RECENT DEVELOPMENTS IN ESTATE PLANNING IMPACTING FARMERS AND RANCHERS

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I. INTRODUCTION

This Article surveys current legal issues involving estate planning in an agricultural context. While legal developments occur frequently in the estate planning context and some significantly impact the estate planning practice, many are less significant and more subtle. In any event, practitioners must always keep the objectives of the client in the forefront. While awareness of current developments is critical, that awareness must meet with the goals and objectives of the particular farm and ranch family. This Article is not intended to provide detailed coverage of all issue impacting farm or ranch estate planning. Comprehensive treatment is beyond the scope of this article.[1] However, significant recent developments are addressed.

II. RECENT DEVELOPMENTS IN ESTATE PLANNING IMPACTING FARMERS AND RANCHERS

A. *Family-Owned Business Deduction (FOBD)*

The Taxpayer Relief Act of 1997 (TRA '97) enacted into law the family-owned business exclusion (FOBE) effective for deaths after 1997.[2] Under the FOBE, interests in farms, ranches, and other small businesses can be excluded (up to a limit) from the decedent's gross estate for federal estate tax purposes.[3] Technical corrections

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1. For a more thorough treatment of the issues discussed in this article as well as additional issues impacting farm estate planning, *see generally*, ROGER A. MCEOWEN & NEIL E. HARL, PRINCIPLES OF AGRICULTURAL LAW (2000).

2. *See* Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788, *amended by* Internal Revenue Reform Act of 1998, Pub. L. No. 105-206, § 6007(b)(1)(A), 1998 U.S.C.C.A.N. (112 Stat. 685) 807 (redesignating I.R.C. § 2033A to I.R.C. § 2057).

3. *See* Internal Revenue Reform Act of 1998, Pub. L. No. 105-206, § 6007(b)(1)(A), 1998 U.S.C.C.A.N. (112 Stat. 685) 807 (redesignating I.R.C. § 2033A to I.R.C. § 2057 and changing FOBE from an exclusion to a deduction).

were made to the FOBE in 1998, and the provision was changed from an exclusion to a deduction and repositioned in the Internal Revenue Code (Code). [4]

TRA '97 also increased the federal estate and gift tax unified credit to $202,050 for deaths occurring and gifts made in 1998, with the amount scheduled to increase to $345,800 for deaths occurring and gifts made in 2006 and later.[5] The applicable exclusion amount of the credit for gifts made and deaths occurring in 1998 was increased to $625,000 with this amount increasing to $1 million for gifts made and deaths occurring in 2006 and later.[6] Under the 1998 amendments,[7] the maximum FOBD amount is set at $675,000 and the applicable exclusion amount in estates electing the FOBD is set at $625,000 and continues at that level.[8] Thus, the combined amount is $1,300,000 for 1998 and thereafter. If an estate has less than the maximum allowable qualified family-owned business interests (QFOBIs), the applicable exclusion amount is increased dollar-for-dollar up to the allowable limit to the extent the FOBD is less than $675,000, but only up to the allowable exclusion amount for the year of death.[9] Thus, for estates utilizing the FOBD, the unified credit will vary from estate to estate depending on the amount of QFOBIs. The FOBD applies only for federal estate tax purposes. [10]

1. *Formula Clauses for Use with Special Use Valuation and FOBD Elections*

The advent of the FOBD[11] gives use to numerous drafting concerns for practitioners. The primary concern may be the proper drafting of marital deduction formula clauses designed to fully utilize the FOBD in an estate where a special use valuation election[12] is also made as well as those estates where only the FOBD is elected.

In general, formula clauses in dispositive instruments for decedents dying after 1997 should not refer to any specific dollar amount to be allocated to the non-marital portion of the estate. However, formula clauses should refer to state estate tax computed with respect to the credit in section 2011 of the Code in addition to federal estate taxes. If a FOBD election might be made in the estate, the formula clause

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4. For a detailed examination of FOBD, see the forthcoming publication by Neil E. Harl & Roger A. McEowen entitled the "The Family-Owned Business Deduction - Section 2057" published by BNA.

5. *See* I.R.C. § 2010(a) (West Supp. 1999). The credit was set at $211,300 for 1999, $220,550 for 2000 and 2001, and is scheduled to increase to $229,800 for 2002 and 2003, $287,300 for 2004, and $326,300 for 2005. *See id.*

6. *See id.*

7. *See id.* § 2057(a)(2).

8. *See id.*

9. *See id.* § 2057(a)(3)(A) (West Supp. 1999).

10. *See id.* § 2057(a).

11. *See id.* § 2057.

12. *See id.* § 2032A (1994 & Supp. III 1997).

should not be based solely on the credit available under section 2010 of the Code, the unified credit, the "applicable credit" or the "applicable exclusion amount."

An important point to keep in mind is that under any typical marital deduction formula that provides that the marital gift is to be the smallest amount necessary to produce the lowest possible total of federal estate tax and state death taxes computed by reference to the section 2011 credit, the amount of the FOBD will automatically be included in the "bypass" or non-marital part of the estate. [13]

Pecuniary credit shelter/residual marital bequest clauses may not be desirable in estates planning for a special use value or FOBD election. For special use value purposes, funding the credit shelter trust at fair market value fails to shelter the amount of value reduction from estate taxation in the surviving spouse's estate.[14] However, standard language tends to make specific reference to the unified credit and may "lock in" the amount at the applicable exclusion amount.[15] With a FOBD election, the standard clause would need to be modified to account for a FOBD election to prevent the credit shelter trust from being limited to the applicable exclusion amount.[16]

Under a "true worth" pecuniary clause, the surviving spouse receives a dollar amount sufficient to obtain the desired marital deduction for the estate, with the assets passing to the surviving spouse valued at the date or dates of distribution. Capital gain (or loss) incurred is taxable to the estate.[17] If assets are distributed at values as finally determined for federal estate tax purposes, rather than at date or dates of distribution, the capital gain (or loss) problem is avoided. [18]

2. *Potential Rev. Proc. 64-19 Problem*

Under Revenue Procedure 64-19,[19] no marital deduction is allowed if the governing instrument or local law allows or requires the executor or trustee, as the case may be, to select assets in kind to satisfy the marital share pecuniary bequest and permits distribution of assets in kind at values as finally determined for federal estate tax purposes (date of death value).[20] Thus, planners may want to consider a ratable sharing pecuniary formula clause. The following is suggested language for a ratable sharing formula clause:

> My executor is authorized to make distributions in kind to my distributees [or to the trust established under this article], but only at values as finally

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13. *See* I.R.C. § 2011 (West Supp. 1999).
14. *See, e.g.*, 5 NEIL E. HARL, AGRICULTURAL LAW § 44.02[4] (1999) (explaining special use valuation in FOBD elections).
15. *See id.* § 44.02[8].
16. *See id.*
17. *See* Kenan v. Commissioner, 114 F.2d 217, 218-19 (2d Cir. 1940).
18. *See* Treas. Reg. § 1.1014-4(a)(3) (1999).
19. Rev. Proc. 64-19, 1964-1 (pt. 1) C.B. 682.
20. *See id.* at 683-84.

> determined for federal estate tax purposes. However, the assets to be distributed to this trust shall be selected in such a manner that the cash and other property distributed to the distributees shall have an aggregate fair market value fairly representative of the proportionate share of the appreciation or depreciation in value from the federal estate tax valuation date to the date or dates of distribution of all assets available for distribution.

A fractional share clause could also be utilized. Under such a clause, the surviving spouse receives a fractional part of each asset in the decedent's estate.[21] However, as a practical matter, such clauses can create substantial administrative problems in a farm or ranch estate, especially if personal property is involved.[22] However, if the executor or administrator is given the power to select assets to equal the value of the fractional share bequest using final federal estate tax values, to avoid the problem of undivided interests as between the marital and non-marital shares, the clause becomes essentially a pecuniary bequest clause. [23]

An advantage of a fractional share clause is that taxable gain or loss is not recognized on distribution of property from the estate.[24] Fractional share clauses also comply with Revenue Procedure 64-19 inasmuch as a fractional part of each asset is allocated to the marital share and a fractional part to the non-marital share. [25]

An estate balancing (equalization) clause may also be utilized. Such clauses do not create a nondeductible terminable interest.[26] Thus, it is unlikely that a FOBD election will cause the amount passing to the surviving spouse in a manner otherwise qualifying for the marital deduction to be a terminable interest not eligible for the marital deduction. Indeed, the courts have supported the argument that a tax election can change the size of the marital deduction under a formula estate plan without causing the resulting marital deduction amount to be converted into a terminable interest.[27]

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21. *See* HARL, *supra* note 14, at § 44.02[4][b].
22. *See id.*
23. *See id.* § 44.02[4].
24. *See* Treas. Reg. § 1.661(a)-2(f) (1999).
25. *See* Rev. Proc. 64-19, 1964-1 (pt. 1) C.B. 682.
26. *See* Estate of Meeske v. Commissioner, 72 T.C. 73, 80-81 (1979), *aff'd sub nom.* Estate of Laurin v. Commissioner, 645 F.2d 8, 10 (6th Cir. 1981), *acq.*, 1982-2 C.B. 2; Estate of Smith v. Commissioner, 66 T.C. 415, 432 (1976)
27. *See* Estate of Patterson v. United States, 181 F.3d 927, 930 (8th Cir. 1999) (holding full marital deduction allowed for QTIP trust where will contained discretionary power to pay death taxes from trust estate; trustee's discretion did not prevent property from passing to the trust and did not amount to an impermissible power of appointment); Estate of Robertson v. Commissioner, 15 F.3d 779, 784 (8th Cir. 1994) (holding QTIP eligibility for property is determined at time of election, not at time of death, and such discretion does not prevent property from passing from decedent to spouse); Estate of Clayton v. Commissioner, 976 F.2d 1486, 1498 (5th Cir. 1992); Estate of Clack v. Commissioner, 106 T.C. 131, 139 (1996), *acq.,* 1996-2 C.B. 1.

3. *Funding Issues*

When allocating special use value property between marital and non-marital shares, a key factor is whether property used to satisfy the federal estate tax marital deduction should be valued at special use value or fair market value.[28] Initially, the Internal Revenue Service (IRS) ruled that special use property used to satisfy the marital deduction could be valued at fair market value if the will or trust specified that fair market value was to be used.[29] However, the IRS has since reversed course. In Private Letter Ruling 84-22-011[30], the IRS ruled that a marital deduction leased on property passing by specific bequest or by operation of law was limited to the special use value of the property rather than the fair market value on the grounds that the property was eligible for the marital deduction only to the extent that the property was included in the decedent's gross estate. [31]

4. *Gift Potential*

The question has been raised as to whether a gift occurs upon allocation of elected land between the marital and non-marital shares of the estate.[32] The same question could be raised in the context of the FOBD. In Private Letter Ruling 83-46-046, the IRS ruled that a gift would not occur where the surviving spouse acting as estate representative proposed to allocate farmland under a special use valuation election and other property to the non-family trust (not intended to qualify for the estate tax marital deduction).[33] The IRS has likewise ruled that where the effect of a surviving spouse's signature on a section 2032A agreement was to reduce the marital share and increase the residuary, no taxable gift to the residuaries would result.[34] The same rationale should apply when a FOBD election is involved.

5. *Potential "Double Deduction" Problem*

In estates where a FOBD election is made, it is crucial to allocate the QFOBIs properly to avoid a potential "double deduction" problem.[35] A proper allocation of the

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28. *See* Estate of Evers v. Commissioner, 57 T.C.M. (CCH) 718, 719 (1989).

29. *See* Priv. Ltr. Rul. 83-14-005 (Dec. 14, 1982), *amplifying* Priv. Ltr. Rul. 83-14-001 (Sept. 22, 1982); Priv. Ltr. Rul. 94-07-015 (Feb. 18, 1994); Estate of Evers, 57 T.C.M. (CCH) at 719 (holding when special use value elected, special use value must be used throughout for federal estate tax purposes including the marital deduction). *But see* Simpson v. United States, U.S. Tax Cas. (CCH) ¶ 60,118, at 86,265 (D.N.M. 1992) (approving funding of marital deduction using fair market value of farm corporation stock at special use value).

30. Priv. Ltr. Rul. 84-22-011 (Feb. 8, 1984).

31. *See id.*

32. *See* Priv. Ltr. Rul. 83-46-046 (Aug. 15, 1983).

33. *See id.*

34. *See* Tech. Adv. Mem. 85-04-005 (Oct. 27, 1989).

35. *See* I.R.C. § 2056(b)(9) (1994).

QFOBIs requires funding the non-marital portion of the estate with the QFOBIs.[36] The Code prevents a deduction of the value of any interest in property under "this chapter" more than once in a particular decedent's estate.[37] The provision was originally enacted to prevent an estate from claiming both a charitable and marital deduction for the same interest in the same property which became possible after enactment of the QTIP rules in 1981.[38] However, the statute was drafted broadly to deny double deductions for any interest in property "under this chapter."[39] Thus, when Congress changed the FOBE[40] to a deduction,[41] the potential for a double deduction problem arose. Conceivably, the IRS could take the position that the amount of any marital deduction allowed for QFOBIs must be reduced by the amount of any FOBD that is elected for those QFOBIs.[42] Interestingly, the IRS has never raised the double deduction issue in a section 2032A context.[43] Arguably, section 2056(b)(9) of the Code requires the FOBD to be reduced by the amount of the marital deduction claimed for the QFOBIs for which section 2057 is elected.[44] Indeed, the instructions to line fifteen of Schedule T (Form 706) take the latter approach.

6. *Funding for Discounts*

Funding can also be done with an eye toward achieving a valuation discount for property included in the estate. Funding marital and non-marital shares with undivided interests, such as with a fractional share clause, positions the estate to claim a discount in valuation at death.[45] A drawback is that the IRS may take the position that, on later sale by individuals receiving undivided interests through both marital and non-marital shares, it may not be possible to maintain the different (usually higher) income tax basis for the interest passing through the marital share with the

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36. *See id.* § 2057 (West Supp. 1999).

37. *See id.* § 2056(b)(9) (1994).

38. *See* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 403(d)(1), 95 Stat. 302 (1981), *adding* I.R.C. § 2056(b)(7)-(8), *as amended by* Technical Corrections Act of 1982, Pub. L. No. 97-448, § 104(a)(2)(A), 96 Stat. 2380 (1983), *adding* I.R.C. § 2056(b)(9).

39. I.R.C. § 2056(b)(9) (1994).

40. *See id.* § 2033A (Supp. III 1997), *amended by* Internal Revenue Reform Act of 1998, Pub. L. No. 105-206, § 6007(b)(1)(A), 1998 U.S.C.C.A.N. (112 Stat. 685) 807 (redesignating I.R.C. § 2033A to I.R.C. § 2057).

41. *See id.* § 2057 (West Supp. 1999).

42. *See* Estate of Reeves v. Commissioner, 100 T.C. 427, 431 (1993) (reducing marital deduction reduced by amount of deduction for sale proceeds to ESOP).

43. *See, e.g.*, *id.* at 431-32.

44. *See id.* at 432.

45. *See* Estate of Bonner v. United States, 84 F.3d 196, 197 (5th Cir. 1996); Estate of Mellinger v. Commissioner, 112 T.C. 26, 33 (1999); Estate of Lopes v. Commissioner, 78 T.C.M. (CCH) 46, 48 (1999); Estate of Nowell v. Commissioner, 77 T.C.M. (CCH) 1239, 1242 (1999).

result that a sale of an undivided interest involves a proportionate part of each basis amount.[46]

7. *Funding When GSTT Involved*

The FOBD has no application to the generation-skipping transfer tax (GSTT).[47] However, drafting concerns are raised for estates of decedents attempting to utilize the FOBD and the marital deduction, and those involving transfers that skip generations. In general, the estate will require a tax formula to allocate the decedent's property between the marital and non-marital shares into the GSTT-exempt and non-GSTT exempt parts, depending on whether a FOBD election is made. [48]

B. *Special Use Valuation*

1. *Disposition of Elected Land*

In *Estate of Gibbs v. United States*,[49] the estate sold a conservation servitude on land subject to a special use valuation election to the state of New Jersey.[50] The servitude stipulated that the land was to be maintained as a farm in perpetuity.[51] By virtue of the special use election, the value of the farmland in the decedent's estate was reduced from a fair market value of $988,000 to a special use value of $349,770 for federal estate tax purposes.[52] The heirs sold the servitude to the state for $1,433,493.72.[53] The deed of easement imposed restrictions on the property that ran with the land, thereby binding the heirs and all future title holders to its provisions. [54]

The IRS argued that the sale of the easement to the state triggered recapture because an interest in elected land was conveyed.[55] The IRS also maintained that recapture tax was due because the heirs realized the developmental value of the property during the recapture period.[56] The heirs argued that the state's acquisition of the conservation servitude was not a disqualifying disposition of an "interest" in the farm because the easement grant imposed only a contractual restriction upon the

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46. *See* Rev. Rul. 67-309, 1967-2 C.B. 263, 264.

47. *See* I.R.C. § 2057(a)(1) (West Supp. 1999). Section 2057(a)(1) specifically states that the provision only applies "for purposes of the tax imposed by Section 2001." *Id.*

48. For a detailed discussion of the drafting issues involved in the context of the GSTT, see Neil E. Harl & Roger A. McEowen, *The Family-Owned Business Deduction B Section 2057*, 829 TAX MGMT. (BNA) (1999).

49. Estate of Gibbs v. United States, 98-1 U.S. Tax Cas. (CCH) ¶ 60,307 at 84,395 (D.N.J. 1997).

50. *See id.*

51. *See id.*

52. *See id.*

53. *See id.* at 84,396.

54. *See id.*

55. *See id.*

56. *See id.* at 84,397.

farmland's future use, and that the restriction guaranteed that the property would be used as farmland well beyond the recapture period. [57]

In ruling for the estate, the court noted that New Jersey law construes land use restrictions as "equitable servitudes" involving contractual rights rather than property interests.[58] Thus, according to the court, the granting of a conservation servitude did not create a possessory interest in the burdened land because the burden imposed was enforceable only as a contractual right.[59] Accordingly, the grant of a conservation servitude was not a disposition of an interest in land resulting in recapture of estate tax under section 2032A(c)(1) of the Code. [60]

On appeal, the Third Circuit reversed the district court and held that the qualified heir's grant of the development easement to the state of New Jersey did constitute a disposition of an interest in the property triggering recapture tax.[61] The Third Circuit held that the transfer of the development easement in the elected land to the state of New Jersey constituted a disposition of "any interest" within the meaning of section 2032A of the Code.[62] The court viewed the elected property in two portions: the "bundle of rights" relating to the agricultural use of the land, and the additional value represented by the "bundle of rights" relating to the development uses of the land.[63] Accordingly, the court opined that the heir disposed of valuable property rights that would have been otherwise taxed when those rights were passed from the heir's father, but did not because of the use value election. [64]

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57. *See id.*

58. *See id.*

59. *See id.*

60. *See id.* In a subsequent action, *Estate of Gibbs v. United States,* the estate sought an award of litigation expenses. *See* Estate of Gibbs v. United States, 161 F.3d 242, 243 (3d Cir. 1998). The court denied the award, noting that the issue presented in the tax refund suit was an issue of first impression and that there was no case precedent directly on point. *See id.* at 250. As such, the government's position did not ignore or run contrary to any well-settled proposition of law and the estate failed to meet its burden of proving that the government's position was not substantially justified. *But see id.* at 245-46.

61. *See* Estate of Gibbs*,* 161 F.3d at 250.

62. *See id.* at 249-50.

63. *See id.* at 248.

64. *See id.* at 250. The court's reasoning appears flawed. The real issue appears to be whether the surface use of the elected land has been interrupted, not whether an interest in property or contract right under state law is involved. For instance, the IRS has ruled that the grant of a pipeline easement was not a recapture triggering event. *See* Priv. Ltr. Rul. 90-35-007 (May 25, 1990). Likewise, the disposition of rights to oil under a subsurface lease was ruled not to be a recapture triggering event, but the well drilling activity and the extraction process that occurred on the surface constituted "cessation of use" triggering recapture. *See* Rev. Rul. 88-78, 1988-2 C.B. 330.

2. *Eligible Real Estate, Timber Production, and Tree Farming*

In Field Service Advice Memorandum 99-24-019,[65] an estate was permitted to elect special use valuation with respect to timberland maintained by the decedent.[66] The decedent had regularly performed maintenance operations as needed.[67] In addition, the decedent inspected the acreage daily and cleared debris to prevent fire and create better growing conditions.[68] Harvesting the timber, however, would not have been profitable.[69] The decedent made all management decisions, and the decedent's activities were consistent with principals of good land management.[70] As a result, the decedent used the parcel for planting, cultivating, caring for or the preparation of trees for market. [71]

The IRS has taken the position that merchantable timber and young growth should be treated as a crop and not part of the real estate.[72] Thus, under the facts of Field Service Advice Memorandum 99-24-019, because an identified acreage was used for planting, cultivating, caring for, or cutting of trees or the preparation of trees for market, the IRS allowed the executor to elect to have the trees growing on the parcel not treated as a crop. [73]

Due to the absence of comparable tracts of real estate, the land was valued under the five-factor formula approach of section 2032A(e)(8) of the Code.[74] However, the potential application of the recapture tax could not be considered in valuing the property.[75] The IRS did note that because the timber was ready for harvest that it was likely that application of the five-factor formula approach would result in a value closely approximating the fair market value of the timber. [76]

In *Estate of Rogers v. Commissioner*,[77] the decedent died in 1992. Under the decedent's late husband's will, farm and timberland were held in trust for the decedent's lifetime benefit.[78] The estate filed a federal estate tax return making a special use value election[79] on five tracts of real estate. The tracts comprised open

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65. Field Serv. Adv. Mem. 99-24-019 (Mar. 17, 1999).
66. *See id.*
67. *See id.*
68. *See id.*
69. *See id.*
70. *See id.*
71. *See id.*
72. *See* Priv. Ltr. Rul. 80-46-012 (Aug. 8, 1989). For "qualified woodlands," if the executor makes an election, growing trees are not treated as a crop for deaths after 1981. *See id.* The term "qualified woodlands" means real property "used in timber operations, and . . . is an identifiable area of land . . . for which records are normally maintained in conducting timber operations." I.R.C. § 2032A(e)(13) (1994 & Supp. 1997).
73. *See* Field Serv. Adv. Mem. 99-24-019 (Mar. 17, 1999).
74. *See id.*; I.R.C. § 2032A(e)(8) (1994 & Supp. 1997).
75. *See* Field Serv. Adv. Mem. 99-24-019 (Mar. 17, 1999).
76. *See id.*
77. *Estate of Rogers v. Commissioner,* T.C. Memo. 2000-133.
78. *See id.*
79. I.R.C. § 2032A (1994 & Supp. 1997).

land, timber, and pasture.[80] An election to treat property as qualifying woodland was also made for portions of three tracts.[81] On Form 706, the land was valued under the five-factor method,[82] but the estate later sought to value the property under the annual gross cash rental of comparable lands provision.[83]

The estate's expert provided an explicit, detailed analysis of the five estate tracts and five leased tracts, concluding that the properties were comparable on nine different factors—differing only in that the timber quality and capability of the five leased tracts that were somewhat superior to the timber quality on the estate tracts.[84] The IRS argued that the five estate tracts and the five leased tracts were not comparable regarding rental values because none of the comparable leases were entered into within five years of the decedent's death.[85]

The court noted that under the rent capitalization approach using a formula based on average cash rentals for comparable lands, the per-acre rent value was $83.6161. [86] However, under the five-factor formula approach,[87] using five valuation factors, the pastureland, not subject to a qualified woodland exception, would be valued at $350 per acre. The court held that the timberland, and the standing timber, and the qualified woodlands on the five-acre tracts wee comparable to the five leased tracts and that the estate could value that property under the rent capitalization approach.[88] The standing timber was not required to be valued separately as a crop because the timber would be included in the rent capitalization value of the land or a value of land where an underlying lease incorporated the right to grow and cut timber.[89] However, the court held that the estate failed to establish the requirements to provide comparable leases and establish rental values of comparable pastureland, not qualified woodlands and, therefore, they must be valued under the five-factor formula approach.[90]

C. *Property Ownership Considerations, Joint Interests, and Basis Issues*

In *Hahn v. Commissioner*,[91] the Tax Court held that the fifty percent inclusion rule of section 2040(b)(1), added to the Code in 1976, does not apply to joint interests created before 1977, if the deceased joint tenant dies after 1981.[92] In 1972, the

80. *See Rogers,* supra note 77.
81. *See id.*
82. I.R.C. § 2032A(e)(8) (1994 & Supp. 1997).
83. I.R.C. § 2032A(e)(7) (1994 & Supp. 1997).
84. *See id.*
85. *See id.*
86. *See id.*
87. I.R.C. § 2032A(e)(8) (1994 & Supp. 1997).
88. *See Rogers*, supra note 77.
89. *See id.*
90. *See id.*
91. Hahn v. Commissioner, 110 T.C. 4486 (1998).
92. *See id.* at 4486-87.

decedent purchased shares of a New York City tenants' corporation in connection with his acquisition of an apartment.[93] He paid $44,000, and the shares were issued to the decedent and his wife as joint tenants with the right of survivorship.[94] The decedent died in 1991, and his estate tax return reported one hundred percent of the value of the shares ($700,000) as his interest.[95] The decedent's surviving spouse sold the shares soon thereafter for $720,000.[96] On her tax return, Form 2119 (Sale of Home), she assumed a basis of $758,400 and reported no gain on the sale. [97]

The IRS claimed that the surviving spouse was entitled to a stepped-up basis for only half of the date-of-death value under the fractional-share rule.[98] The surviving spouse argued that the contribution rule of section 2040(a) of the Code applied, allowing her a stepped-up basis in the one hundred percent of the property because she contributed no part of the original consideration.[99] The IRS moved for summary judgment, contending that because the decedent died after 1981, section 2040(a) did not apply as a matter of law, making the fractional share rule of section 2040(b)(1) applicable.[100]

The court denied the IRS's motion and explained that before 1977, the contribution rule of section 2040(a) of the Code applied.[101] The 1976 amendment adding section 2040(b)(1) created the fractional share rule for "Qualified joint interests" created after 1976.[102] Joint interests created before 1977 were still subject to the contribution rule.[103] The court noted that the 1981 amendments changed the definition of a "qualified joint interest" in section 2040(b)(2), effective for decedent's dying after 1981. However, the court rejected the IRS's position that the 1981 amendments to section 2040(b)(2) expressly or impliedly repealed the effective date of section 2040(b)(1). [104]

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93. *See id.* at 4487.
94. *See id.*
95. *See id.*
96. *See id.*
97. *See id.*
98. *See id.*
99. *See id.*
100. *See id.* at 4489.
101. *See id.* at 4488.
102. *See id.* at 4490.
103. *See id.* at 4489.
104. *See id.* at 4491. It is important to note that the "fractional share" rule cannot be applied to joint interests created before 1977 under the court's reasoning. If assets had declined in value, such that death of the first to die would result in a stepped-down basis, the "fractional share" rule would result in a more advantageous result for the survivor in the event of sale if the survivor could not prove contribution at the death of the first to die. Other courts utilizing the consideration furnished rule for marital joint tenancies include Patten v. United States, 116 F.3d 1029, 1038 (4th Cir. 1997); Gallenstein v. United States, 975 F.2d 286, 292 (6th Cir. 1992); Baszto v. United States, 98-1 U.S. Tax Cas. (CCH) ¶ 60,305, at 84,392 (M.D. Fla. 1997); Wilburn v. United States, 97-2 U.S. Tax Cas. (CCH) ¶ 50,881, at 90,536 (D. Md. 1997); Anderson v. United States, 96-2 U.S. Tax Cas. (CCH) ¶ 60,235, at 86,548 (D. Md. 1996).

Much talk has occurred in recent months concerning the repeal of federal estate tax.[105] Tax legislation has passed the U.S. House of Representatives that includes a provision eliminating the federal estate and gift tax over a ten-year period.[106] The step-up of tax basis would also be eliminated except for property passing to a surviving spouse and property with a fair market value of $2 million or less. Any indebtedness against property would reduce its fair market value. [107]

D. *Inclusion in Gross Estate*

In *Estate of Frazier v. Commissioner,*[108] the decedent formed Frazier Nut Farms, Inc. (FNF) in 1981 and leased a five-acre lot next to it in 1983.[109] Under the renewable ten-year lease, FNF agreed to pay $1,000 per year in rent, maintenance, and all taxes on the land.[110] During the first ten-year term, FNF made numerous improvements on the land, including buildings, fumigation, truck bays, and asphalt paving.[111] When the lease expired, FNF did not exercise its option to renew, but continued to occupy the land and use the fixtures. [112] The decedent died in 1993.[113]

The IRS argued that the fixtures were includible in Frazier's gross estate, because FNF failed to remove them during its continuance of the lease as required under California law.[114] The estate asserted that FNF's failure to remove the fixtures continued after the decedent's death and, thus, they were not includible in the decedent's gross estate because the decedent held no interest in them at the time of death.[115]

The court noted that a decedent's interest in property is determined under state law and that, under applicable California law, where fixtures are placed on leased premises for the purposes of a trade, they become trade fixtures and a tenant has a limited right to remove those fixtures any time during the continuance of the term of the lease.[116] Thus, the court was faced with deciding whether the statutory language referring to the continuance of his term referred only to the original ten-year lease term or whether it also included FNF's holdover period.[117] The court, upon reviewing the

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105. *See, e.g.*, Charles D. Fox, *"Repeal of Estate and Gift Tax: Rising Tide or High-Water Mark?"* 139 TRUSTS & ESTATES 56, 56-61 (Jan. 2000) (discussing issues related to the possible repeal of the federal estate and gift tax).

106. *See* H.R. 2488, 104th Cong. (1998).

107. *See id.*

108. Estate of Frazier v. Commissioner, 77 T.C.M. (CCH) 2197 (1999).

109. *See id.*

110. *See id.*

111. *See id.*

112. *See id.*

113. *See id.*

114. *See id.*

115. *See id.* at 2198.

116. *See id.*

117. *See id.*

applicable California law and cases, concluded that FNF's holdover created a new tenancy after the expiration of the original tenancy.[118] Upon the expiration of the original tenancy, FNF's statutory right to remove its trade fixtures under California law expired.[119] Therefore, at the time of the decedent's death, the trade fixtures belonged to the decedent and were includible in the decedent's gross estate under section 2033 of the Code.[120]

In *Estate of D'Ambrosio v. Commissioner*,[121] the decedent owned preferred stock with a fair market value of $2,350,000.[122] Approximately three years before death, the decedent transferred her remainder interest in the shares in exchange for an annuity of $296,039 per year.[123] The decedent retained her income interest in the shares.[124] The transfer was not made in contemplation of death or with testamentary motivation.[125] At the time of death, the decedent had received $592,078 in annuity payments and $23,500 in dividends.[126] The executor did not include any of the stock interest in the decedent's gross estate.[127] The Tax Court upheld the IRS's position that the full fee simple value of the stock, less the amount of annuity payments the decedent received during life, be included in the decedent's gross estate. [128]

The Third Circuit Court of Appeals reversed the Tax Court, holding instead that the decedent's sale of the remainder interest for fair market value constituted "adequate and full consideration" under section 2036(a) of the Code.[129] The Court noted that the IRS's position would result in double taxation of the transferred interest and cause considerable difficulty in selling remainder interests. [130]

In *Wheeler v. United States*,[131] a case of major significance, the Fifth Circuit Court of Appeals held that the phrase "adequate and full consideration" as used in the parenthetical clause of section 2036(a) of the Code is to be applied in reference to the actuarial value of the remainder interest transferred.[132] As such, the decedent's retention of a life estate interest in his 376-acre Texas ranch did not cause inclusion of the ranch in his estate because the decedent had sold the remainder interest in the ranch to his children for consideration based on the actuarial tables set forth in

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118. *See id.*
119. *See id.* at 2199.
120. *See id.*
121. Estate of D'Ambrosio v. Commissioner, 101 F.3d 309 (3d Cir. 1996).
122. *See id.* at 311.
123. *See id.*
124. *See id.*
125. *See id.*
126. *See id.*
127. *See id.*
128. *See id.* (quoting Estate of D'Ambrosio v. Commissioner, 105 T.C. 252, 260 (1995)).
129. *See id.* at 318.
130. *See id.* at 316.
131. Wheeler v. United States, 116 F.3d 749 (5th Cir. 1997).
132. *See id.* at 767.

Treasury Regulation section 25.2512(A).[133] The court determined that the transfer was a bona fide sale for full and adequate consideration. [134]

The IRS had argued that the estate should have included the difference between the date-of-death value of the ranch ($1,074,200), and the consideration paid by the children for the remainder interest ($337,790).[135] The court noted that the language of section 2036(a) of the Code makes no distinction between transfers of remainders following retained life estates and transfers of remainders following retained estates for a specified term of years where the transferor dies before the end of the term.[136]

Likewise, the court noted that section 2036(a) of the Code makes no distinction between transfers to natural objects of the transferor's bounty and transfers to other individuals.[137] The IRS had argued that the court should ignore the economic reality of a remainder interest sale and decide the tax issue based solely on the identity of the parties.[138] As such, the IRS asserted that the term "bona fide" in section 2036(a) of the Code permitted the IRS to declare that the same remainder interest sold for precisely the same amount, but to different purchasers, would constitute adequate and full consideration for a third party, but not for a family member unless the family member's interests were adverse to the transferor.[139] The court rejected this reasoning and noted that the statute required that all transfers (whether intrafamily or not) must be "bona fide" for purposes of section 2036(a) of the Code.[140] The court noted that the proper analysis when a sale to a family member is involved is whether the transferor actually parted with the remainder interest and the transferee actually parted with the requisite adequate and full consideration. [141]

The court also noted that the IRS's policy-based argument to preclude intrafamily transfers of split-interests for full actuarial value if the transaction appears to have been undertaken in contemplation of death embraced a concept that Congress chose to abandon over two decades earlier when it enacted the three-year rule of section 2035 of the Code.[142] While section 2035 was amended in 1981 to eliminate the three-year rule, the court noted that the rule continues to apply to transfers of an interest included in the gross estate under sections 2036, 2037, and 2038, which includes transfers with retained interests, transfers taking effect at death, and revocable transfers.[143] As such, the court held that section 2036(a) permits the

133. *See id.*
134. *See id.* at 770.
135. *See id.* at 753.
136. *See id.* at 754.
137. *See id.*
138. *See id.* at 763.
139. *See id.* at 764.
140. *See id.*
141. *See id.*
142. *See id.* at 765.
143. *See id.*

conclusion that a split-interest transfer is testamentary when the objective requirement that the transfer be for an adequate and full consideration is not met.[144] As such, the identity of the transferee or the perceived testamentary intent of the transferor is irrelevant.

In arguing that the decedent's sale of the remainder interest was not a bona fide sale, the IRS focused on the fact that the transferees did not pay cash for the remainder interest and were not capable of paying cash at the time of sale because of their relatively low salaries derived from the decedent's corporation.[145] The IRS also focused attention on the receipt of large annual bonuses from the corporation after the transfer of the remainder interest that they used to pay down the note.[146] The court noted that it is not unusual for real estate purchasers to incur a debt obligation, and that the terms of the note specifying annual principal payments of $10,000 and an annual interest rate of seven percent indicated that no donative transfer was intended.[147] The court also noted that bonuses are a common means of employee compensation in close corporations and, as such, did not transform the compensation into a donative transfer scheme.[148]

In *Estate of Magnin v. Commissioner*,[149] the decedent's father was the owner of an upscale women's apparel company.[150] In the late 1930s, the decedent assumed control of the company.[151] The decedent's wife died in 1948 and the decedent's father did not approve of any of the women that the decedent began dating because the father did not want the company stock falling into strangers' hands.[152] To ensure that the company stock would stay in the family, the decedent and his father entered into an agreement in 1951 whereby the father agreed to leave all his stock in the apparel company and another company to the decedent as trustee for the benefit of the decedent's children.[153] The decedent agreed not to transfer any of his stock in the corporations to anyone other than his children.[154] If the corporations were to be sold or dissolved, the decedent was to place the proceeds in a trust, the income of which would be paid to the decedent for life, after which the principal would be distributed to the decedent's children.[155] In return, the decedent was to receive the voting rights to all of his father's stock.[156]

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144. *See id.* at 767.
145. *See id.* at 768.
146. *See id.*
147. *See id.*
148. *See id.* It was undisputed that the children paid income tax on the corporate bonuses. *See id.* at 769.
149. Estate of Magnin v. Commissioner, 184 F.3d 1074 (9th Cir. 1999), *rev'g* 71 T.C.M. (CCH) 1856 (1996).
150. *See id.* at 1076.
151. *See* Estate of Magnin v. Commissioner, 71 T.C.M. (CCH) 1856, 1857 (1996).
152. *See id.* at 1858.
153. *See id.* at 1859.
154. *See id.*
155. *See id.*
156. *See id.*

After the father's death in 1953, the decedent received a fifty percent lifetime income interest in his father's stock.[157] In 1955, the decedent executed a will leaving all of the company stock in trust for the benefit of his children in performance of the 1951 agreement.[158] The decedent sold the stock of the apparel company in 1969, and in 1971 he created three trusts (one for each of his children) and placed the stock sale proceeds into the trusts.[159] Under the terms of the trusts, the decedent retained an income interest for life.[160] The decedent filed a gift tax return, reporting the creation of the trusts and stating that the transfers were not completed gifts.[161] The Service accepted the return.[162]

The decedent died in 1988, and his estate tax return did not include the value of the three trusts in the gross estate.[163] The IRS determined a deficiency and the estate petitioned the Tax Court.[164] The Tax Court held that the transferred property was includible because the value of the life estate the decedent received in his father's stock did not constitute "adequate and full consideration" under section 2036(a). [165]

On appeal, the Ninth Circuit reversed the Tax Court.[166] The court pointed out that the parenthetical exception in section 2036(a) for transfers made for "adequate and full consideration" immediately follows the phrase "to the extent of any interest therein of which the decedent has at any time made a transfer."[167] Thus, the Ninth Circuit agreed with the Third Circuit's opinion in *D'Ambrosio v. Commissioner*, and the Fifth Circuit's opinion in *Wheeler v. United States,* that for the exception to apply, the decedent must have received adequate and full consideration for the remainder interest.[168] The court reasoned that to read the statute otherwise would render the parenthetical exception meaningless.[169] The court also reasoned that the policy behind section 2036(a) requires that adequate and full consideration be measured by the value of the remainder interest, given that the statute's purpose is to prevent the depletion of the decedent's gross estate. [170]

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157. *See id.* at 1860.
158. *See id.*
159. *See id.*
160. *See id.*
161. *See id.*
162. *See id.*
163. *See id.* at 1861.
164. *See id.*
165. *See id.*
166. *See* Estate of Magnin v. Commissioner, 184 F.3d 1074, 1082 (9th Cir. 1999), *rev'g* 71 T.C.M. (CCH) 1856 (1996).
167. *Id.* at 1078.
168. *See id.*
169. *See id*.
170. *See id.* The court concluded that the adequacy of the consideration should be valued at the time of the transfer for purposes of section 2036(a). *See id at 1082.* The court remanded the case for a determination of the value of the property interests both transferred and received by the decedent. *See id* at 1082-83.

E. *Disclaimers*

In *Estate of Lute v. United States*,[171] the decedent died intestate, survived by his wife and his father.[172] The father renounced any property that would have passed to him under state intestacy laws by executing a written, irrevocable and unqualified statement.[173] The spouse executed a trust in which all of the decedent's farm property passed.[174] Under the trust, the farm property was operated as it had been when the decedent was alive, except that the partnership with the father was dissolved.[175] Therefore, the disclaimed property passed to the spouse's trust.[176] Shortly thereafter, the father exchanged property with the trust so that the father's property was all in one county near the father's residence.[177] The decedent's estate tax return valued the gross estate at $6.75 million, but the net estate was zero because of the disclaimer. [178]

The IRS examining attorney argued that the disclaimer was not effective because the father received consideration or other value in exchange for the disclaimer, and requested a technical advice memorandum from the National Office concerning the renunciation.[179] The National Office recommended that the examining attorney not pursue the issue.[180] The examining attorney requested reconsideration, and the National Office again told the examining attorney not to pursue the matter.[181] Approximately one month later, the Service issued a notice of deficiency of about $1.1 million.[182] The examining attorney disallowed all credit for tax on prior transfers to protect the government's interest, and $427,000 in Schedule K deductions (by subtracting them from the gross estate resulting in an understated marital deduction to the extent of $213,863).[183] At trial, the Service conceded the estate was entitled to $319,804 of credits for prior transfers.[184] The estate sold land (incurring capital gain tax in the process) and borrowed money to pay the alleged deficiency (including $193,386 of state inheritance tax) and filed a claim to refund, attorneys' fees and court costs.[185]

The court found that the transactions were all separate and not made in exchange for each other.[186] The disclaimer was made in order to remove the

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171. Estate of Lute v. United States, 19 F. Supp. 2d 1047 (D. Neb. 1998).
172. *See id.* at 1049-50.
173. *See id.* at 1050.
174. *See id.* at 1051.
175. *See id.* at 1050.
176. *See id.* at 1054-58.
177. *See id.* at 1052.
178. *See id.* at 1051.
179. S*ee id.* at 1053.
180. *See id.*
181. *See id.* at 1053-54.
182. *See id.* at 1054.
183. *See id.*
184. *See id.*
185. *See id.*
186. *See id.* at 1057.

decedent's property from the father's estate and the trust was formed to maintain the decedent's business operations.[187] The estate was eligible for a marital deduction for the disclaimed property which passed to the trust for the surviving spouse.[188] The court also held that the government's position was not substantially justified and that the estate was entitled to reasonable attorney's fees and costs. [189]

In a subsequent action the IRS challenged the award of litigation expenses to the estate.[190] In particular, the IRS challenged the court's finding that the estate was a "prevailing party."[191] As statutorily defined, a "prevailing party" is an individual whose net worth does not exceed $2 million at the time the civil action was filed, or any owner of an unincorporated business, partnership, corporation, association, a unit of local government or organization with a net worth not exceeding $7 million and not having more than 500 employees.[192] Accordingly, the IRS argued that the decedent's estate, which reflected a net worth on the federal estate tax return of over $6 million was too large to be awarded attorney's fees. [193]

The court noted that the estate was subject to the $2 million net worth limitation applicable to individuals because the estate arose from the death of an individual and consisted of an individual's assets and liabilities.[194] While the estate exceeded the applicable net worth limitation according to the IRS's calculation, the estate argued that the IRS's calculation was wrong because the acquisition cost of property should have been used to calculate net worth.[195] The court examined the legislative history behind the statute and noted that the term "net worth" is to be calculated by subtracting total liabilities from total assets.[196] In determining the value of assets, the cost of acquisition rather than fair market value should be used.[197] Accordingly, the court determined that net worth was to be calculated using the acquisition cost of property.[198] In addition, the court determined that life insurance payable at the decedent's death to a beneficiary should not be included in the net worth calculation because the funds are not available to the estate to fund a loss due against the government, and including them in the net worth calculation would undermine the purpose of the Equal Access to Justice Act.[199] Applying the acquisition

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187. *See id.*
188. *See id.* at 1058-59.
189. *See id.* at 1060.
190. *See* Estate of Lute v. United States, 98-2 U.S. Tax Cas. (CCH) ¶ 60,324, at 86,556 (D. Neb. 1998).
191. *See id.*
192. *See id.* (citing 28 U.S.C. § 2412(d)(2)(B) (Supp. 1998)).
193. *See id.*
194. *See id.* at 86,556-57.
195. *See id.* at 86,557.
196. *See id.* (citing H.R. REP. NO. 96-1418, at 15 (1980)).
197. *See id.* (citing H.R. REP. NO. 96-1418, at 15 (1980)).
198. *See id.*
199. *See id.*

cost of property to the net worth calculation and eliminating over $700,000 of life insurance from the estate, the court arrived at a net worth less than $2 million.[200] Accordingly, the estate was not prohibited from recovering reasonable litigation costs.[201]

The IRS also challenged the court's finding that the IRS's position in the underlying refund action was not substantially justified.[202] The court disagreed, noting that the IRS continued to maintain up until the time of closing argument that the qualified disclaimer at issue had to meet the requirements of section 2518(b)(4) of Code and did not mention subparagraph (c)(3) which provides that certain transfers will be treated as qualified disclaimers without meeting the requirements of subparagraph (b)(4).[203] As such, the court determined that the IRS's position was not substantially justified and that the estate was entitled to an award of litigation costs.[204]

In *United States v. Davidson*,[205] a case of first impression, the court determined that federal tax liens did not attach to property inherited by a delinquent taxpayer who disclaimed his interest in the inheritance.[206] The court held that state law, not federal law, controls a determination as to the nature of the legal interest that a taxpayer has in property.[207] In accordance with Colorado law, potential beneficiaries have the right to renounce and disclaim any interest in property that is bequeathed by will or in a non-testamentary interest or contract.[208] The taxpayer timely disclaimed his interest in an inheritance from his uncle in accordance with Colorado law.[209]

For purposes of determining whether the taxpayer ever had a property interest in the inheritance to which the tax liens could attach, the court determined that Colorado followed the "acceptance-rejection theory," under which a property interest vests only when the beneficiary accepts the gift or grant.[210] The "transfer theory" under which property vests in the beneficiary immediately upon the death of the testator or grantor, was held to be inapplicable.[211] Because the taxpayer's right to choose whether to inherit was not a right to property, the tax liens did not attach to his inheritance.[212]

In Private Letter Ruling 99-29-027,[213] the IRS held that disclaimers of interests in thirteen paintings bequeathed to children under their mother's will were

200. *See id.*
201. *See id.* at 86,558.
202. *See id.* at 86,557.
203. *See id.* at 86,558.
204. *See id.*
205. United States v. Davidson, 55 F. Supp. 2d 1152 (D. Colo. 1999).
206. *See id.* at 1156.
207. *See id.*
208. *See id.* at 1155.
209. *See id.* at 1153.
210. *See id.* at 1156.
211. *See id.*
212. *See id.*
213. Priv. Ltr. Rul. 99-29-027 (Apr. 27, 1999).

qualified disclaimers even though the paintings were passed on to a charitable foundation in which the children continued to enjoy positions of control.[214] The key to obtaining the favorable ruling was an agreement by the children not to participate in any decisions relating to the paintings.[215] In addition, the IRS ruled that the decedent's estate was entitled to an estate tax charitable deduction for the value of the residuary estate (including the value of the disclaimed paintings) passing to the charitable foundation.[216]

In Private Letter Ruling 99-32-042,[217] a disclaimer executed by a decedent's husband of his one-half interest in a joint brokerage account that passed to him upon his wife's death was qualified.[218] The husband did not accept any benefits with respect to the disclaimed one-half interest.[219] Although he received the first check for the income earned on the account and deposited the funds in a joint bank account, he did not use any of the funds comprising the decedent's share.[220] The disclaimer was in writing and delivered to himself as executor within nine months of the decedent's death.[221] The disclaimed assets passed to a residuary trust of which the husband was the sole income beneficiary, but he would cease to have any interest in the trust upon his death or remarriage.[222]

In *United States v. Brumfield*,[223] the IRS assessed income taxes against the decedent's son in 1985 and 1993 and filed notices of a tax lien in 1993.[224] The decedent died in November 1995, leaving a usufruct interest to the son.[225] In 1996, the son executed a document in which he purported to renounce his usufruct

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214. *See id.*

215. *See id.*

216. *See id.* Among the requirements for qualification, disclaimants must not have accepted the disclaimed interest or any of its benefits before making the disclaimer. *See id.* As members, directors, and officers of the charity that received the disclaimed property, the disclaimants ran the risk of retaining a prohibited discretionary power to direct the enjoyment of that property under Treasury Regulation section 25.2518-2(d)(2). *See id.* The Service concluded, however, that the proposed agreement in which the disclaimants agreed not to participate in any decisions relating to the paintings, the sale of the paintings, or the use of the proceeds from the sale of the paintings, was sufficient to avoid this potential pitfall. *See id.* Another requirement for qualification was satisfied by the passage of the disclaimed property without direction on the part of the disclaimants to a person other than the person making the disclaimer. *See id.* The property passed as part of the residuary estate of which the charitable foundation was a beneficiary. *See id.* Thus, if the respective disclaimers are received by the decedent's legal representative, or the holder of the legal title to the property to which the interest relates within nine months after the decedent's death, the disclaimers will be qualified disclaimers. *See id.*

217. Priv. Ltr. Rul. 99-32-042 (Aug. 13, 1999).

218. *See id.*

219. *See id.*

220. *See id.*

221. *See id.*

222. *See id.*

223. United States v. Brumfield, 82 A.F.T.R.2d 7044 (RIA 1998).

224. *See id.*

225. *See id.*

interest.[226] Two weeks later, he executed another document, renouncing both his usufruct interest and his "forced portion" in the estate's assets.[227] The United States filed a petition to foreclose its tax liens on the usufruct interest.[228] The court noted that under Louisiana law, the son had the right to accept or renounce any portion of the estate that was left to him.[229] If the son accepted a portion of the estate, he was deemed to have succeeded to that portion as of the time of his mother's death.[230] If the son renounced, the renunciation was similarly effective as of the moment of the mother's death.[231] Thus, the court explained, with a valid renunciation, the son would be treated as though he never received any portion of the succession.[232] The court cited *Leggett v. United States* which involved similar Texas statutes and in which the Fifth Circuit concluded that a tax lien never attached because the heir renounced his succession rights.[233] The Fifth Circuit noted that Texas state courts have adopted the "acceptance-rejection" theory which permits an heir to accept or reject the succession despite state statutory law that vests the heir with a property right from the moment of death.[234] Thus, whether the tax lien attached depended upon whether the son accepted or rejected the succession.[235] The court found that the son's renunciation was valid.[236] The court also rejected the government's contention that the renunciation should be annulled because the son acted fraudulently.[237] Nevertheless, the court determined that the son tacitly accepted the succession because he received valuable consideration in exchange for his release of his rights.[238] The son renounced in favor of his brother, receiving in exchange a release from any liability for inheritance taxes and a release from all claims his brother had against him.[239] The court also held that under Louisiana law, the son's assignment of his inheritance rights to a co-heir was considered to be an acceptance.[240]

In *Estate of Delaune v. United States*,[241] the decedent was preceded in death by a spouse who left the entire estate to the decedent.[242] The decedent discussed a disclaimer of the inheritance with attorneys but did not execute a written disclaimer

226. *See id.* at 7045.
227. *See id.*
228. *See id.*
229. *See id.*
230. *See id.* at 7046.
231. *See id.*
232. *See id.*
233. *See* Leggett v. United States, 120 F.3d 592, 594 (5th Cir. 1997).
234. *See id.* at 595.
235. *See id.*
236. *See id.* at 598.
237. *See* Brumfield, 82 A.F.T.R.2d at 7048.
238. *See id.* at 7049.
239. *See id.*
240. *See id.*
241. Estate of Delaune v. United States, 143 F.3d 995 (5th Cir. 1998).
242. *See id.* at 998.

before death.[243] The decedent's heirs petitioned a state court which ruled that the decedent intended to make the disclaimer and that the pre-deceased spouse's estate passed as if the disclaimer had been made.[244] The district court ruled that the disclaimer was not effective for federal estate tax purposes because there was no written disclaimer and state law did not provide for disclaimers by the heirs of an heir.[245] The Fifth Circuit reversed, holding that state law did allow heirs to file disclaimers for a decedent.[246]

F. *Marital Deduction Planning and Drafting*

1. *Savings Clauses*

Estate of Walsh v. Commissioner[247] involved the effectiveness of a "savings clause" in a marital deduction trust.[248] The trust granted the surviving spouse a general power of appointment.[249] This was both a lifetime withdrawal power and a power to appoint by will.[250] However, the surviving spouse's right to the trust's income and principal and his testamentary general power of appointment over the trust terminated if he became incompetent before he either withdrew the corpus or provided in his will for its disposition.[251] The trust provision stated: "if said spouse should at any time be determined as incompetent . . . said spouse shall take no benefits hereunder and this trust shall be treated and distributed as if said spouse had died."[252] Thus, the trust did not give the surviving spouse a lifetime income interest in the trust as required by section 2056(b)(5) of the Code.[253] The executor argued that the surviving spouse could dispose of the trust assets at any time before the trust terminated, and that the trust should therefore qualify for the marital deduction.[254]

The court held that the trust's incompetency provisions took the property passing to the trust outside the statutory and regulatory requirements for the marital deduction, and had the effect of revoking the surviving spouse's right to trust income upon incapacity.[255] In addition, while the trust contained a savings clause, the court noted that another purpose of the trust was to provide subsistence for the surviving spouse during his competency and, thereafter, to allow the spouse to qualify for

243. *See id.* at 998-99.
244. *See id.* at 999.
245. *See id.* at 999-1000.
246. *See id.* at 1000-06.
247. Estate of Walsh v. Commissioner, 110 T.C. 393 (1998).
248. *See id.* at 393.
249. *See id.* at. 395.
250. *See id.* at 394-95.
251. *See id.*
252. *Id.* at 395.
253. *See id.* at 398-99.
254. *See id.* at 399.
255. *See id.* at 402.

medical assistance at minimal family expense.[256] Thus, the savings clause could not cure the defective trust. [257]

In Technical Advice Memorandum 99-32-001,[258] a surviving spouse had a qualifying income interest in a trust created under her predeceased husband's will, even though certain provisions could have been interpreted as limiting the spouse's right to income.[259] The will directed the entire net income of the residuary trust to be paid to the spouse.[260] The trustees were authorized to distribute principal to or for the spouse's benefit, but only if the distribution would not cause the spouse to become ineligible for government assistance.[261] The trust instrument included a savings clause.[262] While savings clauses that void a trustee's power generally are ineffective for transfer tax purposes, they can be used to determine the decedent's intent.[263] Because the trust language was ambiguous, the savings clause clarified that the trustees were to exercise their powers in a manner that would not result in a loss of the marital deduction. [264]

a. *Drafting Language—Will Provision*

> Notwithstanding anything herein contained to the contrary, any power, duty, or discretionary authority granted to my Fiduciary hereunder shall be absolutely void to the extent that either the right to exercise or the exercise thereof, shall in any way affect, jeopardize or cause my estate to lose all or any part of the tax benefit afforded my estate by the Marital Deduction under either Federal or State law.[265]

b. *Drafting Language—Trust Powers*

> It is expressly provided that the grant of rights, powers, privileges, and authority to the trustee in connection with the imposition of duties upon said trustee by any provision of this trust or by any statute relating thereto shall not be effective if an to the extent that the same, if effective, would disqualify the marital deduction as established in the marital trust herein. It

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256. *See id.*
257. *See id*. The court relied primarily on *Estate of Tingley v. Commissioner*, 22 T.C. 402 (1954). *See id.* at 398-99. In *Tingley*, the surviving spouse's right to income and corpus terminated upon legal incapacity or the appointment of a guardian. *See id.* at 399.
258. Tech. Adv. Mem. 99-32-001 (Apr. 29, 1999).
259. *See id.*
260. *See id.*
261. *See id.*
262. *See id.*
263. *See id.*
264. *See id.*
265. *Id.*

> is my intention that my spouse have under the provisions of this trust substantially that degree of beneficial enjoyment of the trust state during my spouse's lifetime which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust and trustee shall not exercise discretion in a manner which is not in accord with this expressed intention. The trustee shall invest the trust estate so that it will produce for my spouse during lifetime such an income or use which is consistent with the value of the trust estate and with its preservation. It is expressly provided that the trustee shall not in the exercise of its discretion make any determination inconsistent with the foregoing especially in regard to and including but not limited to the powers granted herein.[266]

2. *QTIP Developments*

In *Estate of Rinaldi v. United States*,[267] the decedent's will established a trust for his wife's benefit to be funded with corporate stock.[268] The decedent's son was to serve as trustee, but if he gave up day-to-day management of the corporation, the decedent's will directed the trust's fiduciary to offer to sell the trust's stock to the son at book value, which was lower than fair market value.[269] The decedent's will gave the executor the authorization to treat the trust principal as qualified terminable interest property (QTIP).[270] The remainder of the decedent's estate was divided between two residuary trusts.[271] Before death, the corporation elected S corporation status and, after the decedent's death, the corporation redeemed the stock held by the decedent's estate in accordance with S corporation rules.[272]

The executor made a QTIP election for the trust.[273] The IRS determined that the trust was not QTIP because the possibility of the son ceasing day-to-day management of the corporation created the potential for the stock to be purchased at a bargain price which would diminish the value of the trust's corpus.[274]

The estate argued that at the time it made the QTIP election, the trust qualified under section 2056(b)(7) of the Code because the corporation had redeemed the stock.[275] The company was to pay the trust the fair market value of the shares, with $100,000 paid at closing and the balance paid in installments over a twenty-year

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266. *Id.*
267. Estate of Rinaldi v. United States, 38 Fed. Cl. 341 (1997), *aff'd*, 178 F.3d 1308 (Fed. Cir. 1998), *cert. denied*, 526 U.S. 1006 (1999).
268. *See id.* at 343-44.
269. *See id.* at 344.
270. *See id.* at 344-45.
271. *See id.* at 344.
272. *See id.*
273. *See id.* at 345.
274. *See id.* at 345-46.
275. *See id.* at 346.

period with 8.5 percent interest.[276] The court rejected the Service's contention that the point at which property must be statutorily eligible for QTIP treatment is the decedent's date of death.[277] The court held that as long as property's QTIP eligibility is ascertainable when the executor elects QTIP treatment, postponing the eligibility determination until that time does not run counter to the plain meaning of the statute's language nor its objectives.[278] However, the trust established under the decedent's will was ineligible for QTIP treatment because "the will explicitly subjected the trust's value to diminution through the potential sale of its assets at a bargain price to someone other than the surviving spouse."[279] The fact that the trust rid itself of the stock did not change the terms of the will.[280]

In Technical Advice Memorandum 99-24-002,[281] a husband died, survived by his wife and two children.[282] He left $4 million in a trust that became irrevocable on his death and a $22,500 probate estate that passed to the trust.[283] The trust directed payment of all estate taxes out of trust assets, but barred using any assets excludible in computing federal estate taxes.[284] All of the trust corpus, except for the estate's available unified credit passed to the marital trust.[285] The remainder was to pass to a family trust.[286]

When the husband died, shares in two corporations worth $2 million were distributable to either the marital or the family trust.[287] The widow disclaimed her entire interest in the stock, however, which caused the stock to pass outright to her children.[288]

The IRS concluded that the disclaimed assets passed as a residuary bequest despite the disclaimer's reference to specific assets.[289] Because the trust specifically directed that the estate tax excludible assets not be burdened with paying the tax, the

276. *See id.* at 344.

277. *See id.* at 348.

278. *See id.* at 347-48.

279. *Id.* at 348. On a separate issue, the court held that the estate was entitled to claim a casually loss deduction for losses sustained during estate administration to citrus grove damage by unexpected freeze in Florida. *See id.* at 356. The court rejected the Service's contention that the loss had to be calculated on a tree-by-tree basis. *See id.* at 355-56. Instead, the court agreed with the estate that the loss should be determined on the basis of the groves in their entirety. *See id.*

280. *See id.* at 350. The lessons of *Rinaldi* are clear. In those estates where a QTIP election may be utilized, great care must be taken with respect to bargain purchase arrangements. Such arrangements are common in agricultural estates. In addition, circumstances fatal to the QTIP election may not be correctable by post-death, pre-election planning steps.

281. Tech. Adv. Mem. 99-24-002 (Mar. 16, 1999).

282. *See id.*

283. *See id.*

284. *See id.*

285. *See id.*

286. *See id.*

287. *See id.*

288. *See id.*

289. *See id.*

IRS also concluded that all estate taxes should be paid out of the disclaimed stock.[290] It is important to note that the trust directed payment from principal, but it did not specify any particular assets as the source of payment.[291] However, the trust did provide that property excludible from computing the federal estate tax was not to be burdened with payment of estate taxes.[292]

In Revenue Ruling 2000-2,[293] the decedent's individual retirement account (IRA) named a trustee as the primary beneficiary.[294] All of the trust income was to be distributed to the surviving spouse and no one had the power to appoint trust corpus to anyone but the surviving spouse.[295] The spouse had the authority, which could be exercised annually, to compel the trustee to withdraw from the IRA an amount equal to the income earned on the assets held by the IRA during the year and to distribute that amount through the trust to the spouse.[296] The IRS ruled that the executor could elect QTIP treatment for the trust and IRA.[297]

G. *Valuation*

1. *Discounts for Built-in Gain*

In *Estate of Gray v. Commissioner*,[298] the estate was entitled to a discount for lack of marketability in valuing closely-held stock, despite the fact that the decedent owned a controlling interest in the corporation at the time of her death and despite the fact that the company was valued using the net asset method, rather than using comparable sales of freely traded value.[299] However, the Tax Court rejected the estate's argument that the stock should be discounted to reflect the tax on a built-in capital gain of $2.2 million.[300] The estate had contended that as a consequence of the repeal of the *General Utilities* doctrine, a corporation can no longer avoid tax on built-in gain.[301] The tax will be imposed when the corporation is liquidated, if not triggered by an event before liquidation.[302]

In 1987, the corporation made a $2.3 million sale of fifty-six acres of land with a $100,000 tax basis to two irrevocable trusts.[303] The decedent had created the

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290. *See id.*
291. *See id.*
292. *See id.*
293. Rev. Rul. 2000-2, 2000-3 I.R.B. 305.
294. *See id.*
295. *See id.*
296. *See id.*
297. *See id.*
298. Estate of Gray v. Commissioner, 73 T.C.M. (CCH) 1940 (1997).
299. *See id.* at 1947.
300. *See id.*
301. *See id.*
302. *See id.*
303. *See id.* at 1944.

trusts, and owned 82.5% of the corporate stock at the time of death.[304] No payments had been made on the $2.3 million up to the time of trial even though the $2.3 million note was due in 1990.[305] The $2.2 million of built-in gain at issue was the deferred installment gain on the sale of the real estate.[306] The Tax Court determined that the note would be paid only if the trusts sold the fifty-six acres.[307] The personal holding company could repossess the land, but that would not trigger the deferred gain because of section 1038 of the Code.[308] The Tax Court determined that the estate had not shown that it was likely that the personal holding company would pay the tax on the built-in gain.[309] In addition, the decedent's control over the corporation, the lack of a fixed repayment schedule, the lack of a written loan agreement, the decedent's failure to repay the transfers, the corporation's lack of effort to collect even though most of the notes were past due, the lack of adequate collateral and the lack of objective evidence that the decedent intended to repay the amounts transferred all indicated that the transfers were not loans and, as a result, were not deductible as a claim against the decedent's estate. [310]

In *Estate of Welch v. Commissioner*,[311] the decedent owned a minority interest in two closely-held corporations at the time of death.[312] The remaining shares in the corporations were held by a trust established under the will of the decedent's pre-deceased husband.[313] The decedent's estate reported that the corporate stock had a fair market value of $264,000 and $330,000, respectively.[314] The estate derived the values from a valuation report, combined with the estimates of the fair market value of real property owned by the corporations that was subsequently sold under condemnation for $1.3 million.[315] The estate applied a thirty-four percent discount to the stock's value to reflect the built-in capital gains tax on the real property.[316] The IRS disallowed the discount. [317]

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304. *See id.* at 1945.
305. *See id.* at 1944.
306. *See id.*
307. *See id.* at 1947.
308. *See id*.
309. *See id.*
310. *See id.* at 1945-46. Deferred or built-in corporate income taxes should usually be reflected in the initial stock valuation and not be set forth as a separate discount to be deducted after the stock value has been determined. *See id.* at 1947. Business appraisers are not tax experts, however, and it is sometimes worthwhile, to remind them of the potential taxes they need to reflect at the time they are gathering the appraisal information. It is also worth discussing with the appraisers the markets in which the stock might be sold. But remember, tax considerations are irrelevant in valuing publicly traded stock.
311. Estate of Welch v. Commissioner, 75 T.C.M. (CCH) 2252 (1998).
312. *See id. at* 2253.
313. *See id*. at 2254.
314. *See id.* at 2253.
315. *See id.* at 2254-55.
316. *See id.* at 2253.
317. *See id.* at 2254-55.

The Tax Court upheld the IRS' disallowance of the discount and pointed out that the Tax Court had repeatedly rejected discounts for minority interests in closely-held corporate stock to reflect built-in capital tax unless the taxpayer could establish that the corporation was likely to be liquidated or its assets were likely to be sold.[318] In addition, the court noted that the taxpayer must show that the corporation would be likely to incur a tax upon the sale.[319] Here, the court pointed out that it was unlikely that either corporation would incur capital gains tax upon the sale of the properties given the foreseeability of the properties' condemnation and the availability of the section 1033 election.[320] The court noted that the decedent's estate presented no evidence that it intended to recognize the built-in gains tax, thus foregoing the section 1033 election. [321]

On appeal, the Sixth Circuit reversed,[322] based upon the IRS's concession that other courts had allowed a discount for built-in capital gains tax in similar factual settings while the *Welch* case was pending appeal. The Sixth Circuit remanded the case for a determination of the built-in capital gains tax liability, on the basis of what a hypothetical willing buyer and seller would consider a discount of the stock value as of the date of the decedent's death.

In *Estate of Davis v. Commissioner*,[323] the decedent, one of the founders of Win-Dixie Stores, Inc., gifted twenty-five shares of stock in a closely-held corporation to each of two sons several years before his death.[324] The corporation was primarily a holding company for various assets of the donor, principally consisting of more than one million low-basis shares of Win-Dixie stock (eighty-five percent fair market value of total assets), but which also included cattle operations.[325] At the time of the gifts, ninety-seven shares of the closely-held corporation's stock were owned by a trust for the donor's benefit. On the donor's gift tax return, the donor reported the value of the stock at $297,770 per share.[326] The IRS issued a notice of deficiency based on a valuation of $481,879 per share. [327]

Both the IRS and the taxpayer agreed that the net asset value should be reduced by a blockage and/or SEC Rule 144 discount to recognize the legal restrictions placed on the corporation, and the difficulty of disposing of such a large block of stock.[328] What the parties did not agree upon, however, was a discount or

318. *See id.* at 2255.

319. *See id.* at 2255-56.

320. *See id.* at 2256.

321. *See id.*

322. No. 98-2007, 2000 U.S. App. LEXIS 3315 (6th Cir. Mar. 1, 2000). The Sixth Circuit's opinion is not recommended for publication.

323. Estate of Davis v. Commissioner, 110 T.C. 530 (1998).

324. *See id.* at 531.

325. *See id.* at 531-32.

326. *See id.* at 534.

327. *See id*.

328. *See id* at 540-41.

adjustment to reflect the corporation's built-in capital gains (even though the IRS's own experts supported the discount). [329]

The IRS opposed the discount on the ground that no corporate liquidation was contemplated on the date of the gift and that the corporation could have avoided the built-in gains tax by converting to S corporation status and retaining its assets for ten years.[330] In rejecting the first argument, the Tax Court held that no liquidation of the corporation or the sale of its assets need be contemplated.[331] The court rejected the second argument by agreeing with the taxpayer's expert's opinion that it was unlikely that the corporation would have converted to an S corporation. [332]

Thus, because of the repeal of the *General Utilities* doctrine, the fair market of minority blocks of common stock can reflect some reduction for a portion of the built-in capital gains tax even though no corporate liquidation or sale of assets was planned on the valuation date.[333] The portion of the built-in capital gains tax can be included as part of a lack of marketability discount, which can be taken in addition to a minority discount.[334] Thus, in light of the repeal of the *General Utilities* doctrine that had allowed tax-free liquidations and other distributions, the court may consider a company's built-in capital gains tax in making a valuation. [335]

In *Eisenberg v. Commissioner,*[336] the plaintiff owned all outstanding stock of a corporation which owned a commercial building in New York and leased it to third parties.[337] The corporation's only active trade or business was the rental of the building.[338] The corporation did not have plans to liquidate, sell or distribute the building.[339] Over a period of approximately two years, the plaintiff gifted shares of corporate stock to her son and two grandchildren.[340] The plaintiff valued the stock for gift tax purposes by reducing the value of the stock by the full amount of the capital gains tax that she would have incurred had the corporation liquidated, or sold, or distributed its fixed assets.[341] The plaintiff computed the potential capital gains tax by

329. *See id.* at 545.
330. *See id.* at 548.
331. *See id.* at 549.
332. *See id.* at 548-49.
333. *See id.* at 550.
334. *See id.* at 553.
335. *See id.* at 548 n.13, 553. Until recently, the Tax Court had rejected discounts for tax liability on built-in capital gains tax. *See* Estate of Welch v. Commissioner, 75 T.C.M. (CCH) 2252, 2255-56 (1998); Gray v. Commissioner, 73 T.C.M. (CCH) 1940, 1947 (1997). Significantly, the taxpayers in those cases held out for discounts equal to the full amount of capital gains taxes. *See Estate of Welch*, 75 T.C.M. (CCH) at 2253; *Gray*, 73 T.C.M. (CCH) at 1947. In *Estate of Davis v. Commissioner*, the court agreed with both taxpayers and IRS experts that a partial, or fifteen percent discount for this factor was appropriate (for a 1992 valuation date). *See Estate of Davis*, 110 T.C. at 554.
336. Eisenberg v. Commissioner, 155 F.3d 50 (2d Cir. 1998).
337. *See id.* at 52.
338. *See id.*
339. *See id.*
340. *See id.*
341. *See id.*

assuming hypothetical annual sales of the property, and the parties stipulated to the amount of capital gains that would have been realized from the hypothetical sales. [342]

The IRS asserted deficiencies based solely on a determination that the values reported on the plaintiff's tax return should not have included reductions in the value of the corporate stock to account for potential capital gains tax. [343]

Before the Tax Court, the parties agreed that the net-asset-value method was appropriate for valuing the gifted stock, stipulated to a 25 percent minority discount, agreed on the fair market value of the property, and agreed on the valuation of the shares of stock as reported on the taxpayer's gift tax returns.[344] The parties filed cross motions for summary judgment, raising as the only issue the valuation reduction for the capital gains tax liabilities. [345]

The Tax Court held for the IRS, finding that "no reduction in the value of closely-held stock may be taken to reflect the potential capital gains tax liability where evidence fails to establish a liquidation or sale of the corporation or its assets is likely to occur."[346] In that instance, the tax liability is purely speculative. [347]

On appeal, the Second Circuit held that the plaintiff was entitled to reduce the fair market value of the corporate stock to account for potential capital gains tax liability even though no liquidation, sale, or distribution was contemplated as of the stock transfer date.[348] The court stated that "[i]n the past, the denial of the reduction for potential capital gains tax liability was based, in part, on the possibility that the taxes could be avoided by liquidating the corporation."[349] However, the court noted this tax effect was eliminated by the Tax Reform Act of 1986 and its repeal of the *General Utilities* doctrine.[350] As a result, the court noted that it would be "a virtual certainty that capital gains would ultimately be realized" due to the changes brought about by the 1986 Act.[351] As such, the court reasoned that capital gains tax liability is not too speculative to be valued as of the date of the gift, even though no liquidation, sale or distribution of the corporation was planned. [352]

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342. *See id.*
343. *See id.*
344. *See id.*
345. *See id.* at 52-53.
346. *Id.* at 53.
347. *See id.*
348. *See id.* at 59.
349. *Id.* at 54.
350. *See id.* at 54-55.
351. *Id.* at 55.
352. *See* id. *at* 56-58. While gift tax is imposed on property measured by the value of the property at the time of the gift, this case presented the issue of what a hypothetical buyer would take into account in computing fair market value of the stock. *See id.* at 56. It is common business practice and not mere speculation to conclude, the court held, that a hypothetical willing buyer would take some account of the tax consequences of contingent built-in capital gains on the sole asset of the corporation at issue in making a sound valuation of the property. *See id.* at 57. The issue is not what a hypothetical

In *Estate of Jameson v. Commissioner,*[353] the decedent's estate contained more than a ninety-five percent block of stock in a C corporation that owned an unusually large and productive tract of private timberland in Louisiana.[354] The IRS valued the stock at $77 per share for a total value of approximately $6.3 million.[355] The estate argued for a value of $50.94 per share, for a total value of $4.1 million.[356] The parties stipulated that the assets of the company had a net liquidation value of nearly $7 million, and an adjusted income tax basis of slightly over $1 million.[357] The estate's expert estimated that a buyer would sell off the company's assets over a year's time for $6 million, because an investor would require a higher return on the equity of the corporation than the company could provide as an operating business.[358] The estate's expert then discounted the value to account for built-in capital gains taxes that would be due on such sale, and arrived at a value of $4 million for the stock which included a ten percent discount for lack of marketability.[359] The estate's other expert used a similar process to arrive at a value of $4.2 million for the stock.[360] The IRS claimed that no reduction in value should be taken for corporate capital gain taxes, and that no discount should be available for lack-of-marketability, because the decedent's block would have the power to liquidate the company. [361]

The Tax Court held that the appropriate value for the stock in the decedent's estate was $5.8 million.[362] The court rejected the estate's arguments to discount for selling costs and the nuisance value of the small minority shareholder.[363] The court held that it was appropriate to consider the potential corporate tax stemming from the appreciation on the corporation's assets, particularly the timberland.[364] The court treated the discount for capital gains as separate from the lack-of-marketability discount.[365] The court stated that the value reduction for capital gains taxes should be allowed "only in an amount reflecting the rate at which [capital gains] will be recognized, measured as the net present value of the built-in capital gains tax liability that will be incurred over time as timber is cut."[366] The court assumed that the prospective purchaser would continue the existing management philosophy of the corporation, which was to cut timber each year in amounts equal only to the current

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willing buyer plans to do with the property, the court reasoned, but what considerations affect the fair market value of the property the buyer considers purchasing. *See id*.

353. Estate of Jameson v. Commissioner, 77 T.C.M. (CCH) 1383 (1999).

354. *See id.* at 1384-86.

355. *See id.* at 1384.

356. *See id.*

357. *See id.* at 1386.

358. *See id.* at 1391-92.

359. *See id.* at 1391.

360. *See id.* at 1393.

361. *See id.* at 1394.

362. *See id.* at 1399.

363. *See id.* at 1398.

364. *See id.* at 1395.

365. *See id.* at 1395-96.

366. *Id.* at 1396.

year's growth.[367] The court assumed a ten percent projected annual timber growth rate, a four percent per year estimated inflation, a thirty-four percent tax rate, nine years of harvesting to realize all the appreciation existing on the valuation date, and a twenty percent annual discount rate.[368] Accordingly, the court allowed an $850,000 adjustment for the taxes.[369] The court allowed a three percent discount for lack of marketability to reflect the fact that only three percent of the corporate assets were unmarketable.[370] The court noted that, under local law, a ninety-eight percent shareholder could liquidate the corporation and get at virtually all its assets.[371]

2. *Fractional Interest Discounts*

Before 1989, no discount for a fractional interest in property was allowed for federal estate tax or federal gift tax purposes.[372] In 1989, however, the Tax Court, in *Estate of Youle v. Commissioner,*[373] allowed a twelve and one-half percent discount for tenancy in common ownership of land.[374] The *Youle* opinion was followed in subsequent cases.[375] Throughout this time, however, the IRS has consistently

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367. *See id.*

368. *See id.*

369. *See id.* at 1397.

370. *See id.* at 1398.

371. *See id.* at 1397. The Tax Court's reasoning appears incorrect on several points. For instance, the court's approach to the discount for built-in corporate taxes seems inconsistent with its basic strategy for valuing the equity of the corporation. Additionally, the separate treatment of the built-in gain tax issue seems to run counter to *Davis v. Commissioner*, where the Tax Court held that the taxes should be considered as part of the lack-of-marketability discount. *See* Davis v. Commissioner, 110 T.C. 530, 530-31 (1998). Similarly, the Tax Court refused to apply a lack-of-marketability discount to the stock itself, on the ground that a ninety-eight percent stockholder possessed the right to liquidate the company and get at its largely marketable assets. *See* Estate of Jameson, 77 T.C.M. (CCH) at 1397. The IRS can be expected to argue in future cases against applying the lack-of-marketability discount to any controlling block of closely-held stock. Thus, transferors of interests in entities holding nothing but readily tradable investment assets may find it difficult to establish a marketability discount if the transferred interest possesses control. The Tax Court's reasoning, if adopted by other courts, could pose problems for family limited partnerships.

372. *See, e.g.*, Estate of McMullen v. Commissioner, 56 T.C.M. (CCH) 507, 510-11 (1988); Estate of Clapp v. Commissioner, 47 T.C.M. (CCH) 504, 506 (1983); Estate of Pudim v. Commissioner, 44 T.C.M. (CCH) 1425, 1426-27 (1982).

373. Estate of Youle v. Commissioner, 56 T.C.M. (CCH) 1594 (1989).

374. *See id.* at 1595.

375. *See, e.g.*, Estate of Williams v. Commissioner, 75 T.C.M. (CCH) 1758, 1768 (1998); Estate of Casey v. Commissioner, 71 T.C.M. (CCH) 2599, 2602 (1996); Estate of Cervin v. Commissioner, 68 T.C.M. (CCH) 1115, 1118 (1994), *rev'd on other grounds*, 111 F.3d 1252 (5th Cir. 1997); LeFrak v. Commissioner, 66 T.C.M. (CCH) 1297, 1308-09 (1993); Estate of Pillsbury v. Commissioner, 64 T.C.M. (CCH) 284, 287 (1992); Estate of Feuchter v. Commissioner, 63 T.C.M. (CCH) 2104, 2111 (1992); Mooneyham v. Commissioner, 61 T.C.M. (CCH) 2445, 2447 (1991); Robinson v. United States, 90-2 U.S. Tax Cas. (CCH) ¶ 60,045 (1990); Estate of Wildman v. Commissioner, 58 T.C.M. (CCH) 1006, 1010-11 (1989).

maintained that the discount, if any, should be limited to the costs of partitioning the property based on the facts of each particular case. [376]

In *Estate of Young v. Commissioner*,[377] the decedent and his wife owned real property as joint tenants in California, a community property state.[378] The decedent's federal estate tax return reported half of the date-of-death value of the property as the decedent's interest, and then claimed a fifteen percent fractional interest discount.[379] After filing the estate tax return, the estate obtained a state trial court decree holding that the property in question was community property, or quasi-community property, with one-half belonging to each spouse.[380] The IRS was not a party to the state court proceeding. [381]

The IRS determined that the decedent and his wife held the property as joint tenants with right of survivorship, as stated in the deeds, and not as community property.[382] Therefore, the IRS determined that the decedent's gross estate included half the value of the property under section 2040 of the Code.[383] Because the surviving spouse was not a U.S. citizen, section 2040(a) rather than section 2040(b) applied.[384] As a result, the decedent's estate included the entire value of the joint tenancy property, except to the extent of consideration furnished by the surviving tenant.[385] The IRS disallowed the fifteen percent fractional interest discount. [386]

While the Tax Court noted that the state trial court's decree did not bind the Tax Court for federal estate tax purposes, the Tax Court held that the estate failed to overcome the presumption of joint tenancy with right of survivorship created by the deeds under California law.[387] The court noted that in order to deal with the inherent characteristics of joint tenancy with right of survivorship, sections 2031 and 2040 provide an explicit approach to valuing joint tenancy property.[388] Fractional interest discounts and lack of marketability discounts do not apply to the valuation of joint tenancy under section 2040(a).[389] The discount, the court noted, is based on the notion that the interest is worth less than its proportionate share, because of the problems of concurrent ownership.[390] Co-ownership, however, is severed at the moment of death

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376. *See* Priv. Ltr. Rul. 99-43-003 (Jun. 7, 1999); Priv. Ltr. Rul. 93-36-002 (May 28, 1993).
377. Estate of Young v. Commissioner, 110 T.C. 297 (1998).
378. *See id.* at 298.
379. *See id.* at 299.
380. *See id.* at 300.
381. *See id.* at 302.
382. *See id.* at 304.
383. *See id.* at 308.
384. *See id.*
385. *See id.*
386. *See id.* at 316.
387. *See id.* at 306.
388. *See id.* at 314.
389. *See id.* at 316.
390. *See id.*

and alleviates the problems associated with co-ownership.[391] Accordingly, the fractional interest discount was denied. [392]

In *Estate of Fratini v. Commissioner,*[393] the decedent's estate included several properties held in joint tenancy with the decedent's companion.[394] The estate reduced the value of the decedent's interest in several of the jointly-held real properties by fractional interest discounts, but the IRS disallowed the discounts.[395] The court also disallowed any fractional interest discounts, citing the Tax Court's opinion in *Estate of Young v. Commissioner.*[396] The court noted that under section 2040(a) of the Code, the amount includible in a decedent's gross estate does not depend on a valuation of property rights actually transferred at death, or on a valuation of the actual interest held by the decedent (legal title).[397] Rather, a decedent's gross estate includes the entire value of property held in joint tenancy, except to the extent the consideration for the property was furnished by such other person.[398] The court noted that section 2040(a) provides an artificial inclusion of the joint tenancy property — the entire value of the property less any contribution by the surviving joint tenant.[399] As such, except for the statutory exclusion contained in section 2040(a), there is no further allowance to account for the fact that less than the entire interest is included in the gross estate. [400]

In *Estate of Brocato v. Commissioner*,[401] the decedent owned several apartment buildings in co-ownership with another individual.[402] The court allowed a twenty percent fractional interest discount and an eleven percent blockage discount.[403] The court rejected the IRS expert's approach based on the costs of partitioning the properties.[404] However, in early 2000, the Tax Court decided *Estate of Busch v. Commissioner*,[405] where the court displayed a greater willingness to peg the level of

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391. *See id.*
392. *See id.* at 317.
393. Estate of Fratini v. Commissioner, 76 T.C.M. (CCH) 342 (1998).
394. *See id.* at 343.
395. *See id.* at 345-46.
396. *See id.* at 350 (citing Estate of Young v. Commissioner, 110 T.C. 297, 317 (1998)).
397. *See id.*.
398. *See id.* (quoting *Estate of Young*, 110 T.C. at 315-16).
399. *See id.*
400. *See id.* Arguably, *Young* and *Fratini* were not decided properly. Section 2040(a) does not clearly reject a fractional interest discount. *See* I.R.C. § 2040(a) (1994). Likewise, the appellate courts have allowed such discounts. *See* Estate of Bonner v. United States, 84 F.3d 196, 197 (5th Cir. 1996); Estate of Cervin v. Commissioner, 111 F.3d 1252, 1262-63 (5th Cir. 1997), *rev'd on other grounds,* 68 T.C.M. 1115, 1122 (1994); Propstra v. United States, 680 F.2d 1248, 1251 (9th Cir. 1982).
401. Estate of Brocato v. Commissioner, 78 T.C.M. (CCH) 1243 (2000).
402. *See id.* at 1244.
403. *See id.* at 1248-49.
404. *See id.* at 1249.
405. Estate of Busch v. Commissioner, 79 T.C.M. (CCH) 1277 (2000).

the discount at the cost of partitioning the property.[406] The court allowed a ten percent discount (the estate argued for forty percent and the IRS for none).[407] Further litigated cases will be required to determine if the Tax Court is beginning to give greater credence to the IRS's argument.

3. *Discounts Involving Merged Property Interests*

In *Estate of Lopes v. Commissioner*,[408] the decedent, at the time of death, held undivided interests in twenty-one separate ranch properties.[409] The decedent was the surviving spouse and the property interests had been held in two trusts: a survivor's trust and a QTIP marital trust.[410] The pre-deceased spouse's estate had been allowed a marital deduction for the QTIP property.[411] Upon the decedent's death, the remaining property held in the survivor's trust, and the property in the QTIP trust, were included in the decedent's estate.[412] The IRS claimed that the interest of both trusts should be aggregated for valuation purposes in the decedent's estate, thereby denying a fractional interest discount.[413]

The Tax Court disagreed with the IRS position, noting its recent rejection of the IRS aggregation theory.[414] The Tax Court also cited *Bonner v. United States*[415] for the same proposition and noted that neither section 2044 of the Code or the legislative history indicated that the Congress intended for property "passing through" a decedent's estate under section 2044(c) to be treated as if the decedent "owned" the property for aggregation purposes.[416] Accordingly, the property in both trusts was not aggregated for valuation purposes allowing the estate a fractional interest discount.[417]

4. *Miscellaneous Cases and Rulings*

In *Estate of Desmond v. Commissioner*,[418] the decedent owned an 81.93 percent interest in a paint company that faced large potential environmental liabilities resulting from its disposal of hazardous waste at several sites.[419] The taxpayer's expert used three valuation techniques: an asset approach, a discounted cash flow technique,

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406. *See id.* at 1286.
407. *See id.* at 1284-86.
408. Estate of Lopes v. Commissioner, 78 T.C.M. (CCH) 46 (1999).
409. *See id.* at 47.
410. *See id.*
411. *See id.*
412. *See id.*
413. *See id.* at 48.
414. *See id.* at 47-48 (citing Estate of Mellinger v. Commissioner, 112 T.C. 3917, 3922 (1999); Estate of Nowell v. Commissioner, 77 T.C.M. (CCH) 1239, 1242 (1999)).
415. Bonner v. United States, 84 F.3d 196 (5th Cir. 1996).
416. *See Lopes*, 78 T.C.M. (CCH) at 48.
417. *See id.*
418. Estate of Desmond v. Commissioner, 77 T.C.M. (CCH) 1529 (1999).
419. *See id.* at 1530.

and a multiple of earnings method to value the decedent's interest in the company.[420] The expert then averaged the results and then applied a twenty-five percent discount for lack of marketability, which included the negative impact on value attributable to the firm's contingent environmental liabilities.[421] The result was a valuation of just under $6.27 million for the decedent's interest in the company.[422] The IRS claimed that the weighted average of the three valuation methods, $10.2 million, already reflected the potential fallout from the hazardous waste disposal, and so it should not be further reduced for this factor, and that the appropriate level for the lack-of-marketability discount should not exceed five percent.[423]

The court valued the decedent's stock interest at $6.57 million.[424] The court weighted equally the discounted cash flow and price-earnings ratio approaches and did not use the asset method of the taxpayer's expert.[425] The court determined that both a lack-of-marketability discount and a control premium were appropriate.[426] While the court incorporated the environmental liabilities into the percentage adjustment, the court agreed with the IRS that the environmental risks were already reflected in the base value calculated under the "market" approach.[427] The court reasoned that the potential hazardous waste problems were already reflected in the prices of the corporate stock.[428] However, the environmental liabilities, the court reasoned, were not already reflected in the stock value under the discounted cash flow approach.[429] The court noted several factors that supported a relatively high discount, namely:

1. no public market for the corporate stock;[430]
2. corporate profit margins that were below the industry average;[431]
3. all corporate stock "was subject to a restrictive share agreement which provided that a shareholder could transfer his or her stock to a non-shareholder only after the shareholder offered the shares to the remaining shareholders;"[432]

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420. *See id.* at 1531.
421. *See id.* at 1532.
422. *See id.*
423. *See id.*
424. *See id.* at 1534.
425. *See id.* at 1533-34.
426. *See id.* at 1534.
427. *Id.*
428. *See id.* at 1533.
429. *See id.* at 1534.
430. *See id.* at 1533.
431. *See id.*
432. *Id.*

4. "a public offering of the stock was unlikely" given the size and low profitability of the corporation;[433]
5. the size of the interest was large enough to make it "hard to find potential buyers in the future who could finance such a purchase;"[434] and
6. the corporation had large potential environmental liabilities.[435]

Accordingly, the court held that a thirty percent discount was appropriate under the discounted cash flow method, and a twenty percent discount under the price-earnings approach.[436] Thus, the environmental liabilities component of the discount was ten percent.[437] In addition, the court added a twenty-five percent premium for control.[438]

In *Estate of Kaufman v. Commissioner,*[439] the decedent owned 19.86 percent of the stock of a family-owned S corporation, the largest block of stock owned by any one shareholder.[440] The estate valued the stock at $29.77 per share, based upon a pre-death appraisal and two post-death sales of stock by other family members to another family member.[441] The sales were made without negotiation and without any determination of the fair market value of the stock.[442] The court held that the post-death sales were not determinative of the value of the stock because the transactions were not negotiated and the number of shares sold was much smaller than the decedent's holdings.[443] The estate presented an expert's appraisal of the stock in support of the $29.77 value, but the court found that the appraiser's valuation was defective because it was based solely upon sale of the stock to other shareholders, which was not required by the corporation's bylaws.[444] The court held that the IRS's valuation of the stock was to be used because the estate failed to present sufficient evidence to rebut that valuation.[445]

In *Estate of Hendrickson v. Commissioner,*[446] the decedent's shares of stock in a closely-held bank were valued under the market approach using a weighted average of the price-to-book ratio and price-to-assets ratio.[447] The guideline companies

433. *Id.*
434. *Id.* at 1534.
435. *See Id.*
436. *See* i*d.*
437. *See id.*
438. *See id.*
439. Estate of Kaufman v. Commissioner, 77 T.C.M. (CCH) 1779 (1999).
440. *See id.* at 1786.
441. *See id.* at 1781-82.
442. *See id.* at 1781.
443. *See id.* at 1783-84.
444. *See id.* at 1785-89.
445. *See id.* at 1790.
446. Estate of Hendrickson v. Commissioner, 78 T.C.M. (CCH) 322 (1999).
447. *See id.* at 335.

selected by the estate's expert were relied upon as they more closely resembled the size and operating characteristics of the bank than those selected by the IRS's expert.[448] The weighted average cost of capital asset pricing model formula, as used by the IRS's expert in analyzing the discounted cash flow of the bank, was rejected because the greater risk of small stocks was not fully reflected in the capital asset pricing model formula.[449] The adjustments made by the IRS's expert to reflect the bank's excess equity were accepted.[450] While the estate's expert attempted to equally weight three ratios: price-to-earnings, price-to-book equity, and price-to-assets, the court determined that the price-to-earnings ratio might overstate the value of the stock because a large portion of the bank's earnings was attributable to investments in high-yielding treasury securities.[451] In addition, the court determined that the estate's expert failed to address the bank's overcapitalization.[452]

While the decedent's shares (49.97 percent of the outstanding shares of stock) numerically constituted a minority interest, they represented effective control of the bank since there were few circumstances in which they would not determine the outcome of any particular vote.[453] Even though the shares were valued as a controlling interest, rather than a minority interest, a thirty percent marketability discount was applied because the bank had limited growth opportunities, was "capitalized with common stock that was not publicly traded," and could not easily be sold privately.[454]

In *Estate of Shackleford v. United States,*[455] the decedent won a California lottery jackpot prize of $10,160,000 in 1987.[456] The terms of the lottery prize provided for an immediate payment to the decedent of $508,000 and the right to receive nineteen additional annual payments of $508,000 each.[457] To fund the future payments, the California Lottery Board purchased nineteen zero coupon United States T Bonds for $4,306,722.40.[458] The bonds were held in the name of the California Lottery Board and the decedent had no right to receive either principal or interest on the bonds.[459] In 1990, with seventeen installments remaining, the decedent died.[460] The seventeen remaining zero coupon bonds that funded the decedent's prize had a

448. *See id.*

449. *See id.* at 336-39.

450. *See id.* at 338-39.

451. *See id.* at 337.

452. *See id.* at 338.

453. *See id.*

454. *Id.* at 339.

455. Estate of Shackleford v. United States, No. CIV. S. 96-1370-LKKPAN, 1999 WL 744121, at *1 (E.D. Cal. Aug. 6, 1999) (forthcoming in 84 A.F.T.R.2d).

456. *See id.*

457. *See id.*

458. *See id.*

459. *See id.*

460. *See id.*

value on the open market of approximately $4,165,917 at the time of the decedent's death.[461] Under California law, a lottery prize is not assignable but the prize may be paid to the estate of a deceased winner or to a person designated by court order.[462] Thus, at the time of death, the decedent could not assign, hypothecate, or collateralize his future lottery payments.[463] In 1991, the decedent's estate filed a federal estate tax return reporting the value of his interest in the remaining lottery prize on his date of death as $4,023,903.[464] The IRS accepted the estate's valuation of the remaining prize payments, whereupon the estate filed amended returns, asserting that the includible value of the remaining lottery prize payments under section 2039(b) of the Code was equal to zero.[465] The IRS rejected the estate's refund claim. [466]

The court held that the lottery prize, but for the absolute prohibition on transfer, resembled a private annuity whose value is generally determined by reference to the valuation tables referred to in section 7520 of the Code.[467] However, because the tables failed to take into account the absolute lack of liquidity of the prize, the value under the tables was unreasonable and warranted departure from its use.[468] The court determined that the realistic value of the decedent's prize at the time of his death was slightly over $2 million. [469]

In Technical Advice Memorandum 99-33-001,[470] upon the death of a stockholder in two closely-held corporations, the decedent's estate wanted to value the stock on its return, but the IRS proposed a higher value.[471] Eventually, the IRS agreed to an estate tax valuation lower than its proposed amount but higher than the estate's originally claimed value.[472] Later, the corporations redeemed all the stock owned by an individual who inherited one-sixth of the stock.[473] That individual claimed a basis in the stock that was higher than both his proportionate share of the value originally claimed on the return and the agreed value. [474]

The IRS, citing Revenue Ruling 54-97,[475] noted that if an individual is not estopped by his previous actions or statements, there is only a rebuttable presumption that such person's basis in property acquired from a decedent is its value for federal estate tax purposes.[476] The individual who inherited the stock was not a fiduciary of

461. *See id.*
462. *See id.*
463. *See id.*
464. *See id.* at *2.
465. *See id.*
466. *See id.* at *3.
467. *See id.* at *4.
468. *See id.* at *3.
469. *See* id.
470. Tech. Adv. Mem. 99-33-001 (Jan. 7, 1999).
471. *See id.*
472. *See id.*
473. *See id.*
474. *See id.*
475. *See* Rev. Rul. 54-97, 1954-1 C.B. 113.
476. *See* Tech. Adv. Mem. 99-33-001 (Jan. 7, 1999).

the estate and took no other actions that would make the reporting of a basis under section 1014 of the Code different from the value reported on the estate tax return.[477] Thus, in accordance with this ruling, an individual inheriting stock may claim a basis in the stock different from the value used on the decedent's estate tax return, and may rebut the presumptive value of the stock by clear and convincing evidence. [478]

5. *Family Limited Partnerships*

Family limited partnerships (FLPs) have become more popular as an estate/business planning tool in recent years, largely based on the belief that significant valuation discounts can be achieved.[479] FLPs have not gone unnoticed by the IRS, as evidenced by the issuance of proposed regulations disallowing valuation at less than fair market value.[480] In general, FLPs formed for legitimate business reasons and not as a device to transfer property to a family member for less than adequate consideration or formed exclusively for tax purposes are upheld. [481]

In *Adams v. United States,*[482] the decedent and three of her siblings formed a partnership in 1990 to hold and manage the family's ranchland, securities, and oil and gas interests.[483] The decedent died in 1992, causing the partnership to dissolve under state (Texas) law.[484] At the time of death, the decedent owned a twenty-five percent interest in the family partnership.[485] Rather than wind up the partnership's affairs, the remaining partners chose to continue its business.[486] The decedent's estate filed an estate tax return listing the fair market value of the decedent's partnership interest as nearly $7,481,000.[487] The IRS determined that the decedent's interest had a fair market value of approximately $7,604,100, and the estate paid the deficiency and sought a refund.[488] The parties agreed that the partnership's net asset value was $33,081,400, but they disagreed over the applicable discounts. [489]

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477. *See id.*

478. *See id.*

479. *See, e.g.*, Estate of Watts v. Commissioner, 823 F.2d 483 (11th Cir. 1987), *aff'g*, 51 T.C.M. (CCH) 60 (1985) (allowing a thirty-five percent discount of fifteen percent partnership interest for non-marketability for federal estate tax purposes).

480. *See* Treas. Reg. § 25.2704-1 (1999).

481. *See* Church v. United States, No.SA-97-CA-0774-OG, 2000 U.S. Dist. Lexis 714, at *22-23 (W.D. Tex. Jan. 18, 2000).

482. Adams v. United States, 1999 U.S. Dist. LEXIS 3817, 99-1 U.S. Tax Cas. (CCH) P60, 340 (N.D. Tex. Mar. 17, 1999).

483. *See id.* at *2.

484. *See id.* at *2-3.

485. *See id.*

486. *See id.* at *3.

487. *See id.*

488. *See id.*

489. *See id.* at *6.

The court first determined that because the remaining siblings chose to continue the partnership's business, a hypothetical buyer of the decedent's interest would choose to receive twenty-five percent of the dissolved partnership's net asset value rather than remain an assignee of an interest in the new partnership.[490] That way, the court reasoned, the buyer would obtain his or her share of the dissolved partnership's surplus and avoid being a partner in a partnership controlled by the other partners.[491] Accordingly, the court rejected the estate's request for a "lack of control" discount, because the purchaser would not reduce his or her offering price to account for restrictions placed on his or her ability to manage the partnership.[492] For the same reason, the court also refused to apply a discount to reflect the partnership's strange mix of assets.[493] The only discount the court applied was a 5.4 percent discount to reflect liquidation costs.[494] Concluding that the value of the decedent's interest was $7,821,000 (even more than the IRS determined), the court entered judgment in favor of the government. [495]

In Technical Advice Memorandum 99-33-002,[496] the IRS ruled that a donor's transfer of an interest in a trust to form a partnership was subject to the special valuation rules under section 2701 of the Code. [497] The partnership was between a corporation owned by the donor's daughter and son-in-law and a trust with interests held by the donor and her husband.[498] The corporation contributed one percent of the partnership's capital for a thirty-five percent general partnership interest, and the trust contributed ninety-nine percent of the capital for a sixty-five percent limited partnership interest.[499] Under the partnership agreement, proceeds from capital transactions were distributed first to the limited partners until their adjusted capital contributions were reduced to zero, then to the general partner until its adjusted capital contribution was reduced to zero.[500] Any further distributions were to be distributed to the partners in proportion to their partnership interests. [501]

The IRS concluded that for purposes of section 2701(a), the donor made a transfer of an equity interest in the partnership to her daughter and son-in-law.[502] In addition, the IRS reasoned that the transfer was not excluded from the special valuation rules because the donor's retained interest was not of the same class of

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490. *See id.*
491. *See id.* at *7.
492. *Id.* at *10.
493. *See id.* at *11.
494. *See id.* at *14.
495. *See id.*
496. Tech. Adv. Mem. 99-33-002 (Apr. 12, 1999).
497. *See id.*
498. *See id.*
499. *See id.*
500. *See id.*
501. *See id.*
502. *See id.*

equity as the transferred interest, nor was the donor's retained interest of a class proportional to the class of the transferred interest. [503]

In *Church v. United States,*[504] the decedent and her two children created a limited partnership two days before the decedent's death.[505] The partnership consolidated interests in a 23,000 acre family ranch to provide for centralized management and to preserve the ranch as an ongoing enterprise for future generations.[506] The partnership was also formed to protect the decedent's assets from potential future creditors.[507] The other partners in the ranch were another family.[508] The capital contributions to the partnership consisted of each limited partner's undivided interest in the ranch.[509] In addition, the decedent contributed approximately $1 million in securities.[510] The partnership agreement allocated profit or loss from ranch operations in proportion to the interests contributed by the limited partners.[511] The limited partners conveyed their interest in the ranch to the partnership.[512] The organization of the partnerships business matters was not completed before the decedent's death.[513] The general partner of the partnership was not formed until almost six months after the decedent's death.[514] The fair market value of the assets the decedent contributed to the partnership, as of the date of her death, was approximately $1.5 million, but the fair market value of the decedent's limited partnership interest in the partnership, as of the date of her death, was $617,591.[515] At the time of her death, the decedent had been diagnosed with breast cancer, but died suddenly and unexpectedly of cardiac pulmonary collapse.[516] The IRS argued that the formation of the partnership was entered into for no purpose other than to reduce the taxation of the decedent's estate. [517]

The court noted that the partnership was formed in accordance with Texas law and disagreed with the IRS's contention that the formation of the partnership was for no purpose other than to reduce estate tax.[518] The primary purpose of the partners in forming the partnership was to preserve the family ranching enterprise for themselves

503. *See id.*
504. Church v. United States, No. SA-97-CA-0774-OG, 2000 U.S. Dist. LEXIS 714, at *1 (W.D. Tex. Jan. 18, 2000).
505. *See id.* at *2-5.
506. *See id.* at *3.
507. *See id.*
508. *See id.* at *4.
509. *See id.*
510. *See id.*
511. *See id.* at *5.
512. *See id.*
513. *See id.* at *7.
514. *See id.* at *8.
515. *See id.* at *14-15.
516. *See id.* at *7.
517. *See id.* at *11.
518. *See id.* at *11-12.

and their descendants.[519] Bringing organization to the ranch, the court noted, would remove the ranch from the control of one or more fractional, undivided-interest owners who could use the property at will, interfere with operations, and ultimately force a partition or sale of the ranch.[520] The partnership was also formed with an eye towards the possibility of actively engaging in raising cattle. [521]

H. *Gift Tax*

In Technical Advice Memorandum 99-30-002,[522] a father sold real estate to his children, but did not report the real estate sale as a gift.[523] In a later year, the father did make gifts, reported those, and used up almost all of his unified credit.[524] The father later died, and on audit, the IRS took the position that there was a gift element to the original sale.[525] The statute of limitation had closed on the gifts made in the later year.[526] The examining agent asked for technical advice to determine whether the estate could go back and apply the credit against the sale-gift transaction.[527] The IRS ruled that the estate could not do so, as the credit had been "used up" in the later transaction. [528]

In *Rosano v. United States*,[529] the decedent had a checking account with a bank and a cash management account with Merrill Lynch at the time of death.[530] The

519. *See id.* at *12-13.
520. *See id.* at *9.
521. *See id.* at *11.
522. Tech. Adv. Mem. 99-30-002 (Apr. 29, 1999).
523. *See id.*
524. *See id.*
525. *See id.*
526. *See id.*
527. *See id.*
528. *See id.* The law is clear that donors cannot selectively elect to apply or not apply the unified credit, it must be applied to the first transfers made. *See id*. However, in this TAM, the IRS claimed that it was not bound by the same rules used for taxpayers. *See id.* Presumably, if the father had filed the gift tax return reporting no gift at the time of sale, there would probably be no basis for reopening the year of the sale, although the law is not entirely clear. The IRS argued that the taxpayer had a "duty of consistency" that he violated when he claimed the unified credit on the later gift. *See id.* In other words, by claiming the credit on the later gift, he represented that he had not made a gift in a prior year that would have used up the credit. The estate was therefore estopped from claiming the credit for the earlier gift. *See id.* The IRS acknowledged that the taxpayer should have used the credit in the prior year under Rev. Rul. 79-398, but based on the taxpayer's misconception, which need not have been intentional, and the IRS's reliance on when the second gift was made, the credit was used up. *See id.* This appears to be the wrong result. Assuming the IRS's argument is valid, then the correct answer would be to reopen the year of the second gift. That is the year in which the misrepresentation, if any, was made. The IRS apparently is leery of trying to reopen a closed year, and also will collect more interest if it can deny the credit for the earlier year. The ruling illustrates the importance of filing gift tax returns and reporting family transactions that might raise a taxable gift issue. *See id.* Since 1997, it is clear that full disclosure of a sale, made with an addendum to a gift tax return, will accomplish this.
529. Rosano v. United States, 67 F.Supp. 2d 113 (E.D. N.Y. 1999).

decedent wrote a number of checks on the bank account to members of her family or close friends.[531] Some checks were issued in late December of 1989 and did not clear until early January of 1990.[532] Others were written in early January of 1990 and did not clear until the end of the month.[533] The decedent died on January 21, 1990.[534] The decedent issued checks totaling more than $431,000.[535] For tax purposes, the estate treated the checks as gifts in 1989 and 1990 to members of the family or close friends.[536] The estate did not include the Merrill Lynch account as part of the gross estate.[537]

The IRS determined that the checks issued in late 1989 were, in fact, gifts made in 1990.[538] The IRS also included in the decedent's gross estate the value of the Merrill Lynch account the day after the decedent's death.[539]

The court concluded that state property law controlled the determination of whether the decedent's checks were completed gifts at the time of death.[540] Under local (New York) law, the court explained that a gift check that is written and delivered to the donee before the donor's death, but not paid until after the donor's death, will not be considered a completed gift at the donor's death.[541] The court noted that under the relation-back doctrine, a donee may be considered to have received the checks on the date the checks were presented for deposit at the recipient's bank.[542] The court stated that the relation-back doctrine applied to the series of checks paid in early 1990, at the time the decedent was alive.[543] The court also concluded that the checks paid by the bank after the decedent's death were not completed gifts.[544] As a result, the relation-back doctrine did not apply, and the full amount of the checks should be included in the estate for tax purposes.[545] The court rejected the estate's argument that the difference in treatment between non-charitable gifts and charitable donations through the relation-back doctrine violates the equal protection clause of the Fourteenth Amendment.[546]

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530. *See id.*
531. *See id.*
532. *See id.*
533. *See id.*
534. *See id.*
535. *See id.*
536. *See id.*
537. *See id.*
538. *See id.* at 90,434-35.
539. *See id.* at 90,435.
540. *See id.* at 90,436.
541. *See id.*
542. *See id.* at 90,436-37.
543. *See id.* at 90,437 (citing Metzger v. Commissioner, 38 F.3d 118 (4th Cir. 1994); Rev. Rul. 96-56, 1996-2 C.B. 161).
544. *See id.* at 90,438.
545. *See id.*
546. *See id.* at 90,438-39.

In Private Letter Ruling 99-34-001,[547] a father-in-law's will established a trust to benefit his son, his son's wife, and his son's descendants.[548] The son died and the daughter-in-law learned of her interest in the trust.[549] The IRS ruled that the daughter-in-law's proposed disclaimer of her interest in the trust, if executed within nine months of learning of the existence of the transfer, would be timely and would not constitute a taxable gift. [550]

I. *Generation-Skipping Transfer Tax*

1. *Grandfathering Provisions*

In *Simpson v. United States,*[551] the decedent's spouse died in 1966 with a will that created a testamentary trust for the primary benefit of the decedent.[552] The trust gave the decedent a general power of appointment by will.[553] When the decedent died in 1993, she exercised the power in favor of her grandchildren.[554] The district court held that the exercise of the testamentary general power of appointment in favor of the grandchildren triggered the GSTT.[555] The issue was whether the transfer to the grandchildren was a transfer under a trust which was irrevocable on September 25, 1985, and therefore not subject to the GSTT.[556] The Eighth Circuit reversed the district court, holding that the power of appointment that made the transfer possible was created by the trust which became irrevocable on the death of the decedent's spouse in 1966.[557] As such, the transfer was not subject to GSTT because it was made pursuant to a trust which was irrevocable as of September 25, 1985.[558] The IRS has announced a non-acquiescence in the *Simpson* case.[559]

2. *Share of Estate Liable for Tax*

Unless otherwise directed by the governing instrument reference to the GSTT, the GSTT is charged to the property involved.[560] The following sample language is suggested as an example of a specific reference to the GSTT:

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547. Priv. Ltr. Rul. 99-34-011 (May 27, 1999).
548. *See id.*
549. *See id.*
550. *See id.*
551. Simpson v. United States, 183 F.3d 812 (8th Cir. 1999), *rev'g*, 17 F. Supp. 2d 972 (W.D. Mo. 1998).
552. *See id.* at 813.
553. *See id.*
554. *See id.*
555. *See id.*
556. *See id.*
557. *See id.* at 813-14.
558. *See id.* at 816.
559. *See* Action on Decision 200-9 I.R.B. 711.
560. *See* I.R.C. § 2603(b) (1994); *In re Estate of Tubbs,* 900 P.2d 865 (Kan. Ct. App. 1995) (discussing GSTT charged to property transferred, not to residuary of estate; will provision directing "all

> In the event there shall be imposed upon the estate of either of my children the so-called 'generation skipping tax' under Chapter 13 of the Internal Revenue Code, my Trustee shall advance to the estate of such of my children such amount as is necessary to make payment of tax, from the share of this Trust of such deceased child, prior to the distribution of such Trust's share as hereinabove provided.

J. *Activities of Executors/Administrators*

In *In re Estates of Stoskopf*,[561] a married couple died within a week of each other in December 1994.[562] Before their deaths, they had appointed a son as agent under their durable powers of attorney.[563] Acting as agent, the son purchased some of the parents' land and machinery at unspecified amounts without giving an accounting to two brothers.[564] In addition, the son, as agent, consistently refused to keep his brothers informed of his activities concerning managing the parents' assets and gave himself a ten-year lease on pastureland belonging to one of the brothers without that brother's consent or knowledge.[565] The parents' wills named the son as executor and the other two sons filed a petition to remove the executor on the basis that the son had violated certain fiduciary duties and had failed to act in good faith.[566] After the father's death, the son stopped making monthly rental payments to the estate, and substantial testimony revealed that the son provided misleading and inaccurate information to his brothers concerning his dealings involving his parents' assets before their deaths.[567]

The district court removed the son as executor of the estate and, on appeal, the Court of Appeals noted that the only statutory direction guiding when and how an executor should be removed is specified in section 59-1711 of the Kansas State Statute.[568] The court noted that the specific due process requirements afforded to an executor before removal was an issue of first impression in Kansas.[569] The court noted that an executor's removal is designed to protect the estate, rather than punish the

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other death taxes" to be paid from residuary not specific enough reference to shift burden of GSTT). *See also Estate of Monroe v. Commissioner,* 104 T.C. 352 (1995), *rev'd on other grounds*, 124 F.3d 699 (5th Cir. 1997) (delineating testamentary direct skips, not residuary); Priv. Ltr. Rul. 97-31-030 (May 5, 1997) (discussing GSTT payable from property, not residuary; will did not refer specifically to GST tax).

561. *In re* Estate of Stoskopf, 954 P.2d 712 (Kan. Ct. App. 1998).
562. *See id.* at 714.
563. *See id.*
564. *See id.*
565. *See id.*
566. *See id.*
567. *See id.*
568. *See id.* at 715.
569. *See id.*

executor, and, as such, the court could proceed in a summary manner by giving the executor notice of the petition to remove and an opportunity to show cause why the executor should not be removed.[570] The court noted that two hearings had been held, with the first being a full evidentiary hearing at which the executor was given an opportunity to rebut all allegations and evidence presented against him.[571] The court noted that the second hearing tended to support the brothers' allegations that the son had misappropriated the parents' assets before their deaths.[572] The court determined that sufficient evidence was present to establish that a genuine conflict existed between the brothers and son acting as executor, and held that the trial court removed the son as executor based upon facts legitimately before the court, and that the son, as executor, was afforded an opportunity to be heard at both hearings.[573] The court noted that the district court did not abuse its discretion by removing the son as executor without first finding that he had failed to refuse to perform his duties or the orders of the court.[574]

In *In re Estate of Harrison,*[575] the decedent died intestate survived by a spouse, children from a prior marriage and the decedent's mother.[576] Before death, the decedent had conveyed two parcels of real estate to himself and his parents as joint tenants and had designated his parents as beneficiaries of the decedent's retirement plan.[577] The decedent failed to notify his employer of his remarriage and did not obtain the second wife's consent to the designation of his parents as beneficiaries of the retirement plan.[578] The decedent also borrowed from the plan to finance a land purchase for himself and his parents as joint tenants.[579] The surviving spouse was appointed administrator and entered into a settlement agreement with the decedent's mother regarding the joint tenancy land.[580] The surviving spouse then used $19,000 in estate assets to pay the balance of the loan from the retirement plan.[581] The probate court ratified the payment of the $19,000 and the administrator's actions in the absence of the required statutory bond.[582] The probate court also determined that there was no justiciable controversy with respect to the settlement agreement between the decedent's mother and the surviving spouse, and also determined that the surviving spouse was not liable for conversion for failing to pay the proceeds from the settlement agreement into the estate, and that the surviving spouse was not liable for

570. *See id.* at 715-16.
571. *See id.* at 716.
572. *See id.*
573. *See id.*
574. *See id.* at 717.
575. *In re* Estate of Harrison, 967 P.2d 1091 (Kan. Ct. App. 1998).
576. *See id.* at 1093.
577. *See id.*
578. *See id.* at 1094.
579. *See id.*
580. *See id.*
581. *See id.*
582. *See id.*

conversion, embezzlement, fraud, or breach of fiduciary duty with respect to the decedent's retirement plan. [583]

The court of appeals ruled that the probate court did not err in ratifying the payment of the $19,000 of estate assets to pay the balance of the loan from the retirement plan, because the payment was in the estate's best interest.[584] The court also noted that no timely objection was made to the absence of statutory bond or to the surviving spouse's appointment as administrator.[585] Likewise, the settlement agreement involved property that was not part of the estate, thus there was no justiciable controversy concerning the agreement.[586] Because the settlement agreement concerned property that was not part of the estate, the decedent's two children from a prior marriage lacked standing to argue that the proceeds should have been included.[587] Likewise, the court of appeals held that the probate court did not err in finding no conversion, embezzlement, fraud, or breach of fiduciary duty regarding the retirement plan. [588]

K. *Medicaid Planning* [589]

1. *Trusts*

To be effective for Medicaid purposes, a trust must be established in a manner such that there is not an implied agreement to maintain the assets for the grantor's benefit.[590] For income-only irrevocable trusts, the grantor or the grantor's spouse must receive all of the income from the trust, but have no access to principal. If no portion of the principal can be distributed to the individual (i.e., an "income only" trust), then the trust principal is unavailable.[591] Similarly, assets contained in trusts established before April 7, 1986 "solely for the benefit of a mentally retarded individual who resides in an intermediate care facility for the mentally retarded" are not "available" assets for Medicaid eligibility purposes. [592]

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583. *See id.*
584. *See id.* at 1096.
585. *See id.* at 1097.
586. *See id.* at 1097-98.
587. *See id.*
588. *See id.*
589. For a detailed discussion of Medicaid planning, *see* Roger A. McEowen, *Estate Planning for Farm and Ranch Families Facing Long-Term Health Care*, 73 NEB. L. REV. 104, 104-141 (1994).
590. *See, e.g.*, Estate of Philippson, 399 N.Y.S.2d 358 (N.Y. Surr. Ct. 1977) (discussing decedent who made lifetime transfer of all assets to nephew and surviving spouse brought action to recover money; court allowed recovery upon finding an implied promise to take care of decedent).
591. *See, e.g.*, Ahern v. Thomas, 733 A.2d 756, 769 (Conn. 1999).
592. Martin v. Kansas Dept. of Social & Rehabilitation Serv., 988 P.2d 1217, 1219 (Kan. Ct. App. 1999) (discussing a discretionary trust established in 1978 for a mentally retarded person).

In *Sullivan v. County of Suffolk,*[593] the plaintiff sued the defendant and members of its police department after being shot in the back by an officer.[594] During the pendency of the action, the plaintiff sought and began receiving Medicaid benefits.[595] The defendant filed a Medicaid lien against the plaintiff's tort action and any resulting proceeds.[596] The lawsuit was eventually settled and the plaintiff proposed a settlement order and supplemental needs trust that deferred payment of the Medicaid lien until the plaintiff died.[597] The district court ruled that the plaintiff had to pay the Medicaid lien *before* using the settlement proceeds to establish the supplemental needs trust.[598] The plaintiff appealed, arguing that the plain language of section 1396p(d) of the federal Medicaid statute authorized him to defer reimbursement until his death, at which time the state would be reimbursed for the medical assistance provided him throughout his lifetime.[599] The plaintiff argued that section 1396p(d) required that the state be reimbursed for the "total medical assistance paid" at the time a trust beneficiary dies.[600] The Second Circuit rejected the plaintiff's reasoning, holding that the federal Medicaid eligibility rules do not govern the issue of Medicaid lien priority.[601] Instead, the court ruled that the issue of priority was controlled by the state and federal assignment and subrogation laws.[602] The court also rejected the plaintiff's argument that deferral of reimbursement in no way altered the state's right to pursue its subrogation rights.[603]

2. *Estate Recovery*

In *In re Estate of Kirk*,[604] the decedent moved to a nursing home in July of 1993 and began receiving Medicaid benefits.[605] The decedent's husband remained in the marital home until his death in late 1995.[606] The husband's will devised all of his property to the decedent.[607] The husband owned real and personal property valued at $30,000, as well as property held in joint tenancy with the decedent, valued at $26,000.[608] The decedent died three months later in early 1996.[609] The beneficiaries

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593. Sullivan v. County of Suffolk, 174 F.3d 282 (2d Cir. 1999).
594. *See id.* at 283.
595. *See id.* at 284.
596. *See id.*
597. *See id.*
598. *See id.*
599. *See id.* at 284-85.
600. *See id.* at 285.
601. *See id.* at 286.
602. *See id.*
603. *See id.*
604. *In re* Estate of Kirk, 591 N.W.2d 630 (Iowa 1999).
605. *See id.* at 632.
606. *See id.*
607. *See id.*
608. *See id.*
609. *See id.*

under the decedent's will were her three daughters.[610] Within nine months after the husband's death, the executor of the decedent's estate filed a disclaimer of all real and personal property passing from the husband's estate.[611] The disclaimer also included the property held in joint tenancy.[612] The state Medicaid agency filed a claim in the decedent's estate for $41,612, seeking to recover the Medicaid benefits paid to the decedent.[613] The state agency also filed a similar claim in the predeceased husband's estate to recover the cost of the surviving spouse's care. [614]

The district court determined that the husband's estate was not responsible for the Medicaid assistance provided to the decedent.[615] The court also ruled that the executor of the decedent's estate had validly disclaimed the transfer of property from her predeceased husband's estate and that all of the husband's property passed to the daughters free from the state Medicaid agency's claim.[616] The state Medicaid agency appealed, claiming that a disclaimer is against public policy when made to avoid the payment of a Medicaid claim in an estate.[617] The state Medicaid agency also argued that the executor could disclaim only what the decedent inherited, not the portion of the joint tenancy property she already owned. [618]

The Iowa Supreme Court upheld the district court's determination that the disclaimer was proper, but limited the disclaimer to the portion of the jointly held property the decedent actually inherited.[619] The court distinguished between a proportional interest (a joint tenant's interest at the joint tenancy's creation) and an accretive interest (the interest the survivor receives at the death of another joint tenant).[620] Because the decedent acquired her proportional interest in the property at the time the tenancy was created, the court ruled that the disclaimer of joint tenancy property was limited to the accretive interest. [621]

In *In re Estate of Jobe,*[622] a couple's marital home was placed in joint tenancy.[623] In 1993, the husband entered a nursing home and received Medicaid until his death in late 1995.[624] The surviving spouse died in 1996.[625] The home, valued at

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610. *See id.*
611. *See id.*
612. *See id.*
613. *See id.*
614. *See id.*
615. *See id.*
616. *See id.*
617. *See id.*
618. *See id.*
619. *See id.* at 634.
620. *See id.* at 634-35.
621. *See id.* at 635.
622. *In re* Estate of Jobe, 590 N.W.2d 162 (Minn. Ct. App. 1999).
623. *See id.* at 164.
624. *See id.*
625. *See id.*

approximately $35,000, was the only asset in the surviving spouse's estate.[626] In 1998, the county Department of Social Services filed a claim against the surviving spouse's estate for reimbursement of $67,768 in Medicaid benefits provided to the husband.[627] The district court directed the estate to allow the claim, and the estate appealed, arguing that the state statute on which the county based its claim conflicted with federal Medicaid law.[628] Federal law grants states the option to define an individual's estate to include "other" assets in which the decedent held "any legal title or interest at the time of death," including "assets conveyed . . . through joint tenancy . . . or other arrangement."[629] The estate argued that Minnesota law exceeded this authority by allowing recovery from the "estate of a surviving spouse" and from assets owned by a spouse "at any time during the marriage."[630] The estate also argued that allowing claims against surviving spouses' estates is contrary to the asset allocation and spend-down provisions of both federal and state law, which promised that once allocations and spend-downs are met, the assets allocated to the community spouse are no longer "available." [631]

The Minnesota Court of Appeals held that federal law "clearly and unambiguously authorizes a state to define an individual's estate to include non-probate assets, such as those conveyed to a survivor spouse to joint tenancy."[632] The court reasoned that accepting the estate's position would render portions of the federal statute meaningless.[633] As to the estate's argument that the statute violates spend-down provisions, the court held that once a community spouse dies and no longer requires protection from impoverishment, allowing a state to recover Medicaid benefits "furthers the broader purpose of funding future services to the medically needy." [634]

3. *Miscellaneous*

In *Kessman v. Ulster County Department of Social Services*,[635] the plaintiff's wife moved to a nursing home in late 1994, where she remained until her death in late 1997.[636] The plaintiff applied for medical assistance on his wife's behalf in 1996.[637] The application was denied on the ground that the couple's combined resources

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626. *See id.*
627. *See id.*
628. *See id.*
629. 42 U.S.C. § 1396p(b)(4)(B) (1994).
630. *See In re* Estate of Jobe, 590 N.W.2d at 166.
631. *See id.*
632. *Id.* at 165.
633. *See id.* at 166.
634. *Id.*
635. *In re* Kessman v. Ulster County Dep't of Social Serv., 686 N.Y.S.2d 142 (N.Y. App. Div. 1999).
636. *See id.* at 142.
637. *See id.*

rendered the wife ineligible for medical assistance.[638] The plaintiff challenged the denial arguing that the defendant erred in including the couple's resources the plaintiffs twenty-five percent interest in the assets of a family-owned corporation.[639] State law exempted the equity value of business property that was "income-producing" from consideration when determining Medicaid eligibility. [640]

At a fair hearing, the plaintiff testified that he did not receive income from the family-owned corporation, but did receive payment of certain contractual obligations owed to him by the family corporation arising from the sale of a business entity.[641] The corporate account reported that the fair market value of the plaintiff's interest in the corporation was approximately $122,000, but that because it was a minority interest in a closely-held corporation the plaintiff's interest was actually worthless.[642] The court ruled that the plaintiff's testimony and the accountant's report supported the defendant's determination that the company was not "income-producing business property."[643] The fair market value of the plaintiff's interest was therefore included among the couple's resources in determining Medicaid eligibility, rendering the wife ineligible for medical assistance. [644]

Senate Republicans have introduced an amendment to managed care reform legislation that would allow individuals to deduct all of their expenses for long-term care insurance beginning in year 2000 for any long-term care insurance they do not receive through their employer.[645] The proposal would also allow qualified long-term care insurance to be included in cafeteria plans, flexible spending arrangements, and health flexible spending accounts. [646]

L. *Wills and Trusts*

In *In re Estate of Mildrexter*,[647] the decedent's will left all of the decedent's "other personal property" that had not been specifically disposed of to the decedent's only surviving sister.[648] The will also required the decedent's "real and personal property" to be auctioned with the proceeds going to the Mildrexter Foundation Trust.[649] The issue was whether all of the "personal property" other than real estate

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638. *See id.*
639. *See id.* at 143.
640. *See id.*
641. *See id.*
642. *See id.*
643. *See id.*
644. *See id.*
645. *See* Long Term Care and Retirement Security Act of 2000, S. 2225, 106th Cong. § 2 (2000).
646. *See id.*
647. *In re* Estate of Mildrexter, 971 P.2d 758 (Kan. Ct. App. 1999).
648. *See id.* at 760.
649. *See id.*

passed to the surviving sister.[650] Paragraph 24 of the decedent's will provided: "I request my executors to have an auction amongst my family members . . . to auction off my other personal property items not specifically bequeathed. The proceeds shall be divided equally between my brothers and sisters who survive me."[651] Paragraph 29 of the decedent's will, however, "authorized her executors to sell all of the balance of her real and personal property at public auction or private sale, with the proceeds to pass under the residuary clause of her will."[652] The residuary clause directed that "[a]ll of my property, both real and personal, wherever the same may be situated, subject only to the special provisions set forth in this my last will and testament, shall go to the Frank and Marie Mildrexter Foundation Trust."[653] The decedent's sister requested that the district court construe the will such that all of the decedent's "personal property, not just personal effects, be subject to paragraph 24, the private family provision of the will."[654] The district court, however, concluded that the will provisions were not ambiguous and the decedent's "clear intent as expressed in paragraph 24 was that 'personal property items' meant personal effects such as household goods and personal belongings and did not include stocks, CDs, and the other personal property that would pass under the residuary clause." [655]

The Court of Appeals affirmed the district court, noting that if any part of a will restricts or qualifies the general term "personal property," that term must be so restricted and qualified.[656] Accordingly, the court determined that it appeared that it was the decedent's intent to only subject household items and personal effects to auction.[657] The court took special note that the language of paragraph 24 including the phrase "other personal property items" directly followed twenty specific bequests of household items and indicated only those same type of items were to be sold at the auction.[658] In addition, the court noted that paragraph 24 did not contain an expansive phrase requiring "personal property" to be interpreted as all property except real estate.[659] The decedent, however, did use such expansive terms elsewhere in the will, indicating that the decedent could have used them in paragraph 24 if she had intended.[660] As such, the court held that it was the decedent's "expressed intent that only personal property items of the type previously bequeathed in paragraphs 4 through 23 were to be auctioned under paragraph 24, and the balance of real and

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650. *See id.*
651. *Id.* at 759-60.
652. *Id.* at 760.
653. *Id.*
654. *Id.*
655. *Id.*
656. *See id.* at 761.
657. *See id.*
658. *See id.*
659. *See id.*
660. *See id.*

personal property, unless otherwise specifically bequeathed or devised, was to pass in accordance with the residuary clause."[661]

In *In re Estate of Jetter,*[662] the decedent and his brother were lifelong bachelors who farmed and ranched.[663] In 1981, the decedent contacted an attorney to have a will prepared leaving his entire estate to his brother.[664] The third provision of the will provided:

> I have intentionally omitted all of my heirs and all other persons whomsoever, who are not specifically mentioned herein, and I hereby generally and specifically disinherit each and all persons whomsoever claiming to be my heirs-at-law and each and all persons whomsoever who, if I died intestate, would be entitled to any part of my estate except as those herein provided for.[665]

The brother contacted the same attorney the next year and executed a nearly identical will, leaving everything to the decedent.[666] The brother died in 1990, at which time the decedent was incompetent.[667] Upon the decedent's death in 1996, his 1981 will was admitted into probate, and the personal representative petitioned for a determination of heirship.[668]

At the probate hearing, the contestants were cousins claiming through the decedent's mother, nieces and nephews claiming through an alleged half-brother, and the state of South Dakota.[669] The state claimed that because the decedent's will contained no residuary clause, and because the decedent specifically disinherited all persons claiming as intestate heirs, that the entire estate escheated.[670] The trial court determined that the will provision was ineffective to dispose of the decedent's property and denied the state's claim, and directed that the property be distributed according to state intestate succession law.[671] The state appealed, and the South Dakota Supreme Court affirmed the trial court and held that the will provision was designed simply to prevent any person from claiming as a pretermitted heir, and did not operate as an effective disposition of property.[672] The Supreme Court thus remanded the case for completion of the probate proceedings.[673]

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661. *Id.*
662. *In re* Estate of Jetter, 590 N.W.2d 254 (S.D. 1999).
663. *See id.* at 256.
664. *See id.*
665. *Id.*
666. *See id.*
667. S*ee id.*
668. *See id.*
669. *See id.*
670. *See id.*
671. *See id.*
672. *See id.*
673. *See id.*

On remand, the court determined that there was sufficient evidence that the decedent's father had a bastard child in 1899, one year before immigrating to the United States in 1900.[674] The child then joined his alleged father in the United States in 1922.[675] Accordingly, the child was a half-brother of the decedent and the child's heirs were intestate successors.[676] Because the court had already determined that the will provision was ineffective, it prevented the decedent's cousins on both sides from re-litigating the issue of the meaning of the will language. [677]

In *Martone v. Martone*,[678] the decedent died leaving a widow, four adult children from a prior marriage, grandchildren and great-grandchildren.[679] The surviving spouse filed an application for probate of a will executed by the decedent one year before death, and gave notice to the four adult children.[680] The children contested the admission of the will to probate on grounds of lack of testamentary capacity and existence of undue influence.[681] The court ordered all testamentary documents of the decedent to be filed.[682] In accordance with this ruling, another will executed one month before the will that was originally offered for probate was filed along with a pour-over will executed four years earlier.[683] The pour-over will was executed the same day as an inter vivos trust. [684]

Under the pour-over will, the grandchildren and great-grandchildren would take only from the income of the estate while the estate assets were in the hands of the executor and before they were transferred to the trustee.[685] The amounts to be distributed were in the sole discretion of the trustee.[686] As a result, the trial court ruled that the decedent's nine-year-old granddaughter, as a member of the class of "issue" mentioned in the pour-over will, did not have standing to contest the admission to probate of the later executed will.[687] The Virginia Supreme Court affirmed the trial court on this issue, determining that the granddaughter did not have the requisite status as a "person interested" in the estate, as that term is used under Virginia law. [688]

The court characterized the granddaughter's interest as a "mere expectancy, not a legally ascertainable right."[689] Interestingly, the court did not characterize the

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674. *See id.* at 257.
675. *See id.*
676. *See id.* at 258.
677. *See id.* at 260.
678. Martone v. Martone, 509 S.E.2d 302 (Va. 1999).
679. *See id*. at 304.
680. *See id.*
681. *See id.*
682. *See id.*
683. *See id.* at 304-05.
684. *See id.* at 305.
685. *See id.*
686. *See id.*
687. *See id.* at 304.
688. *See id.* at 306.
689. *Id.*

granddaughter's interest as an interest of a beneficiary in a discretionary trust.[690] Generally, beneficiaries of discretionary trusts are treated as having a property interest, not a mere expectancy.[691]

In *Linkous v. Candler*,[692] the decedent and her spouse created an irrevocable trust incident to their divorce.[693] The trust provided that the net income was to be distributed to the decedent during life, and upon the decedent's death, to the decedent's soon to be ex-spouse and the decedent's then living children.[694] If any child died leaving issue, the issue were to take the deceased child's share of the income.[695] Upon the death of the last surviving child of the decedent and the ex-spouse, the trust was to be divided among the then living grandchildren.[696]

There were four children alive at the time of the trust creation and three at the time of the decedent's death.[697] Upon the decedent's death, the three surviving children all renounced their interests and sought immediate distribution to the remaindermen grandchildren.[698]

The court, reversing a lower court decree, held that inasmuch as the trust instrument provided for distribution to the surviving grandchildren, acceleration would not be consistent with the dispositive plan of the settlors.[699] The court emphasized that the class of grandchildren remained open during the lives of their parents.[700] According to the court, acceleration would "deprive potential class members of their share of the trust."[701]

In re Estate of Kleinman[702] involved construction of a provision of the Uniform Probate Code (UPC) in Utah, a UPC state.[703] The UPC allows holographic wills and also allows the testator to use a separate "list" to dispose of tangible personal property.[704] In this case, the decedent drew up an instrument labeled "tangible personal property."[705] Under the terms of the instrument, two charities were to receive certain funds.[706] Because the instrument was in the decedent's handwriting and was

690. *See id.*
691. *See id.* at 307.
692. Linkous v. Candler, 508 S.E.2d 657 (Ga. 1998).
693. *See id.* at 658.
694. *See id.*
695. *See id.*
696. *See id.*
697. *See id.*
698. *See id.*
699. *See id.* at 659.
700. *See id.*
701. *Id.*
702. *In re* Estate of Kleinman, 970 P.2d 1286 (Utah 1998).
703. *See id.* at 1288.
704. *See id.*
705. *See id.* at 1287.
706. *See id.*

signed, the court concluded that it could be considered a valid holographic codicil.[707] The court reasoned that this interpretation was consistent with the decedent's intent.[708] A dissenting judge would have found that the document was not executed with the requisite testamentary intent so as to qualify as a valid holographic will.[709] The dissenting judge reasoned that because the decedent labeled the document "tangible personal property," the decedent intended the document as something other than a will.[710] In addition, the dissenting judge would have held that the instrument could not have qualified as a "list" because the UPC does not allow a "list" to be used to dispose of cash, which is intangible personal property.[711]

Estate of Hume v. Klank[712] is an ademption by extinction case. The decedent, a lawyer, died with a holographic will in existence.[713] The will specifically devised the decedent's Atlanta residence to Meredith Klank, with the residue passing to the University of the South.[714] Before death, the decedent defaulted on the mortgage on the Atlanta property.[715] A foreclosure sale took place and yielded approximately $55,000 of surplus proceeds.[716] By this time, the decedent was dead and his estate was probated.[717] The question before the court was whether the proceeds of the foreclosure sale were to be distributed to the specific devisee, Klank, or to the residuary devisee.[718]

Both the trial court and court of appeals ruled in Klank's favor.[719] On appeal, the Tennessee Supreme Court reversed, holding that the proper test was whether the specific item devised was in the decedent's estate at the time of the decedent's death.[720] Because the residence was not in the decedent's estate at the time of death, it was adeemed.[721]

In *In re Estate of Nagel*,[722] a husband and wife placed their property in living revocable trusts.[723] The settlors were killed simultaneously in an accident that

707. *See id.* at 1289.
708. *See id.*
709. *See id.* at 1292.
710. *See id.* at 1294 (Zimmerman, J., dissenting).
711. *See id.* at 1290 (Zimmerman, J., dissenting).
712. Estate of Hume v. Klank, 984 S.W.2d 602 (Tenn. 1999).
713. *See id.* at 603.
714. *See id.*
715. *See id.*
716. *See id.*
717. *See id.*
718. *See id.*
719. *See id.*
720. *See id.* at 605.
721. *See id.* The UPC has significantly altered the requirement that the "specific property" remain in the estate by express "non-ademption" rules. *See* UNIF. PROBATE CODE § 2-606 (amended 1997), 8 U.L.A. 13 (Supp. 1999). Not all jurisdictions have statutory rules pertaining to ademption.
722. *In re* Estate of Nagel, 580 N.W.2d 810 (Iowa 1998).
723. *See id.* at 811.

precipitated a tort action brought by the estate of a third person, also killed in the accident.[724] Both trusts contained the following provision:

> Upon the death of the trustor: This trust shall become irrevocable and there shall first be paid from the trust all expenses of the last illness and funeral of the Trustor, any indebtedness owed by the Trustor and any estate tax, gift tax, inheritance tax or income tax owed by the Trustor. [725]

The executor of the third party's estate brought an action for declaratory judgment, asserting the trusts' assets should be subject to the wrongful-death claim of the third party's estate. [726]

The Iowa Supreme Court affirmed the district court's determination that the assets of the trust were available to satisfy any wrongful-death judgment entered in favor of the third party's estate.[727] The court noted that the husband and wife had designated themselves as one of the beneficiaries of their respective trusts with their children as the remaining beneficiaries and as successor-trustees.[728] The court noted that when a trust is created for the settlor's own benefit, the settlor's creditors can reach any trust assets available to the settlor.[729] The court reasoned that this rule promoted a valid public policy of not allowing persons to shelter their assets from creditors in a discretionary trust of which the settlor is a beneficiary and thus be able to enjoy the benefits of property ownership without any of the burdens. [730]

While the successor trustees claimed that, in order to reach the trusts' assets, it was necessary to find that the settlors created the trusts with the intent to avoid their creditors, the court determined that such a finding was unnecessary because it was irrelevant if a settlor intended to defraud creditors or was solvent at the time of the creation of the trust.[731] The court also noted that if the settlors had survived the accident and the third party's estate recovered on the wrongful-death claim, the assets of the trust could be used to satisfy a judgment against them. [732]

While the court noted that the settlor's powers to amend or revoke the trusts, or to direct payment from it, died with them, and the remainder beneficiaries' interest in the trust became vested, that was still insufficient to bar a creditor from reaching the trust's assets.[733] The court did cite an Ohio case which held, in 1939, that when the settlor of a revocable living trust dies, the property is no longer subject to his debts.[734]

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724. *See id.*
725. *Id.*
726. *See id.*
727. *See id.* at 812.
728. *See id* at 811.
729. *See id.*
730. *See id.*
731. *See id.* at 811-12
732. *See id.*
733. *See id.* at 812.
734. *See id.* (citing Schofield v. Cleveland Trust Co., 21 N.E.2d 119, 122-23 (1939)).

However, the court also cited other authority to the contrary.[735] The successor trustees also argued that the trusts' assets should not be reachable because the contingent wrongful-death claim was not a "debt" required to be paid out of the trust.[736] The successor trustee's pointed to the language of the trusts that stated "any indebtedness owed by the trustor" for support that the debt must have arisen during the settlor's lifetime in order for the trusts' assets to be reached.[737] The court disagreed, noting that the facts precipitating the tort claim occurred during the settlor's lifetime.[738]

In *In re Estate of Wilkins*,[739] the decedent died in 1988 survived by a brother and three sisters and an alleged non-marital child, Michael Minor.[740] The decedent left a hand-written will that was executed four years before Michael's birth under which the decedent left his estate in varying percentages to his brother and sisters.[741] Michael did not commence a paternity proceeding in family court until January of 1997.[742] The question presented was whether the non-marital child could inherit from his father under New York law.[743] New York law specifies that where there is no order of filiation or duly filed acknowledgment of paternity, clear and convincing evidence of paternity must be present as well as evidence that the father had openly and notoriously acknowledged the child as his own.[744] The court determined that sufficient evidence was present such that no other conclusion could be reached than that the child was the decedent's son.[745] Accordingly, the son acquired the rights of a pretermitted heir and was entitled to his intestate share of the decedent's estate which, in this case, was the entire estate.[746]

In *In re Estate of Wells*,[747] the decedent executed a last will and testament containing an in terrorem clause.[748] At the time the will was executed, the decedent was divorced, and the ex-spouse executed a valid consent, waiving her statutory rights.[749] Later the same day, the decedent and ex-spouse remarried.[750] Three months later, the decedent adopted his spouse's daughter.[751] Three months after the adoption, the decedent executed a codicil leaving his spouse additional vehicles and real estate

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735. *See id.* (citations omitted).
736. *See id.*
737. *Id.*
738. *See id.*
739. *In re* Estate of Wilkins, 691 N.Y.S.2d 878 (N.Y. App. Div. 1999).
740. *See id.* at 879.
741. *See id.*
742. *See id.*
743. *See id.*
744. *See id.* at 880.
745. *See id.* at 881.
746. *See id.*
747. *See In re* Estate of Wells, 983 P.2d 279 (Kan. Ct. App. 1999).
748. *See id.* at 281.
749. *See id.*
750. *See id.* at 280.
751. *See id.*

and adding the spouse to the list of residuary legatees.[752] The codicil contained a provision noting that the decedent was confirming and republishing his will in all respects except as indicated by the codicil.[753] The spouse executed a consent, waiving her statutory rights as surviving spouse.[754] Two weeks later, the decedent executed a second codicil designed to correct typographical errors, but which was essentially identical to the first codicil.[755] The second codicil also contained a clause confirming and republishing the decedent's will.[756] Again, the spouse executed a consent waiving her statutory rights as a surviving spouse.[757] The decedent died two days after executing the second codicil.[758] The will was admitted to probate and the spouse's consents were determined to be valid.[759] Later, the surviving spouse claimed the decedent's will was invalid on the basis that her subsequent marriage to the decedent and the decedent's adoption of the spouse's daughter revoked the will in accordance with Kansas Statute section 59-610, and that, therefore, the decedent died intestate.[760] section 59-610 states that: "if after making a will the testator marries and has a child, by birth or adoption, the will is thereby revoked." [761]

Consequently, the spouse requested a denial of the will to probate.[762] The executor argued that the decedent had republished his will by virtue of the codicils, and that the surviving spouse had not objected to admission of the will to probate.[763] The trial court determined that the decedent's codicils republished his will and that section 59-610 did not apply.[764] The trial court also determined that the purpose of the surviving spouse's assertion of invalidity of the will potentially invoked the will's in terrorem clause.[765] However, the trial court determined that the surviving spouse had probable cause to contest the will and refused to invoke the in terrorem clause. [766]

On appeal, the court noted that the surviving spouse did not oppose admission of the will to probate and did not appeal the order admitting the will to probate or the determination of the validity of the consents.[767] Under Kansas law, probate courts have "continuing control over their own orders, judgments and decrees for 30 days."[768]

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752. *See id.* at 280-81.
753. *See id.* at 281.
754. *See id.*
755. *See id.*
756. *See id.*
757. *See id.*
758. *See id.*
759. *See id.*
760. *See id.*
761. KAN. STAT. ANN. § 59-610 (1994).
762. *See In re Estate of Wells*, 938 P.2d at 281.
763. *See id.*
764. *See id.*
765. *See id.*
766. *See id.* at 282.
767. *See id.*
768. *Id.*

Thereafter, vacating or modifying a judgment is controlled by section 60-260(b).[769] Because the surviving spouse filed her petition fifty days after the court's order, 60-260(b) represented her only avenue for relief in the district court.[770] Thus, the surviving spouse's assertion that the will was void under 59-610 failed on a procedural basis. While the court noted that there were no Kansas decisions directly addressing whether republication by a subsequent codicil revives a will after statutory revocation, the court did note that there were no decisions from any jurisdictions suggesting a prohibition of such a revival.[771] Thus, the court reversed the trial court and determined that a will revoked pursuant to section 59-610 by marriage and subsequent birth or adoption of a child may be revived by republication through a codicil or other instrument which meets the necessary testamentary formalities.[772] As a result, the in terrorem clause was upheld against the surviving spouse.[773]

M. *Pre-Marital Agreements*

In *King v. Estate of King*,[774] the plaintiff entered into a prenuptial agreement with her husband before his death, specifying that each party would "retain as his or her sole property all of the real or personal property owned by each of them at the time of their marriage or that they came into the possession of during the course of their marriage."[775] The prenuptial agreement contained an exception specifying that the parties were going to jointly purchase a residence and would each invest $60,000 toward the purchase.[776] The exception specified that the parties agreed that upon the death of the first of them, the survivor was to have the right to remain in the home as long as the survivor could maintain the property as a primary residence or until death, whichever occurred first.[777] The exception specified that if the survivor was no longer able to maintain the property as a residence, the property was to be sold with the net proceeds divided equally between the survivor and the pre-deceased spouse's children.[778] If the property was owned until the survivor's death, upon the death of the survivor, the exception specified that the residence was to be sold with the net proceeds divided equally between the children of each of the spouses.[779] The home was purchased and a deed was signed by both parties as joint tenants with the right of survivorship and not as tenants in common.[780]

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769. *See id.*
770. *See id.*
771. *See id.* at 283.
772. *See id.*
773. *See id.*
774. King v. Estate of King, 962 P.2d 1118 (Kan. Ct. App. 1998).
775. *Id.* at 1118.
776. *See id.* at 1118-19.
777. *See id.* at 1119.
778. *See id.*
779. *See id.*
780. *See id.*

Slightly more than two years later, the husband died and the surviving spouse filed a petition seeking to quiet title to the residence solely in her name.[781] The surviving spouse argued that the residence was not subject to the prenuptial agreement because the joint tenancy deed gave her legal title to the property at the moment of her husband's death.[782] The decedent's estate filed a motion for summary judgment on the basis that the residence was subject to the prenuptial agreement and that the surviving spouse, therefore, was not the fee simple owner of the real estate.[783] The trial court granted the estate's motion for summary judgment.[784]

On appeal, the surviving spouse maintained that the joint tenancy deeds were an amendment to the agreement, and, therefore, superseded the prenuptial agreement.[785] The court disagreed, noting that there was no conflict between the deeds and the premarital agreement.[786] By adding the exception to the prenuptial agreement, the court noted that "the parties clearly indicated their desire to have the property distributed evenly to their respective estates upon the death of both parties."[787] As such, the exception was not ambiguous and did not require construction.[788] The court also noted that without the joint tenancy provision in the deeds, the decedent's heirs would have become one-half owners in the real estate upon his death.[789] As a result, the heirs could have demanded that the surviving spouse sell the house and provide them with one-half of the proceeds, leaving the surviving spouse without a residence.[790] The court reasoned that the parties contemplated this potential event and included the exception in the prenuptial agreement to avoid the problem.[791]

N. *Administrative Expenses*

In *Lindberg v. United States*,[792] the decedent's will provided for bequests to the decedent's charitable foundation.[793] The decedent's heirs hired attorneys to prepare litigation against the decedent, the foundation and the foundation trustee for tortious interference with inheritance.[794] The parties entered into negotiations after the decedent's death and reached a settlement which included additional payments to the

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781. *See id.*
782. *See id.*
783. *See id.*
784. *See id.*
785. *See id.*
786. *See id.*
787. *Id.* at 1120.
788. *See id.*
789. *See id.*
790. *See id.*
791. *See id.*
792. Lindberg v. United States, 164 F.3d 1312 (10th Cir. 1999), *aff'g*, 927 F. Supp. 1401 (Colo. 1996).
793. *See id.* at 1315.
794. *See id.* at 1316.

heirs from the foundation bequest.[795] The foundation stated that the settlement was reached in order to avoid the legal costs of litigation.[796] The decedent's estate deducted the settlement payments as either a claim against the estate or administrative expenses.[797] The court denied the deduction, holding that the settlement was a nondeductible distribution to heirs because the cause of action for interference with inheritance could not have been brought against the decedent, but was a liability of the foundation or its trustee.[798] The court held that the settlement was not a deductible administrative expense because the estate was not benefited or diminished by the action.[799]

O. *Legislation*

Legislation has been introduced into the United States House of Representatives that would extend the deadline for filing federal estate tax returns from nine months to twenty-four months after a decedent's death.[800]

III. CONCLUSION

Estate planning will continue to be one of the key "bread and butter" areas of practice for practitioners representing farmers and ranchers. This may be especially true for practitioners in rural areas with primarily a rural clientele.

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795. *See id.*
796. *See id.*
797. *See id.* at 1317.
798. *See id.* at 1320.
799. *See id.* at 1321.
800. *See* H.R. 1783, 106th Cong. (1999).