The RPTE Journal’s Fall/Winter Double Issue includes the extensive report of the Section’s Task Force on Reform of Conservation Easement Law.

The Task Force was Chaired by W. William Weeks and included Turney Berry, Jonathan Blattmachr, Jason Havens, Nancy McLaughlin, James Slaton, Steve Swartz, and Philip Tabas. Commissioned in late 2015, the effort aimed to contribute to the clarification and improvement of the federal tax law of conservation easements. Specific objectives were to clarify the rights and responsibilities of conservation easement holders and donors, reduce audits and litigation over conservation easements, and secure better protection for the natural and cultural values that conservation easements are intended to preserve.

The Report provides information about the history, purposes and scope of conservation easement use in the United States, and reviews certain issues raised by IRS and treasury officials. The principal conclusions of the Report can be categorized within five general areas.

First, the Task Force Report recommends that the Department of the Treasury develop and publish safe harbor language covering a number of provisions that are likely to appear in most conservation easements (and particularly those intended to qualify for deduction.) The Task Force suggests, in addition, that existing holders and donors of conservation easement be given a reasonable time to bring their documents into conformity with the safe harbor language. The appendix to the Task Force Report includes sample provisions.

Second, the Task Force recommends that Treasury provide guidance and rules to facilitate appropriate amendments of conservation easements and discourage improper amendments. The Report sets forth principles to guide that effort, suggests that a series of examples that would clarify the guidance be published and provides a number of such examples. The Report recommends that certain kinds of minor or ministerial amendments be recognized as safe enough to proceed without review. For amendments that ought to be independently reviewed, the Report recognizes that judicial review is available and sometimes desirable, but concludes that there may be less formal, less expensive, and comparably reliable ways to review them. The Report outlines a number of possibilities including IRS sanctioned review panels and notice to the relevant state charity regulating body.

Third, the Task Force recommends improvements to a number of forms now used to report on the nature and administration of conservation easements, including Forms 990, 8282, and 8283.

Fourth, the Task Force recommends clarification of the regulations that govern and prohibit inconsistent use of the land subject to easement restriction. These provisions are a well-intended attempt to be sure that easement provisions intended to protect one valuable conservation purpose do not unnecessarily damage another, but as written they may create unintended difficulties.
Fifth the Task Force recommends a number of measures to help improve the reliability of conservation easement appraisals for both donors and the IRS. Possibilities include appraisal panels and the development of a Qualified Easement Qualified Appraisal Form that could guide appraisers and reviewers through a consistent and complete step by step process for deriving values.

In addition, the Task Force acknowledged the concerns of the IRS and the land trust community about the inflated easement appraisals that have driven recent tax shelter activity. So-called conservation easement “syndications” offer investors pass-through deductions that are often larger than the investment made in certain business entities that donate conservation easements. While seeking some clarification in definitions, the Task Force generally expressed support for the approach taken by the IRS in Notices 2017-10 and 2017-29, an approach which has, since the completion of the Task Force Report manuscript, been reflected in legislation.
North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust

June, 2019

State Not Allowed Under Due Process Clause to Tax Undistributed Trust Income Solely on the Basis of Beneficiaries’ Residence in the State Under the Specific Facts Where Beneficiaries Received No Trust Income, Had No Right To Demand Income, and Had No Assurance They Would Eventually Receive Income; Little Guidance Regarding Factors Used by Other States and In Other Situations for Taxing Trust Income

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Table of Contents

Synopsis.................................................................................................................................................. 1
Analysis................................................................................................................................................ 3
Observations.......................................................................................................................................... 6

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June 24, 2019

Important Information Regarding This Summary
This summary is for your general information. The discussion of any estate planning alternatives and other observations herein are not intended as legal or tax advice and do not take into account the particular estate planning objectives, financial situation or needs of individual clients. This summary is based upon information obtained from various sources that Bessemer believes to be reliable, but Bessemer makes no representation or warranty with respect to the accuracy or completeness of such information. Views expressed herein are current only as of the date indicated, and are subject to change without notice. Forecasts may not be realized due to a variety of factors, including changes in law, regulation, interest rates, and inflation.
Synopsis

In a 9-0 decision, the U.S. Supreme Court upheld lower court findings that the taxation of undistributed income from a trust by North Carolina based solely on the beneficiaries’ residence in North Carolina violated the Due Process Clause, but the Court emphasized that its ruling was based on the specific facts of the case for the specific tax years in question.

The first paragraph of the opinion is an excellent synopsis of the case and the Court’s holding.

This case is about the limits of a State’s power to tax a trust. North Carolina imposes a tax on any trust income that “is for the benefit of” a North Carolina resident. N. C. Gen. Stat. Ann. §105–160.2 (2017). The North Carolina courts interpret this law to mean that a trust owes income tax to North Carolina whenever the trust’s beneficiaries live in the State, even if—as is the case here—those beneficiaries received no income from the trust in the relevant tax year, had no right to demand income from the trust in that year, and could not count on ever receiving income from the trust. The North Carolina courts held the tax to be unconstitutional when assessed in such a case because the State lacks the minimum connection with the object of its tax that the Constitution requires. We agree and affirm. As applied in these circumstances, the State’s tax violates the Due Process Clause of the Fourteenth Amendment.


The decision is narrow in the sense that North Carolina may be unique in looking solely to the residency of a beneficiary, including a beneficiary whose interest is “contingent,” but the opinion does respect the fundamental character of trusts and recognizes the distinct interests and functions of the settlor, trustee and beneficiaries. In addition the opinion implies that the Court’s recent opinion in South Dakota v. Wayfair, Inc. 585 U.S. __ (2018), will not have a major impact on the analysis of the constitutionality of state taxation of trusts. While the trend of cases over the last four years has been to find state taxation of trusts on various grounds to be unconstitutional (with most of those cases addressing systems that tax trusts based on the residency of the settlor of the trust), the Court appears to go out of its way to make clear that it is not addressing any of the other regimes for state taxation of trusts. The opinion provides minimal guidance as to the constitutionality of those various systems (or the North Carolina beneficiary-based system under other facts), but reiterates and applies traditional concepts that due process concerns the “fundamental fairness” of government activity and requires “minimum contacts” under a flexible inquiry focusing on the reasonableness of the government’s action.

Background; Basic Facts; Lower Court Opinions

1. Background. All of the 43 states plus the District of Columbia that impose an income tax on trusts tax the undistributed income of a non-grantor trust as a “resident trust” based on one or more of the following five criteria: (1) if the trust was created by a resident testator (for a testamentary trust), (2) if the trust was created by a resident trustor (for an inter vivos trust), (3) if the trust is administered in the state, (4) if the trust has a resident fiduciary, and (5) if the trust has a resident beneficiary. Observe that the governing law of the trust is not one of those criteria (except in Louisiana; also in Idaho and North Dakota that is a factor considered along with other
factors). A trust included in one of the first two categories is sometimes referred to as a “founder state trust” (i.e., the trust is a resident trust if the founder of the trust was a resident of the state).

See Item 20.d of the 2012 Heckerling Musings found here and available at www.bessemertrust.com/for-professional-partners/advisor-insights for a summary of the court cases that have addressed the constitutionality of state tax systems that tax trusts based on the testator of a testamentary trust or settlor of an inter vivos trust residing in the state. Based on those cases, most commentators believe that taxing a nonresident trust solely because the testator or settlor was a resident is likely unconstitutional (but that conclusion is far from certain). However, if that state’s court system is utilized, for example, because of a probate proceeding in that state, chances are better that the state would be found to have the authority to tax the trust.


1. Basic Facts of Kaestner. The trust was originally created by a New York resident in 1992 for his three children. No party to the trust was in North Carolina until one of the daughters, Kimberly, moved to North Carolina in 1997 at age 28. The original trustee was a New York resident, and a Connecticut resident later became trustee. The trust was governed by the laws of New York. The financial assets were held by custodians in Boston. The financial books and records were kept in New York, and the tax returns and accountings were prepared in New York for administrative convenience. The trust eventually was separated into three subtrusts for the three children in 2002 and the separate shares became separate trusts in 2006. Kimberly’s trust was formed for the benefit of Kimberly and her three children.

North Carolina taxed Kimberly’s trust more than $1.3 million in 2005-2008 based on N.C.G.S. §105-160.2, which provides that the state can tax a trust “that is for the benefit of a resident of this State.” The trust paid the tax and filed a claim for refund on the basis that the North Carolina tax provision was unconstitutional.

The beneficiaries were merely discretionary beneficiaries; the trustee had “absolute discretion” to distribute assets to the beneficiaries “in such amount and proportions” as the trustee might “from time to time” decide. No distributions were made to the beneficiaries during the tax years in question. A loan was made to Kimberly, which she repaid the following year.

The trustee provided Kimberly with accountings of trust assets, and she received legal advice about the trust from the trustee and his law firm in New York. She and her husband met with the trustee in New York to discuss investment opportunities for the trust and whether she wanted to receive income distributions.

The trust agreement provided that the trust would terminate in 2009 (on Kimberly’s 40th birthday), but after the tax years in question and before the termination date, the trustee consulted with Kimberly and in accordance with her wishes the trustee decanted the trust into a new trust under the New York decanting statute (N.Y. Est., Powers & Trusts Law Ann. §10-6.6(b)).

2. Lower Court Opinions. The trial court held that taxing the trust was unconstitutional under both the Due Process Clause and the Commerce Clause, but the Court of Appeals addressed only the Due Process Clause.

For its constitutional analysis, the North Carolina Supreme Court quoted rather extensively from the Due Process analysis (not the Commerce Clause analysis) in Quill Corp. v. North Dakota, 504 U.S. 298
(1992), overruled as to physical presence test in Commerce Clause analysis, *South Dakota v. Wayfair, Inc.*, 585 U.S. __ (2018). Quoting *Quill*, “[t]he Due Process Clause requires some definite link, some minimum connection, between estate and the person, property or transaction it seeks to tax.” The North Carolina Supreme Court reasoned that “[t]his ‘minimum connection,’ which is more commonly referred to as ‘minimum contacts,’... exists when the tax entity ‘purposefully avails itself of the benefits of an economic market’ in the taxing state ‘even if it has no physical presence in the state.’” [quoting *Quill*].

The North Carolina Supreme Court emphasized that the trust and the North Carolina beneficiaries have separate legal taxable existences and that “a taxed entity’s minimum contacts with the taxing state cannot be established by a third party’s minimum contacts” [citing several U.S. Supreme Court cases]. The court concisely concluded that the trust, “as a separate legal entity in the context of taxation, would have needed to purposefully avail itself of the benefits and protections offered by the State [citing *Quill*]. Mere contact with a North Carolina beneficiary does not suffice.” The court held that the statute authorizing taxation of the undistributed income of a trust based on the beneficiary’s residence is unconstitutional under the Due Process Clauses of the U.S. and North Carolina Constitutions as applied to the facts of this case.

**Analysis**

1. **General Due Process Principles Regarding State Taxation.** The Due Process Clause of the Fourteenth Amendment provides that “[n]o State shall... Deprive any person of life, liberty, or property, without new process of law.” The Due Process Clause centrally concerns the “fundamental fairness of governmental activity” [citing *Quill Corp. v. North Dakota*]. The clause limits states to imposing only taxes that “bear fiscal relation to protection, opportunities and benefits given by the state.” *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444 (1940). The Court applies a two-step process to make this determination.

   First, and most relevant here, there must be some “some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.” *Quill*, 504 U.S. at 306. Second, “the income attributed to the State for tax purposes must be rationally related to “values connected with the taxing State.”” *ibid.*

   Footnote 5 clarifies that because the Kaestner Trust does not meet the first test, the Court does not address the second.

   In the context of state taxation, the state must have “certain minimum contacts” such that the tax “does not offend ‘traditional notions of fair play and substantial justice.’” [quoting *International Shoe Co.*, 326 U.S., at 316]. The “minimum connection” inquiry is “flexible” and focuses on the reasonableness of the government’s action [citing *Quill*, 504 U.S. at 307].

2. **General Application of Due Process Principles to State Taxation of Trusts.** “One can imagine” various contacts “with a trust or its constituents” that might provide the “minimum connection” to justify taxation of the trust assets. The Court in the past has looked at “the relationship between the relevant trust constituent (settlor, trustee, or beneficiary) and the trust assets.” Prior cases have recognized that basing state taxation on income distributed to an in-state beneficiary or on a trustee’s in-state residence satisfies the Due Process Clause. Other cases “suggest” that a tax based on the site of trust administration is constitutional.

   As to beneficiary contacts, specifically, “the Court has focused on the in-state beneficiary’s right to control, possess, enjoy, or receive trust assets.” A common governing principle for a State basing
trust taxation on the residence of a trust beneficiary is that “the Due Process Clause demands a pragmatic inquiry into what exactly the beneficiary controls or possesses and how that interest relates to the object of the State’s tax.”

The court analyzes this for beneficiary contacts to settlor or trustee contacts with a state. A state can tax a trust based on an in-settlor who retained the “power to dispose of” the trust property or to the in-state residence of a trustee. (The Court in footnote 7 makes clear that it is not addressing whether a lesser degree of control by a settlor could also sustain a tax by the settlor’s domicile state.)

The Court briefly summarizes the Due Process Clause analysis for the various types of trust constituents (beneficiary, settlor, and trustee), and particularly for beneficiaries. That summary is quoted in Item 8 of the Observations, below.

3. **Application of Principles to Kaestner Trust Facts.** The Court makes very clear that its conclusion that the Due Process Clause is not satisfied as to North Carolina’s taxation of the trust is based on the specific facts in these years. The Court concludes that the Kaestner Trust beneficiaries do not have the requisite relationship with the trust property to justify the state’s tax, but footnote 7 makes clear that the Court does “not decide what degree of possession, control, or enjoyment would be sufficient to support taxation.”

The Court points to various reasons that the mere residence of the beneficiaries in North Carolina does not supply the required “minimum connection” necessary to support state taxation of the trust.

First, the beneficiaries did not actually receive any income during the years in question.

Second, “the beneficiaries had no right to demand trust income or otherwise control, possess, or enjoy the trust assets in the tax years at issue.” The trustee had “absolute discretion” in deciding when, whether, and to whom distributions would be made. The Court emphasizes that “Critically, this meant that the trustee had exclusive control over the allocation and timing of trust distributions.” Distributions could be made to one beneficiary to the exclusion of others, “with the effect of cutting one or more beneficiaries out of the Trust.” The trustee and not beneficiaries made investment decisions. A spendthrift clause prevented beneficiaries from assigning their interests in trust property to anyone. (Footnote 9 makes clear that the Court does not address whether the absence of a spendthrift clause would mean that the minimum contacts requirements for due process is satisfied.) While the trust agreement directs the trustee to be liberal in exercising its distribution discretion and the trustee could not act in bad faith or some improper motive, the beneficiaries still could not demand distributions or direct that Trust assets be used for their benefit.

Third, the beneficiaries “could not count on necessarily receiving a specific amount of income from the Trust in the future.” While the trust was scheduled to terminate in 2009, the New York decanting statute allowed the trust to distribute to a new trust with a longer termination date, which the trustee in fact did. As a result of these facts, one might view the interests of the beneficiaries as “contingent” on the exercise of the trustee’s discretion. The Court in footnote 10 says that it specifically is not addressing “whether a different result would follow if the beneficiaries were certain to receive funds in the future.”

In light of these three reasons, Kimberly and her children “had no right to ‘control or posses[s]’ the trust assets ‘or to receive income therefrom.’” “Given these features of the Trust, the
beneficiaries’ residence cannot, consistent with due process, serve as the sole basis for North Carolina’s tax on trust income.”

4. **Rejection of State’s Counterarguments.** First, the State argued a prior case stands “for the broad proposition that that ‘a trust and its constituents’ are always ‘inextricably intertwined,’ and that because trustee residence support trust taxation, so too must beneficiary residence. This argument “fails to grapple with the wide variation in beneficiaries’ interests.” The relationship between beneficiaries and trust assets maybe very close in some situations, but not in others.

Second, the State argued that a ruling in favor of the Trust will undermine numerous state taxation regimes. The Court rejects that argument because few states rely on beneficiary residency as the sole basis for state taxation. Footnote 12 points out that five states (Alabama, Connecticut, Missouri, Ohio, and Rhode Island) look at a beneficiary’s residence in combination with other factors. Furthermore, three states (Georgia, Montana, North Dakota), that purportedly look at beneficiary residency apply flexible tests and may not rely on beneficiary residency alone. Tennessee uses beneficiary residency but will phase out its income tax by 2021. California applies beneficiary residency as a factor, but only where the beneficiary is not contingent. No other state has a regime that is clearly like that in North Carolina.

Third, the State argued that adopting the Trust’s position will lead to “opportunistic gaming of state tax systems,” by delaying taking distributions until the beneficiary moves to a state with a lower level of taxation. The Court responds that such gaming is by no means certain to occur because the trustee, not the beneficiary, has the power to make or delay distributions, and because the holding addresses only circumstances in which a beneficiary receives no income, has no right to demand income, and is uncertain necessarily to receive income. “In any event, mere speculation about negative consequences cannot conjure the ‘minimum connection’ missing between North Carolina and the object of its tax.”

5. **Not Address Rationale of North Carolina Supreme Court.** Footnote 11 observes that the Court does not address the Trust’s “broader argument that the trustee’s contacts alone determine the State’s power over the Trust.” The North Carolina Supreme Court reasoned that the Trust and the beneficiaries have separate legal taxable existences; the Trust itself must have sufficient “minimum contacts” with the State and mere contact with a beneficiary will not suffice.

6. **Concurring Opinion.** A separate brief concurring opinion by Justice Alito, joined by Chief Justice Roberts and Justice Gorsuch, states that its purpose is to make clear that the opinion of the Court is based on the “unusually tenuous” connection between the Kaestner beneficiaries and the trust income, and that “the opinion of the Court merely applies our existing precedent and that its decision not to answer questions not presented by the facts of this case does not open for reconsideration any points resolved by our prior decisions.”

Existing opinions establish that a state in which tangible trust assets are located can tax those assets. *Curry v. McCanless*, 307 U.S. 357, 364-365 (1939). For intangible assets, the issue is whether a resident of the state imposing the tax has “control, possession, or the enjoyment of the asset.” For example, the state of the trustee’s residence can impose a personal property tax on the trust’s intangible assets. *Greenough v. Tax Assessors of Newport*, 331 U.S. 486 (1947). As to whether the connection between a beneficiary and the trust income is sufficient to allow the beneficiary’s state of residence to tax the trust income, the concurring opinion says that two prior cases (from about 90 years ago) provide a clear answer, based on the beneficiary’s lack of “control, possession, or enjoyment” of the
assets of the trust income. *Brooke v. Norfolk*, 277 U.S. 27, 28-29 (1928); *Safe Deposit & Trust Co. of Baltimore v. Virginia*, 280 U.S. 83, 93-94 (1929) (Virginia could not apply its intangibles tax to assets of a trust with a Maryland trustee where neither the grantor nor the beneficiaries who resided in Virginia had control over the trust assets).

**Observations**

1. **Significance of State Trust Income Taxation Issues.** States use a variety of factors to determine whether the state can tax the undistributed income of non-grantor trusts. Questions surrounding the state taxation of trust income are arising more frequently as (1) states are strapped for revenue and are getting more aggressive and (2) beneficiaries and individual trustees are more mobile, which may have the effect of changing the tax situs. These issues impact important estate planning decisions; for example, planners must be careful in naming family members as trustee without considering whether the appointment could cause the trust to be subject to income tax in the state of the trustee’s residence. These issues are exacerbated by the trend of splitting up trustee functions among co-trustees, increasing the possible likelihood of having at least one co-trustee in a state that uses the trustee’s residence as a basis for taxing trusts.

2. **Significance (and Insignificance) of Kaestner.**

   The Due Process and Commerce Clauses of the U.S. Constitution both place limits on the ability of a state to tax income when the income is not directly produced within the state. In particular, courts over the last century have grappled with when a state can tax the undistributed income of trusts based on some connection to the state and still satisfy the Due Process Clause’s requirement of fundamental fairness. A number of state court cases have addressed this issue (increasingly over the last decade, as discussed in Item 9 below), but *Kaestner* is the Supreme Court’s first effort to address this important issue regarding state taxation of trust income in many decades. For that reason, the case is highly significant.

   The opinion is helpful in reiterating established guidance regarding the Due Process Clause’s limits on the ability of states to tax income and the general principles for when a state can tax trust income under the Due Process Clause. The opinion is very limited, however, in establishing guidelines for what specific connections that a state has with a trust income will satisfy the due process requirements.

3. **Steve Akers Points Out That Ron Aucutt Told Us That Three Months Ago.** Ron Aucutt’s summary of the *Kaestner* case over three months ago turns out to be an excellent summary of where we are now in our understanding of the constitutionality of state trust taxation systems. The last two sentences of his article accurately predicted the planning situation following the *Kaestner* opinion “While tax lawyers will undoubtedly parse the Court’s opinion (or opinions) very carefully, we should expect the Court’s holding to be only an acceptance or rejection of the particular way North Carolina taxes trusts. A lot of extrapolation and simple guesswork will probably still be needed to answer most of the questions and evaluate the impact on most other states.”

4. **Recognition of Fundamental Trust Concepts.** The opinion respects the fundamental character of trusts and recognizes the distinct interests and functions of the settlor, trustee and beneficiaries. An amicus brief filed by The American College of Trust and Estate Counsel was designed primarily to inform the Court about fundamental trust concepts and fiduciary income
taxation concepts, and the importance of the nature and connection of the settlor, trustee, and beneficiaries of a trust to trust income with respect to the constitutionality of state taxing systems.

**Little Guidance Regarding Degree of Beneficiaries’ Connection to Trust Income That Would Justify State Taxation Based on Beneficiaries’ Residence in the State.** The opinion reiterates again and again that it is based on the very specific facts for the particular years in question, and that the Kaestner beneficiaries’ “unusually tenuous” (in the words of the concurring opinion) connection to the trust income in those years was not sufficient to meet the due process fundamental fairness requirement.

The opinion leaves open the possibility that states may be able to tax undistributed trust income based on a trust beneficiary’s residence in the state in certain situations (for example, possibly if the beneficiary received some income during the year in question, had the right to demand income from the trust during that year, or had a vested interest in ultimately receiving that trust income). The opinion reiterated various times that it was not addressing what situations involving a beneficiary's connection to trust income would satisfy the due process requirements. See n.8 (“We do not decide what degree of possession, control, or enjoyment [by trust beneficiaries] would be sufficient to support taxation”); n.10 (“We have no occasion to address, and thus reserve for another day, whether a different result would follow if the beneficiaries were certain to receive funds in the future”); n.11 (“Even if beneficiary contacts—such as residence—could be sufficient in some circumstances to support North Carolina’s power to impose this tax, the residence alone of Kaestner Trust beneficiaries cannot do so for the reasons given above”).

The opinion points out in footnote 12 that the North Carolina beneficiary-based regime may be unique, leaving open the question of the constitutionality not only of the North Carolina regime in other fact situations but also the constitutionality of the other (possibly different) beneficiary-based state trust taxing systems. For example, one of the factors mentioned in Kaestner is that the resident-beneficiary was not assured of ultimately receiving the trust income. The Court in footnote 10 said that it specifically was not addressing “whether a different result would follow if the beneficiaries were certain to receive funds in the future.” For example, one of the factors that California uses in taxing the undistributed income of trusts is whether any “non-contingent” beneficiaries reside in California.

**Guidance as to Factors That Would Justify State Taxation of Trust Income.** Page 6 of the opinion addresses three taxing regimes that do pass the Due Process Clause’s “minimum contacts” requirement: (1) taxation of actual trust distributions to a state resident, *Maguire v. Trefry*, 253 U.S. 12, 16-17 (1920); (2) taxation based on the residence of the trustee, *Greenough v. Tax Assessors of Newport*, 331 U.S. 486 (1947); and (3) possibly taxation based on the place of administration (cases suggesting that is constitutional are *Hanson v. Denckla*, 357 U.S. 235, 251 (1958) (involving personal jurisdiction, not trust taxation, issues), and *Curry v. McCanless*, 307 U.S. 357, 370 (1939)).

In addition, cases are clear that states can tax income that comes from sources within the state (sometime referred to as “source income”).

**Minimal Guidance as to Settlor-Based Regimes.** The most prevalent factor that is used by states for taxing undistributed trust income is whether the trust was originally created by a resident of the state. The opinion provides little guidance regarding whether those systems will satisfy the due process requirements. The opinion does observe that prior cases have upheld systems based on the settlor’s residence in situations in which the settlor had the “power to dispose of” the trust property, *Curry v. McCanless*, 307 U.S. 357, 364-365 (1939), or the “right to revoke” the trust, *Graves v. Elliott*, 307 U.S. 383, 387 (1939). Beyond those cases, in which the settlor retains the clear power...
to control or possess the trust property, the opinion gives no guidance regarding the constitutionality of settlor-based taxing regimes. The opinion notes that neither Curry nor Graves explored “whether a lesser degree of control by a settlor also could sustain a tax by the settlor’s domicile (and we do not today address that possibility).” Kaestner n.7

Although a few exceptions exist, a wide variety of state cases have found that systems based solely on the existence of a resident-settlor do not satisfy due process requirements (see Item 20.d of the 2012 Heckerling Musings found here and available at www.bessemertrust.com/professional-partners/advisor-insights), including a number of recent cases over the last several years (see Item 9 below).

Even among settlor-based regimes, the constitutionality analysis may vary. Taxation of testamentary trusts by the state of the decedent’s residence may have a somewhat greater possibility of withstanding constitutional muster than inter vivos trusts because of the utilization of the state's probate courts in the establishment of the testamentary trusts. The courts have generally focused their constitutional analysis of state taxation of trusts under the Due Process Clause (and the involvement of the local courts in creating the trust is an additional contact with the state that may help support the existence of the required “minimum contacts” required for due process), but the state taxation must also be permitted under the Commerce Clause, which requires a substantial nexus between the activity being taxed and the taxing state, and the local court involvement might help in establishing that the required substantial nexus exists.

Another variance is that some settlor-based state regimes also add a "nonresident resident trust" exception (such as New Jersey and New York); the state cannot tax the income of a "resident trust" created by a resident-settlor if no trustees, assets or source income are present in that state.

Settlor-based state systems can sometimes create planning opportunities for trusts created by residents in other states. Because such a state only taxes trusts created by settlors who reside in the state, residents of other states that have a nonresident resident trust exception can create trusts in a settlor-regime state without state income taxation. For example, New York resident-settlers may create trusts with New Jersey trustees and assets and not be subject to New York taxation (because of the absence of a New York trustee or New York assets) or New Jersey taxation (because the trust was not created by a New Jersey testator or settlor).

The Fielding case (discussed in Item 12 below) involved the constitutionality of a settlor-based system, and could potentially have resulted in Supreme Court guidance for settlor-based regimes if the Court had granted petitioner’s certiorari request in that case.

8. **Summary of Opinion's Guidance Regarding Beneficiary, Settlor, or Trustee Based Taxing Regimes.** Future cases addressing the constitutionality, under the Due Process Clause, of factors used by states for taxing trust income will focus on the following summary in *Kaestner*:

In sum, when assessing a state tax premised on the in-state residency of a constituent of a trust—whether beneficiary, settlor, or trustee—the Due Process Clause demands attention to the particular relationship between the resident and the trust assets that the State seeks to tax. Because each individual fulfills different functions in the creation and continuation of the trust, the specific features of that relationship sufficient to sustain a tax may vary depending on whether the resident is a settlor, beneficiary, or trustee. When a tax is premised on the in-state residence of a beneficiary, the Constitution requires that the resident have some degree of possession, control, or enjoyment of the trust property or a right to receive that property before the State can tax the asset. *Cf. Safe Deposit*, 280 U. S., at 91–92. Otherwise, the State’s relationship to the object of its tax is too attenuated to create the “minimum connection” that the Constitution requires. See Quill, 504 U.S. at 306.

8As explained below, we hold that the Kaestner Trust beneficiaries do not have the requisite relationship with the Trust property to justify the State’s tax. We do not decide what degree of possession, control, or enjoyment would be sufficient to support taxation.

Contrary to this recent trend is *T. Ryan Legg Irrevocable Trust v. Testa*, 75 N.E.3d 184 (Ohio 2016), *cert. denied*, 2017 U.S. LEXIS 5567 (U.S. 2017). The Ohio Supreme Court upheld imposition of Ohio income tax on a nonresident Delaware trust’s sale of Ohio S corporation interests, based on a state statute requiring that nonresidents pay Ohio income tax on taxable gains from the sale of a 20% or greater interest in an Ohio pass-through entity. An earlier Ohio case held that the statute was unconstitutional as applied to a seller that had not availed himself of Ohio’s protections and benefits in a direct way. The Ohio Supreme Court nevertheless upheld the imposition of the Ohio tax in this case, even though the Delaware trust had not availed itself of Ohio protections and benefits, because the trust’s settlor was from Ohio and that same person was the original founder and manager of the pass-through entity (though he had withdrawn from the business before the year in question).

Another recent state case addresses a Massachusetts tax on trust income if the trust has a settlor, at least one beneficiary, and at least one trustee that is an “inhabitant” of Massachusetts. The case concluded that Bank of America met the trustee-inhabitant requirement, even though it was not domiciled in Massachusetts, based on its various activities in Massachusetts and based on a construction of the tax statute. *Bank of America N.A. v. Commissioner of Revenue*, 54 N.E.3d 13, 474 Mass. 702 (Mass. 2016).

10. **Impact of Decanting Statute.** One of the reasons the Court gave for concluding that the beneficiaries did not have the requisite “minimum connection” with the income being taxed was that they were not assured of ever receiving the income. The tax years in question were 2006-2008, and the trust agreement said that the trust would terminate in 2009. To reason that the beneficiaries were not assured of receiving the income when the trust would terminate in the *following year* (as to the 2008-year tax) may seem somewhat of a stretch. Apparently, as of 2008, the Court would have been relying on the fact that the trustee had the authority to distribute the assets to a longer-term trust under the New York decanting statute, so the beneficiaries were not assured of receiving the income.

11. **Not Adopt Rationale That Trust Itself Must Have Contacts With State.** The Court did not adopt the reasoning of the North Carolina Supreme Court that the Kaestner Trust and the beneficiaries have separate legal taxable existences, and that the Kaestner Trust itself (rather than trust beneficiaries) must have sufficient “minimum contacts” with the state.

12. **Supreme Court Will Not Hear Fielding.** In *William Fielding, Trustee of the Reid and Ann MacDonald Irrevocable GST Trust for Maria V. MacDonald, et al., v. Commissioner of Revenue*, (Minn. Tax Ct. May 31, 2017), the court addressed the Minnesota statute providing that an inter vivos trust is treated as a
resident trust if the grantor was a Minnesota resident when the trust became irrevocable. The taxpayer paid income tax on all income earned by the trust in 2014, but filed a claim for refund, alleging that Minnesota’s taxation of non-Minnesota income merely on the basis of the grantor being domiciled in Minnesota when the trust became irrevocable was unconstitutional, violating the due process clauses of the Minnesota and U.S. Constitutions, and the Commerce Clause of the U.S. Constitution. The Commissioner tried to point to other (rather minimal) contacts with Minnesota. While the court reasoned that all contacts with Minnesota would be considered, the court concluded that the only factor that was relevant for consideration was the statute’s description of the grantor’s domicile when the inter vivos trust became irrevocable and whether that basis was sufficient on constitutional grounds. The court concluded that the grantor-domicile sole basis under the Minnesota statute for treating an inter vivos trust as a Minnesota resident trust violated the Due Process clauses of the Minnesota and United States constitutions. Minnesota was not entitled to tax the income from the sale of stock (of a Minnesota corporation) or income from an out of state investment account. The Minnesota Supreme Court affirmed on July 18, 2018, largely following the reasoning of the Minnesota Tax Court. The state filed a certiorari petition with the United States Supreme Court. The Court did not address that petition while the Kaestner case was pending, but it denied the petition on June 28, 2019.

13. Minimal Apparent Impact of Wayfair on State Taxation of Trusts. South Dakota v. Wayfair, 138 S. Ct. 2080 (U.S. 2018), holds that states may require sellers to collect sales tax on internet purchases for remission to the purchaser’s state even where the seller does not have a physical presence in the purchaser’s state. Wayfair does not involve trust income taxation, but some of the recent trend of trust state income tax cases have cited Quill Corp v. North Dakota, and Wayfair overrules the physical presence test in Quill for applying the Commerce Clause. However, the state trust taxation cases have quoted Quill primarily for its discussion of the Due Process Clause, not the Commerce Clause. The fact that the Court in Wayfair overruled the Quill case in one respect (albeit not related to the Due Process Clause) has raised some question as to whether the Court might change its analysis of the constitutionality of states’ taxation of trust income. See a detailed discussion of this issue in Item 8.d-e of Estate Planning Current Developments and Hot Topics (June 2019) found here and available at www.bessemertrust.com/for-professional-partners/advisor-insights.

That question has been answered; Wayfair appears to have no impact on the constitutionality of state taxation of trusts (at least under a Due Process Clause analysis). The Wayfair case was not even mentioned in the Kaestner opinion, other than including it in the citation of the Quill case to point out that Wayfair overruled Quill “in part on other grounds” – that is, as to an issue other than Quill’s discussion of the Due Process Clause.

Some of the state trust income tax cases have addressed both the Commerce and Due Process Clauses. Taxing states must satisfy both the Due Process Clause, which requires minimum contacts, and the Commerce Clause, which requires a substantial nexus between the activity being taxed and the taxing state. Wayfair’s overruling of the physical presence test in Quill’s analysis of the Commerce Clause could conceivably have an impact on any future cases that test state taxation of trust income under the Commerce Clause. Wayfair says that an essential element of the Commerce Clause is that an activity exists “with substantial nexus with the taxing State” which can be established when the taxpayer “avails itself of the substantial privilege of carrying on business in that jurisdiction.”

14. Approach While Awaiting Determination of Constitutionality. If a state attempts to tax the accumulated income of a trust based solely on the settlor’s residence when the trust was created
or a beneficiary’s residence under facts different than the *Kaestner* facts, what should the trust do? The most conservative approach would be to pay the tax and request a refund based on the unconstitutionality of the tax.
Lis Pendens: Is It A “Transfer” (And Thus Avoidable in Bankruptcy) Or Not?

By Vicki R. Harding

A recent bankruptcy case illustrates the unpredictable effect of a lis pendens in bankruptcy.

In Viera v. Whitfield (In re Shiver), a chapter 7 trustee sought to avoid a judgment, a lis pendens and a foreclosure decree involving the debtor’s property as preferences and/or by exercising the strong arm power of a bona fide purchaser of real estate. The bankruptcy court discussed the effect of the lis pendens in ruling on cross-motions for summary judgment.

The debtor was an owner and co-partner of an unincorporated association (Permacoat). Permacoat sought to enforce a mechanics lien against another party in a state court action. The defendant (Whitfield) counterclaimed and obtained a judgment against Permacoat. As an owner of an unincorporated association, the debtor was ultimately found to be personally liable for the judgment.

After Whitfield commenced supplemental proceedings against Permacoat, it filed a lis pendens against property owned by the debtor. Whitfield then obtained a decree of foreclosure and order of sale for the property to satisfy the judgment lien he had obtained against Permacoat.

Although the original judgment was not recorded and indexed against the debtor, the foreclosure decree stated that the debtor was personally liable for the judgment. The debtor filed bankruptcy before the foreclosure sale could occur.

The chapter 7 trustee sought to avoid (1) the lis pendens and the foreclosure decree as preferences under section 547 of the Bankruptcy Code, and (2) the original judgment and the foreclosure decree using the strong arm powers of a bona fide purchaser of real estate under section 544(a). A key issue was whether the lis pendens constituted a transfer for purposes of section 547.

The trustee argued that under state law the lis pendens placed a cloud on title to the property that prevented the debtor from freely conveying the property to a subsequent purchaser – drawing an analogy to a mortgage. If the lis pendens was avoided as a preference, then there was no record notice of the original judgment so that a bona fide purchaser could acquire the property free of the judgment.

Whitfield argued that the lis pendens could not be avoided as a preference because it did not constitute a transfer of an interest in property. Instead a lis pendens merely provided notice of pending litigation and did not affect the debtor’s ability to convey title. He also argued that there is a difference between an actual transfer and perfection of a transfer, and the lis pendens constituted perfection as opposed to a transfer.

The court began its analysis by considering whether the lis pendens and the foreclosure decree constituted “transfers” that could be avoided as preferences. It noted that under...
the Bankruptcy Code the concept of transfer is very broad and includes matters where title is changed in a way that affects creditors even though ownership remains intact. The statutory definition\(^5\) expressly includes involuntary dispositions, and transfers clearly include dispositions resulting from state court proceedings.

Courts have disagreed on whether a lis pendens is a transfer that can be avoided as a preference, and those that conclude it constitutes a transfer have used a variety of different theories to reach that result. After reviewing cases on both sides, the bankruptcy court expressed its agreement with the view that a lis pendens is a transfer based on a theory characterizing property rights as a “bundle of sticks.”

Under applicable state law a properly filed lis pendens binds subsequent purchasers to proceedings evolving from the litigation (giving the party filing the lis pendens a superior interest) and places a cloud on title which prevents the owner from freely disposing of the property until the litigation is resolved. Thus, filing a lis pendens deprived the owner of one of its fee simple absolute “bundle of sticks.”

The court similarly found that the foreclosure decree was a preferential transfer. The decree found for the first time that the original judgment constituted a fifth lien on the debtor’s property. Accordingly, the court found that the foreclosure decree created a lien, and thus was a transfer that could be avoided as a preference. (Since the court avoided the foreclosure decree as a preference, it did not address whether the decree was avoidable using the trustee’s strong-arm powers.)

The court also noted that avoiding the lis pendens and the foreclosure decree was consistent with the objective of section 547 – namely to protect creditors from secret liens perfected just before bankruptcy and to facilitate equality of distribution.

The trustee further argued that the original judgment was avoidable using the strong arm power of a bona fide purchaser of real estate. Under state law, recording a judgment in the real estate records creates a lien on the real estate of a judgment debtor. However, the judgment was not recorded under the debtor’s name prior to bankruptcy. So, a hypothetical bona fide purchaser at the time of commencement of the case could avoid the judgment.

Thus, the court avoided the lis pendens and the foreclosure decree as preferences and avoided the original judgment based on exercise of the trustee’s strong arm powers, with the transfers preserved for the benefit of the bankruptcy estate under section 551.\(^6\)

The cases discussed by the court present an interesting array of theories for analyzing a lis pendens. While there is likely to be value in recording a lis pendens, it would be difficult to predict with any confidence the effect of that recording.

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Should Offshore Trusts Stay Offshore – The Problems

By Jennie Cherry, Esq. and Stephen K. Vetter, Esq.

Kozusko Harris Duncan

Introduction

Background

US tax rules attempt to recoup lost tax plus interest on distributions from offshore trusts
Quarantine tainted income to avoid distribution to US beneficiaries
Cleansing distributions relieve prior accumulations but offshore deferral ends
Limitations of cleansing distributions

Comment

Introduction

US beneficiaries of foreign trusts are subject to a throwback tax regime and an interest charge when they receive distributions of accumulated income from the trust. To avoid these punitive payments, families often choose to convert or decant the trust to a US domestic trust. However, the easy answer may not be the best answer; staying offshore may be the better choice (part 2 in this series "Should offshore trusts stay offshore – the long-term trust solution" will propose a multi-generational option). Much depends on a close look at the tax residence and financial needs of each of the beneficiaries, alongside a careful examination of the trust's current investments, investment policy and duration. Most importantly, those factors – and the tax law itself – may change over time, so a static analysis may produce misleading conclusions. The easy answer may also lead to an irreversible error. A trust that tries to rebound from an ill-considered move to the United States may face a tax on the way out – a toll charge that precludes returning offshore.

Background

During the late 1990s, US tax law became increasingly hostile to trusts that were foreign for US income tax purposes but not entitled to income tax treaty benefits, usually because the trusts were created in no-tax jurisdictions outside the United States (hereinafter referred to as 'offshore trusts') and benefited US persons. Tax compliance
and planning became increasingly difficult and new rules were enacted to put more offshore trusts into the category of 'non-grantor trusts' if they were established by a non-US grantor (for further details on trust classification please see "Overview (March 2018)"). As a result, many offshore trusts established by multinational families for the benefit of their US family members have since migrated to the United States.

After major US tax cuts were passed in 2003 and 2017, the reasons for foreign non-grantor trusts to become US domestic trusts seemed even more compelling when family members in the United States were the intended beneficiaries. The lower tax rate of 15% on qualified dividends and long-term capital gains seemed too good to pass up when compared with the punitive tax burden imposed on any future distributions of accumulated income to the US beneficiaries if the trust stays offshore.

**US tax rules attempt to recoup lost tax plus interest on distributions from offshore trusts**

Since offshore trusts are outside the US tax net, a US beneficiary who receives a distribution from a foreign non-grantor trust will owe tax on the income. No tax is owed if no distributions are made to US beneficiaries. This basic principle is implemented by the same complex system of tax rules that apply to domestic trusts, but with two important differences that address the loss of annual tax revenue from a foreign trust: a special 'throwback rule' and an interest charge apply to any distribution from a foreign trust that is treated as passing out income accumulated in a prior year (including realized capital gains).

**Key concepts**

For trusts, the US tax rules employ two key concepts:

- a distribution deduction; and
- a distributable net income (DNI) calculation.

Typically, a cash distribution reduces the trust's income through the distribution deduction and causes an equivalent amount of trust DNI to flow through to the recipient beneficiary as taxable income. The beneficiary is then taxed as though the income was earned directly. For foreign trusts, the DNI is roughly equal to the trust's net ordinary income (including foreign source income and income otherwise exempt from tax by treaty), plus capital gains and other taxable income. Thus, a distribution of $1,000 from
an offshore trust that sold assets that year at a total gain of $1,200 will pass out $1,000 of capital gain income to the US beneficiary.

Income not passed out to the beneficiaries under these tax rules is attributed to the trust itself, leading to different tax results for foreign and domestic trusts. The foreign trust, which is taxed like a non-resident non-citizen individual, is generally subject to US tax only on income derived from US sources, collected by means of a withholding tax. The result is that the typical offshore trust pays no US income tax on either its interest income or capital gains on its investments (except for a special tax regime for US real estate and a withholding tax on any US source dividends).

**Application to offshore trusts**

However, for an offshore trust with US beneficiaries, this tax holiday may provide little benefit. While neither the offshore trust nor the beneficiaries are currently taxed, the economic benefits of this deferral are easily stripped away by the throwback rule and interest charge that apply when the accumulated income (including realized capital gains) is later distributed to a US beneficiary. An accumulation distribution occurs when distributions exceed income for the current year, as measured for both income tax purposes and accounting purposes, and there is undistributed net income (UNI) in the trust from prior years, including undistributed realized capital gains.

**Throwback rule**

The two rules work in concert to magnify the tax liability. The throwback rule artificially raises the applicable tax rate on the accumulation distribution by taxing the income passed out to the US beneficiary at the ordinary income tax rates that would have applied had the distribution been made in the year earned. The beneficiary cannot use the substantially lower maximum US income tax rate on qualified dividends and long-term capital gains (15% compared with ordinary income at a top rate of 37%).

**Interest charge**

An annual interest charge is then imposed to eliminate the benefit of paying the tax later. The interest charge applies to the amount of tax that was effectively deferred during the time the recipient beneficiary was a US person (regardless of the beneficiary’s age). However, notably, the interest is being charged against the artificially high tax liability created by the throwback rule, as if this was the tax previously deferred.
In addition, the interest charge is compounded and is not deductible in computing net taxable income.\(^{(1)}\)

Taken together, the high tax rate generated by the throwback rule and the added interest charge on accumulation distributions create a tax drag that is virtually impossible to overcome through successfully reinvesting the deferred tax funds. The growing liability can consume the entire amount distributed to the US beneficiary when the tax bill comes due at that time. Even the final terminating distribution can disappear. What seemed like a benign or even beneficial deferral can turn into a mounting liability that eats away at the original trust capital.

Tax advisers have tried with some success to develop a cure for the tax drag resulting from the combination of a high tax rate generated by the throwback rule and the added interest charge on accumulation distributions from an offshore trust to a US beneficiary. Generally speaking, these cures are designed to quarantine the tainted income – that is, to isolate and seal off the accumulated income so that it cannot be pulled out of the trust by future distributions to US beneficiaries.

**Quarantine tainted income to avoid distribution to US beneficiaries**

Designing and implementing a quarantine plan is quite a challenge when substantial income (including realized capital gains) has accumulated. For example, life insurance can be used as part of an investment strategy to prevent the accumulation of income in the offshore trust in the first instance, or can reduce it somewhat in future years, but buying a life insurance policy will not resolve the taint on the income that has already been accumulated. Paying premiums on a life insurance policy out of the cash flow generated by the accumulated income does not create a deductible expense, so the deferred tax burden grows almost unabated. The severe income tax costs of the throwback rule and interest charge are still triggered when distributions are later made to US beneficiaries, regardless of whether those distributions are made from policy benefits.\(^{(2)}\) Given the complexity and other limiting factors associated with purchasing an offshore life insurance policy, it is clear that life insurance is not a miracle cure for a trust that already has the disease.
Leaving aside the placebos that foster wishful thinking (and more powerful therapies that are unusually complex), making a cleansing distribution is one of the most common methods used to attempt to quarantine UNI.

**Cleansing distributions relieve prior accumulations but offshore deferral ends**

Cleansing distributions usually make it possible for US beneficiaries to receive the value of the original trust capital – but no more. This is accomplished in two steps over at least two years. First, one or more distributions equal to at least the amount of the total accumulated income are made to a non-US person or a separate non-US entity, who are either members of the original discretionary class of beneficiaries or added by the exercise of a power. Such a distribution reduces the remaining income accumulation even though no US tax will be owed by the recipient. The distribution must be large enough to equal the current year's income and all the historical accumulations (including realized capital gains) in order to exhaust the accumulated income and remove the taint. After this cleansing distribution, the remaining trust funds (ie, the original trust capital) can be distributed to US beneficiaries or a US domestic trust in the following tax year without carrying out any accumulated income. The distribution into the United States can also be staged over several years, or delayed indefinitely, as long as income (including realized capital gains) is paid out currently (or at least accumulations do not build up again without a plan to manage them).

**Limitations of cleansing distributions**

The cleansing distribution method has several limitations. The timing is important because beneficiaries receiving distributions in the same tax year are treated as receiving their allocable share of trust income items (ie, current income and accumulated income) for that year, so the distributions to US and non-US beneficiaries must be made in different years. However, the trustee may be able to make use of the so-called '65-day rule' set out in Section 663(b) of the US Tax Code allowing for the calculation of DNI after the close of the tax year followed by a final cleansing distribution that is allocated to that prior tax year. Careful accounting of the income accumulations (as determined under US tax rules) will be needed to identify the amount of the cleansing distributions.
More importantly, the distribution needed to cleanse the trust may be outsized in comparison to the intended beneficial interest of the non-US beneficiaries. Put another way, the US beneficiaries may view the tax plan as an economic snub. The economic imbalance sends advisers searching for a way to make the US beneficiary whole. Channeling the excess amounts through a non-US beneficiary who then passes the amounts along to the US beneficiaries will not work, as the non-US person will be treated as an intermediary and the US-bound payment will be labelled an accumulation distribution. Making the distribution to another offshore trust is also unavailing. A later distribution from the second offshore trust to the US beneficiary should be treated as a tainted accumulation distribution even if the second trust is not considered an intermediary. For families with significant philanthropic objectives, it may be feasible to distribute the excess amount to an offshore foundation.

Finally, cleansing distributions may be unappealing because this method looks to the past rather than the future. It relieves the effect of the prior accumulations but does not permit further accumulations. Offshore deferral ends, and the trust may just as well be moved to the United States for tax purposes (except where life insurance or annuities can sufficiently contain future accumulations).

**Comment**

Although the problems of keeping a trust with US beneficiaries offshore and the unsatisfactory results of cleansing distributions may lead advisers to advocate moving the trust onshore, a case can be made for an alternative solution, suitable for very long-term trusts, which takes an almost diametrically opposite approach (part 2 of this series "Should offshore trusts stay offshore – the long-term trust solution" will describe this option in detail). The long-term trust solution maximizes the duration of the deferral and then pays current income on the larger asset base. It is a solution that will be attractive to families with multi-generational time horizons, philanthropic values and sufficient wealth to provide for the current generation.

*This article originally appeared at [www.internationallawoffice.com](http://www.internationallawoffice.com) under Private Clients and Offshore Services – USA. ILO is a premium online legal update service for major companies and law firms worldwide. In-house corporate counsel and other users of legal services, as well as law firm partners, qualify for a free subscription. The Kozusko Harris Duncan website can be accessed at [www.kozlaw.com](http://www.kozlaw.com).*
Endnotes

(1) A 6% annual interest rate applies to distributions of accumulations attributed to the period prior to 1996; that rate was compounded as of 1 January 1996. For income earned and accumulated thereafter, the varying rate under US Tax Code Section 6621 for tax underpayments applies. That rate adjusts periodically based on market rates. Over the past few years, the interest charge has ranged between 4% and 9%. To overcome a non-deductible interest charge of 9%, the trust's investments would have to return about 11% if the deferral period lasted more than 10 years.

(2) Since the premium payments do not reduce DNI, the interest charge keeps growing on the prior accumulations and the new accumulations are reduced only to the extent future economic returns are earned inside the policy rather than in the trust directly. Unless the future payments to US beneficiaries can be made only out of the current annual income as determined for trust accounting purposes, tainted accumulated income will be pulled out of the trust by future distributions (see the last sentence of Internal Revenue Code Section 665(b)).

(3) Allowing a pour over from one trust to a second trust to cleanse the accumulated income taint would be inconsistent with the policy of the accumulation distribution rules. The pour over simply moves the accumulated income taint to the second trust. In other situations where the regulations have addressed similar questions, including under prior code sections, such a pour over has not been treated as a cleansing event. See generally Regulation 1.665(b)-1A(b)(1); see also Regulations 1.668(6)-1A(b)(1), 1.668(b)-1A(c)(1)(i), promulgated pursuant to former Section 668(a). TD 7204, 37 Fed Reg 17,149 (25 August 1972).

(4) This foundation would be a philanthropic trust or corporation that is prohibited from benefitting US taxpayers except through clearly charitable grants that qualify as tax-free gifts, and that in any event cannot make grants to the beneficiaries of the original trust.
5 Tips for Environmental Due Diligence in Business Transactions

By Crystal Kennedy

Virtually all business transactions involve some level of environmental risk. The key is to identify all of the potential risks and collect sufficient information about them early in the due diligence period of a transaction. This proactive approach to environmental due diligence will help the buyer determine whether the risks are acceptable in light of the overall transaction and develop a strategy for managing them, both in the contract negotiations prior to acquisition and after the transaction is complete.

How much and to what extent businesses should conduct environmental due diligence typically depends on the nature of the transaction and the anticipated use of the property after purchase.

Below are five tips for buyers to consider when determining the appropriate level of environmental due diligence that should be performed in business transactions.

Although the tips are geared toward buyers, sellers should also consider them so that they can better anticipate the types and level of due diligence that a buyer may perform (and understand their reasons for doing so). Identifying and correcting environmental problems in advance of the transaction may help prevent buyer demands for purchase price reductions or substantial escrows to cover potential environmental liabilities.

1. **Identify the types of environmental liabilities that could be implicated**

The most common types of environmental liability and costs associated with businesses and their properties include:

- Cleanup of contamination on owned or leased property;
- Cleanup of contamination on nearby property owned by others, where contamination has migrated from a company property;
- Cleanup of contamination on property where the company’s waste has been sent for treatment or disposal;
- Tort liability (bodily injury and property damage resulting from exposure to hazardous substances);
- Fines/penalties for violations of environmental laws and permits associated with the company’s operations;
- Capital expenditures necessary to achieve or maintain compliance with environmental laws and permits applicable to company operations;
- Increased costs of demolition or site redevelopment associated with contamination of the property, the presence of asbestos or other hazardous materials in site structures, or the presence of wetlands or other sensitive environmental conditions on the property; and
- Legacy environmental liabilities associated with former properties, operations and businesses of the company.

When purchasing a property with no operations or structures from an unrelated third party, the environmental concerns may be limited to contamination on or emanating from the property. A Phase I environmental site assessment (Phase I ESA) that does not identify any environmental contamination concerns may be sufficient in that context. This scenario, however, is rare.
A buyer planning to redevelop a property with existing structures will be concerned about the potential for added costs and delays associated with removal of hazardous materials in the structure and conditions that may require special permits or design modifications. Purchasers of property who will continue the same operations will be concerned about the company’s compliance with environmental laws and permits and whether substantial expenditures may be necessary for the operations to achieve or maintain compliance. Stock purchasers and, as discussed in Tip 4, some asset purchasers will be concerned about all of these potential liabilities, including legacy environmental liabilities.

2. Understand the limitations of a Phase I Environmental Site Assessment

A Phase I ESA is a non-intrusive investigation into past and current uses of a property to evaluate the potential existence of hazardous substance or petroleum contamination on or migrating from the property.

A Phase I ESA generally consists of the following activities by an environmental professional:

(i) a review of publicly available records;
(ii) a site visit;
(iii) interviews of owners, occupants and government officials; and
(iv) a report describing the results of the investigation and the environmental professional’s opinion as to whether there is specific evidence of, or reason to believe, that the property is contaminated.

Although it may contain general information about the property and facility operations, a Phase I ESA does not specifically address whether the operations comply with environmental laws and permits or whether there are site conditions (such as wetlands, asbestos-containing materials in structures and indoor air quality) that could affect the buyer’s renovation, demolition and/or expansion plans for the property. A Phase I ESA also does not address the company’s potential liability for off-site waste disposal or legacy environmental liabilities. Therefore, buyers may need to expand the scope of environmental due diligence to assess other risks that are beyond the scope of a Phase I ESA.

3. Consider using additional due diligence methods

Given that a Phase I ESA does not address many of environmental liabilities that a buyer may be concerned about, what other environmental due diligence methods are available? Below are a few of the most common additional due diligence methods.

- **Phase II Environmental Site Assessments** – testing of soil/groundwater to determine whether the property is, in fact, impacted

- **Environmental compliance audits** – evaluation of the facility operations to determine whether all required permits have been obtained and the operations comply with the permits and environmental regulations.

- **Asbestos surveys** – identification and testing of building materials suspected to contain asbestos (Building materials that contain asbestos must be removed by a
licensed asbestos contractor prior to any renovation or demolition activity.)

- **Wetland surveys** – identification of wetlands subject to federal or state regulation in connection with construction and development activities

- **Computer database searches** – third-party database search services may be used to research the company’s former properties and businesses as well as determine whether it has been named a potentially responsible party (PRP) at Superfund sites

4. Remember that asset purchasers are not immune from a seller’s environmental liabilities

Following a stock transaction, the surviving corporation will obtain all of the liabilities and obligations of the merging corporation. That's why environmental due diligence in a stock deal should be comprehensive and include not only current properties and operations of the company, but also its former properties and operations, as well as any businesses that have been acquired/divested.

Buyers often assume that if the transaction is structured as an asset deal rather than a stock deal, they need not worry about environmental liabilities that are unrelated to the purchased assets. While the general common law rule is that asset purchasers are not liable for debts and obligations of the seller corporation, there are four exceptions:

(a) The purchaser expressly or impliedly agrees to assume seller’s liabilities;
(b) The transaction is a *de facto* merger;
(d) The purchaser is a "mere continuation" of the seller; or
(e) The transaction is a fraudulent effort to escape liability.

Many federal and state courts have found, applying especially the second and third exceptions, that a purchaser of substantially all of the assets of a company will assume the company’s environmental liabilities, whether or not those liabilities are associated with the purchased assets.

Regardless of the exceptions applied, court decisions on successor liability for asset purchasers are made on a case-by-case basis and tend to involve fact-intensive analyses. The following factors have been relied on in finding that successor liability applies to asset purchasers.

- The purchase includes all or substantially all of the seller’s assets
- Shareholders of the seller become shareholders of the buyer as a result of the transaction
- Officers/directors of the seller continue to serve in the same capacity for the buyer
- The seller ceases all operations and rapidly dissolves after the sale
- The buyer produces the same product and continues the same operations/processes as the seller
- The buyer uses the same name, same locations and same employees of the seller
- The buyer uses the same trade names, trademarks, technology and intellectual property of the seller
- The buyer uses the same management and supervisory personnel
- The buyer’s customers are the same as the seller’s
• The buyer assumes all contractual obligations of the seller ordinarily necessary for uninterrupted continuation of normal business operations
• Company press releases characterize the transaction as an acquisition of the seller
• The buyer holds itself out to the public as being the same company as before the transaction

Each of these factors should serve as potential red flags to the buyer that its asset purchase may make it a successor of the seller — one who is now responsible for all of the seller’s environmental liabilities. If one or more of these factors are present following a transaction, the buyer should investigate the gamut of seller’s potential environmental liabilities, including its compliance history and that of its former properties, businesses and operations.

5. Talk to your environmental attorney early in the transaction

Last, but not least, consult with an environmental attorney early in the transaction. Be sure to provide the attorney with all available details about the proposed structure of the transaction and the plans for the property and operations after the closing. The attorney can assist in developing a strategy and timetable for completing the appropriate environmental due diligence. Often, an attorney can also advise on steps that can be taken before and after the transaction to minimize or manage environmental risk.

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**Section 1202: A Big Deal for Small Business**

By Matthew E. Rappaport, Falcon Rappaport & Berkman PLLC, New York, NY, and Caryn I. Friedman, Ernst & Young LLP, Washington, DC

Section 1202 was enacted in 1993 as an incentive for taxpayers to start and invest in certain small businesses. Currently, the statute provides an exclusion from income for any gain from the sale or exchange of “qualified small business stock” (QSBS) acquired after the effective date of the statute and held for more than five years. However, the amount of gain that is excludible from income depends on when the QSBS was originally issued. The gain exclusion is 50% for QSBS issued before February 18, 2009, and 75% for QSBS issued between February 18, 2009 and September 27, 2010. The Creating Small Business Jobs Act of 2010 increased the exclusion to 100% of the total gain for all QSBS issued after September 27, 2010.

Despite this additional incentive, many businesses shied away from planning for QSBS because only the stock of C corporations qualified. Unless business founders had planned from inception to use the sale of stock as an exit strategy, founders were reluctant to voluntarily impose “double taxation” (i.e., income taxes at both the corporate level and the shareholder level) on the corporation’s taxable income.

Planning for QSBS became important for many more enterprise founders due to the reduction of the corporate rate to 21% under the 2017 tax legislation. Now is the ideal time to review the fundamentals of QSBS treatment and the particulars of section 1202.

I. Overview of Section 1202

A. Basic Mechanics

Section 1202 allows a taxpayer to exclude 100% of the eligible gain realized from the sale or exchange of QSBS issued after September 27, 2010 and held for more than five years. QSBS must be issued by a “qualified small business” and generally be acquired by the taxpayer at original issuance, either in exchange for cash or other property (not including stock) or as compensation for services rendered to the corporation (other than services an underwriter of the stock).

B. Limitations on Gain Exclusion

The statute limits the per-issuer amount that can be excluded to “eligible gain,” which is the greater of:

1) $10 million reduced by any amount the taxpayer excluded from sales or exchanges of QSBS from the same issuer in prior years, or
2) 10 times the aggregate adjusted basis of the QSBS issued by the corporation disposed of by the taxpayer during the taxable year, as measured on the original issue date.°

Because the limitation references the higher amount of the two measurements, the potential total gain excluded from gross income may exceed $10 million. Because a corporation qualifying for the provision could have up to $50 million in assets upon inception,¹⁰ the maximum amount of gain eligible for exclusion could reach $500 million under the ten-times-basis limitation.

C. The “Qualified Small Business”

A “qualified small business” is a domestic C corporation (C-Corp) that meets three threshold requirements:¹¹

1) The aggregate gross assets of the corporation, including any predecessor corporation, did not exceed $50 million at all times on or after August 10, 1993, and prior to issuance.

2) The aggregate gross assets of the corporation immediately after issuance (including amounts received upon issuance) did not exceed $50 million.

3) The corporation agrees to submit reports to the Secretary and its shareholders as the Secretary may require.

Upon satisfying these requirements, the corporation must also satisfy the “active business” test to be eligible for QSBS treatment. The active business test provides:¹²

1) The corporation uses at least 80% of its assets (as measured by fair market value) in the active conduct of a “qualified trade or business” (the “80% test”); and

2) The corporation is a C-Corp that is not a domestic international sales corporation (DISC) or former DISC, regulated investment company (RIC), real estate investment trust, real estate mortgage investment conduit, or cooperative.

For purposes of the 80% test, assets used in the active conduct of a qualified trade or business include (1) assets used in startup activities, research and development, and in-house research;¹³(2) assets held for reasonably required working capital needs;¹⁴ (3) assets held for investment that are reasonably expected to be used within two years to finance research and development or increases in the working capital needs of the business, limited to 50% of the corporation’s total assets after the corporation has existed for two years;¹⁵ and (3) computer software rights leading to the production of section 543(d)(1) royalties.¹⁶

D. Defining a “Qualified Trade or Business”
A “qualified trade or business” (QTB) is defined in section 1202(e)(3). This definition gained significant attention when the 2017 tax legislation “borrowed” and modified part of it to define and limit businesses eligible to take the deduction for qualified business income (QBI) under the new section 199A. Rather than identifying what a QTB is, section 1202(e)(3) sets forth what a QTB is not, namely:

1) Any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business in which the principal asset of such trade or business is the reputation or skill of one or more of its employees;

2) Any banking, insurance, financing, leasing, investing, or similar business;

3) Any farming business (including the business of raising or harvesting trees);

4) Any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or section 613A (i.e., oil or gas properties subject to depletion); and

5) Any business of operating a hotel, motel, restaurant, or similar business.

Beyond this statutory description, scant guidance exists – perhaps because of the relative obscurity of the QSBS statute – to help taxpayers determine whether an activity is a QTB. Two private letter rulings and one tax court case comment on the subject. In PLR 201436001, a pharmaceutical research and clinical testing company was a QTB because it did not “offer value to customers primarily in the form of services … [or] individual expertise.” Likewise, in PLR 201717010, a health care technology company providing laboratory reports was a QTB because the company never offered a patient a “diagnosis or treatment recommendation,” but rather only issued the reports. In Owen v. Commissioner, the Tax Court concluded that a corporation’s principal asset did not include the reputation or skill of one or more employees even though the court acknowledged that the success of the corporation was attributable to its owners. Otherwise, practitioners may need to look to other guidance defining these terms, such as section 448 and the regulations thereunder.

E. Holding QSBS in a Pass-Thru Entity

Section 1202(g) permits taxpayers to hold QSBS through any partnership, subchapter S corporation, RIC, or common trust fund. Generally, however, a transfer of originally issued QSBS to a pass-thru entity will cause the QSBS to cease to be treated as QSBS. For example, if QSBS is transferred to a partnership in exchange for a partnership interest, gain realized on the disposition of the stock by the partnership would not be eligible for exclusion under section 1202(a).
Any QSBS held via pass-thru entity will enjoy the same treatment as QSBS held directly to the extent the pass-thru entity meets all requirements otherwise applicable to an individual holder of QSBS. Taxpayers must hold the interest in the pass-thru entity for at least five years, as well; for instance, a taxpayer may not acquire an interest in a partnership that has held QSBS for ten years, then sell the interest two days later and receive QSBS treatment. Disallowance of QSBS treatment would likewise apply if the aforementioned hypothetical taxpayer received a distributive share of partnership income attributable to the sale of QSBS shortly after acquisition of a partnership interest.

F. Allowable Transfers and Entity Conversions

Section 1202(h) allows for transferees to receive QSBS that retains its character as QSBS in certain permitted transfers. The list of permitted transfers generally reflects a policy of blessing certain QSBS dispositions that provide for carry-over basis treatment. For instance, if a taxpayer holds QSBS through a tax partnership from first issuance, distribution of the QSBS from the partnership to the taxpayer in a non-recognition transaction will allow the taxpayer to tack the partnership’s QSBS eligibility and holding period to her own. If a taxpayer gifts or bequeaths QSBS, the recipient of the QSBS will also be allowed to tack QSBS eligibility and holding period.

Tax-deferred incorporations and reorganizations enjoy similar treatment: any successor stock received in exchange for QSBS will also retain its character and holding period. If a taxpayer holds QSBS and exchanges it for non-QSBS in a section 351 or section 368 transaction, the non-QSBS received will be treated as QSBS to the extent of the built-in gain on the date of the reorganization.

For example, assume Acme Corp. issues QSBS to Tom Taxpayer in 2012, and Tom Taxpayer has a basis of $1 per share. In 2018, after meeting all applicable requirements imposed by section 1202 for the entirety of Tom Taxpayer’s holding period, Acme Corp. merges with Widget Corp. Assume that the adjusted basis of Acme Corp. stock in the hands of Tom Taxpayer remains $1, but Widget Corp. values Acme Corp.’s shares at $11 per share. Unlike Acme Corp., the stock of Widget Corp. is non-QSBS. Under section 1202(h)(4)(B), the Widget Corp. stock that Tom Taxpayer received in exchange for his Acme Corp. stock is treated as QSBS to the extent of the $10-per-share built-in gain at the time of the merger. If Tom Taxpayer sells his Widget Corp. stock when it appreciates to $26 per share, he will enjoy a section 1202(a) exclusion for $10 per share of his gain but will not be able to apply section 1202(a) to the remaining $15 per share of his gain.

G. Section 1045: QSBS Rollovers

Section 1045 allows a taxpayer to “roll over” gain on the disposition of QSBS into QSBS of a different issuer, provided the QSBS is held for more than six months prior to disposition and the rollover occurs within 60 days. If the taxpayer does not purchase “replacement” QSBS with a fair market value equal to or greater than the “relinquished”
QSBS, the taxpayer will recognize “boot” in the form of capital gain, similar to the treatment of a section 1031 exchange. For purposes of determining the five-year QSBS holding period, the taxpayer’s holding period in the “relinquished” QSBS will count toward the holding period of the “replacement” QSBS.\(^\text{28}\)

For example, assume Tina Taxpayer has a $100,000 adjusted basis and a three-year holding period in her Acme Corp. QSBS. Tina then sells her Acme Corp. QSBS for $1 million. Within 60 days of her original sale, Tina purchases Widget Corp. QSBS for $850,000. Tina takes a $100,000 carry-over basis in her Widget Corp. QSBS and recognizes $150,000 of capital gain. To avoid recognition of capital gain entirely, Tina could have reinvested the remaining $150,000 into Widget Corp. QSBS or the QSBS of a different issuer. Tina’s three-year holding period in the Acme Corp. QSBS carries over to her new Widget Corp. QSBS. Thus, Tina would only need to hold her Widget Corp. QSBS for two additional years to qualify for gain exclusion from the sale or exchange of the Widget Corp. QSBS.

II. Traps for the Unwary

A. Put Options as Dispute Resolution

Section 1202(j) prohibits the application of Section 1202(a) to exclude gain from the sale of QSBS from a taxpayer’s gross income if the taxpayer holds an "offsetting short position" with respect to the QSBS. Although the statute was clearly designed for taxpayers who actively seek out strategies to mitigate their economic risk of loss for QSBS holdings, no statutory or regulatory exception exists for the common dispute resolution strategy of allowing shareholders to possess a put option for their stock that would allow the shareholder to exit by compelling a sale to either another shareholder or the corporation itself. Practitioners who are not mindful of section 1202(j) could inadvertently trigger its application by attempting in good faith to set up a method for the corporation to avoid a crippling impasse between its principals.

B. Failure to Monitor Assets or Spend Working Capital

As described above, section 1202(e) measures the “active business requirement” by examining how the corporation uses its assets. Section 1202(e)(1)(A) requires the corporation to use 80% of its assets in the active conduct of a qualified trade or business. While section 1202(e) provides a list of exceptions, failure to meet the requirements of section 1202(e) could result in a tax disaster. Corrective action may cure such a failure, but any rescue attempt must be completed quickly to allow the taxpayer to meet the "substantially all" requirement in section 1202(c)(2)(A). Because no bright-line standard exists for measuring “substantially all of the taxpayer’s holding period” for QSBS, time is of the essence for taxpayers and their advisors to discover and remedy any facts or circumstances causing less than 80% of assets to be used in a qualified trade or business.

III. Interplay with the 2017 Tax Legislation
The 2017 tax legislation cut the statutory income tax rate on C-Corps from 35% (the maximum rate in a graduated rate provision) to a 21% flat rate, making the C-Corp a significantly more attractive choice of entity. Other changes in the tax act also favored C-Corps, such as the limitation on a non-corporate taxpayer’s deduction for state and local income, property, and sales/use taxes, which is not applicable to C-Corps. The introduction of tax incentives for investment in qualified opportunity zones (QOZs) might be the second most important aspect of the 2017 tax legislation to favor planning for QSBS treatment. In brief, Congress provided for the deferral and partial forgiveness of capital gain that is reinvested into a QOZ and the exclusion from gross income of all subsequent appreciation, provided certain conditions have been met. Depending on Treasury’s reconciliation of the incentives in section 1202 with the incentives in section 1400Z-2, seizing the tax advantages of QSBS could become even more compelling if the QSBS also satisfies the requirements to be treated as QOZ stock. In that case, adroit tax planning could result in the permanent exclusion from taxation of gain on the sale of the QSBS, provided forthcoming regulations do not prohibit the technique. The overlap of the QSBS and QOZ systems will require detailed rules, which are unlikely to be a part of the initial wave of QOZ guidance expected in the coming months.

IV. Conclusion

Section 1202 did not receive much attention from the tax community at large because of the relative unattractiveness of C-Corps, but with the passage of the 2017 tax legislation, now is the ideal time for practitioners to review the inner workings of the statute. Despite existing statutory and administrative ambiguity, taxpayers can obtain significant benefits from issuing QSBS, especially if they work closely with their tax advisors to avoid traps for the unwary. In the current environment, the cost-benefit analysis in the choice of entity decision will favor C-Corps more frequently when QSBS treatment applies. Although shareholders, accountants, and lawyers will need to jointly navigate the setup and operation of a corporation issuing QSBS, the reward at the end of the journey is well worth the complexity, and the tax advantages may become even more enticing if Treasury promulgates taxpayer-favorable regulations under section 1400Z-2.


2 § 1202(a)(1). This assumes the taxpayer holds no offsetting position, such as a short sale, put option, hedge, or the like. See § 1202(j).

3 See P.L. 103-66, § 13113(a); P.L. 111-5, § 1241(b).

4 § 1202(a)(4).

5 § 1202(c)(1).
§ 1202(a)(1), as modified by § 1202(a)(4).

§ 1202(c)(1). An exception described further herein exists for certain conversions and non-recognition transactions.

§ 1202(b)(1). For taxpayers filing separately, the limitation in (1) is $5 million instead of $10 million. §1202(b)(3)(A).

§ 1202(d)(1)(A).

§ 1202(d)(1).

§ 1202(e)(1); § 1202(e)(4).

§ 1202(e)(2).

§ 1202(e)(6)(A).

§ 1202(e)(6)(B).

§ 1202(e)(8).

P.L. 115-97, § 11011(a).

T.C. Memo 2012-21.

§ 1202(g)(4).

§ 1202(h).

§ 1202(g)(2).

§ 1202(g)(3).

§ 1202(h)(2)(C).

§ 1202(h)(2)(A), (B).

§ 1202(h)(4).

Note this applies to section 351 transactions only to the extent the corporation issuing the non-QSBS has section 368(c) control of the corporation originally issuing the QSBS. § 1202(h)(4)(D).
§ 1045(a)(1).

§ 1045(b)(5); see § 1202(f)(2).

P.L. 115-97, § 13001(a).

Id. at § 11042.

Id. at § 13823. While a complete discussion of QOZ is beyond the scope of this article, readers should familiarize themselves with the concept because of its seismic effect on a wide variety of taxpayers. See generally §§ 1400Z-1, 1400Z-2.

Id. A QOZ is a population census tract located in a low-income community that is designated as a qualified opportunity zone. Section 1400Z-1(a).

At first blush, § 1202 does not appear to conflict with the congressional intent of §§ 1400Z-1 and 1400Z-2. If this hypothesis proves correct, Treasury could actually adopt the opposite approach and bless the complete exclusion of the deferred capital gain from income and the complete exclusion of any subsequent appreciation from gross income if the QOZ investment is in the form of QSBS, despite the mandate of § 1400Z-2(b)(1)(B) that any deferred capital gain be recognized by December 31, 2026, regardless of whether a realization or recognition event has occurred.
The New York Housing Stability and Tenant Protection Act of 2019
d by
Jeffrey M. Schwartz, Steven D. Sladkus, Jeffrey S. Reich, and Maria I. Beltrani

The New York Housing Stability and Tenant Protection Act of 2019 (the “Act”), which was signed into law on June 14, 2019, will have negative consequences for cooperative housing corporations and also may be applicable to condominium associations.

Set forth below is a summary of the salient sections of the Act and our suggestions for successfully navigating them:

1. **Application Fees**: Pursuant to the Act, a lessor (which would include a cooperative corporation pursuant to its proprietary lease) may not charge an application/processing fee in connection with a new tenancy. As such, cooperative boards are no longer permitted to charge an application fee or processing fee in connection with the sale or lease of a cooperative apartment.

   In addition, the Act limits charges for background checks to the actual cost of the background check or $20.00, whichever is less.

   While individual condominium unit owners would also be prohibited under the Act from charging application/processing fees in connection with the leasing of their own condominium units, the Act does not prohibit a condominium board, or its managing agent, from charging an application/processing fee to a unit owner in connection with the unit owner’s application for a waiver of the condominium’s right of first refusal.

   **Suggestion**: Because this section of the Act does not specifically mention “managing agents” like other sections of the Act do, an argument can be made that managing agents may collect application and/or processing fees for their handling of sales and leases of cooperative apartments.

2. **Security Deposits**: The Act prohibits a lessor (including a cooperative board) from collecting security deposits or advances that are in excess of one month’s rent. Thus, cooperative boards may no longer condition the approval of a purchase application on the deposit of a maintenance escrow in excess of one month’s maintenance. That said, boards may still condition their approval of a purchase application upon the execution of a maintenance guaranty by a financially-responsible guarantor.

   **Suggestions**: A) The Act expressly provides that it does not affect any security deposit arrangements for leases that were entered into before July 14, 2019. Thus, if a cooperative has a maintenance escrow in place prior to July 14, 2019, the cooperative may continue to hold the escrow, draw upon it pursuant to the terms of any pre-existing escrow agreement and, if provided in the agreement, require replenishment.
B) While the Act prohibits a landlord (board) from requiring a tenant (shareholder) to deposit more than one month’s rent, it does not prohibit a landlord from requiring a tenant to provide a guaranty. So a possible workaround may be for a landlord to require a lease guarantor to post an escrow to secure the guarantor’s obligation under the guaranty.

C) Products such as security deposit insurance policies may become more prevalent to protect landlords.

3. **Late Fees:** The Act prohibits a lessor (including a cooperative board) from requiring any payment, fee or charge for the late payment of rent that is in excess of five (5%) percent of the monthly rent or $50.00, whichever is less. Thus, irrespective of the terms of a cooperative’s proprietary lease (many of which specifically provide for a late fee to be determined by the cooperative board from time to time and for the imposition of an interest charge), a cooperative board may not charge fees and/or interest in excess of $50.00 per month on delinquent maintenance payments. Condominium boards are not similarly restrained, due to the lack of a landlord-tenant relationship between the condominium and the unit owner.

   **Suggestion:** While cooperative boards are prevented from charging late fees in excess of $50.00, they may nonetheless seek the imposition of pre-judgment interest from the date of the initial default in any resulting litigation against the delinquent shareholder.

4. **Receipt for Payment of Rent (Maintenance):** The Act requires a lessor (cooperative board) to provide a written receipt in connection with all payments of rent (maintenance) that are made in cash or in any manner other than the lessee’s (shareholder’s) personal check, and also requires the lessor to maintain records of cash payments by tenants for at least three (3) years.

   **Suggestion:** This means that cooperative boards (or their agents) will have to provide payment receipts to any shareholders who make ACH, direct deposit, Clickpay, wire or other similar forms of payment. Auto replies that include the date, the payment amount, the identity of the premises, the period for which the payment is made, and the signature and title of the person receiving the rent may constitute a valid written receipt.

5. **Notices of Non-Payment:** In a significant departure from prior law, the Act now requires a lessor (or cooperative board) to provide a notice by certified mail to any tenant who is at least five (5) days late in the payment of maintenance charges. Failure to send such a notice may bar the cooperative from recovering the unpaid rent in a summary proceeding.

   **Suggestion:** Management companies must now carefully monitor delinquent accounts and ensure that notices are timely sent.
6. **Reimbursement of Attorneys’ Fees/ Late Fees / Repair Fees / Etc.**: The Act provides that lessors (cooperative boards) may not pursue any fees or charges other than basic rent in a summary landlord-tenant proceeding. As such, a board will have to pursue two separate actions – a summary eviction proceeding for unpaid maintenance and a plenary action for unpaid assessments, legal fees, late fees, repair fees, sublet fees and any other amounts due and owing.

**Suggestion**: There is an inconsistency in the Act’s revisions to the Real Property Law and the Real Property Actions and Proceedings Law, which makes it unclear whether a Court will permit a cooperative to recover legal fees in a non-payment proceeding. Given this discrepancy, we will continue to request awards of attorneys’ fees.

7. **Tenant’s (Shareholder’s) Rights to Cure Non-Monetary Defaults**: In the case of a non-monetary default, the Act provides a tenant (shareholder) with a thirty (30) day period to begin curing a default after the lessor (cooperative board) obtains a judgment in connection with the default.

**Suggestion**: If the tenant’s (shareholder’s) breach involves the creation of a nuisance, the cooperative board may, if permitted under the lease, exercise its right to terminate the lease for objectionable conduct, which is a non-curable default. This would result in an eviction if the Court agrees that a nuisance exists and that the shareholder is responsible for causing the nuisance.

The Act imposes numerous obligations and restrictions on landlords which we are ready and able to discuss with our clients. Industry-wide efforts have already begun to exempt cooperative corporations from various provisions of the Act, and SSRGA is taking an active role in those efforts.

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Uniform Law Commission Update

The Uniform Law Commission recently held its 128th Annual Meeting in Anchorage Alaska from July 12-17, 2019. At the meeting, five new or amended uniform acts were approved:

1. Uniform Automated Operation of Vehicles Act
2. Uniform Electronic Wills Act
3. Uniform Registration of Canadian Money Judgments Act
4. Amendments to the Uniform Athlete Agents Act
5. Amendments to the Uniform Probate Code

Each newly approved act is undergoing a final technical review by the ULC Committee on Style and will be published this fall at www.uniformlaws.org. The Tort Law Relating to Drones Act was scheduled to be approved but was ultimately withdrawn due to policy objections from commissioners. No decision has yet been made with respect to the future of this project.

Five more uniform acts were read for comment and could be approved as soon as the next ULC Annual Meeting in July 2020:

1. Alternatives to Bail Act
2. Easement Relocation Act
3. Fundraising through Public Appeals Act
4. Public Participation Protection Act
5. Unregulated Transfers of Adopted Children Act

The drafting committees for these five acts will continue meeting to solicit input and revise the draft uniform laws over the coming year.

Three new drafting committees were approved:

1. Drafting Committee on Collection and Use of Personally Identifiable Data
2. Drafting Committee on Registration and Licensing of Direct-to-Consumer Sales of Wine and Prevention of Illegal Sales
3. Drafting Committee to Revise the Uniform Common Interest Ownership Act and the Uniform Condominium Act

These committees will be appointed soon and begin meeting over the next twelve months. The ABA has been asked to provide an Advisor to each committee, and any interested observers are encouraged to join the committee and participate in the drafting process.

Finally, four new study committees were also approved:

1. Study Committee on Default Judgments in Debt Collection Cases
2. Study Committee on Fines and Fees
3. Study Committee on Third-Party Funding of Litigation
4. Study Committee on Special Deposits

ULC study committees examine whether a topic meets the threshold criteria for drafting a new uniform law. Each committee will ultimately draft a report of its findings with a recommendation as to whether the project should proceed to the drafting stage.

A short description of the new acts and projects that involve the law of real property or trusts and estates follows. More information about all uniform law projects is available at www.uniformlaws.org.

**New Uniform RP/TE Acts**

The **Uniform Electronic Wills Act** permits testators to execute an electronic will and allows probate courts to give electronic wills legal effect. Most documents that were traditionally printed on paper can now be created, transferred, signed, and recorded in electronic form. Since 2000 the Uniform Electronic Transactions Act (UETA) and a similar federal law, E-SIGN have provided that a transaction is not invalid solely because the terms of the contract and the signatures of the parties are in an electronic format. But UETA and E-SIGN both contain an express exception for wills, which, because the testator is deceased at the time the document must be interpreted, are subject to special execution requirements to ensure validity and must still be executed on paper in most states. Under the new Electronic Wills Act, the testator's electronic signature must be witnessed contemporaneously (or notarized contemporaneously in states that allow notarized wills) and the document must be stored in a tamper-evident file. States will have the option to include language that allows remote witnessing. The act will also address recognition of electronic wills executed under the law of another state. For a generation that is used to banking, communicating, and transacting business online, the Uniform Electronic Wills Act will allow online estate planning while maintaining safeguards to help prevent fraud and coercion.

The promulgation of the Uniform Parentage Act (2017) has necessitated amendments to the Uniform Probate Code's intestacy and class-gift provisions. The 2019 **Amendments to the Uniform Probate Code** provide a more consistent formula for determining intestate shares within blended families, remove outdated terminology, and incorporate the concept of de facto parentage. The intestacy formulae will also account for the possibility that a child may have more than two parents, and therefore more than two sets of grandparents.

**New RP Drafting Committee**

**Drafting Committee to Amend or Revise the Uniform Common Interest Ownership Act and the Uniform Condominium Act.** This drafting committee will develop revisions to the Uniform Common Interest Ownership Act (UCIOA) and the Uniform Condominium Act (UCA). UCIOA deals comprehensively with the complex issues posed in condominiums, cooperatives, and planned communities – the three forms of
real estate ownership in which multiple persons each own a separate parcel of real estate, and all those persons collectively own other parcels of real estate in common. The ULC has devoted substantial resources for more than 50 years to the regulation of these forms of shared real estate ownership and has a significant interest in making sure that both UCIOA and UCA are kept up to date.

**Ongoing RP/TE Drafting Projects**

**Amendments to the Uniform Disposition of Community Property Rights at Death Act.** The committee will update this 1971 act that has been adopted in 16 common law states to address the disposition of community property acquired in a community-property state when the record owner’s estate is probated in a common-law state. The amendments will address recent changes to the law, including same-sex marriage and domestic partnerships.

**Easement Relocation Act.** The committee is drafting a law to address whether, and with what conditions, a servient estate owner may unilaterally relocate an easement if the relocation will not materially harm the dominant estate owner.

**Fundraising Through Public Appeals Act.** Crowdfunding is the practice of raising funds via the internet, through web sites designed for that purpose. When the amount of funds raised is large, certain legal issues can arise involving the management and use of funds, particularly when the total funding exceeds the amount needed to accomplish the stated goal. The committee is drafting an act to address these issues.

**Economic Rights of Unmarried Cohabitants Act.** The Drafting Committee will draft a uniform or model law to standardize the economic rights of unmarried cohabitants. The rate of nonmarital cohabitation within the U.S. is increasing, but there is no consistent legal doctrine among the states for division of jointly acquired property when cohabitants break up or when one cohabitant dies. Instead, courts must resolve disputes on a case-by-case basis.

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DOES IT REALLY NEED TO BE SO BINARY?

BY: Joshua Stein

Most landlords like to choose each tenant carefully. But then, as soon as a tenant starts to negotiate its lease, it immediately asks for the right to assign the lease – transfer it to a new tenant, some replacement that the original tenant finds somewhere. The landlord didn’t choose that person and didn’t originally negotiate a lease with them. Having the right to assign the lease matters to tenants because, in theory, it gives them an exit strategy if the lease no longer makes sense for them.

Landlords don’t like that idea. They care who their tenant is. They worry that some future unknown new tenant might try to change the use of the premises. That concern isn’t particularly real, because any new tenant will still have to comply with the lease. More generally, though, the landlord might worry that the new tenant will be more likely than the original tenant to violate the lease or not pay rent.

The landlord probably likes the creditworthiness of the original tenant. If that tenant assigns the lease, then as a legal matter it’s still obligated under the lease, unless the lease says otherwise. But the landlord still worries that if the original tenant assigns, it will no longer have a business reason to pay its rent – its likely need to maintain an operating location. The original tenant, off to greener pastures, will focus its efforts instead on figuring out a way to get off the hook. And, worst of all, if the lease is below market at the time of assignment, the landlord hates the idea that the tenant might profit on the assignment.

So, most landlords prohibit assignment without the landlord’s consent. Often landlords agree to be “reasonable” about approving assignments. In essence this means they’ll approve an assignment if an ordinary landlord in the same circumstances would approve it. This is, of course, a murky standard. But we use it all the time. It sometimes works.

If the landlord doesn’t agree to be “reasonable,” then the landlord can just say no – or can demand any payment or rent increase whatsoever as the price of consenting – to an assignment.

The outcome of this negotiation is typically binary, i.e., it has only two possible results. First, the landlord can lose any reliable right to control the identity of its tenant, even though the landlord originally cared a lot about who that tenant was. Second, the tenant can lose any ability to exit the lease because the tenant is at the landlord’s mercy when it comes to assignment.

Maybe there’s a third way, more nuanced. The parties can recognize that the landlord has a legitimate interest in knowing that its original tenant will stay in place. Any change in the tenant can expose the landlord to risks it didn’t want to bear. Conversely, if the tenant wants the right to assign as a mechanism to exit the lease, maybe it’s legitimate for the landlord not to want an assignment to create a profit opportunity for
the tenant. And the landlord wants some protections against a new and unknown tenant.

In response to some of those concerns, some leases let the landlord recapture the space if the tenant wants to assign. In my experience, no landlord ever exercises that right. It is of no value to anyone except the attorneys paid to negotiate it. All it does is delay the tenant’s exit transaction while the landlord considers recapturing the space and then decides not to do that.

Sometimes a lease will allow the landlord to increase the rent on an assignment, or require extra security, but it’s usually up to the landlord’s unfettered discretion to decide what to require. These requirements effectively allow the landlord to block any assignment.

Maybe the lease should instead give the landlord specific meaningful rights if the tenant wants to assign, but should also define those rights in a way that does not make the tenant’s right to assign entirely illusory. For example, the lease might allow the landlord to increase the security deposit up to a certain amount if the new tenant doesn’t meet some reasonable financial test. Maybe any assignment should trigger a one-time fee. Maybe any existing lease guarantor should not only have to reaffirm its guaranty at the time of assignment, but also deliver security because the assignment changes the landlord’s risk profile.

Similar concepts might apply to the outgoing tenant. If the lease is below market at the time of assignment, the landlord might have the right to increase the rent to market (or at least partly to market), determined in some reasonable and objective way. That increase might be coupled with an extension of the lease, at the tenant’s option. And, instead of leaving the possibility of a fight over what’s a “reasonable” new tenant, the lease might define objective standards the new tenant needs to meet.

Each of these suggestions – and probably others along similar lines – would deal with assignments in a nuanced way that recognizes the needs of the parties, as opposed to just allowing assignments or just banning them. These measures could protect the landlord while also giving the tenant a reasonably reliable right to assign, thus protecting the tenant from potentially ruinous long-term liability if the tenant no longer wants the location.

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The Abolishment of Common-Law Marriage in South Carolina

In a recent opinion of Justice Kaye G. Hearn, the Supreme Court of South Carolina has abolished common law marriage. The court in Stone v. Thompson, No. 27908, 2019 S.C. LEXIS 72 (S.C. July 24, 2019) declared that “from this date forward—that is, purely prospectively—parties may no longer enter into a valid marriage in South Carolina without a license.” Id. at *2. The court proceeded to refine the test courts are to employ for common law marriages entered into prior to July 26, 2019.

Notably, the court reached its conclusion by citing our society’s shift away from accepting someone based on marital status or legitimacy of children and the courts’ frequent struggles to determine if and when parties expressed the requisite intent to be married. Id. at *6. The court further observed that “non-marital cohabitation is exceedingly common and continues to increase among Americans of all age groups.” Id.

The court declined to exercise its prerogative to apply its ruling retroactively, which would have in turn undone numerous marriages which are otherwise considered valid in South Carolina. Instead, it chose to apply its ruling prospectively, following other states, particularly the Pennsylvania Commonwealth Court in PNC Bank Corp. v. W.C.A.B. (Stamos), 831 A.2d 1269 (Pa. Commw. Ct. 2003). Id. at *8-9.

The court took the opportunity to heighten the standards that South Carolina courts are to apply in future common-law marriage litigation. Prior to the order, South Carolina courts recognized and applied the “rebuttable presumption” to living litigants (i.e., those finding themselves in family court typically regarding the dissolution of said marriage), whereby there was presumed to be a marriage by cohabitation, coupled with social acceptance over a long period of time, which could only be overcome by strong, cogent, satisfactory or conclusive evidence. Id. at *10. As of July 26, 2019, future litigants, whether deceased or living, are to utilize the “clear and convincing evidence” where a party asserting a common-law marriage is required to demonstrate mutual assent to be married by clear and convincing evidence, and may use circumstantial factors traditionally considered. Id. at *11-12.

The most significant factual and procedural background of Stone is that the trial to determine if the parties had a common law marriage involved testimony from over 40 witnesses, nearly 200 exhibits, and lasted more than a week. Id. at *13.

As of the date of the order, the following jurisdictions continue to recognize the institution of common law marriage: Colorado, Kansas, Rhode Island, Iowa, Montana, Oklahoma, Texas, Utah, Washington, D.C., and New Hampshire.
# TABLE OF CONTENTS

## Contents

1. Introductory Comments. ................................................................. 1  
   a. Not suggesting standard of practice. ......................................... 1  
   b. Technology and profitability .................................................. 1  
   c. Retainer agreements should reflect technology and ethics concerns. .... 2  
   d. Great variability by practice ................................................... 2  

2. Paperless vs. Paper-Less. ............................................................. 3  

3. Communications. ........................................................................ 5  
   a. Communication requirements under RPCs ................................... 5  
   b. Ethics Opinion 477 .................................................................. 6  
   c. Using technology to communicate with clients ............................ 7  
   d. Email communication ............................................................. 10  
   e. Email Retention And Other Policies .......................................... 10  

4. Policies on Hiring Outside Consultants for Technology .................. 11  

5. Client Property; Original Documents; Electronic Storage ............... 12  
   a. Safekeeping of client property .................................................. 12  
   b. Client records – file destruction ............................................... 12  
   c. Personal Laptops .................................................................... 13  
   d. Using technology to assist with the safekeeping of client property. 13  
   e. The client “file” in the new technological environment ............... 14  
   f. Cloud Storage ......................................................................... 14  

6. Confidentiality of Information in the Electronic Age ..................... 14  
   a. Confidentiality of information .................................................. 14  
   b. Technology crime statistics ...................................................... 15  
   c. Protecting confidential information ............................................. 15  
   d. Actions to take ......................................................................... 16  

7. Collaboration and the Attorney Client Privilege ............................ 17  
   a. The world is too complex and inter-related to practice without collaboration. 17  
   b. Preserving the attorney client privilege ..................................... 18  
   c. Assisting disabled clients in light of the electronic age ............... 18  
   d. Privilege can affect the attorney personally ............................... 19  


9. Aging Clients and Technology .......................................................... 20  

10. Vetting the Prospective Client .......................................................... 24  

   a. How document generation changes drafting and practice ............ 25  
   b. Upgrading skills for document drafting ..................................... 25  
   c. Document automation is important .......................................... 25  
   d. Document assembly options .................................................... 26
e. Questions to ask when shopping for automated drafting solutions ..........27
12. Electronic signing of documents ........................................................................27
13. Illustrative Additional Service for Clients: Change in Domicile. .........................27
14. Illustrative Additional Service for Clients: Longevity Planning; Term of GRATs; etc. 28
   a. Genivity Halo Health, Life Expectancy and Health Care Costs ..................28
   b. Tailoring planning. .........................................................................................28
15. Using Transcription Services For More Effective Meetings And Marketing ........29
   a. How to Use Transcription in Practice ...............................................................29
   b. Outsourcing. ...............................................................................................29
16. Conclusion. .........................................................................................................30
1. **Introductory Comments.**
   a. Not suggesting standard of practice.
      i. This paper is not intended to imply that any approach is essential, or a standard of practice that anyone should follow. Rather the objective is merely to present points estate planners and other practitioners might consider in managing their practice with a particular emphasis on technology and some of the ethical issues they raise.
      ii. The primary goals are to give practitioners practical ways to use technology to:
          1. Make practices more efficient.
          2. Provide better quality services to clients.
          3. Practice more safely to reduce malpractice risks.
      iii. The secondary goal is to identify tech issues that some practitioners might wish to address in their practice, e.g. in their form retainer agreement, ancillary forms, procedures, etc.
   b. Technology and profitability.
      i. As push back from prospective clients grows, the time allocated to drafting documents, and handling paper in the estate practice, will have to be reduced in order for attorneys to remain profitable. Increasing automation of the estate planning practice is only part of story. There will have to be other operational efficiencies incorporated into the process, and in some cases, a rethinking of the planning process. Many clients are quite tech savvy and expect you to mirror their savviness. In the age of “LegalZoom,” some clients will view what is required for estate planners to generate estate planning documents as being far simpler and quicker than it actually is. Personally, we do not subscribe to the worries that consumers who hire estate planning attorneys will flock to any internet solution. The wealth and sophistication of the clients most estate planners serve is such that their clients would not consider using an internet based web service. However, that does not mean that the construct does not impact how they view what their planners provide. Attorneys will have to demonstrate the value of the counsel provided, over and above the production of the actual documents. No doubt, estate planners have a myriad of skills to offer their clients. What this really should translate to is a transformation of the perception of the “product” the estate planner is offering. It will be the counsel and guidance, not the physical documents, that is paramount in providing value to the client. Reducing the cost and time of generating and processing documents will provide attorneys the ability to spend more time in client facing activities: meetings, conferences, and so forth. Serving as a trusted adviser is a role for which clients should continue to appreciate the value provided by the estate planner. That is a role that technologies, social or economic change will not supplant. Further, greater operational efficiency allows the estate planner to serve lower net worth clients without sacrificing profitability. As we all know, it’s much easier to keep a client you’ve
worked with before they were wealthy than to find a new client who is already there.

c. Retainer agreements should reflect technology and ethics concerns.
   i. **Practice Suggestion:** It is advisable for practitioners to periodically review estate planning retainer agreements (engagement letters) to update them to reflect new ethics rules, changing practices, integration of new technology into their practice, and other factors. The majority of states have adopted the ABA Model Rule changes from 2012 which relate to technology. Rule 1.1 was modified to require technical competence; and Rule 1.6 now requires lawyers to use “reasonable efforts” to prevent the inadvertent or unauthorized disclosure of confidential client data. Very importantly, ABA Model Rules 1 state that a client can require a lawyer to implement “special security measures not required by this Rule.” You definitely want to know a prospective client’s disposition on this issue before beginning your representation. Consider advising clients of what your default approach is in your retainer agreement so that you are on record with the client as to how matters are handled.
   
   ii. Retainer agreements can be used as a framework for the discussion of a potpourri of estate and tax practice management technology, and ethics and related considerations, since many of the ideas in this presentation may warrant addressing in retainer agreements (engagement letters).

   iii. Practitioners should not ignore the changes technology and other developments are having on retainer agreements, practice forms, and related practice management steps.

   iv. Engaging in discussion with clients and providing information on how the practitioner protects confidential data can help assuage any concerns the client has and allow the client to provide commentary on what uses of technology they are comfortable with. As each practitioner utilizes technology in unique ways, the engagement letter should be customized by the practitioner.

   v. **Sample Clause:** A sample provision for an engagement letter could include, "You authorize the back-up and storage of records on cloud-based back up services, including but not limited to those provided by ShareFile, Microsoft 365, SugarSync, Datto and NetDocuments and others, posting PDFs of your documents in the cloud on ShareFile or a similar service, and emailing of unencrypted confidential records. If you wish us to use encrypted electronic communications, we can do so through ShareFile."

   d. Great variability by practice.
   
   i. The ideas presented must be adapted and modified for every practice. Every practice is unique in terms of the nature of the typical clients, the practitioner’s comfort level with technology and change, capabilities of the administrative staff, etc.

   ii. A paperless, cloud-based practice will necessarily have to handle these issues differently than a practice that still has yellow pads, Redwelds and other analog tools.
iii. A practice that predominantly focuses on a large volume of flat-fee, lower-wealth clients will have a different emphasis than a boutique firm serving a limited number of ultra-high net worth clients seeking a different level of service and relationship.

iv. Ancillary administrative implications of many of the points addressed concerning technology and the state of practice management are adapted at different rates in different firms. Some practitioners might view something as excessive, while others view it as a mundane task long ago addressed.

v. **Practice Suggestion**: It is important that each practice identify where it is on the technology spectrum, where it wants to be, and how to get there in a practical manner. It will be disruptive, but unless each practice makes the commitment, and a specific plan that it updates periodically, the practice will fall further behind the technology curve and that, if it has not already, will adversely affect the practice, profitability, risk profile, and service quality. The reality is that upgrading an analog practice to a modern, digital one is ALWAYS disruptive because most humans detest change. Further, almost anything can be judged “unreasonable” by someone who doesn’t want to do it.

vi. Each practitioner has to find the technology road map that works for them. This depends upon your style, how technologically savvy you are today, what changes are appropriate, and how you anticipate evolving. Many practitioners only reluctantly and partially adapt a technology strategy. Too often practitioners have opted for steps that were recommended to them rather than being proactively engaged in crafting a process that fits their unique needs. If you can find your comfort zone and the path that works for you, the process does not have to be intimidating. Remember, there is no right or wrong approach. The only wrong approach is to take no action. Perhaps the next worse approach is just to implement what someone, who is unfamiliar with your practice, recommends. Find what fits your style and comfort zone. Then identify a logical sequence to approach the process, and steps that are small enough to be actionable.

vii. **Practice Suggestion**: A firm’s efficiency (or lack thereof) is largely a function of the practice’s technology, processes and people. As such, it would be a mistake to examine one’s technology in a vacuum. Spending money on technological improvements will yield little benefit if a practitioner’s processes are inefficient, or the wrong people are in the wrong seats. For example, upgrading technology often requires that users upgrade their skills. However, some users may be unable or unwilling to upgrade their skills, even if good training is provided. If that situation exists, then it cannot be ignored.

2. **Paperless vs. Paper-Less**
   a. For most practices, it is impossible to go completely paperless. However, nearly every practice can operate more efficiently with less paper. Paperless or paper-lite might be a better option, or certainly a transition point, for some practices.
   b. Set goals to proceed towards the less paper but also be realistic in recognizing that there will still be situations where paper documents are
required for signatory or other purposes. The objective for most practices will be to proactively identify categories of documents that will henceforth be stored and managed exclusively in electronic format. Correspondence, faxes and pleadings are typically good examples for this. However, you also will need to evaluate how to address the volumes of paper documents already accumulated. For many practices, it may not be worth scanning all of the old or closed files, but it’s definitely worth scanning every document for active matters going forward. Regardless, the best way to achieve less paper is to phase it in, keeping in mind that it may be impossible to eliminate all of it.

c. As creatures of habit, many documents are maintained as hard copies simply because the practitioner has always done it that way. But, that mindset needs to be broken to take advantage of technology advances that allow you to streamline operations and reduce costs within the office. Developing a paperless/paper-lite approach for your firm could result in reducing your paper files by as much as 90%. This is accomplished by designing a paperless/paper-lite plan that will work for your office environment. Making simple adjustments to how you handle your files could result in transitioning as much as 90% of your paper files to an electronic format. But as is the case with making changes that have a positive impact on your bottom line, you need to have a plan. Do not try to tackle everything at once because it sometimes results in getting mired in the details and derailing the process. Points of consideration should include a plan that not only moves forward with active client files but one that also addresses converting existing paper files into an electronic format and getting them out of the redwells in the file room or off-site storage.

d. **Practice Suggestion:** Many practices scan everything but also keep all of the paper out of paranoia that they may lose access to the electronic files. Because this approach obviously requires *more* work (maintaining two filing systems instead of one), and is quite costly, it should be avoided. While no one can guarantee that you’ll never lose access to your electronic files, redundant backup systems, excellent cyber defenses, and hosted or cloud servers can make it extraordinarily unlikely. The important point here is that a practitioner never realizes any benefit from creating complete electronic case files unless they stop hanging onto every shred of paper.

e. Taking steps in the paper-lite direction is particularly important to the practitioner endeavoring to profitably and cost effectively serve moderate wealth clients who are likely to prove more fee conscious post-ATRA. “Paper-less” may be a better descriptive term then “paperless,” much less paper, but not necessarily no paper. Each practitioner will find the level of paper or paper-less that is optimal to his/her practice. Making slow, steady progress is really the smarter approach.

f. A practitioner who wants to convert thousands of paper documents into electronic documents has three basic options: 1) scan the documents internally, 2) out-source the scanning, or 3) some combination of internal and out-source. While it’s hard to argue that sitting in front of a scanner for hours on end is a good use of a lawyer or skilled support staff time, out-sourcing can be expensive. Some firms find that a good solution is to hire a low-wage, temporary worker for the sole purpose of scanning in paper files. For example, a college student off for the summer might be able to scan an
entire file-room of files in one summer break. That option should at least be compared against the cost of out-sourcing the task. If out-sourcing is roughly the same cost as hiring a temporary worker to handle it, then out-sourcing is probably the better option simply because it represents less annoyance for the practitioner. Also, if you use lower cost help you should be certain that they are trained to do the tasks involved. Consider creating a simple roadmap of the steps involved in each of the tasks they will do.

g. **Practice Suggestion**: It is important that any paper reduction system relies upon searchable PDFs rather than image-only PDFs. Searchable PDFs contain an image of the original document along with actual text. If you create a PDF from Word or WordPerfect, then you will always get a searchable PDF. Image-only PDFs contain only the image of the original, but no layer of searchable text. Unfortunately, most copiers and scanners create image-only PDFs which means that they can be found in the future solely by their file names. On the other hand, searchable PDFs can be found based upon their file names or any text contained within them. Using any search software or even Windows Instant Search (included with the Windows operating system) or Spotlight (included with the Mac operating system) will allow one to find searchable PDFs based upon their textual content. If a practitioner’s copiers or scanners are creating image-only PDFs, those PDFs can be converted to searchable PDFs by a variety of software programs including Adobe Acrobat, Nuance/Kofax Power PDF, Foxit PhantomPDF, Nitro Pro, Trumpet Symphony OCR and DocsCorp ContentCrawler (among others). If a practitioner continues creating image-only PDFs, they are simply making future accessibility more difficult.

h. **Practice Suggestion**: If a practitioner has no means of conveniently bringing an electronic client file to a conference room or transporting it off-site, then the electronic file loses a lot of utility. In view of this, if a practitioner intends to rely upon an electronic case file, then laptops or tablets are going to be important. With the continued evolution of “2-in-1” laptops, it’s pretty easy to find one device that offers the combined functionality of a powerful laptop and tablet.

3. **Communications**

a. Communication requirements under RPCs.

   i. A lawyer shall fully inform a prospective client of how, when and where the client may communicate with the lawyer.

   ii. A lawyer shall keep a client reasonably informed about the status of a matter and promptly comply with reasonable requests for information.

   iii. **Practice Suggestion**: Technology can provide a myriad of ways to meet these RPCs (all of which are just good practice and probably safer practice). Following is a listing, detailed examples are provided later:

   1. Use your firm website to indicate how a client may communicate.

   2. Use initial form letters to prospective clients to outline communication policies.

   3. Include communication considerations in retainer agreement.
4. Use detailed time entries into your billing system to communicate status to clients.
5. Use newsletters and other electronic communications to keep clients informed.
6. Add footers to invoices with important information the practitioner believes clients should know.

b. Ethics Opinion 477.8
   i. Each device and each storage location offers an opportunity for the inadvertent or unauthorized disclosure of information relating to the representation, and thus implicate a lawyer’s ethical duties under Rule 1.1 of the ABA Model Rules concerning competency, confidentiality, and communication.
   ii. As previously mentioned, the RPC was modified recently to include that lawyers should keep abreast of changes in the law and its practice “including the benefits and risks associated with relevant technology.”9
   iii. Practice Suggestion: One simple solution to consider- have your IT consultant prepare annually a summary of improvements made and steps to take. Use this letter to document that you are keeping current and addressing new threats and issues.
   iv. Lawyers must take reasonable efforts to ensure that communications with clients are secure and not subject to inadvertent or unauthorized security breaches.
   v. Lawyers must use “reasonable efforts” to ensure the security of client information. Citing the ABA Cybersecurity Handbook, the opinion explains that the reasonable efforts standard is a fact-specific inquiry that requires examining the sensitivity of the information, the risk of disclosure without additional precautions, the cost of additional measures, the difficulty of adding more safeguards, and whether additional safeguards adversely impact the lawyer’s ability to represent the client.
   vi. What is “reasonable” is a gray area.
   vii. Practice Suggestion: As a result, practitioners should have their IT or cybersecurity consultant prepare an annual letter, as suggested above, to review matters in the office and suggest improvements. Then be certain to follow up on the improvements recommended to assure implementation. A process of periodic review and follow up documented in this manner may provide corroboration that the practitioner has acted with “reasonable efforts.”
   viii. The opinion notes that generally lawyers may use unencrypted email when communicating routinely with clients.
   ix. Practice Suggestion: However, there are technology solutions that permit certain sensitive emails, e.g. those with tax identification numbers, to automatically be encrypted. There are also efficient encryption services that make the use of encrypted email easy and efficient, e.g. through an extra button on the regularly used email interface, e.g. Outlook.
   x. Practice Suggestion: Practitioners should consider adopting a written policy for internet and email usage, secure passwords, mobile
device security, and electronic equipment disposal. There are many free or low cost sources on the web which can provide starting points for these policies. You might also provide basic cyber security training for all employees. Again, there are many options available for this including the free online courses on cybersecurity best practices from ESET (see https://www.eset.com/us/cybertraining/).

xi. **Practice Suggestion:** Security experts recommend password managers as an easy and effective way to upgrade any individual or office’s security. Anyone can sign up for an individual plan but many password manager providers also offer business plans which enable the employer to grant (or deny) access to firm resources. Good options here include Dashlane, LastPass, 1Password, Sticky Password, True Key and Roboform.

xii. Opinion 477 included several aspects to consider when sending unencrypted emails:

1. Understand the nature of the threat.
2. Understand how client confidential information is transmitted and where it is stored.
3. Understand and use reasonable electronic security measures.
4. Determine how electronic communications about clients should be protected.
5. Label client confidential information. This should include digital files.
6. Train lawyers and non-lawyer assistants in technology and information security.
7. Conduct due diligence on vendors providing communication technology.
8. Practitioners should consider how else they may demonstrate efforts to stay abreast of technology. Some practitioners may be sufficiently steeped in technology to address many issues based on their own expertise. It is likely that this is not the case for most practitioners. While firms of sufficient size may have an on-staff technology consultant, smaller firms will likely rely on outside IT consultants. But is relying on a staff or outside IT consultant sufficient? **Practice Suggestion:** Practitioners might consider adopting a policy, even in small firms, of mandating some professional education in the application of technology to estate planning (or specially law or accounting) practices even if there is no mandatory allocation required by the applicable authorities.

c. **Using technology to communicate with clients.**

i. **Practice Suggestion:** Save covering emails into the client file to corroborate communications. For example, if a practitioner emails a draft will to a client, if the email system doesn’t automatically save that email, adopt a policy to do so in order to prove that the document was sent to the client in advance of the signing. This may be valuable to demonstrate that there was time for the client to review the document in advance of signing.
ii. **Practice Suggestion**: You can avoid repeatedly running through the Opinion 477 email encryption considerations by simply using encryption any time you’re emailing something not already in the public domain. As previously mentioned, a good encryption service makes it easy for you to send encrypted email and for your clients to receive them.

iii. If you use a system that saves all emails, how readily accessible are they? Employing a cataloguing system that allows the practitioner, or administrative staff, to find the required email without excessive effort will save cost and aggravation.

iv. **Practice Suggestion**: Use the calendaring system to document efforts to communicate with clients. For example, if a client cancels a meeting do not delete that meeting entry from the calendar. Rather, mark it as “Canceled by Client.” An easy way to document the cancelation is to enter a “no charge” time entry for the communication whereby you were informed of the cancelation (email or phone call). This is also a gentle reminder to the client of their appointment cancelations when they receive your invoice. Consider excluding historical calendar data from document destruction policies. Save calendar data indefinitely. Example: Searching the client name in a case management system, or even Outlook, can provide a history of meetings, attempted meetings, meetings the client cancelled, etc.

v. **Practice Suggestion**: Mark all client follow up in the billing system even if as a no charge notation entry to create a history of efforts to communicate with the client. For example, if administrative staff is calling a client to schedule an update meeting, the call should be noted in the billing system as a no charge entry so that there is a record of efforts to reach the client. Many practices do not have administrative personnel record any activities in the billing system. Technology has transformed how we all practice. Even if historically having only professional staff time entered may have been the norm, technology has transformed the nature of practice and the roles of everyone. Further, any good case/matter management system makes it easy for anyone in your office to document successful and unsuccessful attempts to communicate with the client.

vi. **Practice Suggestion**: Use regular monthly billing as a means of communication, not only as a means of billing. Of course, this is more effective if everyone enters detailed time entries. Example: Footers with information about new tax developments and limitations on liability to the extent feasible.

vii. Sample Footers on a Bill.

    1. **Sample Clause**: A sample protective billing footer could include the following: “Results of any plan are never guaranteed. Aspects of many, if not most, estate and related plans are not only uncertain, but subject to a wide spectrum of different views by other advisers, the courts, the IRS, and other authorities. Even many common strategies, techniques and transactions are subject to tax, legal, financial, and other risks and uncertainties. While we endeavor to identify some of
the risks of a plan, all risks and issues with each component of a plan are not possible to identify or communicate. Creating a collaborative team will help identify more issues with your plan. Further, the fact that we communicate verbally or in writing certain risks should never be interpreted as an indication that any such listing or communication is a comprehensive listing or communication of every risk involved. The risks of any transaction can be further compounded by improper administration of the plan, failure to meet annually to review and update the plan, changes in the tax and other laws, that reduce hoped for benefits or even result in more costly results then had no planning been pursued. Annual meetings with a collaborative advisor team may identify existing or new risks, help modify the plan to address changes in the law, mitigate risks, but still cannot provide certainty. If you do not meet regularly with a collaborative team of advisers your plan may not succeed.”

2. Important changes in the law could be included in the billing footers as a way to inform clients. As an example, after the Tax Cuts and Jobs Act of 2017, and the subsequent repeal by New Jersey of the state estate tax (or whatever is appropriate for the particular practice), the following provision could be used to inform clients of potential effects of the changes, “Credit Shelter Trusts (under a will or revocable trust for a decoupled state as NJ had been, and as NY remains) will be funded with up to approximately $11.4 million in 2019, not the $675,000 (or another number) that may have been anticipated when the will or revocable trust was completed. Careful thought should be given to the specific provisions of a credit shelter trust, assuring adequate financial provisions for each intended beneficiary (e.g., the surviving spouse) may affect choice of trustees, distribution provisions, the use of trust protectors, trustee removal powers, powers of appointment given to a surviving spouse or other people, and more. You MUST review all formula clauses in existing wills and trusts, including those applicable to funding credit shelter trusts.”

viii. **Practice Suggestion:** Technology can assist practitioners in meeting communication requirements in RPC 1.4. Consider:

1. Use retainer agreements for more than just setting and collecting fees. Include information on how you practice so prospective clients are informed.
2. Post articles and memorandum explaining matters of general interest to your clients on the firm website.
3. Conduct webinars on planning matters that clients can join to keep clients informed of changes in the law and other planning they might consider.
4. Use web meetings to provide a convenient and cost effective means to provide clients an overview of complex documents. Document the review to corroborate what was discussed.
5. Consider recording and transcribing web meetings to provide a record of what was discussed. Almost all web meeting services allow one to easily record the audio and video. Consider the cost of cleaning up a transcription to provide a client with a summary of the web meeting to make it easy for the client to review what was discussed. This can all be done easily and inexpensively with technology options discussed later.

6. Provide a summary of key provisions of complex documents. Document generation systems may provide this automatically.

7. Use schematics to illustrate complex transactions. These can readily be created in Microsoft Excel, flow chart software such as SmartDraw, or web services like Lucidchart.

8. Email drafts of documents in advance of meetings and signings and save the covering email as proof that the clients were provided documents to review in advance.

d. Email communication.
   i. **Practice Suggestions:**
      1. Use email marketing tools, e.g. MailChimp or ConstantContact, to inexpensively and quickly disseminate updates, planning information and other communications to educate and inform clients.
      2. What if regulations or other changes may affect past transactions? What can practitioners do? Attorneys have an ethical obligation to keep clients informed of significant changes in the law. Use client communications above (e.g., MailChimp or ConstantContact), footers on bills (see sample provisions above), articles or memorandum enclosed with bills can be used to inform (and a reference to the materials provided in the footers on the bills).
   
   ii. The key is that technology makes it easy and inexpensive to communicate information to clients and to corroborate that you have done so.

e. Email Retention And Other Policies.
   i. Rules based on paper file storage no longer make sense.
   ii. We asked 12 practitioners about their email retention policies, and received the following responses:
      1. One knew and said they keep every email forever.
      2. Three had their IT people get back to me and the policies ranged from 90-days to forever, from emails saved to the DMS to all emails.
      3. Seven had no idea.
      4. One, a partner in a 10 person firm replied, “What is an email retention policy.”
   
   iii. Software and other technology options.
      1. If you choose to retain emails forever, one option that can be used is Microsoft Outlook’s “Litigation Hold” feature, which
remains all emails until the option is turned off. This may help prevent inadvertent deletion.


3. Consider an add on service like Veeam that can archive and save Outlook data.

iv. Litigation considerations.

1. Is it an advantage or disadvantage to having every email record?
2. Will the Plaintiff have the email you are missing?
3. Consider the cost of having to review every single email.
4. From one firm’s document retention policy statement: “For efficient identification, retrieval, and deletion of email and other electronic documents pursuant to this policy, attorneys and staff are required to organize and store all business record email and other electronic documents in separate folders designated for each client matter in the firm’s electronic document management system.”

   a. RPC 5.3 addresses an attorney retaining nonlawyer assistance, and the ethical requirements regarding that assistance. An attorney must make reasonable efforts “to ensure that the firm has in effect measures giving reasonable assurance that the person’s conduct is compatible with the professional obligations of the lawyer.”

   b. If you retain an outside IT consultant, be certain the firm has familiarity with issues faced uniquely by lawyers. Does the IT firm represent other law firms? Are they familiar with the RPC?

   c. What happens if an outside consultant violates the attorney ethics rules, such as client confidentiality? The RPC indicates that an attorney may be ethically liable for the conduct of an outside consultant, as an attorney is responsible for any violations of the RPC by the nonlawyer if “the lawyer orders or, with the knowledge of the specific conduct, ratifies the conduct involved.”

   d. There may be numerous attorneys, non-attorney staff and outside consultants accessing the firm network, including sections with confidential client data.

   e. While there is no prohibition against members of the same firm maintaining data on the same network, the RPCs state that any partner in a firm needs to take reasonable measures “to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct.”

   f. Consider establishing a firm policy on when an attorney, or non-lawyer staff, can be given access to the firm network, partitioning off sections of the network based on need for each staff member, as well as policies on vetting outside consultants before they are given access to the firm network.

   g. Consider when employing third party vendors the kind of information they may have access to. Would they have the ability to retain these files? Do they have the ability to remotely access your network (such as with IT
consultants)? Consider the use of Non-Disclosure Agreements ("NDA") for any vendors that have access to sensitive information to show reasonable effort made to protect confidential data. Also consider having the NDA include a provision that requires the third-party vendor to destroy any confidential information they may have stored, either in paper or electronic format, separately from your files as part of their assisting you within a reasonable amount of time. You can determine a reasonable amount of time based upon the kind of work the third-party vendor is performing.

5. **Client Property; Original Documents; Electronic Storage.**
   a. Safekeeping of client property.14
      i. ABA Model Rule 1.15(a) provides that complete records of client trust account funds and other property shall be kept and preserved by the lawyer for a certain period of time after the termination of the representation. The number of years varies by jurisdiction, e.g. 7 years.
      ii. A lawyer must hold client entrusted property separate from lawyer's property, e.g. client trust accounts, and original documents, e.g. a will. Original documents retained are subject to RPC 1.15, e.g. storing wills.
      iii. Perhaps a question estate planners in a less-paper firm (or transitioning to one), might ask is whether it is beneficial for the firm to retain original wills and perhaps other key documents?
      iv. What is the liability of retaining original wills? What is the real all-in cost of retaining original documents?
      v. Does holding an original will create any additional responsibility or liability for the firm with respect to notifying the client of changes in the law that affect the will the firm is holding?
   b. Client records – file destruction.
      i. Simply because you can destroy the file after 7 years (or some other period) does not mean that you should. Consider self-protection when deciding to what to do with the file. If there is the possibility of a malpractice claim at some point, might the file be critically important for the lawyer's defense? Or might it be harmful? The policy established should be consistent.
      ii. If any portions of the file are destroyed, care should be taken to preserve the confidentiality of the information contained in the documents. If there is a litigation hold all electronic records should be preserved until the litigation has been concluded.
      iii. It should be noted that storing paper files indefinitely is definitely expensive and the expense is likely to increase over time. Further, making copies of paper records as a backup is also very expensive. On the other hand, storing electronic files indefinitely and making additional copies of them is very inexpensive. For perspective on the storage issue, a 1 page PDF document typically occupies 30 kilobytes of data. An average banker’s box holds 2,500 pages; and there are 1,099,511,627,776 bytes in a terabyte. Therefore, a 6 terabyte external hard drive one can buy for a mere $110 can hold 87,960,930 banker’s boxes of documents. It’s hard to even wrap one’s head around that. The point is that in most cases, all of the files
a law firm has ever created could be backed up on 5 different external hard drives for a total cost of $550.

iv. An index of the file records that have been delivered to the client or destroyed should be maintained. When original documents are returned if they are accompanied by a cover letter that may suffice. That letter is also a simple and cost efficient document to quickly corroborate that the originals were turned over when family calls years later looking for the originals the firm already turned over.

v. **Sample Clause**: One large firm’s retention/destruction policy: “Unless otherwise specified by the Billing Partner, a destruction date equal to ten years from the date the matter is designated closed will be assigned to all files, with the following exceptions… estate plan, estate administration, …. files will be permanently retained.” Some view retaining estate planning documents as different then retaining documents in other areas of practice.15

c. Personal Laptops.

i. Every device of any kind that holds client data should be encrypted. Further, if I have a home computer that is encrypted but to which my wife has access (because she knows the password), it is not okay to store client data on that computer if she can access it via the appropriate password.

ii. **Sample Clause**: Consider the following policy: “An attorney or staff member is specifically prohibited from storing electronic business records of the firm on a home computer or other device to which others have access and which is not encrypted. If an attorney or staff member creates or edits an electronic business record using a home computer, laptop, or other device, that person must save the record on the firm’s electronic document management system as soon as possible. No firm attorney or staff member is permitted to store electronic business records anywhere other than the firm’s electronic document management system.”

iii. Remote access programs such as “GotomyPC” by Citrix, and hosted server arrangements (from companies such as ProCirrus or Uptime Legal) can allow access to a device on the firm’s protected network without storing confidential client information on personal devices.

d. Using technology to assist with the safekeeping of client property.

i. The contents of a client’s file belong to the client and, upon request, an attorney must provide the client with the file.

ii. During the process of going paperless or paper-lite, care should be taken to avoid accidental destruction of client property.

iii. Record retention rules evolved in a paper environment. As the cost of electronic storage becomes insignificant (as contrasted with in-office and offsite paper storage) will the ethical rules evolve to require permanent storage of client data?

iv. Is electronic storage really moving to no cost? Consider the cost of finding relevant information if everything is saved forever. On the other hand, high-powered search programs like Copernic Desktop Search (which costs only $56 per year) would allow one to find any document by file name or the words contained within it within seconds (even if millions of documents were being searched).
e. The client “file” in the new technological environment.
   i. Rules are provided that govern what a lawyer must do when asked by the client for the file. When a lawyer withdraws from representation he or she must take reasonable steps to avoid foreseeable prejudice to the client’s rights, which includes delivering to the client all papers and property to which the client is entitled. The rule does not specify what papers and property the client is entitled to receive. What is a “client file” in a paperless office?
   ii. Maintaining a client file has historically been an important part of the service counsel provided clients, but electronic storage is essentially free for clients as well. So, clients can also readily store all their documents permanently.
   iii. If a client has all original documents, has received all memoranda, letters and emails, what is left that the lawyer must turn over to the client?
   iv. In a paperless office, is there any client property? If you have returned original wills and signed documents in a paperless office, you may have no client property to monitor or return. Consider the cost savings if you are not quite there.
   v. Sample Clause: Consider the following paragraph for follow up letters to clients, “We have previously provided you with copies of all documents we have retained in our file. Thus, you have been provided with the entirety of your client file. Any drafts of documents or internal notes regarding your estate planning that have not been previously provided to you are agreed to be our work product and shall not be provided. If you believe that there are any documents that comprise your file that you have not yet received, please contact our office and we would be happy to review the file to confirm whether any such documents exist.”

f. Cloud Storage.
   i. A law firm is permitted to store the electronic materials relating to the client on a remote server under third-party control as long as the law firm carefully selects the third-party company to ensure that the information is kept confidential.
   ii. What should be done to corroborate the selection?
   iii. Attorneys must take reasonable care to protect a client’s information in a cloud environment.

   a. Confidentiality of information.
      i. The RPC indicated that “A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized to carry out the representation, and except as stated in paragraphs (b), (c) and (d).”
      ii. ABA Model Rule: "A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client."
      iii. A comment to the rule requires a lawyer to competently act to safeguard information relating to the representation of a client.
against unauthorized access by third parties and against inadvertent or unauthorized disclosure.\textsuperscript{20}

iv. What are reasonable efforts? This is a nebulous statement that needs both common sense applications, judgment, and to review what opinions consider reasonable to determine your technology policies moving forward.

v. Reasonable efforts may be interpreted to include due diligence regarding technology procedures. Required training for employees, thoughtful policies implemented and followed, etc. all show that due diligence and that reasonable efforts were made to prevent disclosure.

b. Technology crime statistics.

i. In the first half of 2018, 4.5 billion data records were lost or stolen, reflecting a 133\% increase over the first half of 2017.\textsuperscript{21}
   1. 65\% of the compromised records were identity theft.
   2. North America constituted 57 percent of all breaches in the world, which included 72 percent of all records stolen.

ii. Of those records, only about 4\% were encrypted and thus protected from outside access when stolen.\textsuperscript{22}

iii. The FBI's Internet Crime Complaint Center in 2018 received complaints of 351,936 malicious incidents, over 900 per day, causing a loss of $2.7 billion.\textsuperscript{23}

c. Protecting confidential information.

i. Consider using encrypted emails, e.g. ShareFile, to transmit documentation with TINs, etc.

ii. Take precautions to protect the physical office facilities.
   1. Defensive measures employed are only as strong as their "weakest link." Even if sufficient electronic safeguards are created, if the physical location of the firm's devices and network are not also protected, the data could potentially be compromised.
   2. The use of an alarm system on office locations would provide notification of a break in and reduce time a bad actor would have access to any devices.
   3. Disabling the USB ports on any devices connected to the network, unless proper authorization has been provided, would prevent a weak point in protection from either an inadvertent infection of a network, or malicious actions.

iii. If flash drives or external hard drives are necessary, consider buying encrypted versions of those devices which are readily available. For example, see the Apricorn Aegis Secure Key flash drive or the Apricorn Aegis Padlock Fortress external hard drive. In some instances, firms might limit the use of USB drives solely to non-client data such as powerpoints taken to speeches.

iv. Take precautions to protect the integrity of electronic data. This might include:
   1. Encryption and password protection of laptops, smartphones and other equipment.
2. Providing internet access, which is password protected and outside the firm firewall, for clients and other visitors.

3. Protect all systems with appropriate virus protection, spam filters, intrusion protection, etc.

4. Multi Factor Authentication provides additional protection beyond the use of a password. Even the strongest password can be defeated by programs such as keyloggers, which provide a third party with all keystrokes made on the computer if compromised. The use of Multi Factor, such as requiring an additional numerical password sent to the user’s cell phone, may prevent the compromised password being used to access confidential data, while also potentially providing the practitioner with warning that the password has been compromised when access is attempted without the proper multi factor access.

5. Dark Web Scanning. Compromised information is often uploaded to the dark web, where information brokers sell the stolen information. If the practitioner has regular scans performed, and information is identified on the dark web, it would provide the practitioner with warning a breach has occurred and allow corrective action to be taken.

6. As discussed above, consider requesting that a memorandum be prepared by IT department or consultant outlining steps already taken to protect electronic systems and confidential information, and have additional suggested steps included in the memorandum. Subsequent memoranda should show efforts made to implement the suggestions made in previous years. Establishing a history of activity taken and due diligence performed may show that actions taken by the practitioner in protecting electronic information was reasonable.

v. Use best judgment regarding when you need to take extra security measures. Consider the following reasonable efforts factors:
   2. Likelihood of disclosure if you do not employ additional safeguards.
   3. Cost of employing additional safeguards.
   4. Difficulty of implementing additional safeguards.
   5. Extent to which the safeguards adversely affect the lawyer’s ability to represent clients (e.g. difficult to use).

d. Actions to take.
   i. The ABA rules state that if a data breach occurs that involves client information, lawyers have a duty to notify current clients of that data breach. However, if the data accessed was encrypted, there would be nothing for the client to worry about and the breach notification laws in most states wouldn't be triggered (because they only require notification if “unencrypted” data is accessed by an unauthorized party).
ii. Attorneys have a requirement to monitor for data breaches so current clients can be informed if one is discovered.

iii. There are programs that can be used to assist in monitoring the practitioner’s various devices and network to attempt to identify data breaches and end unauthorized access to confidential data as quickly as possible. One example would be Vijilan.25

iv. Interestingly, there is no requirement to notify former clients. Practitioners might wish to consider what action is appropriate. Notification might be advisable regardless of whether it is required.

7. **Collaboration and the Attorney Client Privilege.**
   a. The world is too complex and inter-related to practice without collaboration.
      i. Collaboration might have been merely a footnote not too many years ago.
      ii. Today it warrants prominent consideration and is an integral part of many estate planning practices.
      iii. Estate planning is more complex and intricate considering changing demographics and what seems to be a permanent state of uncertainty as to the tax laws.
      iv. Attorneys are obligated to safeguard the confidences of their clients.
      v. Generally, the attorney is responsible to protect all communications between the client and the attorney from disclosure without the permission of the client.
      vi. A client intake form might include an authorization to be certain clients understand the importance of collaborative disclosures and provide the relevant contact at the outset of the engagement.
      vii. Many clients do not know how to protect their own data. If PDF copies of estate planning documents are provided to clients after signing, it may be worth providing guidance on how and where they should be stored, how they can be safely shared with loved ones, etc.
      viii. The mere fact that the estate planner has authorization to collaborate does not mean other advisers have obtained permission. Other advisers may refuse to collaborate until they have authorization from the client.
      ix. Counsel could prepare a letter from the client to all advisers authorizing and directing collaboration that the client can sign, and counsel can distribute. **Sample Clauses** that could be used in the letter include:
          1. “The undersigned has hired [firm name] to assist with estate planning. The undersigned understand the benefits of collaboration and request that you communicate and collaborate as reasonably necessary with [practitioner’s name], his/her office, and each other, as a planning team, in order to enhance effectiveness and efficiency, and to foster a better outcome for planning by leveraging and coordinating the knowledge, skills and insights of all of you in a manner that allows for a more comprehensive view of planning for the undersigned’s circumstances, issues, as well as communicate some of the risks regarding any planning proposed by a member of the collaborative team. The
undersigned acknowledges that there are no guarantees for any plan and every plan entails risks.”

2. “The undersigned understand the advantages this collaborative approach has to protecting people and finances and authorize you to all collaborate on reviewing and commenting to each other on draft letters, memorandum or documents circulated to the team, as well as on the proposal and implementation of any planning. Please accept this as the undersigned’s authorization and direction to collaborate.”

b. Preserving the attorney client privilege.
   i. The Privilege belongs to the client as opposed to the lawyer. The communication of confidential information and the privilege can both play an important role in a range of estate planning matters. Address, with some specificity, in the engagement agreement and other communications.26
   ii. Technology has complicated the potential implications of Privilege in designating acceptable forms of communication. Technology has also provided some solutions to these challenges as well.
   iii. In an age where many routine communications occur electronically, the client might not pause to consider the implications of a mode of communication.
   iv. For example, a client might communicate with her personal (not business) counsel through her company email account, saving documents on a company file server, or using a company computer to engage in such communications.

   i. The attorney’s duty to represent a client does not end merely because of a client’s disability.27 An attorney, as far as reasonably possible, is to maintain a normal client-lawyer relationship with a disabled client. An attorney can take protective actions for their client depending on the circumstances.28
   ii. An attorney may reveal confidential information about a client when doing so to the extent reasonably necessary.29 This is generally limited to situations where the client is at risk for substantial physical, financial or other harm. Therefore, it may be advisable for a client to authorize greater latitude in order for the attorney to take steps the client might wish taken in less onerous circumstances.
   iii. A power of attorney prepared for clients comes into effect when the client is disabled. Often, when an agent needs to act in their capacity under the power of attorney, they will reach out to the practitioner that drafted the document for assistance and information. Consider whether the client is or should be willing to waive the attorney client privilege. If not, there may be an issue with you as attorney disclosing information to the agent which may become essential for the agent to have to act to protect your clients interests under the Power.
   iv. **Sample Clause**: Consider the following sample clause: “By executing this Power of Attorney the Principal agrees and acknowledges that Principal hereby waives the attorney client privilege with the law firm who prepared this document, solely for the
purposes of permitting said attorneys and firm, or its employee attorneys and any successor firm (collectively, "Attorney") to communicate with the Agent and Alternate Agents hereunder, including disclosing Principal’s confidential information to them, and providing Principal’s confidential documents to them with respect to their carrying out their duties hereunder. Attorney shall have the right, but no obligation under any circumstance, to act hereunder (including but not limited to distributing any copy or original of this Power of Attorney). Attorney shall be held harmless for any good faith action, or refusal to act, hereunder.”

v. Carefully consider if any exceptions should be made to the waiver of conflicts discussed. **Example:** Have another Agent or successor Agent act with respect to a business, for example, in which the initial Agent holds an interest. Alternatively, the interested Agent could be permitted to act but could be required to give notice of the actions to a successor agent and/or at least one person (or more than one) who could be a beneficiary of the Gift provisions in this Power (presuming that such persons are objects of your largess).

   d. Privilege can affect the attorney personally.
   i. Similar issues can also affect practitioners.
      1. If the attorney sends personal emails from a work email address or stores personal documents or communications on a laptop that is a practice laptop, in later litigation, discovery and data searches might reveal the practitioner’s personal emails and estate planning documents.
      2. If a practitioner is terminated from their employment, usually a firm will immediately cut off the practitioner’s access to the firm network. If personal data was stored by the practitioner on the firm’s network, access to those documents may be lost, and potentially deleted by the firm.

   ii. **Practice Suggestion:** As previously discussed, for personal computers, tablets and phones, consider a written policy to save no client work there, and a requirement to transfer all of it to the office system to be saved in accord with whatever the firm document retention policy states. Consider documenting the characterization of personal equipment as personal in the firm’s technology records.

8. **Billing Rates, Billing Methods and the Impact of Technology.**
   a. Hourly billing may no longer be fair to the practitioner considering the impact of technology, e.g. document generation software.
   b. Various tasks that use to be quite costly, may be more efficient and routine because of technological changes. Thus, some tasks that had been billed on an hourly basis might now be billed on a flat fee or hybrid basis in order to be fair to the practitioner/client.
   c. As practices evolve to paperless, cloud-based document generation driven models, the traditional paradigms for billing will be unfair to clients in some instances, and unfair to practitioners in others. Modifications to billing practices may continue to evolve over time.
   d. Assure that the client has a clear understanding of how they will be billed specified in a written retainer agreement.
e. **Sample Clause**: If the practitioner chooses to include document generation fees, in addition to hourly billing, a sample paragraph could be, "The following fees will be charged as supplemental fees, in addition to regularly hourly rates for work completed, for the preparation of the documents indicated below. These fees are charged in addition to our regular hourly fees to address the substantial and ongoing investment of time and cost we have, and continue to make, in technology, forms, and other matters that have and continue to provide substantial efficiencies to clients. If you wish to discuss the rationale or application of these fees, please call."

f. **Practice Suggestions**:
   i. When rates or fee structures are changed, a footer could be incorporated on the bill explaining that an increase or other change has been put into effect.
   ii. Many billing systems easily accommodate the addition of standard footers to some or all bills to facilitate such communication. In fact, footers designed to appear on all bills can provide an important and no-cost way to communicate important billing, administrative and even tax development information to many clients.
   iii. Firm newsletters and announcements can also be put to similar use. If the latter is done, consider saving copies of all such general client communications in a single file to assure an accessible record of all general communications.

9. **Aging Clients and Technology**
   a. The evolution of aging clients and how estate planners can use technology to be a more substantial and important part of the planning team, render services that remain relevant to the large swath of aging clients who are indifferent to estate tax planning and just won’t get excited about the latest mantra from the estate planning world of “basis maximization.” While most if not all practitioners have, or will, use Uber, Lyft or other such services, how can these and other technologies provide a model for service delivery for estate planners to aging or infirm clients?
   b. Why is this all so necessary? Estate taxes are irrelevant for most clients and that driver for business has largely dissipated. Document generation software is growing more sophisticated and allows less experienced practitioners to create plans and draft documents that can replicate the results of what the most sophisticated practitioners can do. Artificial intelligence has barely nipped at the heels of estate planners, but in short order it will likely obviate many of the services and guidance clients have traditionally sought from practitioners. Estate planners can discuss the merits maximizing the basis of assets transferred to family members (not to say that it is not important) but many clients don’t care, and many if not most who do care still view income tax planning as in the purview of their CPA not their estate planner. That will not lessen the need to incorporate basis maximization planning in estate plans, but it does not seem that such income tax planning will ever be a driver to push clients to their estate planner’s office. Aging clients do fear the impact of dementia, elder physical abuse, elder financial abuse, identity theft and more. Aging clients universally want to retain their independence. Estate planning, in a
somewhat broader and more holistic manner, can help address these concerns.

c. Following is a blog post about seniors using Uber that can provide a construct that estate planners should all embrace:30

i. “Driving to the doctor, the supermarket, to visit friends or just to see the change in seasons through Mother Nature’s eyes is something many of us take for granted. When our senior loved ones no longer drive, whether they are no longer safe behind the wheel, choose to give up their keys, or can’t afford to own a car, they still need to get from one place to another. How can they get to essential services like the grocery store or just to places that will help them enjoy life, like visiting friends or the ice cream shop, especially if they live in suburban or rural cities without a transportation infrastructure? Not being able to get where they need to go or having to rely on family or friends to get there, can rob seniors of their independence and maybe even the ability to age in place… Unfortunately, a large majority of community dwelling seniors have no access to public transportation or walkable city services and need to find a solution to meeting their needs without a car to rely on each day. It is estimated that by the age of 75, 31% of seniors need to find alternative forms of transportation because they no longer drive… There is a way for our senior loved ones to get on the road again! Yes, we are talking about Uber."

d. Uber is far from the only illustration of the growing sharing economy:31

i. Instacart is the personal grocery shopping service that will deliver your grocery order to your door for a nominal fee. Consider seniors for whom travel is difficult, or because of arthritis or other challenges find mobility painful or too time consuming.

ii. Poshmark helps women monetize their closet and declutter at the same time. You can list gently used clothing items for sale in less than 60 seconds with their app. Consider the common and growing problem of seniors downsizing. This can provide a cost efficient and straightforward way to do so. Also, consider the financial challenges facing many clients with longevity.

iii. Getaround can make a client’s car generate income when they are not driving it. Consider the oft discussed challenge for many aging clients of financial resources as longevity continues to expand. Perhaps that car the senior client cannot yet part with, but which is used less and less, can provide cash flow to offset its carrying cost.

e. Technology provides a range of benefits that can help both aging clients and their caregivers:32

i. Technology can provide social connections. Video chat and social media can keep seniors in touch with long-distance loved ones. But how many estate planners schedule periodic reviews with clients? Those reviews could be about much more than just updating an estate plan, but rather to have an objective and independent attorney in effect checking in on a client, providing important social connection, and perhaps minimizing the risk of elder abuse. “Have you had your financial adviser or CPA automate your bill paying yet?”
How does the client appear? Is there anything worrisome in the client’s demeanor? The signs are no different than what any advisor on the planning team might consider in recommending an initial review by a care manager.

ii. Emergency equipment can be vital to the security of aging clients. Surveys consistently show that 80 to 90% of seniors want to stay in their own home as they age. Technological solutions can make doing so safer for them. Every senior that lives alone should have a Personal Emergency Response System (PERS).

iii. According to a 2009 survey by Medco Health Solutions, more than half of the older adults took at least five different prescription drugs regularly, and 25% took between 10 and 19 pills a day. Technological solutions that also provide reminders and "time to refill" alerts can aid adherence to the prescribed medication schedule. Seniors and their caregivers can take advantage of the RxmindMe or Personal Caregiver medication reminder smartphone apps to reduce missed medications and prevent medication errors.

f. So, what do technology, Uber and other sharing economy solutions provide seniors, and how can estate planners adapt similar concepts to their practices to make matters easier?

i. Minimize the need to drive to appointments.

ii. Address the reality that few clients return for annual reviews, which become more critical as clients age.

iii. Facilitate interaction and communication.

iv. Provide additional safety to aging or infirm clients.

v. Assure coordination of a holistic estate planning team.

vi. Minimize or ease check writing and recordkeeping which become more difficult with aging.

vii. Make documents accessible to the client and others who need them in a manner that is convenient to an aging client who might have difficulty locating documents or transmitting them.

g. What are some of the specific ways estate planners can cost-effectively adapt some of these concepts to help aging and infirm clients? How can estate planners broaden the scope of services provided, better assist and protect aging clients, and more?

i. Post short video clips explaining concepts and planning to clients and their loved ones on your website. These can be created inexpensively in the practitioner’s office without the cost of expensive marketing and PR firms. These videos can explain the issues each practitioner sees his or her clients needing information on. Using video clips will be much easier for many clients to digest then the traditional newsletters and written materials. For an illustration see www.laweasy.com.
ii. Document management becomes increasingly difficult for seniors and can be simply resolved. For example, ShareFile provides a cost-efficient and simple means for an estate planner to create a secure password protected cloud vault for each client. PDFs of all key client documents can be uploaded to that vault. The client can choose which persons to share that password with. Practitioners can encourage clients to share the password with their wealth advisers and CPAs to foster collaboration, assure that clients can easily facilitate other advisers having documents, and avoid the need to copy, scan, email or otherwise do so themselves. For practitioners, this approach can virtually eliminate calls and emails by third parties requesting copies of documents. Those inquiries can raise issues of obtaining approvals to provide the documents and create time drains that are difficult to bill for.

iii. **ShareFile** has an app for smart phones which practitioners can make available to clients. If a client or client’s spouse/partner is rushed to an emergency room, his or her health care proxy and other key documents can readily be downloaded from their smart phone to provide to a hospital. Not only with this capability give clients peace of mind but it will also eliminate the urgent document requests inquiries that can be difficult for practitioners to respond to.

iv. Web based meetings are a simple and cost-effective way to meet with clients to maintain communications and eliminate the need for clients to drive to the attorney’s office or for the practitioner to drive to the client’s home thereby increasing the cost of services. When a web-based meeting is combined with cameras, the visual makes the interaction more personal and provides much more insight to the practitioner (than a mere telephone call). These services are readily available from many providers and quite inexpensive. For example, GoToMeeting and Zoom are popular web meeting services (there are many more good options - these are just examples). They’re online meeting, desktop sharing, and video conferencing software services that enable the user to meet with customers, clients or colleagues via the Internet in real time. 5 million seniors are subject to financial scams every year. While most perpetrators are family, friends or home health aides, scammers include fake lotteries, home improvement scams and more. The Federal government passed “The Senior Safe Act.” The theory is that financial advisers can spot signs of elder financial abuse. Advisers need protection from liability and violations of privacy if they alert authorities about potential fraud. FINRA Rules 2165 and 4512 became effective in 2018. Why shouldn’t estate planners be part of this protective effort as well? By communicating through web conferences, visually seeing and hearing clients in their home environments, estate planners may identify issues that financial professionals who may only see clients in their offices, when they are groomed and perhaps rehearsed for the occasion, may miss.

v. The aforementioned GoToMeeting and Zoom can easily record a client meeting. Many practitioners have shied away from video
recording of client meetings to confirm a client’s dispositive intent or capacity. Videos can sometimes be picked apart by a forensic psychiatrist, are costly, and many clients are uncomfortable with formality. That discomfort can readily be translated into questionable capacity on the recording. But has anyone considered the impact of periodic recordings of a client on a web conference from the comfort of their home, at no cost? How might that translate into a different perspective on corroborating capacity or testamentary intent? One option to consider to potentially ensure the client’s wishes in his or her testamentary documents are carried out is to consider pre-mortem probate and declaration of validity of a revocable trust. But few have bothered to use it. More certainly should.

vi. To foster collaboration of the planning team, vital to the protection of many aging clients or clients with health challenges such as cognitive issues or chronic disease, a web meeting of the advisers can be quick and cost-effective. It eliminates the costs of travel time being billed and the social niceties that precede any meeting but add to billable time to the client.

vii. Firms that do not take credit cards for payment should, as it provides an easier means for an aging client to handle payments then writing checks. There are many excellent credit card processing services that also understand a lawyer’s trust accounting rules such as LawPay.

10. **Vetting the Prospective Client.**
   a. The internet changes the dynamic of accepting new clients.
   b. Some practitioners take steps in advance of being retained. Some refer to these preliminary steps as "pre-engagement."
   c. Turning away a bad case or client is important to the security, success and atmosphere of every firm.
   d. Example: if the prospect has significant assets overseas what issues might this suggest? Has the prospect complied with all the requisite reporting requirements?
   e. If the engagement involves the potential creation of Domestic Asset Protection Trusts ("DAPTs") could providing assistance place the attorney at risk of being an aider and abettor?
   f. It may be advisable to perform some due diligence on a prospective client before the prospect becomes an actual client.
   g. The internet has made the vetting process easy and, other than staff time, relatively cost free.
   h. Have staff search the client’s names, and business names, prior to accepting the engagement.
   i. If issues are identified, address them before accepting the prospect as a client.
   j. If a prospective client searches raise worries, e.g. a physician prospect who has scores of negative complaints that sound substantive, perhaps the firm should consider whether that reputation risk is something it is willing to take on in the context of estate planning that typically will entail transferring assets into entities and irrevocable trusts. If the firm is willing to accept the
client, it might choose to discuss these concerns up front as well as steps and costs of addressing them.

k. To avoid any prospective client claiming that for an inappropriate reason they were singled out, it may even be advisable to perform the same procedures for all clients.

11. **Document Generation Transforms Estate Planning**[^35]


i. Estate plan deliverables often involve complex documents.
   1. Initial intake forms.
   2. Recommendations with asset schedules and flowcharts.
   3. Trusts, wills, and asset change documents.

ii. What’s wrong with the status quo?
   1. Lawyers often draft new documents by pulling up an existing document from a previous matter or transaction, saving it as a new file name, and making changes to it.
   2. In 2019, no lawyer should ever draft by pulling up a document prepared for another client and using that as a starting point.
   3. Finding the right document can be time consuming.
   4. There is a high likelihood that you will leave something in that shouldn’t be in the document.
   5. There is a high likelihood that something that should be in the document won’t make it in.
   6. Find and Replace rarely finds everything.
   7. Using an old document means you will need to keep fixing formatting issues that are carried forward.
   8. Many of these “starting point” documents were designed very specifically, and revised based on discussions, with regard to the specific client the document was drafted for. Such provisions could be “landmines” in another client’s document.

iii. The use of document automation software allows attorneys to create functioning documents for both simple and complex plans more efficiently, allowing the attorney to concentrate their time on discussion with the client to determine what the client’s needs and desires are. These conversations allow the attorney to craft a more comprehensive plan for clients than may have not been economically feasible otherwise. This additional “face time” with the client also allows the client to see more of the work being performed by the attorney and may help prevent billing issues raised by clients due to “sticker shock.”

b. Upgrading skills for document drafting.
   i. Lawyers (and staff) should improve their own word processing proficiency or use speech recognition technology.
   ii. Lawyers should recognize the limitations of using other client documents and dictation/transcription and seek new and efficient tools.

c. Document automation is important.

[^35]: Document Generation Transforms Estate Planning
i. Document Assembly (or Automation) is the use of software to quickly and accurately generate customized documents in word processing software.

ii. Document Assembly adds significant functionality to your existing word processor.

iii. Document Automation refers to the process of developing forms into a manner in which they can become part of automated document assembly.

iv. You can capture the consistencies in your documents starting with format.

v. You can prevent (or capture) irregularities in your documents.

vi. Document Automation systems can create a database of client information. You can avoid inputting the same information multiple times.

vii. Once you enter the client names in your system, it should be the last time you enter the names. This will prevent the problem of Laurie L. Jones showing up in one place and Lori L. Jones showing up in another.

viii. You eliminate the risk of Find and Replace missing Janie Jordan when you are trying to insert Laurie L. Jones.

ix. Other improvements.
   1. Document accuracy is improved.
   2. Client intake can be improved. Electronic intake can create data files for the documents that will be drafted.
   3. Document Automation can be integrated with Automated Workflows!

d. Document assembly options.
   i. The least expensive (and least powerful) option is to use the features contained within your word processor to automate. Such approach can be useful for simple documents. Some features that can be used to help automate are: Quickparts, AutoText, Text expanders, Macros, Mail Merge, and Microsoft Word Plug-ins.

   ii. Purchase Document Automation Software: Document Automation Software is a tool you can use to automate documents that you already use. Examples include: HotDocs, TheFormTool, Pathagoras, Xpressdox, ActiveDocs, Contract Express. Generally speaking, these tools are complicated to learn and you are probably better off hiring a professional to automate your documents for you.

   iii. Subscription drafting systems automate document generation, but they include the documents that you will use. That is, you use the forms developed by the subscription service rather than the documents that you developed. Some of the companies that provide these services include:
      1. WealthDocx.
      2. ElderDocx.
      3. Wealth Transfer Planning.
      4. Practical Planning System.
      5. Lawyers With Purpose.
e. Questions to ask when shopping for automated drafting solutions.
   i. Who is “behind” the documents?
   ii. How frequently are the documents updated?
   iii. Are the documents state-specific? Which states are covered?
   iv. Is the system customizable?
   v. Training and support.
      1. What type of training is available for new users?
      2. Is support available for both technical and content-related questions?
   vi. Other resources: What other resources are available to subscribers?

12. **Electronic signing of documents.**
   a. While electronic signing of wills has only been implemented in Nevada\(^36\) by statute, there has been other instances of electronic methods being used to effectuate a will, such as when in 2013 an Ohio court admitted to probate a will written on a tablet.\(^37\) However, there largely has been resistance against making steps towards allowing more prevalent use of electronic signing for wills.
   b. The E-signing of documents other than wills can be implemented into an estate planning practice both for administrative convenience, and the convivence of the clients. Consider the use of e-signature in the following situations:
      i. Providing clients with an engagement letter to be signed.
         1. This can be used both for an initial engagement letter, as well as to provide a client with an engagement letter to reflect additional work that has been requested.
         2. For instance, if a client initially requested only a meeting and a memorandum, but later decides to have planning documents drafted, a practitioner can send an engagement letter specifying the documents to be created. This is a protective measure for the attorney, ensuring written authorization to perform work requested in case of billing issues, as well as a convenience factor for the client.
      ii. Provide Crummey notices that need to be signed by various family members of the client, oftentimes spread across the country, to sign electronically and return. This can be a faster method and avoid the headache of following up with numerous beneficiaries on the part of either the attorney or the client. In addition, some E-signature services allow the user to send out the document to be signed by several email addresses at the same time, reducing administrative load.
      iii. Balance sheets. Having a signed balance sheet by a client can be a protective measure for the attorney when preparing an estate plan and documentation. If a balance sheet is either not prepared or not signed at the initial meeting, providing it to the client electronically reduces the burden on the client while giving the attorney the protection desired.

13. **Illustrative Additional Service for Clients: Change in Domicile.**
   a. Many aspects of planning can involve changing a client’s residence, and perhaps domicile. If a client wants to support the use of a self-settled trust,
being domiciled in one of the 20 states that have such enabling legislation may support the validity of the domestic asset protection trust (“DAPT”). If a client is seeking to avoid estate tax in a decoupled state, changing domicile to a not tax state may be advantageous. Tracking days in and out of the old home state and the client’s new home state, can be important to successfully supporting a change in domicile for the above or other reasons. Technology can help practitioners support the intended result.

b. For example, TaxBird is an app that helps users keep a real-time count of the number of days they’ve spent in each state for residency and/or domicile change purposes. As a client approaches a threshold for residency, TaxBird alerts them when they are 90 days, 30 days, and 10 days or less from meeting the limit. These warnings come as in-app alerts, notifications on the phone, and emails. To check progress in between alerts, the app has a very nice, simple dashboard to display a client’s current count of days in each state and progress toward the bright line. A future enhancement may give counsel notice as well so that the practitioner can follow up with a client to discuss the status and planning implications.

c. TaxBird was designed to be easy to use and understand. By using the location services in the client’s smart phone, the app is able to keep an accurate record of your locations throughout the year. The only requirement from the user is to add their states of residence and input any historical days (those that have passed this year before the app was installed). After that initial setup, the app does the tracking automatically by running in the background and using a location gathering process, TaxBird is able to keep a real-time, automated count without requiring any user interaction. This can be valuable for the many clients that become lax on follow up.

d. At the end of the year, the client is able to request a report with a detailed summary of their counts. This is delivered as a PDF to the client’s (or a professional’s) inbox. This can be used as a supporting document to provide to counsel.

e. The app is currently available on iOS App Store and Google Play.

14. **Illustrative Additional Service for Clients: Longevity Planning; Term of GRATs; etc.**
      i. 1- Clients take the HALO assessment. HALO’s self-guided assessment collects all of the information you need without an uncomfortable conversation about client health.
      ii. 2 - HALO projects clients’ health and care costs. They use science to personalize cost projections to each client’s unique lifestyle, health and longevity.
      iii. 3 - Advisors and clients revisit their plans, together. Whatever your targets were before, they were too low. Now that you know the real numbers, rebuild clients’ plans to make sure to get there.
   b. Tailoring planning.
      i. Use the difference between general life expectancy and calculated life expectancy to tailor planning. For example, might you make a GRAT longer term to reflect greater life expectancy?
      ii. Use real life expectancy in financial forecasts when modeling how much the client can gift away.
iii. Consider the years of the client requiring assistance to plan more realistically for success trustees and agents, care providers, etc.

15. **Using Transcription Services For More Effective Meetings And Marketing.**

a. **How to Use Transcription in Practice.**

i. Record and transcribe meetings to reduce or eliminate the cost of taking notes or producing a memo. Both the recording of the meeting and the transcription can be used by the client as a reminder of what was discussed, as well as being protective for the attorney by showing that a certain option, or risk, was discussed with the client before planning was implemented. Consider [https://otter.ai](https://otter.ai) for an easy-to-use application that can transcribe your meetings in real time.

ii. Strip audio from marketing and educational videos to turn into blogs and articles. This allows the attorney additional usage of the materials prepared. For example, if the attorney participates in a webinar, if the webinar is recorded the recording can be posted on the attorney's website, and then the audio transcribed to produce additional articles.

iii. The voice recordings from a video conference can be quickly (within 10 minutes) transcribed and saved as a Word document using many inexpensive (10 cents per minute of transcription) web-based services, e.g. [Temi.com](https://temi.com). Zoom web meeting business accounts and above include recording and transcription for all web meetings. Consider how easy a written record of a client conference call or web meeting can be created to corroborate the discussions. If the practitioner wants to send a follow up letter to the client, it is quick and easy to copy and paste key points from the transcription into a confirming memorandum or letter. That same transcription, even in rough form, can be circulated to the advisor team to inform other advisers not on the call of the discussions.

iv. Use transcriptions to prepare articles, blogs, etc. Depending on usage, this can be more cost effective than traditional dictation software, as well as less labor intensive if administrative staff time is being used for the dictation.

b. **Outsourcing.**

i. Consider an offshore outsourcing service for writing cleanup of raw transcriptions. This may save the practitioner time in revising the transcription to account for the difference between speech and written word.

ii. Email communications make it seamless.

iii. Outsourcing saves money since you don't need extra staff to deal with upswings in work load.

iv. Cost is substantially less than American workers.

v. Time difference can permit getting work back more quickly compared to a US outsource service.

vi. Use transcribing team that are native English speakers so “tone” and “style” are consistent.

vii. Confidentiality agreements can be used if desired, e.g. for client matters. Care should be exercised in any confidential information
provided to the outsourcing company, similar to the outside consultant concerns discussed above.

16. **Conclusion.**
   a. Technology continues to evolve at an ever-increasing pace. The programs, and the uses of those programs, is a small sample size of the myriad of products and potential applications that the modern estate planning firm can employ to practice more effectively and profitably.
   b. Practitioners should be diligent and thoughtful when employing new technology in their practices. Consider “beta testing” the programs before wide dissemination is performed to ensure that there are no unexpected side effects to use of new technology that could open the firm to issues or liability concerns.
   c. It’s extremely difficult to keep up with the dizzying pace of change related to technology. There are expert companies that can help you with all of these decisions. Lawyers always want their clients to ask for help when dealing with areas of unfamiliarity; and they should be mindful of when it’s prudent to follow their own advice as it relates to technology.

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1 **Thomas Tietz, Esq.** is an Associate with Shenkman Law. He is experienced in assisting with the implementation of all facets of an estate plan, including the preparation of core documents such as the Last Will and Testament, Health Care Proxy, Durable Power of Attorney, to the more advanced techniques of an Irrevocable Life Insurance Trust, Grantor Retained Annuity Trust, self-settled Trusts, and the implementation of asset transfers to those trusts, depending on the client's needs. In addition to Estate Planning, he assists clients with estate administration, including the organization of the documentation and assets of a decedent for tax filings and disbursement, as well as assisting with corporate work, concentrating on the effects to family entities and businesses in relation to estate planning, including assisting with entity documents and complex entity ownership.

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2 **Martin Shenkman** CPA, MBA, PFS, AEP (distinguished), JD, is an attorney in private practice in Fort Lee, New Jersey and New York City, New York where his practice concentrates on estate planning. Mr. Shenkman is the author of 43 books, and more than 1,200 articles. His writing has been recognized with several awards including: the “Editors’ Choice Award” in 2008 from Practical Estate Planning Magazine for his article “Estate Planning for Clients with Parkinson’s.” He received “The Best Articles Published by the ABA” award in 2008 for his article “Integrating Religious Considerations into Estate and Real Estate Planning.” In 1994 he received Probate and Property Excellence in Writing Award. His book *Estate Planning for People with a Chronic Condition or Disability*, was nominated for the 2009 Foreword Magazine Book of the Year Award.

He is on the editorial board of Trusts & Estates Magazine, CCH’s (Wolter’s Kluwer) Professional Advisory Board for which he serves as Co-Chair, the New York Stater Society’s CPA Journal, and the Matrimonial Strategist (through 2018). Has previously served on the editorial board of many other tax, estate and real estate publications. He has been an active member of the American Bar
Association and state and local bars and has served as Co-Chair and Vice Chair of various committees including the Diversity Committee, Elder Law Committee, and others. He is a member of the National Association of Estate Planners and Council (NAEPC)’s Board of Directors (Emeritus).

Mr. Shenkman received his Bachelor of Science degree from Wharton School, with a concentration in accounting and economics; his MBA from the University of Michigan, with a concentration in tax and finance; his law degree from Fordham University School of Law. He is admitted to the bar in New York, New Jersey, and Washington, D.C. He is a CPA in New Jersey, Michigan, and New York. He is a Registered Investment Adviser in New York and New Jersey.

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3 BARRON K. HENLEY, ESQ. is one of the founding partners of Affinity Consulting Group, a legal technology consulting firm focused on automating and streamlining law firms and legal departments. He earned his B.S./B.A. (marketing and economics) and J.D. from The Ohio State University and is a member of the American, Ohio and Columbus Bar Associations, and the Worthington Estate Planning Council. He is a Fellow in the College of Law Practice Management, and a member of both the ABA Law Practice Management and the Real Property Trust and Estate Law ("RPTE") Sections. Mr. Henley heads Affinity’s document assembly/automation and software training departments; he is a renowned expert on document automation tools such as HotDocs and Contract Express; and has authored legal-specific manuals on HotDocs, Adobe Acrobat, and Microsoft Word, Excel & Outlook. Barron is also an expert in launching new law firms, overhauling existing firms, and documenting and re-engineering law firm processes. Finally, Barron teaches continuing legal education (CLE) classes throughout the U.S. and Canada covering a wide variety of topics related to law practice management, technology and ethics.

4 See https://www.lawsitesblog.com/tech-competence
5 6 Comments 18 and 19.
6 For more information on this subject, see Why Your Next Laptop Should Be a 2-in-1 by Sam Rutherford for LaptopMag.com on March 30, 2017 - see http://bit.ly/2H0fhNH
7 RPC 1.4.
8 Ethics Opinion 477 updates Ethics Opinion 99-413 to reflect the now common use of technology such as tablet devices, smartphones, and cloud storage.
9 Comment 8 of Rule 1.1.
10 For an excellent explanation of this, see Everything You Need to Know About Password Managers by Andrew Chaikivsky for Consumer Reports on February 7, 2017 - http://bit.ly/2Z1tJuW.
11 RPC 5.3(a).
12 RPC 5.3(c)(1).
13 RPC 5.1(a).
14 RPC 1.15.
15 See NJ Ethics Opinion 692 and RPC 1.4.
16 RPC 1.16(d).
17 See NYSBA Ethics Opinion 842 (9/10/10).
18 RPC 1.6.
19 ABA Model Rule 1.6(c).
20 Comment 18, paragraph (c).
22 https://breachlevelindex.com/
24 ABA formal opinion 483.
27 See MRPC 1.14(a).
28 MRPC 1.14(b).
29 MRPC 1.14(c).
33 “Best Medical Alert Systems - November 2018,” https://www.best10medicalalerts.com/?utm_source=google&kw=personal%20emergency%20response%20system&c=265742111227&t=search&p=&m=e&adpos=111&dev=c&devmod=mobval=0&network=g&campaignid=362025071&adgroupid=58267178527&targetid=kwd-87883632&interest=&physical=9003430&feedid=&a=9911&ts=&gclid=EAIaIQobChMIp3b7r7hpIQVh9a96874w3QhEAAYASAAEgLqQvD_BwE
34 Section 303 of the Economic Growth, Regulatory Relief, and Consumer Protection Act, which was signed into law on May 24, 2018. See https://www.sec.gov/news/press-release/2019-75 for a press release by the SEC.
35 Acknowledgements to Mary E. Vandenack, Esq. for portions of the following discussion.
37 Note that the instrument written on the tablet was admitted to probate under Ohio’s traditional will statute through use of the harmless error doctrine and was signed on the program it was written on with a Stylus, while acknowledged in front of a witness and presented to another witness later. The court stated that Ohio law “requires only that the will be in ‘writing’. It does not require that the writing be on any particular medium.” See In re Estate of Javier Castro, Deceased, 2013-ES-00140 (Ct. Comm. Pl. Lorain Cnty., Probate Div., Ohio, June 19, 2013) (James T. Walther, Judge) at page 7. Information accessed on https://willing.com/learn/modernizing-the-law-to-enable-electronic-wills.html
Dear eReport Committee Members,

As a leader of the section, I am asking if your firm would sponsored this year's 2019 Fall Leadership Meeting to be held in San Juan, Puerto Rico, November 14 - 16, 2019. The Fall Leadership Meeting provides an intimate opportunity to network with Section leaders.

Sponsorship of the 2019 Fall Leadership Meeting provides your law firm a unique opportunity to:

* Publicize your law firm's name to a national audience of prominent and distinguished real property and trust and estate attorneys;
* Support the Section at its premier annual leadership meetings; and
* Support the Section's commitment to public service and community outreach programs.

All law firm sponsors receive:

* Sponsor recognition on conference website with link to sponsor company url;
* Sponsor acknowledgement in the official Fall Leadership Meeting promotional invitations;
* Prominent display of company name in all digital meeting promotion distributed to 200 + section leadership members;
* Appreciation acknowledgements in RPTE's two publications: the eReport and Probate & Property magazine. The eReport is distributed to over 17,500 subscribers, and the Probate & Property magazine is mailed out to 24,569 section members;
* One (1) complimentary ticket to the Friday reception;
* Oral acknowledgement by the Section Chair in the Welcome Remarks;
* Sponsor name included in the RPTE meeting app where attendees access real time schedules, and onsite meeting details;
* Prominent display of company logo or firm name near onsite registration area;
* Opportunity to brand a conference item or supply separate giveaway item to be displayed in the registration area. Sponsor to provide promotional item and item sample must be provided to ABA for approval at least 6 weeks prior to the conference.

Full details on law firm sponsorship opportunities are available for your review and consideration.
For questions please contact Bryan Lambert at bryan.lambert@americanbar.org or 312-988-5540.
**Using Powers of Appointment to Increase the Period Assets Are Held in Trust**

Jessica A. Cohan & Blake N. Melton

This Article discusses a number of strategies to use powers of appointment to extend the period assets will be held in trust. Specifically, this Article explores three fundamental scenarios and the various tax and state law issues involved with those scenarios: (1) the exercise of a nongeneral power of appointment to extend the term of a trust for a period that does not exceed the currently applicable perpetuities period, (2) the exercise of a nongeneral power of appointment to extend the term of a trust for a period beyond the currently applicable perpetuities period, and (3) the exercise of a general testamentary power of appointment. This Article also addresses the effect of perpetuities savings provisions on the availability and efficacy of the strategies presented.

**Subchapter J After Tax Reform: Ten Planning Considerations**

Raj A. Malviya & Brandon A.S. Ross

This past year has proven to be action-packed for estate planning and tax practitioners thanks to the Tax Cuts and Jobs Act of 2017. A full-service trusts and estates practice presents many opportunities to navigate the income tax rules, particularly the rules that govern both grantor and nongrantor trusts. This Article discusses the fundamental rules when navigating the lifecycle of a nongrantor trust and incorporates ten key planning considerations along the way to create flexibility, help minimize taxes, and preserve more value for trust beneficiaries.

This Article begins by discussing some of the terminology used in the fiduciary income tax rules under subchapter J of the Internal Revenue Code, and then describes the mechanics involved in calculating trust accounting income and trust taxable income and explains the applicability of Category 1–6 deductions. The Article then discusses the calculation of distributable net income and analyzes the differences in calculations between domestic and foreign nongrantor trusts. Further, the Article describes the new rules and objective tests that help a practitioner determine whether a trust will be treated as a foreign or domestic trust. Finally, the Article explores the responsibilities that trust and estate beneficiaries have for paying for fiduciary income tax and concludes with planning considerations for practitioners, including unbundling fiduciary fees, preserving and choosing where to use deductions, and distributing capital gains as part of distributable net income.

**State Theft in Real Property Tax Foreclosure Procedures**

Jenna Christine Foos

There are three major property tax foreclosure systems used in the United States, and one of them—the surplus retention system—prohibits former property owners from receiving the surplus from a property tax foreclosure sale. Surplus retention systems incentivize wrongdoing by allowing foreclosing governments to profit from property tax foreclosures. Surplus retention systems also have a strong negative effect on the most vulnerable people in the population because these are the people who are most likely to fail behind on property tax payments, fail to receive notice, and lose all their home equity. Finally, surplus retention systems violate the Takings Clause of the United States Constitution by allowing local governments to commit a taking for public use without providing just compensation.

The states that use surplus retention systems should change their laws to allow property owners the opportunity to recover the surplus from a tax foreclosure sale. This change would be in line with the requirements of the Takings Clause and with prior Supreme Court decisions. Importantly, allowing property owners a chance to recover the surplus would also ensure that states are protecting their citizens’ Fifth Amendment rights by providing just compensation for a taking of property as required by the United States Constitution.
We are delighted to announce the winners of the 2019 RPTE Law Student Writing Competition.

First place: “The Lender Loophole and the Deductibility of Investment Expenses in Family Offices” by Robert Daily, University of Georgia School of Law.


Third Place: “The Kaestner Trust Case: Due Process and State Taxation of Non-resident Trustees” by Scott Lee, Georgetown University Law Center.

Robert Daily, the first-place winner, will receive $2,500 cash, a one-year free membership in the Section and free round-trip airfare and weekend accommodations to attend the Section’s Fall Leadership Meeting, November 14-16, 2019, in San Juan, Puerto Rico. He is eligible for a full-tuition scholarship to the University of Miami School of Law's Heckerling Graduate Program in Estate Planning OR Robert Traurig-Greenberg Traurig Graduate Program in Real Property Development for the 2019–2020 or 2020–2021 academic year. In addition, Robert’s essay will be considered for publication in a future issue of the Real Property, Trust & Estate Law Journal.

Dalton Barfield, the second-place winner, will receive $1,500 cash. Dalton’s submission will also be considered for publication in a future issue of the Real Property, Trust & Estate Law Journal.

Scott Lee, the third-place winner, will receive $1,000 cash. Scott’s submission will also be considered for publication in a future issue of the Real Property, Trust & Estate Law Journal.

The goal of the RPTE student writing contest is to encourage and reward law student writing on the subjects of real property or trust and estate law. The essay contest is designed to attract students to these law specialties, and to encourage scholarship and interest in these areas. Articles submitted for judging are encouraged to be of timely topics and have not been previously published.

Section Nominations Committee

Pursuant to Section Bylaw §6.1(f), the names of the Section’s 2019-2020 Nominations Committee and the Section officer and council positions to be elected at the 2020 Section Annual Meeting are set forth below. Any Section member wishing to suggest a nomination should send the suggested nomination to one of the Nominations Committee members listed below.

Nominations Committee
Chair: Elizabeth C. Lee, Womble Bond Dickinson (US) LLP, 1200 Nineteenth Street, N.W., Suite 500, Washington, DC 20036; Elizabeth.lee@wbd-us.com
Vice Chair: David English, University of Missouri, C/O 1103 Sunset Drive, Columbia, MO 65203, englishda@missouri.edu
Members: Benetta P. Jenson, JP Morgan Private Bank, 21 S Clark Street, 8th Floor, Chicago, IL 60603-2021, benetta.p.jenson@jpmorgan.com
Soo Yeon Lee, Mauck & Baker, L.L.C., Ste 600, 1 N La Salle Street, Chicago, IL 60602, slee@mauckbaker.com
James E A Slaton, Stone Pigman Walther Wittmann, 301 Main Street Suite 1150, Baton Rouge, LA 70825, jlsaton@stonepigman.com

Positions to be elected for service commencing September 1, 2020

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<th>Office</th>
<th>Incumbent</th>
<th>Eligible for Re-nomination?</th>
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<tr>
<td>Chair-Elect</td>
<td>Stephanie Loomis-Price</td>
<td>Section Chair (Automatic)</td>
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<td>Robert C. Paul</td>
<td>Eligible for nomination as Chair-Elect</td>
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<td>Trust and Estate Division</td>
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<td>Vice Chair</td>
<td>Hugh F. Drake</td>
<td>Eligible for re-nomination as Trust and Estate Division Vice Chair</td>
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<td>Finance and Corporate Sponsorship Officer</td>
<td>Rana Salti</td>
<td>Eligible for re-nomination</td>
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<tr>
<td>Section Secretary</td>
<td>James G. Durham</td>
<td>Eligible for re-nomination</td>
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<td>Section Delegate</td>
<td>Jo Ann Engelhardt</td>
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<td>Dennis Horn</td>
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<td>Real Property Council Members:</td>
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Trust and Estate
Council Members:

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The RPTE Law Journal is offering an opportunity for you to influence the conversation among real property practitioners and to contribute to the Section. The Journal is seeking an Acquisitions Editor for real property articles. An Acquisitions Editor reviews for publication scholarly articles that authors have submitted to the Journal. Additionally, an Acquisitions Editor will occasionally solicit articles for publication; opportunities to discover potential articles include interesting CLE talks and engaging conversation at a Section gathering or law-related event.

The job qualifications are simple: you should have your finger on the pulse of what topics would be useful to our real property members’ practices, you should like to read, and you should like to interact with academic and practitioner authors. Importantly, despite the “editor” title, an Acquisitions Editor is not required to perform actual editing, though an Acquisitions Editor may provide the author with substantive feedback that will strengthen the article and its use to the profession. Thus, the Acquisitions Editor has all the fun of acquiring interesting and practical articles, without any of the tedious wordsmithing and comma placement concerns of a traditional editor.

Finally, the time commitment is minimal. These duties generally take only two to four hours a month to complete.
Filing Estate and Gift Tax Returns

When to File

Generally, the estate tax return is due nine months after the date of death. A six month extension is available if requested prior to the due date and the estimated correct amount of tax is paid before the due date.

The gift tax return is due on April 15th following the year in which the gift is made.

For other forms in the Form 706 series, and for Forms 8892 and 8855, see the related instructions for due date information.

Where to File

To pay Estate and Gift tax online, use the secure and convenient Electronic Federal Tax Payment System.

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<thead>
<tr>
<th>Form Number</th>
<th>Where to File after July 1, 2019</th>
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<tr>
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<td>Kansas City, MO 64999</td>
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Related Topics

- Estate and Gift Taxes
- Gift Tax
- Estate Tax
- Frequently Asked Questions on Gift Taxes
- What's New Estate and Gift Tax
- Frequently Asked Questions on New Tax Rules for Executors
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### Form 8855

*Mailed January 1, 2019 and later*

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<td>Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New</td>
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<tr>
<td>Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania,</td>
<td>Kansas City, MO 64999</td>
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<tr>
<td>Rhode Island, South Carolina, Tennessee, Vermont, Virginia, West</td>
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<td>Virginia, Wisconsin</td>
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<tr>
<td>Alabama, Alaska, Arizona, Arkansas, California, Colorado, Florida,</td>
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</tr>
<tr>
<td>Hawaii, Idaho, Iowa, Kansas, Louisiana, Minnesota, Mississippi,</td>
<td>Internal Revenue Service Center</td>
</tr>
<tr>
<td>Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota,</td>
<td>Ogden, UT 84201</td>
</tr>
<tr>
<td>Oklahoma, Oregon, South Dakota, Texas, Utah, Washington, Wyoming</td>
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<tr>
<td>A foreign country or a U.S. possession</td>
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</table>

### Contact Information

For questions about return accounts, lien discharges, extensions (no tax law questions), and closing letter requests for estate tax returns filed on or after June 1, 2015, call: (866) 699-4083. For more information on closing letters, see When can I expect the Estate Tax Closing Letter? at Frequently Asked Questions on Estate Taxes.

Many general estate and gift tax law questions can still be answered by calling: (800) 829-1040. You may also find many answers to your questions by visiting Forms and Publications.

**Caution:** DO NOT submit tax related questions below. If you have a tax question that was not answered here or by checking Frequently Asked Questions, please call our toll-free tax assistance line at 1-800-829-1040 for individual tax questions or 1-800-
829-4933 for business tax questions. We will not respond to tax related inquiries submitted on this page.

If you have suggestions or comments (or suggested FAQs) for the Estate and Gift Tax website, please contact us by clicking here: CONTACT ESTATE AND GIFT TAX. We will not be able to respond to your email, but will consider it when making improvements or additions to this site.

Rate the Small Business and Self-Employed Website

Page Last Reviewed or Updated: 05-Aug-2019