Year End Estate and Gift Update

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A. ESTATE TAX

1. 2016 Estate, Gift and GST Tax Exemption Amounts.

Revenue Procedure 2015-53. The Internal Revenue Service ("IRS" or "Service") released the 2016 inflation adjustments for the lifetime gift and generation-skipping transfer ("GST") tax and estate tax exemptions. The basic exclusion and GST exemption will increase to $5.45 million, up from $5.43 million in 2015. The gift tax annual exclusion will remain at $14,000. The gift tax annual exclusion for gifts to a non-citizen spouse will increase to $148,000, up from $147,000 in 2015.

For 2017, the projected figures are $5.49 million for the basic exclusion and GST exemption, $14,000 for the annual exclusion, and $149,000 for the non-citizen spouse annual exclusion.

2. Valuation Issues.

***Estate of Giustina v. Comm'r*, 2016 WL 3264351, T.C. Memo. 2016-114 (June 13, 2016).** On remand, the Tax Court followed the instructions of the Ninth Circuit Court of Appeals and revalued a limited partnership engaged in the timber business as a going concern rather than as the sum of its net assets. The Tax Court concluded that the value of the decedent's limited partnership interest was approximately $14 million. This decision was a major taxpayer victory as the position that each of the Estate and Internal Revenue Service took during litigation was that the interest was worth $13 million and $33.5 million, respectively.

In *Giustina*, the decedent's estate included a 41% percent limited partnership interest in a family-owned timberland business. The Estate valued the interest at about $13 million and the Internal Revenue Service valued it at about $34 million. When it first heard the case, the Tax Court determined the value of the interest was about $27 million. The Internal Revenue Service used a weighted average of the cash flow method and the asset method to determine the value.

Seventy-five percent of the value was based on cash flow method, which valued the company using projected cash flow from ongoing operations. This value was subject to discounts for lack of marketability and lack of control. Twenty-five percent of the value was based on the asset method, which valued the company assuming the company liquidated. This value was not subject to discounts.

The Tax Court's basis for using the asset method was that there was a 25 percent probability that the owner of the decedent's interest would combine his voting power with a sufficient number of other limited partners to cause the sale of the partnership's assets.

This line of reasoning was an attempt by the Internal Revenue Service to reintroduce a hybrid version of the "swing vote" premium. By way of background, about ten years ago, the Internal Revenue Service attempted to take the position that a "swing vote" premium may be appropriate for a transfer of a non-controlling interest which could achieve control by aggregating with another interest. Here's a simply example of when this would apply: assume someone gifts a 2% interest in a company, there are two other shareholders who own 49% of the company, and the members act by majority. In this case, the Internal Revenue Service argued the 2% interest should be assigned a "swing vote" premium, which would tend to offset the effect of any

otherwise allowable minority discount. This position was previously rejected by the Ninth Circuit.

On appeal in *Giustina*, the Ninth Circuit relied on its prior decision rejecting the Internal Revenue Service's position regarding "swing vote" premiums. The Ninth Circuit reversed the Tax Court and held it was clear error to assign a 25% likelihood to the occurrence of these hypothetical, "imaginary" scenarios because the facts presented at trial showed (i) the general partners of the company, decedent's family members, repeatedly emphasized the importance of continuing the company's operations; (ii) the general partners were not even required to admit the hypothetical purchaser as a limited partner, so he may not be entitled to vote on this issue at all; and (iii) the other partners testified they weren't interested in selling the entity and "no limited partner had ever asked or even discussed selling the entity."

On remand, the Tax Court followed the instructions of the Ninth Circuit Court of Appeals and revalued a limited partnership solely using the cash flow method. The Tax Court concluded that the value of the decedent's limited partnership interest was approximately $14 million. This decision was a major taxpayer victory.

3. **General Powers of Appointment.**

PLR 201634015 (August 19, 2016). The IRS issued a ruling indicating that the judicial reformation of an irrevocable trust to correct drafting mistake would not result in the taxpayer having (or releasing) a general power of appointment. Settlors created an irrevocable trust for their son. The trust provided that distributions may be made to son for "support, maintenance, health, education or other needs" and that if the trustees deem the trust to be uneconomical, they can terminate it and distribute the proceeds to son or his descendants. The son has the power to remove and replace trustees at age 40 (which he has not yet attained). The trust contains a testamentary power of appointment exercisable by son in favor of his son and surviving issue. The trust goes on to say that "in the event or to the extent that the beneficiary fails to validly exercise the foregoing *general* testamentary power of appointment, the property shall pass to his surviving children…"

The Settlors petitioned the court to reform the trust based on scrivener's errors, mainly that son does not have a general power of appointment as defined in Section 2041(b)(1) and that it is against their intent, which was to have the trust not be subject to transfer tax upon son's death. The Court issued an order that only an independent trustee may make discretionary distributions to son or to terminate the trust. Further, the word "general" was deleted from the relevant provision in the trust. The taxpayers asked the IRS for the following rulings: (1) As a result of the judicial reformation, son never possessed and will not possess a GPOA which would cause the assets to be includible in his gross estate under §2041; and (2) as a result of the judicial reformation, son not treated as having released a general power of appointment for federal gift and estate tax purposes under Sections 2514(b) or 2041(a)(2). The IRS ruled that because it was a mistake in drafting (and the instrument does not contain the terms intended by the settlor) and the parties were entitled to ask the court for reformation, and the order modifying the trust was consistent with the applicable state law, as it would be applied by the state's highest court, the son never possessed a general power of appointment and, therefore, would not be treated as having released a general power of appointment.

B. GIFT AND GST TAX

1. Split-Dollar Insurance Arrangement.

***Estate of Clara M. Morrissette et al. v. Comm'r*, 146 T.C. No. 11; No. 4415-14 (Apr. 13, 2016).** Tax Court held that the economic benefit regime under Treasury Regulation Section 1.61-22 applied to a split-dollar arrangement between a decedent's revocable trust and three dynasty trusts she created for her sons where the dynasty trusts received no additional economic benefit beyond that of current life insurance protection.

Decedent had three sons, each of whom was a shareholder in the family's corporation. The family entered a buy-sell agreement under which it was agreed that upon the death of any of the three sons, the other sons and their dynasty trusts would purchase the family stock held by or for the benefit of the deceased son.

To fund the buy-sell agreement, each son's dynasty trust purchased a universal life insurance policy on the life of each other son. The Decedent's revocable trust entered split-dollar insurance arrangements with the three dynasty trusts and contributed $29.9 million to the trusts to enable them to purchase such policies by making lump sum payments. Under the split-dollar arrangements, the Decedent's revocable trust was entitled to receive a portion of the death benefit from each policy equal to the greater of the cash surrender value of the policy or the aggregate premium payments on that policy. Each dynasty trust would receive the balance of the death benefit under the policy it owns on the life of the deceased. The split-dollar arrangements included a representation that the parties intended the agreement to be taxed under the economic benefit regime. The dynasty trusts executed collateral assignments of the policies to the revocable trust to secure their obligations and none of the trusts had the right to borrow against the policies.

During her lifetime, the decedent reported the gifts to the dynasty trusts under the economic benefit regime. After her death, the IRS determined a gift tax deficiency and penalty against the Decedent's estate, treating the entire $29.9 million as a gift in 2006. The estate challenged and sought partial summary judgment regarding whether the split-dollar arrangements were governed by the economic benefit regime

In order for a split-dollar arrangement to be taxed under the economic benefit regime, the owner or deemed owner will be treated as providing an annual benefit to the nonowners equal to the value of the economic benefits under the arrangement, reduced by the consideration the nonowner pays for those benefits. The value of the economic benefits provided to the nonowner for a taxable year under the arrangement is equal to the sum of (i) the cost of current life insurance, (ii) the amount of cash value to which the nonowner has current access during the year and (iii) any economic benefits not otherwise described that are provided to the nonowner. In this case, the Court determined that the dynasty trusts did not have current or future access to the cash values because the split-dollar arrangements were structured such that at any termination of the arrangement, all of the cash surrender value had to be paid to the revocable trust.

The government tried to argue that the dynasty trusts had indirect access to the cash surrender value because under the terms of the Revocable Trust, the Revocable Trust's interest in the cash values of the polices would pass to the dynasty trusts or to the sons directly upon the decedent's death. The Court rejected this argument noting the that (i) the decedent could at any time during her lifetime change the terms of her revocable trust; (ii) the split-dollar arrangement did not require the revocable trust to distribute the revocable trust's interest to the dynasty trusts; and (iii) the governing regulations look only to the current or future rights to cash value "under the arrangement" and the provisions of the revocable trust were not part of the split dollar arrangement.

The Court also rejected the IRS argument that payment of the premiums in a single lump sum amounts to a benefit other than current insurance protection because such payment paid not only for current life insurance protection, but also future protection. The Court noted that such argument would only hold water if the dynasty trusts were obligated to pay the premiums under the split-dollar arrangements. Because the dynasty trusts were not so obligated, the Court said that regardless of how the Revocable Trust elected to pay the premiums, it would not relieve the dynasty trust of any obligations to pay.

Because the Court found that the dynasty trusts did not receive additional economic benefit beyond that of current life insurance protection, it deemed the revocable trust to be the owner of the policies and the economic benefit regime to apply to the split-dollar arrangements. As a result, the initial loan to the dynasty trusts was not a gift.

Note: This case did not address the question of how to value the receivables due the Decedent's estate under the split-dollar arrangement. The Decedent's estate will likely take a discount, which the IRS will, in turn, likely challenge. It remains to be seen whether that case will also end up in court.

***Estate of Levine v. Comm'r*, Docket No. 9345-15 (Order, July 13, 2016), 136 DTR K-1 (July 15, 2016).** Similar to the *Estate of Morrissette*, discussed above, the Tax Court rejected the IRS's challenges to the validity of inter-generational split-dollar life insurance arrangements. The IRS determined that $6.5 million paid in insurance premiums constituted a gift. The Court ruled that the estate owed none of the gift taxes or penalties assessed by the IRS. This case was consolidated with the *Estate of Morrissette* and, in the Order, the Court noted that the IRS preserved its right to appeal both *Levine* and *Morrissette.*

2. ***Woelbing* Settlements.**

The two closely watched *Woelbing* cases were settled. *Estate of Donald Woelbing v. Comm'r,* (Tax Court Docket No. 30261-13, petition filed Dec. 26, 2013), was settled by "stipulated decision" entered March 25, 2016. *Estate of Marion Woelbing v. Comm'r,* (Tax Court Docket No. 30260-13, petition filed Dec. 26, 2013), was settled by "stipulated decision March 28, 2016).

In these two cases, IRS attacked sales to IDITs using defined value clauses ("Wandry" clauses). The IDIT sale was structured and executed in the fashion most practitioners believed would work (e.g., the purchaser trusts had assets worth 10% of the value of the assets sold to the trusts in exchange for promissory notes).

IRS attacked the sales using IRC Section 2702 (the "note" was really equity so that Section 2702 applied to give no value to the "retained" equity interest). IRS also attacked the sales using IRC Section 2036, stating that the taxpayer had merely made a transfer with a retained interest in assets transferred (effectively taking the position that "10%" was not enough to break the Section 2036 "string" on transferred assets that cause estate tax inclusion). IRS also attacked the use of the defined value clause.

The cases settled on the following terms (as reported on an ACTEC email sent by Adam Weinsch from Foley & Lardner, the attorneys representing the taxpayers):

"1. The IRS accepted the validity of our Wandry-like formula language in the Installment Sale Agreement to avoid any gift in the year of the sale. The tradeoff is more shares were retained, but we avoided penalties and interest.

2. The IRS conceded that Section 2702 did not apply to our transaction because we met the 10% equity test.

3. The IRS conceded that Section 2036 did not apply to our transaction because we met the 10% equity test."

Though a good result for the taxpayers, the settlement is of no precedential value. Does it signal that IRS is now accepting defined value clauses? Or that having 10% "equity" in the trust purchaser as a source of repayment has risen to more than just an urban legend and is in fact now enough to beat IRC Sections 2702 and 2036 arguments? Or was the IRS able to reduce the amount of the discount taken in valuing the assets sold enough such that it was willing to give up on these other points (no one knows how much discount was given back in the settlement)? No one can be sure.

3. **<u>Proposed Regulations Under Internal Revenue Code Section 2704.</u>**

Proposed Regulations under Internal Revenue Code Section 2704 ("Proposed Regulations") were released on August 2, 2016 and published in the Federal Register on August 4, 2016. 81 Fed. Reg. 51413-51425 (Aug. 4, 2016). Rumors abound as to when the Proposed Regulations will "go final" – but best wisdom is certainly not before 2017 and many believe not before January 20, 2017.

What the Proposed Regulations will actually do is unclear at the present time. Most agree that in the context of family owned entities, the lack of marketability discount for transfer tax purposes will be unavailable in most cases. The lack of control discount seems likely to survive, at least in part. Limits on the ability to transfer interests (which give rise to a lack of marketability discount) that existed prior to October 8, 1990 will apparently be grandfathered (so before amending an entity's governing documents that contain a restriction that is prior to that date a great deal of consideration should be given to whether the grandfathering will be lost).

Clearly it's best to complete gifting transactions before the Proposed Regulations go final, and many feel it's best to complete those transactions before 2017 "just to be sure" because no one knows the date the Proposed Regulations will go final. In the future, use of "Wandry" provisions

(or "zero out GRAT gifts) while practitioners and the courts sort out what discounts survive the new rules seems the better course.

4. ***In re: Wyly*, 115 AFTR 2d 2016-682 (Bankruptcy Ct. Tex. 2016).**

Among other issues, the Bankruptcy Court found that the IRS failed to prove that a high-profile taxpayer's and his sister-in-law's incredibly complex, "mind-numbing" arrangements were gifts. The transactions involved the transfers of millions of dollars of offshore cash controlled by the taxpayer to purchase real estate, and other assets which were owned by offshore LLCs, which the Court found were still controlled by the taxpayer.

The IRS argued that the transactions benefitted family members in a lower generation and should be set aside under the economic substance and sham transaction doctrines (among others). However, the taxpayer and his sister-in-law successfully argued that the transfers were not gifts because they were to related entities controlled by the taxpayers or, alternatively, the taxpayers never had donative intent in making the transfers. Accordingly, the Bankruptcy Court denied the IRS's claims for gift tax owed (though the IRS's claims for income taxes due relating to other transfers and arrangements were upheld).

10. ***Estate of Johnson v. Comm'r,* T.C. No. 11708-16 (May 16, 2016).**

The executors of the decedent's estate filed a petition in Tax Court challenging estate, gift, and income tax deficiencies totaling $8.28 million. The IRS disallowed the claimed tax benefits arising from the combination of complex estate-planning arrangements by Johnson, including a SCIN and two separate insurance policy arrangements. The Internal Revenue Service's position on the SCIN merits discussion.

The SCIN transaction occurred in 2005 and the decedent died in 2012 prior to the date the SCIN matured. The Internal Revenue Service issued notices of deficiency related to the SCIN transaction as follows:

- For 2005, the Internal Revenue Service assessed a gift tax deficiency arguing that the decedent did not receive full and adequate consideration when she received a SCIN in exchange for LLC units.

- With respect to the 2012 Fiduciary Income Tax Return for the Trust that issued the SCIN, the Internal Revenue Service assessed an income tax deficiency and accuracy related penalty against the Trustees.

- With respect to the estate tax return, the Internal Revenue Service denied the deduction of income tax attributable to the capital gains that the estate paid on decedent's final Form 1040 relating to the cancellation of the SCIN.

The following facts were set forth in the Petition. In April 2005, decedent created a trust for the benefit of certain family members. She transferred property to the trust, which she properly reported on a timely filed gift tax return. At the same time, decedent and the trust formed an LLC, to which decedent contributed common stock and the trust contributed the gifted assets. Then, the decedent immediately sold her interest in the LLC to the trust in exchange for a SCIN.

The purchase price and initial principal value of the SCIN was approximately $6.5 million. This amount included a $2.5 million principal premium that was calculated using actuarial computations based on the life expectancy factors set forth in the Treasury Regulations and the interest rate was 4.28% which exceeded the AFR rate of 4.09%. The trust made all the required interest payments under the SCIN and decedent reported such interest

The SCIN was secured by the common stock. In addition, the primary beneficiaries of the trust jointly and severally guaranteed payment of the obligation if the trust defaulted. During the negotiation of the SCIN transaction, the decedent retained additional independent outside counsel to negotiate the sale. The purchase agreement also included a price adjustment clause.

The decedent died before the maturity date. Petitioners reported long-term capital gains on her final form 1040 and paid resulting income tax liability. They also deducted the capital gains on Schedule K of her estate tax return.

The IRS argued that the capital gains should have been reported on the Trust's 2012 return, so they disallowed the estate tax deduction and assessed an income tax deficiency against the Trust and asserted accuracy-related penalties against the Trustee. The IRS also argued that there were deficiencies in 2005 related to the exchange of the SCIN for LLC units.

11. **PLR 201634016 (August 19, 2016).** The IRS ruled that certain trust modifications did not result in loss of grandfathered GST exempt status and the trust assets were not includible in taxpayer's gross estate. Grantor created irrevocable trust for taxpayer and taxpayer's issue prior to September 25, 1985, so the trust was grandfathered for GST purposes. The taxpayer petitioned the state court to modify the trust to provide that (1) each co-trustee has power to appoint successor or co-trustees (and revoke such appointment before it becomes effective), (2) taxpayer may remove trustee but only if they replace with an independent trustee, and (3) taxpayer can transfer the power to remove and replace to any of his or her issue; and also to modify the distribution standards so that a beneficiary, as sole trustee, can make distributions for HEMS, and only an independent trustee can make other discretionary distributions. The court approved the modification, contingent on the following rulings: (1) the modification will not shift the beneficial interest in the trust to a beneficiary occupying a lower generation than the person holding the interest under the original trust; and (2) the modification will not extend the time for vesting beyond the perpetuities period of the original trust.

The IRS ruled that the modifications would not shift beneficial interest or extend the time for vesting because the modifications met the "trust modification safe harbor" of the regulations to Section 2601.

C. INCOME TAX

1. Consistent Basis Reporting and the New Sections 1014(f) and 6035.

Consistent Basis Reporting and the New Sections 1014(f) and 6035: Within 30 days of filing Form 706, the executors must provide both the IRS and each beneficiary with a statement showing the value of the property to be received by the beneficiary. The new rules apply to any estate that files a Form 706 after July 31, 2015 (even if the settlor died before then), but compliance has been postponed until June 30, 2016 (See IRS Notice 2016 – 27).

Section 2004(d) of the Highway Bill adds a new Section 1014(f) to the code, which states the general rule that a beneficiary's bas in the property received from a decedent must be consistent with the final value of the property for estate tax purposes. The final value can mean:

a. The value reported on the estate tax return

b. The value as finally determined on audit (either by the IRS or as a result of litigation).

c. If there is no final determination of value, the beneficiary's basis is derived from a statement provided by the executor under new Section 6035(a).

This rule only applies to beneficiaries with respect to property whose inclusion in the decedent's estate increased the estate tax liability; i.e., it does not apply to property that qualifies for the marital deduction and the charitable deduction.

A taxpayer who commits "inconsistent estate basis reporting" (i.e., who incorrectly reports basis as being higher than the final estate tax value) is subject to a 20% penalty on any resulting underpayment of tax under new Section 6662(b)(8) and 6662(k). Again, this specific penalty won't apply (at least not on the beneficiary side) for marital deduction assets (although perhaps other penalties will apply).

Section 6035(a) requires that the executor of any estate required to file for 706 must send a statement to each beneficiary stating the value of the assets that beneficiary will receive. Copies of the statements need to be filed with the IRS. Failure to file a statement (which is considered an "information return") with the IRS could result in a $250 penalty under Section 6721.

6035(b)(1) calls upon the IRS to issue regulations as to how this section applies to property with regard to which no estate tax return is required to be filed. Presumably, statements are still required even if the entire estate qualifies for marital deduction (beneficiaries get out of 1014(f) penalties, but a return still must be filed). The statements must be sent to beneficiaries and filed within 30 days of filing the final return (or 30 days of the due date if the return is late). If any values are adjusted, supplemental statements need to be sent with 30 days after the adjustment is made. It's not clear what obligations a beneficiary who has already disposed of assets and paid taxes (or claimed losses) would have at this point. Presumably, the value of most assets will be adjusted upwards, so it would be in the beneficiary's interests to amend his or her income tax returns.

IRS Notice 2015-57 delays the due date for the statements required by 6035 while the IRS issues guidance regarding these statements. For each statement required by IRC 6035 to be filed with the IRS or furnished to the beneficiary before February 29, 2016, the deadline has been extended to February 29, 2016.

2. ***Sarah D. Holliday v. Comm'r*, T.C. Memo. 2016-51 (Mar. 17, 2016).**

In *Holliday*, the Court reaffirmed that the application of the ‘bona fide sale for adequate and full consideration’ exception to 2036(a) estate tax inclusion is *fact specific*.

Decedent created a limited partnership where she was 99.99% limited partner, and her wholly owned LLC was the 0.1% general partner. One week later she contributed $5.9 million of marketable securities to the partnership, and on the same day, sold all of her membership interest in the LLC to her sons and gifted 10% to an irrevocable trust. She died 2 years later and the estate claimed a 40% discount for the remaining 89% limited partnership interest.

Doubtful tax reasons for the FLP and LLC formation and failure to follow provisions of the FLP partnership agreement led to the taxpayers' failure to qualify for the 'bona fide sale' exception. The non-legitimate reasons argued by the taxpayers were: (1) protection from litigator's claims; (2) protecting against undue influence of caregivers, and (3) preservation of assets for the decedent's heirs.

The Court concluded that no legitimate and significant reasons for creating an FLP existed and that the partnership assets were included in the decedent's estate without a discount.

3. ***Thiessen v. Comm'r*, 146 T.C. No. 7; No. 11965-10 (Mar. 29, 2016).**

A husband rolled over his IRA account into a new IRA. He and his wife then used the funds in their IRAs to establish a new corporation. The new corporation used the cash to purchase an unincorporated business. As part of the purchase, the couple personally guaranteed loans to the company owned by their IRAs.

This case closely resembles *Peek v. Comm'r*, 140 T.C. 216, although the couple raised two new defenses:

a. They fall within the exemption found at IRC §4975(d)(23) which provides that a transaction is not a prohibited transaction, even though otherwise meeting the definition, if it is a transaction "in connection with the acquisition, holding, or disposition of any security or commodity, if the transaction is corrected before the end of the correction period." The Tax Court held that the problem transaction in this case was in connection with purchasing the unincorporated business, not in connection with purchasing stock in the new corporation, the initial purchase to which that section applies.

b. The statute of limitations had expired. The Tax Court denied this argument stating the prohibited transactions were the guaranteeing of the loan, which occurred within the permitted statute of limitations, not the rollover of the husband's IRA account, which occurred outside the statute of limitations.

Relying on *Peek* and denying the couple's new defenses, the Tax Court held the guaranteed loans to a company owned by the couple's IRAs was a prohibited transaction and resulted in a deemed distribution and an early distribution penalty tax.

4. ***Vichich v. Comm'r*, 146 T.C. No. 12; No. 7509-12 (Apr. 21, 2016).**

Tax Court held that the taxpayer is not entitled to use an AMT tax credit that arose from her deceased husband's exercise of incentive stock options to offset her own individual income tax liability because, under general tax principles, (a) the ability to offset one spouse's income with

another's losses is only available to spouses who file joint income tax returns; (b) spouses generally cannot inherit or otherwise retain, after a marriage ends, a tax benefit that was originally conferred on the other spouse; and (c) deductions generally are not transferrable on the death of the taxpayer who incurred them.

5. ***Blagaich v. Comm'r*, TC Memo 2016-2 (Jan. 4, 2016).**

The Tax Court prevented Taxpayer from asserting collateral estoppel against the IRS and relying on a state court decision in a lawsuit between her and her ex-boyfriend.

a. While Diane Blagaich and Lewis Burns were in a relationship, Lewis gave Diane $300,000 and a corvette. They also entered into an agreement to formalize their relationship and, as part of that agreement, Lewis gave Diane an additional $400,000. Months after they executed the agreement, Lewis finds out that Diane is cheating on him which subsequently ended their relationship.

b. Lewis sues Diane in state court for nullification of the agreement and for the return of the money and corvette. The state court ruled that Diane has to pay Lewis back $400,000 (which was connected to the agreement) but the corvette and other cash were treated as gifts from Lewis to Diane.

c. Lewis files a Form 1099-MISC with the IRS reporting the money he gave to Diane as income to her. The IRS audits Diane's income tax return and asserts that the $700,000 and the corvette should be treated as taxable income to Diane. Diane argues that the corvette and the $300,000 should not be treated as income since the state court held that such items were gifts. Diane further argues that the doctrine of rescission should apply to the remaining $400,000 because the state court required her to pay such amount back to Lewis. Diane's motion for summary adjudication that the IRS is collaterally estopped from litigating the state court's gift finding is denied because Diane failed to demonstrate that IRS was in privy with a party to the State court action.

6. **Revenue Procedure 2016-47 (August 2016).**

The IRS has developed a "self-certification" procedure by which a taxpayer can complete a rollover of an IRA even if they missed the original sixty-day deadline. Prior to issuance of Rev. Proc. 2016-47, a taxpayer who missed the sixty-day deadline under Section 402(c)(3) or 408(d)(3) had to request a Private Letter Ruling to obtain waiver of the deadline, and such waiver was only available under certain circumstances discussed in Rev. Proc. 2003-16. Under Rev. Proc. 2016-47, the taxpayer can "self-certify" to plan administrators that they are eligible for the waiver if the following requirements are met:

a. You must not have previously been denied a waiver for this rollover;

b. You must have been unable to complete the rollover within the sixty-day period for any of the following reasons:

- There was an error with the financial institution that distributes or receives the rollover;
- Distribution was made in the form of a check, which was lost and never cashed;
- The taxpayer deposited the distribution into an account they erroneously thought was an eligible retirement plan;
- Taxpayer's principal residence was severely damaged (flood, fire, etc);
- A member of the taxpayer's family died;
- The taxpayer or a member of the taxpayer's family was seriously ill;
- Taxpayer was incarcerated;
- Restrictions imposed by a foreign country;
- Postal error;
- The distribution was made on account of a levy under Section 6331 and the proceeds of the levy have been returned to the taxpayer; or
- The party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite taxpayer's reasonable efforts to obtain the information.

c. You must complete the rollover "as soon as practicable" after the reason that prevented you from complying no longer do so (if the rollover is completed within 30 days after the reason no longer exists, you will automatically be deemed to comply with this requirement.

The plan administrator may rely on the self-certification to determine whether the conditions for a waiver of the 60-day deadline have been met as long as they do not know that the information in the self-certification is false. The self-certification is not a waiver by the IRS. If your income tax returns are audited and the IRS later determines the rollover did not meet the requirements for the waiver, or that the self-certification was false, the taxpayer may be subject to interest and penalties on the income tax associated with the distribution if it had not been eligible for the rollover.

D. CHARITABLE PLANNING

1. Prop. Reg. § 1.170A-13(f)(18).

In 1993, the Internal Revenue Service added § 170(f)(8)(A) to the Internal Revenue Code. Said section sets forth the general rule that no deduction is allowed for charitable contributions of $250 or more unless the taxpayer substantiates the contribution with a contemporaneous written acknowledgment by the charitable organization. This acknowledgment must contain the information set forth in subparagraph (B) of that section, such as the amount of the contribution and whether the taxpayer received any goods or services in return. The purpose of this section was to curb abuses where taxpayers were contributing to charitable organizations and taking full deductions even though they received items of value in return.

There is an exception to this general rule in subparagraph (D), which states that the contemporaneous written acknowledgment is not required if the charitable organization files a return, on such form and in accordance with such regulations as the Secretary may prescribe, which includes the information described in subparagraph (B).

Prop. Reg. § 1.170A-13(f)(18) is the Internal Revenue Service's attempt at prescribing the substance of this form. However, it has stated that given the effectiveness and minimal burden of the contemporaneous written acknowledgment process, it is expected that this donee reporting method will be used in an extremely low percentage of cases. It should also be noted that prior to this proposed regulation, neither the Internal Revenue Service nor the Secretary has identified any existing forms for charitable organizations to use in connection with the exception.

Before finalizing the proposed regulation, the Internal Revenue Service intends to develop a specific-use information return. Charitable organizations will be required to provide a copy of the return to the donor at the address the donor provides, and the return will only contain the information related to that donor.

The proposed regulation requires that charitable organizations who opt to use donee reporting must report the information in subparagraph (B) as well as the donor's name, address and tax identification number. Unlike the contemporaneous written acknowledgment, which is not sent to the Internal Revenue Service, the donee reporting information return will be sent to the Internal Revenue Service. The information return must be filed by the charitable organization no later than February 28 of the year following the year of the contribution.

2. Treasury Regulations Regarding Program- Related Investments (53-4944-3).

Effective April 25, 2016, the IRS published final regulations that adopt, with some changes, the proposed regulations released in 2012 that provide guidance and examples to private foundations engaging in program-related investments. The final regulations add nine new examples to the existing examples illustrating investments that qualify as program-related investments.

Whereas the prior examples were primarily concerned with domestic investments in programs involving economically disadvantaged individuals and deteriorated urban areas, the new examples demonstrate that program-related investments may fund activities in foreign countries

as well as investments in organizations undertaking environmental, scientific, or micro-loan programs and involving financing the building of a child care facility.

The final regulations made changes to three of the proposed examples:

a. Example 11, which allows investing in a subsidiary of a drug company to make drugs available to people who otherwise cannot afford the price, was amended to provide that the drug company is permitted to charge fair market value to those who can afford it.

b. In Example 13, which describes a situation in which the business enterprise offers a private foundation common stock as an inducement for the foundation to make a below-market rate loan, the final regulations remove the sentence that stated that the foundation plans to liquidate its stock in the business as soon as the business is profitable or it is established that the business will never become profitable. Despite removing such sentence, the commentary to the final regulations indicate that the IRS believes that establishing an exit strategy at the outset of an investment is an important indication that a foundation's primary purpose is making a program-related investment (and, therefore, a qualifying investment) is furtherance of its charitable purpose.

c. Another change involved omitting a reference in Example 15 that loans to individuals to allow them to start small businesses (micro-loans) be made in response to a natural disaster. The final rules eliminate the reference to a natural disaster, recognizing that programs involving investing in foreign countries should not require a natural disaster to make them related to an exempt purpose.

3. ***Estate of Dieringer v. Comm'r*, 146 T.C. No. 8 (Mar. 30, 2016).**

The Tax Court held that an estate tax deduction for a charitable contribution was reduced below the date of death value due to subsequent actions of the family.

Victoria Dieringer's trust provided for a gift of a corporation's stock to charitable organizations. Following Victoria's death the corporation made an S election and entered into an agreement to redeem the trust's stock, eventually redeeming all of its voting shares and some non-voting shares and also entered into a stock subscription agreement where the sons purchased additional stock. The estate used the date of death value of this stock for a charitable deduction.

The Tax Court reduced the estate tax charitable deduction for the bequest of stock and found that actions taken after date of death, but before distribution to the charitable foundation, changed the nature and reduced the value of the property that was eventually transferred to the decedent's foundation.

While the Court acknowledged these subsequent actions were taken for legitimate business purposes, it objected to the actual agreements that implemented the redemption, specifically the redemption values. While no lack of marketability discount or lack of control discount was taken for the charitable contribution calculation (since a majority interest was being transferred),

the valuation used for the redemption included both a 15% discount for lack of control and a 35% discount for lack of marketability.

The Court concluded the post death transactions "thwarted decedent's testamentary plan by altering the date-of-death value of decedent's intended donation through the redemption of a majority interest as a minority interest."

4. **IRS Withdraws Proposed Regulations Dealing with Substantiating Charitable Deductions under IRC § 170(f)(8)(D) (Jan. 8, 2016).**

IRC § 170(f)(8)(D) requires that taxpayers substantiate charitable deductions of $250 or more by a "contemporaneous written acknowledgment" of the charitable contribution by the donee organization. The "contemporaneous written acknowledgment" must meet certain requirements. On September 16, 2015, the IRS proposed regulations that would have created a form which the charity had the option of completing and filing with the IRS in the absence of the contemporaneous written acknowledgment.

This new form required charities to report donor's name, address, and taxpayer identification number to the IRS. After receiving many objections about collecting donor's taxpayer information and reporting it to the IRS, the IRS withdrew the proposed regulations on January 8, 2016.

5. ***Gemperle v. Comm'r*, T.C. Memo 2016-1 (Jan. 4, 2016).**

Tax Court held that Taxpayers were not entitled to a charitable income tax deduction for a donation of a conservation easement because they failed to include a qualified appraisal with their return.

a. In 2007, David and Kathryn Gemperle granted to a qualified donee a facade easement on their Chicago residence, which constituted a certified historic structure in a historic district, so that the easement was eligible for classification as a "qualified conservation contribution" within the meaning of IRC § 170(f)(3)(B)(iii) and (h)(1).

b. The Gemperle's obtained an appraisal from appraiser Ms. Fiorenzo that valued the easement at $108,000. However, they did not include the appraisal with their income tax returns when claiming the charitable income tax deduction on their 2007 and (as a carryover) 2008 returns.

c. During trial, the court excluded Ms. Fiorenzo's appraisal as evidence because the Gemperle's failed to list Ms. Fiorenzo as a witness. The IRS argued that the deduction should not be allowed because of: (1) the absence of a qualified appraisal; (2) the fact that the façade easement or restriction was neither granted nor protected by § 170(h)(5)(A); (3) the Gemperle's failure to include a copy of a qualified appraisal and a completed appraisal summary with the return and (4) the Gemperle's failure to prove that the contribution decreased the value of the house by $108,000.

d. Without analyzing the other issues, the Tax Court denied the Gemperle's charitable income tax deduction because they did not include a qualified appraisal with their income tax returns and also held that an accuracy related penalty also applied.

E. FIDUCIARY CONCERNS

1. ***Robert Rauschenberg Foundation v. Grutman, et al.*** **(Fla. 2d DCA Jan. 6, 2016).**

The Florida District Court of Appeals held that the "lodestar method" of determining reasonable *attorney* fees as set forth in *Florida Patient's Compensation Fund v. Rowe* does not apply to calculate reasonable *trustee* fees, but rather the factors set forth in *West Coast Hospital Ass'n v. Florida National Bank of Jacksonville*. The "lodestar method" essentially calculates fees by multiplying the agent's hourly rate by the hours spent acting as agent. On the other hand, the "*West Coast* analysis" takes considers various factors including

a. The amount of capital and income received and disbursed by the trustee;

b. the wages or salary customarily granted to agents or servants for performing like work in the community;

c. the success or failure of the administration of the trustee;

d. any unusual skill or experience which the trustee in question may have brought to his work;

e. the fidelity or disloyalty displayed by the trustee;

f. the amount of risk and responsibility assumed;

g. the time consumed in carrying out the trust;

h. the custom in the community as to allowances to trustees by settlors or courts and as to charges exacted by trust companies and banks;

i. the character of the work done in the course of administration, whether routine or involving skill and judgment;

j. any estimate which the trustee has given of the value of his own services;

k. payments made by the cestuis to the trustee and intended to be applied toward his compensation.

As a result, the 2nd DCA affirmed the trial court's award of a trustee fee of $24,600,000 for 3 individual trustees.

2. ***Kelly v. Orr,* 243 Cal. App. 4th 940 (4th Dist. Jan. 11, 2016).**

The appellate court held that the statute of limitations for professional negligence is tolled until the predecessor trustee's attorney-client relationship is terminated. When a successor trustee replaces a predecessor, he steps into the predecessor's shoes and succeeds to the predecessor's tolling rights.

a. Trustee James Kelly sued Barbara J. Orr, Joseph Holland, Gretchen Shaffer, and DLA Piper LLP ("Defendants") for professional negligence for advice law firms gave to the predecessor trustee of a trust. There was an issue with who was the rightful successor Trustee. Defendants represented the predecessor trustee who advised him that he was the rightful trustee, even though he was not and ultimately stepped down. (The Court did not detail why he was not the rightful successor trustee). Defendants argued that the action was barred by a one-year statute of limitations under the ode of Civil Procedure § 340.6 and filed a demurrer on such grounds. The trial court sustained the Defendant's demurrer.

b. The Court of Appeal concluded that when a successor trustee replaces a predecessor, he steps into the predecessor's shoes and succeeds to the predecessor's tolling rights. In this case, the statute of limitations is tolled until the Defendants ceased representation of the predecessor trustee. Because Kelly filed suit less than one year after the Defendants ceased representation of the predecessor trustee, the Court of Appeal concluded Kelly's action was not time-barred. The Court reversed the judgment and remanded for further proceedings.

3. ***Matter of Kermit Gitenstein Foundation*, 357003A, NYLJ 1202758893277 (N.Y. Surr. Ct. Nassau Co., decided May 26, 2016).**

The Nassau County Surrogate's Court removed a Long Island attorney, who is a member of the character and fitness committee for the Second Department, as receiver of a charitable foundation. The Court's decision was based on over $7,000,000 of distributions the receiver improperly authorized "without the knowledge or approval of the attorney general or [the] court", distributions to organizations that the receiver, his family or his firm had undisclosed interests in, and distributions that did not align with the foundation's history of distributions and purposes.

4. ***U.S. v. McNicol,* 118 AFTR 2d 2016-5150 (CA1 2016, decided July 15, 2016).**

The First Circuit ruled that an executor was liable for unpaid federal income tax when she distributed property from an insolvent estate and had prior knowledge of the tax deficiencies. The decedent owed $340,000 in unpaid federal income tax, which would have left his estate insolvent. Decedent's assets consisted of a 100% interest in one corporation and a 50% interest in another. His wife was the executor. Right after he died and before she was appointed executor, she transferred the 100% interest to herself. About six months later, she was appointed executor and then transferred the other 50% interest to herself.

Section 3713(a)(1)(B) provides that a claim of the U.S. government shall be paid first when an estate is insolvent (it priority over any other claims). If the executors fail to honor that priority,

they become personally liable for the deficiency under Section 3713(b) if three requirements are met: (1) they transfer assets before paying the government's claim; (2) the estate is insolvent; and (3) they had knowledge of the liability.

Here, the wife tried to argue that it should not apply to the stock transferred before she was appointed executor since a strict reading of the statute found it applied to "a representative of the person or an estate…" The court said that whether she had actually been appointed executor at the time was irrelevant because the assets were under her control at the time they were transferred.

F. DRAFTING AND EXECUTION CONCERNS

1. ***Duckett v. Enomoto*, 2016 WL 1554979 (D. Ariz. Apr. 18, 2016).**

The taxpayer, who was delinquent in paying his federal income taxes, was the beneficiary of a trust that provides that the Trustee shall pay to the taxpayer so much or all of the net income and principal of the trust as in the sole discretion of the Trustee may be required for support in the taxpayer's accustomed manner of living. The IRS sought to attach a tax lien to the trust and to seize all of its assets. Generally, the government may only impose a tax lien on any "property" or "rights to property" belonging to the taxpayer.

The Court looked at the specific language in the trust agreement and the Arizona uniform trust code and concluded that taxpayer had a right to the property in his trust because, even though the Trustees had the discretion to determine how much to pay, the language "shall pay" created an enforceable right to payments, the withholding of which would constitute an abuse of discretion in applying an ascertainable standard.

The Court distinguished the facts of this case from a case where a trust provided that the Trustees may distribute income or principal to a beneficiary and directed that any income not so distributed be accumulated. The Court noted that in such case, it was clear that the Trustee was not obligated to distribute anything to the beneficiary and, therefore, the beneficiary did not have a property right in the trust.

Although the Court held that the IRS could attach a tax lien to the assets to be distributed from the trust, it denied the government's motion for summary judgment for permission seize all of the trust assets. The Court noted that although the taxpayer's enforcement right affords him enough control over the trust funds to trigger the lien attachment, it does not by itself justify enforcement of the lien to any specific amount. The IRS must present evidence regarding the value of the taxpayer's property rights in the trust.

Note: The IRS subsequently filed a motion to alter or amend judgment and moved to alter the judgment so that the federal tax lien against the taxpayer would extend over all of the trust fund and to order the Trustee to distribute all funds to the United States. The Court denied the IRS's motion and reiterated that the IRS's lien extends only to the amount to which the taxpayer's right extends (i.e., the amount the Trustee's withholding of which would constitute an abuse of discretion). The Court noted that to enforce its tax lien, the IRS should instead file a motion to enforce judgment, which motion should present evidence of the taxpayer's current needs, living

demands and overall financial situation and show that the Trustee's failure to make distributions from the trust constitutes an abuse of discretion.

2. **Thorson v. Richmond Society for the Prevention of Cruelty to Animals, 2016 WL 3131004 (Va. June 2, 2016).**

Virginia's highest court ruled in a 6-1 decision that an intended third-party beneficiary of a will may sue an attorney for malpractice for inaccurately drafting the document, even though no attorney-client relationship exists between them.

In this case, the testator hired an attorney to draft her will. The testator intended her assets to go to her mother, if her mother survived her. If her mother predeceased her, she intended her assets to go to the Richmond Society for the Prevention of Cruelty to Animals, a charity. The attorney understood her wishes and prepared the will, which testator signed.

The testator died after her mother. Upon the testator's death, the attorney realized that there was a scrivener's error in the will. The will did not include a residuary devise, so only the testator's personal property passed to the charity and her other assets passed intestate to her heirs at law. The attorney fell on his sword and tried to correct the error in state court but was unsuccessful. The charity sued the attorney for malpractice arguing that it was an intended third-party beneficiary. The Court agreed.

The majority opinion acknowledges the general common law rule in Virginia is that strangers to a contract do not have rights under the contract. However, the majority also notes an exception to the rule, which allows third-party beneficiaries to enforce certain contracts. An injured third-party beneficiary may enforce the contract that creates (or should create) the beneficiary's interest if the beneficiary was "clearly and definitely" the intended beneficiary of the contract. The majority applies this exception to reach a contract between an attorney and a client to draw a will for the benefit of a particular beneficiary.

The majority determined that a beneficiary is "clearly and definitely" intended if the client expressed her intent that the beneficiary receive a benefit (or contingent benefit) upon her death and the lawyer assents to the representation.

3. **Amendment to New York Civil Practice Laws and Rules Section 4503(b) (effective as of August 19, 2016).**

Section 4503 of the NY civil practice law and rules protects the attorney-client privilege as it relates to communications over the preparation of wills. Specifically, 4503(b) provides that in any action involving the probate, validity or construction of a will, an attorney or his employee shall be required to disclose information as to the preparation, execution or revocation of any will or relevant instrument, but he shall not be allowed to disclose any communication privileged under subdivision (a) which would tend to disgrace the memory of the decedent.

While 4503(b) unquestionably applies in probate contests, there is no similar statutory exception for contests concerning revocable trusts. The question of whether a revocable trust is a "relevant instrument" (and therefor the exception should apply) has come up in several cases.

This amendment provides that the same attorney-client privilege guaranteed for the probate or construction of a will also extends to revocable trusts.

G. SETTLEMENT CONCERNS

1. **PLR 201623001 (June 3, 2016).** The IRS issued a ruling indicating that an Order of a state court could not be accomplished under federal tax laws. The facts indicate that a state court approved a settlement and ordered an IRA custodian to assign a stated amount of a child's inherited IRA, which child received as sole beneficiary of his father's IRA, to the surviving spouse based on community property rights. IRS ruled that: (1) the spouse cannot be treated as a payee of the inherited IRA for the child because, under IRC Section 408(g), IRC Section 408 is to be applied without regard to the community property laws; (2) the spouse may not rollover any amounts from the inherited IRA for child because, under IRC Section 408(d)(3)(C), rollovers are not permitted for inherited IRAs; and (3) any assignment of an interest in the inherited IRA for child to spouse would be treated as a taxable distribution to child because the child is the named beneficiary of the IRA and the spouse's community property interest is disregarded under IRC Section 408(g). Accordingly, the PLR indicated that the Order of the state court could not be accomplished under federal tax law.

2. **PLR 201628004, PLR 201628005 and PLR 201628006 (July 8, 2016).** The IRS indicated that a state court's retroactive reformation of an instrument is not effective to change the tax consequences of a completed transaction. In each of these PLRs, the decedent had an IRA with Custodian A and named Trust C as a 50% beneficiary and each of Trusts D and E as a 25% beneficiary of the IRA. The decedent's financial advisors later joined another firm and became affiliated with Custodian B. The financial advisors provided the decedent with a beneficiary designation form naming the decedent's estate as the sole beneficiary. Although the decedent signed the forms, he merely intended to move the assets from Custodian A to Custodian B and did not intend to change the beneficiaries. Trusts C, D and E complied with the IRA look through rules and were valid under state law.

After the decedent's death, the trustees petitioned the Court to modify the beneficiary designations to carry out the intent of the decedent. The Court ordered that the beneficiary designations be revised to the original plan, effective as if they were originally made by the decedent when the decedent signed the new beneficiary designation forms. The ruling requested confirmation that the life expectancy of the beneficiary of each trust could be utilized to determine the applicable distribution period with respect to the portion of the IRA payable to each trust.

Generally, if an IRA owner dies on or after his required beginning date without having designated a beneficiary, then post-death distributions must be made over the remaining life expectancy of the IRA owner. An estate or charity is not a designated beneficiary but, if certain provisions are followed, a trust can be a designated beneficiary. The IRS ruled that, because the decedent's estate was named as the beneficiary of the IRA at the time of the decedent's death, there was no designated beneficiary of the IRA. Further, the IRS noted that, although the court order changed the designation of the IRA under state law, the order could not create a designated beneficiary for federal tax purposes. The IRS stated that, if the state court order could change

the federal tax consequences, "there would exist considerable opportunity for 'collusive' state court actions having the sole purpose of reducing federal tax liabilities."

H. STATE AND LOCAL TAX

1. **Advisory Opinion TSB-A-15(1)(M) (May 29, 2015).**

New York State Department of Taxation and Finance held that assets in a single-member LLC will be counted as tangible property and included in a nonresident decedent's estate.

The New York State Department of Taxation and Finance Office of Counsel Advisory Opinion Unit has issued an advisory opinion declaring that membership interests of a single member LLC funded with the condominium of a nonresident would not be considered intangible property for New York estate tax purposes. In effect, the entity form of a single-member LLC is ordinarily disregarded. If, however, the taxpayer would elect for the LLC to be taxed as a corporation, the LLC interests would be intangible property of a nonresident and, therefore, not subject to New York estate tax unless used in the carrying on of a trade or business within New York.

Note that this ruling turns on the fact that the single-member LLC is a disregarded entity for income tax purposes. Although not discussed in the ruling, it would seem that the ruling would not be applicable to a nonresident who owned an interest in a multi-member LLC that owned New York Real Estate. Presumably this would be the case if the decedent owned a 50% interest and a QTIP trust owned the other 50%.

2. ***Blackburn v. Boulis,* 184 So. 3d 565 (Fla. 4th DCA Jan. 20, 2016).**

The Court held that the surviving spouse’s elective share is not reduced by litigation expenses and is increased by interest.

The Florida elective share statue only lists four things that can be charged against the spouse’s elective share and attorney’s fees are not one of them. Therefore, the spouse’s elective share is not reduced by attorney fees or litigation expenses.

The spouse was entitled to interest at the statutory interest rate on 40% of the elective share amount, from the date of the order determining the value of the spouse's minimum elective share. The Court held that it would be inequitable for the spouse to enjoy a windfall of interest on a portion of the value of the elective share, which due to taxes, she would not be entitled to retain (since the elective share must bear its own taxes). Therefore, it was appropriate to assess interest on only a portion of the elective share value.

NOTE: Florida has changed its elective share statute since this case started (in Fla. Stats. § 732.2055 (2015)), but the language is substantially similar so this case should provide strong precedent.

3. ***Rucksapol v. Dir., Div. of Taxation*, N.J. Tax Ct., No. 009356-2015 (unpublished, May, 11, 2016), N.J. Super. Ct. App. Div., No. A-004089-15T2 (brief filed July 22, 2016).**

New Jersey Tax Court held against a New Jersey man whose partner of 31 years died six days before their scheduled wedding so that the partner's estate was not entitled to an estate tax deduction because the couple was neither married nor in a civil union. The couple, a same-sex couple, was, however, in a registered domestic partnership, a status authorized by New Jersey before civil unions or marriages were authorized. Though this afforded the couple certain benefits, treatment as a surviving spouse for the surviving partner was not one such benefit. The Court held that the couple's conscious decision not to enter into a civil union (a status that would have treated the surviving partner as a surviving spouse for estate tax purposes) nor to marry immediately when marriage became available to same-sex couples in New Jersey had consequences. One of these consequences was that the surviving partner could not be treated as a surviving spouse for estate tax purposes.

On July 22, 2016, the surviving partner filed an appellate brief claiming that he has a constitutional right to the estate tax deduction. Under New Jersey law, same-sex couples registered as domestic partners are treated as a couple for purposes of the inheritance taxes but are not treated as such for the estate tax. For New Jersey estate tax purposes, a couple must be married or in a civil union to qualify for the estate tax deduction. In the brief, the surviving partner claimed: (1) New Jersey's Domestic Partnership Act of 2004 violated the equal protection guarantee under the New Jersey state constitution by failing to provide the marital deduction for estate tax purposes and (2) as the New Jersey inheritance tax and the New Jersey estate tax are fundamentally interlinked, there is no rational basis for differentiating the marital deduction between these two New Jersey death taxes. The surviving partner argued that, despite the fact that New Jersey later legalized marriage, whether or not the statute violates the equal protection clause of the New Jersey constitution should not be based upon subsequent legislation. Further, he indicated that, when the civil union statute was enacted, domestic partners were notified of their right to file for a civil union but they were never advised as to the difference in benefits for domestic partners and members of a civil union. Therefore, he argued that there was no fair notice to individuals regarding this issue.

4. ***United States v. Alexander*, 2016 WL 2893406 (D. Arizona May 18, 2016).**

This case is a really interesting asset protection case because it discusses the intersection between charging orders and writs of garnishment. Previously, a judgment was entered against the defendant requiring him to pay almost $10 million in restitution, commencing with $300 monthly minimum payments. When the monthly minimum payments were raised to $750, the defendant defaulted.

To satisfy the outstanding judgment, the government brought him to court and requested a charging order against defendant’s interest in a single-member LLC, which generated a whopping profit of $8000 a year.

The defendant successfully limited the scope of the charging order. The government was solely entitled to charge distributions from the LLC to the extent of 25% of the defendant’s “disposable earnings,” which is consistent with Arizona’s garnishment statutes. Disposable earnings essentially means your gross income less any state or federal tax.

This opinion was very debtor friendly because it confirmed that the government couldn't participate in the management of the entity, couldn't force the defendant to make distributions from the entity, and could only charge distributions from the LLC to the extent of 25% of the defendant's disposable earnings.

Commentators believe that this is a great result for debtors as one of the common questions that derail debtor's during depositions or trials is "Where are you getting the money to live on." This case stands for the proposition that it is okay to live on money from an LLC as long as that amount does not exceed the threshold set forth in a state's garnishment statutes.

5. ***Bernal v. Marin*, Docket No. 3D15-171, 2016 Fla. App. Lexis 9229 (Fla. Dist. Ct. App. 3d Dist., June 15, 2016).**

The Third District Court of Appeals of Florida interpreted Fla. Stat. 736.0602(3) regarding methods for revoking or amending a trust. The Court held that a will can revoke a trust if there is clear and convincing evidence of the Settlor's intent.

In this case, the decedent executed and funded a revocable trust which provided that, upon the decedent's death, a specific bequest be made and the residue distributed to charity. The trust was funded with the decedent's sole residence and a brokerage account. The trust did not provide a mechanism for revoking the trust. Subsequently, the decedent met with an attorney and executed a Will that read, in pertinent part, "I, decedent, a resident of Miami-Dade County, Florida, and a citizen of the US, declare this to be my Last Will and Testament, revoking all other wills, trust and codicils previously made by me." The Will did not specifically refer to her revocable trust by name.

Upon the decedent's death, the trustee of the trust claimed that the alleged revocation was ineffective. The trial court concluded that because the decedent's later Will did not specifically name or expressly refer to the trust or specifically devise her real property and the brokerage account, the Will did not revoke the trust. Relying on Fla. Stat. 736.0602(3)(b)(2), which allows revocation of a trust by "any other method manifesting clear and convincing evidence of the settlor's intent", and extrinsic evidence of the Settlor's intent, the Third District Court of Appeals concluded that the Settlor intended, by clear and convincing evidence, to revoke the trust by the execution of the later Will. The extrinsic evidence considered by the Court was the testimony of the attorney who drafted the later Will and an affidavit provided by an individual who had been friends with the decedent for forty-four years and had knowledge of the Settlor's intent.

I. SERVICE AND LEGISLATIVE DEVELOPMENTS

1. Greenbook.

The Obama Administration has recently announced its Fiscal Year 2016 Revenue Proposals in its annual "Greenbook." The Greenbook sets forth the Administration's proposals for changes in the tax law for the fiscal year. Although these proposals are not proposed legislation, they give us some insight into Administration's legislative agenda for the coming year. Here is a summary of the relevant proposals:

a. Retirement Plans

Require "required minimum distributions" from Roth IRAs

Require non-spouse beneficiaries to take distributions over 5 years, rather than their life expectancy

Limit accrual of retirement benefits in traditional IRAs (no more contributions after $3.4 million in value)

Prohibit after-tax amounts attributable to basis from being converted from a traditional IRA to a Roth IRA (in other word, the conversion would be permitted only to the extent taxable)

b. Estate, Gift and GST Taxes

Return to 2009 exemption amount ($3.5 million estate and GST tax exemption; $1 million gift tax exemption)

Maintain 40 percent tax rate and "portability"

Impose gift tax on distribution from "intentionally defective grantor trusts" to the extent the distribution is from trust appreciation or income; termination of "grantor trust" status would be deemed a distribution

Require same valuation for income tax purposes as used for estate, gift and GST tax purposes

"Grantor retained annuity trusts" ("GRATs")

Require minimum term of 10 years and maximum term of life expectancy plus 10 years

Require that the remainder must be at least equal to greater of 25% of contribution or $500,000

Prohibit a decrease in the annuity over the GRAT term

Prohibit income tax free exchanges between grantor and GRAT (no sales or "swaps")

c. Other Provisions

Increase capital gain / qualified dividend rate to 24.2% (28% when including 3.8% net investment income tax)

Treat gifts and death as a deemed sale for income tax purposes, with certain exemptions

Enact the "Fair Share Tax," which would impose a 30% tax rate phased in between $1 million and $2 million (less whatever amount is paid in regular tax and alternative minimum tax)

Tax "carried interest" as ordinary income and subject to self-employment tax.

2. **Florida Legislation—Florida Fiduciary Access to Digital Assets Act.**

Florida has adopted the Florida Fiduciary Access to Digital Assets Act. The act will be located in the new chapter 740 in the Florida Statutes and will become effective on July 1, 2016. The statute provides owners of digital assets the ability to plan for the management and disposition of those assets, fiduciaries legal authority to manage such assets and custodians that comply with a fiduciary's apparent authority immunity from liability under the statutes that prohibit unauthorized access.

A few quick points on the new law include that:

a. The law applies to four types of fiduciaries: (i) personal representatives of decedents' estates, (ii) guardians of the property of minors or incapacitated persons, (iii) agents who are acting under a power of attorney and (iv) trustees.

b. Fiduciaries are provided the legal authority they need to manage digital assets in compliance with a person's estate plan, while also ensuring that a person's private electronic communications remain private unless the person gave consent for disclosure.

c. A user may specify whether his or her digital assets will be preserved, distributed to heirs, or destroyed.

3. **New Code Section 7345.**

Under new §7345, if an individual has delinquent tax debt of over $50,000 (including interest and penalties), the Commissioner can notify the Secretary of State, who then has the authority to deny, revoke or limit the passport of that individual.

4. **FinCEN Final Customer Due Diligence Regulations.**

The Financial Crimes Enforcement Network (FinCEN) issued final regulations (found at 31 C.F.R. 1010.230) requiring financial institutions to gather information on the identity of the beneficial owners of, and an individual who controls, certain types of legal entities when opening entity bank accounts. 81 F.R. 29397. These regulations were passed in light of the concerns raised by the Panama Papers and to fight terrorist financing. Notably, trusts are not included as such entities from which information has to be gathered. Other entities, such as LLCs and FLPs will be looked through to their beneficial owners and financial institutions will be required to gather information on all beneficial owners of these entities.

5. South Dakota – Special Spousal Trust Statute

Effective July 1, 2016, a new South Dakota statute allows a married couple to create a special trust, called a South Dakota Special Spousal Trust, the assets of which upon transfer will be considered community property under South Dakota law. Further, the statute allows Settlors of such trusts to take advantage of the benefits of the 100% income tax basis step-up provided in IRC Section 1014(b)(6). There is no definitive authority regarding whether residents of non-community property states can avail themselves of this trust and get the benefits of the IRC Section 1014(b)(6) step-up at the first spouse's death. Finally, the statute indicates that a South Dakota Special Spousal Trust can be a spendthrift trust allowing for asset protection benefits for the assets transferred to the trust. There are special requirements for the creation of a South Dakota Special Spousal Trust. *See* SDCL 55-17.

6. Final Regs to Define Terms Related to Marital Status (T.D. 9785, August 2016).

The IRS has issued final regulations that reflect the holdings of *Obergefell v. Hodges*, 676 U.S. ___, 135 S. Ct. 2584 (2015), *Windsor v. U.S.*, 570 U.S. ___, 133 S. Ct. 2675 (2013) and Rev. Rul. 2013-17, to define terms in the Internal Revenue Code describing the marital status of taxpayers for federal tax purposes.

Treas. Reg. § 301.7701-18 has been amended to provide that for federal tax purposes, the terms spouse, husband and wife mean an individual lawfully married to another individual. A marriage of two individuals is recognized for federal tax purposes if the marriage is recognized by the state, possession or territory of the United States in which the marriage is entered into, regardless of domicile.

7. Department of the Treasury 2016-2017 Priority Guidance Plan (released August 15, 2016)

The Treasury has released its annual Priority Guidance Plan, which outlines the projects which have been identified as "priorities" by the Treasury for the upcoming year. Priority issues in the estate and gift tax arena for the 2016-2017 year include the issuance of final regulations under Sections 1014(f) and 6035 regarding consistent basis reporting, guidance on the valuation of promissory notes for transfer tax purposes under Sections 2013, 2033, 2512 and 7872, and guidance on the gift tax effect of defined value formula clauses under Section 2512 and 2511.