HOT TOPICS IN ESTATE PLANNING

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INTRODUCTION

The courts, the IRS, and the Congress (though largely through inaction) are constantly raising new estate planning issues, and bring old ones to the forefront of professional concern. This outline examines some of the key issues currently being pondered by practitioners.

There is also an additional section, "Selected Attachments," that includes sample forms illustrating some of the planning techniques discussed in this outline.

I. ESTATE PLANNING WITHOUT THE ESTATE TAX AND WITHOUT SOME OF THE GST TAX

A. Introduction. The efforts in both the House and the Senate to provide a permanent estate tax solution failed when the Senate was unable to agree on any permanent or even temporary solution. As a result, the estate tax will expire at the end of 2009, and be reinstated in its 2001 incarnation on January 1, 2011. The Administration had sought to have the 2009 law made permanent, and a bill to do so (H.R. 4154) passed the House of Representatives, but not the Senate. See Administration's Budget Proposal, "A New Era of Responsibility Renewing America's Promise," p. 121, Table S5, fn. 1 (Feb. 26, 2009); H.R. 4154, 111th Cong., 1st Sess. (Nov. 19, 2009). H.R. 4154 would have:

- Made the estate and GST taxes permanent;
- Made the applicable exclusion amount (and GST exemption) permanent at $3.5 million;
- Made the top estate and gift tax rate permanent at 45%, for estates and gifts over $1,500,000;
- Retained the present basis step-up rules;
- Made the gift tax exemption permanent at $1 million.

Some Democratic Congressional leaders say that they will try to re-enact the estate and GST taxes retroactively in 2010, but the hiatus in the operation of these rules creates serious problems.

B. **The Law During the 2010 Hiatus.** The following rules will apply in calendar year 2010, unless Congress acts during the year to change the law again:

1. **Repeal of Estate and GST Taxes**. The estate and GST taxes are repealed. No estate tax would be imposed on an estates of a decedent dying during 2010, and no GST tax would be imposed on a taxable termination, taxable distribution, or direct skip transfer made in 2010, regardless of when the trust under which the event occurs was created.

   a. **Estate Tax Preserved for Recapture**. The estate tax is preserved with respect to the imposition of special recapture taxes after December 31, 2009, with respect to the estate of a decedent who dies before January 1, 2010. The post-December 31, 2009 disposition of property for which the estate of a decedent who died before January 1, 2010 was allowed (1) the tax benefits of special use valuation (Section 2032A), (2) the deduction for interests in qualified family owned businesses (Section 2057), or (3) the deferral of estate taxes attributable to a business interest (Section 6166), will still result in the recapture of the previous estate tax benefits, to the extent provided under present law.

   b. **Taxable Events for Pre-2010 QDOTs.** The federal estate tax will continue to be imposed in 2010 in certain cases with respect to a qualified domestic trust (QDOT) created for the benefit of a non-citizen surviving spouse, where the spouse whose will or trust created the QDOT died before January 1, 2010. With respect to an estate of a decedent dying after December 31, 2001, (1) the estate tax will be imposed on any QDOT distribution made after December 31, 2009 and before January 1, 2021 if made before the date of the non-citizen surviving spouse's death; and (2) where the non-citizen surviving spouse dies before January 1, 2010, the estate tax will be imposed on the value of the property remaining in a QDOT on the date of the non-citizen surviving spouse's death.

2. **Gift Tax Preserved**. The gift tax remains in effect with a $1 million lifetime exemption and a 35 percent top tax rate.

3. **Carryover Basis**. Assets received from a decedent dying in 2010 would take a carryover basis, rather than a basis equal to the estate tax value of the decedent’s assets, though this carryover basis would be subject to several important adjustments.

4. **Section 2511(c)**. Under Section 2511(c), a transfer in trust will be treated as a gift for gift tax purposes, unless the trust is a wholly-owned grantor trust owned by the grantor or the grantor's spouse.

C. **The Law After the 2010 Hiatus.** The following rules apply beginning on January 1, 2011, unless Congress changes the law:

1. **Estate Tax Restored.** The estate tax is restored with a top rate of 55 percent, a five percent surtax on estates over $10 million, and a $1 million applicable exclusion amount.

2. **GST Tax Restored.** The GST tax is restored with a 55 percent rate and a $1 million GST exemption (indexed for inflation – one year above $1,340,000).

3. **55% Gift Tax Rate Restored.** The top gift tax rate returns to 55 percent.

4. **State Death Tax Credit Restored.** The state death tax credit is fully restored.

5. **Estate Tax Value Basis Rules Restored.** The date-of-death basis rules return and carryover basis is repealed.

6. **GST Tax Technical Changes Repealed.** Several important GST provisions would be repealed, including: (a) the rules regarding automatic allocation of GST exemption to non-direct skip transfers in trust; (b) the expansion of the predeceased ancestor rule for GST purposes to include certain collateral beneficiaries of a trust; (c) the qualified severance rules; (d) the authority of the IRS to permit late allocations in a broad number of cases; and (e) the substantial compliance rule.

7. **Liberalization of the Conservation Easement Removed.** Certain liberalizations of the conservation easement deduction rules would be repealed.

8. **Liberalization of the Estate Tax Deferral Removed.** Certain liberalizations in the rules for the deferral of the payment of estate taxes on closely-held business interests under Section 6166 would be repealed, including: (a) the rule allowing Section 6166 deferral for interests in qualifying lending and financing businesses; and (b) the rule raising from 15 to 45 the number of partners of a partnership or shareholders of a corporation that will be eligible for deferral under Section 6166.

D. Retroactive Reinstatement. Senator Baucus and Treasury Secretary Geithner have said that they want to reinstate the estate and GST taxes early in 2010, and to do so retroactively, to eliminate a period of effective repeal. Ways and Means Chairman Rangel has informally stated that he opposes retroactivity.

1. Constitutional Issues. Retroactive reimposition of these taxes will face constitutional challenges, but ultimately it is likely to be sustained. The Supreme Court has repeatedly upheld retroactive changes in the tax laws, where such retroactivity is "confined to short and limited periods required by the practicalities of producing national legislation." *Carlton v. United States*, 512 U.S. 24 (1994); see also *United States v. Hemme*, 476 U.S. 558 (1986); *United States v. Darusmont*, 449 U.S. 29 (1981); *Welch v. Henry*, 305 U.S. 134 (1938); *United States v. Hudson*, 299 U.S. 498 (1937); *Milliken v. United States*, 283 U.S. 15 (1931); and *Cooper v. United States*, 280 U.S. 409 (1930). Generally, due process permits retroactive tax legislation if the retroactivity serves a "rational legislative purpose." *Carlton v. United States*, 512 U.S. at 30-31.

a. *Carlton*. In *Carlton*, the Court stated that that a retroactive law is Constitutionally valid if: (a) the government shows that the statute has a rational legislative purpose and is not arbitrary and irrational; and (b) the period of retroactivity is "modest." The Court held that the amendment's retroactive application was rationally related to the legitimate legislative purpose of closing an unintended loophole that would result in revenue losses, and that the period of retroactivity (fourteen months) was modest and consistent with the time requirements inherent in enacting national tax legislation.

b. *Blodgett* and *Untermyer*. *Carlton* strongly suggests that any challenge to a 2010 retroactive reinstatement of the estate and GST taxes would be unsuccessful, but there is one basis on which the reinstatement of the estate and GST taxes differs from the curative provision in *Carlton*. The Ninth Circuit's decision in *Carlton* relied in part on two older Supreme Court decisions – *Blodgett v. Holden,* 275 U.S. 142 (1927) and *Untermyer v. Anderson,* 276 U.S. 440 (1928), which had rejected retroactive imposition of the first Federal gift tax. The Court rejected the relevance of these cases, stating that they "were decided during an era characterized by exacting review of economic legislation under an approach that 'has long since been discarded.' " More importantly, the Court also stated that:

> *Blodgett* and *Untermyer,* which involved the Nation's first gift tax, essentially have been limited to situations involving "the creation of a wholly new tax," and their "authority is of limited value in assessing the constitutionality of subsequent amendments that bring about certain changes in operation of the tax laws."

As the Ninth Circuit stated in a later case, the law distinguishes between the imposition of a wholly new tax and changes in an extant tax, because the Constitution does not approve of the imposition of a new tax when the taxpayer has "no reason to suppose that any transactions of the sort will be taxed at all." *Qarty v. United States*, 170 F.3d 961 (9th Cir. 1999), quoting *United States v. Darusmont*, 449 U.S. at 298, 300 (itself quoting *Cohan v. Comm'r*, 39 F.2d 540, 545 (2d Cir. 1930) (Learned Hand, J.)).

c. **Likely Analysis.** Reasonable minds may differ on whether the re-adoption of the estate and GST taxes constitutes the "creation of a wholly new tax." The government would certainly argue that re-enacting an estate tax that dates to the first world war and a GST tax that has been in place for over 30 years should be distinguished from enacting the nation's first tax on lifetime donative transfers. Nonetheless, a reasonable argument can be made that the critical issue is the imposition of a new tax on a closed transaction, and that there are few ways to close a transaction more firmly than death.

There will be extensive litigation over any retroactive reimposition of the estate and GST taxes, but it seems likely that a Supreme Court that is generally deferential to Congress on tax issues, will sustain any reimposition that occurs in 2010. Thus, practitioners should caution their clients about the chance of retroactive reimposition of an estate and GST taxes, but they should also consider taking advantage of planning opportunities that may exist during the hiatus, particularly where there would be limited downside risk from doing so.

E. **Planning Imperatives.** Practitioners should contact their clients with estates over $1 million (the applicable exclusion amount after January 1, 2010, absent further legislation), and urge them to have their estate plans reviewed.

1. **Formula Clauses.** The most important part of such a review will be an examination of any formula clauses by which the estate would be divided between various shares based on estate tax provisions that

no longer exist. A reduce-to-zero formula that leaves to the nonmarital share the largest amount that can pass without Federal estate taxes could create a 100 percent nonmarital disposition and no marital share in 2010, when the estate tax is repealed. On the other hand, a reduce-to-zero formula clause that leaves the nonmarital share an amount equal to the decedent's applicable exclusion amount could create a 100 percent marital disposition and no nonmarital share if there is no applicable exclusion amount. The result of such a formula may be further complicated by collateral provisions that: (1) reduce the nonmarital share to reflect property that otherwise passes without qualifying for the marital or charitable deduction, or (2) require that the marital share be satisfied solely from property qualifying for the marital deduction. Similarly, a document that creates a generation-skipping trust measured by the maximum amount that can be sheltered from tax by the decedent's available GST exemption may produce a trust with no assets, because there is no GST exemption. On the other hand, a formula clause that gives such a trust the greatest amount that can pass free of GST tax may allocate the entire estate to the trust. None of these results reflect the intention of the testator or grantor, but the law does not consider extraneous testimony about the testator's intent unless the instrument is itself patently ambiguous. One could argue that neither of these formulae are ambiguous – they express a clear intent to have tax considerations determine the division of the estate. Thus, the odd result of the literal language of the clause would, arguably, represent the decedent's actual goals.

The testamentary instruments for a client who desires that his or her estate be divided between a marital and nonmarital share, or between GST exempt and nonexempt shares, without regard to whether there is an applicable exclusion amount or GST exemption by which to measure these shares, should provide a different formula for dividing the estate between various classes of beneficiaries, for 2010 or any other year in which the estate tax is repealed. The particular formula will depend upon the client's nontax goals. A relatively quick way to address these provisions, if one believes that repeal will be limited to 2010, or some portion of 2010, is to add a statement that the references to the applicable exclusion amount, GST exemption, and other tax terms related to the estate or GST taxes should be interpreted as those taxes were on the last date before their repeal, or if they are reinstated, on the date of the decedent's death.

2. **Marital Gifts.** A practitioner must carefully reconsider the form of the client's marital gifts. The carryover basis rules applicable in 2010 grant each estate a $1.3 million basis adjustment, and also grant an additional $3 million basis adjustment to a transfer to a surviving

spouse in a trust that meets the 2009 requirements for a QTIP. This should make practitioners seriously reconsider the use of non-QTIP marital trusts (such as spousal revocable trusts), at least to the extent of the $3 million of appreciation.

3. **Authority to Allocate Basis Increases.** Practitioners should state the factors to be favored in allocating carryover basis increases, such as the likelihood that the sale of the particular asset would produce a short-term capital gain or ordinary income, whether the sale would qualify for favorable tax breaks (such as apply to the sale of a principal residence), and the likelihood that the asset will be sold in the foreseeable future. It may also be appropriate to relieve the fiduciary (particularly if the fiduciary is a family member or friend, rather than a professional fiduciary) from liability for allocating basis disproportionately to some beneficiaries than to others.

4. **Spousal Property Basis Increase.** Wills or revocable trusts of married clients might make a special bequest to the spouse or a QTIP trust to permit the use of the $3 million basis increase for "qualified spousal property." This is more complicated than it sounds, because the $3 million is net appreciation, rather than value. This could be a gift of $3 million of assets with a zero basis, or $20 million of high basis assets. The will or revocable trust should guide the executor regarding whether to satisfy this gift with the most value or the least value that will absorb the $3 million basis adjustment, or with an amount that is fairly representative of the total appreciation in the overall estate assets.

5. **Assemble Basis Information.** Clients should begin assembling data on their basis in assets and keeping it in a place and form where it can be found, read and understood by their executors. It is often far easier for a client to assemble this information than for their executor. This information should not be in a password-protected computer file unless others, including the expected executor, knows the passwords.

6. **GST Transfers.** A 2010 direct skip transfer made to skip-persons or a 2010 termination of interests in or distributions from generation-skipping trusts will not subject to the GST tax, because that tax would not then exist. On the other hand, for transfers to a trust that is itself not a skip-person, the GST exemption in 2010 is zero. Code §§ 2010(c), 2631(c). An argument can be made that transfers to such trusts ought not to be subject to the GST tax upon later distributions or terminations of interests, but it is not clear that this type of effective date protection will be afforded when the law resumes in 2011 or is re-enacted in 2010.

7. **Drafting for GST Re-enactment.** Also, care must be taken with respect to the wording of the EGTRRA re-enactment rules. The Code states that for estates of decedents dying, gifts made, or generation-skipping transfers made after December 31, 2010, the 1986 Code shall apply as if the 2001 Act had never been enacted. This could mean that the inclusion ratio of any nonskip-person generation-skipping trust would, in 2011, be recalculated as if the exemption allocated to it were not, in any event, more than the $1 million, adjusted for inflation. Therefore, a trust to which a $3.5 million transfer were made in 2009 and to which $3.5 million GST exemption were properly allocated, could suddenly have an inclusion ratio of about 63% (1 - [$1,300,000/$3,500,000]).

8. **Accelerate GST Taxable Events.** One may also consider having trusts accelerate taxable terminations or taxable distributions into early 2010, when there is no GST tax. The absence of a GST tax on the date of the distribution or termination would appear to render these acts tax-free, though there is a real risk of retroactive imposition of the tax on these transfers. The transfers could be made with a refunding agreement whereby they were conditional upon the absence of a GST tax and the trust would be reestablished if the tax were retroactively reinstated.

9. **Section 2511(c).** Section 2511(c) states that, during 2010, and except as provided in regulations, "a transfer in trust shall be treated as a transfer of property by gift, unless the trust is treated as wholly owned by the donor or the donor's spouse under" the grantor trust rules. This rule appears to have been intended to reinforce the effectiveness of the gift tax as a backstop to the income tax. The Joint Committee on Taxation stated of Section 2511(c), when it was amended in 2002 to create the provision we now find:

> The provision clarifies that the effect of section 511(e) of the Act (effective for gifts made after 2009) is to treat certain transfers in trust as transfers of property by gift. The result of the clarification is that the gift tax annual exclusion and the marital and charitable deductions may apply to such transfers. Under the provision as clarified, certain amounts transferred in trust will be treated as transfers of property by gift, despite the fact that such transfers would be regarded as incomplete gifts or would not be treated as transferred under the law applicable to gifts made prior to 2010.
>
> For example, if in 2010 an individual transfers property in trust to pay the income to one person for life,

> remainder to such persons and in such portions as the settlor may decide, then the entire value of the property will be treated as being transferred by gift under the provision, even though the transfer of the remainder interest in the trust would not be treated as a completed gift under current Treas. Reg. sec. 25.2511–2(c). Similarly, if in 2010 an individual transfers property in trust to pay the income to one person for life, and makes no transfer of a remainder interest, the entire value of the property will be treated as being transferred by gift under the provision.

Staff of the Joint Committee on Taxation, 107th Cong., 2nd Sess., "General Explanation of Tax Legislation Enacted in the 107th Congress," pp. 249-250 (2003). Section 2511(c) appears, therefore, to have been intended only to eliminate the use of a specific class of trusts the transfers to which were completed gifts for income tax purposes but not completed gifts for gift tax purposes. Moreover, it appears to have not been intended to address the treatment of transfers to wholly-owned grantor trusts. Nonetheless, the wording of Section 2511(c) is difficult to parse and might be open to a broader interpretation than that intended by the drafters. Section 2511(c) could be construed as meaning that any transfer to a nongrantor trust would be taxed as a gift, even if it were made for full and adequate consideration. Thus, a 2010 loan or sale to a nongrantor trust could be taxed as a gift for gift tax purposes.

See discussion of Notice 2010-19, 2010-7 I.R.B. 404 (Feb. 16, 2010), below, stating that Section 2511(c) does not mean that transfers to wholly-grantor trusts are not taxable gifts.

10. **Carryover Basis.** The 2010 carryover basis rules apply to property received from a decedent who dies after December 31, 2009 and before January 1, 2011. A decedent's assets will receive a basis equal to the lesser of their fair market value on the date of death or their adjusted basis in the hands of the decedent. Thus, the step-down in basis in loss assets is preserved, while the step-up in basis for appreciated assets is denied. Code §§ 1014(f), 1022(a).

    a. **Allocable Basis Increases.** A decedent's executor will, however, be permitted to allocate to the decedent's specific assets basis increases so that the total basis of transferred assets was equal to at least $1.3 million (but not more than the actual value of the assets). Code § 1022(b)(2)(B). Additionally, the basis of property transferred to a surviving spouse could be increased by $3 million, with respect to assets passing outright

or in certain marital trusts. Code § 1022(b)(c). The $1.3 million figure is increased by any unused capital losses, net operating losses, and certain "built-in" losses of the decedent, and both the $1.3 million and $3 million figures are indexed for inflation. Code § 1022(b)(2)(C).

b. **Assets to Which No Allocation Possible.** The executor will not be able to allocate these basis adjustments to certain types of assets, such as items of income in respect of a decedent, and property acquired by the decedent by gift (other than from his or her spouse) during the three-year period ending on the date of death. Code § 1022(d)(1).

c. **Nonresident Aliens.** The estates of nonresidents who are not U.S. citizens will be allowed a basis increase only up to $60,000 (but also indexed for inflation after December 31, 2009). Code § 1022(b)(3).

d. **Pecuniary Bequests.** Gain or loss on the transfer of property in satisfaction of a pecuniary bequest after 2009, will be recognized only to the extent that the fair market value of the property at the time of the transfer exceeds its fair market value on the date of the decedent's death, rather than its carryover basis. Code § 1040.

e. **Principal Residence Exclusion.** The $250,000 exclusion for the gain on the sale of a principal residence is extended to estates and heirs, if the decedent used the property as a principal residence for two or more years during the five-year period prior to the sale. The decedent's period of occupancy is added to any actual occupancy by the heir, with respect to the heir's sale. Code § 121(d).

f. **Transfers to Foreign Persons.** Section 684, which currently taxes a donor on the appreciation in property contributed to a foreign trust or estate, will be extended to include testamentary transfers to foreign individuals. Code § 684.

F. **Administration of Taxable Estates During the Hiatus.** One clear problem raised by the repeal and possible reimposition of the estate tax is the proper administration of potentially taxable estates of decedents who die during the hiatus, when there is no estate tax.

1. **When to Prepare the Estate Tax Return?** Does the executor begin preparing an estate tax return to file if the tax is restored retroactively?

It is unreasonable to expect an executor to file an estate tax return and to pay a tax if the estate tax that is not currently imposed, and one would hope that any restoration would include some extension of the time for filing returns for such estates.

2. **Contest Constitutionality of Retroactive Re-enactment.** Should the executor contest the constitutionality of any retroactive restoration of the tax? Each practitioner must evaluate the precedents personally, but the government is certain to pursue this litigation all the way to the Supreme Court, so the costs of litigation will be substantial. At a minimum, fiduciaries should pay the estate tax and file a protective claim for refund, to preserve their rights in the remote possibility that the Court strikes down the retroactive feature.

3. **Selling Assets.** What should the fiduciary do about selling estate assets during the hiatus to raise liquidity to pay the estate taxes that may arise upon restoration. The carryover basis rules apply during the hiatus, so any such sales may generate significant capital gains taxes.

G. **State Estate Taxes.** A number of states, including Maryland and the District of Columbia, have their own stand alone estate taxes. Even without a federal estate tax, planning must be undertaken to minimize state estate taxes.

II. Discounting Tenancy-in-Common Interest in Artwork or Other Tangible Personal Property.

In *Stone v. United States*, 2009 WL 766497, 103 A.F.T.R. 2d 2009-1379 (9th Cir. March 24, 2009), *aff'g per curiam* 2007 WL 2318974, 100 A.F.T.R. 2d 2007-5512 (N.D. Ca. 2007), *making final preliminary order* 2007 WL 1544786, 99 A.F.T.R. 2d 2007-2992 (N.D. Ca. 2007), a district court and the Ninth Circuit raised questions about the size of discounts for tenancy-in-common interests in tangible personal property.

A. **Facts.** Lois's estate included her one-half interest in 16 valuable paintings. (The other one-half interest was held by the nonmarital trust under the will of Lois's late husband.) The estate valued the artwork at $1,420,000, claiming a 44% discount for lack of marketability and control.

B. **IRS Position.** The IRS valued the artwork at $2,766,250 – one-half interest at 50% of the value of the entire collection – with no discounts. This difference also reflected the IRS's determination that two paintings by Camille Pissarro were undervalued by the estate.

C. **District Court Allows Only 5% Discount.** The district court held that a small discount was allowed, and adopted the valuation prepared by the IRS Art Advisory Panel, rather than the estate's valuation from Sotheby's. The

court appeared to be very impressed with the IRS Art Advisory Panel valuation, noting that the panel was a collection of experts who are not paid (except for cost reimbursements), and who are not told whether an item is being valued for a charitable contribution deduction, estate tax valuation, or gift tax valuation. The Art Advisory Panel also does not know the identity of the taxpayer. The panel based its valuation on comparable sales of similar paintings near the date of valuation. The Sotheby's appraisal contained no description of how the valuations were determined, and because the estate did not introduce expert testimony to support the Sotheby's valuations, the court denied introduction of the appraisal, for lack of foundation. Nonetheless, the court noted, even if it had considered the Sotheby's appraisal, it would find it unpersuasive, because of the lack of any basis for its valuations. The court also rejected as relevant the values received when one of the two works of art was sold, because the sale occurred six years after the decedent's death, and because the estate declined to rely on the sales price for another painting sold at the same time. The court held that a hypothetical seller under no compulsion to sell would not accept the 44% discount proposed by the estate, but would demand a greater discount than the two percent proposed by the IRS. The government's experts testified that, while they were aware of sales of undivided interests in art occurring, none of these had ever occurred at a discount. The estate's expert testified that he could find no data regarding sales of undivided interests in art, and so based his valuation in part on data respecting sales of undivided interests in real estate and limited partnerships holding real property. The court rejected the analogy, noting that the art market differs from the real estate or business market, and that the nature of each piece of art means that an investor may not prefer to own 100% of a painting of lesser value than a 50% interest in another painting of greater value. The court stated that a hypothetical willing seller of an undivided fractional interest in art would likely seek to sell the entire work of art and split the proceeds, rather than seeking to sell his or her fractional interest at a discount. The court further stated that, because an undivided interest holder has the right to partition, a hypothetical seller would not likely accept any less for his or her undivided interest than could be obtained by splitting proceeds in this manner. The estate's expert estimated the cost of partitioning to be 51% of the value of the artwork, while the IRS estimated it at two percent of the value. The court rejected both, stating:

> In sum, the Court finds that a hypothetical willing seller who is under no compulsion to sell would seek to gain consent from other co-owners to sell the collection and divide the proceeds or, barring such consent, would bring a legal action to partition. At the very least, a hypothetical seller would consider the potential proceeds from the partition process before agreeing to accept any fractional interest discount when selling his or her partial interest. Because the Court cannot consider

whether other co-owners would consent to a sale, a small discount is appropriate to account for legal fees required to enforce the hypothetical seller's right to partition. No discount is required to account for appraisal fees, but the government's expert agrees that a 2% discount is appropriate to account for the actual costs of selling the art by an auction house. Finally, some discount is appropriate to account for the uncertainties involved in waiting to sell the art until after the partition action is resolved.

The court directed that the parties meet further and attempt to settle on the amount of the discount. When the parties failed to come to an agreement, the court imposed a five percent valuation discount.

D. **Ninth Circuit Affirms.** The Ninth Circuit affirmed *per curiam*, in an unpublished opinion, holding that the taxpayer had simply not met its burden of showing that the trial court's holding was incorrect, and that the trial court correctly had concluded that "[i]n this case, the court simply concluded that the evidence offered by the Estate was neither probative nor convincing." In particular, it noted that the trial judge had cited the total lack of art market experience of the taxpayer's appraiser, the dissimilar motives driving purchasers to acquire art versus real estate or other limited partnership interests, and the unreasonably low appreciation rate and unreasonably high present-value discount rates used by the taxpayer's appraiser in his analysis. "We cannot say the district court clearly erred in adopting the government's 5% discount rate and rejecting the Estate's."

E. **Planning.** This case is the first to uphold the IRS attempt to limit the discount for lack of marketability on a partial interest in tangible assets to the costs of partition. The court refused to consider the many cases that have denied the legitimacy of this limitation on the discount for lack of marketability, because those cases did not deal with artwork. See, *e.g.*, *Estate of Baird v. Comm'r*, 416 F.3d 442 (5th Cir., 2005)*rev'g and rem'g in part, aff'g in part*, T.C. Memo. 2002-299; and *Williams v. Comm'r*, T.C. Memo. 1998-59. Nonetheless, the IRS appears willing to continue to assert this limitation on the discount for lack of marketability with respect to tenancy-in-common interests, at least with respect to artwork and, presumably, such similar assets as antiques and other collectibles.

III. Family Limited Partnerships (FLPs) and Limited Liability Companies (LLCs)

A. Treasury Would Expand Scope of Section 2704(b) to Ignore More Restrictions and to Reduce Partnership and LLC Valuation Discounts.

The Treasury includes in the Administration's 2011 budget revenue proposals a potentially significant expansion of the scope of Section 2704(b), which currently ignores in valuing an interest in a closely-held entity, any applicable restrictions on liquidation that would lapse or that could be removed after the transfer. Dept. of Treasury, "General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals" p. 124 (Feb. 1, 2010).

1. **Disregarded Restrictions.** The Treasury proposes that a new category of restrictions called "disregarded restrictions," which would be ignored under Section 2704(b) in valuing an interest in a family-controlled entity transferred to a member of the family if, after the transfer, the restriction will lapse or can be removed by the transferor and/or the transfer's family. The transferred interest would be valued by substituting for the disregarded restrictions certain assumptions to be specified in regulations. Disregarded restrictions would include limitations on a holder's right to liquidate that holder's interest that are more restrictive than a standard identified in regulations, even if they are no more restrictive than those restrictions imposed by applicable state law. A disregarded restriction also would include any limitation on a transferee's ability to be admitted as a full partner or member, rather than being merely an assignee.

2. **Ignore Certain Nonfamily Interests.** In order to counter the use of small non-family interests (often charitable) to preclude the transferor's family from being able to remove an applicable or disregarded restriction after the transfer, the Treasury proposes that certain interests (to be identified in regulations) held by charities or others who are not family members of the transferor would be deemed to be held by the transferor's family.

3. **Marital and Charitable Deductions.** This proposal would make conforming clarifications with regard to the interaction of this proposal with the estate and gift marital and charitable deductions.

4. **Effective Date.** These proposals would apply to transfers after the date of enactment, for property subject to restrictions created after October 8, 1990 (the effective date of section 2704).

5. **Planning Considerations.** Time and the law have not been kind to Section 2704(b). Courts have held that Section 2704(b) does not apply to a restriction on the withdrawal of a partner from a partnership,

unless that withdrawal would cause the partnership to be liquidated. See, *e.g.*, *Kerr v. Comm'r*, 113 T.C. 449 (1999), *aff'd*, 292 F.3d 490 (5th Cir., June 10, 2002); *Church v. United States*, 268 F.3d 1063 (5th Cir. 2001), *aff'g per curiam* 85 AFTR 2d 2000-804, 2000 WL 206374 (W.D. Tex. 2000); *Estate of Jones v. Comm'r*, 116 T.C. 121 (2001); *Knight v. Comm'r*, 115 T.C. 506 (2000); *Estate of Harper v. Comm'r*, T.C. Memo. 2000-202. This has preserved the ability of provisions that limit the withdrawal of a member or partner to preserve or increase valuation discounts. State legislatures have modified their partnership and LLC acts to impose more stringent default rules on (a) the liquidation of a partnership or LLC; (b) the ability of a partner or member to withdraw from the entity; (c) the admission of a transferee of a partnership or membership interest into full participatory status as a partner or member; and (d) the withdrawal of a partner's or member's share of the entity's assets. These increasingly restrictive state default rules have largely rendered Section 2704(b) insignificant with respect to valuation discount planning, by taking advantage of the fact that Section 2704(b) does not apply to restrictions that are no more restrictive than those imposed by state law. The Treasury proposals seek to undo much of this development and to make Section 2704(b) accomplish more of what it was originally designed to accomplish.

The proposal's heavy reliance on regulations makes it impossible to know exactly what effect the new rule would have on valuation discounts. Certainly, marketability discounts will be reduced significantly, and perhaps even eliminated, for most closely-held entities. The results would likely be most dramatic for FLPs and LLCs whose assets consist largely of cash, marketable securities, life insurance policies and any other highly-liquid assets. The Treasury could modify the disregarded restrictions to force an appraiser to value a partnership or membership interest as if the transferee partner or member had the unilateral right to withdraw from the entity and compel the distribution of the value of his or her share of the entity's assets. FLPs and LLCs that hold illiquid tangible assets, such as real estate, might still be entitled to marketability discounts at least equal to those that would be available for a tenancy-in-common interest in the underlying assets. The treatment of active businesses that do not hold substantial tangible assets, however, is very unclear.

On the other hand, this proposal would also undercut the need for the more sweeping legislative proposals to limit the use of valuation discounts, such as those proposed by the Joint Committee on Taxation in 2005 and reflected in 2005 and 2009 bills introduced by Representative Pomeroy (D-N.D.). See Staff of Joint Comm. on Taxation, 109th Cong., 1st Sess., "Options to Improve Tax Compliance and Reform Tax Expenditures" (Jan. 27, 2005) (Comm. Print);

H.R. 1577, 109th Cong., 1st Sess. (2005); and H.R. 436, 111th Cong., 1st Sess. (Jan. 9, 2009). The process by which regulations are proposed and comments invited and considered may even prove conducive to a reasonable implementation of the authority sought in this proposal, and leave largely unaffected the valuations of partnerships and LLCs that operate active businesses.

See also analysis of the Treasury's proposal in Staff of the Joint Committee on Taxation, 111th Cong., 1st Sess., "Description of Revenue Provisions Contained in the President's Fiscal Year 2010 Budget Proposal. Part One: Individual Income Tax and Estate and Gift Tax Provisions," at 137-145 (Committee Print) (Sept. 2009). One point that the Joint Committee on Taxation makes is that it may be argued that the Treasury already has enough authority to accomplish this task without further legislation. Section 2704(b)(4) authorizes the Treasury to issue regulations that

> provide that other restrictions shall be disregarded in determining the value of the transfer of any interest in a corporation or partnership to a member of the transferor's family if such restriction has the effect of reducing the value of the transferred interest for purposes of this subtitle but does not ultimately reduce the value of such interest to the transferee.

The Tax Court in *Kerr* stated that it was "mindful that the Secretary has been vested with broad regulatory authority under section 2704(b)(4)," but concluded that the current regulations did not support the IRS's position in the case. 113 T.C. 449, at 474 (1999). Also, the Joint Committee on Taxation notes that the IRS and Treasury business plan for 2008-2009 describes "a plan to issue guidance under § 2704 regarding restrictions on the liquidation of an interest in a corporation or partnership."

B. **Check-the-Box Regs and Gift Tax Valuation.** In *Pierre v. Comm'r*, 133 T.C. ___ (No. 2) (Aug. 24, 2009), the Tax Court held that the check the box regulations do not affect gift tax valuation.

1. **Facts.** Suzanne Pierre received a $10 million cash gift from a wealthy friend, and she wanted to use some of this gift to provide for her son Jacques, and her granddaughter, Kati, but she was also concerned about keeping her family's wealth intact. On July 13, 2000, Suzanne created a single-member New York limited liability company (LLC), Pierre LLC. Suzanne did not elect to treat Pierre LLC as a corporation for Federal tax purposes by filing a Form 8832, Entity Classification Election. On July 24, 2000, Suzanne formed irrevocable trusts for her

son and granddaughter. On September 15, 2000, Suzanne transferred $4.25 million in cash and marketable securities to the LLC. On September 27, 2000, Suzanne gave a 9.5 percent membership interest to each trust and then sold a 40.5% of her interest in the LLC to each trust in exchange for an installment note. Suzanne valued the LLC interests based on an independent professional appraisal, that applied a 30% discount for lack of control and marketability.

2. **IRS Position.** On audit, the IRS disallowed the valuation discounts, because the LLC was a disregarded entity for tax purposes for "federal tax purposes" under the check-the-box regulations. Treas. Regs. §§ 301.7701-1 to 301-7703. The regulations set the default classification for an entity with a single owner as a disregarded entity. Treas. Regs. § 301.7701-3(b)(1)(ii). Therefore, the IRS contended, the transfers of interests in Pierre LLC should be treated as transfers of cash and marketable securities, without valuation discounts.

3. **Tax Court Majority Allows Discounts.** The Tax Court, by a 10-judge majority (Judge Wells, for himself and Judges Cohen, Foley, Vasquez, Thornton, Marvel, Goeke, Wherry, Gustafson and Morrison), in a reviewed opinion, held that the check-the-box regulations govern an entity's classification, but do not, for gift tax purposes, alter the nature of the bundle of rights that is transferred. The court looked to the history of the gift tax and Supreme Court precedent, which requires that state law creates property rights and interests, and that federal tax law defines the tax treatment of those property rights and interests. *Morgan v. Comm'r*, 309 U.S. 78 (1940); *United States v. Bess*, 357 U.S. 51, 55 (1958); *Aquilino v. United States*, 363 U.S. 509, 513 (1960); *United States v. Rodgers*, 461 U.S. 677, 683 (1983); *United States v. Nat. Bank of Commerce*, 472 U.S. 713, 722 (1985). The majority stated that, under applicable New York law, Suzanne had no interest in the underlying assets of the LLC and the LLC was a separate entity from its members.

The court then examined the history and purpose of the check-the-box regulations, and stated that the regulations applied "for federal tax purposes" to address only the classification of an entity. 61 Fed. Reg. 21989-21990 (May 13, 1996). The question, the court stated, was whether the check-the- box regulations require that a single-member LLC, validly formed under state law, should be disregarded in deciding how to value a donor's transfer of an ownership interest in the LLC for gift tax purposes. The IRS argued that the courts have sustained the application of the check-the-box regulations beyond the mere income tax classification, citing *McNamee v. Dept. of the Treasury*, 488 F.3d 100 (2d Cir. 2007), where the owner of the single-member LLC was liable, notwithstanding state law, for the

employment taxes owed by the LLC. The majority distinguished *McNamee*, stating:

> While we accept that the check-the-box regulations govern how a single-member LLC will be taxed for Federal tax purposes, i.e., as an association taxed as a corporation or as a disregarded entity . . . . [w]e do not accept that the check-the- box regulations apply to define the property interest that is transferred for such purposes. The question before us (i.e., how a transfer of an ownership interest in a validly formed LLC should be valued under the Federal gift tax provisions) is not the question addressed by the check-the-box regulations (i.e., whether an LLC should be taxed as a separate entity or disregarded so that the tax on its operations is borne by its owner). To conclude that because an entity elected the classification rules set forth in the check-the-box regulations, the long-established Federal gift tax valuation regime is overturned as to single-member LLCs would be "manifestly incompatible" with the Federal estate and gift tax statutes as interpreted by the Supreme Court.

The majority also distinguished *Shepherd v. Comm'r*, 115 T.C. 376 (2000), aff'd, 283 F.3d 1258 (11th Cir. 2002); and *Senda v. Comm'r*, 433 F.3d 1044 (8th Cir. 2006), *aff'g* T.C. Memo. 2004-160, both of which had applied the indirect gift principle to a transfer of interests in a partnership before the funding had been completed. The court noted that, in *Pierre*, the LLC was funded before the interests were transferred. The majority also noted that Sections 2701 and 2703, which disregard valid state law restrictions in valuing transfers, and that Congress knows how to abandon state law rules where it wishes to do so. No such rules have been provided for single-member LLCs.

4. **Concurring Opinion.** Judge Cohen wrote a separate concurring opinion (for herself and Judges Wells, Foley, Vasquez, Thornton, Marvel, Goeke, Wherry and Gustafson), explaining further why she believed that this case was consistent with *Med. Practice Solutions, LLC v. Comm'r*, 132 T.C. __ (No. 7) (2009), which opinion she had written, and which followed *McNamee* in holding that the owner of a single-member LLC was liable for unpaid employment taxes of the LLC. Judge Cohen distinguished *Pierre*, because it involves valuation for transfer tax purposes, rather than liability for employment taxes. Judge Cohen stated that both the phrase "for federal tax purposes" and the word "disregarded" are ambiguous, and that the regulations

implement a statute that, by its terms, applies except where "manifestly incompatible with the intent" of the Code. Code § 7701(a). Judge Cohen explained that the statement in the regulations that an entity is "disregarded as an entity separate from its owner" could mean that a disregarded entity is exempt from tax, that its transactions are disregarded and not reported for tax purposes, or that transfers of interests in the entity are disregarded for Federal gift tax purposes and not taxed. Thus, the regulations must be interpreted in light of the other extant gift tax rules.

5. **Dissents Would Apply Check-the-Box.** Judge Halpern wrote a strong dissenting opinion (for himself and Judges Kroupa and Holmes), stating that the IRS was correct under the rules of statutory and regulatory construction. The regulations state that a disregarded single-owner entity is treated as a "sole proprietorship, branch, or division of the owner." Treas. Regs. § 301.7701-2(a). Judge Halpern explained that the IRS had a ten-year-long history of consistently treating a disregarded entity as a sole proprietorship, beginning with Rev. Rul. 99-5, 1999-1 C.B. 434, which treated the sale of a 50% interest in a disregarded entity as a sale of a half interest in a proprietorship. This was an income tax ruling, but the gift tax issue raised in Pierre is merely a different incarnation of the same principle. Judge Halpern also cited several private rulings that had consistently treated a disregarded entity as a proprietorship for like-kind exchange purposes. PLRs 200732012 (May 11, 2007); 200251008 (Sept. 11, 2002); 200131014 (May 2, 2001); 200118023 (Jan. 31, 2001); 199911033 (Dec. 18, 1998); 9807013 (Nov. 13, 1997); and 9751012 (Sept. 15, 1997). This IRS interpretation, Judge Halpern stated, is due deference under *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

   Judge Kroupa also dissented (for himself and Judges Colvin, Halpern, Gale, Holmes and Paris), stating that the majority ignored the plain language of the check-the-box regs, which she argued requires that the LLC be disregarded as an entity separate from its owner.

6. **Planning.** The IRS also argued that the creation of the LLC and the gifts and sales of the membership interests should be collapsed under the step transaction doctrine, to value the transfers as gifts of the underlying assets. The majority stated in footnote 5 that this issue would be addressed in a separate opinion.

   The IRS argument in *Pierre* seems to be merely an extension of its income tax analysis in Rev. Rul. 99-5, cited above. Rev. Rul. 99-5 treated the sale of a 50% interest in a disregarded single-member LLC as a sale of a one-half interest in the underlying assets, and the contribution of each of the parties interests in the assets to a

new partnership. Applying this analysis to the transfer taxes would result in the disallowance of any discounts on the sales price, except to the extent that the assets of the LLC were real estate or other not readily marketable properties.

Also, Judge Halpern's dissent appears to be very strong and may be appealing to the Second Circuit, to which the case would be appealed. The only question about the dissent's analysis may be whether a revenue ruling is a sufficient declaration of governmental position to be entitled to deference. The courts have been inconsistent in their views of revenue rulings. Revenue rulings generally receive deference from the courts. See, e.g., *Davis v. United States*, 495 U.S. 472 (1990) ("although the Service's interpretive rulings do not have the force and effect of regulations, . . . we give an agency's interpretations and practices considerable weight where they involve the contemporaneous construction of a statute and where they have been in long use"); *AMP, Inc. v. United States*, 185 F.3d 1333, 1339 (Fed. Cir. 1999) ("revenue ruling issued at a time when the I.R.S. is preparing to litigate is often self-serving and not generally entitled to deference by the courts . . . .This is especially true when the ruling cites no authority and is inconsistent with regulations and other pronouncements of the I.R.S."); *Estate of McLendon v. Comm'r*, 135 F.3d 1017, 1023–1024 (5th Cir. 1998) ("revenue rulings are odd creatures unconducive to precise categorization in the hierarchy of legal authorities. They are clearly less binding on the courts than treasury regulations or Code provisions, but probably (and in this circuit certainly) more so than the mere legal conclusions of the parties"); *Wood v. Comm'r*, 955 F.2d 908 (4th Cir. 1992), *cert. granted*, 504 US 972 (1992), *cert. dism'd*, 505 U.S. 1231 (1992) (court reached same result as ruling, and then stated that "considerable weight is to be given to an agency's construction of a statute that it is charged with administering"); *Indiana Nat'l Corp. v. United States*, 980 F.2d 1098 (7th Cir. 1992), *cert. .denied*, 508 U.S. 907 (1993) ("it is proper to consider a relevant revenue ruling, . . . although they are not definitive"); *Stubbs, Overbeck & Assocs. v. United States*, 445 F.2d 1142, 1146–47 (5th Cir. 1971) (rulings are "merely the opinion of a lawyer in an agency"); *Norfolk S. Corp. v. Comm'r*, 104 T.C. 13 (1995) ("a ruling or other interpretation by the Commissioner is only as persuasive as her reasoning and the precedents upon which she relies"); *Stark v. Comm'r*, 86 T.C. 243, 250 (1986) ("absent special circumstances, a revenue ruling merely represents the Commissioner's position with respect to a specific factual situation, [and] typically [is not] substantive authority for a position"); *Reinhardt v. Comm'r*, 85 T.C. 511, 520 (1985) (revenue ruling "merely represents the position of one of the litigants in this case, the Commissioner of

Internal Revenue, and does not necessarily even represent the view of the Treasury Department”).

For practitioners, this case is good news, but one should not rely on a single Tax Court majority opinion, when careful planning can assure a favorable result. The best approach in planning situations such as those in *Pierre*, is for the donor to make a gift of a one percent membership interest to one of the intended donees. This creates a two-member LLC that cannot be disregarded for federal tax purposes. The IRS can contend that this gift is valued without a discount for lack of control, but the size of the gift should be small enough to render a vigorous dispute unlikely. Thereafter, following a reasonable period of deliberation by the donor (perhaps two months, based on the analogous analyses in *Holman v. Comm'r*, 130 T.C. 170 (2008)), the donor can make other transfers of LLC interests, with full discounts for lack of marketability and control.

It might also be noted that the facts in *Pierre* clearly state that the gifts were made before the sales, and the IRS still disallowed the discounts in the values for purposes of the sales, as well as for purposes of the gifts. This could reflect the proximity of the two sets of transfers – the court does not state how much time elapsed between them.

Also, practitioners for whom continued disregarded status is important for income tax purposes, might consider having the donor make gifts to intentional grantor trusts. A partnership or LLC all of the interests of which are owned by the grantor and a grantor trust is disregarded only for income tax purposes. Rev. Rul. 77-402, 1977-2 C.B. 222; Rev. Rul. 2004-77, 2004-2 C.B. 119; see also Danforth, Lane & Zaritsky, *Federal Income Taxation of Estates & Trusts*, ¶ 7.05 (RIA/WG&L, 2d ed.). Grantor trusts to which completed gifts can be made have traditionally been treated as separate entities for estate and gift tax purposes. Therefore, while there is no case or ruling directly on point, a transfer of an interest in a disregarded entity all of the interests of which are, both before and after the transfer, held by the grantor and one or more grantor trusts, should not cause the entity to cease to be a disregarded entity.

C. Impact of Section 2036(a) on FLPs and LLC. Taxpayers have had mixed results regarding the application of Section 2036(a) to assets held in a family limited partnership or LLC, though major victories give new hope on this issue in the future.

1. ***Estate of Jorgensen v. Comm'r*, T.C. Memo. 2009-66 (March 26, 2009).**

a. **Facts.** Col. and Ms. Jorgensen created the Jorgensen Management Association (JMA-1), a Virginia limited partnership, each contributing an equal amount of marketable securities, in exchange for 50% limited partnership interests. They named Col. Jorgensen, their son and their daughter as the general partners, but the children never made contributions to the partnership. Col. and Ms. Jorgensen also gave substantial limited partnership interests to their grandchildren. Col. Jorgensen several years before his wife, and after his death, she created a second partnership (JMA-2), again giving general and limited partnership interests to her children and limited partnership interests to her grandchildren. Low-basis assets were held in JMA-1 and high-basis assets held in JMA-2. After Ms. Jorgensen died, JMA-2 sold several blocks of stock and reported gain calculated using the basis that Ms. Jorgensen had in the assets when she transferred them to the partnership.

b. **IRS Position.** The IRS contended that the value of the partnership assets were includible in Ms. Jorgensen's gross estate, under Section 2036(a)(1).

c. **Tax Court Holds for IRS.** The Tax Court (Judge Haines) held that the value of the underlying partnership assets contributed by Ms. Jorgensen to the two partnerships should be included in her gross estate under Section 2036(a). The court held that the transfer to the partnerships was not a bona fide sale for adequate and full consideration; because there was no "legitimate and significant nontax reason for creating the family limited partnership." The court noted that the partnerships were not designed: (i) to help Ms. Jorgensen manage her assets, because her revocable trust and power of attorney already served that function; (ii) to provide a financial education to the two children, noting that Col. Jorgensen had never attempted to teach his children about investments and their management activities were few; (iii) to encourage family unity, noting that the different relationship each child had with money made placing them together as general partners "as likely to cause family disunity as unity"; (iv) to perpetuate the Jorgensens' buy-and-hold investment philosophy, because "[t]here are no special skills to be taught when adhering to a 'buy and hold' strategy, especially when one pays an investment adviser

to recommend what to buy and when to sell"; (v) pool assets, because the assets had been managed together before the partnerships were created and the children and grandchildren did not contribute to the partnerships; (vi) to protect assets against the claims of the creditors of the children and grand-children, because the son, who was admittedly a spendthrift, was designated as a general partner and because there was no evidence of actual creditor issues. The court also cited the failure of the parties to follow partnership formalities (neither partnership maintained books and records other than a checkbook that went unreconciled and monthly brokerage statements; there were no formal meetings between or among the partners; no minutes were ever kept; and Ms. Jorgensen used partnership assets to pay personal expenses and paid partnership expenses with her personal assets.) Ms. Jorgen-sen was not financially dependent on distributions from the partnerships for her day-to-day expenses, but she was dependent on the partnerships to satisfy her gift-giving pro-gram. Furthermore, the court noted, JMA-II lent $125,000 to the son, on which loan he did not regularly pay interest or principal. The court also noted that Col. Jorgensen formed the partnerships without input from his wife and children. The court also held that Ms. Jorgensen retained the beneficial enjoyment of the partnership assets, noting that (i) Ms. Jorgen-sen retained sufficient assets outside the partnership for her day-to-day expenses, but not enough to make the gifts she wished to make; and (ii) partnership distributions were used to pay transfer taxes, legal fees, and other obligations of the decedent's estate.

d. **Note on Equitable Recoupment.** The court then applied the doctrine of equitable recoupment to allow the estate to deter-mine the gain on its sale of securities by the partnership using a basis equal to their date-of-death value, rather than the value of those assets when transferred to the partnership by the decedent. The doctrine of equitable recoupment allows a litigant to avoid the bar of an expired statutory limitation period, where an inequitable windfall would otherwise result from the inconsistent tax treatment of a single transaction, item, or event affecting the same taxpayer or a sufficiently related taxpayer. Here, the refund of the income taxes on the sales was barred by the statute of limitations, but the court found that the basis in those assets was determined by the same taxable event as the decedent's estate tax. See *Estate of Branson v. Comm'r*, 113 T.C. 6, 15 (1999), *aff' d*, 264 F.3d 904 (9th Cir. 2001)

(capital gains taxes equitably recouped against estate tax deficiency when value of closely-held stock sold by estate was increased by Tax Court for estate tax purposes). The court also held that the taxpayers involved in this case (the decedent's estate and the partners of the two family limited partnerships) had a sufficient identity of interest so that they should be treated as a single taxpayer in equity. The court rejected the IRS contention that the taxes paid with respect to the grandchildren's interests in the partnerships should not be recouped because they were not involved in the estate administration, finding that the law did not require that the taxpayer who overpaid tax must be the one responsible for the related deficiency for equitable recoupment to apply. Rather, the grandchildren were involved through their implied agreement that Ms. Jorgensen would retain control of the assets she contributed to the partnerships.

2. *Estate of Miller v. Comm'r,* T.C. Memo. 2009-119 (May 27, 2009)

a. **Facts.** Valeria, on advice of counsel, created the Miller Family Limited Partnership (the FLP) when she was 86 years of age, but in relatively good health. Her son, Virgil G., was the general partner (one percent) and a limited partner (one percent), Valeria's funded revocable trust was the largest limited partner (92%), and her other three children were each two percent limited partners. The children received their interests by gift. Valeria named Virgil G. as general partner so that he could continue to manage the assets according to his father's investment philosophy, which he had learned from his father. The FLP had hired a corporation created by Virgil to manage the FLP investments, and paid it for its services. A year later, additional contributions were made to the FLP. At her death, Valeria's executor claimed a 35-percent discount on the value of her trust's FLP interests.

b. **IRS Position.** The IRS assessed a deficiency, contending that Valeria's gross estate should include the undiscounted value of the assets transferred to the FLP in both 2002 and 2003 under Section 2036(a).

c. **Tax Court Allows Some Discounts, Disallows Others.** The Tax Court (Judge Goeke) held that the securities transferred in 2002 were not includible in the gross estate and were valued with a discount for lack of marketability, while those transferred in 2003 were includible in the gross estate without discount.

The court held that there was a substantial nontax purpose for creating the FLP and making the 2002 transfer to the FLP – continuing, through Virgil G., the investment approach developed by the elder Mr. Miller. The estate planning attorney, Virgil G. and his brother all testified about the elder Mr. Miller's investment strategy, which involved charting stocks by hand and making detailed records, actively trading stocks, including sales on margin. Virgil G. testified that he spent about 40 hours per week managing the FLP assets, including monitoring and trading the assets regularly once they were contributed to the FLP. He evaluated stocks daily. He subscribed to a number of trade publications and purchased computer software to assist in his securities trading. Virgil G. was the only family member versed in his father's trading philosophy, and he was given authority to trade securities on behalf of the FLP. The court stated that the investment function was sufficient to constitute a legitimate and substantial nontax purpose, even though the FLP and Virgil's management company had no employees or bank accounts and kept no books of account. The securities were actually transferred to the FLP and were never commingled with Valeria's personal assets, and FLP formalities were satisfied. The court stressed that the activities need not be a business for income tax purposes; it needs only involve active management of the assets in question for a bona fide nontax purpose.

On the other hand, the court noted that the 2003 transfers were made without a legitimate and substantial nontax purpose, but because of the "precipitous decline in Valeria's health in the weeks before the transfers." In addition to breaking her hip, Valeria had just undergone pacemaker implantation surgery, her rehabilitation was not progressing, and she was forced to return to the hospital with congestive heart failure. The witnesses' credibly testified that Valeria's family hoped for her recovery, but her health was clearly in decline and that was the motivating factor in making additional contributions to the FLP. The court rejected the argument that Valeria contributed the remainder of her assets to the FLP in 2003 in order that they would be managed in accordance with her late husband's investment strategy, noting that she could have done that at any time during the past year. As the 2003 transfer was not a bona fide sale for full and adequate consideration, the court then looked at whether Valeria retained a lifetime beneficial enjoyment over the 2003 assets. The court noted that Virgil G knew, when the 2003 transfer was made, that the transferred funds would be needed to pay Valeria's

estate tax liabilities, and that she did not retain sufficient assets outside of the FLP to meet those obligations. The partnership made distributions to pay these liabilities in 2004. The distribution was pro rata, but the court noted that "part of the 'possession or enjoyment' of one's assets is the assurance that they will be available to pay various debts and expenses upon one's death." *Strangi v. Comm'r*, 417 F.3d 468, 477 (5th Cir. 2005), *aff'g* T.C. Memo. 2003-145.

3. ***Keller v. United States*, 2009 WL 2601611, 104 A.F.T.R. 2d 2009-6015 (S.D. Tex. Aug. 20, 2009).**

   a. **Facts.** In June 1998, when they were each 88 years of age, Maude O'Connor Williams and her husband, Roger T. Williams, created a joint revocable trust funded with approximately $300 million in cash, certificates of deposit, and bonds. (The trust did not include the couple's extensive land and mineral holdings.) On Roger's death in January, 1999, the trust divided into Trust M, containing the deceased spouse's separate property and one-half of their community property, and Trust A, containing the surviving spouse's separate property and his or her half of their community property. Maude was the trustee for both trusts. At Maude's death, both trusts would devolve into separate shares for the couple's children. Maude then met with her advisers to consider options for the protection and disposition of some of the assets held in the two trusts. Rayford Keller, an accountant who had been the primary financial adviser for the Williamses for 30 years and who was also co-executor of Roger's estate, met with Maude and other advisers to discuss creating a series of family limited partnerships to hold some or all of the family's real estate, mineral interests, and the investment assets held by the family trust -- one limited partnership for each class of asset. The Investment Partnership was to be formed to hold the couple's bonds, and to have two limited partners and one general partner. The two limited partners were to be Trust M (49.5%) and Trust A (49.5%). The general partner (0.1%)was to be an LLC that would be formed concurrently with the Partnership. Maude would initially own all of the shares in the general partner, but was to transfer and/or sell her shares to other family members who would jointly control the Investment Partnership after her death.

      In March, 2000, Maude was diagnosed as having cancer, but her physicians did not believe, at that time, that her death was imminent. On May 9, 2000, after Maude's advisers

prepared what they believed were the final drafts of the partnership and incorporation papers. Maude then signed a number of the organizational papers from her hospital bed. Some of these papers still had blanks, because of uncertainty about certain fair market value amounts. On May 11, 2009, the articles of incorporation of the LLC were filed. On May 15, 2009, Maude died, before new accounts were opened and before the entities were formally funded. The plan had called for the LLC-general partner to be funded with $300,000, and the partnership with $250 million worth of bonds. This would have left Maude with over $110 million of other assets.

Maude's estate paid $147.8 million in Federal estate taxes, claiming no discounts for the investment partnership interests because, at Maude's death, the advisers thought that the partnership had been properly formed. In May 2001, Lane Keller (Rayford's son and another close advisor of the family) learned at an estate planning seminar of the decision in *Church v. United States*, 2000 WL 206374, 85 A.F.T.R. 2d 2000-804 (W.D. Tex. 2000), *aff'd in unpub'd decision*, 268 F.3d 1063 (5th Cir. 2001), which had allowed valuation discounts for an unfinished family partnership. In August 2001, the estate filed its estate tax return. In November 2001, the estate filed a claim for refund requesting a refund of $40.5 million, plus interest, based on the allowance of 47.5% valuation discounts for the interests in the Investment Partnership. The IRS denied the claim for refund, and the estate sued.

b. **District Court Sustains Discounts.** The district court held that, when she died, Maude clearly intended that the community property bonds be partnership property, and that the partnership agreement was enforceable and the executors had a duty to complete the transactions surrounding its formation. The court stated that, because Maude was shown to have intended to transfer the community property bonds to the partnership at the time she signed the agreement, and the partnership was a valid Texas limited partnership before her death, the assets are considered partnership property before her death and her estate may be able to obtain a refund for the taxes paid. The court noted that the evidence supported the claim that Maude was a shrewd businesswoman and frugal heiress -- with annual living expenses of about $60,000 -- who was singularly dedicated to safeguarding the family's fortune for the benefit of her children and descendants. Maude was particularly concerned with protecting the family's interests from loss through divorces, particularly after the divorce of one

of her daughters, which was lengthy and expensive. She addressed these concerns principally through various trusts and by rigorously tracking family members' separate and community property for the purpose of characterizing them under Texas' community property law. These efforts reduced the losses in later divorces. The court stated that it was clear that the primary purpose of these partnerships was to consolidate and protect family assets for management purposes and to make it easier for these assets to pass from generation to generation, and that any estate tax savings that resulted from these partnerships were merely incidental. Therefore, the transfers to the partnership were bona fide sales for full and adequate consideration. Also, the court noted, when the partnership was created, Maude's health was declining, but not failing. She was legally blind, but was credibly described as cogent and able to see well enough to read with some difficulty and to sign her name. She was further credibly described by Rayford and Lane Keller as being sharp enough to discuss the details of her plans for the partnership in detail. The court also held that a spreadsheet created by Rayford Keller describing Maude's various assets, their locations, and those contemplated to become partnership property, and the handwritten notes made by the Kellers concerning Maude's intent that the community property bonds fund the partnership are both admissible under several exceptions to the hearsay rule.

c. **Planning Impact.** This is a wonderful case to keep in a drawer of your desk, and produce whenever the estate tax examiner suggests that your client did not fully comply with the legal requirements for a valid partnership or LLC.

This case was very fact intensive. The trial lasted four days and two-thirds of the opinion is a recitation of the facts. This highlights the importance of trial preparation and a very full development of the facts of an FLP case.

One might also note that the decedent never signed a funding document, and the Schedule A on the partnership agreement was never completed, yet the court held that the decedent had clearly expressed her intent to fund the partnership with specifically identified bonds and cash. This suggests very good lawyering and very convincing witnesses.

4. ***Estate of Malkin v. Comm'r*, T.C. Memo. 2009-212 (Sept. 16, 2009).**

a. **Facts.** Roger, as part of his estate plan, created two family limited partnerships (FLPs) and four trusts. Roger was the

general partner and he and two trusts were the limited partners of each FLP. Two trusts were created for his son and two for his daughter. In 1998, Roger created and funded trusts for his two children (the MFLP trusts) and, later the same month, he created the Roger D. Malkin Family Limited Partnership (MFLP), and assigned to it shares of the stock of Delta & Pine Land Company, of which he was the CEO, and which operates the world's largest and longest running private cotton seed breeding program. Roger then sold his limited partnership interests to the MFLP trusts for a self-cancelling installment note (SCIN). The sales price reflected a valuation discount of approximately 40%. Each year, Roger made gifts to the trusts to provide funds to make the SCIN payments. (Actually, the facts demonstrated that Roger did this in two years for the son's trust, and at least one year for the daughter's trust.) Slightly more than a year later, the trustees authorized Roger to pledge MFLP assets to secure his personal bank debt to; Roger promptly pledged nearly all of the D&PL shares held by the partnership. Roger executed a personal guaranty, promising to use his "personal assets" to repay his debt, plus interest. Roger agreed to pay MFLP a fee of 0.75 percent of the $4,345,000 security. The assets were repledged the next year, to secure Roger's personal debt to another bank, and the pledge extended to the few remaining shares held by the partnership. Again, Roger executed a personal guaranty to the partnership, and paid another fee.

In 1999, Roger was diagnosed with pancreatic cancer. Several months later, he assigned shares of D&PL stock and interests in four family LLCs which he controlled with his son, to the Cotton Row Family Limited Partnership (CRFLP), of which two other trusts for his children (the CRFLP trusts) were limited partners. Roger first created and funded the partnership, and then created the trusts and sold to the trusts limited partnership units, in exchange for a ten-percent downpayment and a nine-year promissory note bearing interest at 6.8 percent. Roger gave the trusts the cash to pay the downpayment. The following year, Roger transferred 80,000 more D&PL shares to CRFLP. These shares had previously been pledged as collateral for a personal bank loan. The partnership never paid interest on the promissory notes, and Roger died before payment became due. The estate never made any demand for payment under the pledge.

b. **Tax Court Holds Rejects Discounts.** The Tax Court (Judge Halpern) held for the IRS on all issues. The court held that

Roger retained a right to the beneficial enjoyment of the stock transferred to the partnership (though not the LLC interests transferred to the CRFLP), because he used the stock to secure his personal debts. The estate argued that the decision to pledge the stock for Roger's personal debts was a sound business decision, made by the trustees to put the stock to additional profitable use, but the court noted that the estate had offered no proof that the fee paid by Roger for the guaranty was a reasonable fee, or that there was a sound business reason for the trusts to make the guarantees. The court did not distinguish between the transfer of pledged shares to one partnership or the pledging of transferred shares by another. Applying the rules adopted in *Estate of Bongard v. Comm'r*, 124 T.C. 95 (2005), the court also found that the transfer of assets to the partnerships was not a bona fide sale for full and adequate consideration, because it had no substantial nontax purpose. The court rejected as sufficient purposes (a) providing for the decedent's children, because that is too closely interwoven with tax savings; (b) preventing a sale of any of the D&PL shares, because if that were a real purpose, the son's substantial block of shares would have also been contributed to the partnerships; and (c) centralized management of the family's wealth, because there was no pooling of the family's assets in the FLPs – the decedent transferred all of the assets.

c. **Note on Beneficial Enjoyment.** This is the second case to treat a contribution of property that is encumbered by the transferor's personal debt as if the transferor had used partnership assets to satisfy that debt, for purposes of establishing beneficial enjoyment under Section 2036(a). See also *Bigelow v. Comm'r*, 503 F.3d 355 (9th Cir. 2007), *aff' g* T.C. Memo.2005-65.

d. **Other Issues.** This case involved several other issues. In 2000, before his death, Roger paid debts owed by the various LLCs, and transferred $730,000 to his son in exchange for a promissory note for that amount. In November, decedent wired Jonathan Malkin and Melissa Malkin both $100,000 in exchange for a promissory note from each for that amount.

The executors of Roger's estate filed an estate tax return excluding the value of the trust assets from Roger's gross estate, and deducting $16,085,376 for debts of decedent, including a $12,936,886 loan secured by D&PL stock worth $10,475,066 and a $2,346,724 obligation to one of the LLCs.

The Tax Court also held that the transfer of LLC interests to the CRFLP were actually disguised indirect transfers of the underlying assets, for which gift tax valuation discounts would not be allowed. See discussion below.

The court also held that: (1) the purported sales of partnership interests were shams, because all of the loan payments were made from gifts made by Roger; (2) other loans to the children were disguised gifts, as none of the loans were ever repaid and there was no evidence that the borrowers ever intended to repay them; (3) Roger had made gifts to his children when he gratuitously paid debts of the LLCs and transferred assets to the LLCs, of which he was no longer a member.

The court also allowed only a limited estate tax deduction for the decedent's obligation to pay the debt to one bank that was secured by some of the partnership stock. See discussion below.

It is also noteworthy that the court, in a footnote, stated that the assets includible in the gross estate under Section 2033 must be adjusted to subtract the partnership interests the underlying assets of which are included under Section 2036. This appears to reject the argument suggested by some that all a decedent's estate would receive, when the underlying assets were included, was an offset under Section 2043 for the value of the assets transferred to the partnership. The court here appears to reject the notion of any form of double-counting of the partnership interests or assets.

5. *Estate of Murphy v. United States*, 2009 WL 3366099 (W.D. Ark. Oct. 2, 2009).

a. **Facts.** Charles H. Murphy, Jr. owned substantial interests in Murphy Oil Company, a publicly traded oil company of which he was the CEO and Chairman of the Board, Deltic Timber Corporation (a timberland and farmland company), and BankcorpSouth, in each of which he played an active role. The decedent became concerned about dissipation of family assets because two of his children, Mike and Chip, did not share his view that certain family financial assets ("legacy assets") should be retained, and had pledged and sold their interests in some of these assets, and run into financial difficulties. Furthermore, Chip lost some of his legacy assets in a divorce. After various planning sessions with his other two children, Madison and Martha, who shared the decedent' buy-and-hold investment philosophy and his general financial

maturity, the decedent formed the Charles H. Murphy, Jr. Family Limited Partnership (MFLP), with an LLC as the general partner. The decedent transferred $90 million worth of interests in the three companies to MFLP and the LLC, in exchange for a 96.75% limited partnership interest, individually and as trustee of several revocable trusts, and a 49% LLC membership interest. The other 51% of the LLC was owned equally by Madison and Martha, who acquired their membership interests in exchange for some of their own assets. Chip and Mike declined to buy any interests in MFLP, though they were offered the chance. The decedent retained $130 million worth of assets for his own support. MFLP thereafter bought some timberland and farmland that had previously been owned by the Murphy family, which greatly appreciated in value by the decedent' death. MFLP made only two distributions during the decedent' life: (1) a pro rata distribution to partners in one year to cover the partners' federal taxes attributable to MFLP; and (2) a nonpro rata distribution to the decedent of stock in another company (so the company could convert to an S corporation), which distribution was charged against the decedent' percentage interest and capital account. The decedent made annual exclusion gifts of FLP interests to his children, their spouses, and eight grandchildren and, at his death, he owned a 95.25365% limited partnership interest in MFLP, and a 49% interest in the LLC, which held a 2.28113% general partner interest.

The decedent' estate valued the FLP interests with discounts for lack of control and marketability, and valued the LLC interests with tiered discounts, in addition to those applied to the general partnership interests.

b. **IRS Position.** The IRS disallowed the discounts, and included the underlying partnership assets directly in the decedent's gross estate under Sections 2036(a)(1) and 2036(a)(2).

c. **District Court Allows Discounts.** The District Court for the Western District of Arkansas (Judge Barnes) held for the estate, that the value of the partnership interests and LLC membership interests should be included in the decedent' gross estate, rather than the value of the underlying assets, and that they should be valued with an appropriate (41%) discount for lack of control and marketability, and tiered discounts for the LLC membership interests. The court rejected the IRS argument that the underlying assets of the partnership should be included in the decedent' gross estate

under Sections 2036(a)(1) and 2036(a)(2), noting that the transfers of assets to the partnership was a bona fide sale for full and adequate consideration in money or money's worth. The court stated that a bona fide sale occurs if there is a transfer in good faith with "some potential benefit other than the potential estate tax advantages that might result from holding assets in the partnership form." Citing *Estate of Korby v. Comm'r*, 471 F.3d 848 (8th Cir. 2006); *Estate of Thompson v. Comm'r*, 382 F.3d 367 (3rd Cir. 2004); *Estate of Kimbell v. Comm'r*, 371 F.3d 257 (5th Cir. 2004). Here, the partnership had been formed to centralize management in the decedent, Madison and Martha, in a manner consistent with the decedent's long-held buy-and-hold investment philosophy, and to protect against the dissipation of key family assets. The court noted that: (a) the decedent' family had used limited partnerships in the past and was very familiar with how they operated and what they could and could not do (their oil company had started as a family limited partnership); (b) both Martha and Madison had input into how the partnership and LLC would be structured and Martha had her own attorney; (c) over several years, the decedent's participation in management had declined and Martha and Madison had taken a more dominant role in managing MFLP; (d) the decedent had retained adequate other assets for his comfortable support; (e) the members of the general partner met on a regular basis at least every other month to discuss management of partnership assets; (f) in one instance, the two children prevailed in a disagreement with the decedent regarding how much land to buy; (g) personal assets were not commingled with partnership assets; (h) the children who invested in the partnership did so with their own money, which two of the children declined to do. The IRS contended that the partnership was not created for legitimate non-tax purposes because the decedent knew of the tax advantages associated with the family limited partnership when he created MFLP, but the court stated that this is not dispositive, if the "transaction is otherwise real, actual and genuine." Furthermore, the court stated that the sale was for adequate and full consideration, because (a) the partnership interests received were proportionate to the value of the assets contributed; (b) the value of each partner's contribution was credited to his or her own capital account; and (c) on termination or dissolution of the partnership, each partner would be entitled to distribution from the partnership in amounts equal to their respective capital accounts. Citing *Estate of Kimbell v. Comm'r*, 371 F.3d at 266.

The court valued the limited partnership interests by first establishing the net asset value of the stock in the three companies owned by the FLP, after subtracting discounts for the application of SEC Rule 144 and blockage (5%, 10.6%, and 1.3% for the three corporations, based on the taxpayer's appraisal), and the value of the timber and farm land owned by MFLP. The court then applied a 12.5% lack of control and 32.5% lack of marketability discount (41% combined discount, as opposed to a 19% combined discount suggested by the IRS expert) to determine the value of the 95.25365% limited partnership interest. The court valued the decedent's 49% LLC membership interest with a 20% lack of control/lack of marketability discount for its general partnership interest, and an 11.1% lack of control discount and 32.5% lack of marketability discount for the decedent's 49% interest in the LLC. The overall discount of the tiered entity was, therefore, 52% of the net asset value.

d. **Good Lawyering Pays Off.** This is a wonderful case of good lawyering. The estate's attorney laid out the role of the various family members in great detail, and clearly established the nontax business reasons for creating and operating the partnership. The decedent, presumably on the direction of his advisers, also properly operated and maintained the partnership, holding regular partnership meetings and actually voting on key partnership decisions.

It is also interesting that the district court tended to pick the figures from one of the two appraisers on each issue, rather than to do its own appraisal, as is often done by the Tax Court. Generally, the court favored the estate's lead appraiser, Donald Barker of Howard Frazier Barker Elliott, Inc., over the IRS's lead appraiser, Francis Burns, CPA International.

While strictly a question of dueling appraisers, the court also resolved a dispute over the value of four works of art held by the decedent, including a painting by Childe Hassam, an unfinished charcoal and pastel sketch by Edgar Degas, a Richard Claque landscape painting, and an Emil Nolde landscape watercolor. The court in each case evaluated the three appraisals presented (one by the taxpayer and two by the IRS, including the appraisal of the Art Advisory Panel), and reached varying conclusions, some in favor of the IRS, and some in favor of the estate.

See also discussion of the opinion of this court on the deductibility of interest on certain loans of the Murphy estate, below.

6. ***Estate of Black v. Comm'r*, 133 T.C. ___ (No. 15) (Dec. 14, 2009).**

a. **Facts.** From 1927 until 1993, Samuel P. Black Jr. was either an employee or director of the Erie Indemnity Co., which grew from selling automobile insurance in Pennsylvania to selling multiple types of insurance in several states. He was an integral part of the company's success, becoming a member of its board of directors where he served until he was 95. Over the years he acquired a substantial amount of Erie stock. Samuel, Jr. gave some stock to his son Samuel P. Black III (Samuel III) and contributed more stock to trusts he created for his two grandsons. In 1993, Samuel, Jr., Samuel III, and a trust for Samuel III's sons each contributed their Erie stock to Black Interests Limited Partnership (Black LP), a family limited partnership, in exchange for partnership interests proportionate to the fair market value of the stock each contributed. Samuel, Jr. was the managing partner from formation until October 1998, when he ceded to his son his one-percent general partnership interest and his responsibilities as a managing partner. Samuel III retained all of the partnership's Erie shares until Samuel, Jr.'s death. Samuel, Jr.'s estate plan established a pecuniary marital trust for his wife, Irene, and a $20 million bequest to the endowment for Penn State Erie. Samuel, Jr. died in 2001 and Irene died five months later — before the QTIP marital trust under Samuel, Jr.'s revocable trust could be funded. Samuel III was the executor of both estates and he intended to fund the QTIP trust with a portion of Samuel, Jr.'s Black LP interest.

b. **IRS Position.** The IRS assessed deficiencies for gift and estate tax against Samuel, Jr. and his estate, and Irene and her estate, in amounts totaling over $210 million. The IRS claimed that the value of the Erie stock apportionable to Samuel, Jr.'s partnership interest in Black LP at his death was includable in his gross estate under either Section 2035(a) or Section 2036(a)(1) or (2). The IRS also claimed that, while the gross estate included the undiscounted value of the assets of the partnership, the marital deduction for Samuel, Jr.'s estate was limited to the value of the partnership interest actually passing to the marital trust.

c. **Tax Court Sustains Discounts and Marital Deduction.** The Tax Court (Judge Halpern) held for the taxpayers on the issues relating to the partnership and the marital deduction, but for the

IRS on other issues, in whole or in part. The court held that the value of Samuel, Jr.'s estate did not include the value of the stock held in the partnership, because Samuel, Jr.'s transfer of the Erie stock to the partnership in exchange for a partnership interest constituted "a bona fide sale for an adequate and full consideration in money or money's worth". The court noted that the Third Circuit, to which this case would be appealed, has held that a "bona fide sale" does not necessarily require an "arm's length transaction", but the sale or exchange must be "made in good faith", *Estate of Thompson v. Comm'r*, 382 F.3d 367, 383 (3d Cir. 2004), *aff'g*, T.C. Memo. 2002-246. The court then explained that the good faith requirement demands a showing that the sale or exchange provided the transferor some potential for benefit other than estate tax savings. This, the court stated, was consistent with the Tax Court's requirement, of "a legitimate and significant nontax reason for creating the family limited partnership". See *Estate of Bongard v. Comm'r*, 124 T.C. 95 (2005). The Tax Court noted that Samuel, Jr.'s advisers informed him of the estate tax advantages of placing his Erie stock in the limited partnership, but the transaction was actually initiated to implement several important nontax purposes, including: (1) Preserving Samuel, Jr.'s buy-and-hold position regarding Erie shares. Samuel, Jr. was very bullish about the growth prospects for Erie stock, and he bought it at every opportunity. He had an absolute buy-and-hold philosophy regarding the Erie shares, which he wanted to preserve; (2) Preventing Samuel III from selling Erie shares, particularly in light of the fact that Samuel III had pledged a block of Erie stock for a bank loan; (3) Preventing Samuel, Jr. from selling Erie shares at the urging of his wife, whom Samuel, Jr. thought to be lazy and profligate, and her parents, who had suffered financial reversals; (4) Preventing Samuel III from losing any Erie shares in a future divorce (Samuel III and his wife did divorce after Samuel, Jr.'s death); (5) Preventing sale of Erie shares by Samuel, Jr.'s grandsons, who would receive shares from the trusts Samuel, Jr. had created for them (each grandson would be able to withdraw the trust principal, one-half at age 25 and the balance at age 30); (6) Preserving the Erie shares because Samuel, Jr. foresaw that a split between the principal corporate shareholders was likely, and that the Black family's stock could become an important swing vote, further enhancing its value; and (7) Preserving a seat for some member of the Black family on Erie's board of directors (where Samuel, Jr. had already been succeeded by his son).. Thus, the court concluded, creating the Black LP served the

legitimate nontax purpose of consolidating and holding the Black family's Erie stock. The court went on to find that the stock was sold for adequate and full consideration since partnership interests were proportionate to the stock transferred. Based on these findings the court concluded that the fair market value of the partnership interest was includable in Samuel, Jr.'s gross estate. Therefore, also, the question of the basis for the estate tax marital deduction in Samuel, Jr.'s estate was moot.

d. **Planning.** It is interesting that the court recognized that one of the reasons for creating the partnership was to reduce estate taxes, and also that the decedent had formed the partnership after considering a list of possible reasons for doing so in an article by Stacey Eastland, who wrote the Black LP documents. These factors did not negate the existence of substantial nontax purposes. The court also noted that while Samuel, Jr. was 91 when he created the partnership, he was not suffering from any life-threatening illness and he maintained an active lifestyle. The court also noted that Samuel, Jr. had reserved ample assets and income sources to support him and his wife without recourse to the assets held by the Black LP. The court also rejected the IRS argument that the decedent's fears regarding disposition of shares by his son or grandsons, and about his son's marriage ending in divorce, were merely "speculative". The court appears to have been persuaded by cogent testimony of the decedent's friends and business associates to the decedent's having expressed these sincere beliefs.

See also discussion of this case with respect to marital deduction and deduction of administrative expenses, below.

7. ***Estate of Shurtz v. Comm'r*, T.C. Memo. 2010-21 (Feb. 3, 2010)**

a. **Facts.** Charlene Shurtz created the Doulos Limited Partnership and transferred to it some timberland and interests in a timber partnership created by her parents (Timberland) to simplify the management of their timber holdings and to protect their wealth from the "jackpot justice" creditor problems they felt pervaded their state (Mississippi). Charlene had Parkinson's disease, but she was able to manage her condition with medication and the disease did not affect her cognitive abilities. Charlene created Doulos by giving her husband some of her Timberland interests, and then the two of them formed Doulos. The Doulos partnership agreement substantially restricted the

right of a limited partner to transfer partnership interests and the right of an assignee to become a substitute partner. Charlene and her husband made 26 annual exclusion gifts of limited partnership interests to her children and to trusts for her grandchildren. At her death, Charlene and her husband each owned a 1% general partnership interest and Charlene held an 87.6 percent limited partnership interest in Doulos. The partnership maintained no books of account, as required in the agreement, but their CPA created his own "work papers like a trial balance" in creating the partnership's tax returns. The partnership did not establish its bank account until nearly four months after it was created, and distributions to partners were not always proportional. Charlene and her husband received disproportionately greater shares of the distributions. Charlene's broader family was conscientious about managing the timber business, however, and Timberland held annual meetings and discussed issues relating to the business. Minutes of these meetings were kept even though under state law there was no requirement to do so. Charlene and her husband regularly attended, and actively participated in, these meetings, and then started combining the Doulos annual meeting with the Timberlands meeting.

b. **IRS Position.** The IRS contended that the assets contributed to Doulos L.P. were includable in the value of Charlene's gross estate by reason because she had retained their control, use, and benefit under Sections 2036(a) and 2035(a), but that the value of the partnership interests passing as the marital share should be discounted.

c. **Tax Court Sustains Discount.** The Tax Court (Judge Jacobs) held for the taxpayer, finding that Charlene's transfer to the partnership was a "bona fide sale for an adequate and full consideration in money or money's worth" and that, therefore, neither Sections 2035 nor 2036 applied. The court stated that the "bona fide sale" rule applies if there is "a legitimate and significant nontax reason" for creating the partnership and if the transferors received partnership interests proportionate to the value of the property transferred. *Estate of Bongard v. Comm'r*, 124 T.C. 95, 118 (2005); *Estate of Bigelow v. Comm'r*, 503 F.3d 955, 969 (9th Cir. 2007), *aff'g* T.C. Memo. 2005-65; *Estate of Korby v. Comm'r*, 471 F.3d 848, 854 (8th Cir. 2006), *aff'g* T.C. Memo. 2005-102 and T.C. Memo. 2005-103. The IRS argued that the legitimate and significant nontax business must also be predominate. The court agreed, but stated that

finding that the transferor sought to save estate taxes does not preclude a finding of a *bona fide* sale so long as saving estate taxes is not the predominant motive. *Estate of Mirowski v. Comm'r*, T.C. Memo. 2008-74; *Estate of Schutt v. Comm'r*, T.C. Memo. 2005-126. The court then pointed out that: (a) Charlene was in relatively good health when she created the Doulos; (b) Charlene was concerned about protecting the Timberlands from the litigious environment they believed Mississippi to be (Charlene's attorney "credibly testified that he regularly advised his clients about the use of limited partnerships to protect family assets from the risks imposed by Mississippi's litigious atmosphere"); and (c) establishing Doulos facilitated the management of the timberland Charlene and her husband contributed to the partnership. The court recognized that only 15.8 percent of the assets transferred Doulos required active management, but noted that courts have been satisfied with this before. *Kimbell v. United States*, 371 F.3d 257, 259 (5th Cir. 2004) (oil and gas properties contributed amounted to only 11 percent of the total assets contributed to the family limited partnership). The court also stated that the full and adequate consideration requirement was met because each partner received an interest in Doulos that was proportionate to his or her contributions, and the respective assets contributed were properly credited to each partner's respective capital account. The partnership agreement also required a negative adjustment in the distributee partner's capital account.

D. **Indirect Gift on Formation vs. Gift of FLP or LLC Interests – The Devil is in the Details.** The IRS has become partial to the argument that the creation of a family limited partnership or LLC is an undiscountable indirect gift of the underlying assets. They are winning some, losing some, and careful planning is essential on this point.

1. ***Linton v. United States*, 2009 WL 1913255, 104 A.F.T.R. 2d 2009-5176 (W.D. Wash. July 1, 2009).**

a. **Facts.** In November, 2002, William and his wife, Stacy, formed WLFB Investments, LLC, and issued all of the membership interests to William. On January 22, 2003, William gave one-half of the membership interests to Stacy, signed a quit claim deed to transfer undeveloped real property to the LLC, and directed his broker to transfer cash and municipal bonds to the LLC. On that same date, William and Stacy also executed documents creating an irrevocable trust for each of their four children, and each spouse assigned an 11.25% LLC interests to each trust. William and Stacy each retained a five percent LLC interest. The dates of the transfers to the trusts were filled in later by the Lintons' general attorney, who testified (as did their tax attorney) that the general attorney had erroneously filled in a transfer date of January 22, rather than the intended date of January 31, 2003. William testified that he decided how much assets he would transfer to the LLC based on the amount of available gift tax exemptions, taking into account valuation discounts. The LLC agreement restricted the transfer of membership interests to nonfamily members and reserved management functions to the Managers (William and Stacy). The taxpayers claimed a 47% valuation discount based on the theory that the limitations on alienability and non-controlling status rendered the percentage interests in the LLC unmarketable.

b. **IRS Position.** The IRS denied any discount. The taxpayers paid the gift tax deficiency and sued for a refund, and the IRS moved for summary judgment.

c. **District Court Denies Discount.** The district court (Judge Zilly) granted summary judgment to the IRS, stating that the transfers of LLC interests on the same date as the transfers of property to the LLC constituted indirect gifts of the underlying assets, which should be valued without a discount. The court reviewed the key cases in this area, including *Shepherd v. Comm'r*, 115 T.C. 376, 388 (2000), *aff'd on other grounds*, 238

F.3d 1258 (11th Cir. 2002) (donor deemed to have made indirect gift of underlying assets); *Estate of Jones v. Comm'r*, 116 T.C. 121 (2001) (decedents deemed to have made gifts of partnership interests, rather than indirect gifts of underlying assets) *Gross v. Comm'r*, T.C. Memo. 2008-221 (same); *Senda v. Comm'r*, 433 F.3d 1044, 1046 (8th Cir. 2006) (donor deemed to have made indirect gift of assets transferred to partnership, because the order of the events was not reliably established by the taxpayers); and *Holman v. Comm'r*, 130 T.C. 170, 187-88 (2008) (donor made discountable gifts of LLC interests; step transaction doctrine did not apply). The court held that, in this case, the sequence of events here was as uncertain as that in *Senda*, noting that the contributions to the LLC and the assignments of LLC interests were all signed on the same day, and while the trust instruments and deeds of gift were executed in blank they were all eventually dated January 22, 2003. Also, letters directing the taxpayers' broker to transfer bonds and cash to the LLC were signed and dated on January 22, 2003, though they were not received by the broker for two more days and they were not carried out for several more days. The court allowed the taxpayers to introduce parol evidence concerning the documentation, but it found that evidence not actually probative of a more favorable sequence of events. Each trust agreement was expressly effective upon contribution of property to the trust, and when signed, property consisting of interests in the LLC had been transferred to the trustee. Thus, the court stated that the documents established that the trusts were created and the gifts were made on January 22, 2003, and on that same date, LLC interests had been or were contemporaneously given to the trusts, thereby making the trusts effective.

The court also refused to reform the trust agreements and deeds of gifts to reflect a January 31, 2003 effective date. The taxpayers claimed that a scrivener's error had caused the January 22 date to be inserted, but the court held that the evidence did not show that the parties always intended that the later date apply.

Finally, the court also upheld the IRS's alternate theory that, even if it were established that the LLC was funded before gifts were made of LLC interests, the step transaction doctrine would apply and treat the transfers as indirect gifts of the underlying assets. The court stated that the step transaction doctrine "treats a series of formally separate 'steps' as a single transaction if such steps are in substance integrated, interdependent, and focused toward a particular result." *Penrod v.*

Comm'r, 88 T.C. 1415, 1428 (1987). The court noted that no specific standard has been universally applied in assessing whether a number of separate steps or activities should be viewed as comprising one transaction; but that courts have generally used: (i) the "binding commitment" test; (ii) the "end result" test; and (iii) the "interdependence" test. *Holman*, 130 T.C. at 187-88. Under any of these three tests, the court held that the taxpayers made "stepped" indirect gifts to their children's Trusts of the assets they contributed to the LLC. The court stated:

> The binding commitment test is met because plaintiffs executed binding Trust Agreements and Gift Documents at the same time they took the first step of contributing property to the LLC; as counsel for plaintiffs conceded during oral argument, these documents would have been valid after signing had they never been dated. The end result test is likewise satisfied because plaintiffs undisputedly had a subjective intent to convey as much property as possible to their children while minimizing their gift tax liability, pursuant to which they crafted, with the aid of an attorney and a tax advisor, a scheme consisting of "pre-arranged parts of a single transaction." Penrod, 88 T.C. at 1429. The pre-arrangement is most apparent in Mr. Linton's explanation for why he did not date the Gift Documents, namely in an effort to ensure, for tax purposes, that [the broker] completed the transfers of securities before the gifts became effective. . . . In addition, the interdependence test is met because the undisputed evidence demonstrates that plaintiffs would not have undertaken one or more of the steps at issue absent their "contemplation of the other integrating acts."

The court declined to pick a specific test, and held that as a matter of law, the step transaction doctrine applied and the taxpayers made gifts to their children's trusts of pro rata shares of the assets they contributed to the LLC. The court distinguished *Holman* and *Gross*, because in those cases the taxpayers affirmatively delayed the gifts for some period of time after funding. In this case, the taxpayers submitted no data concerning the fluctuations, if any, in the prices of the various

securities at issue on a daily basis during the period in question. The IRS noted that with respect to the real property, cash, and municipal bonds, the taxpayers "cannot show the volatility necessary to establish a real economic risk associated with the passage of less than ten days."

2. ***Heckerman v. United States*, 2009 WL 2240326, 104 A.F.T.R. 2d 2009-5551 (W.D. Wash. July 27, 2009).**

a. **Facts.** As part of their estate planning, David and Susan, a married couple created trusts for their two children and assigned to the trusts interests in their family LLC. The LLC held interests in several other LLCs that the couple had also created, one of which held real estate and one of which held $2.85 million in mutual funds. The LLCs were first funded with real estate on December 28, 2001, and on January 11, 2002, the taxpayers transferred the mutual funds to the LLC. They also that same day transferred membership interests to their children's trusts. The IRS characterized the gifts of the LLC interests attributable to the mutual funds as undiscountable indirect gifts of the mutual funds to the children's trusts, rather than discountable gifts of LLC interests. The taxpayers paid the gift tax deficiency and sued for a refund.

b. **Same Court, Same Result.** The U.S. District Court (Judge Coughenour) held for the IRS, finding that the gifts of the membership units occurred on the same day as the transfers of the mutual funds, and that the transactions were indirect gifts of the underlying mutual funds, either under the basic indirect gift analysis, or the step transaction doctrine. The court rejected the testimony of the taxpayers that the gifts of the membership units were actually made several days later, finding that the testimony was self-serving and unspecific, and that all of the documentary evidence said that the transfers of the mutual funds and of the membership interests had occurred on the exact same date. The court also reviewed the history of the indirect gift doctrine, and found that the facts of this case were closest to those of *Senda v. Commissioner*, 433 F.3d 1044, 1046 (8th Cir. 2006), *aff'g* T.C. Memo. 2004- 160 in which the evidence about the order of the events was not reliable. In *Senda*, the courts concluded that, absent adequate proof of the chronology of events, the taxpayers had made gifts of partnership interests to their children before transferring property to the partnership, causing the contributions of property to be taxed as indirect gifts. See also discussion in

the February, 2006 issue of this Reporter. The court found that this accurately described the situation in *Heckerman*, too. The court also stated that the same result would be reached under the step transaction doctrine. The court acknowledged that there were three different judicial tests for applying the step transaction doctrine: the "binding commitment" test, the "end result" test, and the "interdependence" test. The court held that the taxpayers failed under the latter two of these tests.

3. ***Estate of Malkin v. Comm'r*, T.C. Memo. 2009-212 (Sept. 16, 2009).**

a. **Facts.** Roger, as part of his estate plan, created two family limited partnerships (FLPs) and four trusts. In 1999, Roger was diagnosed with pancreatic cancer. Several months later, he assigned shares of D&PL stock and interests in four family LLCs which he controlled with his son, to the Cotton Row Family Limited Partnership (CRFLP), of which two other trusts for his children (the CRFLP trusts) were limited partners. Roger first created and funded the partnership, and then created the trusts and sold to the trusts limited partnership units, in exchange for a ten-percent downpayment and a nine-year promissory note bearing interest at 6.8 percent. Roger gave the trusts the cash to pay the downpayment. The following year, Roger transferred 80,000 more D&PL shares to CRFLP.

b. **Tax Court Allows Discounts.** The Tax Court (Judge Halpern) held, in part that the transfer of LLC interests to the CRFLP were actually disguised indirect transfers of the underlying assets, for which gift tax valuation discounts would not be allowed. The court noted that the CRFLP agreement was signed on the same day that Roger transferred his LLC interests to the partnership and on which he assigned partnership interests to the trusts. State law did not recognize a one-person partnership, so CRFLP was valid only after the formation of the trusts.

E. **Gifts of Limited Partnership Interests Do Not Qualify for the Gift Tax Annual Exclusion.** In *Price v. Comm'r*, T.C. Memo. 2010-2 (Jan. 4, 2010) and *Fisher v. United States*, ___ F.Supp.2d ___, No. 1:08-cv-00908, 2010 TNT 49-20 (S.D. Ind. March 11, 2010), the courts held that the gift tax annual exclusion does not apply to gifts of interests in many family limited partnerships or LLCs.

1. ***Price*.**

a. **Facts.** Walter, as part of a careful financial plan, placed some closely-held stock and leased commercial real estate in a family limited partnership, of which a closely-held management corporation was the sole (one percent) general partner. Initially, Walter's revocable trust and his wife Sandra's revocable trust were each 49.5 percent limited partners, Sandra owned the stock of the general partner and Walter was its president. Thereafter, the partnership sold its closely-held stock and reinvested the proceeds in marketable securities. In 1997 through 2002, Walter and Sandra made annual exclusion gifts of limited partnership interests to their three adult children. The taxpayers claimed that the gifts qualified for the gift tax annual exclusion, but the IRS disagreed.

b. **Tax Court Holds for Government.** The Tax Court (Judge Thornton) held that the gifts were future interests not qualifying for the annual exclusion. The court stated that merely because a gift is made outright does not mean that it is a gift of a present interest. A present interest requires that the transfer confer on the donee "an unrestricted and noncontingent right to the immediate use, possession, or enjoyment" of either property or the income from property, and that both of these "demand that such immediate use, possession, or enjoyment be of a nature that substantial economic benefit is derived therefrom." *Hackl v. Comm'r,* 118 T.C. 279, 293 (2002), *aff'd*, 335 F.3d 664 (7th Cir.2003).

(1) The court held that the partnership interests in this case failed to provide the required degree of immediate use, possession or enjoyment, noting that:

(a) the partnership agreement stated that the partnership would be held for long-term growth, rather than the production of current income distributions;

(b) the partnership agreement generally prevents any partner from withdrawing capital contributions;

(c) the partnership agreement prohibits any partner from selling or otherwise transferring or encumbering his or her partnership interest, other than

to transfer it to another partner or a trust held for the benefit of a partner, without the written consent of all of the other partners;

(d) any assignment made to someone who is not already a partner creates only an assignee interest and does not relieve the assignor from liability under any agreement to make additional contributions to capital;

(e) in the event of any voluntary or involuntary assignment of a partnership interest, the partnership and each of other partners have a right to buy the partnership interest for its appraised value; and

(f) while profits are shared by the partners according to their proportional partnership interests, they are distributed "in the discretion of the general partner except as otherwise directed by a majority in interest of all of the partners, both general and limited."

(2) The court stated that merely being able to sell your partnership interest to other partners was insufficient to constitute a present interest.

(3) It also stated that there was no evidence that the partners had ever followed the partnership agreement procedures for admitting the children as limited partners, and that they actually were only assignees, with even fewer rights and privileges than they would have had were they limited partners (though this was not, the court stated, dispositive, and as limited partners, they would have had only future interests for gift tax purposes).

(4) The court also rejected the taxpayer's arguments that *Hackl* was incorrectly decided and that, if not, it was distinguishable. The taxpayers also argued that the donees could have sold their interests to the general partner, but the court noted that the general partner was owned by one of the taxpayers and run by the other, that they had "engineered the gifts of partnership interests" in the first case, and that if the "possibility of a

donor's agreeing to buy back a gift sufficed to establish a present interest in the donee, little would remain of the present interest requirement and its statutory purpose would be subverted if not entirely defeated." Cf. *Chanin v. United States,* 183 Ct. Cl. 840, 850, 393 F.2d 972, 977 (1968) (rejecting the proposition that an annual exclusion should be allowed " in every case in which the donee received a future interest in property, which was marketable, thus doing violence to the well recognized statutory purpose").

(5) The taxpayers also argued that there was a present interest because the donees had a right to partnership income, but the court explained that this argument required a showing that the partnership would generate income at or near the time of the gifts, that some portion of that income would flow steadily to the donees, and that the portion of income flowing to the donees can be readily ascertained. *Hackl,* 118 T.C. at 298. In this case, the rental real estate would meet the first of these three prongs, but there was no showing of an ascertainably steady flow of income, and there was clearly no right to distributions.

2. *Fisher*.

a. Facts. John and Janice transferred 4.762 percent membership interests in Good Harbor Partners, LLC, to each of their seven children in each of four years. Good Harbor's principal asset was a parcel of undeveloped land. The operating agreement states that:

(1) the Management Committee has operating powers, acting through a General Manager;

(2) capital proceeds are first used to pay expenses, debts and liabilities, establish reserves deemed necessary by the General Manager, and the balance distributed to interest holders proportionately to their interests;

(3) the donee members can transfer their interests, conveying only a right to share in profits, losses and distributions;

(4) Good Harbor has a 30-day right of first refusal before any transfer, paying the offered purchase price by a non-negotiable 15-year promissory note;

(5) the right of first refusal applies to a transfer to someone other than the Fishers or their descendants.

b. **District Court Denies Annual Exclusion**. The District Court in Indianapolis (Judge McKinney) held that the gifts did not qualify for the gift tax annual exclusion, relying on *Hackl v. Comm'r*, 335 F.3d 664 (7th Cir. 2003), because the donee was not "entitled unconditionally to the present use, possession, or enjoyment of the property transferred, the gift is one of a future interest. . . ." Quoting *Stinson Estate v. United States*, 214 F.3d 846, 849 (7th Cir. 2000).

(1) The court noted that the taxpayers' children did not have the unrestricted right to receive distributions of Good Harbor's Capital Proceeds, because those distributions were within the exclusive discretion of the general manager.

(2) The court also noted that the Operating Agreement did not give the children the right to possess, use, and enjoy Good Harbor's assets.

(3) Furthermore, the court stated that "[r]egardless, the right to possess, use, and enjoy property, without more, is not a right to a 'substantial present economic benefit.'" *Hackl v. Comm'r*, 335 F.3d at 667. The court further stated that, while the children had a unilateral right to transfer their interests, those transfers could be made only subject to Good Harbor's right of first refusal, "which effectively prevents the Fisher Children from transferring their interests in exchange for immediate value, unless the transfer is to one of the Fisher's descendants."

3. **Planning Considerations.** The partnership agreement in *Price* and the operating agreement in *Fisher*, like the operating agreement in *Hackl* gave the donees little or no control over the economic activities and benefits of the partnership or LLC, but these terms are not really much different from those of most FLPs and LLCs. Most agreements assure the dominant family member (the donor) or some other person effective control over the operation of the enterprise, and limit the

rights of the donees to withdraw or transfer their interests. Few donors would enter into these arrangements without the ability to control the future operations of the enterprise.

a. **Right to Sell.** It was thought that the simplest and most acceptable solution to this problem was to permit the donee members freely to sell their interests, with only a right of first refusal in the entity and the other partners or members. This carries no significant risk that the donees actually will sell their interests, because virtually no one will buy a minority or nonvoting interest in an FLP or LLC. Unfortunately, this was rejected in *Fisher*, presumably because the buyer would have no right to income or to control over the venture.

b. **Crummey Powers.** Another approach to assuring the availability of the gift tax annual exclusion for a gift of an FLP or LLC interest is to give the donee partners or members the equivalent of a *Crummey* withdrawal power with respect to gifts of their interests. Such a right would enable the donee to withdraw their share of the partnership capital for a limited period after each gift. Such a right would, however, reduce or eliminate any discount for lack of marketability or control with respect to that portion of each gift that qualified for the annual exclusion, but that is a modest penalty to pay for the entire elimination of the gift tax on the first $13,000 of gifts to each donee each year.

c. **Put Right.** A third approach is to give each donee the temporary right to "put" his or her interest to the partnership or LLC for an amount equal to its fair market value, taking into account all applicable discounts. This is functionally equivalent to a *Crummey* power, and so should obtain the gift tax annual exclusion. It also should preserve the appropriate discounts. The lapse of the put right could be an event described in Section 2704(a), but this would cause a taxable transfer by the donee of the difference between the value of the partnership interest with the put right and the value of the interest without it. Code § 2704(a)(2). This figure should be zero. the Tax Court rejected the gift tax annual exclusion for gifts of limited partnership interests, because of restrictive provisions in the partnership agreement.

IV. Gifts Under a Durable Power of Attorney. In *Barnett v. United States*, 2009 WL 2426246, 104 A.F.T.R.2d 2009-5143 (W.D. Pa. May 27, 2009), *report and*

recommendation adopted, 2009 WL 1930192, 104 A.F.T.R.2d 2009-5148 (W.D. Pa. June 30, 2009), a U.S. District Court illustrated the importance of clear drafting for lifetime transfers under a durable power of attorney.

A. **Facts.** Willis Barnett granted a durable power of attorney to his son, Elton, which Elton used to issue 17 annual exclusion gift checks between July 31, 2003 and October 13, 2003. Twelve of the checks were issued before Willis's death, but were cashed after his death. The power of attorney did not contain an express authorization to make gifts, but it

Also, between December 1988 and December 1997, Elton advanced $312,490 to his father. On December 21, 2000, Willis received an advance distribution from his wife's estate in the amount of $303,000, and on January 9, Willis incorporated Barnett Garage as Barnett Auto Sales & Service, Inc. ("BASS"). In exchange for assets of Barnett Garage, Willis received 300,000 shares in BASS, each with a $1.00 par value. On January 24, 2001, Willis signed a check drawn on his personal bank account to pay $305,000 into Barnett Garage's bank account. On January 26, 2001, Willis signed a check drawn on Barnett Garage's bank account to pay $350,000 to Elton. On January 29, 2001, Elton Barnett paid $300,000 to BASS and, in return, received 300,000 shares in BASS.

B. **IRS Position.** The IRS stated that all of the checks written by Elton were incomplete gifts on the date of death, because Elton lacked authority to make them. Therefore, they were all includible in Willis' gross estate under Section 2038. In addition, the IRS stated that the January 26, 2001 $350,000 check to Elton was a gift from Willis. The estate paid the additional estate taxes and sued for a refund.

C. **Magistrate Denies Validity of Gifts.** The magistrate (Ms. Bissoon) held for the government on both issues, and the district court (Judge McVerry) adopted the magistrate's opinion. The estate contended that Elton had authority to make the gifts under his durable power of attorney because he and Willis "discussed the making of gifts and [Decedent] agreed to do so." The court noted that applicable state law (Pennsylvania) states that a principal may authorize an agent to make a gift, but that this can be done only by including specific language set forth in the statute or similar language evidencing the principal's intent to authorize limited or unlimited gifts. 20 Pa. Consol. Stat. § 5601.2. The magistrate stated that these rules overruled a Pennsylvania case that permitted an agent to make a gift under a power of attorney that did not specifically authorize the making of gifts. *Estate of Reifsneider,* 531 Pa. 19, 610 A.2d 958 (Pa.1992). Furthermore, the lower state courts have construed the statute narrowly. See *Metcalf v. Pesock*, 885 A.2d 539 (Pa. Super. Ct.2005). (power of attorney did not empower the agent to make a gift, and court rejected argument that more general language in the power of attorney allowing the agent to otherwise to "dispose of the

decedent's interests in real property" was sufficient under the statute. The court rejected the argument that Willis's oral authorization was sufficient to allow Elton to make the gifts. It also rejected the argument that Willis had ratified the gifts, finding that the statute does not permit ratification to validate gifts made under a durable power of attorney.

D. **District Court Rejects Summary Judgment, Agrees with Magistrate.** The court refused to grant a summary judgment regarding whether the $350,000 payment from Barnett Garage (via a check executed by Willis) to Elton was a gift, finding that there *remained* material issues of fact to determine whether the check was written as a loan repayment.

E. **Planning.** At common law, specific authorization is required for an agent to have the power to make gifts. *Restatement (Third) of Agency* §2.02 (comment h). Different states have adopted different statutory variations on the common law. See, *e.g.*, Va. Code § 11-9.5 (broad authority for agent to "do, execute, or perform any act that the principal might or could do" or that otherwise evidences the principal's intent to give the attorney-in-fact or agent full power to handle the principal's affairs or deal with the principal's property, allows the agent to make gifts "in accordance with the principal's personal history of making or joining in the making of lifetime gifts."); and Unif. Power of Attorney Act §§ 201 (no power to make gifts absent express authority in the instrument) and 217 (general authority to make gifts authorizes only annual exclusion gifts, gift splitting, and double-the-annual-exclusion gifts if gift splitting is elected.) The smartest approach is to authorize gifts expressly, either in a durable power of attorney or a funded revocable trust.

Also note that, even if the power of attorney in question had authorized the making of gifts, a majority of the gifts would have been brought back into the gross estate because the checks were not honored by the bank on which they were drawn until after the date of death. See Rev. Rul. 96-56, 1996-2 C.B. 161 (gifts by check are complete when the donee deposits or cashes the checks if: (a) the check is paid by the donor's bank when first presented for payment; (b) the donor was alive when the check was paid by the donor's bank; (c) the donor intended to make a gift; (d) the delivery to the donee was unconditional; and (e) the check was deposited, cashed, or presented for payment within the same calendar year for which completed gift treatment is sought and within a reasonable time of its issuance.

V. **Self-Settled Spendthrift Trusts.** In PLR 200944002 (Oct. 30, 2009), the IRS sustained favorable estate tax treatment for a self-settled spendthrift trust created under Alaska's favorable state law. The ruling does not address all of the relevant issues, but it certainly suggests support for the use of this technique.

A. **Facts.** Grantor created an irrevocable trust and directed that income and principal be distributed, in the trustee's discretion, to and among Grantor, his spouse and his descendants. After the death of Grantor and his spouse, the trust will continue for his descendants. When there are no more descendants alive, the trust fund will be distributed to charities selected by the trustee. The trustees cannot be related or subordinate to Grantor or his spouse, and Grantor has no right to remove the trustees. Grantor has a power to reacquire trust assets by substituting assets of equivalent value. State law governing the trust states that a person who in writing transfers property in trust may provide that the interest of a beneficiary of the trust, including a beneficiary who is the grantor, may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee. Under State law, a trust instrument containing such a transfer restriction prevents a creditor existing when the trust is created or a person who subsequently becomes a creditor, from satisfying a claim out of the beneficiary's interest in the trust, unless, (1) the trust is revocable by the grantor without the consent of an adverse party; (2) the grantor intends to defraud a creditor by transferring the assets to the trust; (3) the grantor is currently in default of a child support obligation by more than 30 days; or (4) the trust requires that all or a part of the trust's income or principal, or both, must be distributed to the grantor.

B. **Transfers are Complete.** The IRS concluded that the transfers to the trust were completed gifts for gift tax purposes and that, absent a collateral agreement between the trustee and the grantor under which the grantor retained beneficial enjoyment of the trust assets, the trust assets would not be included in the grantor's gross estate for estate tax purposes. On the completed gift issue, the IRS noted that Grantor retained no power to revest beneficial title or to name new beneficiaries or change the interests of the beneficiaries. Treas. Reg. § 25.2511-2. On the estate tax issues, the IRS explained that the power to substitute assets did not constitute a reserved power to alter beneficial enjoyment, because the trustee has a fiduciary obligation to ensure that the properties acquired and substituted are in fact of equivalent value, and Grantor's power cannot be exercised in a manner that can shift benefits among the trust beneficiaries. Rev. Rul. 2008-22, 2008-16 I.R.B. 796 (April 21, 2008). Furthermore, the IRS noted that the trust precludes the trustee from paying Grantor or his executors any income or principal of the trust in discharge of Grantor's income tax liability, and that under Rev. Rul. 2004-64, 2004-2 C.B. 7, this further precludes the creation of a reserved income interest in the trust.

C. **What the IRS Did Not Say.** The IRS specifically did not rule on whether the trustee's discretion to distribute income and principal to Grantor would, combined with other facts (such as, but not limited to, an understanding or pre-existing arrangement between Grantor and trustee regarding the

exercise of this discretion) cause inclusion of trust's assets in Grantor's gross estate for federal estate tax purposes under Section 2036. The IRS also did not rule on whether the trust was a grantor trust. Nonetheless, this is an important private ruling.

The IRS did not state which jurisdiction's law was controlling, but it appears to have been Alaska. There are, however, a dozen states that have self-settled spendthrift trust statutes. See Alas. Stat. § 34.40.110; Colo. Rev. Stat. § 38-10-111; Del. Code Ann., tit. 12, §§ 3570 to 3576; Mo. Rev. Stat. § 456.5-505; Nev. Rev. Stat. §§ 166.010 to 166.170; N.H. Rev. Stat. § 564-D: 1 - 18; Ok. Stat., tit. 31, §§ 11 to 18; R. I. Gen. Laws §§ 18-9.2-1 to 18-9.2-7; S.D. Cod. Laws §§ 55-16-1 to 55-16-17; Tenn. Code. § 35-16-101; Utah Code § 25-6-14; Wyo. Stat. §§ 4-1-505, 4-10-510 to 4-10-523. For an excellent comparison of these various state statutes, see Shaftel, "Comparison of the Twelve Domestic Asset Protection Statutes: Updated Through November, 2008," 34 ACTEC J. 293 (2009); and Shaftel, "Variations in State Domestic Asset Protection Trust Statutes Compared," 35 Est. Plan. 14 (April 2008) and 35 Est. Plan. 3 (March 2008). Also, for cases suggesting that the grantor's creditors cannot reach a self-settled spendthrift trust even in states without express statutory provisions, see Uhl v. United States, 241 F2d 867 (7th Cir. 1957) (Indiana law); Estate of German v. Comm'r, 7 Cl. Ct. 641 (1985) (Maryland law); Herzog v. Comm'r, 116 F2d 591 (2d Cir. 1941), aff'g 41 BTA 509 (1940) (New York law).

D. Planning. The analysis in PLR 200944002 appears to be sound and consistent with the analysis used to reach contrary results in states where a grantor's creditors can reach the assets of a self-settled spendthrift trust. See Rev. Rul. 76-103, 1976-1 CB 293; *Outwin v. Comm'r*, 76 TC 153 (1981), *acq*. 1982-1 CB 2 (construing Massachusetts law); *Paolozzi v. Comm'r*, 23 TC 182 (1954), *acq*. 1962-1 CB 4 (construing Massachusetts law). See also *Estate of Uhl v. Comm'r*, 241 F. 2d 867 (7th Cir. 1957) (the portion of the trust the decedent created during lifetime and from which the trustee could pay him the income was not included in his gross estate because, under state law, his creditors could not attach the trust assets).

The best analysis should be the same even if the grantor does not reside in the state in which the trust is created. See PLR 9332006 (Aug. 20, 1993) (U.S. grantors created self-settled spendthrift trusts under the laws of a foreign country that validated the spendthrift provisions, and the IRS excluded the assets from the grantors' gross estates); and *Estate of German v. United States*, 7 Ct. Cl. 341, 55 A.F.T.R.2d 85-1577 (1985) (assets of a Maryland trust created by a Florida grantor were excludible from the grantor's gross estate because Maryland appeared to validate self-settled spendthrift trusts). See, however, *In re Portnoy*, 201 B.R. 685 (Bankr. S.D. N.Y. 1996); *In re Brooks*, 217 B.R. 98 (Bankr. D. Ct. 1998) (refusing to grant bankruptcy discharge to grantor of foreign situs self-settled spendthrift trusts, seemingly in part because the law of the grantor's domicile did not permit such trusts).

See also critique of these cases in Rothschild, Rubin & Blattmachr, "Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch?" 9 J. Bankr. Law & Pract. 1 (December 1999).

VI. **Estate Tax Deduction For Contingent Claims And Expenses.** The IRS issued final regulations and a notice that dramatically changes the way that an estate can deduct claims against the decedent that are subject to some contingency. 74 Fed. Reg. 53652 (Oct. 20, 2009); Notice 2009-84, 2009-44 I.R.B. 592 (Nov. 2, 2009), amended 74 FR 61524-01 (Nov. 25, 2009).

A. **Deductibility of Expenditures Limited to Amounts Actually Paid.** The final regulations address claims and debts of a decedent's estate and funeral and administration expenses. The regulations allow an estate to deduct a claim or debt (an expenditure), or a funeral or administrative expense only if the amount is actually paid, but create several exceptions to this rule that were not included in the proposed regulations. They also create a new set of tests to determine whether the amount in question is a bona fide debt, claim or expense.

Generally, the amount deductible as a claim, expense or debt takes into account *post mortem* events that occur before the expiration of the applicable statute of limitations (either for assessment of deficiencies or, where relevant, a timely claim for refund). Treas. Reg. § 20.2053-1(d)(2). An expenditure that is contested or contingent and that cannot be resolved during the limitations period for a refund claim is not deductible, but the executor can file a protective claim for refund, to preserve the estate's right to claim a deduction under Section 2053(a). Treas. Reg. §§ 20.2053-1(d)(1), 20.2053-1(d)(5).

B. **Amounts of Claim or Expense May Be Determined by Court Decree.** The regulations state that the amount of an expense, claim or debt may be determined for estate tax purposes by a final decision of a court of competent jurisdiction over the administration of an estate that reviews and approves such expenditures, if the court actually passes upon the facts on which deductibility depends. Treas. Reg. § 20.2053-1(b)(3)(i). A claim or expense that is paid without a court decree may still be deducted, if applicable state law does not require a court review of such claim or expense. Treas. Reg. § 20.2053-1(b)(4), Ex. 2; see also 74 Fed. Reg. 53654 (Oct. 20, 2009).

The court must actually pass upon the merits of the claim, and such passage is presumed in "all cases of an active and genuine contest." An unreasonable result creates a rebuttable presumption that there was not an active and genuine contest. Once a court has made such a valid determination, the amount so adjudicated is generally deductible to the extent it actually has been paid or will be paid. Treas. Reg. § 20.2053-1(b)(3)(i).

A deduction for the amount of a claim or expense that is otherwise deductible under Section 2053 and the regulations is not denied merely because a local court decree has not been entered with respect to such amount, unless such an affirmative decree is legally required to determine the amount or allowability of the claim or expense. Treas. Reg. § 20.2053-1(b)(3)(ii).

C. **Amounts of Claim or Expense May Be Determined by Consent Decree.** A consent decree of a local court may establish the amount of a claim or expense if the consent resolves a *bona fide* issue in a genuine contest. Consent given by all parties having interests adverse to that of the claimant is presumed to resolve a *bona fide* issue in a genuine contest. Treas. Reg. § 20.2053-1(b)(3)(iii). A consent decree at variance with applicable state law will not establish the amount of a claim or expense. Treas. Reg. § 20.2053-1(b)(4), Ex. 1.

D. **Amounts of Claim or Expense May Be Determined by Settlement.** The regulations state that the amount of an expense, claim or debt may be determined for estate tax purposes by a settlement that resolves a *bona fide* issue in a genuine contest and that is the product of arm's-length negotiations by parties having adverse interests with respect to the claim or expense. On the other hand, a deduction will be denied for amounts paid in settlement of an unenforceable claim, such as a claim that exceeds the applicable limit under local law. A claim is not deemed unenforceable, however, if enforceability of the claim is one of the issues in a *bona fide* dispute. Treas. Reg. § 20.2053-1(b)(3)(iv).

The final regulations add a provision that does not deny the deduction for amounts paid in settlement by an estate, if the executor establishes that the cost of defending or contesting the claim or expense, or the delay associated with litigating the claim or expense, would impose a higher burden on the estate than the payment of the amount paid to settle the claim or expense. Treas. Reg. § 20.2053-1(b)(3)(iv); see also 74 Fed. Reg. 53654 (Oct. 20, 2009).

It is noteworthy that the final regulations removed the requirement that the settlement be within the range of reasonable outcomes under applicable state law. The Treasury stated that this requirement would have placed the IRS or a court "in the position of having to evaluate the legal merits of a claim adjudicated in another court proceeding" and that it was superfluous, in light of the requirement that there must have been a bona fide issue and an active and genuine contest. See 74 Fed. Reg. 53654 (Oct. 20, 2009).

The final regulations also removed statements in the proposed regulations that would have expressly denied the deduction for expenses incurred merely to extend the time for payment unreasonably or otherwise incurred in bad faith. The Treasury stated in the preamble to the final regulations that it agreed with commentators who suggested that such

situations are rare, and that the rule could subject the estate's legal strategy to IRS inquiry. The Treasury stated that it also believed that this sentence was not necessary because expenses incurred merely for the purpose of unreasonably extending the time for payment or other than in good faith would not be considered actually and necessarily incurred in the administration of the decedent's estate and, therefore, are not deductible for that reason. 74 Fed. Reg.53656 (Oct. 20, 2009).

E. **Reimbursements.** No deduction is allowed to the extent that a claim or expense is or could be reimbursed or otherwise be compensated for by insurance. In a change from the proposed regulations, the final regulations state that the executor may certify that the executor neither knows nor reasonably should have known of any available reimbursement for a claim or expense. A potential reimbursement does not reduce the deductible amount of a claim or expense to the extent that the executor provides a "reasonable explanation" on the estate tax return for the executor's "reasonable determination" that the burden of necessary collection efforts in pursuit of a right of reimbursement would outweigh the anticipated benefit from those efforts. Even if such a reasonable explanation is provided, however, any subsequent events, such as an actual reimbursement, that occur within the period of the applicable statute of limitations, must be considered in determining the amount (if any) of the claim or expense that is deductible. Treas. Reg. § 20.2053-1(d)(3); see also 74 Fed. Reg. 53655 (Oct. 20, 2009).

F. **Amounts Ascertainable with Reasonable Certainty.** An estate may deduct an unpaid claim or expense if the IRS is satisfied that the amount to be paid is ascertainable with reasonable certainty and that the amount will be paid. For example, executor's commissions and attorneys' fees that are not yet paid are deductible on the estate tax return, if they are ascertainable with reasonable certainty, despite the fact that they have not yet been paid. Treas. Reg. §§ 20.2053-1(d)(4)(i), 20.2053-1(d)(7), Ex. 1. No deduction may be claimed, however, to the extent that the claim or expense is contested or contingent, because such claims cannot be ascertained with reasonable certainty. *Id*.

The final regulations added the statement that the test involves satisfaction of the IRS that the amount will be paid and that its amount is ascertainable with reasonable certainty. The IRS declined to adopt a recommendation of one commentator that the standard generally should not be that the amount will be paid, but rather that it "may reasonably be expected to be paid." The requirement that the IRS be satisfied appears to be a compromise between the proposed regulations and the commentator's requested language. See 74 Fed. Reg. 53654 (Oct. 20, 2009).

The IRS will determine whether the amount of a claim or expense is ascertainable with reasonable certainty and that it will be paid taking into

account *post mortem* events. The regulations state that a deduction that is disallowed as not being ascertainable with reasonable certainty (whether that determination is made by the executor or by the IRS), should be addressed in a claim for refund if that amount is thereafter actually paid or becomes ascertainable with reasonable certainty. The executor should file a protective claim for refund to preserve the estate's right to claim a refund for amounts that become deductible after the expiration of the period of limitations. Treas. Reg. § 20.2053-1(d)(4)(ii).

Thus, for example, a claim against the estate in a tort suit against the decedent brought by an unrelated plaintiff and against which the estate is asserting legitimate affirmative defenses cannot be deducted until such claim is actually paid, because the deductible amount cannot be ascertained with reasonable certainty. Treas. Reg. § 20.2053-1(d)(7), Ex. 2. In such a case, the executor should file a protective claim for refund to preserve the estate's right to claim a refund at a later date, once a final judgment is entered in the case and the claim is either paid or becomes ascertainable with reasonable certainty.

The preamble to the final regulations makes it clear that the executor has no affirmative duty to report after the expiration of the statute of limitations the failure to pay amounts that were deducted as being certain to be paid. 74 Fed. Reg. 53654 (Oct. 20, 2009).

G. **Related Party Claims.** The proposed regulations would have created a rebuttable presumption that claims by a decedent's family member, a related entity, or a beneficiary of the decedent's estate or revocable trust are illegitimate and not *bona fide*, and therefore are not deductible. Prop. Treas. Regs. § 20.2053-4(b)(4) (April 23, 2007). The final regulations take a slightly different approach, creating a regulatory requirement that any deductible claim, debt or expense must be a *bona fide* obligation, rather than being founded on a donative transfer (other than a transfer that produces a charitable deduction). Treas. Reg. § 20.2053-1(b)(2). The preamble to the final regulations states that this change reflects the concerns expressed by some commentators that the presumption "was unfair and unwarranted because the proposed regulations and the burden of proof provisions adequately deter the manipulation of claims by family members, related entities or beneficiaries." 74 Fed. Reg. 53656 (Oct. 20, 2009).

The regulations list the factors that indicate that a claim or expense involving a decedent's family member, a decedent's related entity, or a beneficiary of a decedent's estate or revocable trust. These factors include, but are not limited to:

1. The transaction underlying the claim or expense occurs in the ordinary course of business, is negotiated at arm's length, and is free from donative intent;
2. The nature of the claim or expense is not related to an expectation or claim of inheritance;

3. The claim or expense originates pursuant to an agreement between the decedent and the related party, which agreement is substantiated with contemporaneous evidence;
4. Performance by the claimant is pursuant to the terms of an agreement between the decedent and the related party and both the performance and the agreement can be substantiated;
5. All amounts paid in satisfaction or settlement of claim or expense are reported by each party for Federal income and employment tax purposes, to the extent appropriate, in a manner that is consistent with the reported nature of the claim or expense. Treas. Reg. §§ 20.2053-1(b)(2)(ii)(A) to 2053-1(b)(ii)(E), 20.2053-1(b)(4), Ex. 2.

For this purpose, a decedent's family member includes:
1. the decedent's spouse;
2. the grandparents, parents, siblings (including adopted), and lineal descendants (including adopted) of the decedent or of the decedent's spouse; and
3. the spouse and lineal descendants (including adopted) of any such grandparent, parent, and sibling. Treas. Reg. § 20.2053-1(b)(2)(iii)(A).

For this purpose, a "related entity" is any entity in which the decedent had a direct or indirect beneficial ownership interest on the date of death or during the three-year period ending on that date. An entity is not a related entity, however, if it is publicly-traded or if it is closely-held entity but the combined beneficial interest, either direct or indirect, of the decedent and his or her family members is collectively less than 30 percent of the beneficial ownership interests. This latter determination takes into account both voting and nonvoting beneficial ownership interests, and interest in stock, capital and/or profits. The 30-percent ownership is determined when the claim for deduction is being asserted, rather than on the date of death. In all cases, a decedent is deemed to be related to an entity in which the decedent, directly or indirectly, had on the date of death any managing interest, such as a general partnership interest or a managing membership interest. Treas. Reg. § 20.2053-1(b)(2)(iii)(B).

H. Protective Claims for Refund. ne of the most important effects of these regulations is to cause the executors of a great many estates to file protective claims for refund to protect the right of the estate to deduct amounts that were not paid or ascertainable with reasonable certainty by the date on which the estate tax return was filed. A protective claim for refund may be filed at any time before the expiration of the relevant statute of limitations, in order to preserve the estate's right to claim a refund by reason of claims or expenses that are not paid or do not otherwise meet the requirements of deductibility under Section 2053 until after the expiration of the statute of

limitations for filing a claim for refund. The regulations states that the IRS will provide guidance regarding the filing of such claims. The protective claim need not state a particular dollar amount or demand an immediate refund, but it must identify each outstanding claim or expense that would have been deductible under Section 2053(a) or Section 2053(b), had such item already been paid. Furthermore, the claim must describe the reasons and contingencies delaying the actual payment of the claim or expense. Treas. Reg. § 20.2053-1(d)(5)(i).

A protective claim relating to an amount that is payable from an otherwise-deductible charitable or marital share or from a combination of such shares will avoid reducing the charitable and marital deductions, until the amount is actually paid or otherwise becomes ascertainable with reasonable certainty. Treas. Reg. §§ 20.2053-1(d)(5)(ii), 20.2053-1(d)(7), Ex. 3. See also 74 Fed. Reg.53655 (Oct. 20, 2009).

The preamble to the final regulations also states that the Treasury plans to revise the estate tax return form to include in it a protective claim for refund. 74 Fed. Reg. 53655 (Oct. 20, 2009).

I. **Related Contract and Tort Claims Against the Estate.** The final regulations include a rule that permits a deduction of a claim against the decedent's estate, if the value of the gross estate includes a claim in the same or a substantially-related matter or includes an asset integrally related or subject to the claim against the estate state. The regulations state that a claim against the estate arising out of contract or tort will normally be deductible if the claim is:

1. a bona fide claim;
2. a personal obligation of the decedent existing on the date of death;
3. enforceable against the decedent's estate (and not unenforceable when paid); and
4. actually paid by the estate in satisfaction of the claim or otherwise becomes ascertainable with reasonable certainty in amount (as discussed above) and will be paid.

Treas. Reg. § 20.2053-4(a)(1). For this purpose, post mortem events are considered to determine whether and to what extent the claim is allowable, under the rules discussed above. Treas. Reg. § 20.2053-4(a)(2).

However, an executor can deduct the value of a claim that has not been paid and the amount of which is not ascertainable with reasonable certainty, if:

1. the gross estate includes one or more claims or causes of action in the same or a substantially-related matter, or there are one or more claims against the decedent's estate integrally related to a particular asset included in the gross estate;
2. each amount of each such claim against the estate is ascertainable with reasonable certainty, under the rules discussed above;

3. each such claim is a personal obligation of the decedent on the date of death;
4. each such claim is enforceable against the decedent’s estate (and is not unenforceable when paid);
5. the value of each such claim is determined from a “qualified appraisal” performed by a “qualified appraiser” (see Section 170(f)(11) and the regulations thereunder);
6. the value of each such claim is subject to adjustment for post-death events; and
7. the aggregate value of the related claims or assets included in the decedent’s gross estate exceeds 10 percent of the decedent’s gross estate.

Treas. Reg. § 20.2053-4(b)(1). This deduction is, however, limited to the value of the related claims or particular assets included in decedent’s gross estate. Treas. Reg. § 20.2053-4(b)(2).

The deduction for a claim that, before the expiration of the applicable statute of limitations, is paid or becomes ascertainable with reasonable certainty, still cannot exceed the amount actually paid or that becomes ascertainable with reasonable certainty, and that amount is subject to adjustment accordingly. A claimed deduction for a claim that remains unpaid and unascertainable with reasonable certainty during the period of limitations is also subject to adjustment and may not exceed the current value of the claim. A value of the claim is considered current if it reflects events occurring after the decedent’s death. Treas. Reg. § 20.2053-4(b)(3). Again, an estate may preserve its right to claim a refund for claims that are later paid or that become ascertainable with reasonable certainty after the limitations period, by filing a claim for refund by filing a protective claim for refund. *Id*.

J. **Aggregate Claims Under $500,000.** The regulations also provide a special rule intended to permit an estate to deduct a reasonable amount of unpaid debts or claims. See discussion at 74 Fed. Reg. 53654-53655 (Oct. 20, 2009). An executor may deduct the current value of one or more unpaid and unascertainable claims against the decedent’s estate to the extent that:

1. each claim is otherwise deductible;
2. each claim is a personal obligation of the decedent on the date of death;
3. each claim is enforceable against the decedent’s estate (and is not unenforceable when paid);
4. the value of each claim is determined from a “qualified appraisal” performed by a “qualified appraiser” (see Section 170(f)(11) and the regulations thereunder);
5. the total amount of such claims deducted by the estate does not exceed $500,000;

6. the full value of each such claim, rather than just a portion of that amount, must be deductible under this rule and, for this purpose, the full value of each such claim is deemed to be the unpaid amount of that claim that is not otherwise deductible under the rules of Section 2053; and
7. the value of each claim deducted under this rule is subject to adjustment for post-death events. Treas. Reg. § 20.2053-4(c)(1).

If such a claim is actually paid within the period of limitations, the amount of the claimed deduction must be adjusted to reflect the amount actually paid on the claim or the amount that actually becomes ascertainable with reasonable certainty. Similarly, if such a claim is not actually paid and does not become ascertainable with reasonable certainty within the period of limitations, the amount of the allowable deduction for that claim must be adjusted to reflect the current value of the claim. The value of the claim will be considered current if it reflects events occurring after the decedent's death. To claim a deduction for amounts in excess of the amount deductible under this special $500,000 rule, the estate may preserve its right to claim a refund for claims that are not paid or that do not become ascertainable with reasonable certainty until after the expiration of the period of limitation by filing a protective claim for refund. Treas. Reg. § 20.2053-4(c)(2).

This rule permits an estate to select $500,000 of claims (considering each claim in full) that it will deduct on the estate tax return. Treas. Reg. § 20.2053-4(c)(3), Exs. 1 and 2. The value of a claim is determined net of the value of any counterclaim. Treas. Reg. § 20.2053-4(c)(3), Exs. 3.

K. **Potential and Unmatured Claims and Contested Claims.** Generally, no estate tax deduction may be taken for a claim against the decedent's estate while it is only a potential or unmatured claim, though claims that later mature may be deducted once they are actually paid or ascertainable with reasonable certainty, and the right to such a claim may be protected by a timely claim for refund filed within the period of limitation for filing such claims. Treas. Reg. § 20.2053-3(d)(1). Similarly, no estate tax deduction may be taken for a claim against the decedent's estate that is contested, though such claims that later become uncontested may be deducted once they are actually paid or ascertainable with reasonable certainty, and the right to such a claim may be protected by a timely claim for refund filed within the period of limitation for filing such claims. Treas. Reg. §§ 20.2053-3(d)(2), 20.2053-3(d)(7), Exs. 1 and 2.

If payment of such a claim is later made pursuant to a court decision or a settlement, the payment, and any expenses incurred incident to the claim and not previously deducted, may be deducted on a timely-filed claim for refund. Treas. Reg. § 20.2053-3(d)(7), Ex. 1. If the contest over a claim is resolved by a final court decree before the filing of the estate tax return and no timely appeal is filed by that date, or by a binding settlement of the claim,

the claim can be deducted on the estate tax return, together with any interest accrued prior to the date of death and any expenses incurred in defending the estate from the claim. Treas. Reg. § 20.2053-3(d)(7), Exs. 2 and 3.

L. Claims Against Multiple Parties. A decedent's estate may deduct only the portion of a claim due from and paid by the estate, where the decedent or the estate is one of multiple parties against whom the claim is asserted. The amount deducted must be reduced by the total of any reimbursement received from another party, insurance, or otherwise, and by the contribution or other amount the estate could have collected from another party or an insurer, but which the estate declines or fails to attempt to collect. Treas. Reg. §§ 20.2053-3(d)(3), 20.2053-3(d)(7), Exs. 4 and 5.

M. Unenforceable Claims. Claims that are unenforceable prior to or at the decedent's death are not deductible, even if they are actually paid. No deduction is allowed for a payment made on a claim that becomes unenforceable during the administration of the estate. Treas. Reg. §§ 20.2053-3(d)(4), 20.2053-3(d)(7), Ex. 7. An estate may, however, deduct payments made on a claim the enforcement of which is in dispute, if that dispute is resolved in favor of enforceability by a settlement or final court determination. In such cases, the estate may also be able to deduct the expenses incurred in defending the estate, reaching a settlement, and processing payment of the claim. Treas. Reg. § 20.2053-3(d)(7), Ex. 7.

N. Claims Founded Upon a Promise or Agreement. The estate's deduction for a claim founded upon a promise or agreement requires that the promise or agreement be *bona fide* and that it be made in exchange for adequate and full consideration in money or money's worth, except with regard to charitable pledges or subscriptions. The promise or agreement must have been bargained for at arm's length and the price must have been an adequate and full equivalent reducible to a money value. Treas. Reg. § 20.2053-3(d)(5).

O. Claims Involving Recurring Payments. The amount of an enforceable noncontingent claim that requires the decedent to make recurring payments may be ascertainable with reasonable certainty, even though the payments are recurring. A deduction is allowed for such recurring payments. The amount of a recurring claim is not ascertainable with reasonable certainty, however, if the claim is subject to a contingency (other than the death or remarriage of the claimant), and the estate may deduct only the amounts actually paid in satisfaction of the claim. Treas. Reg. § 20.2053-3(d)(6)(ii).

Recurring payments for this purpose excludes payments made in connection with a mortgage or indebtedness. Treas. Reg. §§ 20.2053-3(d)(6)(i). Also, the actuarially-determined amount of a claim against a decedent's estate based on the decedent's obligation to make a recurring payment contingent on the death or remarriage of the claimant is not

unascertainable with reasonable certainty merely because the payments are recurring. Treas. Reg. §§ 20.2053-3(d)(6)(i), 20.2053-3(d)(7), Exs. 8 and 9.

An executor may need to purchase a commercial annuity to make recurring payments, in order to close the estate before the recurring payments have all been made. The purchase of a commercial annuity from an unrelated dealer in an arm's-length transaction will be deemed to be payment of a recurring obligation that is ascertainable with reasonable certainty, whether or not contingent. The amount deductible in such cases is the sum of:

1. the amount paid for the commercial annuity, to the extent that the amount paid is not refunded, or expected to be refunded, to the estate;
2. any amount actually paid to the claimant by the estate prior to the purchase of the commercial annuity; and
3. any amount actually paid to the claimant by the estate in excess of the annuity amount as is necessary to satisfy the recurring obligation.

Treas. Reg. §§ 20.2053-3(d)(6(iii), 20.2053-3(d)(7), Exs. 9. The annuity need not be assigned to the creditor or claimant in order to perfect this deduction. See also 74 Fed. Reg. 53657 (Oct. 20, 2009).

The preamble to the final regulations notes that the Treasury is considering the comments it received regarding the disparate treatment afforded noncontingent obligations (deduction for present value of obligations) and contingent obligations (dollar-for-dollar deduction as paid). The commentators requested that the regulations allow an estate to choose between deducting the present value of a noncontingent recurring payment on the estate tax return, or deducting the full amounts paid in the same manner as provided for a contingent obligation (after filing an appropriate protective claim for refund). The Treasury decided to reserve this issue for further consideration and possible future regulations. Treas. Reg. § 20.2053-1(d)(6); 74 Fed. Reg. 53656-53657 (Oct. 20, 2009).

P. Interest on a Claim. The interest on a deductible claim against the decedent is itself deductible as a claim, to the extent of the amount of interest accrued at the decedent's death that is actually paid or ascertainable with reasonable certainty. The deductible interest includes only that amount accrued by the date of death, even if the executor elects the alternate valuation date. Treas. Reg. § 20.2053-3(e)(1). Post-death accrued interest may be deductible in appropriate circumstances either as an estate tax administration expense under Section 2053 or as an income tax deduction. Treas. Reg. § 20.2053-3(e)(2).

Q. Tax Claims. Generally, *post mortem* increases in a decedent's tax liabilities accrued prior to the date of death increase the amount of the deduction for such tax claims. Similarly, any refund later determined to be due to and

received by the estate with respect to taxes deducted by the estate reduce the amount of the deduction taken for that tax liability. Expenses associated with defending the estate against the increase in tax liability or with obtaining the refund may be deductible as administration expenses, though an example in the regulations appears to permit deduction only of the costs of a non-frivolous defense. Treas. Reg. § 20.2053-6(g), Ex. 1.

Here, too, the executor may file a protective claim for refund of estate taxes to protect the right to take advantage of the deduction for taxes paid after the date of death on liabilities accrued before the date of death. Treas. Reg. § 20.2053-6(g).

R. **Notice 2009-84.** Notice 2009-84, provides a limited administrative exception to the ability of general limitations period within which the IRS must assess deficiencies and award refunds with respect to Federal estate tax returns. Specifically, in processing a timely-filed protective claim for refund of tax based on a deduction under Section 2053, if the claim for refund ripens and becomes ready for consideration after the expiration of the limitations period on assessment, the IRS will review the estate tax return only with respect to the evidence relating to the deduction under Section 2053 that was the subject of the protective claim.

Generally, the IRS has the authority to examine each item on an estate tax return when a claim for refund has been filed, including items that are unrelated to the claim. See *Lewis v. Reynolds*, 284 U.S. 281, 283 (1932). Even if the IRS is barred from assessing any additional amount of tax by reason of the expiration of the statute of limitations on assessment, it may reject the claim for refund to the extent that the IRS determines there is no overpayment of tax.

Some of the comments received by the IRS relating to the proposed regulations under Section 2053 expressed concerns that the protective claim procedures would effectively keep the period of limitations on assessment open to the extent of the amount of the claim for refund and, therefore, impede the goal of achieving finality in the administration of a decedent's estate. Practitioners were concerned that, executors could not rely on the closing letter for finality, if the estate had to file a protective claim for refund in order to claim a deduction for a claim or expense under Section 2053 of the Code. In order to achieve a greater measure of finality in the administration of estates and in making the regulations under Section 2053 more administrable, the IRS stated in Notice 2009-84 that, if the period of limitations on assessment expires and the IRS is notified that a timely-filed protective claim for refund of tax based on a deduction under Section 2053 has ripened and is ready for consideration, the IRS generally will refrain from exercising its authority to examine each item on the return to determine if there is an overpayment of tax. Rather, in such cases, the IRS will limit its examination of the estate tax return to the evidence relating to the deduction under Section 2053 that was the subject of the protective claim.

This rule applies only to:

1. estates in which a timely protective refund claim was filed to preserve an estate's ability to claim a deduction under Section 2053 for a claim or expense;
2. the expense subsequently is paid or otherwise meets the requirements for deductibility under the final regulations;
3. the IRS is not considering, in the same estate, a claim for refund not based on a protective claim regarding a deduction under Section 2053;
4. the protective claim for refund ripens after the expiration of the period of limitations on assessment; and
5. there is no evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a material fact.

This notice applies with respect to protective claims for refund filed on behalf of estates of decedents dying on or after October 20, 2009.

S. Planning. These final regulations add a greater degree of consistency to the estate tax treatment of claims against and debts of a decedent's estate, but despite the Treasury's arguments, they are not a correct interpretation of the Supreme Court's decision in *Ithaca Trust.* Most courts have viewed *Ithaca Trust* as a broad rule that estate tax provisions should, whenever possible, be based on those facts known and extant on the date of the decedent's death. This seems the correct reading of Justice Holmes' opinion, in which he stated, for example, that:

> The first impression is that it is absurd to resort to statistical probabilities when you know the fact. But this is due to inaccurate thinking. The estate so far as may be is settled as of the date of the testator's death. See Hooper v. Bradford, 178 Mass. 95, 97, 59 N. E. 678 . . . Therefore the value of the thing to be taxed must be estimated as of the time when the act is done. 279 U.S. at 155.

This language suggests a rule applicable to a broader class of issues than, as the IRS suggests, merely the computation of the estate tax charitable deduction. Such a construction is supported by the fact that *Hooper v. Bradford*, to which Mr. Justice Holmes cites, related to the inheritance tax value of an estate asset, and not to any charitable gift.

Furthermore, it is unreasonable to ignore *post mortem* events when valuing a claim in the estate of the claimant, and to consider those events in valuing that same claim in the estate of the person against whom it is asserted. Consistency between judicial circuits is not the only form of consistency to be desired.

Nonetheless, few, if any, practitioners are likely to contest the validity of the final regulations, considering the broad deference given by the courts

to Treasury regulations. See *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc*., 467 U.S. 837 (1984). Thus, one must look at the final regulations as the new rules under which practitioners will file estate tax returns.

In this context, the new regulations are a substantial improvement over the proposed regulations. They are clear and leave few points of uncertainty. They will, of course, result in a great many estates filing protective claims for refund, and extend the administration of a great many estates for a far greater period of time than under the prior law.

VII. *Graegin* Loans.

A. Full Deduction Allowed for Interest on *Graegin* Loan. In *Estate of Murphy v. United States*, 2009 WL 3366099 (W.D. Ark. Oct. 2, 2009), a district court permitted the full deduction for interest on a *Graegin* loan.

1. **Facts.** Charles H. Murphy, Jr.'s estate sold its shares in a bank, but because the stock had declined substantially in value, the estate was short $16 million in liquid assets required to pay its estate taxes. The estate borrowed funds to raise needed cash, including: (a) a $5.4 million loan from a residuary trust; (b) an $11 million 9-year loan from a family limited partnership created by the decedent and two of his children. The partnership loan was secured by a 14.36% limited partner interest, required payment of $500,000 per year and had a fixed interest rate of 3.31%, and prohibited prepayment (the "*Graegin* note"). After a deficiency was assessed, the estate borrowed $41.8 million four trusts created in 1956 for the decedent's children. The estate sought to deduct the interest on these the *Graegin* loan and on the $41.8 million loan from the 1956 trusts.

2. **Interest Deducted.** The District Court for the Western District of Arkansas (Judge Barnes) held that the interest on the *Graegin* loan was deductible by the estate in full, and the interest on the loan from the 1956 trusts was deductible, to the extent paid to date. The court noted that state law (Arkansas) permits an executor to borrow money and pay interest, and that borrowing money to pay estate taxes with respect to an illiquid estate creates an interest obligation that is a "'necessarily incurred' administrative expense" deductible under Section 2053. Citing *McKee v. Comm'r*, TC Memo 1996-362; *Estate of Todd v. Comm'r*, 57 T.C. 288 (1971). The full amount of interest over the 9-year period of the Graegin note is deductible under *Estate of Graegin v. Comm'r*, T.C. Memo. 1988-477, because the total amount of interest is "not vague or uncertain but instead is capable of calculation." The IRS argued that the interest should not be deduct-

ible because the debt resulted from an unnecessary estate-tax avoidance transfer to a family limited partnership that drained decedent's estate of liquid assets. The court rejected this argument because it found that the partnership had been created "in good faith and for legitimate and significant non-tax purposes," and because decedent retained sufficient assets at the time the partnership was created to pay his living expenses and his anticipated estate taxes. The partnership assets, however, had greatly increased in value rendering the estate taxes higher than expected, while the retained assets had not been so fortunate. The IRS also argued that the partnership could have sold some of its assets and distributed cash to the estate to pay the estate taxes, but the court noted that "[i]f the executor acted in the best interest of the estate, the courts will not second guess the executor's business judgment." The court noted that the loans from the 1956 trusts had a floating rate of interest and permits early payments, so that only the interest paid to the date of the court's determination is ascertainable and deductible.

B. **Deduction for *Graegin* Loan Interest Disallowed.** In *Estate of Black v. Comm'r*, 133 T.C. ___ (No. 15) (Dec. 14, 2009), the Tax Court disallowed the deduction of interest on a Graegin loan because, the court concluded, the loan was not necessary for payment of estate expenses and taxes.

1. **Facts.** From 1927 until 1993, Samuel P. Black Jr. was either an employee or director of the Erie Indemnity Co., which grew from selling automobile insurance in Pennsylvania to selling multiple types of insurance in several states. He was an integral part of the company's success, becoming a member of its board of directors where he served until he was 95. Over the years he acquired a substantial amount of Erie stock. Samuel, Jr. died in 2001 and his wife, Irene, died five months later. Irene's estate lacked sufficient liquid assets to discharge its tax and other liabilities, and no bank would lend money secured by the family limited partnership interests that held the principal assets of the estate. Also, the many commercial banks that Samuel III consulted all insisted on a collar for the Erie stock, which could have resulted in its sale if its value dropped. Samuel III, as managing partner of the family limited partnership, together with Erie, agreed to have the partnership sell some of its stock in a secondary offering, which raised $98 million. The partnership then lent $71 million to Irene's estate for a Graegin loan (not permitting prepayment). The interest on the loan was payable in a lump sum on a due date more than four years from the date of the loan. Irene's estate deducted the full interest payment as an administrative expense. Irene's estate used the borrowed funds to discharge its federal and state tax liabilities, pay the $20 million bequest to the

university endowment, and reimburse $980,625 the partnership for its reimbursement of Erie for its costs incurred in the secondary offering. Irene's estate also paid nearly $1 million to the partnership, to repay Erie for the underwriting costs.

2. **IRS Position.** The IRS assessed deficiencies for gift and estate tax against Samuel, Jr. and his estate, and Irene and her estate, in amounts totaling over $210 million. The IRS claimed, in part, that the interest payable on the partnership's loan to Irene's estate was not a deductible administration expense under Section 2053.

3. **Tax Court Denies Interest Deduction.** The Tax Court (Judge Halpern) held that the loan from the partnership to Irene's estate was not "necessarily incurred" within the meaning of Treas. Regs. § 20.2053-3(a), and, therefore, the interest is not a deductible administration expense. The court reviewed its earlier decision in *Estate of Graegin v. Comm'r*, T.C. Memo. 1988- 477, which allowed a current deduction for the interest on a 15-year promissory note that was secured from the decedent's closely held corporation to pay his estate's Federal estate tax liability. The court noted that the interest on a *Graegin* loan is deductible because it is capable of precise calculation, but that it must still also be "necessarily incurred." The court held that the loan was not necessary, because Samuel III, as executor of both estates and managing and majority partner in Black LP, could have easily and legally distributed Erie stock from the partnership, which would have provided liquidity without jeopardizing the interests of the other partners.

VIII. Settlement Agreements.

In TAM 201004022 (Jan. 29, 2010), the IRS rejected a charitable deduction for part of the property of a decedent's estate passing to charity under a settlement agreement resolving a *bona fide* dispute.

A. **Facts.** D died leaving a will that made several gifts to various individuals, including D's son, Son, for life, with the remainder of each gift passing to a charitable trust that D had created during life. D, however, neglected to make a residuary gift. The charitable trust claimed that the residue was omitted by scrivener's error and that it was the residuary beneficiary. Son claimed that, as intestate heir, he was the residuary beneficiary. Son and the charitable trust negotiated for several months and then agreed to divide the residuary estate between them.

B. **Charitable Deduction Denied.** The IRS, in technical advice, stated that the charitable trust lacked an enforceable claim and that, therefore, the amounts passing to it were not passing from the decedent, but rather from Son, and

were not deductible for estate tax purposes. The IRS relied primarily on several marital deduction cases that concluded that payments under a settlement agreement were not deductible unless the spouse had an enforceable right under state law properly interpreted. The existence of an adversary contest and a good faith settlement is not sufficient. *Ahmanson Foundation v. United States*, 674 F.2d 761 (9th Cir. 1981); *Estate of Hubert v. Comm'r*, 101 TC 314 (1993), aff'd on another issue, 63 F3d 1083 (11th Cir. 1995), aff'd on another issue, 517 US 1166 (1996). The IRS noted that this principle had been extended to the charitable deduction area in *Terre Haute First Nat'l Bank v. United States*, 1991 WL 496865, 67 A.F.T.R.2d 91-1217 (S.D. Ind. 1991). The IRS noted that state law presumes that a decedent did not intent an intestacy, but that presumption "is met by an equally potent presumption that an heir is not to be disinherited except by plain words or necessary implication." (Quoting from a state case without citation.) Here, too, the IRS stated, the will was not ambiguous, but merely did not dispose of the residue, and so testimony of the drafter or others should not have been admissible.

IX. Defined Value Gifts

A. Eighth Circuit Reaffirms Validity of Value-Based Disclaimer.

Eighth Circuit Reaffirms Validity of Value-Based Disclaimer. *Estate of Christiansen v. Comm'r*, 586 F.3d 1061 (8th Cir. Nov. 13, 2009), *aff'g* 130 T.C. 1 (2008) presents a strong support for the use of defined value disclaimers and, more broadly, defined value gifts.

1. **Facts.** Helen's last will left all of her estate to her daughter, Christine, after payments of any debts and funeral expenses. The will stated that 25 percent of any disclaimed assets would pass to a charitable foundation and 75 percent to a twenty-year charitable lead annuity trust. Christine disclaimed a fractional share of the estate, equal to the excess of the estate over $6,350,000 (an amount she and her advisers determined would allow the family business to continue, as well as to provide for her and her own family's future.) Christine did not disclaim her contingent remainder in the charitable lead trust; she remained a potential beneficiary of the trust funds remaining after the twenty-year annuity term. The disclaimer also contained a savings clause that stated "the extent that the disclaimer set forth above … is not effective to make it a qualified disclaimer, Christine … hereby takes such actions to the extent necessary to make the disclaimer set forth above a qualified disclaimer within the meaning of section 2518 of the Code." The estate deducted the amount passing outright to the foundation as a result of the foundation, and the present value of the annuity in the charitable lead trust.

2. **IRS Position.** The IRS disputed the valuations chosen by the estate, but the parties eventually settled regarding a substantially increased valuation for the estate based largely on adjustments to marketability discounts the estate had claimed for limited partnership interests in a family ranching enterprise. This resulted in a corresponding increase in the valuation of the contribution to the charitable foundation. The IRS denied the estate an increased charitable deduction.

3. **Tax Court Likes Some Aspects of the Disclaimer, Others, Not So Much.** The Tax Court (Judge Holmes for a ten-judge majority), held that the disclaimer of the portion of the estate passing to the lead trust was not a qualified disclaimer because Christine had not disclaimed her interest in the remainder of the trust, and it thus denied the estate tax charitable deduction for that portion of the estate. The Tax Court (Judge Holmes for a ten-judge majority), held that the disclaimer of the portion of the estate passing to the lead trust was not a qualified disclaimer because the daughter had retained an interest in that trust, and the court denied the estate tax charitable deduction for that portion of the estate. The estate argued that the daughter's remainder interest in the charitable lead trust was either "severable property" or "an undivided portion of the property," and that the disclaimer was qualified. The Tax Court majority disagreed on both counts. The regulations define "severable property" as property that can be divided into separate parts each of which, after severance, maintains a complete and independent existence. Treas. Reg. § 25.2518-3(a)(1)(ii). The regulations define "an undivided portion of the property" as a fractional or percentile share of each and every substantial interest or right owned by the decedent in the property. Treas. Reg. § 25.2518- 3(b). The majority stated that neither definition fit the interests in the charitable lead trust.

   The IRS argued that the use of a formula clause to increase the charitable deduction when the valuation of the assets increased was inherently invalid. The majority rejected this notion, stating that it would have the "remarkable" effect of increasing the estate tax because more property passed to the charity. The IRS argued that any increase in that amount was contingent on a condition subsequent — the IRS challenge to the value of the gross estate — and that the formula adjustment (valuing the disclaimed property "as such value is finally determined for federal estate tax purposes") was contrary to the requirement that the amount the charity will receive be ascertainable at death. Treas. Reg. § 20.2055-2(b)(1). The majority noted that this was a transfer by disclaimer, rather than a "testamentary charitable contribution," and that the disclaimer relates back to the date of death.

The IRS also argued that the increased charitable gift was contingent because it depended on a disclaimer and because it occurred only because the IRS examined the estate tax return and challenged the fair market value of its assets. The majority disagreed, noting that the transfer of property to the foundation was not contingent on any event that occurred after the decedent's death, other than the execution of the disclaimer which related back to the date of death. The majority stated that clauses which depend for their effectiveness on a condition subsequent are ineffective for disclaimers, as they are for revocable spousal interests and gift adjustment agreements. See *Estate of Focardi v. Comm'r*, T.C. Memo. 2006-56 (spousal interests); and *Ward v. Comm'r*, 87 T.C. 78, 110-11 (1986) (gift adjustment agreements). The majority also held that the disclaimer of the portion of the estate passing outright to the foundation was a qualified disclaimer for which an estate tax charitable deduction was allowed.

The IRS contended that the disclaimer's adjustment clause was void on public policy grounds, because it would discourage the IRS from examining estate tax returns because any deficiency in estate tax would just end up being offset by an equivalent additional charitable deduction. The court disagreed, explaining that the public policy being frustrated must be shown by a governmental declaration, and the frustration that would be caused by allowing the contested deduction must be severe and immediate. The court found that the IRS had not met this burden of proof.

4. **Eighth Circuit Sustains Disclaimer.** The Eighth Circuit (Judge Melloy) affirmed. On appeal, the IRS raised two arguments. First, it argued that because the overall value of the estate was finally determined only after the IRS's partially successful challenge, the transfer to the foundation was dependent upon the performance of some act or the happening of a precedent event, rendering it nondeductible. Treas. Reg. § 20.2055-2(b)(1). The Eighth Circuit rejected this argument, holding that the IRS wrongly failed to distinguish between events that occur after death that change the actual value of an asset or estate, and events that occur after death merely as part of the legal or accounting process of determining value at the time of death. finding that the regulation clearly and unambiguously did not apply to accounting valuation that might be negotiated over after the date of death or disclaimer. Only the former result in disallowance of a charitable deduction. In this case, all that remained uncertain after the disclaimer was the valuation of the estate, and therefore, the value of the charitable donation. See Treas. Reg. § 20.2055-2(b)(1) (If, as of the date of a decedent s death, a transfer for charitable purposes is dependent upon the performance of some act

or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.); see also Code § 2518(a) (a qualifying disclaimer relates back to the time of death by allowing disclaimed amounts to pass as though the initial transfer had never occurred); S.D. Codified Laws § 29A-2-801 (b) (same).

Second, the IRS argued that fractional disclaimers should be disallowed if they have a practical effect of disclaiming all amounts above a fixed-dollar amount, because they fail to preserve a financial incentive for the IRS to audit an estate s return. The Eighth Circuit agreed that the Tax Court's holding in this case "may marginally detract from the incentive to audit estate returns," but it rejected the IRS's policy-based argument as a matter of law. The IRS argued that the law supports audits as a means to enforce accurate reporting requirements, and that this policy compels that fixed-dollar-amount partial disclaimers be disallowed, "because of the potential moral hazard or untoward incentive they create for executors and administrators to undervalue estates." The Eighth Circuit found no statutory or regulatory effort to maximize the incentive to audit, and stated that the IRS's role is to enforce the tax laws, and not merely to maximize tax receipts. Code §§ 7801(a)(1), 7803(a)(2). In addition, the court found no evidence of a clear Congressional policy to maximize incentives for the IRS to challenge or audit returns. In this case, the court stated, the key Congressional policy is to encourage charitable donations by allowing deductions for such donations. Code § 2055(a)(2); *Comm'r v. Sternberger's Estate*, 348 U.S. 187 at 190 n.3 (1955) (The purpose of the deduction is to encourage gifts to the named uses.). Allowing fixed-dollar-amount partial disclaimers supports this broad policy.

Finally, the court held that, even if there were a general congressional intent to maximize the incentive-to-audit, no corresponding rule of construction would be necessary in the present context to promote accurate reporting of estate values. The IRS argued that executors and administrators will intentionally undervalue assets to take advantage of a marginally decreased incentive to audit, but the court noted that there are many other mechanisms in place to ensure that fiduciaries accurately report estate values, including state laws that impose personal liability on fiduciaries, and state and federal laws that impose financial liability and, in some circumstances criminal sanctions, for false statements, fraud, and knowing misrepresentations. See, *e.g.*, S.D. Codified Laws §§ 29A-3-703(a); 55-9-5; 18 U.S.C. 1001 et seq.; *Ward v. Lange*, 553 N.W.2d 246, 250 (S.D. 1996). With a fixed-dollar-value disclaimer, the contingent beneficiaries taking the disclaimed property have an interest in ensuring that

the executor or administrator does not under-report the estate's value, and they will serve as watchdogs against fiduciary errors. Further, in this case, the daughter was not only the primary beneficiary who made the contested partial disclaimer, she was the executor of the estate and a board member for the foundation. She owed a fiduciary obligation to both the estate and the foundation, any self-dealing in this instance would be a clear violation of her general state-law fiduciary obligation to put the interests of the foundation above her own interests and possibly a violation of state and federal statutory prohibitions on certain forms of self dealing.

B. **Tax Court Approves Defined Value Gift.** *Estate of Petter v. Comm'r*, T.C. Memo. 2009-280 (Dec. 7, 2009) provides a huge boost to the use of defined value gifts.

1. **Facts.** Anne Petter was the niece of one of the first investors in what became United Parcel Service (UPS). When her uncle died in 1982, he left Anne his stock. Anne had three adult children and grandchildren and worked with attorneys to create arrangements that would take care of her heirs and also fund public charities. Anne's estate planning included creating an irrevocable life insurance trust, a charitable remainder trust, a family LLC, and some intentional grantor trusts. During this time, UPS went public, and the value of Anne's stock roughly doubled in value. Anne did a part-gift/part sale of her interests in the LLC to the intentional grantor trusts, after first giving the trusts seed capital equal to ten percent of the value of the total LLC units she planned to transfer to the trust. She then simultaneously sold the balance of the units to the trusts and gave some units to two public charities. The document of sale and gift provided that the transferred units would be divided between the charities and the trusts as follows:

> Transferor * * *
>
> 1.1.1 assigns to the Trust as a gift the number of Units described in Recital C above that equals one-half the minimum dollar amount that can pass free of federal gift tax by reason of Transferor's applicable exclusion amount allowed by Code Section 2010(c). Transferor currently understands her unused applicable exclusion amount to be $907,820, so that the amount of this gift should be $453,910; and 1.1.2 assigns to The Seattle Foundation as a gift to the A.Y. Petter Family Advised Fund of The Seattle Foundation the difference between the total number of Units described in Recital C above

> and the number of Units assigned to the Trust in Section 1.1.1.
>
> 1.2: The Trust agrees that, if the value of the Units it initially receives is finally determined for federal gift tax purposes to exceed the amount described in Section 1.1.1, Trustee will, on behalf of the Trust and as a condition of the gift to it, transfer the excess Units to The Seattle Foundation as soon as practicable.

Both trusts repaid their promissory notes to Anne. The charities were effectively represented by separate counsel. The transfers were appraised by a qualified appraiser and were fully disclosed with all of the documentation on Anne's federal gift tax return.

2. **IRS Position.** On audit of the federal gift tax return, the IRS argued for a higher unit value than that opined by Anne's appraiser. Additionally, the IRS argued that the defined value gift clause was unenforceable and violated public policy, and that no additional income tax deduction would be allowed for the additional units of LLC interest allocated to the charities on account of the revaluation.

3. **Tax Court Sustains Defined Value Gifts – Proctor Does Not Apply.** In the Tax Court (Judge Holmes) held for the taxpayer. The court reviewed the history of defined value gifts and sales and similar transactions, from *Comm'r v. Proctor*, 142 F.2d 824 (4th Cir. 1944), *cert. denied* 323 U.S. 756 (1944), through *Christiansen v. Comm'r*, 586 F.3d 1061 (8th Cir. 2009). The court stated succinctly that "savings clauses are void, but formula clauses are fine." The court then analyzed Anne's transaction documents and concluded that what she had done was to make "gifts of an ascertainable dollar value of stock; she did not give a specific number of shares or a specific percentage interest in the [LLC]." The court rejected the IRS public policy arguments, noting that:

> the facts in this case show charities sticking up for their interests, and not just passively helping a putative donor reduce her tax bill. The foundations here conducted arm's-length negotiations, retained their own counsel, and won changes to the transfer documents to protect their interests. Perhaps the most important of these was their successful insistence on becoming substituted members in the PFLLC with the same voting rights as all the other members. By ensuring that they became substituted members, rather than mere assignees, the

charities made sure that the PFLLC managers owed them fiduciary duties.

Judge Holmes also noted that there are other situations in the Code and regulations where the law expressly approves of formula clauses, such as charitable remainder trusts and the marital deduction. The court also held that the charitable deduction for the additional allocation of shares to charities was properly taken on the date of the original transfer, even though there were subsequent revaluations and reallocations.

4. **Planning.** This is one of the clearest expressions of approval of the use of defined value gifts. After *Christiansen* and *Petter*, practitioners can feel quite comfortable using these clauses for blended charitable and noncharitable gifts to eliminate the risk of additional gift taxes on transfers of hard-to-value assets.

Donors who are not charitably inclined, may consider having the excess gift above the fixed dollar amount go to the donor's spouse or to a trust in which an independent trustee has discretion to distribute income and principal among a class of beneficiaries that includes the donor. The latter will be an incomplete gift if created in any of the majority of states that do not specifically authorize self-settled spendthrift trusts.

A donor who does not use a charitable donee, however, loses the benefit of the strong policy encouraging charitable gifts, that was cited by the court in *Estate of Petter*. In such a case, it might be best to provide that some portion (perhaps, five percent) of the excess transfer will still go to the original donees and constitute an additional taxable gift. This further undercuts the IRS argument that the defined value gift frustrates the audit process.

X. **GRATS.** The Treasury's explanation of the Administration's Fiscal Year 2011 budget includes proposals to limit seriously the utility of GRATs. Dept. of Treasury, "General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals" p. 126 (Feb. 1, 2010). This proposal is included in the Ways and Means version of H.R. 4849, 111th Cong., 2d Sess. (Reported by the Committee May 17, 2010), the Small Business and Infrastructure Jobs Tax Act of 2010, which provides more detail on the proposal. This proposal is estimated by the Staff of the Joint Committee on Taxation as raising $4.45 billion over 10 years.

A. **Minimum 10-Year Term.** This proposal would eliminate the use of short-term GRATs by requiring that all GRATs last for at least 10 years, thus tending to limit the use of GRATs to taxpayers who are either under 75 years of age and in average health, or above 75 years of age and in extraordinarily

good health, so that the taxpayer has a life expectancy in excess of 10 years. Thus, older taxpayers would likely forego the use of GRATs in favor of installment sales to an intentional grantor trust, as a means of shifting a significant portion of the growth in the value of the transferred assets to selected donees.

B. **Eliminate Zero Gift GRATs.** The proposal would require that all GRATs have some minimum remainder interest. The proposal does not state how much of a taxable gift would be required, and it may be just that the Treasury wants the GRAT creator to file a gift tax return that can be audited.

C. **Eliminate Decreasing GRATs.** The proposal would preclude the use of GRATs with decreasing annuity payments. This is necessary to protect the required minimum term, but it also eliminates a good planning technique by which GRATs made very large payments in the first year and smaller payments in the second year, setting the stage for a more agressive rolling schedule.

D. **Effective Date.** This proposal would apply to transfers after the date of enactment.

XI. Life Insurance

A. **Employer-Owned Life Insurance.** The IRS provided the first substantial guidance on employer-owned life insurance under Section 101(j) and 6039I in Notice 2009-48, 2009-24 I.R.B. 1085 (June 15, 2009). This guidance is in the form of questions and answers.

1. **Definition of EOLI Contract.** The IRS explains in the first three Q&A that an insurance contract cannot be an EOLI contract unless it is owned by a person engaged in a trade or business; ownership by a related person is insufficient. Section 101(j) applies to an EOLI contract owned by an applicable policyholder and payable to a related person who is not engaged in a trade or business, but it does not apply to a policy that is owned by someone who is not engaged in a trade or business, even if payable to someone who is engaged in a trade or business. The IRS also stated that a life insurance contract can be an EOLI contract if it is subject to a split dollar arrangement, as long as it is owned by a person engaged in a trade or business and meets the other requirements of Section 101(j)(3). The general rule of Section 101(j)(1) does not, however, apply to the extent any amount received by reason of the death of the insured is paid to a family member of the insured, an individual who is a designated beneficiary, or a trust established for the benefit of a family member

or designated beneficiary. Therefore, the vast majority of split dollar arrangements will not be taxed under the special EOLI rules. The IRS also stated that a contract owned by a partnership or proprietorship engaged in a trade or business can be an EOLI contract – the policy need not be owned by a corporation.

2. **Statutory Exceptions to the EOLI Rules.** Most of the question relate to the exceptions to the EOLI rules. In particular, the IRS noted that:

   a. **Officers, Directors and Highly-Compensated**. For purposes of the EOLI rules, an "employee" includes an officer, director, and highly compensated employee, as well as a common law employee. A director is an independent contractor in his or her capacity as a director, but is still treated as an employee for purposes of the income tax.

   b. **Notice to Owner-Employees?** As silly as it seems, notice and consent are required of an owner-employee of a wholly-owned corporation, and actual knowledge alone will not substitute for the statutory requirement that notice and consent be "written." (The requirement that notice and consent be written avoids factual controversies that otherwise could result where, for example, the sole owner of a corporation delegates financial matters to an employee.)

   c. **Actual Transfer of Policy by Employee to Employer.** The actual transfer of an existing life insurance contract by an employee to an employer is itself sufficient to satisfy the requirements that the employee be notified in writing of the intention to insure and the maximum face amount of insurance, that written consent be secured, and that the employee be notified that the employer will be a beneficiary upon his or her death. If the employer later increases the face amount of the contract, however, written notice and consent must be secured to establish the requisite notice to the employee and consent to the new face amount.

   d. **Timing.** In order for the employee's consent to satisfy the requirements of Section 101(j)(4) with regard to a contract, the contract must be issued before the earlier of the expiration of the one-year period beginning on the date the consent was executed, or the termination of the employee's employment with respect to the trade or business of the applicable policy-holder. It is not necessary to provide further notice or to renew

an employee's consent with regard to an existing contract, merely because additional premiums are paid or other amounts added to or withdrawn from the policy. If the total face amount of the EOLI contracts with regard to the employee exceeds the amount of which the employee was notified and to which the employee consented as described in Section 101(j)(4), however, one should note that new notice and consent are required.

e. **Single Consent for Multiple Contracts.** A single consent may apply to more than one EOLI contract, as long as the notice and consent requirements of Section 101(j)(4) are otherwise met. The fact that more than one contract is acquired with regard to an employee who executed a single consent does not prevent an exception under Section 101(j)(2) from applying.

f. **Electronic Notice and Consent.** The notice and consent requirements may be satisfied electronically, as long as the system for electronic notification and consent notifies the insured of the intention to insure and maximum face amount, the insured consents to insurance and continuation after termination of employment, and the notification states that an applicable policyholder will be a beneficiary of any proceeds payable upon the employee's death. In addition, the system must (a) ensure that the information received by the employee is the same as the information sent by the employer; (b) make it reasonably certain that the person accessing the system is the employee for whom notice and consent is required; (c) include a process for electronic signature or other means of formally recording the employee's consent to being insured; and (d) permit the production of a hardcopy of the electronic notice and consent upon request by the IRS and a statement that, to the best of the employer's knowledge, the required notice was provided to the employee and the employee consented to being insured.

g. **Beware Shortcuts.** The notice and consent requirements are not met by advising an employee that the face amount of life insurance may be "the maximum face amount for which the employee could be insured" at the time the contract is issued. The employee be informed of the maximum amount of insurance coverage, expressed either in dollars or as a multiple of salary, that the applicable policyholder reasonably expects to

buy with regard to the employee during the course of the employee's tenure.

h. **Additional Notices When Policy Amounts Grow Unexpectedly.** Additional notice and consent are required if the aggregate face amount of the EOLI contracts with regard to an employee exceeds the amount of which the employee was given notice and to which the employee consented.

i. **No Correction Mechanisms.** Unfortunately, there is no provision in Section 101(j) for correcting an inadvertent failure to satisfy the notice and consent requirements, but that the IRS will not challenge the applicability of an exception under Section 101(j)(2) based on an inadvertent failure to satisfy the notice and consent requirements if (a) the applicable policyholder made a good faith effort to satisfy those requirements, such as by maintaining a formal system for providing notice and securing consents from new employees; (b) the failure to satisfy the requirements was inadvertent; and (c) the failure to obtain the requisite notice and consent was discovered and corrected no later than the due date of the tax return for the taxable year of the applicable policyholder in which the employer-owned life insurance contract was issued.

3. **Transition Rule and Section 1035 Exchanges.** Section 101(j) applies to life insurance contracts issued after August 17, 2006, except for a contract issued after that date pursuant to a Section 1035 exchange for a contract issued on or before that date. For this purpose, any material increase in the death benefit of other material change causes a pre-August 18, 2006 contract to be treated as a post-August 17, 2006 contract and thus subject to Section 101(j).

a. **Material Changes.** Q&A 14 states that the following changes will not be treated as material changes for purposes of determining whether an existing contract is treated as a new contract for purposes of Section 101(j): (i) increases in death benefit that occur as a result of either the operation of Section 7702 or the terms of the existing contract (provided the insurer's consent to the increase is not required); (ii) administrative changes; (iii) changes from general account to separate account or from separate account to general account; or (iv) changes as a result of the exercise of an option or right granted under the contract as originally issued.

b. **Death Benefit Increases.** Furthermore, a death benefit increase will not cause a contract to be treated as a new contract if: (i) the increase is necessary to keep the contract in compliance with Section 7702; (ii) the increase results from the application of policyholder dividends to purchase paid-up additions; or (iii) the increase is the result of market performance or contract design with regard to a variable contract.

c. **Additional Notice and Consent.** Notice and consent are required if a contract is treated as a new contract by reason of a material increase in death benefit or other material change, unless a valid consent remains in effect with regard to the insured.

d. **Section 1035 Exchanges.** Q&A 15 explains that, generally, the taxability rule of Section 101(j)(1) will not apply to a contract issued after August 17, 2006 in an exchange described in Section 1035 for a contract issued on or before that date, but that a Section 1035 exchange that results in a material increase in death benefit or other material change (other than a change in issuer) is treated as the issuance of a new contract after August 17, 2006 for purposes of determining whether Section 101(j) applies to the contract.

4. **Information Reporting under Section 6039i and Form 8925.** The final Q&A states that only one taxpayer – the applicable policyholder – is ever required to file Form 8925 by reason of the same EOLI contract. Related persons are not, however, applicable policyholders. Therefore, only the applicable policyholder "owning 1 or more employer-owned life insurance contracts" is required to file Form 8925.

5. **Effective Date.** Notice 2009-48 is effective June 15, 2009. The IRS will not challenge a taxpayer who made a good faith effort to comply with Section 101(j) based on a reasonable interpretation of that provision before that date.

6. **Drafting.** The EOLI rules can be a trap with respect to redemption buy-sell agreements, where the shareholders are also employees. The following language may be used to satisfy the EOLI requirements with respect to such an agreement:

Section 5. Life Insurance

5.1. Required Policies. The Corporation shall apply for, own, maintain and be the beneficiary of life insurance policies on the life of each Shareholder, in the following amounts:

Shareholder1 - *InsAmount1*
Shareholder2 - *InsAmount2*
Shareholder3 - *InsAmount 3*
Shareholder4 - *InsAmount4*

5.2. Added Policies. The Corporation may acquire any additional policies of life insurance that it deems appropriate to carry out this Agreement, and each Shareholder shall cooperate fully in any such acquisitions, including submitting to any physical examinations and providing any medical information required by the insurer. All additional policies shall be listed on Schedule.

5.3. Premiums. The Corporation shall pay every premium on any life insurance policies that it is required or permitted to maintain under this Section, and give each Shareholder proof of such payment within fifteen (15) days of the date the premium was due. If the Corporation fails to supply such proof, any Shareholder may pay the premium and be reimbursed for his or her payment by the Corporation. All dividends on any such policies shall be applied to the payment of premiums.

5.4. Notice and Consent.

5.4.1 Initial Notice and Consent. This Section 5 shall constitute written notice to each Shareholder that the Corporation intends to insure the Shareholder's life and the amount indicated above and that the Corporation shall be the beneficiary of the death benefits under all such insurance policies. The signature of each Shareholder to this Agreement shall constitute a written consent to being insured on such terms and that such coverage may continue even if any employment of the Shareholder with the Corporation shall have hereafter been terminated, regardless of cause and regardless of whether the termination shall have been by the unilateral decision of the Corporation,

the unilateral decision of the Shareholder, or by mutual consent of the Corporation and the Shareholder.

5.4.1 Later Notice and Consent. The Corporation shall give a Shareholder separate written notice of any increase in the amount of insurance that may be acquired by the Corporation on the life of the Shareholder. Such separate written notice shall include (1) the fact that the Corporation intends to insure the Shareholder's life for a sum different than that indicated above and the maximum face amount for which the Corporation then plans to insure the Shareholder's life; (2) written consent to being insured under the contract and that such coverage may continue after the insured Shareholder terminates employment; and (3) written information that the Corporation will be a beneficiary of any proceeds payable upon the death of the Shareholder.

B. Transfer of Life Insurance Policies

1. **IRS Explains Income Taxation of Life Insurance Policy Sale.** In Rev. Rul. 2009-13, 2009-21 I.R.B. 1029 (May 26, 2009), the IRS for the first time gave a relatively comprehensive, if a bit unsatisfying, treatment of the income taxation of the sale of a life insurance policy. The IRS posed three situations addressing the amount and character of income recognized upon the surrender or sale of the life insurance contracts by the insured owner.

   a. **Situation 1. Surrender of a Cash Value Life Insurance Policy.** Situation 1 involved A, a cash method, calendar year individual who bought and owned an insurance contract on A's own life. The policy had cash values and the named beneficiary was a member of A's family. A had the right to change the beneficiary, take out a policy loan, or surrender the contract for its cash surrender value. The contract was a capital asset in A's hands. On June 15 of Year 8, A surrendered the contract to the issuer for $78,000 – its cash surrender value. The cash surrender value reflected a $10,000 subtraction for the "cost-of-insurance" charges collected by the issuer for periods ending on or before the surrender of the contract. A had paid a total of $64,000 of premiums on the policy, and had neither received any distributions under the contract nor borrowed against its cash surrender value. As of the date of sale, A was neither terminally nor chronically ill, within the

meaning of the accelerated death benefit rules. Code § 101(g)(4).

The IRS ruled that A recognized $14,000 of ordinary income on the surrender of the life insurance policy, based on Section 72(e), which expressly governs amounts received on the complete surrender of a non-annuity life insurance contract. The IRS noted that Section 72(e)(5)(A) requires that any non-annuity amount received on the complete surrender of a life insurance contract must be included in gross income, to the extent that it exceeds the owner's investment in the contract. The investment in the contract is the aggregate amount of premiums or other consideration paid for the contract before that date, less the aggregate amount received under the contract before that date to the extent that amount was excludable from gross income. Code § 72(e)(6). A received $78,000 on the complete surrender of the policy, so A includes in income the $14,000 excess of $78,000 over A's $64,000 investment in the contract. The IRS stated that the entire gain is ordinary income, because although the policy was a capital asset, there was no sale or exchange.

The IRS also stated, without analysis or authority, that Section 1234A does not change this result. Section 1234A, enacted in 1981 and amended in 1983, provides for capital gain treatment on the cancellation or termination of a right with respect to a capital asset, even absent a sale or exchange. That Section, by its terms, applies to the "cancellation, lapse, expiration, or other termination of . . . a right or obligation . . . with respect to property which is (or on acquisition would be) a capital asset in the hands of the taxpayer." It is entirely unclear why this rule would not apply to the surrender of a life insurance contract, and indeed, the IRS had earlier ruled in technical advice that it did not apply to amounts received on the termination or surrender of whole life insurance contracts, but only to extent that amounts are attributable to ordinary income accretions to the value of the contracts. TAM 200452033 (Dec. 26, 2004). The statement in Revenue Ruling 2009-13 makes no such limited denial of the application of Section 1234A.

b. **Situation 2. Sale of a Cash Value Policy.** The facts of Situation 2 were identical to those of Situation 1, except that on June 15 of Year 8, A sold the contract to B for $80,000. B was a person unrelated to A, who would suffer no economic or personal loss upon A's death.

The IRS first noted that Section 72 does not apply to sales of a life insurance policy. A's gain on the sale was the excess of the amount realized by A on the sale over A' s adjusted basis in the contract. Code §§ 1011, 1012. The amount A realized was $80,000 – the sum received on the sale. A's adjusted basis in the insurance contract was its cost, adjusted to reflect expenditures, receipts, losses, or other items properly chargeable to capital account. Code § 1016(a)(1). In this case, the IRS reduced A's basis by the cost of the pure life insurance protection prior to the sale. *London Shoe Co. v. Comm'r*, 80 F.2d 230, 231 (2d Cir. 1935), *cert. denied*, 298 U.S. 63 (1936); *Century Wood Preserving Co. v. Comm'r*, 69 F.2d 967, 968 (3d Cir. 1934), and *Keystone Publishing Co. v. Comm'r*, 26 B.T.A. 1210 (1932). The IRS measured the cost of insurance by the $10,000 by which the insurer reduced the cash surrender value to reflect cost-of-insurance charges. Thus, A's adjusted basis in the contract was $54,000 ($64,000 premiums - $10,000 cost of insurance), and A recognized a $26,000 gain ($80,000 - $54,000).

In Situation 2, there was an actual sale so capital gains treatment was relevant. Nonetheless, the IRS applied the "substitute for ordinary income doctrine," which convert s part of the gain on a sale into ordinary income, because neither "property" nor "capital asset" includes "property representing income items or accretions to the value of a capital asset themselves properly attributable to income." *United States v. Midland-Ross Corp.*, 381 U.S. 54, 57 (1965); *Comm'r v. P.G. Lake, Inc.*, 356 U.S. 260 (1958); *Arkansas Best Corp. v. Comm'r*, 485 U.S. 212, 217, n.5 (1988); *Prebola v. Comm'r*, 482 F.3d 610 (2d Cir. 2007); *United States v. Maginnis*, 356 F.3d 1179 (9th Cir. 2004); *Davis v. Comm'r*, 119 T.C. 1 (2002). This doctrine is limited to the amount that would be recognized as ordinary income if the contract were surrendered, which the IRS said was the inside build-up under the contract – the excess of the cash surrender value over the premiums paid. Capital gains treatment is afforded the excess of the gain realized over the inside build-up. *Comm'r v. Phillips*, 275 F.2d 33, 36 n. 3 (4th Cir. 1960). Here, the inside build-up under A's life insurance contract immediately prior to the sale was $14,000 ($78,000 cash surrender value less $64,000 aggregate premiums paid). A must recognize $26,000 of gain, of which $14,000 is ordinary income and $12,000 is capital gain.

c. **Situation 3. Sale of Term Policy.** The facts in Situation 3 were identical to those in Situation 2, except that the contract

was a level premium fifteen-year term life insurance contract with no cash surrender value. The monthly premium was $500 and A paid a total of $45,000 in premiums through the date of sale. A sold the policy to B for $20,000.

The IRS applied the same rules that it used in Situation 2, noting that the amount realized from the sale was the $20,000 that A received from B. The IRS stated that, absent any other proof, the cost of the pure life insurance protection would be presumed to be equal to the entire premium paid. Therefore, $44,750 of the total premium payments was attributable to pure life insurance protection and was not included in A's adjusted basis. A's adjusted basis was $250 (the unexpired portion of the last premium), and A would recognize a gain of $19,750 on the sale ($20,000 amount realized - $250 basis).

The IRS explained, further, that the entire gain would be capital gain, because there was no investment component to which the substitution for income doctrine could apply.

d. **Effective Date.** Rev. Rul. 2009-13 states that "the holdings of this revenue ruling with respect to Situations 2 and 3 will not be applied adversely to sales occurring before August 26, 2009." This assurance might not be a complete protection for taxpayers who have sold policies to life settlement companies in the past. This declaration promises that this ruling will not be applied retroactively, but an IRS agent might take the same positions espoused in this ruling, based on the underlying precedents, and merely not take advantage of the additional weight that a revenue ruling affords. Of course, it is not entirely clear what that weight might be. Revenue rulings generally receive deference from the courts. See, e.g., *Davis v. United States*, 495 U.S. 472 (1990) ("although the Service's interpretive rulings do not have the force and effect of regulations, . . . we give an agency's interpretations and practices considerable weight where they involve the contemporaneous construction of a statute and where they have been in long use"); *AMP, Inc. v. United States*, 185 F.3d 1333, 1339 (Fed. Cir. 1999) ("revenue ruling issued at a time when the I.R.S. is preparing to litigate is often self-serving and not generally entitled to deference by the courts . . . .This is especially true when the ruling cites no authority and is inconsistent with regulations and other pronouncements of the I.R.S."); *Estate of McLendon v. Comm'r*, 135 F.3d 1017, 1023–1024 (5th Cir. 1998) ("revenue rulings are odd creatures unconducive to precise categorization in the hierarchy of legal authorities. They are clearly less

binding on the courts than treasury regulations or Code provisions, but probably (and in this circuit certainly) more so than the mere legal conclusions of the parties"); *Wood v. Comm'r*, 955 F.2d 908 (4th Cir. 1992), *cert. granted*, 504 US 972 (1992), *cert. dism'd*, 505 U.S. 1231 (1992) (court first reached same result as ruling, and then stated that "considerable weight is to be given to an agency's construction of a statute that it is charged with administering"); *Indiana Nat'l Corp. v. United States*, 980 F.2d 1098 (7th Cir. 1992), *cert. denied*, 508 U.S. 907 (1993) ("it is proper to consider a relevant revenue ruling, . . . although they are not definitive"). The Tax Court and at least one other court, however, have viewed revenue rulings as little more than the statement of position by one of the litigants. *Stubbs, Overbeck & Assocs. v. United States*, 445 F.2d 1142, 1146–47 (5th Cir. 1971) (rulings are "merely the opinion of a lawyer in an agency"); *Norfolk S. Corp. v. Comm'r*, 104 T.C. 13 (1995) ("a ruling or other interpretation by the Commissioner is only as persuasive as her reasoning and the precedents upon which she relies"); *Stark v. Comm'r*, 86 T.C. 243, 250 (1986) ("absent special circumstances, a revenue ruling merely represents the Commissioner's position with respect to a specific factual situation, [and] typically [is not] substantive authority for a position"); *Reinhardt v. Comm'r*, 85 T.C. 511, 520 (1985) (revenue ruling "merely represents the position of one of the litigants in this case, the Commissioner of Internal Revenue, and does not necessarily even represent the view of the Treasury Department").

e. **Planning and Analysis.** The IRS determination that the initial owner's basis in a life insurance policy must be reduced by the cost of insurance protection received by the insured before the sale is likely to be one of the most controversial features of either ruling. The IRS reliance on the cash surrender value as the primary determinant of basis appears to be reasonable, however, and certainly administratively convenient. All cash value life insurance policies reduce the cash surrender values to reflect both the costs of current insurance protection and the agent's commissions. It is not clear from the rulings whether the IRS views the agent's commissions as a proper charge against the seller's adjusted basis.

This ruling may have a chilling effect on the promotion of stranger-owned life insurance (SOLI) arrangements, because most of those promotions have suggested that there will be little gain recognized by the insured on the sale of a policy on his or her life, based in part on the assumption that

the insured's basis would be the total premiums paid. The reduction of the basis to the cash surrender value significantly increases the tax on the insured's sale, and will make such arrangements less appealing.

2. **IRS Also Examines the Income Taxation of the Third-Party Purchaser of a Life Insurance Policy.** The IRS also issued Rev. Rul. 2009-14, 2009-21 I.R.B. 1031 (May 26, 2009), addressing the income tax consequences to the third-party buyer of a life insurance contract, regarding the collection of the death benefit or the resale of the policy. This ruling also posited three situations.

a. **Situation 1: Receipt of Death Benefit by Third Party Purchaser.** B, a cash basis, calendar year, U.S. taxpayer bought a life insurance contract on the life of A. The sale occurred on June 15, 2008 and the sales price was $20,000. The contract originally issued to A on January 1, 2001, by a domestic insurer, and, was a level premium fifteen-year term life insurance contract with no cash surrender value. At the time of purchase, the remaining term of the contract was 7 years, 6 months, and 15 days. The monthly premium was $500, payable on the first day of each month. After the purchase, B continued to pay the premiums. B had paid $9,000 of premiums by December 31, 2009, when A died. The insurer paid a $100,000 death benefit to B. B had no insurable interest in A's life and B bought the contract with a view to profit, promptly naming itself beneficiary. The contract in B's hands was a capital asset. The likelihood that B would allow the contract to lapse by failing to pay any of the remaining premiums was remote.

The IRS ruled that B must recognize $71,000 of ordinary income on the receipt of death benefits. The IRS explained that life insurance death benefits are not includible in gross income, unless the policy or an interest in the policy has been acquired in a transfer for value. Code §§ 101(a)(1), 101(a)(2). The death benefits paid with respect to a policy that has been acquired in a transfer for value is includible in the recipient's gross income, except to the extent of the consideration paid and the premiums and other amounts subsequently paid by the transferee. Code § 101(a)(2). There are four "safe harbor" exceptions to the transfer for value rule, but none of these applied in this situation. Therefore, the amount realized is $71,000 ($100,000 - $20,000 - $9,000) and B can exclude from gross income the $20,000 it paid for the policy and the $9,000 of premiums it paid after the sale.

The IRS stated that the gain on the receipt of the death benefit is ordinary income, because although the policy might be a capital asset in B's hands, neither the surrender of a life insurance contract nor the receipt of a death benefit from the issuer under the terms of the contract is a sale or exchange. Therefore, all realized gain must be taxed as ordinary income.

b. **Situation 2: Resale of the Contract by the Buyer.** The facts in Situation 2 were identical to those of Situation 1, except that B resold the policy to C, a person unrelated to A or B. The sale occurred on December 31, 2009, and the sales price was $30,000. The IRS ruled that B should recognize a $1,000 capital gain on this sale.

The IRS stated that B's gain on the resale of the contract would be the amount realized by B on the resale ($30,000) over B's adjusted basis in the contract ($29,000). As in Situation 1, B's adjusted basis in the contract includes both the amount B paid to A for the contract ($20,000) and the premiums B paid after the purchase to maintain the policy in force ($9,000). The IRS explicitly stated that "B is not required to reduce its basis in the life insurance contract by any cost of insurance charges that may have been imposed," because B is wholly unrelated to A, the policy was not bought to protect B against any economic loss upon A's death, B bought the policy solely with a view to profit, and the additional premiums were paid solely to prevent the loss of B's financial investment. Thus, B's basis for a resale is computed differently from A's basis on the initial sale.

The IRS stated that the gain on the resale was a capital gain, because the policy was property owned by B and was not described in any of the exceptions from the definition of a capital asset under Section 1221(a), and because there was a sale or exchange. Assuming that B meets the holding period requirements, B's gain on the resale is taxable as a long-term capital gain. The substitute for ordinary income doctrine will not apply, because the contract was a term contract with no cash value.

c. **Situation 3. Death Benefits Received by a Foreign Corporation.** The facts in Situation 3 were identical to those in Situation 1, except that B is a foreign corporation not engaged in a trade or business within the United States (including the trade or business of purchasing, or taking assignments of, life insurance contracts). The IRS stated that, B must recognize $71,000 on the receipt of the death benefit ($100,000 -

$20,000 - $9,000), and that this amount is subject to U.S. income taxes.

The IRS ruled that this income is "fixed or determinable annual or periodical" income within the meaning of Section 881(a)(1), and that B is subject to U.S. income taxes on this income, because it is deemed to be from sources within the United States. Generally, the IRS explained, interest received from a domestic corporation is considered to be U.S. source income, as are insurance premiums received on insurance contracts issued in respect of the lives of U.S. residents. The Code does not, however, specify the source of income from a term life insurance contract death benefit. Therefore, the source of such income is determined by comparison and analogy to classes of income that are specified within the statute. See *Bank of America v. United States*, 680 F.2d 142, 147 (Ct. Cl. 1982); *Howkins v. Commi'r*, 49 T.C. 689 (1968); *Clayton v. United States*, 33 Fed. Cl. 628 (1995), *aff'd without published opinion*, 91 F.3d 170 (Fed. Cir. 1996), *cert. denied*, 519 U.S. 1040 (1996). See also Rev. Rul. 79-388, 1979-2 C.B. 270; Rev. Rul. 2004-75, 2004-1 C.B. 516. Here, A is a United States citizen residing in the United States, and the insurer is a domestic corporation. Therefore, B must recognize $71,000 of ordinary income from sources within the United States, and pay tax with respect to this amount.

d. **Effective Date.** While Rev. Rul. 2009-13 stated that it was not retroactive, Rev. Rul. 209-14 contains no such representation. Therefore, this ruling should be applied retroactively.

3. **Treasury Would Require Reporting of Transactions Related to Sale of Life Insurance Policies.** The Administration's 2011 revenue proposals, issued as part of its budget, includes a proposal to increase reporting of the sales of life insurance policies. Dept. of Treasury, "General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals" pp. 69-70 (Feb. 1, 2010).

a. **Proposals.** The 2011 budget proposes that a person or entity who buys an interest in an existing life insurance contract with a death benefit equal or exceeding $500,000 (2010 proposal set figure at $1 million) should be required to report the purchase price, the buyer's and seller's taxpayer identification numbers (TINs), and the issuer and policy number to the IRS, to the insurance company that issued the policy, and to the seller. This proposal also would modify the transfer-for-value rules "to ensure that exceptions to that rule would not apply to buyers of policies." Furthermore, upon payment of any policy

benefit to the buyer, the insurance company would be required to report the gross benefit payment, the buyer's TIN, and the insurance company's estimate of the buyer's basis to the IRS and to the payee.

If enacted, this proposal would apply to sales or assignments of interests in life insurance policies and to payments of death benefits for taxable years beginning after December 31, 2010.

b. **Purpose of the Proposals.** This proposal is intended to facilitate treating life insurance proceeds as ordinary income when the policies are bought in a transfer for value. The IRS has difficult enforcing the transfer-for-value rules currently, because they do not receive information about the identity of parties to transfers of contracts, amounts paid for transferred contracts, and payments under transferred contracts currently. See analysis of the Treasury's proposal in Staff of the Joint Committee on Taxation, 111th Cong., 1st Sess., "Description of Revenue Provisions Contained in the President's Fiscal Year 2010 Budget Proposal. Part Two: Business Tax Provisions," at 133-136 (Committee Print) (Sept. 2009).

XII. Intentional Grantor Trusts

A. Beneficiary Owns Nongrantor Trust Because of Withdrawal Right.

In PLR 200949012 (Dec. 4, 2009), the IRS approved beneficiary-ownership of a trust by virtue of lapsed withdrawal rights.

1. **Facts.** The grantor created a trust for the current benefit of B, to whom the trustee could distribute income or corpus. B also had a lifetime power to withdraw or direct the distribution of such income and principal as was necessary for B's health, education, maintenance or support. At B's death, the trust fund will be distributed pursuant to B's limited power of appointment or, in the default of the exercise of that power, to one or more qualified charitable organizations. The grantor retained no powers over or interests in the trust which would make the trust a grantor trust. B was also given a Crummey power to withdraw any property given to the trust. This appears to be a hanging power; the IRS stated that it lapses each calendar year in an amount equal to the greater of $z or y% of the value of the trust corpus. It is reasonable to assume that $z is $5,000 and that y% is five percent of the trust corpus from which the withdrawal power could be satisfied .It is reasonable to assume that $z is $5,000 and that y% is five percent of the trust corpus from which the withdrawal power could be satisfied,

and that the trust corpus was large enough that the lapse was based on the percentage figure, rather than the specific pecuniary sum.

2. **Beneficiary Deemed Owner.** The IRS stated that the grantor owned no portion of the trust for income tax purposes, but that:

> We further conclude that Beneficiary will be treated as the owner of Trust for federal income tax purposes under §§ 671 and 678, before and after the lapse of Beneficiary's power of withdrawal with regard to any transfer to Trust.

3. **Analysis and Planning.** The beneficiary's ownership of the trust reflects two features of Section 678, under which a beneficiary can own a trust for income tax purposes. Under Section 678(a)(1), the beneficiary owns that portion of the trust that he or she can withdraw. This ownership, however, expires as the beneficiary's withdrawal power lapses. Section 678(a)(2) states that the beneficiary owns any portion of a trust as to which he or she "has previously partially released or otherwise modified such a [withdrawal] power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject to grantor of a trust to treatment as the owner thereof." The IRS has long treated the lapse of a withdrawal power, for this purpose, as a partial release or other modification. See, *e.g.*, PLRs 200747002 (Nov. 23, 2007); 200147044 (Nov. 23, 2001); 200104005 (Jan. 26, 2001); 200022035 (June 2, 2000); 200011058 (March 17, 2000), 200011054 - 200011056 (March 17, 2000).

Often, withdrawal powers are limited by the dollar amount of the annual exclusion, or lapse based on a specific dollar amount. Such powers bring into play Regulations section 1.671-3(a)(3), which states in applicable part:

> (3) If the portion of a trust treated as owned by a grantor or another person consists of an undivided fractional interest in the trust, or of an interest represented by a dollar amount, a pro rata share of each item of income, deduction, and credit is normally allocated to the portion. Thus, where the portion owned consists of an interest in or a right to an amount of corpus only, a fraction of each item (including items allocated to corpus, such as capital gains) is attributed to the portion. *The numerator of this fraction is the amount which is subject to the control of the grantor or other person and the denominator is normally the fair market*

> *value of the trust corpus at the beginning of the taxable year in question.* The share not treated as owned by the grantor or other person is governed by the provisions of subparts A through D.

The comparison between the numerator (the amount over which the withdrawal power lapsed) and the denominator (the value on the first day of each year) should almost certainly create a decreasing ownership percentage each year. The planning in PLR 200949012 likely avoided this issue in two ways. First, the general withdrawal right was not limited by the annual exclusion. Second, the lapse was likely to be limited by five percent of the trust fund, rather than $5,000, so that ownership under Section 678(a)(2) was not affected by this regulation.

B. **IRS Reviews Income Tax Treatment of Turning On Grantor Trust Status.** CCA 200923024 (June 5, 2009) stated that turning on grantor trust status may be abusive in certain cases, but it does not result in automatic recognition of gain on appreciated assets.

1. **Facts.** The Office of Chief Counsel examined transactions involving trusts created by a parent and three adult children who hold S corporation shares. Each taxpayer transferred their shares to a partnership, then formed an irrevocable nongrantor trust, funded with $100,000 in cash, and sold his or her partnership interest to his or her respective trust, in exchange for unsecured private annuities. The partnership made a Section 754 election and stepped up its inside basis of the S corporation stock to fair market value, and then sold all the shares in an initial public offering. The corporate trustee of the nongrantor trust was then terminated by an outside trust adviser, converting the trusts into grantor trusts under Section 674(b) and 674(c).

2. **No Gain Recognized.** The IRS Chief Counsel stated that the transactions were abusive, but rejected both arguments raised by the agent to tax them.

    a. **Not a Deemed Transfer.** First, the IRS stated that the conversion of a nongrantor trust into a grantor trust is not a deemed transfer for income tax purposes and that gain is not recognized on the transaction.

    b. **Private Annuities Not Debt.** Second, the IRS stated that private annuities are not debt obligations, and the grantors are not considered to have indirectly borrowed the trust property by

selling partnership interests to the trusts in exchange for unsecured private annuities, thus becoming the owners of the trusts under Section 675(3) and causing the sale to be disregarded for federal income tax purposes.

c. **Interesting Dictum.** The IRS Chief Counsel, in its analysis of the first issue, discussed Rev. Rul. 77-402, 1977-2 C.B. 222, Treas. Reg. § 1.1001-2(c), Ex. 5, and *Madorin v. Comm'r*, 84 T.C. 667 (1985), and then stated:

> The authorities cited only discuss the application of § 1001 to the party who is considered to have transferred ownership (the "transferor") of trust assets. Regulation 1.1001-2(c), Example 5, Madorin, and Rev. Rul. 77-402 are silent regarding the income tax consequences to the party who receives trust assets (the "transferee"), which in these examples was the nongrantor trust. We would also note that the rule set forth in these authorities is narrow, insofar as it only affects inter vivos lapses of grantor trust status, not that caused by the death of the owner which is generally not treated as an income tax event.

This is the most favorable statement that the IRS has made officially regarding the effect of the death of the grantor on encumbered assets held by an IGT.

The Chief Counsel also stated that the conversion of a nongrantor trust to a grantor trust is not typically a recognition event, and that to hold otherwise would tax many nonabusive transactions.

C. **IRS States that Assets in Intentional Grantor Trust Receive No Basis Increase at Grantor's Death.** In E.C.C. 200937028 (Sept. 11, 2009), the IRS stated that no basis increase is available on an intentional grantor trust when the grantor dies.

1. **IRS Statements.** In an e-mail response, an IRS attorney stated that they "strongly disagree" with the contention that the assets of an intentional grantor trust, which are not themselves included in the estate of a deceased grantor, receive a basis increase at the grantor's death. The taxpayer had transferred assets into an irrevocable trust and reserved the power to substitute assets under Section 675(4)(C), creating an intentional grantor trust. The IRS explained that Section 1014(b)(1)-(10) describes the circumstances under which property is

treated as having been acquired from the decedent for purposes of obtaining a date-of-death value basis. The IRS noted that, as the decedent transferred the property into trust, section 1014(b)(1) ("[p]roperty acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent") did not apply. The IRS stated that the decedent had not retained a right to revoke the trust or to receive the trust income (Section 1014(b)(2)) or to control the trust's beneficial enjoyment or to alter, amend, or terminate the trust (Section 1014(b)(3)). Also, none of the other provisions of Section 1014(b) described the situation of the taxpayer. The IRS quoted Treas. Regs. § 1.1014-1(a), which states:

> The purpose of section 1014 is, in general, to provide a basis for property acquired from a decedent which is equal to the value placed upon such property for purposes of the Federal estate tax. Accordingly, the general rule is that the basis of property acquired from a decedent is the fair market value of such property at the date of the decedent's death. . . . Property acquired from the decedent includes, principally, . . . property required to be included in determining the value of the decedent's gross estate under any provision of the [Internal Revenue Code.]

Based on these authorities, the IRS concluded that "it would seem that the general rule is that property transferred prior to death, even to a grantor trust, would not be subject to section 1014, unless the property is included in the gross estate for federal estate tax purposes as per section 1014(b)(9)."

2. **Contrary Argument.** It may be argued, however, that the assets of an IGT do receive a date-of-death value basis adjustment under Section 1014(b)(1), as property "in the hands of a person [the trust] acquiring the property from a decedent or to whom the property passed from a decedent." This would be the analysis most consistent with Rev. Rul. 85-13 and *Madorin*, which say that the grantor is deemed to own the trust assets for all income tax purposes, which should include determination of basis. See Blattmachr, Gans & Jacobson, "Income Tax Effects of Termination of Grantor Trust Status by Reason of the Grantor's Death," 96 J. Tax'n 149 (Sept. 2002). Unfortunately, a court may be reluctant to give a basis increase without a concomitant estate or income tax, and a practitioner must consider whether the basis increase is a position on which there is a more-than-50% chance of success.

D. **Grantor Recognizes Gain on Distribution of Assets to Satisfy Annuity Under Grantor-Owned Charitable Lead Trust.** In PLR 200920031 (May 15, 2009), the IRS stated that the use of appreciated property to satisfy the annuity obligation of a grantor charitable lead trust would result in recognition of gain.

1. **Facts.** Grantor created Trust and funded it with interests in a family-owned LLC. The trust is a CLAT that pays an annuity to Private Foundation for 20 years. The trustees of Trust wish to distribute appreciated securities to Private Foundation to satisfy the annuity obligation in Year. The trust instrument directs that the annuity will be paid from income, and to the extent that income is insufficient, from principal. Grantor reserved the nonfiduciary right to reacquire trust assets by substituting assets of equivalent value.

2. **Gain Recognized.** The IRS stated that the trust was deemed owned by Grantor, because of the substitution power. Code § 675(4)(C). Therefore, Grantor is deemed to own the assets of Trust for income tax purposes, and during the charitable lead annuity period is taxed on all income earned by Trust and receives no charitable income tax deduction for the annuity payments by Trust. Code § 170(f)(2)(B). The IRS noted that the distribution of appreciated property in satisfaction of the obligation to pay a fixed sum is a taxable disposition of the assets on which gain is recognized. *Kenan v. Comm'r*, 114 F.2d 217 (2d Cir. 1940); Rev. Rul. 83-75, 1983-1 C.B. 114. The satisfaction with appreciated property of a mere pledge, however, is not a recognition event. Rev. Rul. 55-410, 1955-1 C.B. 297. This rule, however, does not apply to distributions from a CLAT to satisfy its annuity obligation, because a pledge to a charity is not a debt, while a required annuity distribution is a debt. Therefore, in this case, Grantor recognizes gain on the use of appreciated securities by the trustees to make the annuity payments to Private Foundation as required by the terms of Trust.

3. **Utility of CLTs.** The grantor charitable lead trust is a useful estate planning tool, because it allows the transfer of substantial amounts of wealth with little or no gift tax liability. Three key points that should be noted are that the trust can run for any length of term, unlike the charitable remainder trust, which is limited to a 20-year term. Secondly, the annuity payments may vary in size, as long as the value of the annuity remains ascertainable. Therefore, one could create a charitable lead trust to continue for 40 years and to pay an annuity that increases by 150% per annum. Such an arrangement results in very low payments in the first 20-30 years, and very large payments in the later years, which enables the trustees to increase the size of

the fund before the annuity payments become too significant. This, in turn, reduces the wealth transfer risk inherent in a market drop in the early years of the trust. Third, the grantor charitable lead annuity trust may be a particularly good offset for the income in a year in which the grantor converts an ordinary IRA into a Roth IRA.

SELECTED ATTACHMENTS

PLEASE NOTE

THESE ATTACHMENTS INCLUDE SEVERAL FORMS INSPIRED BY SPECIFIC CASES OR RULINGS. THESE FORMS ARE THESE ARE NOT THE ACTUAL DOCUMENTS ON WHICH THE IRS OR COURT OPINED. THEY ARE MY INTERPRETATION BASED ON THE RULINGS OR CASES CITED, OR OF TECHNIQUES THAT MAY ADDRESS PROBLEMS RAISED BY THESE CASES OR RULINGS.

THESE FORMS HAVE NOT BEEN SUBMITTED TO OR APPROVED BY THE IRS OR ANY OTHER AGENCY OR COURT, AND THEY MAY CONTAIN PROVISIONS WITH WHICH VARIOUS IRS AGENTS AND ATTORNEYS MAY NOT AGREE.

USE YOUR INDEPENDENT JUDGMENT -- NEITHER THE AUTHOR NOR THE CONFERENCE SPONSOR CAN TAKE ANY RESPONSIBILITY WHATSOEVER FOR THE INDIVIDUAL USE OF THESE SAMPLE DOCUMENTS.

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1. Family Limited Partnership/Limited Liability Company Checklist

PLANNING AND DRAFTING

- **Create Partnership in a Good State.** Assure that the state whose law governs the partnership provides, as default rules:

  - No requirement that the partnership certificate state the time at which the limited partnership is to be dissolved;

  - Partnership does not terminate upon the withdrawal or death of a general partner (usually if there is another general partner or if a majority of the limited partners elect to continue the business);

  - Majority of the limited partners cannot remove the general partner and indirectly effect the dissolution of the partnership;

  - Transferee of a partnership interest becomes only an assignee, rather than a partner, without the vote of the remaining partners; and

  - A withdrawing partner is not entitled to his or her capital account. Often, the withdrawing partner is entitled to "fair value," but this should be based his or her right to share in reasonably anticipated future distributions from the continuing entity. Alternatively, state law may ont permit a partner to withdraw without the consent of the other partners. The Tax Court and Fifth Circuit have held that a right to withdraw is not a right to liquidate under Section 2704(b), but it is just as well that the partners have no specific right to withdraw.

- **Have and Document Nontax Purposes.** Carefully document in the agreement or collateral instruments or letters the various nontax purposes for which the partnership is created. Among the nontax purposes that the courts may accept are:

  - Avoiding likely creditors, such as spouses of children, if there is a realistic basis for worrying about creditor claims, such as prior divorces by some of the children;

  - Assuring the continued management of assets according to a specific and definite investment philosophy, whether or not it is one that the donor espouses. This may also be combined with teaching this philosophy to the various family members;

- Forcing the children to work together to manage key family assets, but the children must then actually work together to manage these assets;

- Dividing key assets among children through the use of separate partnerships, to reduce family discord; and

- Consolidating assets of various family members (or dividing interests in gifts from donor among various family members) to facilitate purchase of investments with minimum entry costs, such as hedge funds that require that the investors have at least $10 million in net worth, though it is important to show that there were actual purchases of such investments or that they were under serious consideration.

○ **Consider Annual Exclusion.** Avoid undue restrictions on transfer, or give a donee partner the right to withdraw up to the annual exclusion from the partnership at the time of the gift, to assure that such gifts qualify for the gift tax annual exclusion.

○ **Create Partnership ASAP.** The partnership should be created and funded while the donor is in good health and as young as practicable. Once the donor is terminally ill, the chances of the partnership being respected for tax purposes drops precipitously.

○ **Fund Partnership with Active Management Assets.** Fund the partnership with assets that require active management, though favorable cases do exist regarding partnerships that hold solely passive assets.

○ **Do Not Fund Partnership with Personal Use Assets.** Do not transfer personal use assets to the partnership, even if the donor then leases them from the partnership. This includes, among other things, the donor's residences.

○ **Donor Should Not Control Partnership Distributions.** The donor should not be the general partner, if possible. Family members or trusts to whom the client wishes to pass the bulk of the partnership assets should themselves be general partners and participate in the operations of the enterprises. There are several ways to limit or avoid control by the donor of the partnership distributions.

- A corporate or LLC general partner could be named in which the donor has only a minority interest;

- You can have two classes of general partnership interests, one of which has control over distributions, and the other which manages the partnership assets. The donor can then transfer the former, retaining the latter; and

- The partnership can prohibit all distributions during the donor's lifetime.

- **Each Partner Should Have Separate Representation.** All prospective partners should be represented by legal and financial counsel and should have input into the terms of the governing instruments.

- **Avoid Participation Via Powers of Attorney.** Consider a provision that precludes voting for a general partner through a power of attorney.

- **Assure that Significant Interests Are Held by Others.** Give or sell significant limited partnership interests to others, particularly including trusts with independent trustees. The retention of 99% of the partnership interests will encourage a court to ignore the transaction.

- **Assure that Limited Partners Pay for Their Interests**. Limited partners should pay for their partnership interests with their own assets. If they do not have assets, the donors should make gifts and let the gifts gather some age, before creating the partnership.

- **Reserve Adequate Assets.** Never put too much of the donor's wealth in the partnerships; the donors should retain enough assets on which to live comfortably and pay any expected estate taxes or claims. The donor should retain sufficient liquid assets, as well as sufficient wealth. It is not a bad idea if the other family member partners only contribute excess assets, too.

- **Have A Charitable Partner.** Consider giving at least a 1% interest to a charity or other unrelated person, to make it impossible for the family to remove any restrictions on liquidation in the agreement.

- **Use Independent Trustees.** Ech trust that holds a partnership interest should have an independent trustee.

- **Use Good Timing to Avoid Step Transaction and Indirect Gift Doctrines.**

  - **Do Not Plan Specific Gifts at Start of Transaction.** The attorney and client should not make definite plans to make gifts until they have formed the partnership and obtained an independent professional appraisal of the value of the limited partnership interests. Only then will they have enough financial data to make intelligent gift plans.

  - **Form the Entity in a No-Gift Situation.** The client should first form the partnership in a non-gift environment, such as having the client and his or her U.S. spouse as the only initial owners, or having the client and a controlled corporation as the only initial owners. Similarly, you can form the entity by having each prospective partner contribute a proportionate share of the nominal initial consideration. Thus, any constructive gifts would not produce a gift tax.

- **Do All Paperwork to Form Entity.** Make sure that the client signs the partnership agreement and that the partnership certificate is promptly filed. The client (and spouse, if relevant) should then transfer to the entity whatever assets they want the entity to hold.

- **Reflect the Transfers in the Donor's Capital Account.** The contributions to the partnership must be reflected in the donor's capital account. This will mean that the donor has a substantial increase in his or her (or their) proportionate partnership interest. Assure that capital accounts determine distributions on liquidation or termination.

- **Get Appraisal.** Next, obtain the best professional appraisal the client can afford. The appraiser makes an independent judgment, and the amount of gifts (or the existence of gifts at all) depends upon the judgment of the appraiser. This usually puts at least several weeks between the formation and funding of the entity and any gifts. Two or three months is even better.

- **Then Make Transfers.** Once you have an appraisal, and a reasonable time has passed, meet with the client and decide whether gifts will be made, to whom they will be made and the amount of the gifts. Execute a document of transfer and make all necessary amendments to the partnership or operating agreement, including any required waivers of buy-sell restrictions.

- **Adjust Capital Accounts.** Reduce the capital accounts of the donor and transfer the capital to the donees.

○ **File a Timely Gift Tax Return.** File the gift tax return and, where appropriate, allocate GST exemption.

ADMINISTRATION

○ **Have Partnership (or GP) Stationery.** The partnership should have stationery that identifies precisely who the general partners are, to assure that the general partner never acts in a different capacity.

○ **Have Partnership Bank and Security Accounts.** The partnership must have its own bank and securities accounts, accessible only by the general partners.

○ **Hold Regular Partners' Meetings.** The general partners should meet at least quarterly to discuss partnership activities. If possible, the attorney or paralegal should be present.

- **Keep Good Records.** The general partners should keep books of account and detailed records of their decisions and activities.

- **Inform Limited Partners.** The general partners should send copies of the minutes of the partnership meetings to the limited partners.

- **Avoid Commingling.** Never, never commingle partnership and personal assets.

- **Avoid Paying Personal Expenses.** Never, never pay personal expenses from the partnership assets, even if capital account adjustments are made.

- **Avoid Paying Estate Expenses.** Generally, the partnership should not pay estate expenses for the principal partner.

- **Avoid Non-*Pro Rata* Distributions.** Generally, the partnership should avoid making non-*pro rata* distributions.

- **Avoid Loans to the Donor or Donor's Estate.** Generally, the partnership should not make loans to the principal partner or his or her estate.

- **Do Not Unwind Partnership (Even Partially) After Donor's Death.** The partnership should not be unwound or make large distributions after the death of the donor partner.

2. Family Limited Partnership Agreement Giving Donee Limited Partners Full Right to Sell their Interests (Subject to a Right of First Refusal) and 30-Day Put RIght -- Gifts of Limited Partnership Interests Should Qualify for the Gift Tax Annual Exclusion Under *Price v. Comm'r*, T.C. Memo. 2010-2 (Jan. 4, 2010) and *Hackl v. Comm'r*, 118 T.C. 279 (2002), *aff'd*, 335 F.3d 664 (7th Cir.2003) -- Formed Under 2001 Revised Uniform Limited Partnership Act – Corporate General Partner Limits Lapse of Liquidation Rights[1]

Limited Partnership Agreement

On [date], *GeneralPartner*, of [locality, state] (the general partner, defined below) and *LimitedPartner1*, of [locality, state] , and *LimitedPartner2*, of [locality, state] (together the limited partners and individually a limited partner, defined below), agreed to form this limited partnership (the partnership, defined below).

Recitals

A. The partners (defined below) desire to enter into this agreement (the agreement, defined below) to establish a limited partnership to own certain property and transact certain business;

B. The partners desire to share in the risks, benefits, profits, and losses of the partnership's activities;

C. The partners desire that any gift of a partnership interest and any gratuitous addition to a partner's capital account qualify for the federal gift tax annual exclusion by providing the donee partner with a substantial and immediate present economic benefit;

D. The partners desire that *GeneralPartner* be the sole general partner and that all other partners be limited partners.

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[1] KEY:

GeneralPartner	-	Full name of general partner
Partner1	-	Full name of first limited partner
Partner2	-	Full name of second limited partner
Name	-	Full Name of the partnership
Agent	-	Full name of registered agent
State	-	State in which the partnership is formed

Agreements

Section 1. Name

The Partnership's name is *Name*.

Section 2. Place of business and agent

2.1 Place of business. The partnership's principal place of business is at [full street address], but the general partner may change the partnership's principal place of business to another location and add additional places of business.

2.2 Agent. The partnership's agent for service of process shall be *Agent*, of [address]. All records that the partnership is required to keep at a specified office shall be kept at its principal place of business.

Section 3. Business

The partnership is formed to own and manage certain real and personal property as the general partner may buy for the partnership, and to conduct any other legal business.

Section 4. Term

4.1 Initial term. The partnership begins on the date of the agreement and ends on December 31, 2052, unless terminated earlier.

4.2 Extension. The partnership may be continued beyond its scheduled termination date by an affirmative vote of all of the then-remaining partners.

Section 5. Capital and Partnership Interests

5.1 Partnership Interests. Each partner's partnership interest (defined below) and each partner's percentage of the total partnership capital accounts (defined below) shall be set forth in a schedule to the agreement [omitted form this exemplar]. A partner’s percentage of partnership interest shall always be the same as his, her, or its percentage of the total partnership capital accounts, and a change in a partner’s percentage of the total partnership capital accounts shall automatically be reflected in the partner’s percentage of partnership interest.

5.2 Additions. A partner shall not be compelled to make any additional capital contributions.

5.3 Adjustments. Each partner's capital account shall be adjusted as necessary to reflect the economic conditions of the partners and their partnership interests. These adjustments shall include, but are not limited to, the following:

5.3.1 Adjustments to reflect each partner's distributive share of partnership profits and losses, including capital gains and losses, and tax-exempt income;

5.3.2 Adjustments to reflect each partner's additional contributions to the partnership;

5.3.3 Adjustments to reflect distributions made by the partnership to each partner;

5.3.4 Tax-sensitive adjustments (defined below).

5.4 Loans. A partner's loans to the partnership shall not be added to that partner's capital account.

5.5 Amount of contributions. The amount of a partner's contributions of property to the partnership and of the partnership's distributions of property to a partner shall be reflected in the partner's capital account at the fair market value of the property on the date of the contribution or distribution, reduced by any liabilities secured by that property, if those liabilities are treated under applicable federal income tax laws as being assumed by or taken subject to by the transferee.

5.6 No Interest Paid. A partner shall receive no interest on his, her, or its capital contributions or partnership interest.

5.7 Withdrawals. A partner may not withdraw any of his, her, or its capital account, except as provided in Section 5.8.

5.8 Put Right. For sixty (60) days immediately following any partnership interest gift (defined below), the donee-partner (defined below), shall have the put right (defined below), set forth in this Section 5.8.

5.8.1 This put right entitles a donee-partner to require that the partnership buy the interest or capital account addition that was the subject of the partnership interest gift.

5.8.2 Each donee-partner may exercise this put right by a writing delivered to the general partner. The put right may be exercised on behalf of a donee-partner who is unable to exercise this right because of a legal disability (including minority), by a legally authorized guardian or other personal representative. If the disabled donee-partner has no then-serving personal. representative, the general partner shall appoint an appropriate adult individual to act for the disabled donee-partner in this matter.

5.8.3 The general partner must, immediately following a partnership interest gift, promptly and reasonably notify the donee-partner or other person who would exercise

the put right of the existence of this right, and the date, existence, and amount of the partnership interest gift.

5.8.4 The maximum amount that a donee-partner may require the partnership to buy under this put right, with respect to partnership interest gifts by the same donor in the same calendar year, shall be the lesser of: (a) the total amount of the partnership interest gifts to the donee-partner from the same donor, valued as for federal gift tax purposes; and (b) the amount of the federal gift tax annual exclusion in effect on the date of the earliest partnership interest gift by the same donor during the calendar year (or twice that amount if the donor of the partnership interest gift is married to a U.S. citizen on the date of the gift).

5.8.5 The price that the partnership shall pay for a partnership interest or capital account addition under this Section 5.8 shall be the fair market value of that interest or addition, as determined for federal gift tax purposes.

5.8.6 For purposes of this Section 5.8, the following definitions shall apply:

(A) A "partnership interest gift" is any gratuitous transfer of a unit of partnership interest or gratuitous addition to a partner's capital account.

(B) A "donee-partner" is a partner to whom a partnership interest gift is made.

(C) A "put right" is the right of a donee-partner under this Section 5.8 to compel the partnership to buy the transferred partnership interest or gratuitous capital account addition.

Section 6. Profits, Losses, and Cash Flow

6.1 Profits and Losses. The partnership's net profits and losses (and each item of income, deduction, gain, loss, and credit that makes up net profits and losses) shall be computed in accordance with generally accepted accounting principles, consistently applied, and shall be allocated among the partners in proportion to their partnership interests.

6.1.1 Notwithstanding the general rule stated in Section 6.1., any income, gain, loss, and deduction with respect to property contributed to the partnership by a partner shall be shared among the partners so as to take account of any variation between the basis and the fair market value of the contributed property at the time of the contribution, in accordance with any applicable U.S. Treasury regulations.

6.1.2 There shall be an income offset (defined below), under which net losses that would otherwise be allocated to a limited partner and that would cause the limited partner's capital account to be in deficit shall instead be allocated to the general

partner. After such an allocation of net losses, net profits shall be allocated to the general partner, until the general partner shall have received an allocation of net profits equal to the aggregate allocation of net losses allocated under this paragraph.

6.1.3 Profits and losses shall, whenever a partner is dissociated (defined below) from the partnership be allocated among the partners based on the number of days (defined below) in that year during which each partner owned a partnership interest, or on any other reasonable basis selected by the managing general partner, consistent with applicable United States tax laws and regulations.

6.2 Cash Flow. The general partner shall cause the partnership to distribute its net cash flow (defined below) to the partners annually, in proportion to their partnership interests.

Section 7. Management

7.1 General Partner. The general partner shall have the full and exclusive power on the partnership's behalf to manage its business and affairs and to do or cause to be done anything deemed necessary or appropriate for the partnership's business. This authority includes, but is not limited to, the following:

7.1.1 The general partner may sell real or personal property to any person, giving any warranties or assurances deemed appropriate;

7.1.2 The general partner may buy, lease, or otherwise acquire real or personal property to carry on and conduct the partnership's business;

7.1.3 The general partner may borrow money for the partnership's business;

7.1.4 The general partner may issue promissory notes and other debt instruments (negotiable or nonnegotiable), in any amounts and secured by any encumbrance on all or any part of the partnership's assets;

7.1.5 The general partner may assign any debts owing to the partnership;

7.1.6 The general partner may engage in any other means of financing;

7.1.7 The general partner may enter into any agreement for sharing of profits and any joint venture agreement with any person or entity engaging in any business or venture in which this partnership may engage;

7.1.8 The general partner may manage, administer, conserve, improve, develop, operate, lease, utilize, and defend the partnership's assets, directly or through third parties;

7.1.9 The general partner may execute any type of agreement or instrument in connection with any other partnership power;

7.1.10 The general partner may employ all types of agents and employees (including lawyers and accountants), even if they are related by blood, marriage, or business relationship to the general partner, and pay them reasonable compensation;

7.1.11 The general partner may buy or otherwise obtain the use of any type of equipment or other property that may be convenient or advisable in connection with any partnership business;

7.1.12 The general partner may incur any reasonable expense for travel, telephone, telegraph, insurance, taxes, and such other things, in carrying on the partnership's business;

7.1.13 The general partner may sue and be sued, complain and defend in the partnership's name and on its behalf; and

7.1.14 The general partner may quitclaim, release, or abandon any partnership assets with or without consideration.

7.2 Multiple General Partners. Multiple general partners shall act by unanimous agreement.

7.3 Compensation and Expenses. Each general partner shall receive reasonable compensation for management of the partnership, and all reasonable expenses incurred by the general partner in managing and conducting the partnership's business, including (but not limited to) overhead, administrative and travel expenses, and such professional, technical, and other services, shall be reimbursed by the partnership.

7.4 Limited Partners. A limited partner (other than one who is also a general partner) shall take no part in the management of the partnership, except to the extent expressly provided by applicable state law.

7.5 Tax Matters Partner. *GeneralPartner* shall be the tax matters partner and, as such, shall be solely responsible for representing the partnership in all dealings with the U.S. Internal Revenue Service and any state, local, and any foreign tax authorities. The tax matters partner shall keep the other partners reasonably informed of any partnership dealings with any tax agency.

Section 8. Financial statements

Within a reasonable period after the close of each fiscal year, the general partner shall, at the partnership's expense, give a written report to each partner who requests it, indicating that partner's share of the partnership income or loss and any changes in that

partner's capital account. This requirement may be satisfied by giving each partner a copy of any tax form which includes such information.

Section 9. Banking

All partnership funds shall be deposited in the partnership's name in such accounts as the general partner may designate. The general partner may authorize other persons to draw checks on partnership bank accounts, but such authority must be in writing. Each bank in which a partnership account is maintained is relieved of any responsibility to inquire into a partner's authority to deal with such funds, and is absolved of all liability with respect to withdrawals from such partnership accounts by any person duly authorized by the general partner.

Section 10. Admission, Expulsion, and Transferees

10.1 Admission. A person may be admitted as an additional partner by the unanimous vote of the other partners, and the new partner's consent in writing to be bound by the agreement.

10.2 Expulsion. Any partner may be expelled from the partnership on the unanimous decision of the other partners. The partnership must pay an expelled partner an amount equal to the fair market value of his, her, or its partnership interest. The fair market value of an expelled partner's partnership interest shall be determined by an independent appraisal performed by a professional appraiser selected by the partnership whose decision in this matter shall be conclusive.

10.3 Transferable Interest. A partner's only transferable interest in the partnership is his, her, or its share of the profits and losses of the partnership and his, her, or its right to receive distributions.

10.3.1 A partner's transfer (defined below) of his, her, or its transferable interest in the partnership shall not, by itself, cause the partner's dissociation or a dissolution of the partnership.

10.3.2 A person to whom a partner attempts to transfer his, her, or its partnership interest, and to whom a partner does transfer his, her, or its transferable interest in the partnership, shall not become a partner unless admitted into the partnership pursuant to Section 10.1. A transferee of a partner's transferable interest in the partnership shall not be entitled to participate in the management or conduct of the partnership business, to require access to information concerning partnership transactions, or to inspect or copy the partnership books or records, unless admitted into the partnership pursuant to Section 10.1.

Section 11. Transfer of Partnership Interests

A partner shall not transfer any of his, her, or its transferable interest in the partnership except in accordance with the terms of this Section 11. An attempted transfer of any transferable interest in the partnership not in accordance with the terms of this Section11 shall not be valid and shall not be reflected on the partnership's books.

11.1 Right of First Refusal. A partner who wishes to transfer any transferable interest in the partnership, or who has reason to believe that an involuntary transfer (defined below) or a transfer by operation of law is reasonably foreseeable (an offering partner), shall first give each other partner written notice of the intent to transfer such transferable interest in the partnership (the offered interest) or of the knowledge that an involuntary transfer or transfer by operation of law is reasonably foreseeable. This notice must contain a description of the portion of interest in the partnership to be transferred, the consideration (if any) to be paid, the terms of transfer and of the payment of consideration (including, but not limited to, the relative percentages of cash and debt, and the terms of any debt instruments), and the name, address (both home and office), and business or occupation of the person to whom the transferable interest in the partnership would be transferred, and any other facts that are or would reasonably be deemed material to the proposed transfer.

11.1.1 Upon the receipt of such notice, each other partner shall have a right to buy that share of the offered interest having the same proportion to all of the offering partner's partnership interest as the buying partner's partnership interest bears to the partnership interests of all partners (except the offering partner).

11.1.2 Each partner may exercise this purchase option by giving the offering partner written notice within thirty (30) days after receipt of the latter's notice.

11.1.3 If the partners do not agree to buy all of the offered interest, the offering partner may complete the intended transfer. If this transfer is not completed within thirty (30) days after expiration of the option period, any attempted transfer shall be deemed pursuant to a new offer and this Section 11 shall again apply.

11.2 Purchase Price. The purchase price that the partners must pay for the offered interest under this Section 11 shall be the same as those of any proposed transfer if the proposed transfer for which notice was given is to be made for any valuable consideration in money or money's worth of property. Otherwise, the purchase price that the partners must pay for the offered interest under this Section 11 shall be the fair market value of the offered interest. The fair market value of a partnership interest shall be determined by an independent appraisal performed by a professional appraiser, selected by the general partner, whose decision in this matter shall be conclusive.

11.3 Purchase Terms. One quarter (1/4) of the purchase price shall be paid in cash or by good personal check at the closing for the sale of such partnership interest, and

the balance shall be paid in twenty (20) equal quarterly principal payments beginning three (3) months after the date of such closing. Simple interest shall be added to each installment, computed against the outstanding principal balance at the applicable federal rate determined for federal income tax purposes on the date of the closing. The buyer shall give the offering partner a promissory note as evidence of this debt, and the buyer may prepay all or any part of the principal balance of the note at any time without penalty or premium.

11.4 The Closing. The purchase of a transferable interest in the partnership under this Section 11 shall take place at a closing to be held not later than the tenth (10th) day after the earlier of the date on which the partners' purchase options have all expired, or the earliest date on which the partners in the aggregate exercise their purchase options, if any, to buy all of the offered interest. The closing shall be held during normal business hours at the partnership's principal business office, or at any other place to which the parties agree. If the offering partner is not present at the closing, then the buyer shall deposit the purchase price by check, note, or both, as this Section 11 requires, with any state or federally chartered bank with which the partnership has an account, as escrow agent, to be paid to the offering partner as soon as is reasonably practicable, less an appropriate fee to the partnership (not to exceed one thousand dollars) to cover additional administrative costs, and the partnership shall adjust its books to reflect the transfer of these transferable interest in the partnership.

11.5 Condition Precedent to Admission of Substitute Partner. No person to whom an interest in the partnership is transferred shall become a new partner in place of the offering partner until:

11.5.1 The transferee agrees in writing to assume all of the obligations and undertakings of the offering partner under the agreement;

11.5.2 The transferee pays the partnership a fee not to exceed one thousand dollars ($1,000.00) to cover the costs of preparing, executing, and recording all pertinent documents; and

11.5.3 The transferee is elected a partner by a unanimous vote of the other partners.

Section 12. Dissociation

12.1 Dissociation as Limited Partner. A limited partner who dissociates from the partnership shall have no further rights as a limited partner, and shall own his, her, or its interest as a transferee, and not as a partner.

12.2 Dissociation Events. A general or limited partner shall be dissociated from the partnership if any of the following events shall occur.

12.2.1 The partner notifies the partnership of his, her, or its intention to withdraw as a partner.

12.2.2 The partner is expelled from the partnership.

12.2.3 The partner, if a trust or if acting as a partner by virtue of being a trustee of a trust, distributes the trust's entire transferable interest in the partnership.

12.2.4 The partner, if an estate or if acting as a partner by virtue of being a personal representative of an estate, distributes the estate's entire transferable interest in the partnership.

12.2.5 The partner's termination, if the partner is not an individual, partnership, corporation, trust, or estate.

12.3 Dissociation by a General Partner. A general partner may dissociate as a general partner at any time, rightfully or wrongfully.

12.3.1 A general partner who dissociates from the partnership shall have no right to participate as a general partner in the management and conduct of the partnership's activities and shall own his, her, or its interest as a transferee, and not as a partner.

12.3.2 In addition to the provisions of Section 12.2, a general partner also dissociates from the partnership if:

(A) The partner dies, has appointed a guardian or general conservator, or is the subject of a judicial determination that the partner has otherwise become incapable of performing the partner's duties under the partnership agreement.

(B) The partner becomes a debtor in bankruptcy, executes an assignment for the benefit of creditors, seeks, consents to, or acquiesces in the appointment of a trustee, receiver, or liquidator of that partner or of all or substantially all of that partner's property.

(C) The partner fails, within ninety (90) days after the appointment, to have vacated or stayed the appointment of a trustee, receiver, or liquidator of the partner or of all or substantially all of the partner's property obtained without the partner's consent or acquiescence, or fails within ninety (90) days after the expiration of a stay to have the appointment vacated.

12.3 Wrongful Dissociation.

12.3.1 A limited partner's dissociation from the partnership before December 31, 2050, or such earlier date as the partnership shall otherwise terminate, shall be a wrongful dissociation.

12.3.2 A general partner's dissociation is wrongful if it occurs before December 31, 2050, or such earlier date as the partners shall elect to terminate the partnership, and the general partner dissociates by voluntary withdrawal, by expulsion by judicial order, or pursuant to Sections 12.3.2 or 12.3.3, or 12.2.5.

12.3.2 A partner who wrongfully dissociates is liable to the partnership and to the other partners for damages caused by the dissociation. The liability is in addition to any other obligation of the partner to the partnership or to the other partners.

Section 13. Dissolution

13.1 Dissolution. The partnership shall be dissolved upon the expiration of its stated term, the written vote of all of the partners, or the happening of any of the following:

13.1.1 The consent of all of the general partners and of limited partners owning a majority of the rights to receive distributions as limited partners;

13.1.2 After the dissociation of a person as a general partner, except that if the partnership then has at least one remaining general partner, the partnership shall be dissolved only with the consent of the owners of a majority of the rights to receive distributions at the time the consent is to be effective, such consent to be given within ninety (90) days after the dissociation;

13.1.3 After the dissociation of a person as a general partner, except that if the partnership then has no remaining general partners, the partnership shall be dissolved unless, within ninety (90) days after the dissociation, the limited partners holding a majority of the rights to receive distributions at the time the consent is to be effective, vote to continue the partnership and to elect a new general partner, and a new general partner is, in fact, admitted;

13.1.4 Ninety (90) days after the dissociation of the limited partnership’s last limited partner, unless before the end of this period the partnership admits at least one limited partner; or

13.1.5 The Secretary of State signs a declaration of dissolution.

13.2 Upon Dissolution. Upon its dissolution, the partnership shall end and commence to wind up its affairs. The partners shall continue to share in profits and losses during liquidation as they did before dissolution. The partnership's assets may be sold, if a price deemed reasonable by the managing general partner can be obtained. The proceeds from liquidation of partnership assets shall be applied as follows:

13.2.1 First, all of the partnership's debts and liabilities to persons other than partners shall be paid and discharged in the order of priority as provided by law;

13.2.2 Second, all debts and liabilities to partners shall be paid and discharged in the order of priority as provided by law;

13.2.3 Third, all remaining assets shall be distributed proportionately among the partners based on their respective positive capital accounts.

13.3 Gain or Loss. Any gain or loss on the disposition of partnership properties in the process of liquidation shall be credited or charged to the partners in proportion to their positive capital accounts, except that gain or loss with respect to property contributed to the partnership by a partner shall be shared among the partners so as to take account of any variation between the basis of the property so contributed and its fair market value at the time of contribution, in accordance with any applicable U.S. Treasury regulations. Any property distributed in kind in the liquidation shall be valued and treated as though it were sold and the cash proceeds distributed. The difference between the value of property distributed in kind and its book value shall be treated as a gain or loss on the sale of property, and shall be credited or charged to the partners accordingly.

13.4 Partnership Assets Sole Source. The partners shall look solely to the partnership's assets for the payment of any debts or liabilities owed by the partnership to the partners and for the return of their capital contributions and liquidation amounts. If the partnership property remaining after the payment or discharge of all of its debts and liabilities to persons other than partners is insufficient to return the partners' capital contributions, they shall have no recourse therefor against the partnership or any other partners, except to the extent that such other partners may have outstanding debts or obligations owing to the partnership.

Section 14. Amendments

The agreement shall be amended automatically to reflect any valid transfers of partnership interests. Otherwise, the agreement shall be amended only with the unanimous consent of the partners.

Section 15. Power of Attorney

15.1 General. Each limited partner names the general partner as the limited partner's attorney-in-fact, and gives the general partner full power and authority, in the place of the limited partner, to file and record any written instruments that are necessary or appropriate to: (a) amend the certificate of partnership; (b) satisfy requirements of the laws of any state in which the partnership is doing business; (c) continue the partnership, admit additional or substituted partners, dissolve or terminate the partnership or any interest in it; (d) obtain or settle any loan; and (e) transfer any partnership assets.

15.2 Power with an Interest. The power of attorney granted under this Section 15 is coupled with an interest, is irrevocable, and survives the Limited partner's incompetency. The general partner may exercise this power of attorney by a facsimile signature or by

listing all of the limited partners with the signature of the general partner as the attorney-in-fact for all of them. This power of attorney survives the assignment of a limited partner's interest, and empowers each general partner to act to the same extent for any successor limited partner.

Section 16. Miscellaneous

16.1 Notices. Any notice under the agreement shall be given and served either by personal delivery to the party to whom it is directed, or by registered or certified mail, postage and charges prepaid, and if it is sent to a partner, it shall be addressed with his, her, or its address as it appears on the records of the partnership.

16.1.1 Any notice shall be deemed given when it is personally delivered, or, if mailed, on the date it is postmarked by the United States Postal Service, if it was addressed as required in this Section 16.

16.1.2 Any partner may change his, her, or its address for purposes of the agreement by written notice to a general partner, stating his, her, or its new address. A change of address shall be effective fifteen (15) days after the notice is received by a general partner.

16.2 Non-waiver. Any party's failure to seek redress for violation of or to insist upon the strict performance of any provision of the agreement shall not prevent a subsequent act, which would have originally constituted a violation, from having the effect of an original violation.

16.3 Severability. Every provision of the agreement is intended to be severable. If any term or provision hereof is invalid for any reason whatsoever, its invalidity shall not affect the validity of the remainder of the agreement.

16.4 Good Faith. The performance of any act, or the failure to perform any act, by a partner or the partnership, the effect of which causes any loss or damage to the partnership, shall not subject such partner or the partnership to any liability, if the decision to perform or not to perform the act was made pursuant to advice of the partnership's legal counsel or in good faith to promote the partnership's best interests.

16.5 Governing Law. The agreement is to be construed according to the laws of the state of *state*.

16.6 Cumulative Rights. The rights and remedies provided in the agreement are cumulative and the use of any right or remedy does not limit a party's right to use any or all other remedies. All rights and remedies in the agreement are in addition to any other legal rights the parties may have.

16.7 Other Activities. A partner may engage in whatever activities he or she chooses without any obligation to offer any interest in such activities to any party hereof.

16.8 Confidentiality. No partner may, without every general partner's express written consent, divulge to others any information not already known to the public pertinent to the services, clients, customers, or operations of the partnership, whether before or after the partnership's dissolution.

16.9 Counterparts. The agreement may be executed in any number of counterparts with the same effect as if all parties hereto had all signed the same document. All counterparts shall be construed together and shall constitute one (1) agreement.

16.10 Waiver of Partition. Each partner waives any right to maintain any action for partition with respect to the partnership's property or assets during the partnership's term.

16.11 Binding Terms. The terms of the agreement are binding upon and inure to the benefit of the parties and, to the extent permitted by the agreement, their heirs, executors, administrators, legal representatives, successors and assigns.

16.12 Personal Property. The interests of each partner in the partnership are personal property.

16.13 Gender and Number. Unless the context requires otherwise, the use of a masculine pronoun includes the feminine and the neuter, and vice versa, and the use of the singular includes the plural, and vice versa.

Section 17. Definitions

17.1 Agreement. The "agreement" is the agreement of *Name*, as amended from time to time. The agreement shall include all schedules, as they may be amended from time to time.

17.2 Capital Accounts. The "capital accounts" or "partnership capital" is the total of the partners' capital contributions, adjusted as provided in the agreement.

17.3 Certificate. The "certificate" is the certificate of limited partnership filed on behalf of the partnership, as amended from time to time.

17.4 Days. "Day" or "days" refers to a calendar day, including any days which fall on legal holidays or weekends.

17.5 General Partner. The "general partner" shall refer to *GeneralPartner*, and any additional or successor general partner.

17.6 Income Offset. The "income offset" shall be synonymous with and interpreted consistently with the "qualified income offset" defined in U.S. Treasury Regulations § 1.704-1(b)(2)(ii)(d), as amended.

17.7 Limited Partner. The "limited partner" or "limited parrtners" shall refer to *LimitedPartner1*, *LimitedPartner2*, and *Partner3*, and any persons who later become limited partners, each of whom is a limited partner.

17.8 Net Cash Flow. "Net cash flow" is the partnership's total net income, computed for federal income tax purposes, increased by any depreciation or depletion deductions taken into account in computing taxable income and any nontaxable income or receipts (other than capital contributions and the proceeds of any partnership borrowing); and reduced by any principal payments on any partnership debts, expenditures to acquire or improve partnership assets, any proceeds from the sale or exchange of partnership assets, and such reasonable reserves and additions thereto as the general partner shall determine to be advisable and in the best interests of the partnership, having due regard to the interests of the limited partners.

17.9 Partners. The "partners" or a "partner", when used without the words "general" or "limited," shall refer to both the general partners and the limited partners.

17.10 Partnership. The "partnership" refers to *Name*.

17.11 Partnership Capital. The "partnership capital" is the total of the partners' capital contributions, as adjusted pursuant to the agreement.

17.12 Partnership Interests. The "partnership interests" are the relative interests of the individual partners in the partnership, as listed on a schedule to the agreement.

17.13 Tax-Sensitive Adjustments. The "tax-sensitive adjustments" are all adjustments to a partner's capital account that are not specifically required under the terms of the agreement, but that are required by U.S. Treasury Regulations § 1.704-1(b)(2)(iv) ("Maintenance of Capital accounts"), as amended. Such adjustments shall be made annually, unless these regulations require a more frequent adjustment.

17.14 Transfer. A "transfer" of a partnership interest includes any sale, pledge, encumbrance, gift, bequest, or other transfer or disposition of the partnership interest or permitting it to be sold, encumbered, attached, or otherwise disposed of, or changing its ownership in any manner, whether voluntarily, involuntarily, or by operation of law. A "transfer" does not include any assignment of any partnership interest to another partner or to any trust that is entirely revocable by the assignor, but such trust shall be treated as the agent of the assignor, and any subsequent disposition of such partnership interest by such trust shall be deemed to have been made by the trust's settlor or grantor.

AGREED on the date first noted above.

[Signature and notarial clauses and schedule omitted from this exemplar]

3. Private Collateral Assignment, Non-Equity Split-Dollar Life Insurance Agreement (and Collateral Assignment) for Second-to-Die Life Insurance Policy – See PLR 200910002 (March 6, 2009)[2]

FAMILY SPLIT-DOLLAR AGREEMENT

THIS AGREEMENT IS MADE on [date], among *Insured-1* (*Insured-1-Short*), *Insured-2* (*Insured-2-Short*) and *Trustee*, Trustee of the *Insured* Irrevocable Trust, dated [date] (sometimes the "trustee" and the "trust").

RECITALS:

A. The trustee wishes to acquire certain insurance on the life of *Insured–1-Short* and *Insured-2-Short* (sometimes collectively the "insureds" or individually an "insured"), to be held as an asset of the trust; and

B. *Insured-1-Short* and *Insured-2-Short* wish to help provide this life insurance protection under a policy described in the exhibit to this agreement (the "policy"); and

C. *Insured-1-Short* and *Insured-2-Short* are willing to pay a portion of the premiums due on the policy on the terms and conditions described below.

AGREEMENTS:

NOW, THEREFORE, the parties to this agreement agree as follows:

1. Ownership of the Policy. The trust shall own the policy, subject to the terms of the agreement and the collateral assignment filed with the insurance company issuing

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[2] **KEY:**

Insured-1	--	Full name of the one of the two insured grantors of the trust
Insured-1-Short	--	Shorthand name for the first insured, such as "Howard", "Mr. Zaritsky" or "Skippy"
Insured-2	--	Full name of the other insured grantor of the trust
Insured-2-Short	--	Shorthand name for the second insured, such as "Martha", "Ms. Zaritsky" or "Sweetie"
Trustee	--	Full name of the initial trustee
Insurer	--	Full name of the company issuing the policy

the policy, *Insurer*, its successors and assigns (the "insurer"). The trustee shall possess and be able to exercise the incidents of ownership in the policy, subject to the rights of *Insured-1-Short* and *Insured-2-Short*, or the survivor, to recover the repayment amount (defined below), to the extent provided herein. The trustee may not exercise any right or incident over the policy in a manner that could defeat or impair the right of either of the insureds to recover the repayment amount.

2. Premiums. The trustee shall continue to own the policy and shall pay during the joint lives of the insureds an amount equal to the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. After the death of the first of the insureds to die, the trustee shall pay an amount equal to the lesser of: (a) the applicable amount provided in IRS Notice 2001-10, 2001-1 C.B. 549, or subsequent IRS guidance; or (b) the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. The trustee shall furnish *Insured-1-Short* and *Insured-2-Short*, or the survivor, with a statement of each premium due under the policy and of the amount that the trustee has paid or anticipates paying towards such premium, and prompt notice of any changes in these amounts. No fewer than ten (10) business days thereafter, *Insured-1-Short*, *Insured-2-Short*, or both of them, shall pay to the trust an amount equal to the balance of the premium due, after subtracting the amount payable by the trustee. The trustee shall timely pay each premium on the policy, and shall furnish *Insured-1-Short* and *Insured-2-Short*, or the survivor, timely evidence of these payments.

3. Collateral Assignment. The trustee shall, contemporaneously with the execution of this agreement, assign an interest in the policy to *Insured-Short* as collateral, to secure the repayment to *Insured-1-Short*, *Insured-2-Short*, or the survivor, of the repayment amount. The rights of *Insured-1-Short*, *Insured-2-Short*, or the survivor, under this collateral assignment shall be limited to the recovery of the repayment amount. The repayment amount shall be recovered from the policy's cash surrender value, if the agreement is terminated or the policy is surrendered or cancelled before the death of the surviving insured. Recovery of the repayment amount shall be made from the policy's death benefits if the surviving insured dies while the policy and this agreement are both in force. This collateral assignment shall not be terminated, altered or amended without the express written consent of both the trustee and both of the insureds (or the surviving insured).

4. Certain Rights in the Policy.

4.1 Right to Borrow. The trustee may not use the policy to secure a loan, whether from the insurer or a third-party, in a principal amount exceeding the difference between the cash surrender value of the policy and the repayment amount. Interest charges on any loans secured by the policy, whether they are loans from the insurer or a third party, shall be the responsibility of and shall be paid by the trustee, from assets other than the policy.

4.2 Right to Cancel. The trustee, without the consent of *Insured-1-Short* and *Insured-2-Short*, or the survivor, may surrender or cancel the policy and receive the cash surrender value from the insurer. The cash surrender value received when the policy is canceled shall be divided between the parties in accordance with the right to the repayment amount under this agreement.

5. Dividends. All dividends declared and paid on the policy shall be applied as the trustee shall deem appropriate.

6. Repayment Amount Defined. The repayment amount means the amount that shall be paid to *Insured-1-Short*, *Insured-2-Short*, or the survivor, if the policy is canceled or the agreement terminated during the joint or survivor lifetime of the insureds, or if it is held at the surviving insured's death. The repayment amount shall be the total amount that *Insured-1-Short* and *Insured-2-Short* have, in the aggregate, provided for premium payments or the cash surrender value of the policy, if that is greater and the policy is cancelled or the agreement terminated during the lifetime of either or both insureds.

7. Upon the Death of the Surviving Insured. Upon the death of the surviving insured, all actions shall be taken to obtain the death benefit provided under the policy. The surviving insured shall recover the repayment amount solely from the death benefits. The remaining death benefits under the policy shall be paid directly to the trustee in the amount and manner provided in the policy's beneficiary designation and settlement option provisions.

8. Termination. This agreement terminates, without notice, upon the occurrence of any of the following conditions.

8.1 Bankruptcy, Etc. This agreement terminates upon the bankruptcy or receivership of *Insured-Short*;

8.2 Death of the Surviving Insured. This agreement terminates upon the death of the surviving insured and the distribution of the death benefit as provided in this agreement;

8.3 Surrender of Policy. This agreement terminates upon the surrender of the policy for its cash surrender values and the distribution of the cash surrender value as provided in this agreement.

9. Overriding Intent. The parties intend to create what is commonly known as a split-dollar agreement, as described in Revenue Ruling 64-328 of the U.S. Internal Revenue Service, and all provisions of this agreement shall be construed so as to effect this intent.

10. Miscellaneous.

10.1 Nonassignability. The rights of the insureds under this agreement are not assignable.

10.2 Insurer Protected. The insurer shall be fully discharged from its obligations under the policy by payment of the policy's death benefit to the beneficiary named in the policy, subject to the policy's terms and conditions. In no event shall the Insurer be considered a party to this agreement. No provision of this agreement shall in any way be construed as enlarging, changing, varying, or in any other way affecting the Insurer's obligations as expressly provided in the policy or in the collateral assignment.

10.3 Binding Agreement. This agreement is binding on and enforceable by and against the parties, their successors, legal representatives, and assigns.

10.4 Integration. This instrument constitutes the parties' entire agreement with respect to this transaction, and supersedes any prior oral or written understandings or agreements. This agreement may be amended only in writing.

10.5 Governing Law. This agreement shall be governed by and construed according to the laws of [state].

10.6 Severability. No part of this agreement shall be affected if any other part of it is held invalid or unenforceable.

10.7 Notices. All notices required or permitted to be given under this agreement must be given in writing, and shall be deemed given when personally delivered or, if earlier, when received after mailing by registered or certified United States mail, postage prepaid, with return receipt requested.

10.8 Days Defined. Any reference in this agreement to "days" means all business days, excluding Saturdays, Sundays, and days that are legal holidays under the laws of the United States.

10.9 Waiver. Any party's failure to insist on compliance or enforcement of any provision of this agreement shall not affect its validity or enforceability or constitute a waiver of future enforcement of that provision or of any other provision of this agreement.

10.10 Tax-Related Terms. Any references to the "Internal Revenue Code" are to the Internal Revenue Code of 1986, as amended, and all tax-related terms shall have the same meaning that they have in that Code.

10.11 Copies. More than one (1) copy of this agreement may be executed and all parties agree and acknowledge that each executed copy shall be a duplicate original.

10.12 Gender and Number. Whenever the context of this agreement requires, the masculine gender includes the feminine and neuter, and the singular number includes the plural and *vice versa*.

[Signatures, notary clauses, and schedule]

COLLATERAL ASSIGNMENT OF LIFE INSURANCE POLICY

This assignment is made by the undersigned policy owner effective on [date].

RECITALS:

A. *Trustee*, Trustee of the *Insured* Irrevocable Trust, dated [date] (sometimes the "trustee" and the "trust"), wishes to acquire a policy of insurance on the life of *Insured-1* (sometimes referred to as *Insured-1-Short*) and *Insured-2* (sometimes referred to as *Insured-2-Short*); and

B. *Insured-1-Short* and *Insured-2-Short* have agreed to finance the payment of premiums on this policy of life insurance (the "policy"); and

C. *Trustee* is the owner of the policy and, as such, possesses all of the incidents of ownership in and to the policy; and

D. *Insured-1-Short* and *Insured-2-Short* wish to have the policy collaterally assigned to it by *Trustee*, in order to secure the repayment of the amounts the insureds will pay towards the premiums on the policy, under which the insureds shall receive only the right to such repayment, with *Trustee* retaining all other incidents of ownership and other rights in the policy.

AGREEMENTS:

NOW, THEREFORE, in consideration of the mutual promises contained in this agreement, the parties agree as follows:

1. Assignment. *Trustee* hereby assigns, transfers, and sets over to *Insured-1-Short* and *Insured-2-Short*, the right to realize against the policy, to the extent of their interest in the policy, in the event of their deaths or the termination of this agreement. *Trustee* assigns, transfers, and sets over to *Insured-1-Short* and *Insured-2-Short* no other rights in the policy. In no event may *Insured-1-Short* or *Insured-2-Short* have or exercise any right as assignee of the policy that could in any way defeat or impair *Trustee*'s right to receive the cash surrender value or the death proceeds of the policy in excess the insureds' interest in the policy.

2. Retained Rights. Except as expressly provided elsewhere in this agreement, *Trustee* retains all rights under the policy, including but not limited to the exclusive right to surrender the policy without the consent of both *Insured-1-Short*, *Insured-2-Short*, or the survivor.

3. Insurer. The insurer is hereby authorized to recognize and is fully protected in recognizing: (a) the claims of *Insured-1-Short*, *Insured-2-Short*, or the survivor to rights hereunder, without investigating the reasons for any such action or the validity or the amount of such claims; (b) *Trustee*'s request for surrender of the policy with or without the consent of *Insured-1-Short*, *Insured-2-Short*, or the survivor, and upon surrender, the policy shall be terminated and of no further force or effect.

4. Release of Assignment. Upon payment to *Insured-1-Short*, *Insured-2-Short*, or the survivor, of their interest in the policy, *Insured-1-Short*, *Insured-2-Short*, or the survivor, shall execute a written release of this assignment.

5. Miscellaneous.

5.1 Binding Agreement. This agreement is binding on and enforceable by and against the parties, their successors, legal representatives, and assigns.

5.2 Governing Law. This agreement will be governed by and construed according to the laws of [state].

5.3 Severability. No part of this agreement will be affected if any other part of it is held invalid or unenforceable.

5.4 Gender and Number. Whenever the context of this agreement requires, the masculine gender includes the feminine and neuter, and the singular number includes the plural and vice versa.

6. Definitions.

6.1 The "Insurer". The insurer is *Insurer*, its successors or assigns.

6.2 The "Policy". The policy is the life insurance policy number [number], together with any supplementary contracts issued in conjunction therewith, and any policies issued by the insurer or any other corporation in exchange for the policy.

6.3 The Insureds' "Interest in the Policy." The interest of *Insured-1-Short*, *Insured-2-Short*, or the survivor in the policy shall be as set forth in the split-dollar agreement. The insurer is entitled to rely on the insureds' certification of the amount and nature of their interest in the policy.

6.4 The "Split-Dollar Agreement." The split-dollar agreement is that agreement executed on the same date as this agreement, between *Trustee* and *Insured-1-Short*, *Insured-2-Short*, or the survivor. The insurer is not bound by nor deemed to have notice of the provisions of the split-dollar agreement.

Agreed to by each of the undersigned on the date first noted above.

[Signatures and notary clauses]

4. Durable Power of Attorney Authorizing Annual Exclusion Gifts. See Problems Raised in *Barnett v. United States*, 2009 WL 2426246, 104 A.F.T.R.2d 2009-5143 (W.D. Pa. May 27, 2009), *report and recommendation adopted,* 2009 WL 1930192, 104 A.F.T.R.2d 2009-5148 (W.D. Pa. June 30, 2009)[3]

The *Principal* Durable Power of Attorney

I, *Principal*, of [address], appoint *Agent*, of [address], as my agent and attorney-in-fact (my "agent"). If *Agent* is unable or unwilling to continue serving as my agent, I appoint, *Alternate*, of [address] as substitute agent. My substitute agent shall have all of the authorities and powers granted under this instrument.

Article 1. Durability

This power of attorney shall not terminate on my disability, and my agent shall continue to be able to exercise any power or authority I have given *him/her*, regardless of my later disability, incompetence, or incapacity.

Article 2. Authorities Granted

I authorize my agent acting alone to do all things required to manage and control all of my property and my affairs for my exclusive benefit, including (but not limited to) the powers enumerated below.

A. Gifts. My agent may make from any or all of my assets, such gifts as *he/she* shall deem appropriate, to and among my *husband/wife*, my children, my more remote descendants, the step-children of any such of these individuals, and to any organizations the contributions to which are deductible for federal income and gift tax purposes, to which I have, within the past five (5) years, made contributions of more than one thousand dollars ($1,000.00).

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[3] **KEY:**

Principal	--	Full name of the principal
Agent	--	Full name of the agent
Alternate	--	Full name of alternate agent
him/her	--	“him” or “her,” referring to the agent
his/her	--	"his" or "her", referring to the agent
he/she	--	“he” or “she,” referring to the agent
husband/wife	--	"husband" or "wife", as the case may be

1. Discretion. My agent shall have sole and absolute discretion in selecting the persons to whom gifts are made from my assets and the date, frequency, and form of such gifts. The discretion of my agent in such matters shall not be subject to challenge by any person other than me.

2. Gifts to My *Husband/Wife*. My agent shall make gifts to my "husband/wife" only to the extent and in a manner that such gifts will qualify for the gift tax marital deduction under Section 2522 of the Internal Revenue Code of 1986, as amended (the "Code").

3. Gifts to My Children. My agent may make gifts to some of my children without making gifts to all of my children, and may make gifts unequally to and among my children.

4. Gifts to Other Donees. My agent may make gifts to some individuals other than my children without making gifts to my children, and without making gifts to all similarly situated individuals or to all individuals who are related to me in the same manner and degree of closeness, and may make gifts unequally to and among any such groups.

5. Excludible or Deductible Gifts Only. My agent may make gifts from my assets only to the extent that such gifts are, by both form and amount, reasonably expected to be excluded or deducted from my adjusted taxable gifts by virtue of the gift tax marital deduction under Section 2523 of the Code, the gift tax charitable deduction under Section 2522 of the Code, the gift tax annual exclusion under Section 2503(b) of the Code, or the unlimited gift tax exclusion under Section 2503(e) of the Code.

6. Other Gifts by Me or My *Husband/Wife*. In making gifts from my assets, my agent shall take into account the amount of other gifts that I or my *husband/wife* may have made to the same donee as those to whom my agent contemplates making a gift from my assets during the same taxable year. My agent may request from me a statement of the amount of such gifts, and may rely entirely upon the validity of such statement, without liability to me if such statement understates the amount of my other gifts to a donee, or to the donee if such statement overstates the amount of my other gifts.

7. Gift Splitting. My agent may determine the amount of the available gift tax annual exclusion with respect to a donee by doubling the amount permitted under Section 2503(b) of the Code, for gifts made whenever I am married on the date of the gift. My agent shall have no liability to me if my *husband/wife* and I do not elect to gift-split under Section 2513 of the Code in that year.

8. GST Exemption. My agent may make gifts from my assets only to the extent that such gifts are reasonably expected not to be subject to the Federal generation-skipping transfer tax under Section 2642(c) of the Code.

9. Medical and Educational Expenses. My agent may make gifts by the direct payment of medical or educational expenses of a donee, if those gifts qualify for the unlimited exclusion from gift tax under Section 2503(e) of the Code, including gifts of the advance direct payment of such medical or educational expenses. Advance payments may be made only if my agent has written advice of competent tax counsel that such gifts, in the form being made, will, more likely than not, qualify for the unlimited gift tax exclusion under Section 2503(e) of the Code, or if my agent receives a private letter ruling from the U.S. Internal Revenue Service that such gifts, in the form being made, will qualify for the unlimited gift tax exclusion under Section 2503(e) of the Code.

10. Form of Gifts. My agent may may make gifts from my assets by outright transfer, transfer to a custodian (who may be my agent) under the Uniform Transfers to Minors Act or the Uniform Gifts to Minors Act or transfers to a trust. My agent may make a gift to a donee by creating a trust of which my agent shall serve as trustee. My agent may make gifts to an existing trust for the benefit of an intended donee.

11. Gifts to My Agent. If my agent is also a member of the class of permissible donees, *he/she* shall give to *him/her*self no more than may be appropriate for *his/her* health, education, support or maintenance, determined without taking into account other assets and income available to *him/her* from all other sources.

B. Adding to My Revocable Trust. I have created at least one (1) revocable trust – the *Principal* Revocable Trust, dated [date], and I authorize my agent to transfer any or all of my assets to my revocable trust at any time, and to execute all documents required to effect such transfers.

C. Financial Accounts. My agent may handle and maintain any financial accounts, including (but not limited to) any checking, savings, or credit union accounts presently in my name, and may establish new financial accounts in my name, and deposit money into, withdraw money from, and draw checks on these accounts.

D. My Retirement Accounts. My agent may handle and maintain any retirement accounts, including individual retirement arrangements, presently in my name, and may establish new retirement accounts in my name, and deposit money into, transfer funds among, withdraw money from, and draw checks on these accounts.

E. Checks, Drafts, Etc. My agent may receive, endorse, and collect any currency or commercial paper, including (but not limited to) any checks or drafts payable to me.

F. Investments. My agent may invest and reinvest any or all of my funds in any type of investment, including (but not limited to) corporate obligations of every kind, preferred or common stocks, securities of any mutual fund or regulated investment trust, and partnership interests.

G. Move Situs of Assets. My agent may move any of my property to any place, whether or not within the United States.

H. Sales and Transfers. My agent may sell or otherwise transfer any of my property, real, personal, or mixed, tangible or intangible, on such terms and conditions as my agent shall deem advisable, and execute any instruments and give any warranties or indemnifications that *he/she* shall deem useful in effecting such sale or transfer.

I. Business. My agent may participate in the operation of any business or other enterprise, including voting any stock, and incorporate, dissolve, or otherwise change the form of such business.

J. Loans. My agent may borrow and lend money on such terms, including (but not limited to) interest rates, security, and loan duration, as *he/she* shall deem advisable.

L. Life Insurance. My agent may apply for and own any policies of insurance on my life, on any of my property, and against any liabilities or damages as *he/she* shall deem advisable, pay any premiums or other charges required to maintain such policies, and exercise any incident of ownership over such policies, including (but not limited to) any right to change beneficiaries, cancel the policy, borrow against any cash values, or make any elections with respect to the policies.

M. Development of Property. My agent may improve, develop, manage, lease, or abandon any of my property.

N. Nominees. My agent may hold any of my property in the name of any trustee, custodian or nominee, without disclosing this relationship, but *he/she* will be responsible for the acts of any such trustee, custodian or nominee.

O. Motor Vehicles. My agent may apply for or transfer any certificate of title on any motor vehicle and represent that such vehicle is free and clear of all liens and encumbrances not otherwise noted in the transfer documents.

P. Legal Actions. My agent may prosecute or defend any action for my protection or that of my property, or for *his/her* protection in the performance of *his/her* duties, or both, and may pay, contest, or settle any claim by or against me or against my agent in the performance of *his/her* duties.

Q. Employ Agents. My agent may employ persons, even if they are associated with *him /her*, to advise or assist *him/her* in the performance of *his/her* duties under this instrument.

R. Tax Returns. My agent may prepare, sign, and file any returns of tax, refund claims, requests for extension of time to file or pay, petition to any court with respect to any tax, offers, waivers, consents, powers of attorney, and other documents relating to any type

of federal, state, local, or foreign tax, and execute any elections I may have under any such tax laws. I waive any privileges I may have against disclosure of any confidential tax information to my agent.

S. Safe Deposit Boxes. My agent may enter my existing safe deposit boxes, close them out, and open any new safe deposit boxes in my name.

T. Other Actions. My agent may do any other thing that *he/she* shall deem advisable, necessary, or desirable for the management of my affairs or for my health, comfort, or welfare.

Article 3. Real Property

This power of attorney relates to and gives my agent the power to manage and deal with all of my real property, including (but not limited to), that property located at: [addresses], and all fixtures attached thereto and all personal property used in connection therewith, and all policies of casualty insurance on such real property.

Article 4. Revocation of Power

This power may be revoked by me at any time, by a written instrument. All persons shall, however, recognize my agent's authority to manage my affairs and transact my business as my agent, until actual receipt of a written notice of revocation. No person shall be liable to me or my estate in any way for any losses resulting from his or her good faith recognition of my agent's authority prior to having received a written notice of revocation.

Article 5. Counterparts

Any person may rely fully, completely, and equally on: (1) the original of this power of attorney, (2) a duly executed counterpart of this power of attorney, or (3) a copy certified by my agent to be a true copy of the original power of attorney.

Article 6. Purchasers from My Agent

Anyone who buys any of my property from my agent is not obligated to see to the application of the purchase money or other consideration paid for such property.

Article 7. Miscellaneous

A. State Law. This power of attorney shall be governed by and construed according to the laws of [state].

B. Number. Whenever the context of this power of attorney requires, the singular number includes the plural and vice versa.

C. Gender. As used in this instrument, any reference to the masculine includes also the feminine, and *vice versa*.

[Signatures, notary clauses and schedule]

5. *Graegin* **Loan – Fixed Interest Rate and Term – No Prepayment Permitted – See Loan in *Estate of Murphy v. United States*, 2009 WL 3366099 (W.D. Ark. Oct. 2, 2009)**[4]

PROMISSORY NOTE

PR, as personal representative of the estate of *Decedent*, deceased (sometimes referred to as "Borrower"), promises to pay to *Lender*, of [address] (sometimes referred to as "Lender"), *Sum*, together with interest compounded semi-annually on the unpaid principal balance at the rate of *Rate* percent per annum.

Section 1. Payments

1.1 Maturity. This note matures on the *Term* anniversary of the date the note was made.

1.2 Amortization Schedule. Borrower shall pay to Lender on or before each anniversary date of this note, such amount as is indicated on the amortization schedule attached to this note and made part thereof, such payment constituting the sum of the principal and interest owed on that date, as also reflected in such amortization schedule. Borrower and Lender agree that this amortization schedule is accurate and will control, absent any prepayment. Both parties also agree to report their interest and principal payments and balances for tax and financial purposes according to this schedule.

1.3 Holidays. If the anniversary date of this note falls on a Saturday, a Sunday, or a day that is a legal holiday under the laws of the United States, the payment for that year shall be due on the next succeeding business day.

1.4 Timely Payment Defined. Payment is timely made if it is actually received by Lender or his legal representatives on or before the date on which it is due, or if it is mailed

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[4] KEY:

PR	--	Name of personal representative of decedent's estate
Decedent	--	Full name of decedent
Lender	--	Full name of lender
Sum	--	Amount borrowed, expressed in both words and numbers, such as "One Hundred Dollars ($100.00)"
Rate	--	Interest rate, expressed in both words and numbers, such as "Three Percent (3%)"
Term	--	Year in which the note matures, expressed as "Fifth", "Sixth" etc.

by the United States Postal Service and is postmarked on or before the date on which it is due.

1.5 Medium of Payment. Payment may be made by cash, personal check, certified check, cashier's check, money order, or any other additional means acceptable to Lender.

1.6 Where Payment Made. Payment may be made to Lender at Lender's address indicated above, or at such other place as Lender shall designate in writing from time to time.

Section 2. No Prepayment

Borrower may not prepay all or any portion of the principal balance of this note at any time.

Section 3. Negotiability

This promissory note is negotiable.

Section 4. Security

This note is not secured by any specific property, but by the full assets of Borrower, including all assets hereafter acquired.

Section 5. Default

5.1 Default Defined. Borrower will be in default if Borrower fails to pay any installment of principal or interest when due and does not cure his deficiency within thirty (30) calendar days of the date the payment was due.

5.2 Acceleration. Whenever Borrower is in default, Lender may declare the entire principal balance in default, and immediately due and payable.

5.3 Lender's Remedies. Upon any default, Lender may take such other legal actions as he deems necessary or appropriate to collect the amounts in default.

5.4 Confession of Judgment. Upon any default, except where prohibited by law, Borrower empowers any attorney of any court of record within [state] to appear for him and, after one or more declarations or complaints have been filed, to confess judgment against Borrower for any sums due under this instrument, including attorney's fees of twenty-five

percent (25%) percent of the outstanding principal balance of the debt evidenced by this instrument. All exemptions from levy, garnishment, attachment, or seizure of assets are hereby waived by Borrower with respect to amounts due under this instrument.

Section 6. Cancellation

Upon payment of all principal and interest required to be paid under this note, Lender will return to Borrower all copies of this note, marked CANCELED/PAID IN FULL, and all of Borrower's obligations under this note will be terminated.

Section 7. Construction

7.1 Choice of Law. This note, and the parties' rights and liabilities thereunder, shall be construed under the law of [state].

7.2 No Presumption Against Drafter. This note shall be construed with no presumption against Borrower or against Lender based on the writing of this note by counsel to one of them.

7.3 Number. In construing this Note, the singular shall include the plural and the plural the singular.

AGREED on the date first written above.

[Signatures, notary clauses and amortization schedule]

6. Alaska Asset Protection Trust — Grantor and Spouse Are Discretionary Beneficiaries — Transfer Is Completed Gift for Transfer Tax Purposes — Crummey Withdrawal Rights Limited to $5,000 or 5 percent of Corpus (to Avoid Multiple Transferors) — Generation-Skipping Perpetual Dynasty Trust (No Rule Against Perpetuities Limitations) — GST Exemption Will Be Allocated to All Transfers — Trust Is a Grantor Trust – Based on PLR 200944002 (Oct. 30, 2009)[5]

ALASKA DYNASTY TRUST

On [date], I, *Grantor*, of [locality, state] (sometimes referred to in the first person and sometimes as the "grantor"), *FirstTrustee*, of [locality, state] (referred to as the "trustee"), and *AlaskaTrustee*, of [locality, state] (also sometimes referred to as a "trustee"), make this trust.

Article 1. My Family

I am married to *Spouse*, and all references to my *husband/wife* shall be to *him/her*. and I have [number] children, *Children* and [number] grandchildren, *Grandchildren*.

Article 2. Alaska Situs

A. Initial and Future Situs. The trust shall have its situs within the State of Alaska.

B. Alaska Situs. The trustee shall do all things and take all actions required to maintain the Alaska situs of the trust, and to assure that the trust complies with the

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[5] **KEY:**

Grantor	—	Full name of the grantor
FirstTrustee	—	Full name of the initial non-Alaska trustee
AlaskaTrustee	—	Full name of the Alaska trustee
Spouse	—	Full name of grantor's spouse
husband/wife	—	"husband" or "wife," as the case may be
him/her	—	"him" or "her," referring to Grantor's spouse
Children	—	Full name of grantor's child or children
Grandchildren	—	Full name of grantor's grandchild or grandchildren
SecondTrustee	—	Full name of the alternate non-Alaska trustee
Protector	—	Full name of the person who can take away grantor's power of substitution and re-grant it
2ndProtector	—	Alternate to *Protector*

descriptions in the Alaska Statutes, unless and until the trustees shall change the situs of the trust. The trustee shall, with respect to the trust, assure that (1) at least one trustee of the trust is always a “qualified person” as defined in the Alaska Statutes; (2) the duties of the trustee who is a “qualified person” shall include, but not necessarily be limited to, maintaining records for the trust on an exclusive or a nonexclusive basis, and preparing or arranging for the preparation of an income tax return that must be filed by the trust, on an exclusive or a nonexclusive basis; (3) at least part of the administration of the trust shall occur within the State of Alaska, including physically maintaining trust records within the State of Alaska, as defined in the Alaska Statutes; and (4) some or all of the assets of the trust are deposited within the State of Alaska and are administered by a “qualified person”, as defined in the Alaska Statutes.

C. Governing Law. The validity, construction, and administration of the trust shall in all respects be governed by the laws of the State of Alaska, and shall be construed by and subject to the jurisdiction of the courts of the State of Alaska.

1. Exclusive Jurisdiction of the Alaska Courts. The courts of Alaska shall have exclusive jurisdiction over:

a. proceedings initiated by interested parties (as defined in the Alaska Statutes) concerning the internal affairs of the trust;

b. appointing or removing a trustee of the trust;

c. reviewing fees charged by trustee;

d. reviewing and settling interim and final accountants;

e. ascertaining beneficiaries;

f. determining any question arising in the administration or distribution of the trust, including questions of construction of the trust instruments, instructing trustee, and determining the existence or nonexistence of any immunity power, privilege, duty, or right; and

g. release registration of a trust.

2. Issues Determined Under Alaska Law. The validity, construction, and administration of the trust shall be determined by the laws of the State of Alaska, including (but not limited to):

a. capacity of the grantor;

b. powers, obligations, liabilities, and rights of the trustee and the appointment and removal of the trustee;

c. existence and extent of powers, conferred or retained, including a trustee's discretionary powers, the powers retained by a beneficiary of the trust, and the exercise of a power.

Article 3. Transfers to the Trust

I transfer to the trustee the property listed in the schedule to this trust, and may transfer additional assets to be held on the terms and conditions set forth in this instrument. I retain no right or interest in any trust property.

Article 4. Irrevocability

This trust is irrevocable, and I cannot alter, amend, revoke, or terminate the trust in any way.

Article 5. Annual Withdrawal

Each of my then-living children and each of my then-living grandchildren shall have the right to withdraw an amount equal to a proportionate share of each contribution to the trust (other than a contribution by reason of a transferor's death), subject to the guidelines described below.

Article 6. Dynasty Trust

As long as I, my *husband/wife*, or any of my children, grandchildren, and more remote descendants shall be then living, the trustee shall hold all of the trust funds remaining after the exercise or lapse of the withdrawal powers created earlier in this instrument, under this Article.

A. Distributions. The trustee shall distribute to or for the benefit of me, my *husband/wife*, my then-living children, my then-living grandchildren, and my then-living more remote descendants, as much of the net income and principal of the trust as the trustee may deem appropriate for any purpose, annually adding to principal any undistributed income. The trustee may distribute income and principal unequally and may make distributions to some beneficiaries and not to others.

B. Preservation of Corpus. The trustee shall administer the trust in a manner designed to conserve its principal as long as possible. The trustee shall, therefore, lend income and principal to beneficiaries or buy assets for their use, rather than distributing income or principal outright to beneficiaries, unless the trustee shall determine that outright distributions are more appropriate.

C. Termination of the Trust. Upon the death of the last to die of me, my *husband/wife*, my children, my grandchildren, and my more remote descendants, the trustee shall distribute the remaining trust fund to one (1) or more organizations selected by the trustee, gratuitous transfers to each of which are deductible as charitable transfers for federal income, estate, and gift tax purposes.

Article 7. Minor Beneficiaries

The trustee may make distributions to a beneficiary (other than a child of mine) from any trust under this instrument, while such beneficiary is under twenty-one (21) years of age, under any of the options provided in this article.

A. Minor's Trust. The trustee may hold such distributions for such minor beneficiary in a separate trust for the beneficiary, on the following terms and conditions:

1. Until the Termination Date. Until this trust's termination date (defined below), the trustee shall distribute to or for the benefit of the beneficiary as much of the net income and principal as the trustee may consider appropriate for the beneficiary's health, education, support or maintenance, annually adding to principal any undistributed income.

2. Upon the Termination Date. Upon this trust's termination date, the trustee shall distribute the remaining trust funds to the beneficiary, outright and free of trust, if the beneficiary is then living, or otherwise to the beneficiary's estate to be distributed as part of that estate.

3. "Termination Date." This trust's "termination date" shall be the earlier of (1) the date on which the beneficiary dies; or (2) the date on which the beneficiary reaches twenty-one (21) years of age.

B. Custodianship. The trustee may make such distributions to a custodian or successor custodian under any state's version of the Uniform Transfers (or Gifts) to Minors Act, including a custodian selected by the trustee. The trustee may select any age for termination of the custodianship permitted under such state law, giving due consideration to selecting twenty-one (21) years of age if that is permitted, and may designate successor custodians. The trustee may also sell any asset that cannot be held under this custodianship and invest the sales proceeds in assets that can be so held.

C. Other Distributions. The trustee may make such distributions to a minor's parent or legal guardian or directly to such minor, if he or she has then reached fourteen (14) years of age and the trustee deems it appropriate to do so, considering the property in question and the capabilities of the beneficiary.

D. Minority. The fact that the legal age of majority in any jurisdiction in which the beneficiary under this article may live, or in which my will or a trust thereunder may be

administered, may be younger than twenty-one (21) years of age, shall not alter the terms or options under this article, and such beneficiary shall still be treated as a “minor” under this article.

E. Exoneration. The trustee shall have full authority to select one or more forms for the distribution of property to a minor under this article, and may select different options for different beneficiaries and different property distributions to the same beneficiary.

Article 8. The Trustee

A. Initial Co-Trustees. *FirstTrustee* and *AlaskaTrustee* shall together serve as the trustee of this trust.

B. Successor Trustees.

1. Successor Alaska Trustee. If *AlaskaTrustee* shall cease or decline to serve, the remaining trustee, if any, shall appoint as replacement another person meeting the requirements set forth in Article 2, that is not “related or subordinate” to me as defined for federal income tax purposes.

2. Successor Other Trustee. *SecondTrustee*, of [locality, state], shall be the successor trustee, to serve if *FirstTrustee* is unable or unwilling to serve or to continue serving.

3. Additional Trustee. I authorize the trustee to appoint any person as an additional trustee, to serve at the pleasure of the appointing trustee.

4. Certain Persons Disqualified. Neither my *husband/wife* nor I, nor any former *husband/wife* of mine if I ever have one, may ever be a trustee of this trust. Every trustee of this trust must be a person who is not related and subordinate to me or to my *husband/wife* as defined under Section 672(c) of the Internal Revenue Code (defined below).

C. Bond. No trustee named by me or by another trustee shall be required to provide surety or other security on a bond.

D. Delegation. The trustee may delegate to another trustee any power or authority granted by me to the trustee, to continue at the pleasure of the delegating trustee, unless otherwise agreed. Any person dealing in good faith with a trustee may rely on that trustee's representation that a delegation has been made and remains in effect under this paragraph.

E. Resignation. A trustee may resign by giving written notice specifying the effective date of the resignation to the designated successor. If no successor is

designated, the resigning trustee shall give notice to the then-living adult beneficiaries to whom income may then be distributed.

F. Vacancies. A corporation no substantial portion of the stock of which is owned by beneficiaries of this trust, may be named as successor trustee to fill any vacancy, by majority vote of the adult beneficiaries to whom trust income may then be distributed, except that there shall always be at least one Trustee meeting the requirements of Article 2.

G. Responsibility of Successors. No trustee shall be responsible for or need inquire into any acts or omissions of a prior trustee.

H. Compensation. In addition to reimbursement for expenses, each individual trustee is entitled to reasonable compensation for services. Each corporate trustee is entitled to compensation based on its written fee schedule in effect at the time its services are rendered or as otherwise agreed, and its compensation may vary from time to time based on that schedule.

I. Management Powers. The trustee may exercise the powers described below, in a fiduciary capacity.

1. Invest and Reinvest. The trustee may invest and reinvest the trust (or leave it temporarily uninvested) in any type of property and every kind of investment, in the same manner as a prudent investor would invest his or her own assets. The trustee may apply trust income and principal to pay premiums on policies of insurance on my life, on the life of my *husband/wife*, or on both of our lives.

2. Sell and Exchange. The trustee may sell or exchange any real or personal property contained in the trust, for cash or credit, at public or private sale, and with such warranties or indemnifications as the trustee may deem advisable.

3. Borrow. The trustee may borrow money (even from a trustee and from any beneficiary of the trust), for the benefit of the trust and secure these debts with assets of the trust.

4. Security Interests. The trustee may grant security interests and execute all instruments creating such interests upon such terms as the trustee may deem appropriate.

5. Compromise Claims. The trustee may compromise and adjust claims against or on behalf of the trust on such terms as the trustee may deem appropriate.

6. Title to Securities. The trustee may take title to any securities in the name of any custodian or nominee, without disclosing this relationship.

7. Receipts and Disbursements. The trustee may determine whether receipts are income or principal and whether disbursements are to be charged against income or principal, to the extent not established clearly by state law. Determinations made by the trustee in good faith shall not require equitable adjustments.

8. Tax Elections. The trustee may make all tax elections and allocations that the trustee may consider appropriate; however, this authority is exercisable only in a fiduciary capacity and may not be used to enlarge or shift any beneficial interest except as an incidental consequence of the discharge of fiduciary duties. No tax elections or allocations made by the trustee in good faith shall require equitable adjustments.

9. Employ Advisers. The trustee may employ such lawyers, accountants, and other advisers as the trustee may deem useful and appropriate for the administration of the trust. The trustee may employ a professional investment adviser in managing the investments of the trust (including any investment in mutual funds, investment trusts or managed accounts), delegate to this adviser any discretionary investment authorities, and rely on the adviser's investment recommendations without liability to any beneficiary.

10. Distributions in Kind. The trustee may divide and distribute the trust in kind, in money, or partly in each, without regard to the income tax basis of any asset and without the consent of any beneficiary. The decision of the trustee in dividing any portion of the trust between or among two (2) or more beneficiaries shall be binding on all persons.

J. Special Limits on Interested Trustee. The following limitations shall apply, notwithstanding other provisions of this instrument.

1. Limiting Actions by Interested Trustee. No interested trustee (defined below) may participate in the exercise of any discretion to distribute principal to himself or herself, except as is appropriate for his or her health, education, support or maintenance. No interested trustee may participate in the exercise of any discretion to distribute or expend principal or income in a manner that would discharge that trustee's personal obligation to support the beneficiary to whom such distribution is or may be made. No interested trustee may participate in the exercise of any incident of ownership over any policy owned by the trust insuring the life of such interested trustee.

2. Disinterested Trustee Exercising Certain Powers. A disinterested trustee who is serving as a co-trustee with an interested trustee, may exercise those discretions granted under this instrument the exercise of which by an interested trustee is precluded.

3. Multiple Trustees. The number of trustee who must consent to the exercise of a power granted under this instrument, as determined under this article shall be determined by treating the interested trustee who are not entitled, under this article, to participate in the exercise of the power or discretion, as if they were not then serving. If this article precludes every then-serving trustee from exercising a power otherwise granted to

the trustee under this instrument, the then-serving trustee shall appoint a disinterested trustee who may exercise such power (or decline to exercise it) as if that disinterested trustee were the sole then-serving trustee.

K. Disabled Individual Trustee. A trustee may not serve during a disability.

1. When An Individual Trustee is Disabled. An individual trustee is "disabled" or "under a disability" if: (a) he or she is determined to be legally incompetent by a court of competent jurisdiction; (b) a conservator or guardian for such person has been appointed, based upon his or her incapacity; (c) two (2) physicians licensed to practice medicine in [state] certify in writing to another trustee or a person who would become the successor trustee upon such disability, that in the opinion of such physicians, such individual trustee, as a result of illness, age or other cause, no longer has the capacity to act prudently or effectively in financial affairs; or (d) thirty (30) days after any other trustee or a person who would become the successor trustee upon such disability, requests that such individual trustee provide a certificate from a physician licensed to practice medicine that, in the opinion of such physician, such individual trustee has the capacity to act prudently or effectively in financial affairs and such individual trustee fails to provide such certification. The effective date of such incapacity shall be the date of the order or decree adjudicating the incapacity, the date of the order or decree appointing the guardian or conservator, the date of the certificate of incapacity of the two (2) physicians described above, or thirty (30) days after other trustee or any person who would become the successor trustee upon such disability requests a certificate of capacity and one is not provided, whichever first occurs.

2. Liability. No person is liable to anyone for actions taken in reliance on these certifications or for dealing with a trustee other than the one removed for disability based on these certifications. This trust shall indemnify any physician for liability for any opinion rendered in good faith as to the existence or recovery from any disability.

Article 9. Overriding Purposes

This article states some of my purposes in creating the trust, and all provisions of the trust shall be construed so as best to effect these purposes. No trustee shall exercise any discretion in a manner that could reasonably be expected to frustrate the effectuation of these purposes.

A. Income Tax. The trust, to the extent attributable to transfers by me, shall be a grantor trust deemed owned by me for federal income tax purposes, unless and until the powers under the article entitled "Reserved Right to Substitute Assets" are released and not re-granted.

B. Gift Tax. All transfers to the trust shall be completed gifts for federal gift tax purposes. I recognize that gifts made to this trust are not gifts of a present interest and will not qualify for the gift tax annual exclusion.

C. Estate Tax. The assets of the trust shall be excluded from my gross estate for federal estate tax purposes.

D. Generation-Skipping Transfer Tax. I intend that no distributions from or terminations of interests in this trust or any trust under this instrument shall be subject to the Federal tax on generation-skipping transfers.

E. Creditor Protection. The trust shall be an Alaska trust, the assets of which are not subject to the claims of my creditors, or those of my *husband/wife*, my children, my grandchildren, and my other more remote descendants.

F. Limited Power to Amend. The trustee may, by an instrument in writing, amend this agreement in any manner required to meet any of objectives set forth in this Article. No amendment under this paragraph may increase the class of beneficiaries or provide me with any beneficial interest or economic benefit in this trust. This power to amend may not be exercised by any trustee who is me, my *husband/wife* or a descendant of mine, or who is appointed as successor trustee by me, my *husband/wife* or a descendant of mine.

Article 10. Reserved Right to Substitute Assets

A. Right Reserved. I reserve and shall have the right, exercisable at any time and from time to time, to demand that the trustee transfer to me any or all of the trust assets in exchange for assets of equivalent value. This power shall be exercisable by me solely in a nonfiduciary capacity, and without the consent or approval of any other person who has a fiduciary duty. This power shall enable me to determine the occurrence and timing of any such exchange, but the trustee shall have the sole and absolute right to ascertain and determine, in the exercise of the trustee's fiduciary duties to the beneficiaries, the equivalent value to the trust assets transferred to me. For purposes of this article, "equivalent value" shall have the same meaning given that phrase in Internal Revenue Code, Section 675(4)(C).

B. Inapplicability. I shall have no right to require the transfer to me of the following assets, notwithstanding paragraph A of this article:

1. Life Insurance Policies. I shall have no right to require that the trustee transfer to me any policies of insurance on my life.

2. Voting Stock. I shall have no right to require that the trustee transfer to me any shares of the voting stock of any corporation in which I have directly or indirectly, including ownership by attribution under Internal Revenue Code, Section 318, the right to

vote stock constituting at least twenty percent (20%) of the total combined voting power of all classes of the said corporations' stock.

C. Exercise. I may exercise this power only by an instrument in writing signed by me and delivered to the trustee and to each then-living current adult beneficiary of the trust.

1. Certification of Value. In the writing by which I exercise this power, I shall certify to the trustee the value of the assets transferred by me to the trust in exchange for trust assets, to the extent that the assets I transfer are not cash, cash equivalents, or stock or other securities that is regularly listed on a major U.S. stock exchange.

2. Effective Date. Such writing shall state the date on which such exchange shall occur, but not earlier than thirty (30) days after the date on which such instrument is received by the trustee.

D. Trustee's Fiduciary Duties. In addition to all other fiduciary duties imposed upon the trustee under local law and this instrument, the trustee shall have the following duties.

1. Assure Equivalence. The trustee shall have a fiduciary obligation to ensure my compliance with the terms of this power by the trustee being satisfied that the properties acquired and substituted by me are in fact of equivalent value.

2. Impartiality. The trustee shall have the power to invest and reinvest the trust corpus and a duty of impartiality with respect to the trust beneficiaries.

E. I Cannot Shift Beneficial Enjoyment. I shall not be able to exercise this power in any manner that shifts benefits among the trust beneficiaries. The trustee shall not honor an attempt to exercise this power if the trustee believes that such effectuation of my attempted exercise of this power would shift benefits among the trust beneficiaries.

F. Removal and Regrant of Power. *Protector* may cancel my power under this article by a writing delivered to me and to the trustee, designating the effective date of the cancellation. *Protector* may re-grant the power under this article to me, by a writing delivered to me, with a copy to the trustee and to each then-living adult beneficiary of the trust, designating the effective date of the re-grant of this power.

G. Alternate Holders of the Right to Re-Grant. If *Protector* shall be unable or unwilling to serve under this article, *2ndProtector*, of [address] shall hold and exercise the power granted first to *Protector* under this article. If both *Protector* and *2ndProtector* are unable or unwilling to serve under this article, the trustee shall name as the holder of this power an individual who is neither related nor subservient to me, as defined in Section 672(c) of the Internal Revenue Code.

Article 11. Trust Administration

A. Spendthrift Clause. No beneficiary may either voluntarily or involuntarily transfer any interest in this trust before payment or delivery of the interest to the beneficiary by the trustee. No interest in the trust shall be subject to any beneficiary's liabilities or creditor claims, assignment, or anticipation. If the trustee determines that a beneficiary would not benefit as greatly from any outright distribution of trust income or principal because of the availability of the distribution to the beneficiary's creditors, the trustee shall instead expend those amounts for the benefit of the beneficiary. This direction is intended to enable the trustee to give the beneficiary the maximum possible benefit and enjoyment of all of the trust income and principal to which the beneficiary is entitled.

B. Multiple Trusts and Shares. The trustee may invest the assets of multiple trusts in a single fund if the interests of the trusts are accounted for separately.

1. Merge or Consolidate. The trustee may merge or consolidate any trust into any other trust that has the same trustee and substantially the same dispositive provisions.

2. Divide. The trustee may divide any trust into multiple separate trusts.

C. Rule Against Perpetuities. All assets of every trust created under this instrument (including every trust created by the exercise of a power of appointment created under this instrument, unless the exercise of such power of appointment starts a new period for the rule against perpetuities or similar rule that limits the time that property may remain in trust) shall vest in and be distributed to the persons then entitled to the income from such property at the expiration of the date twenty (20) years and eleven (11) months after the death of the last survivor of my *husband/wife* and those of the descendants of my grandparents alive on the date of this instrument. Upon termination of a trust under this provision, the accumulated trust income and principal shall be distributed to those beneficiaries then entitled to receive or have benefit of the income from such trust in the proportion in which they are so entitled. If the proportion of the income interests of the beneficiaries of such trust cannot be determined with reasonable certainty, the accumulated trust income and principal shall be distributed equally to such beneficiaries.

D. Accountings. The trustee shall not be required to file annual accounts with any court or court official in any jurisdiction.

E. Disabled Beneficiary. The trustee may distribute income, principal, or both for a disabled beneficiary to his or her parent, guardian, personal representative, or the person with whom the beneficiary resides, without looking to the proper application of those payments.

F. Additional Transfers. Any person may transfer property to the trustee at any time. The trustee may refuse to accept a transfer if acceptance is not in the trust's best

interests. The trustee may accept a gift subject to one or more conditions imposed by the donor or the trustee if it is in the best interests of the trust and the beneficiaries and if the condition does not change the rights of a beneficiary with respect to any prior gift. The trustee shall hold all transfers to the trust by someone other than me, if made during my lifetime, in a segregated fund, as a separate and independent trust from the trust created by assets transferred by me to the trust. Such a separate and independent trust shall be held for the benefit of the same beneficiaries and on the same terms and conditions as the trust created and funded by transfers by me, but the assets of such separate and independent trust shall not be commingled or otherwise mixed with those assets contributed by or attributable to contributions by me. Such separate and independent trust shall not be deemed owned by me for Federal income tax purposes, notwithstanding any other provisions of this instrument.

G. Income Taxes. The trustee shall not pay or reimburse me for the payment of any incremental income taxes imposed upon me with respect to income or gains received by the trust and not distributed to me, notwithstanding any requirement of state law that I be paid or reimbursed for such tax payments.

Article 12. Annual Withdrawal Power: Guidelines

This Article applies to the annual withdrawal power created in Article 5 of this instrument, entitled "Annual Withdrawal Power."

A. Immediate Power. This withdrawal power shall arise immediately after each contribution to the trust (defined below).

B. Shares. The proportionate share of a contribution of each of my children and grandchildren is the amount of such contribution, divided by the number of my then-living children and grandchildren.

C. Annual Limit. The maximum amount that any child or grandchild may withdraw with respect to all contributions made by the same donor in a single calendar year shall be the least of the following three figures: (1) the total amount of the child's or grandchild's share of a donor's contributions to this trust during that year; (2) the amount of the federal gift tax annual exclusion in effect on the date of the earliest of such contributions, or twice the gift tax annual exclusion if the donor is married on the date of the last of all contributions made during that year; and (3) the greater of that sum referred to in Internal Revenue Code, Section 2514(e)(1) (currently, five thousand dollars ($5,000)) or that percentage referred to in Internal Revenue Code, Section 2514(e)(2) (currently, five percent (5%)) of the trust corpus out of which, or the proceeds of which, the exercise of this withdrawal right could be satisfied.

D. Priority. This withdrawal power takes precedence over any other power or discretion granted the trustee or any other person.

E. Exercise. Each child or grandchild can exercise this withdrawal power by a written request delivered to a trustee. The legally authorized personal representative of any person unable to exercise a withdrawal power because of a legal disability, including minority, may make the demand on the child's behalf. If there is no legally authorized personal representative, the trustee shall designate an appropriate adult individual (who may be a trustee but may not be me) who may make the demand on such child's or grandchild's behalf.

F. Notice. The trustee must reasonably notify the person who would exercise a child's or grandchild's withdrawal power of its existence and that of any contributions made to the trust that are subject to the power.

G. Lapse. The unexercised withdrawal power of each child or grandchild shall lapse on the last day of each calendar year or, if earlier, sixty (60) days after the contribution to which it relates.

H. Contribution Defined. "Contribution" means any cash or other assets transferred to the trustee to be held as part of the trust funds, and any payment of premiums on life insurance policies owned by the trust. The amount of any contribution is its federal gift tax value, as determined by the trustee at the time of the transfer.

Article 13. Arbitration & Contests

The provisions of this article are included in order to avoid or minimize the cost of court proceedings and promote the prompt resolution of any disputes regarding the interpretation of this instrument.

A. Arbitration. Any dispute over the administration or distribution of any trust created under this instrument shall be decided by binding arbitration before an arbitrator who shall be a Fellow of the American College of Trust and Estate Counsel selected by its chair of the state that has jurisdiction the trust in question. The arbitrator shall establish the procedures which govern the arbitration. The arbitrator's decision shall not be appealable to any court and shall be final and binding on any and all persons who have or may have an interest in the trust under discussion, including unborn or incapacitated persons, such as minors or incompetents. No guardian or trustee ad litem shall be appointed to represent the interests of unborn or incapacitated persons in any such arbitration. The arbitrator's fee shall be paid by the trustee from the principal of the trust in question.

B. Contests. The terms of this instrument reflect my carefully considered objectives for the disposition of the trust funds and I intend that this paragraph discourage any beneficiary from frustrating my objectives by disinheriting that beneficiary and his or her descendants.

1. Revocation for Contest. I revoke every disposition under this instrument to any person who participates in any contest (defined below), regardless of good faith or subsequent withdrawal of the contest, and I revoke any dispositions to his or her descendants.

a. I leave all of these revoked shares of the trusts under this instrument to [Name of Charity], [locality, state], for its general charitable purposes.

b. If at the time of such Contest, [Name of Charity] is not an existing organization to which deductible transfers may be made for Federal estate tax purposes, I leave the revoked shares of the trusts under this instrument to another organization selected by the trustee to which such deductible transfers may be made, that is organized and operated for purposes similar to those for which [Name of Charity] is organized and operated on the date of this instrument.

2. Expenses. The trustee may defend, at the expense of the trust fund, any contest or other attack of any nature on this instrument or any of its provisions.

3. "Contest" Defined. "Contest" shall, for purposes of this article, be interpreted in the broadest possible manner, and shall include any direct or indirect attempt to challenge the validity or all or any portion of this trust instrument. It shall also include, but not be limited to, abetting, commencing, conducting, and inciting any action, caveat, claim, demand, dispute, proceeding, or suit to resist, oppose, upset, or object to the validity of any trust under this instrument, asserting, filing, or raising an objection to any such trust based upon any allegation, including, but not limited to, forgery, lack of capacity, duress, fraud, undue influence, or failure of due execution; and impairing, invalidating, modifying, setting aside, or preventing the carrying out of any part of any trust under this instrument. "Contest" also includes, but is not limited to, agreeing with or procuring any other person to do any of the foregoing acts.

Article 14. Definitions and Miscellaneous

A. Definitions.

1. "Children" and "Descendants." "Children" and "descendants" include those now living and those later born, subject to the following rules:

a. "Children" and "descendants" include an adopted person and that adopted person's descendants if, that adopted person is adopted before reaching eighteen (18) years of age;

b. "Children" and "descendants" includes those born outside of wedlock, if, during such child's or descendant's lifetime, his or her parent through whom such child or descendant claims hereunder, has acknowledged such person

as his or her child in a writing duly signed and notarized during such parent's lifetime; and

c. "Children" and "descendants" include a child produced before the parent's death by donor artificial insemination, in vitro fertilization or other form of surrogate parenthood, whether or not such child was legally adopted by such parent before such parent's death.

2. "Disinterested Trustee." A "disinterested trustee" means a trustee who is not an interested trustee (see below).

3. "GST Exemption." The "GST exemption" or my "GST exemption" shall mean the exemption allowed a transferor against the Federal tax on generation-skipping transfers, as provided in Section 2631(a) of the Internal Revenue Code.

4. "Interested Trustee." An "interested trustee" is a trustee who is also (a) a beneficiary of the trust of which he or she is a trustee or the insured under a policy of insurance owned by a trust of which he or she is a trustee; (b) married to and living together with a beneficiary of the trust of which he or she is a trustee; (c) the father, mother, issue, brother or sister, of a beneficiary of the trust of which he or she is a trustee; (d) an employee of a beneficiary of the trust of which he or she is a trustee; (e) a corporation or any employee of a corporation in which the stock holdings of the trustee and the trust are significant from the viewpoint of voting control; or (f) a subordinate employee of a corporation in which such trustee is an executive.

5. "Internal Revenue Code." Any reference to the "Internal Revenue Code" means the U.S. Internal Revenue Code of 1986, as amended, or any similar successor provision of Federal tax law.

6. "Trust." The "trust," without further qualification or specification, shall refer to all trusts under this instrument.

7. "Trustee." The "trustee" shall include each trustee, multiple trustees acting together or separately, and any successor trustee.

B. Tax-Related Terms. All tax-related terms shall have the same meaning in this instrument that they have in the Internal Revenue Code of 1986, as amended.

C. Number. Whenever the context requires, the singular number includes the plural and the plural, the singular.

D. Applicable Law. The trust shall be governed by and construed according to the laws of the State of Alaska.

E. Copies. There is only one signed original of this instrument. Anyone may rely on a copy of this instrument certified by a notary public or similar official to be a true copy of the signed original (and of any amendments) as if that copy were the signed original. Anyone may rely upon any statement of fact certified by the person who appears from the original document or a certified copy to be a trustee.

DECLARED AND AGREED on the date indicated above.

[Signatures, notary clauses and schedule]

WAIVER OF CERTAIN RIGHTS

I, *Spouse*, waive all of my right, title, and interest in any property transferred to the attached trust, dated [date] (the trust), by *Grantor*. This waiver shall apply both to current and inchoate interests that I may have, including, but not limited to, rights to an intestate share of *Grantor* s estate, to a statutory share of *Grantor* s augmented estate, to another statutory share of *Grantor* s estate, to a share as an omitted spouse, and to a share in the nature of dower or curtesy. The waiver shall constitute a third-party beneficiary contract for the benefit of all the beneficiaries of the trust, and these beneficiaries or the trustee of this said trust may enforce this waiver by appropriate legal action.

Dated: [date]

[Signature and notary clause]

AFFIDAVIT

I, *Grantor*, do hereby declare under oath, pursuant to Alas. Stat. § 34.40.110(j), that:

(1) I have full right, title, and authority to transfer the assets to the trust;

(2) The transfer of the assets to the trust will not render me insolvent;

(3) I do not intend to defraud a creditor by transferring the assets to the trust;

(4) I do not have any pending or threatened court actions against me, except for any court actions identified by me on an attachment to this affidavit;

(5) I am not involved in any administrative proceedings, except for any administrative proceedings identified on an attachment to the affidavit;

(6) At the time of the transfer of the assets to the trust, I am not currently in default of a child support obligation by more than thirty (30) days;

(7) I do not contemplate filing for relief under the provisions of the U.S. Bankruptcy Code (11 U.S.C.); and

(8) The assets being transferred to the trust were not derived from unlawful activities.

[signature of grantor, notarial clause and attachments]

7. Defined Value Disclaimer – Based on *Estate of Christiansen v. Comm'r*, 586 F.3d 1061 (8th Cir. Nov. 13, 2009), *aff'g* 130 T.C. 1 (2006)[6]

DISCLAIMER

On ____________, pursuant to the laws of [State], I, *Disclaimant*, a resident of [locality and state], do hereby unqualifiedly, irrevocably, unconditionally, and completely disclaim and refuse to accept a fractional portion of the gift to me under the last will of *Decedent* (the "Gift").

The numerator of this fraction shall be the fair market value of the Gift (before payment of debts, expenses and taxes) on *DOD*, less ____________ Dollars ($________) and the denominator of which is the fair market value of the Gift (before payment of debts, expenses and taxes) on that same date ("the Disclaimed Portion"). For purposes of this paragraph, the fair market value of the Gift (before payment of debts, expenses and taxes) on *dateofdeath*, shall be the price at which the Gift (before payment of debts, expenses and taxes) would have changed hands on that date, between a hypothetical willing buyer and a hypothetical willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts for purposes of Chapter 11 of the U.S. Internal Revenue Code of 1986, as amended (the "Code"), as such value is finally determined for federal estate tax purposes.

I have not accepted any of the benefits of these disclaimed assets and this disclaimer is completely irrevocable, regardless of any occurrence either prior to or subsequent to its execution.

I intend that this disclaimer constitute a qualified disclaimer for federal gift tax purposes, under Section 2518 of the Code, and all provisions of this disclaimer shall be construed consistent with this intent.

[signature and notarial clause]

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[6] **KEY:**

Decedent — Full name of the decedent
Disclaimant — Full name of the disclaimant
DOD — The date of the decedent's death or, if elected, the alternate valuation date

8. Defined Value Deed of Gift – Based on *Estate of Petter v. Comm'r*, T.C. Memo. 2009-280 (Dec. 7, 2009)[7]

DEED OF GIFT

On _______________, I, *Grantor* (sometimes referred to in the first person and sometimes as “*ShortforGrantor*”), do hereby make this declaration of gift, in order to give certain property to various parties, as described below.

Recitals:

A. I own [number] of units of membreship interest in [name of LLC] (my “Units of Membership Interest” or the "Units"); and

B. I wish to give part of my Units of Membership Interest to *NoncharitableDonee* (sometimes referred to as *ShortforNoncharitableDonee*); and

C. I also wish to give part of my Units of Membership Interest to *Charity*; and

D. I do not wish to incur any federal gift tax on this transfer; and

E. *ShortforNoncharitableDonee* and *Charity* wish to receive these gifts, on the terms and subject to the conditions set forth in this agreement;

NOW, THEREFORE, I do hereby make the following gifts:

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[7] KEY:

Grantor	--	Full name of the grantor
ShorthandforGrantor	--	Shorthand description of the grantor, such as “Mr. Zaritsky” or “Howard” or “Stinky”
NoncharitableDonee	--	Full name of noncharitable donee; if a trust, the donee should be identified with the name of the trustee and the name of the trust, such as “Trust Company of Virginia, trustee for the Howard M. Zaritsky Intentional Grantor Trust, dated January 1, 2009"
ShorthandforNoncharitableDonee	--	Shorthand description of the noncharitable donee, such as “Ms. Jones” or “Lolla” or “the Trust”
Charity	--	Full name of charitable donee
he/she/it	--	“he” “she” or “it”, referring to the noncharitable donee

Article 1. Gift to *NoncharitableDonee*

I hereby give and transfer to *ShortforNoncharitableDonee* that number of units of Membership Interest the value of which is equal to the maximum dollar amount that can pass free of federal gift tax by reason of my applicable exclusion amount allowed by Code Section 2010(c), as finally determined for federal gift tax purposes. I understand that my unused applicable exclusion amount to be One Million Dollars ($1,000,000), so that the amount of this gift to "ShortforNoncharitableDonee" should be One Million Dollars ($1,000,000).

Article 2. Gift to *Charity*

I also hereby give and transfer to *Charity* all of my Units of Membership Interest remaining after my gift to *ShortforNoncharitableDonee* under Article 1. This gift shall be held and applied by *Charity* for its general charitable purposes.

Article 3. Condition on Gift to *NoncharitableDonee*

ShortforNoncharitableDonee agrees that, if the value of my Units of Membership Interest given to *him/her/it* under Article 1 is finally determined for federal gift tax purposes to exceed the maximum dollar amount that can pass free of federal gift tax by reason of my applicable exclusion amount allowed by Code Section 2010(c), as finally determined for federal gift tax purposes, *he/she/it* will, as a condition of the gift under Article 1, transfer the excess Units to *Charity* as soon as practicable.

[signature and notarial clause]

9. Irrevocable Dynasty Trust Deemed Owned by Grantor's Child Due to Current and Lapsed Withdrawal Rights Under Section 678(a) — GST Exemption Will Be Allocated to All Transfers — See PLR 200949012 (Dec. 4, 2009)[8]

BENEFICIARY-OWNED DYNASTY TRUST

On [date], I, *Grantor*, of [locality, state] (sometimes referred to in the first person and sometimes as the "grantor") and *FirstTrustee*, of [locality, state] (referred to as the "trustee") make this trust.

Article 1. My Family

I am married to *Spouse*, and all references to my *husband/wife* shall be to *him/her*. and I have [number] children, *Children* and [number] grandchildren, *Grandchildren*.

Article 2. Transfers to the Trust

I transfer to the trustee the property listed in the schedule to this trust, and may transfer additional assets to be held on the terms and conditions set forth in this instrument. I retain no right or interest in any trust property.

Article 3. Irrevocability

This trust is irrevocable, and I cannot alter, amend, revoke, or terminate the trust in any way.

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[8] **KEY:**

Grantor	—	Full name of the grantor
FirstTrustee	—	Full name of the initial trustee
Spouse	—	Full name of grantor's spouse
husband/wife	—	"husband" or "wife," as the case may be
him/her	—	"him" or "her," referring to Grantor's spouse
Children	—	Full name of grantor's child or children
Grandchildren	—	Full name of grantor's grandchild or grandchildren
Child	---	Full name of child who is the deemed owner of the trust
ShortforChild	---	Shorthand for *Child*, such as *Phillip* or *Junior*
SecondTrustee	---	Successor named trustee

Article 4. *Child*'s General Withdrawal Right

Child (sometimes "*ShortforChild*") shall have the right to withdraw all of each contribution to the trust (other than a contribution by reason of a transferor's death), subject to the guidelines described later in this instrument.

Article 5. Dynasty Trust

As long as I, my *husband/wife*, or any of my children, grandchildren, and more remote descendants shall be then living, the trustee shall hold all of the trust funds remaining after the exercise or lapse of the withdrawal powers created earlier in this instrument, under this Article.

A. Limited Withdrawal Right. *ShortforChild* may, at any time and from time to time, withdraw so much of the trust income and principal as is appropriate for the health, education, support or maintenance of *ShortforChild*.

B. Other Distributions. The trustee shall distribute to or for the benefit of me, my *husband/wife*, my then-living children, my then-living grandchildren, and my then-living more remote descendants, as much of the net income and principal of the trust is is not withdrawn by *ShortforChild* under the other provisions of this instrument, and as the trustee may deem appropriate for any purpose, annually adding to principal any undistributed income. The trustee may distribute income and principal unequally and may make distributions to some beneficiaries and not to others.

C. Preservation of Corpus. The trustee shall administer the trust in a manner designed to conserve its principal as long as possible. The trustee shall, therefore, lend income and principal to beneficiaries or buy assets for their use, rather than distributing income or principal outright to beneficiaries, unless the trustee shall determine that outright distributions are more appropriate.

D. Termination of the Trust. Upon the death of the last to die of me, my *husband/wife*, my children, my grandchildren, and my more remote descendants, the trustee shall distribute the remaining trust fund to one (1) or more organizations selected by the trustee, gratuitous transfers to each of which are deductible as charitable transfers for federal income, estate, and gift tax purposes.

Article 6. Minor Beneficiaries

The trustee may make distributions to a beneficiary (other than a child of mine) from any trust under this instrument, while such beneficiary is under twenty-one (21) years of age, under any of the options provided in this article.

A. Minor's Trust. The trustee may hold such distributions for such minor beneficiary in a separate trust for the beneficiary, on the following terms and conditions:

1. Until the Termination Date. Until this trust's termination date (defined below), the trustee shall distribute to or for the benefit of the beneficiary as much of the net income and principal as the trustee may consider appropriate for the beneficiary's health, education, support or maintenance, annually adding to principal any undistributed income.

2. Upon the Termination Date. Upon this trust's termination date, the trustee shall distribute the remaining trust funds to the beneficiary, outright and free of trust, if the beneficiary is then living, or otherwise to the beneficiary's estate to be distributed as part of that estate.

3. "Termination Date." This trust's "termination date" shall be the earlier of (1) the date on which the beneficiary dies; or (2) the date on which the beneficiary reaches twenty-one (21) years of age.

B. Custodianship. The trustee may make such distributions to a custodian or successor custodian under any state's version of the Uniform Transfers (or Gifts) to Minors Act, including a custodian selected by the trustee. The trustee may select any age for termination of the custodianship permitted under such state law, giving due consideration to selecting twenty-one (21) years of age if that is permitted, and may designate successor custodians. The trustee may also sell any asset that cannot be held under this custodianship and invest the sales proceeds in assets that can be so held.

C. Other Distributions. The trustee may make such distributions to a minor's parent or legal guardian or directly to such minor, if he or she has then reached fourteen (14) years of age and the trustee deems it appropriate to do so, considering the property in question and the capabilities of the beneficiary.

D. Minority. The fact that the legal age of majority in any jurisdiction in which the beneficiary under this article may live, or in which my will or a trust thereunder may be administered, may be younger than twenty-one (21) years of age, shall not alter the terms or options under this article, and such beneficiary shall still be treated as a "minor" under this article.

E. Exoneration. The trustee shall have full authority to select one or more forms for the distribution of property to a minor under this article, and may select different options for different beneficiaries and different property distributions to the same beneficiary.

Article 7. The Trustee

A. Initial Trustee. *FirstTrustee* shall be the trustee of this trust.

B. Successor Trustees. *SecondTrustee*, of [locality, state], shall be the successor trustee, to serve if *FirstTrustee* is unable or unwilling to serve or to continue serving.

1. Additional Trustee. I authorize the trustee to appoint any person as an additional trustee, to serve at the pleasure of the appointing trustee.

2. Certain Persons Disqualified. Neither my *husband/wife* nor I, nor any former *husband/wife* of mine if I ever have one, may ever be a trustee of this trust. Every trustee of this trust must be a person who is not related and subordinate to me or to my *husband/wife* as defined under Section 672(c) of the Internal Revenue Code (defined below).

C. Bond. No trustee named by me or by another trustee shall be required to provide surety or other security on a bond.

D. Delegation. The trustee may delegate to another trustee any power or authority granted by me to the trustee, to continue at the pleasure of the delegating trustee, unless otherwise agreed. Any person dealing in good faith with a trustee may rely on that trustee's representation that a delegation has been made and remains in effect under this paragraph.

E. Resignation. A trustee may resign by giving written notice specifying the effective date of the resignation to the designated successor. If no successor is designated, the resigning trustee shall give notice to the then-living adult beneficiaries to whom income may then be distributed.

F. Vacancies. A corporation no substantial portion of the stock of which is owned by beneficiaries of this trust, may be named as successor trustee to fill any vacancy, by majority vote of the adult beneficiaries to whom trust income may then be distributed, except that there shall always be at least one Trustee meeting the requirements of Article 2.

G. Responsibility of Successors. No trustee shall be responsible for or need inquire into any acts or omissions of a prior trustee.

H. Compensation. In addition to reimbursement for expenses, each individual trustee is entitled to reasonable compensation for services. Each corporate trustee is entitled to compensation based on its written fee schedule in effect at the time its services are rendered or as otherwise agreed, and its compensation may vary from time to time based on that schedule.

I. Management Powers. The trustee may exercise the powers described below, in a fiduciary capacity.

1. Invest and Reinvest. The trustee may invest and reinvest the trust (or leave it temporarily uninvested) in any type of property and every kind of investment, in the same manner as a prudent investor would invest his or her own assets. The trustee may apply trust income and principal to pay premiums on policies of insurance on my life, on the life of my *husband/wife*, or on both of our lives.

2. Sell and Exchange. The trustee may sell or exchange any real or personal property contained in the trust, for cash or credit, at public or private sale, and with such warranties or indemnifications as the trustee may deem advisable.

3. Borrow. The trustee may borrow money (even from a trustee and from any beneficiary of the trust), for the benefit of the trust and secure these debts with assets of the trust.

4. Security Interests. The trustee may grant security interests and execute all instruments creating such interests upon such terms as the trustee may deem appropriate.

5. Compromise Claims. The trustee may compromise and adjust claims against or on behalf of the trust on such terms as the trustee may deem appropriate.

6. Title to Securities. The trustee may take title to any securities in the name of any custodian or nominee, without disclosing this relationship.

7. Receipts and Disbursements. The trustee may determine whether receipts are income or principal and whether disbursements are to be charged against income or principal, to the extent not established clearly by state law. Determinations made by the trustee in good faith shall not require equitable adjustments.

8. Tax Elections. The trustee may make all tax elections and allocations that the trustee may consider appropriate; however, this authority is exercisable only in a fiduciary capacity and may not be used to enlarge or shift any beneficial interest except as an incidental consequence of the discharge of fiduciary duties. No tax elections or allocations made by the trustee in good faith shall require equitable adjustments.

9. Employ Advisers. The trustee may employ such lawyers, accountants, and other advisers as the trustee may deem useful and appropriate for the administration of the trust. The trustee may employ a professional investment adviser in managing the investments of the trust (including any investment in mutual funds, investment trusts or managed accounts), delegate to this adviser any discretionary investment authorities, and rely on the adviser's investment recommendations without liability to any beneficiary.

10. Distributions in Kind. The trustee may divide and distribute the trust in kind, in money, or partly in each, without regard to the income tax basis of any asset and

without the consent of any beneficiary. The decision of the trustee in dividing any portion of the trust between or among two (2) or more beneficiaries shall be binding on all persons.

J. Special Limits on Interested Trustee. The following limitations shall apply, notwithstanding other provisions of this instrument.

1. Limiting Actions by Interested Trustee. No interested trustee (defined below) may participate in the exercise of any discretion to distribute principal to himself or herself, except as is appropriate for his or her health, education, support or maintenance. No interested trustee may participate in the exercise of any discretion to distribute or expend principal or income in a manner that would discharge that trustee's personal obligation to support the beneficiary to whom such distribution is or may be made. No interested trustee may participate in the exercise of any incident of ownership over any policy owned by the trust insuring the life of such interested trustee.

2. Disinterested Trustee Exercising Certain Powers. A disinterested trustee who is serving as a co-trustee with an interested trustee, may exercise those discretions granted under this instrument the exercise of which by an interested trustee is precluded.

3. Multiple Trustees. The number of trustee who must consent to the exercise of a power granted under this instrument, as determined under this article shall be determined by treating the interested trustee who are not entitled, under this article, to participate in the exercise of the power or discretion, as if they were not then serving. If this article precludes every then-serving trustee from exercising a power otherwise granted to the trustee under this instrument, the then-serving trustee shall appoint a disinterested trustee who may exercise such power (or decline to exercise it) as if that disinterested trustee were the sole then-serving trustee.

K. Disabled Individual Trustee. A trustee may not serve during a disability.

1. When An Individual Trustee is Disabled. An individual trustee is "disabled" or "under a disability" if: (a) he or she is determined to be legally incompetent by a court of competent jurisdiction; (b) a conservator or guardian for such person has been appointed, based upon his or her incapacity; (c) two (2) physicians licensed to practice medicine in [state] certify in writing to another trustee or a person who would become the successor trustee upon such disability, that in the opinion of such physicians, such individual trustee, as a result of illness, age or other cause, no longer has the capacity to act prudently or effectively in financial affairs; or (d) thirty (30) days after any other trustee or a person who would become the successor trustee upon such disability, requests that such individual trustee provide a certificate from a physician licensed to practice medicine that, in the opinion of such physician, such individual trustee has the capacity to act prudently or effectively in financial affairs and such individual trustee fails to provide such certification. The effective date of such incapacity shall be the date of the order or decree adjudicating the incapacity, the date of the order or decree appointing the guardian or

conservator, the date of the certificate of incapacity of the two (2) physicians described above, or thirty (30) days after other trustee or any person who would become the successor trustee upon such disability requests a certificate of capacity and one is not provided, whichever first occurs.

2. Liability. No person is liable to anyone for actions taken in reliance on these certifications or for dealing with a trustee other than the one removed for disability based on these certifications. This trust shall indemnify any physician for liability for any opinion rendered in good faith as to the existence or recovery from any disability.

Article 8. Overriding Purposes

This article states some of my purposes in creating the trust, and all provisions of the trust shall be construed so as best to effect these purposes. No trustee shall exercise any discretion in a manner that could reasonably be expected to frustrate the effectuation of these purposes.

A. Income Tax. The trust shall be deemed owned entirely by *ShortforChild*, and not owned by me, for federal income tax purposes.

B. Gift Tax. All transfers to the trust shall be completed gifts for federal gift tax purposes. All transfers to the trust shall also be gives of a present interest, with respect to *ShortforChild*.

C. Estate Tax. The assets of the trust shall be excluded from my gross estate for federal estate tax purposes.

D. Generation-Skipping Transfer Tax. I intend that no distributions from or terminations of interests in this trust or any trust under this instrument shall be subject to the Federal tax on generation-skipping transfers.

E. Limited Power to Amend. The trustee may, by an instrument in writing, amend this agreement in any manner required to meet any of objectives set forth in this Article. No amendment under this paragraph may increase the class of beneficiaries or provide me with any beneficial interest or economic benefit in this trust. This power to amend may not be exercised by any trustee who is me, my *husband/wife* or a descendant of mine, or who is appointed as successor trustee by me, my *husband/wife* or a descendant of mine.

Article 9. Trust Administration

A. Spendthrift Clause. No beneficiary may either voluntarily or involuntarily transfer any interest in this trust before payment or delivery of the interest to the beneficiary by the trustee. No interest in the trust shall be subject to any beneficiary's liabilities or

creditor claims, assignment, or anticipation. If the trustee determines that a beneficiary would not benefit as greatly from any outright distribution of trust income or principal because of the availability of the distribution to the beneficiary's creditors, the trustee shall instead expend those amounts for the benefit of the beneficiary. This direction is intended to enable the trustee to give the beneficiary the maximum possible benefit and enjoyment of all of the trust income and principal to which the beneficiary is entitled.

B. Multiple Trusts and Shares. The trustee may invest the assets of multiple trusts in a single fund if the interests of the trusts are accounted for separately.

1. Merge or Consolidate. The trustee may merge or consolidate any trust into any other trust that has the same trustee and substantially the same dispositive provisions.

2. Divide. The trustee may divide any trust into multiple separate trusts.

C. Rule Against Perpetuities. All assets of every trust created under this instrument (including every trust created by the exercise of a power of appointment created under this instrument, unless the exercise of such power of appointment starts a new period for the rule against perpetuities or similar rule that limits the time that property may remain in trust) shall vest in and be distributed to the persons then entitled to the income from such property at the expiration of the date twenty (20) years and eleven (11) months after the death of the last survivor of my *husband/wife* and those of the descendants of my grandparents alive on the date of this instrument. Upon termination of a trust under this provision, the accumulated trust income and principal shall be distributed to those beneficiaries then entitled to receive or have benefit of the income from such trust in the proportion in which they are so entitled. If the proportion of the income interests of the beneficiaries of such trust cannot be determined with reasonable certainty, the accumulated trust income and principal shall be distributed equally to such beneficiaries.

D. Accountings. The trustee shall not be required to file annual accounts with any court or court official in any jurisdiction.

E. Disabled Beneficiary. The trustee may distribute income, principal, or both for a disabled beneficiary to his or her parent, guardian, personal representative, or the person with whom the beneficiary resides, without looking to the proper application of those payments.

F. Additional Transfers. Any person may transfer property to the trustee at any time. The trustee may refuse to accept a transfer if acceptance is not in the trust's best interests. The trustee may accept a gift subject to one or more conditions imposed by the donor or the trustee if it is in the best interests of the trust and the beneficiaries and if the condition does not change the rights of a beneficiary with respect to any prior gift. The trustee shall hold all transfers to the trust by someone other than me, if made during my lifetime, in a segregated fund, as a separate and independent trust from the trust created

by assets transferred by me to the trust. Such a separate and independent trust shall be held for the benefit of the same beneficiaries and on the same terms and conditions as the trust created and funded by transfers by me, but the assets of such separate and independent trust shall not be commingled or otherwise mixed with those assets contributed by or attributable to contributions by me. Such separate and independent trust shall not be deemed owned by me for Federal income tax purposes, notwithstanding any other provisions of this instrument.

G. Income Taxes. The trustee shall not pay or reimburse me for the payment of any incremental income taxes imposed upon me with respect to income or gains received by the trust and not distributed to me, notwithstanding any requirement of state law that I be paid or reimbursed for such tax payments.

Article 10. *Child*'s General Withdrawal Right: Guidelines

This Article applies to the *ShortforChild*'s general withdrawal power created in Article 4 of this instrument.

A. Immediate Power. This withdrawal power shall arise immediately after each contribution to the trust (defined below).

B. Priority. This withdrawal power takes precedence over any other power or discretion granted the trustee or any other person.

C. Exercise. *ShortforChild* can exercise this withdrawal power by a written request delivered to a trustee. The legally authorized personal representative of *ShortforChild* may make this withdrawal on *ShortforChild*'s behalf, if *ShortforChild* is unable to exercise this withdrawal power because of a legal disability. If there is no legally authorized personal representative, the trustee shall designate an appropriate adult individual (who may be a trustee but may not be me) who may make the demand on *ShortforChild*'s behalf.

D. Notice. The trustee must reasonably notify the person who would exercise this withdrawal power of its existence and that of any contributions made to the trust.

E. Lapse. The unexercised withdrawal power shall lapse on the last day of each calendar year or, if earlier, sixty (60) days after the contribution to which it relates, to the extent of the five percent (5%) of the trust fund from which the withdrawal could be satisfied or, if greater, greater of Five Thousand Dollars ($5,000).

F. Contribution Defined. “Contribution” means any cash or other assets transferred to the trustee to be held as part of the trust funds, and any payment of premiums on life insurance policies owned by the trust. The amount of any contribution is its federal gift tax value, as determined by the trustee at the time of the transfer.

Article 11. Arbitration & Contests

The provisions of this article are included in order to avoid or minimize the cost of court proceedings and promote the prompt resolution of any disputes regarding the interpretation of this instrument.

A. Arbitration. Any dispute over the administration or distribution of any trust created under this instrument shall be decided by binding arbitration before an arbitrator who shall be a Fellow of the American College of Trust and Estate Counsel selected by its chair of the state that has jurisdiction the trust in question. The arbitrator shall establish the procedures which govern the arbitration. The arbitrator's decision shall not be appealable to any court and shall be final and binding on any and all persons who have or may have an interest in the trust under discussion, including unborn or incapacitated persons, such as minors or incompetents. No guardian or trustee ad litem shall be appointed to represent the interests of unborn or incapacitated persons in any such arbitration. The arbitrator's fee shall be paid by the trustee from the principal of the trust in question.

B. Contests. The terms of this instrument reflect my carefully considered objectives for the disposition of the trust funds and I intend that this paragraph discourage any beneficiary from frustrating my objectives by disinheriting that beneficiary and his or her descendants.

1. Revocation for Contest. I revoke every disposition under this instrument to any person who participates in any contest (defined below), regardless of good faith or subsequent withdrawal of the contest, and I revoke any dispositions to his or her descendants.

a. I leave all of these revoked shares of the trusts under this instrument to [Name of Charity], [locality, state], for its general charitable purposes.

b. If at the time of such Contest, [Name of Charity] is not an existing organization to which deductible transfers may be made for Federal estate tax purposes, I leave the revoked shares of the trusts under this instrument to another organization selected by the trustee to which such deductible transfers may be made, that is organized and operated for purposes similar to those for which [Name of Charity] is organized and operated on the date of this instrument.

2. Expenses. The trustee may defend, at the expense of the trust fund, any contest or other attack of any nature on this instrument or any of its provisions.

3. "Contest" Defined. "Contest" shall, for purposes of this article, be interpreted in the broadest possible manner, and shall include any direct or indirect attempt to challenge the validity or all or any portion of this trust instrument. It shall also include, but not be limited to, abetting, commencing, conducting, and inciting any action, caveat,

claim, demand, dispute, proceeding, or suit to resist, oppose, upset, or object to the validity of any trust under this instrument, asserting, filing, or raising an objection to any such trust based upon any allegation, including, but not limited to, forgery, lack of capacity, duress, fraud, undue influence, or failure of due execution; and impairing, invalidating, modifying, setting aside, or preventing the carrying out of any part of any trust under this instrument. “Contest” also includes, but is not limited to, agreeing with or procuring any other person to do any of the foregoing acts.

Article 12. Definitions and Miscellaneous

A. Definitions.

1. “Children” and “Descendants.” “Children” and “descendants” include those now living and those later born, subject to the following rules:

a. “Children” and “descendants” include an adopted person and that adopted person’s descendants if, that adopted person is adopted before reaching eighteen (18) years of age;

b. “Children” and “descendants” includes those born outside of wedlock, if, during such child’s or descendant’s lifetime, his or her parent through whom such child or descendant claims hereunder, has acknowledged such person as his or her child in a writing duly signed and notarized during such parent's lifetime; and

c. “Children” and “descendants” include a child produced before the parent’s death by donor artificial insemination, in vitro fertilization or other form of surrogate parenthood, whether or not such child was legally adopted by such parent before such parent’s death.

2. “Disinterested Trustee.” A “disinterested trustee” means a trustee who is not an interested trustee (see below).

3. “GST Exemption.” The “GST exemption” or my “GST exemption” shall mean the exemption allowed a transferor against the Federal tax on generation-skipping transfers, as provided in Section 2631(a) of the Internal Revenue Code.

4. “Interested Trustee.” An “interested trustee” is a trustee who is also (a) a beneficiary of the trust of which he or she is a trustee or the insured under a policy of insurance owned by a trust of which he or she is a trustee; (b) married to and living together with a beneficiary of the trust of which he or she is a trustee; (c) the father, mother, issue, brother or sister, of a beneficiary of the trust of which he or she is a trustee; (d) an employee of a beneficiary of the trust of which he or she is a trustee; (e) a corporation or any employee of a corporation in which the stock holdings of the trustee and the trust are

significant from the viewpoint of voting control; or (f) a subordinate employee of a corporation in which such trustee is an executive.

5. "Internal Revenue Code." Any reference to the "Internal Revenue Code" means the U.S. Internal Revenue Code of 1986, as amended, or any similar successor provision of Federal tax law.

6. "Trust." The "trust," without further qualification or specification, shall refer to all trusts under this instrument.

7. "Trustee." The "trustee" shall include each trustee, multiple trustees acting together or separately, and any successor trustee.

B. Tax-Related Terms. All tax-related terms shall have the same meaning in this instrument that they have in the Internal Revenue Code of 1986, as amended.

C. Number. Whenever the context requires, the singular number includes the plural and the plural, the singular.

D. Applicable Law. The trust shall be governed by and construed according to the laws of [state].

E. Copies. There is only one signed original of this instrument. Anyone may rely on a copy of this instrument certified by a notary public or similar official to be a true copy of the signed original (and of any amendments) as if that copy were the signed original. Anyone may rely upon any statement of fact certified by the person who appears from the original document or a certified copy to be a trustee.

DECLARED AND AGREED on the date indicated above.

[Signatures, notary clauses and schedule]

WAIVER OF CERTAIN RIGHTS

I, *Spouse*, waive all of my right, title, and interest in any property transferred to the attached trust, dated [date] (the trust), by *Grantor*. This waiver shall apply both to current and inchoate interests that I may have, including, but not limited to, rights to an intestate share of *Grantor* s estate, to a statutory share of *Grantor* s augmented estate, to another statutory share of *Grantor* s estate, to a share as an omitted spouse, and to a share in the nature of dower or curtesy. The waiver shall constitute a third-party beneficiary

contract for the benefit of all the beneficiaries of the trust, and these beneficiaries or the trustee of this said trust may enforce this waiver by appropriate legal action.

Dated: [date]

[Signature and notary clause]