the will & the way

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The Chair's Comments

Craig Dalton

The Legislative Committee, under the leadership of Rebecca Smitherman, Chair, and Linda Johnson, Vice Chair, has drafted and submitted a bill to the Legislature containing eight provisions related to estate planning and estate administration issues. As of the date of this Article, the bill has been adopted by the House of Representatives and will likely be adopted by the Senate. A number of the provisions are quite progressive and will provide useful new tools to the estate planner. The following is a summary of some of the new laws.

1. Living Probate

New N.C.G.S. Section 28A-2B-1 creates a process for probate of a will (or codicil) *before* the testator's death by filing a petition seeking a judicial declaration that the will or codicil is valid. Under the statute, the testator files the petition with the Clerk of Superior Court and the matter is treated as a contested estate proceeding under Article 2 of Chapter 28A.

At the hearing, the testator shall produce evidence necessary to establish that the will or codicil would be admitted to probate if the testator were deceased. If an interested party contests the validity of the will or codicil, that person must file a written challenge before the hearing or make an objection to the validity of the will or codicil at the hearing. Upon such a challenge, the Clerk will transfer the matter to the Superior Court and it will be heard as a caveat proceeding. If no interested party contests the validity of the will or codicil and if the Clerk determines that the will or codicil would be admitted to probate if the testator were deceased, the Clerk will enter an order adjudging the will or codicil to be valid. Such order shall be binding on all parties to the proceeding, and no party bound by the judgment shall have any further right to caveat to the will or codicil when such document is entered into probate. However,

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Kaestner and the Future of North Carolina Fiduciary Income Taxation

By Carl L. King

On April 23, 2015, North Carolina's state fiduciary income tax was held to be unconstitutional as imposed upon the income earned and accumulated by an out-of-state trust in the case of **The Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Dep't of Rev.**, No. 12 CVS 8740, 2015 WL 1880607 (N.C. Sup. Ct, 2015), by Judge Gregory P. McGuire, Special Superior Court Judge for Complex Business Cases. This article explores the questions trustees and their tax advisors should ask and the action steps they should take in response to this important decision.

The Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Dep't of Rev. – Summary of Facts, Ruling, and Procedural Posture

Kimberly Rice Kaestner was one of the beneficiaries of a family trust established by her father, a New York resident, under New York law in 1992. Kaestner relocated to North Carolina in 1997. Kaestner's share of the family trust was separated from the primary trust in 2006, forming the Kimberly Rice Kaestner 1992 Family Trust (the "Kaestner Trust"). Ms. Kaestner and her three children were the only current beneficiaries of the Kaestner Trust. All decisions regarding the Kaestner Trust investments and distributions were at the sole discretion of the trustee. At no

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if a party shows by clear and convincing evidence that before or during the hearing, the testator was subject to duress or coercion, the party may file a motion to be permitted to file a caveat. The statute allows for confidentiality with respect to the proceedings. Upon receipt of a motion, the Clerk may seal the contents of the file from public inspection and the file may not be released to any person other than the petitioner or the testator.

2. Uniform Powers of Appointment Act

A new statute, N.C.G.S. Chapter 31D, adds the North Carolina Uniform Powers of Appointment Act. It provides a number of planning opportunities with respect to powers of appointment and provides clarity with respect to creation and exercise of powers of appointment. The Act applies to a power of appointment created before, on, or after the effective date of the Act. A general power of appointment means a power of appointment exercisable in favor of the power holder, his estate or a creditor of the power holder or his estate. All other powers of appointment are referred to as a "non-general power of appointment" (previously often referred to as a limited power of appointment or a special power of appointment).

The Act clarifies when a power of appointment is deemed to be exercised:

1. By substantial compliance with the formal requirements, if any, imposed by the donor of the power;
2. By an instrument exercising the power and making specific reference to the power;
3. Through a residuary clause that contains either (a) a "blanket-exercisable clause" (a clause that uses the words "any power" of appointment); or (b) through a clause that specifically refers to and exercises a particular power of appointment; or
4. By a determination of intent to exercise the power of appointment based upon the terms of the residuary clause if certain requirements are met.

Note that unless the instrument exercising a power of appointment indicates a contrary intent, it will apply to a power of appointment acquired by the power holder after the power holder executes the instrument exercising the power.

A power holder may release a power of appointment unless the instrument creating the power prevents a release. The release is accomplished by compliance with the method provided in the instrument creating the power, and if no method is provided, by an instrument manifesting the power holder's intent by clear and convincing evidence.

3. Decanting From a Traditional Trust to a Supplemental Needs Trust

N.C.G.S. Section 36C-8-816.1 provides that a trustee under an original trust agreement granting the trustee the power to distribute principal and income of the trust to one or more current beneficiaries, may appoint all or a part of the principal or income of the original trust to a second trust, the beneficiaries of which are one or more of the beneficiaries of the original trust. The second trust may be in the form of a supplemental needs trust designed to allow a disabled beneficiary of the second trust to receive greater governmental benefits than the disabled beneficiary would receive under the original trust.

This new law provides flexibility where one of the beneficiaries of the original trust would be at risk of not qualifying for governmental benefits in the future due to the terms of the original trust.

I have enjoyed serving as Chair of the Section this year and on behalf of all the members of our Section, I want to thank the many members of our Section who have devoted their time and energy this year to serving as officers, Council members, committee members, and volunteers. In particular, on behalf of the Estate Planning and Fiduciary Law Section, I thank the members of the Legislative Committee for their hard work this year.

Craig G. Dalton Jr.

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time did a North Carolina resident or entity serve as trustee of either the family trust or the Kaestner Trust, and custody of all trust property was maintained outside of North Carolina at all times. During the years at issue, no distributions were made to any beneficiary in North Carolina.

Under N.C.G.S. Section 105-160.2, the North Carolina Department of Revenue ("NCDOR") considered the trust ripe for taxation. In tax years 2005-2008, North Carolina income tax was assessed on the income accumulated in the Kaestner Trust based on N.C.G.S. Section 105-160.2, which provides that a tax may be imposed on the taxable income of estates and trusts that are "for the benefit of a resident of this State." The Kaestner Trust challenged this statutory clause on the grounds that it violated the Due Process and the Commerce Clauses of the United States Constitution, as well as Article I, section 19 of the North Carolina Constitution. The Kaestner Trust argued that the statute was unconstitutional because it subjected an out-of-state trust to taxation by the state of North Carolina based solely on the residence of its beneficiaries within the state. The state did not dispute the facts, and the parties filed cross motions for summary judgment on the constitutional questions in Superior Court.

Judge McGuire ruled for the taxpayer on all issues. The Court concluded that the beneficiaries' mere residence in North Carolina, standing alone, was not a sufficient contact with the state to support the imposition of tax on the trust, and therefore, the portion of N.C.G.S. Section 105-160.2 taxing income "that is for the benefit of a resident of this State" violated the Due Process clause of the United States Constitution and Article I, Section 19 of the North Carolina Constitution. Additionally, the Court found that the portion of N.C.G.S. Section 105-160.2 at issue violated the Commerce Clause of the United States Constitution and Article I, Section 19 of the North Carolina Constitution because it failed the first and fourth prongs of the test set forth by the United States Supreme Court in **Complete Auto Transit, Inc. v. Brady**, 504 U.S. 274 (1977). Specifically, the North Carolina tax was applied to an activity having no "substantial nexus to the taxing state" and was not "fairly related to services provided by the state." **Complete Auto Transit, Inc. v. Brady** at 279. The Court ordered the NCDOR to "refund any and all taxes and penalties paid by Plaintiff pursuant to G.S. § 105-160.2, with interest." **Kaestner** at Para. 57.

On May 22nd, the NCDOR gave notice of its intention to appeal the decision, so it is unlikely that we have heard the last of **Kaestner**. Furthermore, on June 1, the Superior Court ordered a stay on the judgment (meaning that the NCDOR need not pay the refund to the Kaestner Trust) until the appeal is complete. Also of interest, on March 26, Senator Fletcher L. Hartsell Jr. introduced North Carolina Senate Bill 468, "An Act to Clarify Allocation of Trust Income," which seeks to proactively reform N.C.G.S. Section 105-160.2 to fix its perceived constitutional defects.

Which Trusts Are Affected by the Case?

Before this article addresses the actions fiduciaries should take, it is important to consider the scope of the **Kaestner** decision. **Kaestner** highlights our state's constitutional problem in taxing a trust under one relatively common factual scenario: where a beneficiary of a trust that is formed and administered out-of-state moves to North Carolina. As a matter of constitutional procedure, practitioners should note that the court did not hold the statute to be unconstitutional on its face (i.e., as to all taxpayers), but only as applied to the Kaestner Trust. The holding states: "Plaintiff has shown, beyond a reasonable doubt, that the portion of G.S. § 105-160.2 providing that a trust may be taxed on income 'that is for the benefit of a resident of this State' is unconstitutional under the Due Process and Commerce Clauses of the United States Constitution and Article 1, Section 19 of the North Carolina Constitution *as applied to Plaintiff in this case* where the only basis for imposition of the taxes is the beneficiaries' residence in the State of North Carolina." **Kaestner** at Para. 51 (emphasis added).

The **Kaestner** Court's holding leaves open the question of which trusts (and estates), if any, are properly subject to taxation under N.C.G.S. Section 105-160.2. The statute may be unconstitutional in several circumstances involving trusts.

First, despite the **Kaestner** Court's limitation of its holding to the Kaestner Trust, it seems clear that trusts like the Kaestner Trust—which were formed and administered out of state, where the trustee is domiciled out of state, where the trust owns no substantial North Carolina-situs assets, and where no distributions were made to North Carolina residents—are not properly subject to N.C.G.S. Section 105-160.2.

Second, while not addressed specifically by **Kaestner**, following the reasoning in the case, it seems likely that N.C.G.S. Section 105-160.2 is being unconstitutionally applied in another common factual scenario. Consider trusts with several beneficiaries that may have been formed and even administered in North Carolina, but where the primary beneficiary now resides in another state. A common example is a credit shelter trust held primarily for the benefit of a surviving spouse who has now relocated to a beach home in our sister state of South Carolina. Assume that, in addition to the nonresident surviving spouse, six North Carolina residents (two children and four grandchildren) are permissible secondary beneficiaries of the credit shelter trust. Where, as a matter of practice in such trusts, trustees accumulate trust income solely for the use of the out-of-state surviving spouse and discretionary distributions, when made, are paid solely to such spouse, North Carolina currently subjects such trusts to taxation "*where the only basis for imposition of the taxes is the* [secondary] *beneficiaries' residence in the State of North Carolina.*" Id. Following its present practice, the NCDOR would tax six sevenths, or 85.7 percent, of this trust's income. 17 NCAC 6B.3724(b). When the fiduciary income tax under N.C.G.S. Section 105-160.2 is levied upon "the taxable income of the estate or trust that is for the benefit of a resident of this State," and where as a matter of both trust administration and the settlor's intent, no income is in fact applied "for the benefit of a resident of this State," the reasoning in **Kaestner** suggests that N.C.G.S. Section 105-160.2 violates of the Due Process and Commerce clauses of the Constitution in this situation, as well.

Third, extending the logic of the preceding paragraph, except in extraordinarily rare cases where all distributions to all trust beneficiaries are exactly equal on a per capita basis, it seems that the NCDOR's current practice of per capita taxation of *all trusts that*

include both resident and nonresident beneficiaries (i) does not reflect a substantial nexus between North Carolina and the trusts' nonresident beneficiaries, and (ii) is not rationally or fairly related to services provided by North Carolina, thereby violating the Constitution. See **Complete Auto Transit, Inc. v. Brady** at 279 (first and fourth prongs); **McNeil v. Commonwealth of Pa**., 67 A.3d 185, 192 (Pa. Commw. Ct. 2013) (cited by the **Kaestner** court and holding Pennsylvania's fiduciary income tax unconstitutional under a case factually similar to **Kaestner**).

Finally, while this author feels that the following argument may be over-confident, some have argued that **Kaestner** may effectively render N.C.G.S. Section 105-160.2 unconstitutional as applied to *all* fiduciary income taxpayers. North Carolina is one of only five states to use the residence of a beneficiary as a factor in determining tax nexus. While California, Georgia, North Dakota, and Tennessee also take a beneficiary's residence into account, North Carolina stands alone in imposing tax based *exclusively* on the residence of the beneficiary. **Kaestner** held that "the portion of G.S. § 105-160.2 providing that a trust may be taxed on income 'that is for the benefit of a resident of this State' is unconstitutional under the Due Process and Commerce Clauses of the United States Constitution and Article 1, Section 19 of the North Carolina Constitution as applied to Plaintiff in this case *where the only basis for imposition of the taxes is the beneficiaries' residence in the State of North Carolina*." **Kaestner** at Para. 51 (emphasis added). However, not just in **Kaestner**, but in *every case*, under the plain language of N.C.G.S. Section 105-160.2 "the only basis for imposition of the taxes is the beneficiaries' residence in the State of North Carolina." Id. While the holding in **Kaestner** is limited to the Kaestner Trust, given the plain language of N.C.G.S. Section 105-160.2, it is *possible* that the logic of the decision indicates that the statute is unconstitutional on its face as applied to *all* fiduciary income taxpayers.

What Actions Should Trustees and Practitioners Take?

Trustees and their tax advisors should assess carefully whether their facts and income fall within the scope of the **Kaestner** holding and belong to one of the categories of trusts described above for which a viable argument that N.C.G.S. Section 105-160.2 is being unconstitutionally applied exists. These trusts should consider filing for a refund of prior taxes paid. The NCDOR's decision to appeal the **Kaestner** decision leaves the status of the law uncertain. What does seem certain (although of death and taxes, the latter may be absent in this rare instance) is that the NCDOR soon will receive an onslaught of requests for refunds by trusts that have been subject to taxation within the past three years.

Years not yet barred by the statute of limitations likely include calendar tax years 2014 (if filed), 2013, 2012, and 2011 in cases where the fiduciary income tax return was extended on a month and day less than three years from the month and day of filing for refund in 2015. N.C.G.S. § 105-241.6(a). Fiduciaries and their tax advisors carefully should review their trust clients' files to determine whether pursuing a refund is appropriate. Based upon the State of North Carolina's motion (and the **Kaestner** Court's subsequent order) to stay the refund in **Kaestner**, it seems probable that the state will not remit refunds until the appeal (and perhaps further related cases) is resolved.

Additionally, trustees and their tax advisors should explore whether relief may be available beyond the typical statute of limitations. They should be careful to consider whether "closed" tax years truly are closed. The general rule is that a statute, when declared unconstitutional, is as inoperative as if it had never been passed and never existed, and thus is void *ab initio*. **16A Am. Jur. 2D Constitutional Law § 195** (updated May 2012). Unconstitutionality dates from the time of a defective statute's enactment and not merely from the date of the decision finding it unconstitutional.

The burden for addressing this concern may lie with the State of North Carolina. As a general matter, the Due Process Clause of the Fourteenth Amendment requires that the state afford a meaningful post-deprivation remedy for taxes remitted under an unconstitutional tax scheme. In dicta, the United States Supreme Court has addressed this issue tangentially, suggesting that statutes of limitations *might* rationally afford that remedy and supercede unconstitutionality claims: "And in the future, States may avail themselves of a variety of procedural protections against any disruptive effects of a tax scheme's invalidation, such as providing by statute that refunds will be available to only those taxpayers paying under protest, *or enforcing relatively short statutes of limitation applicable to refund actions*…. Such procedural measures would sufficiently protect States' fiscal security when weighed against their obligation to provide meaningful relief for their unconstitutional taxation." **McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, Dept. of Business**, 496 U.S. 18, 50, 110 S.Ct. 2238, 2257 (June 4, 1990) (emphasis added). See also **Reich v. Collins**, 513 U.S. 106, 115 S.Ct. 547 (Dec. 6, 1994) (holding that Georgia must honor a refund statute as its post-deprivation remedy).

North Carolina's Supreme Court already has dealt with issues surrounding the refunding of taxes paid when a law is declared unconstitutional. In the **Bailey I** case, the North Carolina Supreme Court found that refunds for an unconstitutional act which placed a cap on the tax exemption for state and local government employees' retirement benefits were only available to those who properly protested via a procedural statute. **Bailey v. State**, 330 N.C. 227, 412 S.E.2d 295 (1991). The court ruled that without such protest, a voluntary payment of taxes is not refundable even though the tax is unconstitutional. Id. at 236.

However, the North Carolina Supreme Court subsequently reversed in part that decision in **Bailey II**, ruling that since the state had notice that the legislation was potentially unconstitutional and had opportunity to budget for that contingency before the case was brought, the refund was available to all taxpayers who wrongfully had their benefits impaired by the state, not just those who complied with the statutory requirements for the refund claims. **Bailey v. State**, 348 N.C. 130, 166, 500 S.E.2d 54, 75 (1998). The court held that since "the State unconstitutionally collected taxes from all of these individuals . . . [i]t would be unjust to limit recovery only to those taxpayers with the advantage of technical knowledge and foresight to have filed a formal protest and demand for refund." *Id.,* see also **Reich v. Collins,** 513 U.S. 106, 115 S.Ct. 547 (Dec. 6, 1994). Accordingly, it may be appropriate and worthwhile for fiduciaries of affected trusts to pursue the refund of all taxes paid under N.C.G.S. Section 105-160.2, including taxes paid in seemingly "closed" years.

Historically, in situations where there is pending litigation or other uncertain contingencies, a protective refund claim could be filed with the NCDOR to preserve a taxpayer's request for a refund before the expiration of a statute of limitations. However, North Carolina repealed this policy after January 1, 2014. To replace the refund claim system, North Carolina passed N.C.G.S. Section 105-241.6(b)(5), which provides an exception to the general statute of limitations: "If a taxpayer is subject to a contingent event and files written notice with the Secretary, the period to request a refund of an overpayment is six months after the contingent event concludes." For purposes of this statute, a "contingent event" includes litigation "the pendency of which prevents the taxpayer from possessing the information necessary to file an accurate and definite request for a refund of an overpayment." *Id.* at (b)(5)(a). This written notice must be filed prior to the expiration of the statute of limitations in N.C.G.S. Section 105-241.6(a), being the later of three years after the due date of the return or two years after payment of the tax. *Id.* The statute also details the notice's requirements: it must (1) identify and describe the contingent event, (2) identify the type of tax, (3) list the return or payment affected by the contingent event, and (4) state in clear terms the basis for and an estimated amount of the overpayment. *Id.* This can be completed by sending either a letter containing all of the required information or Form NC-14, Notice of Contingent Event or Request to Extend Statute of Limitations to the Secretary of Revenue.

In light of the uncertainty created by the **Kaestner** decision, it may be wise for fiduciaries of relevant trusts and their tax advisors to plan to file notice for all open years and, as discussed above, perhaps for seemingly "closed" years, since N.C.G.S. Section 105-241.6(b)(5) provides an adequate post-deprivation remedy that meets the requirements of **Bailey II, Reich v. Collins,** and the United States Constitution. While it might be possible to wait to file notice until the date that is "six months after the contingent event concludes" (i.e., six months after the final resolution of the **Kaestner** litigation and appeal), under N.C.G.S. Section 105-241.6(b)(5), the better practice may be to file refund claims for open years and the notice for closed years as soon as is practical.

Where is the Law Concerning Fiduciary Income Taxation Headed?

The Legislative Committee of the Estate Planning and Fiduciary Law Section of the North Carolina Bar Association actively has been involved in developing a solution to the perceived constitutional defects of N.C.G.S. Section 105-160.2. The committee has reviewed and remained sensitive to the thoughtful assessments of the Multistate Tax Commission's now-tabled project concerning the Interstate Taxation of Trusts. "Interstate Taxation of Trusts: The Multistate Tax Commission Project." Lila Disque, address and materials in connection with the American Bar Association Section of Real Property, Trust and Estate Law Spring Symposium, **State Income Taxation of Trust Holding Business Interests** (Apr. 30, 2015) ("Due to increasing state interest in attracting financial institutions, the group decided to eliminate any factor from the residency test related to trustees or trust administration. The project therefore would involve determining which remaining factors best reflect a trust's presence in the state; whether multiple factors or a hierarchy would be involved….")

While it is inappropriate to comment on pending legislation, to give readers a glimpse into one plausible future of North Carolina's fiduciary income tax, a copy of **2015 North Carolina Senate Bill 468** may be found at: ***http://www.ncga.state.nc.us/Sessions/2015/Bills/Senate/PDF/S468v2.pdf***

Conclusion

The **Kaestner** case and current legislative efforts to fix the constitutional defects of N.C.G.S. Section 105-160.2 likely will meaningfully alter the North Carolina state taxation of trusts and estates. In the wake of **Kaestner**, fiduciaries and their tax advisers should closely examine the validity of any taxes previously paid. The reasoning of the **Kaestner** court holding could apply to a broad variety of trusts with out-of-state beneficiaries (and perhaps without them). Fiduciaries and their tax advisers should be mindful both of the typical three year statute of limitation on tax refunds as well as the six month post-deprivation statutory remedy provided by N.C.G.S. Section 105-241.6(b)(5) as applied to a taxing statute that has been declared unconstitutional and therefore void *ab initio*. Finally, fiduciaries and their tax advisers should monitor the progress of 2015 Senate Bill 468 which may change the manner in which trusts are taxed into the future.

Carl L. King is a partner with Culp, Elliott & Carpenter, P.L.L.C. in Charlotte and is a North Carolina board certified specialist in estate planning and probate law. Nationally, Carl is the rising Vice Chair of the *Individual and Fiduciary Income Tax* sub-committee of the Real Property, Trust and Estate Law Section of the American Bar Association, and he has a particular professional interest in fiduciary income tax issues. Carl is grateful to his colleague, Sydney J. Warren, Esq., and to John G. Hodnette (University of Florida LLM candidate) for their assistance with this article.

Protecting Assets from a Spouse as a Future Creditor — North Carolina Courts Will Enforce "Divorce Clauses" in Trusts

By John N. Hutson Jr.

Recently, the North Carolina Court of Appeals held that a clause in a trust created by a husband for the benefit of his wife and that terminated her beneficial interest upon divorce was enforceable and not contrary to public policy. **Ward v. Fogel**, 768 S.E.2d 292, 2014 N.C. App. LEXIS 1248. (N.C. Ct. App. Dec. 2, 2014), disc. rev. denied, 2015 N.C. LEXIS 287 (N.C. Apr. 9, 2015). This decision confirms the validity of an important tool for protecting assets from spouses as creditors and points out some areas of caution for practitioners.

Ward v. Fogel

In **Ward,** the husband and wife married in 1987. In 1997, husband became a 50 percent owner of a successful closely-held business. He then conveyed his 50 percent interest in the business to an irrevocable trust ("Trust I") in 2005. Wife was named as a current beneficiary of Trust I during her lifetime; however, Trust I contained a "divorce clause" providing that wife would retain her beneficial interest only so long as she remained married to husband. Husband's son and future grandchildren were also named beneficiaries of Trust I. The purpose of Trust I was to protect family assets from the claims of potential future creditors given the high risk nature of the husband's business. Wife was not involved in the drafting of Trust I and claimed that she did not discover the divorce clause until after the parties separated.

In 2006, wife created an irrevocable trust ("Trust II") naming husband as primary beneficiary. Trust II was funded with various membership interests titled in the sole name of wife at the time of the conveyance. Trust II did not contain similar language terminating husband's beneficial interest upon divorce from wife. Together, Trust I and Trust II contained most of the couple's wealth.

In 2009 the couple separated and then in 2010 husband filed for divorce.

The wife contended that the Trusts should be dissolved based on claims of breach of fiduciary duty and actual and constructive fraud. With respect to Trust I, the wife also asserted that the "divorce clause" was contrary to public policy.

The Court of Appeals upheld the Trial Court's entry of summary judgment dismissing the wife's claims regarding Trust I. The fact that the wife was completely excluded from the drafting and execution of Trust I meant that no fraud could have occurred as no representations of any type were made to the wife in connection with the creation of Trust I. The exclusion of the wife from the creation of the trust also meant that no breach of fiduciary duty occurred. In a marital setting fiduciary duties only arise in connection with transactions involving both the husband and the wife. Here, there was no transaction involving both the husband and the wife. The wife's only status with respect to Trust I was the recipient of a gift from the Husband.

The Court of Appeals also held that the divorce clause in Trust I did not violate the public policy of North Carolina. In so holding, the court recognized that a trust may only exist to the extent that its purpose is lawful, not contrary to public policy, and possible to achieve. **Ward**, 2014 N.C. App. LEXIS 1248, at 24 (*quoting* N.C.G. S. § 36C-4-404). The court provided three rationales for why the divorce clause did not violate public policy. First, North Carolina law already allows for certain similar rights to terminate upon divorce such as those in a will. *Id.* (*citing* N.C.G.S. § 31-5.4). Second, the clauses that may run afoul of public policy are those that provide a payment to a beneficiary if he or she would procure a divorce, because "enforcement would tend to encourage the disruption of the family by creating an improper motive for terminating the family relation." *Id.* (*quoting Restatement (Second) of Trusts § 62 comment e).* To the contrary, the court found that, rather than disrupting the family unit, the divorce clause in **Ward** incentivized the wife to remain married to husband so that she could continue to enjoy distributions from Trust I. Third, the court found similar divorce clauses in common estate planning form manuals and held that ruling such divorce clauses against public policy would disrupt the estate plans of citizens who have already planned their estates using similar clauses.

The Court of Appeals overturned the trial court's entry of summary judgment with respect to Trust II. The wife was the settlor of Trust II and testified that she had been misled in connection with its creation. Based on this testimony the Court of Appeals found that issues of fact existed on the wife's claims of fraud, constructive fraud, and breach of fiduciary duty with respect to Trust II.

Features Present In Trust I

The following features were present in Trust I: (a) the Trust was irrevocable; (b) the Trust was created at a time when divorce was not contemplated and there were no claims from creditors or potential creditors of the settlor[1]; (c) there was a valid reason for creating the Trust which had nothing to do with divorce; (d) the Trust was funded with assets held in the husband's name (The Court of Appeals took no position as to whether the corpus of Trust I included marital property.); (e) the Trustees of Trust I were independent parties and the husband retained no control over the Trust; (f) the husband surrendered all of his legal and equitable interest in the corpus of the Trust[2]; and (g) the wife was not involved in the creation of the Trust.

It is not known whether literally all of the above features need to be present for a future trust to be upheld.

Attorney/Client Issues

The same attorney drafted both Trust I and Trust II. Even though the husband was the settlor of Trust I and the wife was the settlor of Trust II, the attorney testified that he believed he represented only the husband in both transactions. The wife testified that she believed the attorney represented her in connection with the creation and execution of Trust II. This confusion about representation could have been avoided through the use of clear written agreements and acknowledgments of representation or absence of representation executed by the husband and the wife.

Conclusion

A trust settled for the benefit of a spouse for only so long as the spouse remains married to the settlor is a potentially powerful asset protection tool that does not violate North Carolina's public policy. Practitioners employing this tool should take care that the trust is otherwise valid and ensure that the scope of their representation is clear. The precise factors that need to be present to make such a trust valid under North Carolina law remain to be developed by future cases.

As a disclosure, Mr. Hutson was involved in the **Ward** case. He represented the son who was one of the beneficiaries of Trust I.

John Hutson is a member of Howard, Stallings, From, Hutson, Atkins, Angell & Davis, P.A. located in Raleigh, North Carolina. His practice includes estate, trust, guardianship, and business litigation.

(Endnotes)

1 The existence of creditors at the time of the creation of the Trust could cause the transaction to be deemed a transfer in fraud of creditors in violation of N.C.G.S. § 39-23.4

2 The trustees of Trust I were authorized to reimburse the settlor for any tax on trust income or principle that was payable by the settlor, as authorized by N.C.G.S. § 36C-5-505(a)(2a).

What Do Beef Stew and Mystery Novels Have To Do With Fiduciary Duties? Lessons for Fiduciaries Following Lacey v. Kirk

By Molly A. Whitlatch

Frances Longest died in June 2011 at the age of 91, after being bed bound for a decade and suffering from an extended illness. In her will, she left half of her estate to her daughter, Bonnie Kirk, and half of her estate to her grandchildren, Mary Lacey and Jonathan Lucas, the children of Kirk's deceased sister. Kirk was named executrix of the estate.

Months before her death, Lacey visited Longest and brought her some homemade beef stew. Kirk believed that her mother was in good health and would live to be 100, and attributed Longest's decline in health to having eaten the beef stew. Kirk testified that she suspected Lacey of poisoning Longest because many years earlier, while receiving morphine during a hospitalization, Longest acted strangely and a nurse commented that she had received a bottle of morphine. Kirk deduced that Lacey had tampered with the machine and caused Longest to receive an overdose, although the medical records clearly refuted that position. Kirk further testified that she had a "suspicious mind" and had read numerous mystery novels in which people used antifreeze or arsenic as poison.

Six months after Longest's death, Kirk combined food from several containers in a blender, added water, and sent the samples to a lab for testing. The results indicated a slightly elevated level (30 mg/kg) of Cesium chloride. Kirk and her daughters conducted Internet searches about *radioactive* Cesium (which is a different chemical that is highly explosive when mixed with water) and read articles relating to the Fukushima tsunami disaster, and concluded that Lacey had poisoned Longest with radioactive Cesium. Kirk did not contact the lab to obtain an explanation of the report. Had she done so, she would have learned that Cesium chloride (not radioactive Cesium) is a type of salt commonly found in cooking spices and other sources, and it is not lethal at that level (even to a mouse). Kirk also did not contact Longest's doctor to discuss whether her symptoms were consistent with Cesium poisoning.

There was no evidence that the food which Kirk had tested was the same food that Lacey had brought to her grandmother. There was no evidence that Longest actually ate the stew (or if she did, how much), and nothing in the medical records supported the assertion that Longest was poisoned. Longest's doctor testified that she died of natural causes. Kirk alleged that Lacey had access to Cesium in connection with her 3D/4D ultrasound baby picture business which was also determined not to be true.

Kirk refused to make any distributions from the Estate to Lacey or Lucas on the basis of this murder allegation, and made numerous statements to people in the community and to family members that Lacey had poisoned Longest and caused her death, that Lacey had previously attempted to murder Longest with morphine, and that Lacey had caused the death of other family members. She also told people that Lacey and Lucas had stolen from Longest.

Kirk did not initiate any proceedings in the Estate to recover

the purportedly stolen property, nor did she initiate a wrongful death suit. Kirk reported her allegations to the police and, after a thorough investigation, the police found no evidence of theft or murder and closed their file. Afterwards, Kirk told the police that "if you won't get Mary, I will." The evidence showed that Kirk had a longstanding history of animosity towards Lacey and Lucas. After Ms. Longest's death, Kirk stated to Lucas' wife that Plaintiffs "were going to get a little bit from the estate, but they weren't going to get as much as they thought because they should have come around more often."

After receiving no distributions from the Estate and being refused entry into the real properties that they owed jointly with Kirk, in September 2012, Lacey and Lucas filed suit. The case was mediated in May 2013 and the parties reached a settlement which provided that Kirk would distribute one half of the Estate to Lacey and Lucas, and the parties would pay their own fees. Kirk ultimately refused to carry out the terms of the settlement, and Lacey and Lucas brought an action to have her removed as Executrix. After being removed, Kirk caused further delay by failing to turn over property and records of the Estate to the new personal representative.

Summary judgment was granted on liability for the defamation claim, and Kirk did not contest it. After a four day jury trial, Lacey and Lucas prevailed on their breach of fiduciary duty claim and were each awarded $6,569.02 in compensatory damages and $300,000 in punitive damages (reduced to $250,000 by statute), and Lacey was awarded $50,000 in presumed damages and $100,000 in punitive damages on the defamation claim. The court further awarded $93,709 in attorneys' fees, but stated that it "would have awarded a much greater amount in attorneys' fees to the Plaintiffs under these facts were it not for the amount of punitive damages assessed against the Defendant by the Jury."

Kirk appealed the actual damages (claiming they were unsupported by the evidence) and the punitive damages (claiming they were unconstitutionally excessive). Kirk further appealed the award of damages for the defamation claim. Lacey and Lucas appealed the attorneys' fee award on the basis that an otherwise reasonable award of attorneys' fees cannot be reduced to offset a successful punitive damages verdict. The Court of Appeals affirmed the jury verdict, and remanded the attorneys' fee award for a determination of reasonable attorneys' fees without reducing such award due to the punitive damages award. **Lacey v. Kirk**, 767 S.E.2d 632 (N.C. Ct. App. 2014). Regarding the punitive damages, the Court held that Kirk's "exceedingly reprehensible" conduct supported the substantial award (which resulted in a 38:1 ratio of punitive to compensatory damages). Kirk filed a petition for discretionary review, which was denied on April 9, 2015. The Superior Court has not yet issued its ruling on the amount of attorneys' fees on remand.

Lesson 1: Rule 408 doesn't always apply. Ordinarily, Evidence Rule 408 prohibits the admission of evidence regarding settlement negotiations and offers to compromise at trial for the purpose of proving liability or the amount of a claim. This rule is meant to encourage parties to engage in open settlement discussions as a matter of public policy. But, there are limits to the exclusion of evidence under this rule. Here, Kirk's refusal to carry out the terms of the settlement, which only required her to distribute to the Plaintiffs their share of the Estate, was significant evidence of delay and malice which supported the breach of fiduciary duty claim. This evidence was presented to the jury and was also a basis for the Court's award of attorneys' fees. The admission of this evidence for the purpose of demonstrating delay, rather than for the purpose of establishing liability, was permitted.

Lesson 2: Personal animosity by a fiduciary can become a problem. It is often the case that one family member is the personal representative of an estate involving other family member beneficiaries. And, these relationships are often strained. Though this case was extreme in that Kirk accused Lacey of murder, it underscores the point that fiduciaries must be impartial and fair. Plaintiffs' fiduciary expert, Stan Atwell, testified that in cases involving significant animosity between an executrix and beneficiaries, the fiduciary may need to step down.

Lesson 3: A fiduciary must either take action or distribute in a reasonable time. Fiduciaries have a right and duty to investigate and pursue claims on behalf of the Estate. But, they also have a duty to distribute "expeditiously." The fiduciary must act reasonably to determine if there is a viable claim and, if so, pursue it or otherwise proceed with administration of the Estate and distribution. Atwell testified at trial that Kirk had a duty to make distributions within a reasonable time after the creditors' claims and any estate income tax issues were resolved or to actively pursue a claim to recover assets of the estate and a wrongful death claim. Even after the statute of limitations expired on the wrongful death claim, Kirk refused to distribute. It was a breach of Kirk's fiduciary duty to use these purported claims as a basis for withholding distribution while failing to actually pursue the claim.

Lesson 4: The Court can't assess a merit penalty. While success at the trial level is a factor that can support an award of reasonable attorneys' fees, the court cannot penalize a successful litigant by reducing the amount of fees awarded to offset a large punitive damages verdict, as these two remedies serve separate purposes.

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Recent Developments

Authorship and editing provided by the Trusts and Estates Team of Womble Carlyle Sandridge & Rice, LLP.

Federal Case Law Developments

No charitable deduction for conservation easement because it did not qualify as a "qualified real property interest" due to the reservation of the right to make boundary changes.

In **Balsam Mountain Investments, LLC v. Comm'r**, T.C. Memo. 2015-43 (March 12, 2015), the Tax Court addressed whether an easement was a "qualified real property interest" under Code Section 170(h)(2)(C). In 2003, Balsam Mountain Investments, LLC ("Balsam") entered into a perpetual conservation agreement with the Northern American Land Trust. The agreement restricted Balsam in perpetuity from developing or altering the land in an area defined in the agreement as a specific 22-acre parcel of real property located in Jackson County, North Carolina. The exact boundaries of the parcel were described in an attachment to the agreement; however, the agreement authorized minor modifications to the boundaries if certain conditions were met such as: (i) the area of the parcel could not be reduced; (ii) any land added had to be contiguous and connected by an area of substantial width; (iii) any added land would create an equal or greater contribution than the land removed; (iv) the removed land could not exceed 5 percent of the area within the original parcel; (v) any boundary adjustment could only be made within 5 years of the creation of the easement; (vi) any boundary alterations were subject to the North American Land Trust's prior review and approval and the Trust was not authorized to approve a change if the change would result in any material adverse effect on the conservation purposes either directly or indirectly; and (vii) any resulting new boundary had to be set forth in a written amendment to the conservation easement agreement. On the 2003 Form 1065, U.S. Return of Partnership Income, Balsam reported the conservation easement grant as a charitable deduction and in 2011, the Service issued a notice of final partnership administrative adjustment disallowing the charitable deduction contending that the granted easement was not a "qualified real property interest" described in Code Section 170(h)(2)(C) and as a result was not a "qualified conservation contribution." The tax partner for Balsam filed a petition with the Tax Court challenging the Notice. The Tax Court held that since the easement allowed Balsam to change the boundaries of the parcel, the easement was not an interest in an identifiable, specific piece of real property. Thus, the easement was not a "qualified real property interest" under Code Section 170(h)(2)(C). The Tax Court relied on **Belk v. Commissioner**, 140 TC 1 (2013), supplemented by TC Memo 2013-154, aff'd, 774 F.3d 221 (4th Cir 2014) where the Fourth Circuit held that the easement granted in that case did not restrict a defined parcel of real property and was as a result not a qualified real property interest. A provision in the underlying agreement in that case allowed a substitution of the property donated. The Tax Court in this case found that although the agreement at issue only allowed a substitution of up to 5 percent of the land subject initially to the easement which was distinguishable from the Belk agreement allowing for a total substitution of the land, such a distinction was one without a difference. The Tax Court also rejected the argument by Balsam that the Tax Court should overrule the Belk decision.

Novel argument for application of waiver doctrine fails; prior correspondence did not constitute informal claim.

In **Green v. US**, 115 AFTR 2d 2015-1074 (March 12, 2015), the court addressed the application of the waiver doctrine. The decedent died in 1980 survived by his wife, daughter (plaintiff in this matter) and son (attorney for plaintiff). The family previously had filed six federal lawsuits seeking a refund of estate taxes paid. This case was the seventh such lawsuit. Under Code Section 6511(a) a claim for a refund must be filed within three years from the later of the time the return is filed or two years from the time the tax is paid. In this case, the tax for which the refund was sought was paid in 1996, and the plaintiff admitted that a formal request for refund was not filed until 2002, thus not satisfying the terms of Code Section 6511. An exception has evolved to the formal refund request where an "informal claim" has been filed within the Code Section 6511 timeframe followed by a subsequent formal claim being filed. To successfully toll the filing period for the claim, the informal claim must set forth a written description of the claim that has sufficient particularity to allow the Service to undertake an investigation. In the six prior cases involving this issue, the court concluded that the Greens did not submit an informal claim. Thus, in the seventh case, collateral estoppel prohibited them from arguing that their prior correspondence (consisting of a set of letters to the Service and to Congress) constituted an informal claim. The plaintiff argued that the "waiver doctrine" cured any inadequacies in the refund claim. The waiver doctrine applies when an informal claim has been filed and the Service acts on the claim's merits before the taxpayer files a subsequent formal claim. Having unsuccessfully argued the waiver doctrine in a prior case, the plaintiff's waiver doctrine in this case relied on a new theory that the waiver doctrine is a "completely different" "ticket to court" than the doctrine of informal claim. The plaintiff argued that it is irrelevant whether or not the taxpayer's communications with the Service constitute an informal claim where the Service acts on the complaints the claimant made. The court rejected the plaintiff's argument stating that the submission of an informal claim is necessary to assert the doctrine of waiver. Accordingly, plaintiff was collaterally estopped from arguing the application of the waiver doctrine in this case.

Beneficiaries possessed a present interest under Code Section 2503(b) where each beneficiary held unconditional right to withdraw property from trust.

In the consolidated cases of **Israel Mikel v. Comm'r; Erna Mikel v. Comm'r**, T.C. Memo. 2015-64 (April 6, 2015), the court addressed the Service's disallowance of gift tax annual exclusions claimed by the petitioners. The petitioners, a married couple, each made gifts to a family trust during 2007 with an asserted value of $1,631,000. Each petitioner claimed annual exclusions under Code

Section 2503(b) in the amount of $720,000 as gifts of a present interest to each of the family trust's sixty beneficiaries. In accordance with the Crummey-type provisions in the trust instrument, all of the beneficiaries were given notice of the gifts to the trust and their right to demand a distribution of a stated portion of the gifts. The trust instrument required that, in the event the Trustees denied a demand right, the denial be reviewed by an arbitration panel consisting of three members of the Orthodox Jewish faith (called a beth din). The trust instrument also included an in terrorem clause. Pursuant to the Trust Agreement, the Trustees were obligated to immediately distribute any funds requested by a beneficiary pursuant to the demand right. However, the Service disallowed the claimed annual exclusions, arguing that the gifts were of future, not present, interests because the beneficiaries lacked legally enforceable rights to withdraw funds from the family trust. The Service reasoned that the beneficiaries rights were not legally enforceable because, if the Trustees refused to honor the demand right and the beth din supported such a decision, a beneficiary would not pursue an action in state court to enforce his or her rights because of the in terrorem provision. However, the court did not find this reasoning persuasive and held in favor of the taxpayer-petitioners, opining that the beneficiaries of the family trust possessed a present interest under Code Section 2503(b) because each beneficiary held an unconditional right to withdraw property from the trust and such withdraw rights could not be thwarted by the Trustees. In support of this rationale, the court noted that (i) the demand right was not illusory because a beneficiary could seek redress from the beth din if the Trustees did not distribute trust property in accordance with the withdrawal right; and (ii) the in terrorem clause was intended to discourage beneficiaries from challenging discretionary distributions not mandatory distributions pursuant to a demand right.

Tax Court finds taxpayer's appraisal of conservation easement persuasive, makes only slight downward adjustment to charitable contribution deduction.

In **SWF Real Estate, LLC v. Comm'r**, T.C. Memo 2015-63 (April 2, 2015), the Tax Court held that the correct valuation of a conservation easement contributed to charity was over 99 percent of the amount deducted by the donor. The Service issued a notice of final partnership administrative adjustment (FPAA) to Yellowfish Investments, Inc., petitioner, as tax matters partner of SWF Real Estate, LLC (SWF), with respect to SWF's 2005 tax year. The FPAA proposed an increase in ordinary income and a corresponding decrease in capital contributions and noncash charitable contributions of $4,921,233. The petitioner filed a timely petition for readjustment of respondent's determinations in the FPAA. There were three issues before the court (i) whether SWF engaged in a disguised sale under Code Section 707; (2) if there was a disguised sale, whether the proceeds from the disguised sale were income to SWF during its 2005 tax year; and (3) whether SWF overstated the value of a conservation easement on Sherwood Farm and, therefore, the amount of the charitable contribution deduction allowed pursuant to Code Section 170 should be reduced. This summary focuses on the court's holding as to issue (3).

The relevant facts of the case were as follows: SWF was a Virginia limited liability company that was formed on May 4, 2001. The petitioner, which was the tax matters partner of SWF, was incorporated in 2000 as a Delaware corporation and elected to be taxed as a subchapter S corporation effective Sept. 30, 2000. An individual, John L. Lewis IV, owned 100 percent of the shares of petitioner. On May 21, 2001, the petitioner purchased a 674.65-acre contiguous tract of land in Albemarle County, Virginia, known as "Sherwood Farm" for $3,450,000. During 2001, petitioner contributed Sherwood Farm to SWF in exchange for 100 percent of the membership interests in SWF. From the time of that contribution during 2001 until December 2005, petitioner owned 100 percent of the membership interests in SWF and disregarded SWF as an entity separate from petitioner for Federal tax purposes. During 2005 and 2006, SWF started a farming business and cattle breeding operation. SWF filed a Schedule F, Profit or Loss From Farming, for 2006, reporting $43,288 in gross income and $408,268 in expenses from its farming activity. SWF owned all of the property at Sherwood Farm, including Mr. Lewis' residence, the businesses, the tractors, and the farm equipment. SWF reported $6,889,400 in assets on its 2005 tax return and $7,434,935 in assets on its 2006 tax return. During November 2005, Mr. Lewis and petitioner decided to place a conservation easement on Sherwood Farm and enter into a transaction involving the transfer of Virginia tax credits (VTC transaction).

On its tax year 2005 Form 1065, SWF reported a charitable contribution of $7,398,333 from the donation of the conservation easement. The Service contended that SWF overstated the value of the easement on Sherwood Farm and therefore overstated the amount of the deduction allowed pursuant to Code Section 170. The court favored the lower of the two appraisals submitted by the taxpayer, finding the appraisal by the Service's expert unreliable because it included numerous errors and omissions. The petitioner's charitable contribution deduction for donation of the conservation easement was adjusted downward by $48,333 to account for the amount by which the petitioner, in accord with an estimate provided by a certain expert who did not testify at trial, overstated the easement's value. The court noted that the report by the petitioner's expert properly accounted for the conservation easement's restrictive nature and the market conditions at the relevant time, used more numerous and accurate comparable properties than did the Service's expert and avoided other errors and inconsistencies when adjusting the comparable properties' values. In contrast, the court found that the Service's expert's report was "burdened by multiple errors and inconsistencies."

Noncash charitable contribution deductions denied where taxpayers' failed to obtain contemporaneous written acknowledgment of donations.

In **Kunkel v. Comm'r**, T.C. Memo. 2015-71 (April 8, 2015), the Tax Court held that the taxpayers, a married couple, had not properly substantiated under Code Section 170(f)(8)(A) $37,315 in noncash charitable gifts, and sustained an accuracy-related penalty. The taxpayers took charitable contribution deductions for donations of books, household items, toys, clothing, furniture and other items to a church, Goodwill and various veterans' organizations. At trial, the taxpayers did not produce any written acknowledgment of their donations to the church and Goodwill, and were only able to produce undated, generic doorknob hangers

left by the veterans' organizations that did not describe the property donated. The taxpayers argued that they were not required to obtain contemporaneous written acknowledgments because they made contributions in multiple batches of items worth less than $250. The noncash donations were denied because the taxpayers did not meet the contemporaneous written acknowledgment requirement under Code Section 170(f)(8), and the court refused to believe that the taxpayers made ninety-seven separate donations of property valued at less than $250. The taxpayers also failed to meet the additional requirements imposed under Code Section 170(f) for contributions valued in excess of $500. Further, the Tax Court upheld the accuracy-related negligence penalty assessed against the taxpayers finding that the Service met its burden of proof with evidence that the taxpayers did not keep adequate records (e.g., donation dates, description of items donated, fair market value calculations).

Federal Administrative Developments

Executor fails to report foreign financial assets and triggers suspended assessment period.

In **Program Manager Technical Advice Memorandum 2014-018** (April 2, 2015), the decedent, a United States person, died owning interests in foreign financial assets within the meaning of Code Section 6038D. Information regarding the assets was required to be reported on Internal Revenue Service Form 8938 (Statement of Specified Foreign Financial Assets) and attached to the decedent's income tax return. The Executor of the estate filed the estate tax return for the decedent's estate, the decedent's final income tax return and fiduciary income tax return for the estate but failed to furnish the information required to be attached to the decedent's final income tax return, omitted income from the foreign assets on the income tax returns, and omitted the foreign assets on the estate tax return for the decedent's estate. The standard three-year assessment period had concluded for each of the three returns; however, the Service concluded that in the event of a failure to properly furnish the information required to be provided under Code Section 6038D, Code Section 6501(c)(8) suspends the period of limitation on assessment. Under Code Section 6501(c)(8) for information required to be reported to the Service under Code Section 6038D, the time for assessment of tax with respect to any tax return, event or period to which the information relates will not expire prior to the date which is three years following the date the information is furnished to the Service. The phrase used in Code Section 6501(c)(8) of "any tax imposed by this title" is broad and would include any income, gift, estate or excise tax and related penalties and interest. Further, the Service reasoned that the phrase "any return" used in Code Section 6501(c)(8) should include any return the Secretary requires to be filed for a taxpayer. In this case, the period of limitation for assessment for any tax reportable on the decedent's final income tax return, the fiduciary income tax return for the estate and the estate tax return was suspended. The omitted information would have assisted the Service in identifying the omitted items, and the Service stated that it appeared clear that the omitted information would relate to all three returns at issue because it identified a source of income to be reported on the two income tax returns as well as an item which should have been reported on the estate tax return.

Notice provides advance notification of a provision the Service anticipates will be included in proposed regulations to be issued under Code Section 529A for tax-advantaged ABLE accounts.

IRS Notice 2015-18, IRB 2015-12 (March 10, 2015) provides notification of a provision the Service anticipates will be included in proposed regulations under Code Section 529A. Under Code Section 529A, added by the Achieving a Better Life Experience Act of 2014 (the "ABLE Act"), states can establish a qualified ABLE program. Under the program, contributions may be made to an account created to meet the qualified disability expenses of the account designated beneficiary who is disabled. Distributions from an ABLE account are not included in the beneficiary's gross income, if the distributions do not exceed the beneficiary's qualified disability expenses as defined in Code Section 529A(c)(1)(B)(i). The Service is developing proposed regulations, but it is concerned that states are currently engaged in developing legislation to enable their citizens to create ABLE accounts during the year 2015, prior to the Service issuing regulations or other guidance. The Service does not want the lack of such guidance or regulations to act to discourage states from creating ABLE programs. This Notice provides notice of significant ways in which the future guidance for Code Section 529A will most likely differ from the proposed regulations under Code Section 529 from which Code Section 529A was modeled. The Service states that it wants to assure states enacting legislation establishing ABLE programs and individuals who establish ABLE accounts that they will still receive the Code Section 529A benefits even though the legislation or account may not fully comply with the Service's guidance when issued. Further, the Service states that it will provide transition relief for changes necessary to ensure that the state-created programs and the ABLE accounts established meet the regulations set forth in future guidance.

Disclaimers by Husband Qualify under Code Section 2518.

In **PLR 201516056** (April 17, 2015), the Service approved qualified written disclaimers executed by a husband regarding transfers made to him by his wife. The transfers at issue were (i) the addition of the husband as joint owner with right of survivorship to a securities account owned by the wife (the "Joint Account"), and (ii) the contribution of the wife's separate assets to a securities account owned by the husband ("Husband's Account 1"). Pursuant to the terms of the Joint Account, the wife had the right to unilaterally withdraw all of the funds of the Joint Account without the consent of the husband. After the wife contributed assets to Husband's Account 1, the husband made cash withdrawals from Husband's Account 1 and transacted sales and purchases of securities in Husband's Account 1. Similarly, after the husband was added as an owner of the Joint Account, the husband made cash withdrawals from the Joint Account and transacted sales and purchases of securities in the Joint Account. Subsequently, the husband opened Husband's Account 2 and transferred all of the assets, except one security, in the Joint Account to Husband's Account 2. Thereafter, Husband made cash withdrawals from Husband's Account 2 and made sales and purchases of securities in Husband's Account 2.

The husband represented that he intended to execute a disclaimer identifying specific securities in Husband's Account 1, acknowledging receipt of those securities from his wife on the transfer date, and stating his irrevocable and unqualified refusal to accept those securities ("Proposed Disclaimer 1"). Proposed Disclaimer 1 would not include any security in Husband's Account 1 that was purchased or sold after the transfer date. The husband also represented that he intended to execute a disclaimer identifying specific securities in Husband's Account 2 (previously in the Joint Account), acknowledging his receipt of those securities on the transfer date, and stating his irrevocable and unqualified refusal to accept those securities (Proposed Disclaimer 2). Proposed Disclaimer 2 would not include any security in Husband's Account 2 (or previously in Joint Account) purchased or sold from the transfer date through the date the husband executed Proposed Disclaimer 2. Further, the husband represented that he, as personal representative of his wife's estate, would establish a two brokerage accounts on behalf of his wife's estate (Estate Account 1 and Estate Account 2) and transfer to Estate Account 1 the securities identified in Proposed Disclaimer 1 (and all income earned on those securities from the transfer date through the disclaimer date) and transfer to Estate Account 2 the securities identified in Proposed Disclaimer 2 (and all income earned on those securities from the transfer date through the disclaimer date). The Service ruled that the husband's disclaimers would constitute qualified disclaimers under Code Section 2518.

Extension of time granted to allocate decedents' GST exemption to two trusts, the allocation to be effective retroactive to funding of trusts.

In **PLR 201510029** (March 6, 2015), the Service granted an extension of time to allocate the GST exemption. Prior to 2001, Decedent 1 and Decedent 2 executed an irrevocable trust pursuant to which two trusts were created, one for the benefit of Child A and her issue and one for the benefit of Child B and his issue. Decedent 1 and 2 made gifts to these two trusts and other gifts to trusts established for their grandchildren. Decedent 1 and 2 hired an accounting firm to prepare their Forms 709 US Gift (and Generation-Skipping Transfer) Tax returns. On the gift tax returns, the decedents' GST exemption was incorrectly allocated to the trusts for the grandchildren and no exemption was allocated to the two trusts for Child A and B. Decedent 1 died prior to January 1, 2001, and Decedent 2 died after that date. At death, both decedents had GST exemption available which was automatically allocated pursuant to Code Section 2632(e) (formerly Code Section 2632(c)). The Service concluded that the requirements of Treasury Regulations Section 301.9100-3 were satisfied because the decedents acted reasonably and in good faith having reasonably relied on a qualified tax professional and granting the relief would not prejudice the government's interests. The Service granted an extension of time to allocate the GST exemption of the decedents deemed allocated by Code Section 2632(e) to the two trusts for Child A and Child B on the decedent's estate tax returns, the allocation to be effective as of the date of the transfer to the trusts.

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