PHILADELPHIA ESTATE PLANNING COUNCIL

VOL. XXVIII, NO. 3 • SUMMER 2019

President's Message

J.R. Burke

It has been an honor to serve as President of the PEPC for this past year. I cannot believe how quickly it went by and am pleased to report that the PEPC has had another very successful year from both a program and financial standpoint.

For the second year in a row, our net membership numbers have increased thanks to the dedicated members of our Membership Committee as well as current members discussing the benefits of the Council with prospective members. Council events have been extremely well attended as our Committees continue to arrange for relevant and interesting national speakers and distinctive networking events. As I have frequently stated, the Council relies on the strength of our committees and the support of our sponsors, and I encourage each of you to get involved in one of these ways.

I mentioned in the Winter Newsletter that Vice President Scott Isdaner and I represented PEPC at the National Association of Estate Planners & Councils (NAEPC) Annual Conference in Ft. Lauderdale, Florida in November. The themes we were to ask ourselves:

- What is estate planning today?
- What has it been in the past?
- What will it be in the future and what are we going to do differently to remain viable and sustainable?

The Board discussed these questions at the subsequent Board meetings and have decided to form an Ad-hoc Strategic Planning Committee. We are still putting our thoughts together about this, but my initial thinking is that the Committee's mission will be to create a strategic plan that will enable PEPC to move forward, remain relevant, and allow for change as needed in order to continue to be a successful organization. In order to do that we will need diversity of thought and experience on the committee and I anticipate that the committee will consist of people from different professional backgrounds and people with different tenures and experience levels within PEPC. *Please let me know if you would like to be considered to be a member of the Committee.*

I want to thank every board and committee member for their assistance this year, as well as Denise Downing, CMP, our Administrative Secretary. The year was successful because it was a total team effort. I look now forward to transitioning the presidency to Scott Isdaner whom I know will do an excellent job on PEPC's behalf. Lastly, I want to extend a sincere thank you to all of our sponsors for their support in making this such a successful year.

I hope you have an enjoyable summer and look forward to seeing everyone at the Welcome Back Party on Thursday, September 12 from 5:30 to 7:30 PM at Revolution House at 200 Market Street.

Insights from the Trenches of Transfer Tax Audits and Controversies in an Era of Higher Exclusions

Steven R. Akers

a. **Statistics of Gift Tax Returns and Revenue.** In 2005, 260,000 gift tax returns were filed, and in 2017 about 240,000 returns were filed (staying fairly consistent). 370,000 returns were filed in 2013 reporting gifts made in the infamous 2012 year.

The number of **taxable** gift tax returns has dropped dramatically, from about 7,600 in 2005 to 2,804 in 2017.

About $1.7 billion of gift tax revenue was collected in both 2005 and 2017, staying constant.

Total gifts have doubled, from $37 billion in 2005 to $75 billion in 2017. In 2013 (reporting 2012 gifts), $421 billion of gifts were reported, with about $4.7

continued on page 3

IN THIS ISSUE:

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UPCOMING EVENTS

LUNCHEON PROGRAMS

The Union League of Philadelphia
140 South Broad Street
Philadelphia, PA 19102
www.unionleague.org

11:45 a.m. – 12 p.m.	Registration
12 – 12:30 p.m.	Luncheon
12:30 – 1:45 p.m.	Program

2019 Luncheon Program Dates
Tuesday, September 17, 2019
Tuesday, October 22, 2019
Tuesday, November 19, 2019
Tuesday, January 7, 2020
Tuesday, February 11, 2020
Tuesday, March 17, 2020

WELCOME BACK PARTY

Thursday, September 12, 2019
5:30 – 7:30 p.m.
Revolution House
200 Market Street
Philadelphia, PA 19106

HOLIDAY CELEBRATION

Wednesday, December 4, 2019
5:30 – 7:30 p.m.
JG Domestic
2929 Arch Street
Philadelphia, PA 19104

Please register at www.philaepc.org.

Insights continued

billion of gift tax collected.

In summary, the total number of gift tax returns and the gift tax revenue is staying about the same, but the number of taxable gift tax returns is dropping.

In 2016, the IRS **closed** about 1,800 gift tax returns, with about $300 million of proposed upward adjustments. In 2017, the goal was for 1,700 returns to be closed. Accordingly, the IRS is closing about 1,700 of the 2,800 taxable gift tax returns that are filed, reflecting about a two-thirds audit capacity of the taxable returns. Therefore, about 60% of taxable gift tax returns are audited, but only about 1% of total gift tax returns are audited.

b. **Statistics of Estate Tax Returns and Revenue.** The number of filed estate tax returns has dropped dramatically from 109,000 returns in 2001 to about 11,000 returns in 2016 and 2017. For deaths occurring in 2018, estimates are that 4,000 returns will be filed, with only 1,900 taxable returns. Presumably, a lot of the estate tax returns are portability returns.

Of the 12,711 estate tax returns filed in 2017, 5,185 were taxable returns, and 7,526 were nontaxable returns. Interestingly, only 603 of the nontaxable returns had gross estates under $5 million, suggesting a relatively few returns being filed merely to elect portability.

In 2017, the target was for the IRS to close about 2,400 estate tax returns. If this same experience continues in the future, at current staffing levels, the IRS will have **capacity to audit almost all** taxable gift and estate tax returns.

Estate tax revenue is dropping significantly: $24 billion in $2011; $20 billion in 2017; and an expected $15 billion is expected for deaths in 2017.

c. **Whether to Report Sale to Grantor Trust Transactions.** The gift tax audit statistics would seem to favor reporting sale to grantor trust transactions on a gift tax return in order to get the statute of limitations running that the sale price was adequate to avoid gift treatment. That return could be used to bolster an argument that the full and adequate consideration exception to §2036 was satisfied if the IRS should argue that §2036 applies to the sale transaction in an estate tax audit at the seller's death. (Ultimately, that is a client decision. Many clients may conclude "that is my children's problem," and do not want to risk a gift tax audit during their lives.)

Another factor for current consideration is whether gift tax returns filed under the current administration may see less scrutiny than under future administrations.

d. **"Flagging" of Gift Tax Returns for Adequate Disclosure Problems.** IRS officials have indicated informally that when gift tax returns are reviewed, if potential adequate disclosure problems are observed, the returns are "flagged" so that the issue will be revisited in connection with the estate tax return when the donor dies. If the gift tax return did not satisfy the adequate disclosure requirements, the statute of limitations would not have run on the gift, and substantial additional adjusted taxable gifts may be added to the estate tax calculation, and if gift taxes are due, penalties and interest may be added to those amounts for the intervening years. As an example, the *Estate of Redstone* estate tax case revisited gifts that occurred in 1972 and the ongoing *Marshall* case involves a 1995 transaction. Furthermore, donees may have personal liability for added gift taxes under the transferee liability rules. Awareness of this "flagging" system heightens the importance of making adequate disclosure on gift tax returns.

Keep in mind that if a planner discovers that a prior gift has not been reported properly by a prior planner, an amended gift tax return can be filed that would satisfy the adequate disclosure requirements.

Similarly, the DSUE reported on portability returns will be revisited at the surviving spouse's subsequent death (the *Sower* case confirms that the statute of limitations does not run on the DSUE amount until it is applied in some manner), emphasizing the importance of having adequate documentation for the value of assets passing in a way that does not qualify for the marital or charitable deduction at the first spouse's death.

e. **Changes in Planning Under 2017 Tax Act.**

- Even very wealthy donors have expressed hesitancy about making $22 million of gifts, partly over concerns that such large gifts may have a bad influence on their children, even for amounts given in trust.
- Silicon Valley planners are seeing significant increased interest in "qualified small business stock" with the possibility of 100% gain exclusion under §1202.
- Some planners are seeing a significant interest in upstream planning, using the exclusion amounts of parents for basis adjustment purposes and for using the parents' GST exemptions.
- For some clients, significant interest

continued on page 4

Insights continued

in causing estate inclusion to achieve basis adjustments is important, such as trying to use §2036 to cause estate inclusion for QPRTs.

f. **Focus on what is Actually Transferred for Valuation Purposes; Lessons from Cavallaro.** The *Cavallaro* case (TC Memo 2014-189) involves a merger of companies owned separately by parents and children, and whether proper values were used in determining shares of the new company that each received. Gift tax returns were not filed at the time of the merger transaction. When shares of the merged company were later sold, the income tax examiner spotted the gift issue and referred it to gift tax representatives. The court discussed that important intellectual property was probably still owned by the parents' company, and that the parents' company contributed to the merger was substantially undervalued. The case raised questions about the ownership of the intellectual property rights, but that issue was not ultimately resolved. The court determined that the taxpayers' appraisal did not consider the additional intellectual property that appeared to be owned by the parents' company, so it was disregarded, and the court based its decisions on the IRS expert's appraisal. The Tax Court held that the parents made a gift equal to the difference between the value of the shares that they received in the merger and the value of the company they owned before it went into the merger.

The Court of Appeals determined that the parties should still have the ability to point out the defects in the IRS expert's appraisal. The case was remanded for that consideration, and it is still ongoing (being heard by Judge Gustafson).

This case highlights the importance of focusing on what is actually transferred. First, a resolution of what intellectual property rights were actually owned by the parents' company and what was owned by the children's company was never determined. The court merely raised questions. Second, the gift amount determined by the Tax Court was the total diminution of the parents' value in the merger, but that is not what was actually transferred for gift tax valuation purposes. The court should have valued the gifts that were made to *each* of the three children, which would have been minority interests in the company entitled to significant lack of control discounts.

The case also raises the issue of whether to have multiple appraisals, taking into account alternative ownership scenarios. Expert testimony regarding the nature of underlying assets (for example, who legally owns intellectual property rights) may also be needed.

g. **IRS In-House and Outside Appraisals.** IRS examining agents routinely refer valuation matters to in-house appraisers. That process often takes 6 to 8 months, and the quality of the reports varies dramatically. Some are good detailed reports, and others are just several pages, sometimes merely canned reports from prior cases.

In litigation, the IRS typically gets outside appraisals. The IRS also sometimes gets outside appraisals in audits, but this seems to depend not on the complexity or amount involved, but upon whether the IRS still has money in its budget for outside appraisals in the current fiscal year. (Toward the end of each summer, it is likely that no funds will be available.)

One professional said he has offered to pay for the IRS to get an outside appraisal, but the Service would not agree to that.

h. **Unaccepted Offers.** Unaccepted offers should not be ignored by the appraiser. If no better evidence of value exists, they may be given heightened significance. But a good appraisal methodology supported by truly comparable public companies is a better indicator of value.

i. **Post-Transfer Sales; Anticipated Sales.**

(1) **Post-Transfer Sales.** Sales after the date of a gift or the date of death must be considered by the appraiser. Some appraisers indicate that they are not able to consider post-event sales under standard valuation principles, but the IRS and courts will require it.

Post-event sales may not be determinative if market conditions have changed. For real estate sales, real estate contracts are often just a way of locking up the property, but the purchaser may have 1-3 years to walk away from the contract with little risk. That is not an "as is" sale that is an indicator of value for transfer tax purposes.

The Tax Court is consistently looking at post-event sales up to **three years** after the valuation date. The trend of the cases, in the absence of other good valuation evidence, is merely to discount the subsequent sales price to present value at the valuation date.

(2) **Anticipated Sales.** If a pending sale is contemplated, report that to the appraiser. John Prokey: "There's no hiding from this. Your appraiser needs to address it and deal with it. If they don't, the cases show that the report will be disregarded by the Tax

continued on page 5

Insights continued

Court. That has happened to both taxpayers and the IRS in valuation cases."

j. **Tax-Affecting.** Cases generally have not allowed "tax affecting" the earnings of S corporations that are valued based on earnings in light of the fact that the earnings are taxed to the shareholders. The seminal case was *Gross v. Commissioner*, 272 F.3d 333 (6th Cir. 2001), *aff'g*, T.C. Memo 1999-254 (court concluded that the IRS's expert used a "preshareholder-tax discount rate," so there was no necessity of "tax affecting" the earnings). Various cases have followed the *Gross* reasoning. *E.g., Giustina, Gallagher* (LLC taxed as S corporation; "we will not impose an unjustified fictitious corporate rate burden on PMG's future earnings").

(1) **Appraisers Typically Tax Affect.** Valuation experts are critical of the refusal to allow any adjustment to reflect that an S corporation's income is subject to shareholder-level taxes and most appraisers do tax affect the earnings of S corporations.

(2) **Court Reaction.** When a taxpayer's expert's report tax affects, the court's reaction is that the expert did not demonstrate that shareholder taxes affected the value of the shares (a corporate level tax is traded for an increased shareholder level tax). Appraisal reports should focus on the total tax burden on C corporations (on which public company comparables are based) vs. flow-through entities.

(3) **Empirical Research Resource.** A lot of empirical research supports using an after-shareholder tax discount rate, taking into account shareholder tax rates. An excellent resource is a book by Nancy Fannon and Keith Sellers, *Taxes and Value: The Ongoing Research and Analysis Relating to the S Corporation Valuation Puzzle.*

(4) **IRS Valuation Aid Report.** In 2014 the IRS published *A Job Aid for IRS Valuation Analysts – Valuation of Non-Controlling Interests in Business Entities Electing to be Treated as S Corporations for Federal Tax Purposes.* Its position is that absent a compelling showing that unrelated parties dealing at arms-length would reduce the projected cash flows by a hypothetical entity level tax, no entity level tax should be applied in determining the cash flows of an S corporation.

(5) **Actual Buyers and Sellers Do Tax Affect.** Clients have told John Porter that they buy and sell S corporations as their business, and they clearly tax affect the cash flows of S corporations in determining the purchase price.

(6) **Appraisal Report Approach.** If the appraiser tax affects the cash flows, the appraisal should address the reasons for doing so in detail. Otherwise, the court will ask why the appraiser adjusted for entity-level taxes when the entity pays no taxes. In addition, the report should take into consideration and balance any benefits that exist associated with flow-through status. (For high cash-flowing businesses, the flow-through treatment is typically better, but entities that retain all of their cash flows may fare better under C corporation treatment.)

(7) **Settlements.** John Porter has settled a number of these cases, sometimes in a backdoor way. Some examining agents and appeals officers take the position that until Gross is overturned, they are not allowing tax affecting. John's approach is that if the agent is assuming S corporation status in perpetuity (i.e., not considering an entity-level tax), the pool of hypothetical buyers has shrunk substantially because the hypothetical buyer must be a qualified S corporation shareholder. Therefore, the lack of marketability discount should be substantially greater. John has settled a number of cases on that basis. His experience is that the ability to settle these cases depends upon how creative the examining agent or appeals officer is willing to be.

(8) **Impact of Lower Corporate Rates.** The lower C corporation tax rate may have some effect on this issue, but substantial discounts from tax affecting will still exist. John Porter reports that failing to tax affect S corporations results in a 60 to 70% greater value in some cases, and that does not make any economic sense.

(9) ***Estate of Cecil v. Commissioner.*** A case that has been tried in the Tax Court and is awaiting decision will address tax affecting for S corporation stock. *Estate of William Cecil v. Commissioner,* Cause Nos. 14639-14 and 14640-14 (trial held February 2016). In Cecil, both the taxpayer and the IRS's expert used tax affecting in their analysis. The Tax Court may have a hard time rejecting tax affecting as a matter of law when both experts agree in its application. (Tax affecting is not the only issue in the case.)

(10) ***Kress v. U.S.*** Both the taxpayer and government experts tax-affected the earnings of an S corporation, and the court followed

continued on page 6

Insights continued

that approach in valuing the S corporation stock in *Kress v. U.S.* (E.D. Wis. March 26, 2019).

(11) Law is Evolving on Tax Affecting. John Porter: "The final chapter in this story has yet to be written." John Pokey: "We may need a Fifth Circuit or Eleventh Circuit case to get the final answer – as with the built-in gains discount cases."

k. **Client Must Review Appraisal.** Too many times, preparers of gift or estate tax returns simply report the value that is in an appraisal report on a gift or estate tax return without further review. Not only should planners review appraisals in detail, clients also have an obligation to review appraisals. If something is in the report that the taxpayer knows is wrong, the taxpayer will not be entitled to penalty protection for relying on the report.

The defense to a valuation penalty is that the client has in good faith and reasonably relied on professional advice. An appraisal by a quality appraiser that does not have missing pieces will qualify for the exception from penalties even if the value is ultimately determined to be too low. In addition, Judge Laro added in a case that to avoid penalties, the taxpayer must provide necessary and accurate information to the appraiser.

l. **Section 2036 Issues.** The most litigated transfer tax issue is whether assets contributed to an FLP/LLC should be included in the estate under §2036 (without a discount for restrictions applicable to the limited partnership interest). About 39 reported cases have arisen. The cases largely seem to be decided largely on a "smell test" basis.

(1) **Bona Fide Sale for Full Consideration Defense.** This defense is the key for defending both §2036(a)(1) and §2036(a)(2) cases. Almost every one of these cases that the taxpayer has won was based on the bona fide sale for full consideration exception to §2036.

(a) **Bona Fide Sale Test – Legitimate and Significant Non-Tax Reason.** The key is whether "legitimate and significant nontax reasons" existed for using the entity. Having tax reasons for creating entities is fine; the test is whether "a" legitimate and significant nontax reason applied as well. The tax purposes are not weighed against the non-tax purposes.

Also, make sure that other planning is consistent with the purposes of the partnership. For example, if the same person is in charge of the partnership, is the agent on the power of attorney, and is the trustee of trust owning other assets, is the partnership really necessary? If one of the reasons for creating the partnership is to involve next-generation family members in the management, don't make them solely limited partners.

Consider documenting the non-tax reasons. Contemporaneous evidence really helps satisfy the court. John Porter has tried seven §2036 cases that have gone to decision and in every one the estate planning lawyer testified and in some the CPA testified as well. If the estate planning attorney testifies, the client will have to waive the attorney-client privilege. The taxpayer is willing to do that because the taxpayer has the burden of proof to establish a legitimate and significant nontax reason. The estate planning attorney's files can significantly help (or hurt) at trial.

(b) **Full Consideration Test.** To satisfy the full consideration requirement, the interest received by the parties making contribution to the entity should be proportionate to their contributions, and the value of contributed property should be credited to capital accounts. This must be done when the entity is created. On liquidation, the owners will receive their proportionate interest in the partnership based on the capital accounts.

(2) **Section 2036(a)(1).** The IRS typically argues that assets should be included under §2036(a)(1) as a transfer to the FLP/LLC with an implied agreement of retained enjoyment. The government wins about 2/3 of those cases. (In some of those cases, the FLP/LLC assets have been included in the estate under §2036 even though the decedent had transferred the partnership interests during life (*Harper* and *Korby cases*).)

Agreement of Retained Enjoyment. If the bona fide sale for full consideration exception does not apply, the IRS must still establish an implied agreement of retained enjoyment in the assets that were transferred to the partnership or LLC.

(3) **Section 2036(a)(2).** In a few cases, the IRS has also made a §2036(a)(2) argument, that the decedent has enough control regarding the FLP/LLC to designate who could possess or enjoy the income or property contributed to the entity. Two cases have applied §2036(a)(2) where the decedent had some interest as a

continued on page 7

Insights continued

general partner (*Strangi* and *Turner cases*).

(a) **Possible Defenses Even as General Partner.** The Tax Court in *Cohen* (79 T.C. 1015 (1982)) said that being co-trustee of a Massachusetts business trust does not necessarily require inclusion under §2036(a)(2) if cognizable limits on making distributions apply rather than a situation in which trustees could arbitrarily and capriciously withhold or make distributions. Traditionally, planners have relied on the *Byrum* Supreme Court case for the proposition that investment powers are not subject to §2036(a)(2).

As discussed in *Strangi*, §2036(a)(2) applies even if the decedent is just a co-general partner or manager, but as a practical matter, the IRS does not view co-manager situations as critically as if the decedent was the sole manager. Having co-managers also typically helps support the non-tax reasons for the partnership or LLC.

(b) ***Powell* and *Cahill*.** The *Powell* and *Cahill* cases add a significant additional risk under §2036(a)(2), focusing on whether the decedent could act with third parties to undo whatever is causing a discount. These seem to be the ability to join with others to cause a liquidation of an entity (or termination of an agreement, as in *Cahill*), and would seem to extend to the ability to join with others in amending documents to permit liquidation or termination. (The ability to amend the partnership agreement without consent of limited partners was one of the factors that the court mentioned in *Turner I* for applying §2036(a)(2)). One possible response is to provide in the underlying agreements that the decedent owns a class of interest that does not permit joining with others to liquidate the entity or amend the agreement. Query whether the absence of a right to vote on liquidation or amendment would be a §2703 restriction that is ignored under the *Cahill* reasoning?

Other cases have limited the broad application of the "in conjunction with" argument relied on in *Powell* and *Cahill*. The taxpayer in *Morrissette* made these arguments (so far, unsuccessfully) in that pending Tax Court case (trial in May 2019).

(c) **IRS Agents Are Making the *Powell* Argument.** John Porter tried *Estate of Wittingham v. Commissioner* in February 2018. The case was ultimately settled, but the IRS made the *Powell* argument with respect to an LLC created by the decedent, in which the decedent and her two sons were the managing members and held the Class A units with voting rights. The case involved the sale of units in return for a private annuity even though the decedent had just found out that she had pancreatic cancer. The case ultimately settled with the taxpayer conceding that some prior purported loans were gifts and conceding about 20% of the private annuity issue because of uncertainty about some medical issues.

The summary was prepared by Steve R. Akers, Senior Fiduciary Counsel Bessemer Trust with the help of John Porter (Houston, Texas) and John Pokey (San Jose, California) who both handle a significant amount of audit controversy and litigation involving transfer tax matters.

Developments in Fiduciary Litigation: Notable Cases

Timothy S. Egan

These three recent cases have significant implications for practitioners and corporate fiduciaries, involving grantor intent, trust modification, and state income taxation of trusts.

Horgan v. Cosden (Fl. Dist. Ct. App. 2018)

In this Florida case, the current and remainder beneficiaries of an irrevocable trust sought to terminate the trust early. The co-trustee objected to the early termination as being contrary to the intent of the settlor based on the plain language of the trust instrument.

Yvonne Cosden created a revocable trust in 1993, later amended and restated, which became irrevocable at her death in 2010. The successor trustees were Joseph Horgan, her personal assistant and friend, and Christopher Cosden, her only child. The trust provided for a distribution of $250,000 to Horgan at Yvonne's death, with the remaining assets (approximately $3,000,000) to be held in trust for the benefit of Christopher Cosden. During Christopher's lifetime, the net income of the trust was to be distributed to him at least quarterly. There was no provision for the distribution of principal during Christopher's lifetime. At his death, the principal of the trust would be distributed

continued on page 8

Developments continued

among three educational institutions.

Christopher and the remainder beneficiaries entered into a settlement agreement to terminate the trust early, with Christopher receiving a lump sum payment of $2,000,000, based on the actuarial value of his income interest. The educational institutions would receive the remaining $1,000,000. Horgan, the co-trustee, objected to the termination agreement, so Christopher filed a complaint to terminate the trust and distribute the assets in accordance with the agreement.

Florida law permits termination of a trust when the termination is not inconsistent with the settlor's purpose, and the purposes of the trust have been fulfilled or continued administration would be wasteful, or is in the best interests of the beneficiaries.

The trial court found that there were no issues of material fact, granted summary judgment in Christopher's favor, and ordered the termination of the trust. Citing section 736.04113 Florida Statutes (2015), the trial court determined that the statutes permitted the termination of a trust "if the purposes of the trust have become fulfilled or wasteful." Further, citing section 736.04115 Florida Statutes (2015), it found that the termination agreement was in the beneficiaries' best interest "because it will preserve the assets held in the Trust by eliminating unnecessary expenses relating to trust administration. A continuation of the Trust would incur unnecessary expenses and trustee's fees."

Horgan appealed. In reversing the trial court decision, the Florida 2nd District Court of Appeals determined that "the plain language of the Trust reflects that the Settlor wanted to provide for her son financially via incremental distributions of income until he died and then give the entire principal to three educational institutions. Terminating the Trust before this event will frustrate the purposes of the Trust."

The Court of Appeals found that, viewed through the lens of the settlor's intent ("the pole star of trust interpretation"), the early termination would "frustrate the purposes of the Trust" and that, contrary to the trial court's findings, there was no evidence that the trust's purpose had been fulfilled or that continued administration of the trust would be wasteful. The 2nd District Court of Appeals reversed the summary judgment order and remanded to the trial court in favor of Hogan, denying the termination of the trust.

Hodges v. Johnson (2017 N.H. 232)

Many states, including New Hampshire, permit trustees to decant from one irrevocable trust to a second trust, for the benefit of one or more beneficiaries of the first trust. In Hodges v. Johnson, the Supreme Court of New Hampshire found that the trustee of two irrevocable trusts improperly engaged in decanting transactions designed to remove beneficiaries.

David A. Hodges, Sr., was the settlor of two trusts created in 2004 for the benefit of his spouse, three biological children, two step-children, and their descendants. The trusts were funded with interests in David's real estate company, where several of his children and step-children were employed. Over a period of several years, the relationships between Hodges and four of his children and step-children deteriorated, and those employed with the company were eventually terminated. The settlor appointed his estate planning attorney as an additional trustee of the trusts, and the other two trustees (both employed at the settlor's company) delegated their decanting power to him as the "decanting trustee." The decanting trustee then engaged in three separate decantings which successively removed the step-children, one biological child, and the settlor's spouse as beneficiaries of the trusts.

The trial court ruled, and the New Hampshire Supreme Court affirmed, that the decantings were improper and void because one of the purposes of the trust was to support the beneficiaries, and the decanting trustee had failed to "give any consideration to the [removed beneficiaries'] beneficial interests." The Supreme Court agreed with the trial court's conclusion that the decanting trustee had violated the duty of impartiality, and explicitly favored one group of beneficiaries over another. The decanting trustee had "failed to give any consideration to the plaintiffs' future beneficial interests, contrary to the statutory duty of impartiality." The Supreme Court also affirmed the trial court's order removing the delegating trustees.

North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust (588 U.S. 2019)

At issue in this highly anticipated case decided by the U.S. Supreme Court was whether the Due Process Clause of the Fourteenth Amendment permits states to tax the accumulated income of non-resident trusts based solely on the residency of the trust beneficiaries.

In 1992, Joseph K. Rice, III, a New York resident, created three separate share trusts for the benefit each of his children and their descendants. The trust was governed by New York law, and the initial trustee was a New York resident (later a Connecticut resident became successor trustee). The books and records of the

continued on page 9

Developments continued

trust were maintained in New York, while the custodian of the trust assets was in Massachusetts. Kimberly Rice Kaestner, one of Rice's three children, moved to North Carolina in 1997. Other than her residence, the trust had no other connections to North Carolina.

Kaestner and her descendants were not entitled to any distributions of income or principal until Kaestner attained the age of 40 in 2009, at which time the trust would distribute all of its assets to her. While the trustee was permitted to make discretionary distributions of income and principal to Kaestner and her descendants before the age attainment, no such distributions were made.

Under N.C. GEN. STAT. Sec. 105-160.2 (2017), North Carolina taxes the undistributed income of non-resident trusts based on the residency of trust beneficiaries in the state. For the tax years 2005-2008, North Carolina assessed over $1,300,000 in taxes on the trust's undistributed income. The trust paid the taxes and requested a refund, which was denied. The trustee then filed a complaint challenging the North Carolina statute under the Due Process Clause of the Fourteenth Amendment to the United States Constitution. Section 1 of the Fourteenth Amendment provides that no state shall "deprive any person of life, liberty, or property, without due process of law." The case, *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992), established that in the context of taxation, the Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," and that the minimum connection requires that the person or entity to be taxed "purposely avails itself of the benefits" of the taxing state.

The trust argued successfully in the trial, appellate, and North Carolina Supreme Courts that North Carolina's statute violated the Due Process Clause because the mere fact of the beneficiaries' residence in North Carolina was not sufficient to meet the minimum connection requirement. The North Carolina Supreme Court ruled that it was the beneficiaries, not the trust itself, that "availed themselves of the benefits and protections of North Carolina's laws."

Justice Sonia Sotomayor delivered the Court's unanimous opinion affirming the judgment of the North Carolina Supreme Court (Justice Samuel Alito filed a concurring opinion, with Chief Justice John Robert and Justice Neil Gorsuch joining). Contrasting the Kaestner facts with other resident-beneficiary cases, the Court noted that the Due Process Clause demands that the resident beneficiary "have some degree of possession, control, or enjoyment of the trust property before a State can tax the asset." The Court concluded that the residence alone of the Kaestner beneficiaries in North Carolina was insufficient to supply the minimum connection required to impose tax: the beneficiaries had received no income from the trust during the period in question; the beneficiaries had no right to demand income or otherwise control trust assets; and any future distributions were at the discretion of the trustee and therefore uncertain in timing and amount.

While the Court found in favor of the Kaestner beneficiaries, it declined to decide "what degree of possession, control, or enjoyment . . . would be sufficient to support taxation." Justice Sotomayor emphasized in her opinion that this decision is a narrow one: "In limiting our holding to the specific facts presented, we do not imply approval or disapproval of trust taxes that are premised on the residence of beneficiaries whose relationship to trust assets differs from that of the beneficiaries here."

Timothy S. Egan is a Relationship Manager and Wealth Advisor at The Glenmede Trust Company, N.A.

Enrichen Your Legacy: Passing Down The Intangibles of Family Values

Clémence R. Scouten

Adding value is no easy task these days. Why not think of adding *values* instead? Making room in estate planning for a family narrative—including family stories, principles, traditions, history, etc.—is possible, and can have a transformative impact on those involved.

Most people would agree that an inheritance is different from a legacy, though it doesn't have to be. Estate planning is a concrete activity around a set of assets, and the advisors and lawyers in that field are the logical experts clients seek out. But when it's over, too few clients have ventured beyond the tax code and financial planning to contemplate their whole legacy. Thinking about the whole process as legacy planning, rather than estate planning, is a natural step to enrich the value of what is left behind, as well as the value advisors can provide.

Incorporating a family narrative has concrete activities and benefits just as estate planning does. From documenting a basic family tree to writing a memoir, there are any number of ways to capture intangible family values for the whole family's benefit.

continued on page 10

Enrichen continued

Money vs. Meaning

Allianz Life conducted two surveys about the emotional complexities of intergenerational wealth transfer. One of their major discoveries was that money was not the most important legacy. Family stories consistently ranked higher in importance than personal possessions and financial inheritance. And yet, this important part of the inheritance doesn't always get the focus it deserves. It's especially a shame considering that people generally do like to think about what is meaningful in their lives. And the information is right there, just waiting to add meaning to the financial assets.

Why the hesitation?

As my father said in the opening lines of his autobiography, "the more I thought about the past, the recollection of blunders and bad errors in judgment tended to make the reconsideration of those early periods most unpleasant." But it's exactly that act of discussing our mistakes and mishaps that offers real life experiences others can relate to. I truly enjoying knowing some of my father's faults (and successes), especially as his autobiography is all I have left of him.

Another hesitation is the common discomfort generated by focusing on oneself. What if we sound silly? What if we don't do it "right"? Or, the least important but most frequent, "my life isn't really that interesting anyway." The process of thinking about one's values, one's motivations, or what brought on the successes and failures, is meaningful regardless of the richness of one's life. It's not a self-indulgent process, just the opposite. It's our actions, not the events themselves, that define our beliefs and values, and provide an example to future generations. Teaching and guiding others even after we are gone is not only the realm of historical/famous figures.

In fact, our society has greatly increased its attention on capturing the story of everyday people. Take StoryCorps, which launched as a tiny endeavor in 2003, and has since then published book after book of their collections (based on more than 200,000 interviews!), gathering incredible support and attention along the way. The Library of Congress's Veteran's History Project preserves first-hand interviews and narratives of our military veterans. Another remarkable example is the Shoah Foundation at USC, founded by Steven Spielberg, which started out as an effort to record the experience of Holocaust survivors.

It's not just for the very wealthy

Just as with everything else, family history can be as simple or as complicated as we want to make it. It's not uncommon to hear of families paying tens of thousands of dollars to have a memoir commissioned. Yet there are also many activities people can do on their own, without any outlay of cash, that are equally compelling. How is that possible? Because of a simple reason that goes to the heart of what this type of project is about: it's a person's *own* family and *their own* family values. The subject can't be purchased, nor do any tools need to be acquired for self-reflection. Furthermore, its inherent worth doesn't change because of appearance of the final product.

Consider the different activities people can engage in on their own:

Genealogy research

With modern online tools, genealogy research is within anyone's reach. Gone are the days where writing to civil records offices, waiting for a response, writing back, etc., was the only way. The incredible mass of online information available through the big sites like Ancestry.com (a premium site), MyHeritage.com (a freemium site) or FamilySearch.org (a completely free site) delivers *billions* of records to our desktops. This can be a good place to start for someone who wants to think about their family history. Documenting the lives of our closest family members is satisfying, and discovering special facts about them can be especially meaningful.

Imagine finding a ship manifest for the first person in your family to come to the United States. In many cases, you will see who he (or she) traveled with, what age he was, how much money he had with him, and where he was going. This type of detail opens the door to a conversation about what makes life easy or hard, or what work goes into making a good life for oneself and one's family—two great examples of subjects that are completely timeless, that any generation can relate to, and which are very closely linked to the family values that should be part of legacy planning.

Memoirs

Technological advances in the printing industry have also impacted family history work. Now that it's possible to print one's memoirs in small, custom runs (as opposed to a minimum of 1,000 copies) it's also much more affordable. On-demand printing isn't just for photobooks.

It's not clear how many "personal" memoirs are published every year. Of course the publishing industry still looks for potential best-seller autobiographies, but personal memoirs printed only for friends and loved ones are more and more common. With the obstacle of prohibitively expensive and burdensome printing removed, the focus can be on content.

That's not to say it's easy. The measure of introspection and discipline necessary to

continued on page 11

Enrichen continued

write one's life story is not insignificant. The timeline is measured in months or years rather than weeks, especially for those who don't have experience writing. On the other hand, again thanks to inexpensive printing options, unfinished manuscripts, or even very short pieces, can still be put in book format and passed on as a special family heirloom. There are also more and more memoir writing classes available as the subject continues to gain popularity.

Legacy letters

For those who are not interested in writing a memoir and documenting their entire life, a legacy letter can be a wonderful alternative. Even a long letter doesn't take up much space, but the emotional dimension it adds to financial assets is significant.

These letters have a very old history, especially in the Jewish community. Short or long, they contain a description of whatever is meaningful to the author: life lessons, principles, values, religion, advice, hopes, expression of affection, and stories. This leave-behind has the potential to be one of the most valued possessions of the next generation.

A quick review of examples available on the internet offers different approaches, subjects and variety of styles. As with many tasks of this nature, the hardest part is kicking it off. Having someone to talk to about its content, taking one's time and accepting that there will be many drafts before the final version, are just a few aspects of the process to consider.

Benefits

The obvious benefit, and usually the main motivation behind engaging in some type of legacy project of this nature, is to add a dimension of meaning to the financial assets or to leave a record of one's life as a gift. But there are other reasons to consider. Focusing on family history and reflecting on the events of one's own life is actually good for you.

Knowledge of family history is an indicator of psychological well-being. According to Dr. Robin Fivush who studies this at Emory University, "knowledge of family history is significantly correlated with internal control, higher self-esteem, better family functioning, greater family cohesiveness, lower levels of anxiety, and lower incidence of behavior problems [for children]."

These findings are similar to those around the study of nostalgia, which is a universal feeling found "to bolster social bonds, increase positive self-regard, and generate positive affect." In older adults, it's long been believed that life review alleviates depression, and it has even generated treatment terms such as "reminiscence therapy" or "life review therapy."

It can also be just plain fun. Older adults may enjoy the satisfaction of taking stock of their life, but for everyone else, the process of discovery and sharing is a group activity that is both meaningful and interesting.

Just do it

No matter what motivation or benefit, whatever form the exercise takes, the process itself forces a person to think about what is important to them about family, our most fundamental societal bond. Is it one person who made a mark, or several? Should the focus be on how the family obtained money, or how the money was lost? How does hard work and hard times influence a family? These are only a few of the many questions which can be asked.

Good financial planning may make life easier, but family is what makes life meaningful. As Fivush says, "narrating our personal past connects us to our selves, our families, our communities and our cultures." So regardless of whether someone chooses to engage with you or do it on their own, documenting family values it is a step worth contemplating.

Clémence R. Scouten is the founder of Attics Anonymous, a service that helps individuals capture and share their family stories across generations.

February Luncheon Program

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John A. Terrill, II is the new President of The American College of Trust and Estate Counsel (ACTEC)

Washington, DC: The American College of Trust and Estate Counsel (ACTEC) is proud to announce that John A. ("Jack") Terrill, II became President. The official "Passing of the Gavel" ceremony took place Saturday, March 23, 2019, at ACTEC's Annual Meeting in La Quinta, California. Terrill, a partner at Heckscher, Teillon, Terrill & Sager, P.C. in West Conshohocken, Pennsylvania, and a member of the Philadelphia Estate Planning Council succeeded ACTEC Fellow Charles D. "Skip" Fox, IV from Charlottesville, Virginia.

ACTEC is a professional organization of approximately 2,500 lawyers from both the United States and abroad. Fellows of ACTEC have extensive experience in one or more of several practice areas including among others estate and trust planning; estate tax, gift tax and generation-skipping tax planning; fiduciary income tax planning; charitable planning; planning for owners of closely-held and family businesses; fiduciary litigation; and estate and trust administration. Terrill was elected to ACTEC in 1991 and has been an officer since 2015. He has been an active participant in the work of the College and is the founding Chair of ACTEC's Asset Protection Committee. He also chaired the FATF Task Force and has been an active member of a number of committees including Professional Responsibility Committee, Sponsorship Advisory Committee, Legal Education Committee, and Executive Committee.

Terrill is a nationally recognized authority on asset protection planning and on the international efforts to involve lawyers in the war against money-laundering and terrorist financing under the auspices of the Financial Action Task Force. Terrill was a lecturer at University of Pennsylvania Law School, where he taught Trusts and Estates, and an adjunct professor in the graduate tax program at Villanova University. "Knowing ACTEC, its Fellows and Staff, as I do, I must say that it is the greatest honor of my professional life to be chosen to lead this organization during its 70th year. I have had a close-hand view of the Fellows of the College showing the highest level of professional excellence in what they do, for their clients and for the trust and estate practice in their broader communities. Collectively they play an important role in the creation, improvement and interpretation of laws and rules for the benefit of our local communities, states and country. As President, my most important role will be to facilitate the delivery of that excellence in every possible way."

At the La Quinta Annual Meeting, ACTEC's Board of Regents elected the following 2019-2020 officers, each of whom will serve with Terrill on the Executive Committee and on the Board of Regents:

- President-Elect: Stephen R. Akers (Dallas, Texas)
- Vice-President: Ann B. Burns (Minneapolis, Minnesota)
- Treasurer: Robert W. Goldman (Naples, Florida)
- Secretary: Kurt A. Sommer (Santa Fe, New Mexico)

Skip Fox will also serve on the Executive Committee as the immediate Past- President during the 2019-2020 year.

About the American College of Trust and Estate Counsel (ACTEC): Established in 1949, The American College of Trust and Estate Counsel, ACTEC, is a national organization of approximately 2,500 lawyers peer-elected to membership by demonstrating the highest level of integrity, commitment to the profession, competence, and experience as trust and estate counselors. Our members, "Fellows," are the best and brightest in the trust and estate practice, with decades of experience representing and advising families. ACTEC offers technical comments about the law and its effective administration but does not take positions on matters of policy or political objectives.

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The Section, which is comprised of lawyers in private practice, government practice, trust officers, and in-house counsel, serves its members through our many committees to provide important opportunities to grow and develop in an area of expertise, contribute to the quality of the profession, and network with colleagues.

To learn more and to get involved, visit **PhiladelphiaBar.org** and **join** the **Probate and Trust Law Section** today!

2019 GOLF & TENNIS OUTING

The Philadelphia Estate Planning Council held its 23rd Annual Golf & Tennis Outing on Monday, June 24, 2019. The golf outing was held at the Union League Golf Club at Torresdale and the tennis outing was held at the Philmont Country Club.

Putting practice before the golf outing

Fran Reed, Susan Fisher, Leanne Johannes, Liz Vibber

J.R. Burke, Richard Schwartz, Justin O'Malley and Douglas DiSesa

Stuart Katz at the tennis outing

2019 Tennis Outing participants

continued on page 11

Christopher Borden putting at the golf outing.

Vince Mitchell, Christopher Borden, Kevin Manning and Justin Esposito

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2019 ANNUAL MEETING, SEMINAR AND RECEPTION

The 2019 Annual Meeting, Seminar & Reception was held on Thursday, May 16, 2019 at the National Museum of American Jewish History. This year's program featured Steven K. Mignogna, Esq. from Archer & Greiner, Terrence M. Franklin, Esq. from Sacks Glazier Franklin & Lodise and Robet Goldman, Esq. from Goldman, Felcoski & Stone, P.A. speaking on "Seven Deadly Claims." Meeting attendees enjoyed a cocktail reception following the program.

President J.R. Burke passes the gavel to Vice President Scott Isdaner

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2018-2019 Officers: Richard Schwartz (Immediate Past President), Eric Hildenbrand (Secretary), J.R. Burke (President), Scott Isdaner (Vice President) and Andrew Haas (Treasurer)

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2019 ANNUAL MEETING, SEMINAR AND RECEPTION continued

2019-2020 Board of Directors

Our speakers, Robert Goldman, Esq. Terrence M. Franklin, Esq., and Steven K. Mignogna, Esq.

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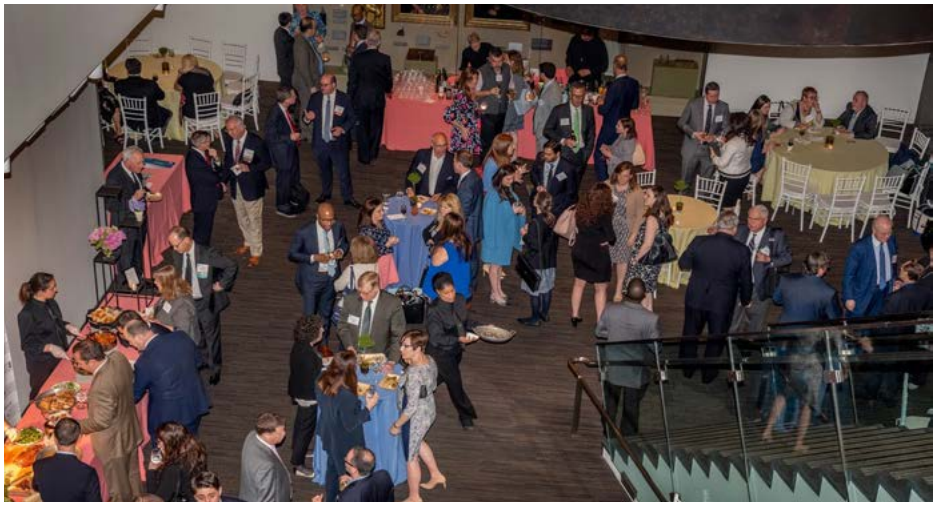

Cocktail reception following the program

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The Philadelphia Estate Planning Council thanks all of our volunteers who served on one or more of our committees this past year. Our council is one of the largest councils in the country, and it takes the time and dedication from many members to be successful.

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continued on page 16

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