affect the Pennsylvania inheritance tax which is independent of the federal state death tax credit. Pennsylvania recognizes a state QTIP election.</td>
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</tr>
<tr>
<td>Rhode Island</td>
<td>Pick-up Only</td>
<td>Tax frozen at federal state death tax credit in effect on January 1, 2001, with certain adjustments (see below). RI ST § 44-22-1. Rhode Island recognized a separate state QTIP election in the State’s Tax Division Ruling Request No. 2003-03. Rhode Island’s Governor signed in to law on June 30, 2009, effective for deaths occurring on or after January 1, 2010, an increase in the amount exempt from Rhode Island estate tax from</td>
<td></td>
<td>$910,725</td>
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<tr>
<td>State</td>
<td>Type of Tax</td>
<td>Effect of EGTRRA on Pick-up Tax and Size of Gross Estate</td>
<td>Legislation Affecting State Death Tax</td>
<td>2013 State Death Tax Threshold</td>
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</table>
| South Carolina      | None             | $675,000, to $850,000, with annual adjustments beginning for deaths occurring on or after January 1, 2011 based on “the percentage of increase in the Consumer Price Index for all Urban Consumers (CPI-U)…. rounded up to the nearest five dollar ($5.00) increment.”  
RI ST § 44-22-1.1. |                                                                                                                         |                                                                                                          |                               |
| South Dakota        | None             | Tax is tied to federal state death tax credit.  
| Tennessee           | Inheritance Tax  | Pick-up tax is tied to federal state death tax credit.  
On May 2, 2012, the Tennessee legislature also passed HB 2840/SB 2777 | On May 2, 2012, the Tennessee legislature passed HB 3760/SB 3762 which phases out the Tennessee inheritance Tax as of January 1, 2016. The Tennessee inheritance Tax Exemption is increased to $1.25 million in 2013, $2 million in 2014, and $5 million in 2015.  
On May 2, 2012, the Tennessee legislature also passed HB 2840/SB 2777 |
<table>
<thead>
<tr>
<th>State</th>
<th>Type of Tax</th>
<th>Effect of EGTRRA on Pick-up Tax and Size of Gross Estate</th>
<th>Legislation Affecting State Death Tax</th>
<th>2013 State Death Tax Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Texas</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit. TX TAX §§ 211.001; 211.003; 211.051</td>
<td>which repeals the Tennessee state gift tax retroactive to January 1, 2012.</td>
<td></td>
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<tr>
<td>Utah</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit. UT ST § 59-11-102; 59-11-103.</td>
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<tr>
<td>Vermont</td>
<td>Modified Pick-up</td>
<td>In 2010, Vermont increased the estate tax exemption threshold from $2,000,000 to $2,750,000 for decedents dying January 1, 2011. As of January 1, 2012 the exclusion is scheduled to equal the federal estate tax applicable exclusion, so long as the FET exclusion is not less than $2,000,000 and not more than $3,500,000. VT ST T. 32 § 7442a. Previously the estate tax was frozen at federal state death tax credit in effect on January 1, 2001. VT ST T. 32 §§ 7402(8), 7442a, 7475, amended on June 21, 2002. Threshold was limited to $2,000,000 in 2009 when the legislature overrode the Governor’s veto of H. 442. No separate state QTIP election permitted.</td>
<td>$2,750,000</td>
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<tr>
<td>Virginia</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit. VA ST §§ 58.1-901; 58.1-902.</td>
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<tr>
<td>State</td>
<td>Type of Tax</td>
<td>Effect of EGTRRA on Pick-up Tax and Size of Gross Estate</td>
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<td>The Virginia tax was temporarily repealed effective July 1, 2007. Previously, the tax was frozen at federal state death tax credit in effect on January 1, 1978. Tax was imposed only on estates exceeding EGTRRA federal applicable exclusion amount. VA ST §§ 58.1-901; 58.1-902.</td>
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<tr>
<td>Washington</td>
<td>Separate Estate Tax</td>
<td>On February 3, 2005, Washington State Supreme Court unanimously held that Washington’s state death tax was unconstitutional. The tax was tied to the current federal state death tax credit, thus reducing the tax for the years 2002 - 2004 and eliminating it for the years 2005 - 2010. Hemphill v. State Department of Revenue 2005 WL 240940 (Wash. 2005). In response to Hemphill, the Washington State Senate on April 19 and the Washington House on April 22, 2005, by narrow majorities, passed a stand-alone state estate tax with rates ranging from 10% to 19%, a $1.5 million exemption in 2005 and $2 million thereafter, and a deduction for farms for which a Sec. 2032A election could have been taken (regardless of whether the election is made). The Governor signed the legislation. Washington voters defeated a referendum to repeal the Washington estate tax in the November 2006 elections.</td>
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<td>On June 14, 2013, Governor Inslee signed HB 2075 which closed an exemption for marital trusts retroactive immediately prior to when the Department of Revenue was about to start issuing refund checks, created a deduction for up to $2.5 million for certain family owned businesses and indexes the $2 million Washington state death tax threshold for inflation.</td>
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<tr>
<td></td>
<td></td>
<td>$2,000,000</td>
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<tr>
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<td>Washington permits a separate state QTIP election. WA ST §83.100.047.</td>
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<tr>
<td>West Virginia</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit. WV § 11-11-3.</td>
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<tr>
<td>Wisconsin</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit. WI ST § 72.01(11m).</td>
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<td>For deaths occurring after September 30, 2002, and before January 1, 2008, tax was frozen at federal state death tax credit in effect on December 31, 2000 and was imposed on estates exceeding federal applicable exclusion amount in effect on December 31, 2000 ($675,000), not including scheduled increases under pre-EGTRRA law, even though that amount is below the lowest EGTRRA applicable exclusion amount. Thereafter, tax imposed only on estates exceeding EGTRRA federal applicable exclusion amount. WI ST §§ 72.01; 72.02, amended in 2001; WI Dept. of Revenue website.</td>
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<td>On April 15, 2004, the Wisconsin governor signed 2003 Wis. Act 258, which provides that Wisconsin will not impose an estate tax with respect to the intangible personal property of a non-resident decedent that has a taxable situs in Wisconsin even if the non-resident’s state of domicile does not impose a death tax.</td>
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</tr>
<tr>
<td>State</td>
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<tr>
<td>Wisconsin</td>
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<td>Previously, Wisconsin would impose an estate tax with respect to the intangible personal property of a non-resident decedent that had a taxable situs in Wisconsin if the state of domicile of the non-resident had no state death tax.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wyoming</td>
<td>None</td>
<td>Tax is tied to federal state death tax credit. WY ST §§ 39-19-103; 39-19-104.</td>
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</table>
EXHIBIT “E”

DIGITAL PROPERTY

A. WILL CLAUSES

1) Tangible Personal Property and Definition of Digital Property

I give and bequeath all of my jewelry, clothing, books, silverware, glassware, works of art, antiques, all other personal and household effects, furniture, furnishings, automobiles, digital devices of every nature and kind, including, but not limited to, computers, laptops, notebooks, and smartphones and similar devices that now exist or may exist in the future, and "digital assets", hereinafter defined, of every nature and kind (except for any digital financial accounts or digital business accounts such as on-line banking or brokerage accounts, which digital financial accounts and digital business accounts shall be disposed of as a part of my "Residuary Estate", as hereinafter defined, to the extent that such accounts are testamentary assets) to my wife, ________________, if she shall survive me. For all purposes of this my Last Will and Testament, the term "digital assets" shall include, but not be limited to, all of my files stored on my digital devices and backup systems, including but not limited to, files stored on desktops, laptops, tablets, peripherals, storage devices, mobile telephones, smartphones, and any similar digital device which currently exists or may exist as technology develops, and all emails received by me, my email accounts such as any and all Gmail, Yahoo, America on Line (AOL) accounts, my digital music, digital photographs, digital videos, and digital games, my software licenses, my social network accounts such as any Facebook, Twitter, LinkedIn, Flickr, Shutterfly and YouTube accounts, my file sharing accounts, my domain registrations and domain name system (DNS) service accounts, my web hosting accounts, my tax preparation service accounts, and my online stores, affiliate programs, other online accounts and similar digital items which currently exist or may exist as technology develops or such comparable items as technology develops regardless of the ownership of the physical device upon which the digital item is stored.

2) Digital Executor - (A) I hereby nominate, constitute and appoint ____________ as the Digital Executor of this my Last Will and Testament in connection with the administration of all of my "digital assets", as hereinbefore defined. If __________ shall die or shall be or become unwilling or unable to qualify and/or act or continue to act as Digital Executor, I hereby nominate, constitute and appoint __________ to be Digital Executor in his/her place and stead.

(B) I hereby nominate, constitute and appoint ____________ as the Executor of this my Last Will and Testament in connection with the administration of all of my assets, except for my "digital assets". If __________ shall die or shall be or become unwilling or unable to qualify and/or act or continue to act as Executor, I hereby nominate, constitute and appoint __________ to be Executor in his/her place and stead.

3) Powers Clause re Digital Assets - My Executors (or my Digital Executors) shall have full authority granted to them under applicable law to administer all of my "digital assets", as
hereinbefore defined, including, but not limited to: (i) the power to access, use, control, transfer and dispose of my digital devices, including but not limited to, desktops, laptops, tablets, peripherals, storage devices, mobile telephones, smartphones, and any similar digital device which currently exists or may exist as technology develops or such comparable items as technology develops for the purpose of accessing, using, modifying, deleting, controlling, transferring or disposing of my "digital assets", as hereinbefore defined, and (ii) the power to access, use, modify, delete, control, transfer and dispose of all of my "digital assets", as hereinbefore defined.

B. POWER OF ATTORNEY

My agent, to the extent permissible under applicable law, shall have the same powers and rights that I possess over all of my "digital assets", as hereinafter defined, including, but not limited to: (i) the power to access, use, control, transfer and dispose of my digital devices, including but not limited to, desktops, laptops, tablets, peripherals, storage devices, mobile telephones, smartphones, and any similar digital device which currently exists or may exist as technology develops or such comparable items as technology develops for the purpose of accessing, using, modifying, deleting, controlling, transferring or disposing of my "digital assets", as hereinafter defined, and (ii) the power to access, use, modify, delete, control, transfer and dispose of my "digital assets" as hereinafter defined. For all purposes of this Power of Attorney, the term "digital assets" shall include, but not be limited to, all of my files stored on my digital devices and backup systems, including but not limited to, desktops, laptops, tablets, peripherals, storage devices, mobile telephones, smartphones, and any similar digital device which currently exists or may exist as technology develops, and all emails received by me, my email accounts such as any and all Gmail, Yahoo, America on Line (AOL) accounts, my digital music, digital photographs, digital videos, and digital games, my software licenses, my social network accounts such as any Facebook, Twitter, LinkedIn, Flickr, Shutterfly and YouTube accounts, my file sharing accounts, my domain registrations and domain name system (DNS) service accounts, my web hosting accounts, my tax preparation service accounts, and my online stores, affiliate programs, other online accounts and similar digital items which currently exist or may exist as technology develops or such comparable items as technology develops regardless of the ownership of the physical device upon which the digital item is stored.
CHAPTER THREE

NEW YORK ESTATE AND GIFT TAXES

Michael E. O’Connor, Esq.
[3.0] I. HISTORICAL OVERVIEW

Historically, New York State has imposed estate and gift taxes upon the transfer of wealth by New York residents; it also has taxed the passage of real estate and tangible personal property located in New York and owned by nonresidents. Until 2000, the New York estate tax was based on the federal estate tax but typically was calculated at a rate substantially higher than both the rate used by most other states and the state death tax credit allowed on the federal return. The extra cost of the New York estate tax was perceived as yet another reason for clients to establish their domicile in Florida or other states.

New York repealed both the New York estate tax and gift tax by legislation in 1997.1 The gift tax was permanently repealed for all gifts made on or after January 1, 2000. The separate estate tax was repealed for deaths occurring on or after February 1, 2000, and replaced with a state estate tax limited to the amount allowed as a credit against the federal estate tax.2 This sop tax, so-called because the tax imposed was only as much as was needed to “sop up” the federal credit, was essentially a federal subsidy of New York and the 35 other states, including Florida, that had such a tax. If any of these states failed to actually tax this amount, the credit was not available and the revenue passed to the federal government instead of the state.

In adopting the sop tax, the legislature expected that, because New York law then mirrored Florida law, fewer citizens seemingly would need or want to change their domicile to Florida. If more people remained domiciled in New York, more estates would pay the sop tax upon the decedent’s death. Therefore, New York would reap a greater number of federal credits, and, because the credit was substantial, the consequent revenues to the state were expected to offset the loss of revenue resulting from elimination of the higher New York estate tax.

Had the federal estate tax remained unchanged, New York would have continued to collect an amount equal to the state death tax credit as computed on the federal estate tax return. There would have been little need for estate tax administration, because the amount due New York was computed on the federal return and, presumably, the enforcement of that tax and the valuations used were issues for the Internal Revenue Service.

However, the smooth operation of New York’s estate tax was short-lived. The Economic Growth and Tax Relief Reconciliation Act of 20013 gradually eliminated the state death tax credit. The credit was reduced over four years and then completely eliminated for deaths occurring after 2004. Now, any estate tax due a state is simply a deduction on the federal return, not a credit. The federal subsidy of the states by the credit has disappeared.

Even without the elimination of the state death tax credit, the impact of EGTRRA’s changes to the federal estate tax (i.e., incrementally increasing the amount of assets exempted from the federal estate tax until completely repealing the tax in 2010) would have dramatically affected those states that had limited their estate tax revenue to the amount sheltered by the federal state death tax credit. With each increase in the applicable federal exclusion amount, the state death tax credit would have applied only to bigger

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1 1997 N.Y. Laws ch. 389, pt. A, § 7. The repeal resulted in large part because of the tireless efforts of Joshua Rubenstein, former chair of the New York State Bar Association’s Trusts and Estates Law Section, and the many section members who worked with him. See also N.Y. Tax Law § 952.


estates, thus reducing the revenue the state previously could have recouped from the multiple smaller estates.

The reaction of the states to the elimination of the state death tax credit was prompt and diverse. Some states, like Florida, have constitutional provisions that prevent them from instituting a separate estate tax strictly by legislation. Of those states that could institute a new estate tax, most did. New York’s solution to the federal changes was simpler. When it repealed its estate tax, New York did not automatically conform to any changes that might be made in federal law in the future, as such conformity is prohibited by the New York State Constitution.\footnote{N.Y. Const. art. 3, § 22.} New York’s estate tax repeal was tied to the workings of I.R.C. § 2011 (the state death tax credit) as it existed on July 22, 1998.\footnote{Tax Law § 951(a).} In other words, New York’s estate tax equaled the state death tax credit as it would have been computed for an estate on July 22, 1998. The state repeal disregarded both the federal repeal of the state death tax credit and the increase in the applicable exclusion amount created by the federal legislation. The New York tax is now decoupled from the federal law, as has been done in most states.

Consequently, New York estate tax returns must be filed for all estates that exceed the $1 million exemption, regardless of the federal exclusion amount. For example, if a decedent dies in 2011 with a taxable estate of $2 million, the federal exclusion amount would far exceed the estate. The New York tax would be $99,600, as computed under I.R.C. § 2011 as it would be applied in 1998. There would be no beneficial deduction on the federal return for an estate of that size because there would be no federal tax. The New York tax would be due nine months following death.

If EGTRRA sunsets in 2013 as currently scheduled, the New York estate tax will once again conform to the federal tax. The New York gift tax will not be reestablished unless the legislature and governor choose to do so in the future, without regard to federal legislation.

So, what is the moral of this historical recounting? The planner has a continuing obligation to know the status of conformity legislation in New York and to be aware that federal changes are not New York changes until, and if, the legislature acts. Further, given the lack of uniformity among the various states, the planner must assess the impact of each state’s estate tax. Thus, an estate-planning attorney for a New York client who owns real property or tangibles in other states must closely examine the laws of all states involved.

\[3.1\] II. ESTATE TAX PLANNING GUIDELINES

The New York estate tax is still computed based on federal guidelines, but it relies only on those provisions of the Internal Revenue Code that relate to the state death tax credit and applicable credit amount enacted or amended on or before July 22, 1998. Thus, New York estate planners must always be conscious of the frozen $1 million exemption amount, as that figure will largely dictate the type of planning necessary for different estates. In addition to determining whether an estate tax is due and, if so, how much, the practitioner must address several state-specific legal issues in preparing estate-planning documents. The most important are the client’s residency, the tax-apportionment language in the planning documents and the potential spousal elective share. Each of these issues is discussed below.
[3.2] A. Residency

Is the client a New York resident or a resident of another state? The answer to that question determines what estate tax will be due New York. This section addresses, first, the way in which residency is determined and, second, how such determination affects the New York State estate tax a client will pay.

[3.3] 1. Domicile

When a client maintains homes in more than one state, where is the client a resident? The determination is important because the nature of the property will affect the extent to which the property can be taxed in New York. Once the attorney has advised the client of his or her potential tax liability in New York, as part of the planning process, a client with an estate worth more than $1 million may want to consider establishing residency in another, less onerous, taxing jurisdiction.

Although the New York statute refers to resident and nonresident estates, “domicile is the controlling factor in determining residency.”6 Although domicile is not defined in the Tax Law, it is defined in the N.Y. Surrogate’s Court Procedure Act as “[a] fixed, permanent and principal home to which a person wherever temporarily located always intends to return.”7 This definition turns on subjective intent. Domicile has been termed in the case law as a question of fact rather than one of law.8 Ultimately, one’s domicile is a combination of intent to regard a particular place as the principal abode, coupled with conduct that evidences such intent.

The best way to determine whether a person is domiciled in New York for estate tax purposes is to review and complete the aptly named Estate Tax Domicile Affidavit (Form ET-141).9 This affidavit, used when filing a New York estate tax return to establish that a decedent is not a New York resident, contains a series of questions about the decedent. It calls for information about the decedent’s past residences, work history, declarations and other patterns of conduct bearing on domicile. When completed, it provides a profile of the decedent’s actions (facts) against which declarations (expressions of intent) can be compared.

For planning purposes, the form is useful as a checklist to determine where the client is currently domiciled and what actions the client should take if a change of domicile is desired. Upon reviewing the completed ET141 form, the planner can counsel the client about what further (or other) steps to take in order to resolve any domicile ambiguities.

Appropriate and consistent actions to support a desired domicile determination, or to change a current domicile, are critical. Because New York State presumes a continuance of domicile, the taxpayer (or party alleging the change) bears the burden of proving a change in domicile.10 Factual ambiguity may lead to a negative domicile determination or, at the least, the need to argue the domicile issue. Worse yet for clients with more than one residence is the possibility of multiple jurisdictions seeking to impose estate taxes on the client’s assets. The result in In re Dorrance’s Estate,11 in which Pennsylvania and New Jersey both

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7 N.Y. Surrogate’s Court Procedure Act 103(15).
8 See In re Chivatsky, N.Y.L.J., Aug. 15, 1977, p. 12, col. 6 (Sur. Ct., Nassau Co.).
9 See N.Y. State Dep’t of Taxation and Finance, www.tax.state.us (a copy of this form is set forth in the appendix to this chapter).
10 See In re Newcomb’s Estate, 192 N.Y. 238 (1908).
11 309 Pa. 151, 163 A. 303, cert. denied, 287 U.S. 660 (1932); In re Dorrance’s Estate, 115 N.J. Eq. 268, 170 A. 601 (1934), cert. denied sub
found that the decedent was domiciled in their state, can be avoided with appropriate attention to the domicile issue.

[3.4] 2. Taxability

If the client is a resident of New York, then all the client’s property, except real property and tangibles located outside the state, is subject to New York estate taxation. Thus, a New York resident’s intangibles (e.g., bank accounts, stocks and other investments), wherever they are located, will be taxed in accordance with New York law. The house, furniture and car owned by a New York decedent in Florida would not be taxable in New York.

The reverse is true for the non–New York domiciliary. If the client is a nonresident, only the client’s “real [property] and tangible personal property” located in New York are subject to the New York estate tax. The New York State Constitution bars the state from subjecting a nonresident’s intangible personal property to estate tax, unless such property was used in carrying on a business in the state.

Intangible personal property is statutorily defined in terms of what tangible personal property does not include—that is, “deposits in banks, mortgages, debts, receivables, shares of stock, bonds, notes, credits, evidences of an interest in property, evidences of debt, or choses in action generally.” Thus, bank accounts and investments, even if located in New York State and held by New York advisers or institutions, will not be taxable if the client is not a resident of New York.

Understanding the taxability difference is critical for properly advising clients. If the client is or becomes a nonresident, his or her New York estate tax exposure likely will substantially decrease as a result. But such is not always the case. When the total property in all states of a nonresident exceeds $1 million, the nonresident may owe estate tax in New York, even if the amount of real property or tangible personal property located in New York is small. This is because the New York estate tax is based on what the tax would be on the entire estate if the decedent were a New York resident and what proportion of the entire estate is New York real property or tangibles. This calculation effectively precludes the nonresident’s estate from receiving the benefit of the entire $1 million credit equivalent, since a major portion of that amount may be allocated to property outside New York.

In order to reduce or avoid New York estate taxation of a non–New York domiciliary’s estate, the nonresident may wish to restructure his or her real property or tangible personal property to make it intangible. For example, if a Florida domiciliary transfers his New York real property into a corporation, the shares of that corporation would be an intangible asset taxable only in Florida. A similar result might be obtained by transferring ownership of the New York real property into a multi-member limited liability company (LLC).

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12 Tax Law § 954.
13 Tax Law § 960.
14 N.Y. Const. art. 16, § 3.
15 Tax Law § 951-a(c).
16 The planner should be cautious about creating a single-member LLC to effect such a change because such entities are deemed nullities for all federal tax purposes. Thus, New York likely would agree that such an entity is equally ineffective in changing the nature of the assets held within it for New York tax purposes.
[3.5] B. Tax Apportionment

The burden of paying the estate tax by default falls on the estate’s beneficiaries. The statute calls for an equitable apportionment of the estate taxes (federal and state) among those who receive taxable property from the distribution of the estate, unless the instrument governing the distribution expressly directs otherwise. In other words, a provision in a will or trust instrument providing for payment of the estate taxes from a particular source, most often the residuary estate, will override the statute. For the will provision to control, such provision must be clear and unambiguous. Thus, the planner must discuss with the client which beneficiaries should bear the burden of the estate taxes, and prepare planning documents that clearly provide for appropriate apportionment of the tax liability.

Tax allocation may become particularly challenging if the client has several documents that control the disposition of taxable assets. Further, any property interests that pass by operation of law will create their own tax burdens for the estate. Should these assets bear their own tax liabilities, or should they be exonerated from contributing to the tax payment by a specific provision in the will or revocable trust? The answer depends on the client’s intent.

Thoughtful tax allocation during drafting is necessary to ensure that marital and charitable gifts are preserved in full. For example, a poorly drafted tax clause can require, albeit unintentionally, that an otherwise qualified marital or charitable share be used for estate tax payment (i.e., if the clause provides that estate taxes are to be paid from the residuary and the residuary is the marital or charitable share). In that instance, because some of the funds that would have gone to a spouse or a charity are instead going to pay taxes, and because estate tax payments are not deductible expenses, those funds no longer qualify for the marital or charitable deduction and become taxable.

This creates a spiraling cause-and-effect relationship: By not qualifying for the deduction, these amounts increase the taxable estate, which further increases the taxes, which increases the amounts to be taken from the marital or charitable share, which further increases the taxable estate, which further increases the taxes, and so on, thereby requiring the application of a complex, algebraic formula, commonly called the \textit{interrelated tax calculation}, to determine the tax liability and appropriate charitable or marital deduction.

The interrelated tax computation became even more complex with regard to deaths occurring on or after January 1, 2005. That date is when the New York estate tax became a deduction, rather than a credit, on the federal return. Consequently, the state estate tax deduction increases as the charitable or marital deduction decreases because the estate tax is paid from the otherwise deductible share. That was not previously the case when the state death tax credit was the only adjustment for state estate tax.

In other words, a bad tax allocation provision can result in more money being paid in taxes and less passing to the spouse or charity, and, except in unusual cases, this should not happen. If it does, absent a well-documented, client-approved reason, the drafter of the tax-clause provision has erred.\footnote{For a detailed analysis and discussion of drafting tax-apportionment clauses, see Jonathan G. Blattmachr and Dan T. Hastings, \textit{The Tax Apportionment Clause—Often the Most Important Provision in the Will}, The Chase Rev. (1987), revised and reprinted, Part I, N.Y. St. B.J. (Apr. 1988) p. 26; Part II, N.Y. St. B.J. (May 1988) p. 42.}

[3.6] C. Spouse’s Elective Share

If the total assets of both spouses together are valued at $1 million or less, the estate is exempt from paying an estate tax at both the federal and state level. For estates valued above $1 million, however,

\footnote{N.Y. Estates, Powers & Trusts Law 2-1.8.}
practitioners must be diligent in determining the actual amounts of federal and New York estate tax due and keep in mind that an estate that is exempt from federal estate taxes may not be exempt from New York estate taxes.

Some of the traditional drafting techniques for dealing with a potential federal estate tax may now result in a substantial and possibly unnecessary New York estate tax. In reviewing existing plans or structuring new plans, the planner must carefully consider the effect of the New York tax, particularly upon the death of the first spouse.

**EXAMPLE**

Consider a client couple that has a will or trust agreement that provides for the creation of a credit-shelter trust upon the first spouse’s death, which will contain the greatest amount that can pass free of federal estate tax in the first estate. Further assume that the credit trust is structured so that it would not qualify for the estate-tax marital deduction under any circumstance (e.g., a trust that provides that income or principal be sprinkled among descendants could not qualify for the marital deduction). Next, assume the first spouse to die has individually owned assets with a total value of $2 million, and the date of the first death is in 2011. Lastly, assume the surviving spouse has only nominal assets independently or through joint ownership or beneficiary designation.

The death of the first spouse will result in no federal estate tax being due and, in fact, no return will be required because the applicable credit would completely eliminate the federal tax. New York, however, would apply its tax based upon a taxable estate of $2 million (everything passing into the credit trust). Because of the reduced New York exclusion, the resulting tax would be $99,600. Had the taxable estate of the first decedent spouse been reduced to $1 million, the New York estate tax would have been eliminated. Further, at the second spouse’s death, assuming no change in asset values, there would also be no federal or New York estate tax with the lower taxable amount.

This example illustrates one of the problems that improper drafting can cause, when all tax otherwise could be fairly easily eliminated.

In some cases, a federal estate tax may be due, but the client must carefully consider whether any tax should be paid on the first estate. Sometimes, the payment of even a relatively small percentage tax years in advance of when it might otherwise have been paid is not good planning. The time use of money illustrates that even a larger tax paid years later could be preferable to the early tax payment.

Regarding the New York estate tax, the client must also consider whether the surviving spouse will even be subject to taxation in New York. If the survivor moves to Florida, for example, he or she may avoid all state estate tax. Further, the federal government may well either raise the amount protected from federal estate tax, thus sheltering the client’s estate, or even repeal the federal estate tax.

For all these reasons, the client must carefully consider the wisdom of paying any estate tax on the first estate. Perhaps the most important term to remember when planning the taxable estate is *flexibility*. Some possible approaches are discussed below.

**[3.7] 1. Disclaimer**

Wills of married clients with large estates now commonly incorporate a disclaimer to allow a surviving spouse to choose (1) whether to create a credit trust to protect the applicable estate-tax exclusion amount
and (2) if such a trust is elected, how large that trust should be. The ongoing uncertainty surrounding the imposition of the estate tax and the applicable exclusion amounts virtually mandate that well-heeled married clients consider including such a disclaimer in their wills.\footnote{See chapter 4, Appendix A for a sample will with disclaimer trust.}

[3.8] 2. Limited Size of Credit Trust

If a client’s will or trust agreement provides for the creation of a traditional credit trust, the client should consider limiting the amount that can pass into such a trust. Although credit shelter trusts traditionally have been funded with “the greatest amount that can pass free of federal estate tax” or something similar, such a trust could be limited to the greatest amount that can pass free of New York estate tax. Such an approach would eliminate a New York estate tax while providing the advantages of a sprinkling trust or an accumulation trust during the survivor’s life.

In addition, a limited credit trust would not involve the spouse in creating the trust by disclaimer or selecting its size, which could be advantageous when a second marriage is involved or when the surviving spouse is incapable of making appropriate decisions or managing his or her finances.

A potential disadvantage of a limited credit shelter trust arises from the different federal and New York gift tax schemes. Although New York has repealed its gift tax, the federal gift tax remains in place. If the client while alive makes any taxable gifts, the planner must consider how such gifts will affect the funding of the credit trust at death.

[3.9] 3. QTIP Trust

If a trust created for the benefit of a surviving spouse qualifies as qualified terminable interest property (QTIP), the executor can elect for the trust, or a portion of it, to qualify for the estate tax marital deduction. Such election defers estate taxation on the elected trust property until the death of the second spouse. Because the QTIP election can be partial, a client could elect to qualify for the marital deduction all but $1 million of the trust. Doing so would eliminate any New York estate tax and, of course, avoid federal tax if the client has made no taxable gifts during his or her life.

Some states that have decoupled their estate tax from the federal tax have authorized a separate QTIP election for state tax purposes. Thus, a client could take the greatest exemption possible for federal tax purposes and claim a smaller exemption for state tax purposes to avoid state estate taxation in the first estate. Necessarily with such a two-part election, more of the surviving spouse’s estate would be subject to state estate taxation at the second death than would be the case absent such election.

Although the New York State Bar Association’s Trusts and Estates Section has supported a separate New York QTIP election, New York has failed to enact such legislation. Consequently, an executor who currently makes a QTIP election to avoid imposition of the New York estate tax in the first estate will elicit a higher federal estate tax in the second estate, if the second estate is large enough to warrant such higher tax.


The traditional QTIP trust is structured to qualify for the estate tax marital deduction, which means that all income must be paid to the surviving spouse at least annually and that no income or principal can be paid to anyone other than the spouse during his or her lifetime. The executor’s election to qualify part of the trust for the marital deduction would not change the terms of the trust. As a result, the portion of the
QTIP trust that did not qualify for the marital deduction (call it the credit trust) would continue to pay its income to the surviving spouse for life. This flow of income to the spouse would cause the second estate to become larger. It would also prevent passage of the property to the decedent’s children or grandchildren during the surviving spouse’s life, thereby eliminating a convenient way to reduce the size of the estate. This disadvantage is addressed by the so-called Clayton QTIP.

With a Clayton QTIP, two trusts would be created under the will or trust agreement. One trust would be ineligible for the marital deduction and might sprinkle income and principal among family members. The second trust would provide all income to the spouse and would be qualified for the marital deduction. The allocation of assets between the two trusts is controlled by the share of the residual estate that the executor elects to qualify for QTIP treatment. The entire portion that is qualified for the marital deduction would pass into the trust that pays all its income to the spouse. The portion that is not qualified for the marital deduction would pour into the sprinkling trust. The IRS has approved this approach.

The advantage of the Clayton approach is that the nonqualified trust can be designed in any way the client wishes, thereby increasing flexibility. Because the QTIP election need not be made until the extended due date of the return, the executor has potentially 15 months to decide, compared to the 9 months a surviving spouse has to elect to exercise a disclaimer.

One disadvantage of the Clayton election is that the fiduciary is making disposition decisions over the client’s property. The inherent conflict of interest that the spouse or any other beneficiary would have as executor suggests that an independent party should make that election. Many clients are hesitant to give dispositional control of their estates to someone other than a spouse or, occasionally, a child. In the case of a second marriage, the surviving spouse might have to elect against the will, or risk the executor electing a QTIP in such a way that the spouse has little or no benefit because substantially all the property is allocated to the credit trust. The executor would be able to wait until the time to elect against the will had expired and then allocate the property by the QTIP election.

[3.11] 5. Relocation to Florida

When New York repealed its estate tax, it created an even playing field with states such as Florida that had previously repealed their estate taxes. Current law, however, again makes dying a resident of New York more costly. Because Florida is prohibited constitutionally from either reinstituting an estate tax or decoupling, it very likely will not establish an independent estate tax. A complete repeal of the federal estate tax in the future would create a substantial difference in the tax cost of dying domiciled in New York versus Florida. If, on the other hand, the current federal legislation sunsets in 2013, then New York and Florida will once again have the same estate tax, and Florida will lose its advantage in this regard.

Few people choose where they will live in their later years based upon estate tax, no matter how large it is. Nonetheless, the estate planner must help the client assess the risks and advise carefully on such questions. At this point, the topic is not especially ripe for consideration—at least until such time as the federal estate tax is completely repealed.

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20 Treas. Reg. § 20.2056(b)-7(d)(3), (b) ex. 6.
21 See discussion supra at § 3.2 regarding the tax issues applicable to nonresidents.
III. GIFT TAX

Effective January 1, 2000, New York’s gift tax was repealed, and no gifts made since that date, including lifetime transfers, have been taxed. Consequently, planning can now be based entirely upon the federal transfer tax system. The annual gift tax exclusion amount under that system is based on a rate of $10,000 per donee, increased at regular intervals by a cost-of-living adjustment. The 2011 rate is $13,000, which means a donor can make an unlimited number of gifts, as long as none individually exceed $13,000. Such a scenario ensures no tax consequences for all parties involved. Planning such gifts carefully is an effective way to reduce the size of an estate without reducing the unified credit, which currently is $5 million and is scheduled to remain at that level through 2012. For example, a donor could make gifts of $13,000 to 12 different individuals, thereby reducing his estate by $156,000, preventing himself and his donees from suffering any adverse tax consequences and avoiding any reduction in the unified credit.

Whenever a taxpayer makes gifts above the allowable maximum in a given year, “a gift tax return is required, even if no gift tax is due because the applicable credit amount is available.” The gift tax applies to transfers of property by gift, “whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.”

Numerous other aspects of the federal gift tax must be considered when counseling a client on the planning process.

24 I.R.C. § 2503.
26 Currently, the only states that have an independent gift tax are Connecticut, Delaware, Louisiana, North Carolina and Tennessee. John A. Hartog, Post-Mortem Planning and Estate Administration, SK070 A.L.I.-A.B.A. 81, 88 (2004).
27 Id. at 91 (citing I.R.C. § 2511(a)).
28 A discussion of these considerations is beyond the scope of this chapter. See ch. 2, “Federal Estate and Gift Taxation: An Overview.”
APPENDIX

New York State Department of Taxation and Finance

New York State Estate Tax Domicile Affidavit

ET-141

For estates of decedents dying after May 25, 1990

Complete Form ET-141 if it is claimed that the decedent was not domiciled in New York State at the time of death. The fiduciary (executor or administrator), the surviving spouse or a member of the decedent's immediate family who can provide all the information requested below should complete this affidavit.

Answer all questions completely. Attach this form to Form ET-90 or Form ET-85.

Decedent's last name

First

Middle initial

Social security number

Address of decedent at time of death (number and street)

City, village or post office

County

State

ZIP code

Country of residence

Age at death

Place of birth

1. If born outside the United States, was the decedent a naturalized citizen of the United States? Yes No

Name and address of court where naturalized

2. Did decedent ever live in New York State? Yes No

If Yes, list periods.

3. Did decedent ever own, individually or jointly, any interest in real estate located in New York State? Yes No

If Yes, list addresses and periods below (attach additional sheets if necessary)

Periuds of time from to

Addresses of property

4. Did decedent lease a safe deposit box located in New York State at the time of death? Yes No

If Yes, complete box below. Also, if Yes, has it been inventoried? Yes No

Name and address of bank where box is located

5. Provide the following information regarding the residences of the decedent during the last five years preceding death (attach additional sheets if necessary).

<table>
<thead>
<tr>
<th>In New York State</th>
<th>Outside New York State</th>
</tr>
</thead>
<tbody>
<tr>
<td>Period of time</td>
<td>Residence number</td>
</tr>
<tr>
<td>from to</td>
<td>address</td>
</tr>
</tbody>
</table>

6. For the five years prior to death, list (1) the Internal Revenue Service Centers and (2) the states or other municipalities where the decedent filed income tax returns if no income tax returns were filed, enter none.

<table>
<thead>
<tr>
<th>Year</th>
<th>Internal Revenue Service Center</th>
<th>State, county, or municipality</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Privacy Notification

The right of the Commissioner of Taxation and Finance and the Department of Taxation and Finance to collect and maintain personal information, including mandatory disclosure of social security numbers in the manner required by tax regulations, instructions, and forms, is found in Articles 22, 26, 26-B, 30, 30-A, and 30-B of the Tax Law; Article 2-E of the General City Law; and 42 USC 405(c)(2)(C)(i).

The Tax Department will use this information primarily to determine and administer tax liabilities due the state and of New York and the city of New York. We will also use this information for certain tax offset and exchange of tax information programs authorized by law, and for any other purpose authorized by law.

Information concerning quarterly wages paid to employees and identified by unique random identifying code numbers to preserve the privacy of the employee's names and social security numbers will be provided to certain state agencies for research purposes to evaluate the effectiveness of certain employment and training programs.

Failure to provide the required information may result in civil or criminal penalties, or both, under the Tax Law.

This information will be maintained by the Director of the Registration and Data Services Bureau, NYS Tax Department, Building 8 Room 924, W A Harriman Campus, Albany NY 12227; telephone 1-800-225-5829. From areas outside the U.S. and outside Canada, call (518) 485-6800.
ET-141 (1999) (back)

7 List the states where the decedent was registered to vote during the last five years preceding death (list latest year first).

<table>
<thead>
<tr>
<th>Years</th>
<th>State</th>
</tr>
</thead>
<tbody>
<tr>
<td>From</td>
<td>To</td>
</tr>
</tbody>
</table>

If decedent did not vote in those five years, when did he or she last vote? Where?

8 List employment or business activities (if any) engaged in by the decedent during the five years preceding the date of death.

<table>
<thead>
<tr>
<th>New York State</th>
<th>Outside New York State</th>
</tr>
</thead>
<tbody>
<tr>
<td>Period of time</td>
<td>Nature of employment</td>
</tr>
<tr>
<td>from - to</td>
<td>or business activities</td>
</tr>
</tbody>
</table>

9 Was decedent a party to any legal proceedings in New York State during the last five years?

10 Did decedent have a license to operate a business, profession, motor vehicle, airplane or boat?

<table>
<thead>
<tr>
<th>License number</th>
<th>Type of license</th>
<th>Date of issuance</th>
<th>Name and location of issuing office</th>
</tr>
</thead>
</table>

11 Did decedent execute any trust indentures, deeds, mortgages or any other documents describing his or her residence during the last five years preceding death?

12 Was the decedent a member of any church, club or organization?

13 What other information do you wish to submit in support of the contention that the decedent was not domiciled in New York State at the time of death? (Attach additional sheets if necessary.)

Applicant’s last name | First | Middle initial | Relationship to decedent | Address (number and street) | City, village or post office | State | ZIP code |

The undersigned states that this affidavit is made to induce the Commissioner of the Department of Taxation and Finance of the State of New York to determine domicile, and that the answers herein contained to the foregoing questions are each and every one of them true in every particular.

Signature of applicant ___________________________________________ Notary Public, Commissioner of Deeds or Authorized New York State Department of Taxation and Finance employee (no seal required) ___________________________________________

Sworn before me this ______ day of ______ 19 ______

Signature

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