the will & the way

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The Chair's Comments

Craig Dalton

The past quarter has been quite a productive period for a number of the Committees of our Section. The Legislative Committee, led by Rebecca Smitherman, has prepared fourteen proposed bills, most of which have been approved by the Legislative Action Committee, the Board of Governors and have been submitted to the Legislature. This slate of proposed legislation represents the largest number of proposed bills offered by any North Carolina Bar Section during this legislative session. The legislation includes amendments to North Carolina's fiduciary income tax statutes, allows sale of real estate by an estate without a court order, a new Uniform Powers of Appointment Act and numerous amendments to the Uniform Trust Code. A number of the proposed bills are quite progressive, including a living probate statute that permits a testator to petition a court to probate a will during the testator's lifetime. I want to thank Rebecca for her leadership and the Legislative Committee for its substantial work.

The CLE Committee led by Parrish Peddrick has completed planning for the annual meeting. Nationally known Natalie Choate will be a speaker. A fiduciary litigation program was presented on February 5. On April 28, a CLE on Emerging Issues related to estate planning will be presented and on May 29, there will be a joint CLE program with the Elder Law Section. The Survey Course will be held on September 23-24.

The Fiduciary Litigation Committee led by Jim Hickmon is presenting a seminar on fiduciary litigation and dispute resolution involving trusts. The Estate Administration Manual Committee led by Heidi Royal and Jessica Hardin, is developing a new Manual with more topics and forms.

I am pleased to report that the Board of Governors recently announced that it will award our Section the

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Intermediate Asset Protection Planning: LLCs, Dynasty Trusts and Captive Insurance Companies

By Jesse T. Coyle and W. Y. Alex Webb

In a prior article, we provided a reconsideration of how basic planning devices/strategies – IRAs, life insurance, and holding property as Tenancy by the Entirety – serve as our first tier of asset protection, even if not always viewed that way. In this article, we are going to discuss a second and third tier of asset protection. In the second tier, we will discuss the widely known, but often underutilized, use of Limited Liability Companies and Dynasty Trusts. In the third tier, we will discuss Captive Insurance Companies.

Limited Liability Companies

A Limited Liability Company ("LLC") is a hybrid entity that provides its owners with the benefits of both a corporation and a partnership (unless elected otherwise in *Form 8832* with or without filing *Form 2553* to be taxed as an S Corp). An LLC provides its owners with limited liability, flow-through income tax treatment under *I.R.C. § 701*, lack of marketability and/or lack of control valuation discounts (on gifts and death

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NORTH CAROLINA BAR ASSOCIATION
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The Chair's Comments, *continued from the front page*

Chief Justice Award for its services in organizing a pro bono program to provide services to victims of the North Carolina Eugenics program. This award recognizes a statewide bar organization whose members have given outstanding support and assistance for programs for low income residents. It will be made at the annual meeting of the Bar Association this summer. As I previously reported in this column, last year our Legislature appropriated the sum of $10,000,000 to compensate the victims, one half of which was distributed in October. The Department of Administration established a program led by Dee Jones to identify the victims and to distribute the settlement proceeds. A total of 220 victims were identified. Members of the Elder and Special Needs Law Section provided pro bono advice as to the effects of receipt of the settlement proceeds on continued qualification for federal benefits, and members of our Section provided pro bono services in preparation of estate planning documents. Forty lawyers from the two Sections volunteered their services and a total of 82 of the 220 victims requested pro bono services. The final distribution of the settlement proceeds will occur in two years and again the victims may call upon the volunteers for assistance. On behalf of the North Carolina Bar Association, I want to thank each volunteer for his or her service to a population of North Carolina that has likely never before received legal advice. Surely this exemplifies volunteerism at its best. Also, on behalf of the North Carolina Bar Association, I thank Dee Jones for her leadership in this important program and for the opportunity for the two Sections to provide legal services to the victims.

In addition to the Chief Justice Award, the North Carolina Bar Association provides a number of ways to commemorate the volunteer services of North Carolina lawyers. The Justice Fund, a part of the North Carolina State Bar Association Foundation, honors North Carolina lawyers, past and present, whose careers have shown dedication to the pursuit of justice and outstanding service to the profession and the public. A Justice Fund is a named endowment and may be established in recognition of an attorney with a gift of $35,000 by one or more contributors, such as a group of attorneys, friends, and family members. There are now over 100 such funds. North Carolina lawyers honored by a Justice Fund receive recognition in the form of a permanent plaque and biographical sketch maintained at the North Carolina Bar Center. I am pleased to report that a Justice Fund was recently created and funded in honor of Christie Eve Reid who passed away in 2014. Christie served as Chair of our Section and on the Board of Governors of the Bar Association.

Supporting The Liberty Garden located at the Bar Association is another way to recognize the important contributions of a diverse array of North Carolina lawyers who embody the values of integrity, civility, competence, and a commitment to the administration of justice. The Liberty Garden is the newest addition to the Bar Center campus. A wide variety of naming opportunities have been incorporated into the Liberty Garden, including memorial benches. Memorial benches have been established in memory of Christie Eve Reid, as well as Susan Ivy McCrory and John W. Mason, both leaders of the Estate Planning and Fiduciary Law Section. Finally, a Liberty Garden Fund has been established in honor of Dean A. Rich, a prior chair of our Section. All such persons certainly exhibited the volunteerism that has so benefited our Section and the public.

Tom Hull of the N.C. Bar Association Foundation is responsible for administering the Justice Fund and the Liberty Garden, as well as other programs that provide support to the Foundation. We thank him for his leadership.

–Craig G. Dalton Jr.

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transfers), basis step-up for certain transferred or inherited assets (*I.R.C. § 754*), and operational/structural flexibility, while avoiding some of the perceived disadvantages of Family Limited Partnerships ("FLP") or subchapter S corporations. Specifically, every member of an LLC (even the managing member) benefits from limited liability, which is a distinct advantage over the FLP, where the general partner may face unlimited personal liability from the operations of the business. Also, LLCs are much more flexible than S Corporations in regards to potential owners, management, control arrangements, and ownership types. For the purposes of this article, we are only going to focus on the asset protection benefits of the LLC (as well as some drafting considerations to enhance these benefits).

But to get the best protection possible from an LLC, a proper domicile must be chosen. In general, state law provides what acts and documents are required for the creation and operation of an LLC in that particular state and what protections and restrictions are given to the LLC and its members. In North Carolina, Articles of Organization are required to be filed with the Secretary of State, as well as Annual Reports ($125 and $200 respectively). *N.C.G.S. § 57D-2-21*; *N.C.G.S. § 57D-2-24*. If an Annual Report is not received, then the LLC can be administratively dissolved by the Secretary of State. In North Carolina, an LLC (as a PLLC) can also render professional services to the same extent as a professional corporation. *N.C.G.S. § 57D-2-02.* However, professional licensees do not get malpractice protection in a PLLC. *N.C.G.S. §§ 55B-9(a)* and *57D-2-02(b)*. A PLLC is, notwithstanding, better than a general partnership. *N.C.G.S. §§ 55B-9(b)* and *57D-2-02(b)*.

Once the LLC is formed, an Operating Agreement and organizational minutes for the LLC generally should be prepared, as well as ownership certificates and a minute book. But even with the absence of organizational minutes or an Operating Agreement, in North Carolina an LLC may still provide asset protection to its members via default to the state statute. However, attorneys should put much thought into the Operating Agreement (the controlling contract) as this is the place where the asset protection of an LLC can be enhanced by creative drafting and where the rights and responsibilities between the members are determined. As stated in the statute, the purpose of the statute is to give LLCs a "flexible framework" for business operations and to "give the maximum effect to the principal of freedom of contract and the enforceability of operating agreements". *N.C.G.S. § 57D-10-01.*

In regards to asset protection, LLCs provide both significant inside-out and outside-in asset protection for its members. With inside-out asset protection, unless personally guaranteed by one or more members, the members are not personally liable for the LLC's debts and obligations; therefore, the most a member stands to lose is the amount of his or her investment in the LLC. Also, unlike a limited partnership, LLC members do not lose their limited liability status if they actively participate in management of the LLC. *N.C.G.S. 57D-3-30*. But in order to maintain the limited liability advantage for the LLC's members, it is important to always act fairly and legally, fund the LLC adequately, and not to comingle personal and LLC business.

In addition, each member also receives significant outside-in protection. Outside-in protection limits a member's individual creditors from accessing the assets in the LLC. In North Carolina, an individual member's creditor has only one remedy against that member in relation to accessing that member's interest in the LLC – a "charging order". *N.C.G.S. § 57D-5-03*. A charging order is a lien on the debtor member's economic interest that provides the creditor of that particular member with only a right to receive whatever distribution that the member would have received. *N.C.G.S. § 57D-5-03(b)*. Much to the chagrin of creditors, North Carolina law does not allow the creditor to foreclose on the member's interest. *N.C.G.S. § 57D-5-03(d).* Therefore, if an interest becomes charged, then the debtor member being compensated by a management fee or salary can vitiate the charging order (the charging order would have little or no distribution to attach to). Specially, "the entry of a charging order is the exclusive remedy by which a judgment creditor of an interest owner may satisfy the judgment from or with the judgment debtor's ownership interest." *N.C.G.S. § 57D-5-03(d).*

But to enhance the creditor protection within an LLC, we often recommend several enhancements be drafted into the LLC's Operating Agreement. First, for the sake of notice to third parties, we recommend each membership interest certificate have certain language on its face referencing the restrictions of both ownership and transfer that should have been set forth in the Operating Agreement. For example:

> "Ownership, encumbrance, pledge, assignment, transfer, or other disposition of the Membership Interest represented by this certificate, or any certificate issued in lieu hereof, is subject to the restrictions contained in an Operating Agreement dated _____, among the Members of the Company, a copy of which is on file in the business office of the Company."

Next, we typically create a provision whereby a member that receives an offer from an unrelated third party for his or her LLC interest must then offer his or her ownership interest sought by the third party to all other members for significantly less than of the amount offered (i.e. a right of first refusal for the other members) if that member still desires to sell his or her interest. If after a limited period of time no member wishes to purchase the ownership interest, the selling member may sell to the third party. If multiple members wish to buy the ownership interest, those members may purchase the ownership based on their percentage of ownership in the Company. Third, we also create what we call a "Russian Roulette" provision. Under this provision, if one member ("the offeror") attempts to purchase the LLC interests of another member ("the offeree"), the offeree can purchase the interests of the offeror for the same price. This creates a scenario that forces the offeror to offer a legitimate FMV for the interests he/she/it is attempting to purchase.

Additionally, we create an enhancement to the charging order defense where if by court order a member's interest is subject to a charging order, then the Company can either redeem this interest or, if a majority of the members not subject to a charging order choose, they can purchase this interest. The interest will be purchased at fair market value ("FMV") adjusted for appropriate

discounts and the purchase price will be paid by an unsecured promissory note, providing for interest only payments for 10 years at the lowest AFR interest rate. Lastly, and as an alternative to, or complement to, the purchase scenario prior, we provide the opportunity when a member's interest becomes charged for the members to recapitalize this interest and turn it into a non-voting "frozen interest". A frozen interest will have no right to receive any future distributions from the Company, but the member's capital account will reflect the distribution he/she/it would have received. Also, the frozen interest would have no voting rights, except for the right to vote upon a proposed dissolution or liquidation of the Company.

We are aware of some issues that may occur in bankruptcy, but that is outside of the scope of this article. A more thorough discussion of the North Carolina LLC Act will come in a forthcoming article.

Dynasty Trusts

A dynasty trust is an irrevocable trust created for the benefit of multiple generations while eliminating estate, gift and generation-skipping transfer taxes at each generational level. A dynasty trust may be created as an *inter vivos* or testamentary trust, with the former being a terrific way to leverage an estate freeze.

One of the primary reasons for a dynasty trust is the generation skipping transfer tax. The generation skipping transfer tax ("GST tax") was enacted to tax property passing down through the family at least once per generation and serves as a backstop to the estate tax. The GST tax is imposed whenever there is a transfer to a "skip" person, a descendant who is two or more generations below the grantor (such as a grandchild or great-grandchild), or a non-family member if that person is more than 37½ years younger than the grantor. The GST tax is a flat, 40% tax on the value of the property subject to tax.

Each person has a limited exemption from the GST (currently, the same as the estate tax exemption). Dynasty trusts are often created during the grantor's lifetime with the grantor's GST tax exemption so that the property held in trust, including all appreciation on the property, will pass to the beneficiary (regardless of generation) free of GST tax upon the death of the grantor (or remain in Trust for perpetuity). A grantor can also leverage his or her GST exemption through gifting assets subject to valuation discounts, such as LLC or FLP interests, to a dynasty trust. Regardless, the assets within the trust will be protected by a properly drafted spendthrift clause.

Another benefit of a dynasty trust is the grantor's ability to maintain control from the grave. This too enhances the credit protection of the trust as the beneficiaries will not be given lifetime or testamentary general powers of appointment, meaning that they cannot make distributions to themselves, their creditors, their estates, or the creditors for their estates. *I.R.C. § 2041(b)(1)*. Beneficiaries can still receive plenty of benefits and even serve as trustee if distributions are limited to ascertainable standards, such as health, education, maintenance, and support (the so-called "HEMS" standard) or if distributions to the beneficiary-trustee are contingent upon approval by an independent co-trustee. *I.R.C. § 2041(b)(1)(A); I.R.C. § 2041(b)(1)(C)*.

Ideally, a dynasty trust should be able to exist in perpetuity. However, the "rule against perpetuities" prevents perpetual trusts by limiting the life of a trust. The most common version of the rule states that each trust must terminate, or at least "vest", twenty-one years after the deaths of all lives in being when the trust was created. North Carolina has seemingly eliminated the rule against perpetuities, thereby seemingly allowing for the existence of perpetual trusts. *N.C.G.S. § 41-15; N.C.G.S. § 41-23(h)*. Nevertheless, there is a debate regarding the validity of dynasty trusts in states with statutes that permit these trusts but that have conflicting constitutions that ban entails (i.e. North Carolina, Nevada, and a few others). The easy fix is to cap the term of the trust to the perpetuities limit, but this does ultimately minimize the effectiveness of a dynasty trust. Such a clause may state as follows:

> Except as may otherwise be extended by applicable law, any trust under this trust instrument in which equitable title to the property is not indefeasibly vested in the beneficiary shall terminate twenty-one (21) years after the date of the death of me and all of my issue who are alive on the date of my death. Upon such termination the Trustee shall distribute the then remaining principal and undistributed income of such trust to the person(s) to whom the income payments could be made under such trust immediately prior to its termination, with such person(s), if there be more than one who are issue of mine, to take *per stirpes*.

But this work around does not resolve the debate of the legality of the rule against perpetuities in North Carolina. In 2007, House Bill 1384 was passed and the rule against perpetuities was repealed. *N.C.G.S. § 41-15; N.C.G.S. § 41-23*. The repeal of the rule against perpetuities at first blush appeared to resolve the prohibition of creating true dynasty trusts in North Carolina. But, alas, the debate was not resolved. North Carolina is one of several states that contain a constitutional prohibition on perpetuities. *N.C. CONST. ART. I, §34*. This ban against perpetuities goes back to the 18th century when the fear of monopolies and the monarchy was still rife amongst the populace. But whether the perpetuities considered by the North Carolina constitution is the same as the perpetuities addressed in the Rule Against Perpetuities is currently up for heated debate. For these to be synonymous would appear to be questionable at best as it is hard to surmise that the North Carolina Constitution would ever portend the awkward and arbitrary Rule Against Perpetuities where anecdotal fertile octogenarians must be considered and where 21 years is a magical operative number.

This debate has reached a near fever pitch recently with Steve Oshins Rebuttal to Unconstitutional Trusts in Steve Leimberg's December 22, 2014 Estate Planning Newsletter. In this rebuttal, Mr. Oshins takes the offensive against articles written by other estate planning attorneys, including Jonathan Blattmachr, that have claimed that constitutional prohibitions against perpetuities invalidate state attempts to legislate away the rule against perpetuities. The strength of Mr. Oshins' arguments are further buffered by the 2010 North Carolina case **Brown Brothers Harriman Trust Co. v. Benson**, 202 N.C. App. 283, 688 S.E. 2d 752 (2010). In that case, the court found the prohibition against perpetuities in the North Carolina Constitution to apply not to the vesting of remote interests that the Rule Against Perpetuities pertains to and therefore finds the North Carolina repeal of the Rule Against Perpetuities valid. Further, the North Carolina Supreme Court has so far declined to review the decision of that case.

Traditionally, Alaska, Delaware, Nevada, and South Dakota have been preferred dynasty domiciles (offshore jurisdictions are not being discussed in this article), but North Carolina has an opportunity as well to acquire a greater share of the dynasty trust market once this issue is resolved. And once considered a preferred domicile for dynasty trusts, North Carolina will likely experience a considerable positive economic impact similar to what it has experienced since the passing of North Carolina's Captive Insurance Company law, discussed below.

Captive Insurance Companies

Due to the rising costs of insurance and the continual need for self-insurance, more and more businesses are utilizing captive insurance companies. A captive insurance company ("CIC") can take many forms, but in essence it is a subsidiary or affiliate of a limited number of commonly owned insureds and formed for the purpose of writing insurance to that limited group of insureds and no others. The proper use of a CIC will allow the owners to create and issue policies for the insureds that are more cost effective and customized and with a more efficient claims process, as well as create policies for risks that may not have otherwise been insurable and allow access to the reinsurance market. If no claims are submitted, then the CIC serves as a very effective cash reserve for these owners. In essence, a CIC allows the operating business to transfer assets from its balance sheet that were being used for self-insurance, thereby allowing the assets of the CIC to be insulated from the non-insured claims and losses of the operating business.

The fact of the matter is that everyone self-insures whether they know it or not (e.g., through commercial policy exclusions and deductibles, if nothing else), but a CIC forces the owner to think about and quantify risk and to pay for it with a properly drafted policy. If a business would fail from losing a key person(s), but the business owner is not required to consider this, then so often the business owner will fail to properly insure his or her business. With a CIC, not only are risks being insured, but the state regulators of the chosen domicile in essence protect the wealth of the CIC by forcing the CIC owner(s) to maintain the proper CIC formalities. Further, if foreclosed on, the regulators would have to approve the ownership change (but even this could be circumvented by owning the CIC as a LLC with an 8832 election).

As with other business and estate planning strategies, choice of domicile is vital. On the whole, North Carolina is a fairly regulated, low-cost, and progressive domicile for a captive. Fortunately, the North Carolina statute gives North Carolina a very competitive edge in the CIC market. The statute (which begins at *N.C.G.S. § 58-10-335*) is extensive, but the benefits of the North Carolina statute are many:

1. No licensing fees (except for special purpose financial captives).
2. No mandatory Department of Insurance examinations.
3. Possible exemption from annual audit requirements for captives writing less than $1.2 million in premium.
4. No investment restrictions except for association captive insurance companies and risk retention groups.
5. No Insurance Commissioner "pre-approval" required for attorneys, auditors or actuaries.
6. Competitive premium tax rates (generally only 0.4%) with a $100,000 premium tax cap ($200,000 cap for large protected cell companies).
7. Competitive capital requirements (including the unique ability to lower pure CIC capital required).

In addition, there are rumblings that the annual report requirement for North Carolina CICs may be lifted via a future amendment to the statute.

One of the primary benefits for CICs is the asset protection that they provide. CICs are asset protected regardless of the amount of their funding (and receive an even greater layer of protection if owned by a properly designed LLC and/or dynasty trust, both of which were discussed above). Typically, the only creditor claimant against a CIC is the insured of the CIC (i.e. the operating entity that paid the premium, which is usually the same as or related to the owners of the CIC). If the CIC is owned by a trust for the business owner's children or other descendants, there can be great wealth transfer opportunities and an additional layer of asset protection. If the CIC is owned by an LLC, the LLC can permit the business owner to retain control while allowing the children/grandchildren of the owner to be economically benefitted by the LLC.

Summary

This introductory rendition on LLCs, Dynasty Trusts and Captive Insurance Companies has only scratched the surface of the asset protection planning opportunities available through each of these vehicles. Combining them can also achieve outstanding gift, estate and income tax relief.

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Kissing Cousins: Breach of Fiduciary Duty and Constructive Fraud

By Trey Lindley

Breach of fiduciary duty and constructive fraud are probably the most conflated causes of action in fiduciary litigation. If you can't readily discern between them, you're in good company—many practitioners allege them in tandem as a single claim for relief, and a number of opinions from our appellate courts treat them likewise. Breach of fiduciary duty and constructive fraud are nonetheless distinguishable in two important ways.

To prevail on a claim for breach of fiduciary duty, the plaintiff must prove: (1) the existence of a fiduciary relationship, (2) a breach of the duty owed, and (3) damages proximately caused by the breach. *See* **Green v. Freeman**, 367 N.C. 136, 749 S.E.2d 262, 268 (2013). Although the elements for constructive fraud have appeared in various permutations, a widely accepted articulation is found in **White v. Consolidated Planning, Inc.**, 166 N.C. App. 283, 603 S.E.2d 147 (2004): "To survive a motion to dismiss, a cause of action for constructive fraud must allege (1) a relationship of trust and confidence, (2) that the defendant took advantage of that position of trust in order to benefit himself, and (3) that plaintiff was, as a result, injured." *Id.* at 294, S.E.2d at 156 (*citing Sterner v. Penn*, 159 N.C. App. 626, 631, 583 S.E.2d 670, 674 (2003)).

The first and third elements of both claims, while expressed slightly differently, are identical as a practical matter and that may explain the persistent confusion. In its most distilled essence, a fiduciary relationship is "a relationship of trust and confidence". *See generally Ward v. Fogel*, 2014 N.C.App. LEXIS 1248, 20 (Dec. 2, 2014) ("Like constructive fraud, '[a] claim for breach of fiduciary duty requires the existence of a fiduciary relationship.'") (*quoting White* at 293, 603 S.E.2d at 155). Similarly, a plaintiff's allegation that the defendant's misdeeds resulted in injury is tantamount to claiming the conduct proximately caused damages.

The difference, then, hinges on the second element of each cause of action. To breach a fiduciary duty, the defendant must fail to "act in good faith and with due regard to plaintiff's interests." **Vail v. Vail**, 233 N.C. 109, 114, 63 S.E.2d 202, 206 (1951). Constructive fraud, on the other hand, incorporates that sentiment while adding the requirement that the defendant sought to benefit himself in the transaction. *See Toomer v. Branch Banking & Trust Co.*, 171 N.C. App. 58, 67, 614 S.E.2d 328, 335 (2005). In sum, we are left with the logical syllogism that conduct amounting to constructive fraud is also a breach of fiduciary duty, but not every breach of fiduciary duty constitutes constructive fraud.

The second critical difference between breach of fiduciary duty and constructive fraud is their respective statutes of limitations. For breach of fiduciary duty, the statute of limitations is three years. N.C.G.S. § 1-52(1) (2015). The statute begins to run when the claimant "'knew, or by due diligence, should have known' of the facts constituting the basis for the claim." **Toomer** at 68-69, 614 S.E.2d at 336. If, however, the alleged conduct rises to the level of constructive fraud, the statute of limitations is ten years. N.C.G.S. § 1-56 (2015). The tolling date also arguably differs between the two. For constructive fraud, the aggrieved party is under no duty to make inquiry "until something occurs to excite his suspicions". *See Shepherd v. Shepherd*, 57 N.C. App. 680, 682-83, 292 S.E.2d 169, 171 (1989) (quotation omitted). While the plaintiff cannot be willfully ignorant, so long as he remains ignorant through no fault or negligence of his own, the statute will not begin to run. *Id.*

There is an understandable impulse to allege constructive fraud claims wherever they may lie to exploit its longer limitations period. Simply countenancing a claim as one for constructive fraud may not salvage an otherwise stale cause of action. For instance, to the extent a plaintiff's lawsuit challenges a will, it cannot be the subject of a constructive fraud claim because that type of action may only be brought by caveat. **James v. Schoonderwoerd**, 2013 N.C. App. LEXIS 943, 17, 750 S.E.2d 920 (2013) (unpublished). Caveat proceedings, like breach of fiduciary duty claims, have a three-year statute of limitations. N.C.G.S. § 31-32 (2015). In the context of trusts, both causes of action are subject to the five-year statute of limitations provided in N.C.G.S. Section 36C-10-1005(a) (2015).

Fiduciary litigation has risen significantly in recent years. Given the aging baby boomer population, that trend likely will continue. Understanding the subtle differences between a breach of fiduciary duty and constructive fraud could mean be the difference between winning and losing your case.

Trey Lindley organized Lindley Law, PLLC in July 2014. The firm is located in Charlotte and concentrates on fiduciary litigation matters.

Estate Planning and Tax Basis Planning in 2015 and the Future

By Linda Funke Johnson

The New Year brings many changes and new opportunities. "Out with the old and in with the new." Never before has this been more appropriate in the approach and thought to estate planning for our clients. Our old planning thoughts, documents, and advice may be "old", and we need to focus on the "new". On January 1, 2013, Congress passed the American Relief Act "ATRA", which made permanent changes to the laws governing federal estate taxes, gift taxes and generation skipping taxes. The estate tax exemption for 2015 is $5,430,000 per taxpayer with a tax rate of 40%. Currently, married couples can transfer $10,860,000 of assets without attracting estate tax. As stated in *Wealth Counsel Quarterly*, 99.8% of all Americans are not subject to estate tax. So after we share this with our clients and determine that minimizing estate tax is not the focus of their estate planning goals, what do we talk about next during our planning meeting?

Nontax reasons for estate planning still exist including: disability planning, creditor protection, blended family planning, special needs planning, charitable giving, retirement planning, business succession planning, and minimizing probate.

Although many of our clients currently don't face estate tax issues in their planning, all Americans are subject to income tax. One important area to carefully consider when planning is capital gains tax and the impact that death has on the tax basis of each asset even when drafting the most basic of wills and trusts. The differential between estate tax rates and income taxes rates are diminishing. Income taxes are more important than estate tax since they apply to all clients. Short-term gains are taxed at the ordinary income tax rate, which in 2014 might range from 10% to nearly 40%. The 2014 long-term capital gains tax rates, which also apply to qualified dividends, are as follows: 0% if you're in the 10% or 15% marginal income tax brackets; 15% if you're in the 25%, 28%, 33%, or 35% marginal income tax brackets; 20% if you're in the 39.6% top bracket; Collectibles have a 2014 capital gains tax rate of 28%. There is also a 3.8% net investment income surtax for high earners.

Capital gain or loss is the difference between your basis and the amount you receive when selling an asset. Basis may be determined by the amount paid for the asset (***http://www.irs.gov/uac/Newsroom/Ten-Facts-about-Capital-Gains-and-Losses***). Basis may be recalculated upon the death of the taxpayer owner. Under IRC Section 1014(a), the general rule applied to property that a beneficiary receives from a benefactor is that the beneficiary's basis is equal to the fair market value of the property at the decedent's death. Under IRC Section 1014(a), if a decedent's adjusted basis in the property is higher than the fair market value, the beneficiary's basis will equal the fair market value of the property at the time the decedent dies. "Property acquired from the decedent" under IRC Section 1014(b) generally includes property acquired by bequest, devise, inheritance, property the decedent gives to his or her estate and certain revocable trusts. IRC Section 1014(b)(1) (10) has a complete list of "property acquired from the decedent".

Let's illustrate the current challenge. In traditional estate planning, a family credit shelter trust was funded at the death of the first to die of a married couple. The credit shelter trust was funded, and the assets received a stepped up basis as of the decedent's date of death. The remainder of the assets would pass to the surviving spouse in or out of trust. The surviving spouse may die one to twenty years later, for example. The assets held in this spouse's individual name or marital trust are valued at the current date of death value. The assets which funded the first-to-die spouse's family trust are not revalued at the second death, and considerable appreciation and gain may be attributed to these assets.

One solution in certain situations is that if a Federal Estate Tax return was not filed with the IRS when the first spouse died, due to the fact that there was no estate tax due. One could be filed now although it will be considered not timely filed. See Reg. 20.2056(b)-7(b)(4)(i) ... "The election referred to in section 2056(b)(7)(B)(i)(III) and (v) is made on the return of tax imposed by section 2001 (or section 2101). For purposes of this paragraph, the term return of tax imposed by section 2001 means the last estate tax return filed by the executor on or before the due date of the return, including extensions or, if a timely return is not filed, the first estate tax return filed by the executor after the due date." A QTIP election can be made for the family credit shelter trust to include the assets in the second spouse's estate. The assets held in the trust will now receive a stepped-up basis. Care must be taken to not avoid creating estate tax in the second-to-die spouse's estate.

A second solution is to utilize the Like Kind Exchange provisions of IRC Section 1031, Exchange of property held for productive use or investment; ***http://www.law.cornell.edu/uscode/text/26/1031***. IRC Section 1031 provisions determine which types of assets qualify for the exchange. We recommend these exchanges for investment real property assets. The assets can be sold, proceeds transferred to a qualified intermediary, and the proceeds reinvested in like property. There are strict rules in application of 45 days to identify replacement property and 180 days to close the transaction. If the property is distributed to the beneficiary at the termination of the trust, then it is recommended that the beneficiary hold the property for two years prior to entering into a Like Kind Exchange transaction.

Estate planning thoughts: Many planners want to add flexibility to their planning documents, resulting in many planners having a married couple leave all of their assets to the survivor, who may or may not have a disclaimer trust in place. At the death of the first spouse, the survivor and the attorney can determine whether or not they need to fund the disclaimer trust or just allow the surviving spouse receive the assets outright. The assets passing

from the decedent will have a stepped up basis. At the death of the surviving spouse, all assets will receive a stepped up basis. A Form 706, Estate Tax Return, may need to be filed to claim the decedent's portable exemption. The portable exemption may be used by the surviving spouse for lifetime gifting and at their death. After the death of the first spouse, upon receipt of the assets, the surviving spouse may want to make a gift to an irrevocable trust and use the exemption they received from the first spouse. In ordering the estate exemptions, portable exemptions are used first when gifting. This will prevent the loss of the portable exemption due to the remarriage of the surviving spouse. Note in your planning that the Generation Skipping Tax exemption of the first to die is not portable to the surviving spouse.

A Testamentary Charitable Lead Annuity Trust (TCLAT) is another tool to utilize when considering tax basis planning with wills or living trusts. The decedent retains control and use of the assets until their death, at which time the assets receive a stepped up basis. At that point in time the TCLAT is funded. The named charities in the TCLAT will receive an income stream during the trust term, and the beneficiaries will receive the remaining assets at the end of the trust term. There is an unknown factor to this planning regarding the interest rates in effect at the time of the decedent's death and its impact on the estate tax deduction. IRC Section 7520 rates, ***http://www.law.cornell.edu/uscode/text/26/7520***.

Other attractive planning thoughts are to unwind Family Limited Partnership entities and have a greater value for the underlying partnership assets be included in the decedent's estate. Note, do not create estate tax by the unwinding of the entity and foregoing discounts. Also, for taxpayers that created and funded a Qualified Personal Residence Trusts (QPRT), planning may include no written lease and nonpayment of rent after the term of the QPRT. This would result in the inclusion of the real estate in the estate and a step up in basis of the real estate.

Another planning tool for assets held by a trust, is that the Trustee shall elect to treat capital gains as income for Distributable Net Income (DNI) purposes. The Trustee then makes distributions to the beneficiaries to move the income out of the trust tax bracket to the individual tax brackets.

In summary, there are many opportunities available to us as planners in 2015 and the future. Our planning environment is dynamic and in constant flux. Therefore, our documents must be flexible and nimble, adjusting for foreseen and unforeseen changes. The services and advice we offer our clients must reflect the flux. Our focus is redefined and tax basis planning should be one of our new focuses.

Articles reviewed to draft this article include: ***http://wills.about.com/od/understandingestatetaxes/a/fute-of-estate-tax-2014-beyondhtm***, 11/25/2014; ***www.aboutlivingtrust.com***, 11/25/2014; ***www.apslaw.com***, Insight on Estate Planning, October/November 2014; Wealth Counsel Quarterly, Estate Planning in 2014 and Beyond, Jonathan A. Mintz, Partner, Matsen Voorhees Mintz LLP; 2011 American Institute of Certified Public Accounts, The New Normal of Estate Planning by Martin M. Shenkman and Steve R. Akers.

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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

Fractional Ownership Discounts in Works of Art Upheld.

In **Estate of Elkins, Jr. v. Commissioner**, 767 F.3d 443 (5th Cir. 2014), the Fifth Circuit Court of Appeals reversed a decision of the United States Tax Court regarding the question of the taxable value of Decedent's fractional interests in original works of art. Decedent and his wife acquired various original works of art which were owned equally by them as community property during their joint lifetimes. Decedent and wife each created an inter vivos Grantor Retained Income Trust ("GRIT") to hold title to their respective half interests in only three works of original art (the "GRIT Art"). Upon the death of Decedent's wife, Decedent's children each inherited a 16.667 percent interest in the GRIT Art. Also upon the death of Decedent's wife, Decedent inherited his wife's one-half interest in each of sixty-one works of art. Decedent disclaimed a 26.945 percent interest in each of the sixty-one remaining works of art so that Decedent's three children acquired an 8.98167 percent interest in each work of art. Various restraints on possession, partition and alienation were imposed on the works of art from time to time. Thus, upon Decedent's death, he owned fractional interests in sixty-four original works of art.

The Decedent's estate applied a fractional ownership discount of 44.75 percent uniformly to the value of the decedent's fractional interest in each work of art on the estate tax return, however, in the Tax Court proceeding, the Estate introduced expert testimony of discrete discounts for the various works of art. On audit, the IRS refused to allow any fractional ownership discounts to the value of decedent's fractional interests and assessed an estate tax deficiency of $9,068,266. In the Tax Court proceeding, the estate's experts concluded that a hypothetical willing buyer would demand significant fractional ownership discounts in the face of becoming a co-owner with the Decedent's descendants given the (i) financial strength and sophistication of the descendants, (ii) the legal restraints on alienation and partition, and (iii) the descendants' determination to never sell their interests in the art. The Commissioner adduced no expert testimony or other evidence to establish alternatives to the fractional ownership discounts set forth by Decedent's estate. An expert appraiser of modern contemporary art as witness for the Commissioner opined that there was no established market for partial interests in the sale of works of art. The Tax Court, applying the willing buyer/willing seller standard, held that the Decedent's fractional interests were subject to fractional ownership discounts, but that the price on which the fictitious willing buyer and willing seller would finally agree would be the fair market value stipulated to by the parties, reduced by a nominal discount of 10 percent. On review, the court affirmed that fractional ownership discounts were applicable to Decedent's fractional ownership interests in the works of art.

The court notes that the Tax Court committed error by failing to assign the burden of proof to the Commissioner on the question of the size of the fractional discounts applied to the works of art since 26 U.S.C. Section 7491 mandates that when the petitioning taxpayer adduces sufficient evidence to establish the material facts, the Commissioner has the burden of refuting such facts and providing different ones. The court further notes that the petitioning taxpayer presented sufficient evidence to establish materials facts regarding the amount of the fractional ownership discounts applicable to the works of art, and that the Commissioner, maintaining a zero discount position, failed to provide any evidence of the amount of the discounts. Based on this analysis, the court concluded that under 26 U.S.C. Section 7491, the case should have ended with a judgment for the Estate. While the court finds error in the Tax Court's failure to assign the burden of proof to the Commissioner, it also finds that the error does not make a difference to the outcome of the case.

The Court of Appeals next reviews the Tax Court's decision to determine the amount of the fractional discounts to apply based on a preponderance of the evidence. The Court of Appeals states that there is no preponderance when the only evidence is evidence presented by one party, and finds error in the Tax Court's use of the preponderance standard to determine the amounts of the fractional interest discounts. Again, the error does not make a difference to the outcome of the case because the Commissioner, having produced no evidence as to the amounts of the discounts at trial, could not be heard on appeal as to the question of quality, quantity or sufficiency of the evidence adduced by the Estate as to the amount of the discounts. Finally, the court finds no viable factual or legal support for the Tax Court's 10 percent nominal fractional interest discount.

Accordingly, the court (i) affirmed the Tax Court's rejection of the Commissioner's argument that no fractional ownership discounts could be applied to Decedent's fractional interests in the works of art; (ii) affirmed that Tax Court's holding that the Estate was entitled to apply fractional ownership discounts to the Decedent's fractional interests in the works of art; (iii) reversed for lack of supporting evidence the Tax Court's holding that the appropriate fractional ownership discount was a nominal 10 percent (iv) in the absence of evidence from the Commissioner, found the appropriate fractional interest discounts to be those applied by the Estate's experts; and (v) rendered judgment in favor of the Estate for a refund of taxes overpaid in the amount of $14,359,508.21.

Ownership interest received by taxpayers as part of tax free merger was not full and adequate consideration.

In **Cavallaro v. Commissioner**, T.C.M. 2014-189 (September 17, 2014), the taxpayers merged their company with a company owned by their sons, and granted their sons an 81 percent interest in the merged entity. The Tax Court addressed (i) whether the

ownership interest received by the taxpayers as part of the tax-free merger was full and adequate consideration, and (ii) if not, how much excess value was conferred on the taxpayers' sons as a taxable gift. In the notices of deficiency, the Service took the position that the corporate interests contributed to the merger by the sons had zero value, and that the taxpayers collectively made $46.1 million in taxable gifts to their sons by granting the 81 percent interest.

In its opinion, the court addressed the burden of proof. In general, the Service's notice of deficiency is presumed correct and the petitioner has the burden of proving it to be wrong. At trial, the Commissioner acknowledged that the corporate interests contributed to the merger by the taxpayers' sons accounted for 35 percent of the value of the merged entity instead of the zero value stated in the notice of deficiency. Since the Commissioner conceded at trial that the taxable gifts totaled less than the amount stated in the notices of deficiency, the Commissioner argued that the burden of proof remained with the taxpayers to prove that the remaining determination was wrong. However, the taxpayers argued that the burden shifted to the Commissioner because (i) the Commissioner's litigating position was a new matter, as to which the burden shifted to the Commissioner under Tax Court Rule 142(a)(1), and, in the alternative, (ii) the Commissioner's assessment was excessive and arbitrary. As to the petitioner's first argument, the court held that the Commissioner's litigation position (the sons' corporate interests accounted for 35 percent of the value of the merged entity) was still consistent with the Service's overarching theory of the case – that the merger resulted in a taxable gift – and was not a new matter as to which the Service would bear the burden of proof under Tax Court Rule 142. As to the petitioner's second argument, the court held that the Service's failure to obtain an appraisal before issuing the notices of deficiency did not make the notices arbitrary.

As to the question of the valuation of the corporations, the court was not swayed by either of the expert opinions presented by taxpayers and held that the gifts were as valued in the Commissioner's concession.

In the notices of deficiency, the IRS determined that the taxpayers were both liable for the addition to tax imposed by Code Section 6651(a)(1) for failure to timely file gift tax returns. Further, at trial, the Commissioner asserted Code Section 6662 accuracy-related penalties. The court held that the Commissioner had shown that the additions and the penalties were applicable, but sustained the taxpayers reasonable cause defense based on reliance on a tax professional's advice.

Person, other than taxpayer, alleging ownership interest in property not entitled to receive notice of Commissioner's intent to levy or seek judicial review in Tax Court.

In **Greenoak v. Commissioner**, 143 T.C. No. 8 (September 16, 2014), the Tax Court addressed (i) whether the petitioners' alleged ownership interest in property that might be subject to levy by the Commissioner entitled them to the rights afforded to "persons" under Code Section 6330, and (ii) whether the court had jurisdiction under Code Section 6330(d) to hear an appeal filed by entities other than the taxpayer.

Decedent's estate failed to timely pay the estate tax reported on the estate tax return, and the Commissioner issued a notice of deficiency to the personal representative of Decedent's estate. Petitioners, entities owned by an offshore trust governed by the laws of Jersey in the Channel Islands to which Decedent allegedly made property transfers before death, filed a petition for judicial review with the Tax Court. The Petitioners asserted that because they had an ownership interest in the nonprobate property of Decedent's estate, which could be subject to levy, they did not receive proper notice of the Commissioner's proposed levy action and were not afforded a fair opportunity to contest the proposed levy action and underlying tax liability. The court held that a person, other than the taxpayer, who alleges an ownership interest in property which the Commissioner seeks to levy upon is not entitled to receive a notice of intent to levy and is not able to seek judicial review in the Tax Court pursuant to a notice of determination issued to a delinquent taxpayer. Thus, the court found that it did not have jurisdiction under Code Section 6330(d) to hear petitioners' appeal. The court noted when the Service levies upon a third party's property to collect taxes owed by another, that the third party may bring a wrongful levy action against the United States pursuant to Code Section 7426(a)(1), which provides the exclusive remedy for third-party wrongful levy claims. Code Section 7426(a) gives the District Courts jurisdiction to hear wrongful levy actions.

Tax-free Rollovers Cannot Be Made to the Civil Service Retirement System.

In **Bohner v. Commissioner**, 143 T.C. No. 11 (September 23, 2014), the Tax Court addressed whether assets of a traditional IRA account may be rolled over tax-free to an account under the Civil Service Retirement System. The court held that a taxpayer was required to include in income amounts that he withdrew from his traditional IRA in order to cover a deposit to the Civil Service Retirement System to increase his retirement annuity. The majority reasoned that rollover contributions cannot be made to, and that the remittance was not accepted as a rollover by, the Civil Service Retirement System.

Contributions to Scholarship Fund Fail to Qualify as Charitable Contributions.

In **Kalapodis v. Commissioner**, T.C.M. 2014-205 (October 6, 2014), the Tax Court addressed the deductibility of contributions made to scholarship recipients from an irrevocable trust established by the taxpayers on the taxpayers' personal return. The taxpayers established a scholarship fund with the proceeds of a life insurance policy on their late son. The fund was structured as an irrevocable trust. The trust did not apply for or receive tax-exempt status under Code Section 501. The taxpayers reserved the right to amend the trust agreement so long as all funds would be distributed to students solely for educational purposes. The taxpayers did not report the trust's gross income on their personal return, but claimed $6,000 in charitable deductions on their Schedule A, Itemized Deductions for three $2,000 checks written to students from the trust's investment income on an account owned solely in the name of the trust. The irrevocable trust agreement did not contain Grantor trust provisions entitling the taxpayers to report the tax attributes of the trust on their personal return (they had not reported the $6,000 of income, only claimed the charitable de-

duction). Further, the payments were not even charitable contributions since the student recipients were not qualified donees under Code Section 170(c). Finally, even if the taxpayers could report the contributions and the donees qualified as charitable organizations, the contributions were not substantiated by contemporaneous written acknowledgments pursuant to Code Section 170(f)(8)(A-C). Thus, the Tax Court concluded that the taxpayers, husband and wife, were not entitled to a charitable deduction for the three $2,000 payments made by the trust they established as a scholarship fund because (i) the taxpayers were not the owners of the trust and could not report its tax attributes; (ii) the payments from the trust did not qualify as charitable contributions; and (iii) even if the payments qualified as charitable contributions, the taxpayers did not meet the Code's substantiation requirements for contributions exceeding $250.

Income Tax Charitable Deduction Disallowed Where Taxpayer Fails Charitable Contribution Substantiation Tests.

In **Smith v. Commissioner**, T.C.M. 2014-203 (October 2, 2014), the Tax Court addressed whether the taxpayer met the requirements to substantiate his charitable contributions under Code Section 170. The taxpayer claimed as charitable deductions donations to an organization exempt from federal income tax under Code Section 501(c)(3) of (i) furniture from his late mother's house, (ii) clothing belonging to him and his children, and (iii) electronic equipment of unspecified provenance. Prior to donating the items, the taxpayer obtained blank "tax receipt" forms signed by agents of the organization. The forms specified that it was the donor's responsibility to determine the FMV of all items.

To substantiate his contributions, the taxpayer provided two tax receipt forms on which the taxpayer assigned the following values to the items donated: (i) $11,730 to the furniture; (ii) $14,487 to the clothing, and (iii) $1,550 to the electronic equipment. The receipts did not identify any specific items of donated property. The taxpayer also attached to his return an undated spreadsheet which was not provided to the charitable organization. The court found that the taxpayer failed to meet the substantiation requirements. The two tax receipts did not contain a "description…of the property…contributed" as required by Code Section 170(f)(8)(b)(i) for any contributions exceeding $250. The taxpayer further failed to maintain written records establishing the acquisition date, cost basis and fair market value at the time of donation of non-cash items. The taxpayer claimed that he established the fair market value of the items based on a Salvation Army website guide, but did not take photos or provide any other evidence establishing why he chose values greater than the "high" range suggested by the Salvation Army's guide. Finally, for the household goods and clothing assigned values of $11,730 and $14,487, respectively, the taxpayer failed to obtain and attach to his return a qualified appraisal as is required by Code Section 170(f)(11)(c) for contributions of property (other than publicly traded securities) valued in excess of $5,000. Accordingly, the court rejected the taxpayer's approximately $27,000 income tax deduction for the three charitable contributions and approved the imposition of accuracy-related penalties.

District Court of the Virgin Islands follows General Rule that IRS Tax Lien Attached to Property Owned Jointly with Survivorship Rights Extinguished upon Death of Co-Owner.

In **NPA Associates, LLC v. Estate of Dennis A. Cunning et al.**, 114 AFTR 2d, 2014-5364 (District Court of the Virgin Islands, Division of St. Thomas and St. John) (October 17, 2014), the court granted Plaintiff's motions for default judgment and summary judgment against all persons claiming a right, title, lien, estate or interest in certain real property which passed by operation of law to the surviving owner. Two individuals owned property as joint tenants with rights of survivorship. When one owner died, the surviving owner succeeded to the decedent's interest by process of law. Although neither the applicable Virgin Islands' statute or local case law addressed the specific issue, the court concluded that the Supreme Court of the Virgin Islands would not depart from the general rule that if property is owned jointly with survivorship rights, the surviving owner becomes the sole owner of the property upon co-owner's death, and an IRS Tax Lien which attached only to the deceased owner's interest is extinguished because there is no property interest left to which the lien could continue to attach.

Federal Administrative Developments

60-Day Rollover Requirement Waived Where Taxpayer Died Prior to Completion of Direct Rollover.

In **PLR 201436055** (September 5, 2014), the Service addressed whether to waive the 60-day rollover requirement where taxpayer's failure to timely rollover plan funds was due to his death prior to the completion of a direct rollover. Prior to his death, the taxpayer completed paperwork requesting a rollover of his plan (Plan C) to another plan (Plan D) and the administrator of Plan D acknowledged receipt of the taxpayer's rollover request form. Approximately, one month after the taxpayer's death, the taxpayer's personal representative received a check from Plan C payable to Plan D on behalf of the taxpayer. The taxpayer's personal representative, also the taxpayer's surviving spouse and the beneficiary of Plan C, was unable to complete the rollover due to the taxpayer's death. The Service ruled that, provided all other requirements of Code Sec. 402(c)(3) were met, the taxpayer's surviving spouse, as beneficiary of Plan C, would be granted a 60-day extension of time from the date the PLR was issued to contribute the stated amount, which would be considered a valid rollover contribution. However, the Service also ruled that, since Treasury Regulations Section 1.401(a)(9)-4, Q&A-4 provides that a designated beneficiary must be a beneficiary as of the date of death, the Service would not treat any beneficiary of Plan D named by the surviving spouse as the personal representative of the taxpayer's estate as a designated beneficiary. Thus, the new Plan D IRA account would not have a designated beneficiary. The PLR assumed that the personal representative of the taxpayer's estate had the necessary authority under state law to carry out the transactions described in the ruling.

Distribution of IRA Fails to Qualify as Trustee-to-Trustee Transfer.

In **PLR 201436054** (September 5, 2014), the Service addressed whether a transfer of IRA funds qualified as a trustee-to-trustee transfer within the scope of Rev. Rul. 78-406, 1978-2 CB 157. Prior

to death, Decedent ("Decedent B") maintained an IRA held with Custodian ("Custodian E"). Another Decedent ("Decedent D"), then still alive, was the spouse of Decedent B and was the named beneficiary of the IRA. The Executor of Decedent B's estate was also the guardian of Decedent D, an incompetent, while Decedent D was still living. Upon the death of Decedent B, the Executor/Guardian executed documents to transfer the IRA to an account in the name of Decedent B's estate without proper authorization because the Executor/Guardian executed the IRA transfer forms in her capacity as Executor of Decedent B's estate, which was not a beneficiary of the IRA, rather than in her capacity as Guardian of Decedent D, who was the beneficiary of the IRA. In addition, the IRA was improperly transferred to an account titled in the name of the Estate of Decedent B instead of to an account in the name of Decedent D. The Service ruled that the taxpayer did not provide a basis for the transfer to fall under the exceptions in Code Section 408(d). Among other things, the Ruling cites that Rev. Rul. 78-406 does not support the transfer of an IRA to an individual or entity that does not have ownership rights in the IRA. Decedent D, still alive at the time of the transfers at issue, had rights as the beneficiary of the IRA, while the Estate of Decedent B had no ownership rights to the IRA. Thus, the unauthorized transfer of Decedent B's IRA naming Decedent D as beneficiary to an account in the name of the estate of Decedent B for the benefit of Decedent D, was not a trustee-to-trustee transfer within the scope of Rev. Rul. 78-406. Thus, the Service concluded that the transfer of the IRA constituted a distribution or payment as those terms are used in Code Section 408(d) and did not constitute a trustee-to-trustee transfer that satisfied the requirements of Rev. Rul. 78-406.

Distribution of Trust Property by Distribution Committee Not Completed Gifts by Members of Distribution Committee.

In **PLR 201436008** (September 5, 2014), the Service addressed whether a distribution committee's distribution of property from a trust to a beneficiary of the trust, other than a grantor of the trust, would be a completed gift subject to gift tax by any distribution committee member. The Grantor proposed to establish a trust for the benefit of the Grantor and his parents, siblings and issue. Pursuant to the terms of the trust, the Trustees would be required to make distributions of income and principal as directed by the distribution committee and/or the Grantor, as follows: (i) the Trustees, pursuant to the direction of a majority of the distribution committee members and with the written consent of Grantor, would distribute to the Grantor or the beneficiaries such amounts of the net income or principal as directed by the distribution committee; (ii) the Trustees, pursuant to the direction of all the distribution committee members, other than Grantor, would distribute to the beneficiaries such amounts of the net income or principal as directed by the distribution committee; and (iii) the Grantor, in a non-fiduciary capacity, could, but would not be required to, distribute to any one or more of the beneficiaries other than the grantor, such amounts of the principal (including the whole thereof) as the Grantor deemed advisable to provide for the health, maintenance, support and education of the Grantor's issue. The Grantor retained a limited testamentary power of appointment over the trust assets. Further, the Trust Agreement provided that at all times the distribution committee must consist of at least two adults other than the Grantor who are members of the class of persons eligible to receive distributions of income or principal, or if there are not two such members of the class, two adults who are the parents or guardians of members of the class, and that the distribution committee would cease to exist upon the death of the Grantor. The Service ruled that transfers from the Grantor to the trust were incomplete for federal gift tax purposes due to the powers retained by the Grantor, and that the members of the distribution committee did not hold general powers of appointment under Code Section 2514. Accordingly, the Service concluded that any distribution of property by the distribution committee from the trust to any beneficiary of trust, other than grantor, would not be a completed gift subject to gift tax by any distribution committee member. Further, the Service ruled that any distribution of property from the trust to any beneficiary of the trust, other than the Grantor, would be a completed gift by the Grantor. *See also* PLR 201436009, PLR 201436010, PLR 201436011, PLR 201436012, PLR 201436013, PLR 201436014, PLR 201436015, PLR 201436016, PLR 201436017, PLR 201436018, PLR 201436019, PLR 201436020, PLR 201436021, PLR 201436022, PLR 201436023, PLR 201436024, PLR 201436025, PLR 201436026, PLR 201436027, PLR 201436028, PLR 201436029, PLR 201436030, PLR 201436031and PLR 201436032.

Powers Held by Members of Trust Approval Committee Not General Powers of Appointment.

In **PLR 201438010** the Service addressed whether any powers held by members of a trust approval committee would be considered a general power of appointment under Code Sections 2041 and 2514 while more than one of the Grantor's children served on the approval committee. Pursuant to the terms of the Trust Agreement, distributions of trust property from trusts for the benefit of the Grantor's children were subject to review by an approval committee. The approval committee was comprised of four of the Grantor's children. The approval committee would terminate upon the death of the last of the Grantor's surviving children. The approval committee had the following powers: (i) acting by majority vote, to override a trust beneficiary's exercise of his or her power of appointment, (ii) acting by majority vote, to override the default allocation of trust assets upon the death of a beneficiary among one or more of the Grantor's descendants in such proportions as decided by the committee, (iii) acting by 50 percent vote if three members are acting or acting unanimously if two members are acting, to override the independent distribution Trustee's determination that a termination event has occurred; and (iv) acting by majority vote, to override the default allocation of trust assets upon the early termination of a trust among one or more of the Grantor's descendants or a charitable foundation in such proportions as decided by the committee. The Service concluded that, since the approval committee composed only of the Grantor's four children had broad powers to amend the trust, alter trust distributions, make trust distributions and approve all distributions, each member of the approval committee had interests adverse to the other members and none of the committee powers would be considered a general power of appointment under Code Sections 2041 and 2514 for so long as more than one child of the Grantor serves on the approval committee. *See also* PLR 201438011, PLR 201438012 and PLR 201438013.

Judicial Construction and Modification would Address Issue Regarding Management of Trust and would not Jeopardize Trust's Exemption from Generation-Skipping Transfer Tax.

In **PLR 201438016** (September 19, 2014), the Service addressed whether the proposed judicial construction and modification of a trust would cause the trust to lose its GST tax exemption under Code Section 2601 and Treasury Regulations Section 26.2601-1(b)(4)(i). The governing instrument of the trust, Testator's Will and Codicil dated prior to September 25, 1985, was construed (several years prior to the submission of the request for a PLR) as granting the Trustee the unrestricted power to sell real property owned by the trust. Subsequently, the Trustee sold real property owned by the trust and segregated the proceeds of the sale into a separate trust account. The governing instrument provided for the assets to be held in trust for the benefit of Testator's grandson during his lifetime, and upon the grandson's death, to be distributed in the Trustee's discretion as follows: (1) real property was bequeathed and devised "to such of the blood issue of my grandson as shall survive him, by right of representation"; (2) one-third of the remaining trust estate was to be set apart and continued in trust for the benefit of an academy; and (3) the remaining two-thirds of the trust estate was "to be divided equally among the grandson's "blood issue," by right of representation." The governing instrument did not address how the proceeds from the sale of any real property owned by the trust should be distributed upon the death of Testator's grandson. Testator's grandson died and was survived by eight members of his "blood issue." In the PLR, the Trustee proposed to file a petition in state probate court for judicial construction and modification of the trust to address, among other ambiguities, how the proceeds from the sale of any real property should be distributed and how the term "right of representation" should be construed for distribution purposes. The trust was irrevocable on September 25, 1985, and the Trustee represented that there had been no additions to the trust after September 25, 1985. The Service found that the governing instrument of the trust was ambiguous with regards to the distribution of the proceeds from the sale of real property. Thus, the Service concluded that the probate court's construction of the governing instrument would resolve a bona fide issue regarding the proper management and distribution of assets in the trust. Accordingly, the Service found that, if the state probate court approved the proposed petition, the judicial construction and modification of the trust to interpret the ambiguities in the governing instrument would not cause the trust to lose its status as exempt from the GST tax under Code Section 2601 and Treasury Regulations Section 26.2601-1(b)(4)(i).

Taxpayer's Failure to Take Required Minimum Distributions from Inherited IRA Due to Reasonable Error.

In **PLR 201437025** (September 12, 2014), the Service addressed whether taxpayer's failure to take required minimum distributions from an inherited IRA was due to reasonable error. The Service ruled that taxpayer's failure was due to reasonable error because of the existence of ongoing litigation over the beneficiary designation of the IRA and other delays, and that a reasonable remedy for the error was for the taxpayer to take the shortfall in minimum distributions for the missed years by the end of the stated tax year. Further, the Service agreed to waive the 50 percent excise tax imposed under Code Sec. 4974(a) if the taxpayer took the shortfall in the state tax year as described.

IRA Not Treated as Inherited IRA.

In **PLR 201437029** (September 19, 2014), the Service addressed whether an IRA would be treated as an inherited IRA under Code Sec. 408(d) as to the taxpayer ("Taxpayer A"), the surviving spouse and personal representative of Decedent's ("Decedent B") estate. Taxpayer A was the surviving spouse of Decedent B, who died on February 29, 2012, having attained age 70½. At his death, Decedent B maintained an IRA ("IRA C"), with Custodian ("Custodian D"). Taxpayer A represents that Decedent B had not designated a beneficiary for IRA C. Consistent with Custodian D's plan agreement, Custodian D would be required to distribute Decedent B's proceeds to Decedent B's estate. Decedent B died testate, and his Last Will and Testament named Trust E as beneficiary of his estate. Decedent B's Will appoints Taxpayer A as his personal representative, and Taxpayer A represents that she intends to assign all of Decedent B's estate assets to Trust E, including assigning a beneficial interest in IRA C to Trust E. Trust E appoints Taxpayer A as Successor Trustee of all Trusts created under Trust E. Trust E provides that upon Decedent B's death, Trust E is divided into two shares, the Marital Share and the Residuary Trust. Taxpayer A is the sole beneficiary of the Marital Share portion of Trust E. Trust E provides that the Marital Share is to be funded with a pecuniary amount which, if allowed as a federal estate tax marital deduction, would result in the least possible federal estate tax payable at Decedent B's death. Taxpayer A, as Successor Trustee of Trust E determines which estate assets will fund the Marital Share portion of Trust E with the remainder of estate assets placed in the Residuary Trust. Taxpayer A represents that she intends to transfer IRA C to the Marital Share portion of Trust E. Taxpayer A further represents that the Residuary Trust will be sufficiently funded with non-IRA assets to satisfy the specific bequests of Decedent B. As sole trustee of Trust E, Taxpayer A proposes to either transfer IRA C directly into an IRA in her name, by way of a trustee-to-trustee transfer from Trust E, or to make a distribution of the assets of IRA C to herself as beneficiary of Trust E under her power as Successor Trustee of Trust E. It is Taxpayer A's intention to rollover the distribution of IRA C into one or more IRAs set up and maintained in her own name. Based on the foregoing, the Service ruled that (i) since the proceeds of IRA C will be distributed to a trust, and not to Taxpayer A directly, such proceeds would not be treated as an inherited IRA under Code Sec. 408(d) as to Taxpayer A, and (ii) Taxpayer A would be eligible to rollover or transfer, by means of a trustee-to-trustee transfer, any distribution of the proceeds of IRA C into an IRA maintained in her own name, as long as the rollover occurred no later than 60 days from the date the distribution was made from the IRA.

Failure to File Required ESBT Election Inadvertent.

In **PLR 201438015** (September 19, 2014), Company represented that a trust was eligible to be an electing small business trust within the meaning of Section 1361(e) and had been treated as though a timely ESBT election had been made. However, an election was

mistakenly filed under Section 1361(d)(2) for the trust to be treated as a qualified subchapter S trust even though the trust did not qualify as a QSST and was, in fact, treated as an ESBT. Since an election was never made to treat the trust as an ESBT, the trust was not an eligible shareholder and the Company S corporation election was terminated. The Service concluded that the Company's failure to file the required ESBT election was inadvertent within the meaning of Section 1362(f), and that Company would continue to be treated as an S corporation, provided that the trustee of the trust file an ESBT election within 120-days of the ruling date.

IRS Refuses to Recognize Trust Reformation.

In **PLR 201438014** (September 19, 2014), the Service addressed whether the payment of IRA assets from a trust in satisfaction of pecuniary legacies would be recognized by the trust as income-in-respect of a decedent. Upon Decedent's death, trust's non-IRA assets were insufficient to satisfy certain pecuniary bequests to two charities. A state court reformed the trust to ensure that the trust's distribution of IRA assets to the two charities would be treated as direct bequests to the charities and not as income-in-respect of a decedent, and, in the alternative, to ensure that, if trust was required to recognize income-in-respect of decedent on payments of IRA assets, that the trust would be able to claim a charitable deduction under Section 642. The Service concluded that the purpose of the court order reforming the trust was to obtain the tax benefits and not to resolve a conflict with respect to the trust. The Service reasoned that neither Rev. Rul. 59-15 nor **Emanuelson v. United States**, 159 F. Supp 34 (Conn. 1958) held that a modification to a governing instrument will be respected in situations where the modification does not stem from a conflict with respect to the trust. Accordingly, the Service refused to respect the trust's reformation. Since the Service would not recognize the trust's reformation and the trust intended to use the IRA assets to satisfy its pecuniary legacies, the Service found that the trust would be required to treat such payments as sales or exchanges. Under Code Section 691(a)(2), such payments would be characterized as transfers of rights to receive income-in-respect of a decedent and the trust would be required to include in its gross income the value of the portion of the IRA which was income-in-respect of a decedent to the extent that the IRA was used to satisfy the trust's pecuniary legacies. Further, because the unreformed terms of the trust did not direct or require that the trustee pay the pecuniary legacies from the trust's gross income, the Service found that the transfer of a portion of the IRA in satisfaction of the pecuniary legacies would not entitle the trust to a charitable deduction under Code Section 642(c)(1).

Income and Transfer Tax Consequences of Nevada Incomplete Nongrantor Trusts.

In **PLRs 201440008 – 201440012** (October 3, 2014), five identical rulings, the Service confirmed the income and transfer tax consequences of Nevada Incomplete Nongrantor Trusts ("NING"). Taxpayer proposed executing an irrevocable trust as Grantor with two Independent Trustees. During Grantor's lifetime, Grantor and her siblings, if any, otherwise her parents, would be beneficiaries of the trust. The Trustees would make distributions as directed by a Distribution Committee and/or Grantor. A majority of the Committee Members, with consent of Grantor, could direct distributions to Grantor. All of the Committee Members, without consent of Grantor, could direct distributions to the other beneficiaries. And Grantor, in a non-fiduciary capacity, could direct HEMS distributions to any beneficiary other than herself. The Distribution Committee must have at least two adults, other than Grantor, who are permissible distributees or parents or guardians of permissible distributees. Grantor would retain a limited testamentary power of appointment, and the default provisions would provide for distributions to Grantor's issue, *per stirpes*, otherwise to the issue of Grantor's parents or by the applicable laws of intestacy. The Service determined that, under the facts presented, no circumstances would cause Grantor to be treated as the owner of any portion of the Trust under Code Sections 673, 674, 676, 677. Nor would any member of the Distribution Committee be treated as owner as any portion of the Trust under Code Section 678(a) because none has a power exercisable solely by himself to vest assets in himself. The Service found further that contributions to the Trust by Grantor would not be completed gifts subject to federal gift tax nor would distributions from the Trust to Grantor be taxable as to any member of the Distribution Committee. Distributions from the Trust would be returns of Grantor's property since Grantor's transfers to the Trust would not be completed gifts. Grantor retained a power over the corpus sufficient to cause her transfer to be a wholly incomplete gift under Treasury Regulations Section 25.2511-2. She retained a consent power over Trust income and principal, in conjunction with the Distribution Committee, which terminated at her death (thus making the Committee non-adverse). In addition, Grantor retained the power over the principal of the Trust to change the interests of the beneficiaries, and retained a testamentary power of appointment sufficient to cause Grantor to retain "dominion and control" over the corpus. And the Distribution Committee's distribution power is not a condition precedent to Grantor's powers, which are presently exercisable until the Distribution Committee exercises its power. Finally, the Service determined that any distribution of property by the Distribution Committee from Trust to any beneficiary, other than Grantor, will not be a completed gift by any member of the Distribution Committee, but will be a completed gift by the Grantor. The Distribution Committee's powers exercisable only in conjunction with the Grantor are non-general powers, and its independent powers do not survive Grantor. Thus, all distributions to beneficiaries other than Grantor, are completed gifts only as to Grantor.

Reformation of Trust to Correct Scrivener's Errors Ab Initio Caused Transfers to Trust to be Completed Gifts.

In **PLR 201442042 – PLR 201442046** (October 17, 2014), taxpayer, on the advice of counsel, established two GRATs and named a single Children's Trust as the remainder beneficiary of both. The Children's Trust was revocable by Taxpayer. Taxpayer hired an accountant to prepare Form 709 reporting gifts to the GRATS, and accountant noted that language allowing Taxpayer to revoke the Children's Trust defeated Taxpayer's purpose in creating the two GRATs by (i) causing the remainder interests in the GRATs to be included in Taxpayer's estate for tax purposes, and (ii) causing any distributions from the Children's Trust to Taxpayer's children to

be taxable gifts. When contacted by the accountant and later by Taxpayer, and on the advice of a financial planner, the drafting attorney insisted that his drafting was proper and that the non-attorneys did not understand the state law governing the trust. Taxpayer subsequently took financial planner's advice and hired a different attorney to petition to reform the Children's Trust under the state versions of Sections 415 and 416 of the Uniform Trust Code. This second attorney obtained an order correcting the mistakes as scrivener's errors, and stating that the reformation was effective *ab initio*, as if the revised terms were included in the original Children's Trust. As a result of the reformation of the Children's Trust, Taxpayer's transfers of the remainder interests in the two GRATs will be completed gifts, and upon the completion of the respective GRAT terms the distribution of the remainder interests to the Children's Trust will not cause the Taxpayer to make an additional gift. Further, the assets of the Children's Trust will not be included in the gross estate of Taxpayer when he dies. Lastly, no current or future beneficiary of the Trust was deemed to have made a gift to any other current or future beneficiary of the Trust upon reformation.

Recapitalization of LLC was Taxable Gift from Taxpayer to Sons.

In **Chief Counsel Advice 201442053** (October 17, 2014), the Service determined that the recapitalization of a closely-held LLC was a transfer from Taxpayer to her two sons and resulted in a gift from Taxpayer to her sons. A mother and her two sons formed an LLC for gifting purposes. The mother made the sole initial capital contribution to the LLC and subsequently gifted interests in the LLC to her sons and grandchildren. The mother and sons decided to recapitalize the Company -- in exchange for the agreement of the sons to manage the Company, the Company's operating agreement was amended to provide that going forward all profit and loss, including all gain or loss attributable to Company's assets, would be allocated equally between the sons. After the recapitalization, the mother and grandchildren retained a right to distributions based on their capital account balances as they existed immediately before the recapitalization. Taxpayer held an equity interest in the LLC coupled with a distribution right before and after the recapitalization. However, she exchanged her right to participate in future profits and losses (a subordinate interest) for the right to distributions based upon her existing capital account balance (a senior interest). Taxpayer received property in the form of the agreement of the sons to manage the Company; however, the recapitalization still constituted a transfer to which Code Section 2701 applied since taxpayer surrendered an equity interest junior to her applicable retained interest and received property other than her applicable retained interest in return. After confirming the transfer constituted a gift, the Service determined the amount of the gift by subtracting the value of all family-held applicable retained interests and other non-transferred equity interests from the aggregate value of the family-held interests.

Designation of Trust Distributable to Charity as Beneficiary of IRA Not Transfer of IRD under Code Section 691.

In **PLR 201444024** (October 31, 2014), Decedent owned an IRA with Trust designated as the primary beneficiary. The terms of the Trust directed the Trustee to transfer the IRA to a Charity. Trustee requested a ruling from the Service whether or not the transfer to the Charity would constitute a transfer of a right to receive income in respect of a decedent (IRD) under Code Section 691. Code Section 691(a)(2) provides the fair market value of a right to receive income, plus any consideration in excess of fair market value which is transferred by an estate or a person who received such right by bequest, devise, or inheritance from a decedent, shall be included in the gross income of the estate of such person. Section 1.691(a)-4(b) of the Income Tax Regulations provides that, if the estate of a decedent or any person transmits the right to IRD to another who would be required by Code Section 691(a)(1) to include such income when received in his gross income, only the transferee will include such income when received in his gross income. The Service advised that the Trust may retitle the name of the IRA to the Charity and that such change will not constitute a payment or distribution out of the IRA to the Trust or Charity within the meaning of Code Section 408(d). Further, the Charity will include the IRD transferred to it as gross income when the distributions from the IRA are actually received. In this situation, a transfer within the meaning of Code Section 691(a)(2) has not occurred. Treasury Regulations Section 1.691(a)-4(b)(2) specifically provides that if a right to IRD is transferred by an estate to a specific or residuary legatee, only the specific or residuary legatee must include such income in gross income when received.

Property Held by Taxpayer Primarily for Sale to Customers Valued for Purposes of Calculating the Income Tax Deduction for Charitable Contribution of Property at Lesser of Taxpayer's Basis or Fair Market Value of Donated Property.

In **PLR 201443019** (October 24, 2014), the Service concluded that property held by Taxpayer primarily for sale to customers in the ordinary course of Taxpayer's business would be valued for purposes of calculating the income tax deduction for a charitable contribution of the property at the lesser of the Taxpayer's basis or the fair market value of the donated property. Explaining how a Taxpayer's income tax deduction for a large number of items can be limited, the Service reviewed rulings where there was a reduction from fair market value by the appreciation in the value of donated assets, and where a "blockage discount" for donation of many similar donated items has been applied. The Service cited Rev. Rul. 79-256, 1979-2 CB 105 (art dealer donating lithographs) and Rev. Rul. 79-419, 1979-2 CB 107 (layperson donating 100 books after only a short-term hold) as examples of how an income tax deduction may be reduced from basis by the appreciation in the value of assets donated. The policy behind the rule is that if a donor sold the items instead of donating them, he or she would have been classified as a "dealer" in the items and the amount of the appreciation would have been taxed to the donor as ordinary income. The determination of whether activity is tantamount to those of a professional dealer is necessarily factual. The Service also discussed the following rulings and cases which applied a discount from the claimed fair market value due to the sheer volume of similar gifts simultaneously hitting the "willing buyer-willing seller" market contemplated by Treasury Regulations Section 1.170A-1(c)(2); Revenue Ruling 80-233, 1980-2 CB 69 (purchaser of large vol-

ume of Bibles donated all of them to charity); **Skripak v. Comm'r**, 84 T.C. 285 (1985) (taxpayer purchased and then donated 150,000 books to multiple libraries); and **Rimmer v. Comm'r**, T.C.M. 1995-215 (taxpayer purchased 85,000 pieces of sheet music and then contributed all of them to a charitable organization).

Testamentary Power of Appointment Granted to Taxpayer does not Constitute a General Power of Appointment within the Meaning of Code Section 2041(b)(1).

In **PLR 201444002 – 201444006** (October 31, 2014), the Service addressed facts where taxpayer was the grandchild of Decedent and a beneficiary of a discretionary trust created under Decedent's Will. The terms of the trust provided that upon Taxpayer's death, the Trustees are to pay the assets of the trust "to such among [Decedent's] issue" as taxpayer appoints by Will, with any unappointed assets distributed according to the default provisions of Decedent's Will. The Service declared that the testamentary power of appointment granted to Taxpayer did not constitute a general power of appointment within the meaning of Code Section 2041(b)(1) because the power is testamentary and Taxpayer may not appoint any assets to him/herself or his/her creditors during his/her lifetime. Further, although the Service did not elaborate, it indicated that the terms of the trust implied Decedent's reference to "such among [my] issue" (the permissible class of appointees) did not include Taxpayer's estate or the creditors of Taxpayer's estate after Taxpayer's death. Because Taxpayer's power was not a general power of appointment under Code Section 2041(b)(1), the exercise or release of the power did not cause the value of the property in Trust to be included in Taxpayer's gross estate under Code Section 2041(a).

Executor failed to present prima facie evidence that Form 8939 was delivered, thus Decedent's estate failed to elect out of the estate tax in a timely manner.

In **PLR 201442015** (October 17, 2014), the decedent died in 2010 and his Executor desired to elect not to have the provisions of chapter 11 apply to the decedent's estate, but rather, to have the provisions of Code Section 1022 apply. The Executor retained a law firm to assist in the administration of the estate and an accounting firm to prepare a Form 8939 for the election. The Executor signed a Form 8939 at the accounting firm's office, and the accounting firm made copies of the signed Form 8939 for its file and for the Executor. The accounting firm then mailed the original Form 8939 by regular mail to the IRS Service Center. This was the accounting firm's longstanding practice for mailing returns that show little or no tax due. The accounting firm did not advise the Executor that alternative methods of mailing the Form 8939 would have guaranteed timely delivery. The Service later notified the Executor that the Service had no record of receiving a Form 706, and that if the Executor determined that a Form 706 was not necessary, then he should send a written explanation of the basis for that determination to the Service. Executor's law firm wrote the Service to explain that Executor did not file the Form 706 because Executor elected not to have the estate be subject to federal estate tax. The law firm also informed the Service that the accounting firm previously filed a Form 8939. The assigned IRS examiner contacted the IRS Service Center to obtain a copy of Decedent's Form 8939, which the examiner did not have, and the IRS Service Center responded that it never received a Form 8939. After back and forth correspondence, the Executor provided the examiner with a copy of the Form 8939. Because the Service had no record of ever having received the Form 8939, the Service requested proof of the alleged initial mailing from the accounting firm. The accounting firm provided the Service with affidavits affirming the Form was mailed, but the Executor could not provide any other proof that the Form 8939 was mailed. The Executor claimed that the United States Postal Service lost the Form 8939.

Code Section 7502(a) provides, in pertinent part, that the date of the United States postmark stamped on the cover of a return shall be deemed to be the date of delivery of that return. Code Section 7502(c)(1) provides that if a return is sent by United States registered mail, the registration is prima facie evidence that the return was delivered to the agency to which it was addressed. Treasury Regulations Section 301.7502-1(e)(2) provides that other than proof of actual delivery, proof of proper use of registered or certified mail are the exclusive means to establish prima facie evidence of delivery.

The Service denied Executor's request for extension of time to file a Code Section 1022 election. The Service had no record of receiving Decedent's Form 8939, and the affidavits supplied by accounting firm were not prima facie evidence that the Form 8939 was delivered. Executor could not provide direct proof of actual delivery or proof that the Form 8939 was sent by registered or certified mail, or other designated delivery service; he maintained only that the postal service lost the filing. Because the Executor failed to present prima facie evidence that Form 8939 was delivered, Decedent's estate failed to elect out of the estate tax in a timely manner. The Executor alleged that the United States Postal Service's losing the form was beyond his control. However, the Service took the position that the Executor could have sent the form by registered or certified mail, which would have constituted prima facie evidence of delivery to the Service on the postmark date. Because Executor could have prevented the circumstances, intervening events beyond Executor's control did not cause Executor to fail to make the election under Treasury Regulations Section 301.9100-3(b)(1)(ii). The Service further rejected the Executor's contention that he relied on a qualified tax professional to deliver the form, and noted that the Executor still failed to deliver the Form 8939 until several months after being notified that it was missing.

Division and Modification Will Not Cause Any of the New Sub-trusts to Lose Grandfathered GST Exempt Status.

In **PLR 201443004** (October 24, 2014), Grantor created a trust of which Grantor's three children and eight grandchildren were all permissible distributees of income and principal. Each beneficiary has a hanging Crummey power to withdraw pro rata portions of contributions to the Trust. After Grantor's death and after all surviving children reach a set age, the Trust will be divided among Grantor's issue, per stirpes. Each share for a child is to be held in further trust, with discretionary distributions among each child and his or her issue. Each child has a limited testamentary power to appoint the remainder of his or her trust among the Grantor's issue. Each share for a grandchild or more remote descendant will be distributed to the beneficiary, outright.

The Trustees brought an action in state court while the Grantor was still alive to divide the trust into three shares, one for each of the three children and his or her respective descendants, and to modify the terms of each sub-trust. The Grantor and the beneficiaries cooperated in the modification action. The goal of the modification was to leave the dispositive trust terms the same, but to revise the successor trustee terms so that each child could be co-trustee of his or her separate trust. The state court granted the petition, subject to IRS approval. The Service determined that the division and modification would not cause any of the new sub-trusts to lose its grandfathered GST exempt status because neither the division nor the modification (i) shifted a beneficial interest to a beneficiary assigned to a lower generation, or (ii) extended the time for vesting of any interest in trust property. The Service further determined that the division and modification would not cause any of the children to be treated as having made a taxable gift; would not cause any portion of any of the trusts to be includible in the gross estate of any of the children; would not cause any of the trusts or any of the beneficiaries to recognize ordinary income or loss, or capital gain or loss, whether or not assets were allocated on a pro rata or a non-pro rata basis; and would not affect the basis or holding period of any assets held in any of the trusts.

Private operating foundation did not meet the requirements of Code Section 4962(a) to show that excess business holdings were due to reasonable cause.

In **TAM 201441021** (October 10, 2014), the Service determined that a private operating foundation did not meet the requirements of Code Section 4962(a) to show that excess business holdings were due to reasonable cause, and thus the Service denied the Foundation's request to abate its first-tier taxes. The Foundation's board is comprised of the founder, his spouse, and his eldest son. The Founder, the other directors, other family members of Founder, and Investment Firm are all disqualified persons as to the Foundation as a result of contributions to or investments by the Foundation. According to information submitted by the Foundation, the disqualified persons became limited partners in Investment Firm funds and also acquired direct interests in portfolio companies held by many of these funds. The combined holdings of Foundation and the disqualified persons in portfolio companies exceeded the permitted 20 percent threshold for excess business holdings under Code Section 4943(c)(2)(A) for three years. The Foundation claims this fact was not obvious since the Foundation and its disqualified persons held partnership interests in eight different funds. The Foundation discovered the excess business holdings when new accountants were retained to prepare a Form 990-PF. Upon discovering the excess holdings, the Foundation filed Form 4720 to report the excess holdings. The Foundation also made a Request for Abatement under Code Section 4962 of first-tier excise taxes due. The Foundation eventually donated its excess holdings to a public charity (since transfer restrictions made sale difficult). The IRS rejected both of the Foundation's arguments for abatement based on reasonable cause – (i) that it had reasonably relied on legal opinions when it made the investments which caused it to have excess business holdings, and (ii) that the accumulation of excess business holdings was caused by ignorance of the law and of the fact that the taxable events had occurred. As to the first argument, the IRS found insufficient evidence of reliance on advice of counsel. As to the second argument, the IRS found that the Regulations were not intended to allow ignorance of the law by the Board as a qualification for abatement. Further, the IRS found that the Foundation's situation did not meet the guidelines under Treasury Regulation Section 53.4943-2(a)(v), because the Foundation failed to establish the factors relevant to a determination that it did not have reason to know of the taxable events, such factors including the existence of procedures reasonably calculated to discover problematic holdings, a diversified portfolio, and large numbers of disqualified persons with little or no contact with the Foundation or its managers. Rather, the IRS found that the Foundation did not have procedures in place to discover problematic holdings, did not have an overwhelming diverse portfolio of holdings and had a limited number of disqualified persons, all of whom had substantial contact with the Foundation and its managers.

Grantor's Transfers to Trust Not Completed Gifts.

In **PLR 201440008** (October 8, 2014), Grantor proposed to create a self-settled irrevocable trust for the benefit of Grantor and her siblings, if living, otherwise her parents. The irrevocable trust has two independent trustees who must distribute income and principal as directed by a Distribution Committee and/or the Grantor. A majority of the Distribution Committee members may make distributions to Grantor or the other beneficiaries with Grantor's consent. All of the Distribution Committee members may make distributions to the beneficiaries (other than Grantor) on their own volition. The Grantor, in a nonfiduciary capacity, may distribute principal to her issue subject to the HEMS standard. The Distribution Committee will be composed of Grantor, Grantor's son, Grantor's siblings and Grantor's nephew. The Committee will cease to exist upon Grantor's death. The Distribution Committee must consist of at least two adults (other than Grantor) either (1) who are members of the class of permissible distributees, or (2) if there are not two permissible distributees willing and able to serve, then the parent or guardian of a permissible distributee. Grantor has a limited testamentary power of appointment over the Trust.

The Service examined the manner in which Grantor used an "adverse party" -- a person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power – in light of Code Sections 673 through 677 specifying when a grantor is treated as the owner of trust assets. The Service concluded that the Grantor would not be treated as the owner of any portion of the Trust (1) under Code Section 673 (no reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5percent of the value of such portion); (2) under Code Section 674 (power to distribute corpus to or for a beneficiary provided that the power is limited by a reasonably definite standard which is set forth in the trust instrument, such that beneficial enjoyment of trust assets is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party does not cause deemed ownership); (3) under Code Section 676 (no power to power to re-vest title to portion of trust assets in Grantor

exercisable by Grantor or a nonadverse party, or both); or (4) under Code Section 677 (adverse party must approve (i) income distribution to the grantor or the grantor's spouse; (ii) accumulation of income for future distribution to the grantor or the grantor's spouse; or (iii) payment of life insurance premiums on policies on grantor or the grantor's spouse. Nor would any other Distribution Committee member be treated as an owner of trust property under Code Section 678(a) because no member may unilaterally vest Trust income or corpus in himself. Further, it can only be determined if Grantor is an owner of trust property under Code Section 675 because of his administrative control after examination of the facts surrounding eventual operation of the Trust.

Grantor's transfer of property to the Trust is not a completed gift. A distribution from the Trust to Grantor will be a return of Grantor's property. The Grantor's retained power to direct the disposition of Trust assets (Treasury Regulations Section 25.2511-2(e)), and the fact that the Distribution Committee ceases to exist upon the death of Grantor and thus has no powers after Grantor's death (Treasury Regulations Section 25.2514-3(b)(2)) caused Grantor not to part with dominion and control such that she had no power to change the ultimate disposition of the Trust property. A Distribution Committee distribution to Grantor will not be a completed gift subject to gift tax by any member of the Distribution Committee. And upon Grantor's death, the value of the Trust property is includible in the Grantor's estate. Grantor's reserved power to change the interests of the beneficiaries causes the gift to be incomplete under Treasury Regulations Section 25.2511-2(c). Further, under Treasury Regulations Section 25.2511-2(b) Grantor's retained testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder.

Finally, the Service concluded that distributions by the Distribution Committee to a beneficiary other than Grantor will not be completed gifts by any member of the Committee subject to tax, but would be completed gifts by the Grantor. The Distribution Committee's powers exercisable with the consent of the Grantor are not general under Code Section 2514(c)(3)(A). Further, similar to the example at Treasury Regulations Section 25.2514-3(b)(2), the Distribution Committee members have substantial adverse interests in the property subject to all powers which they may exercise unanimously, without the Grantor's consent.

Extension of Time to File a Supplemental Form 709 and Elect Out of Automatic Allocation Rules Based on Tax Preparer's Error.

In **PLR 201444019** (October 31, 2014), Settlor created and funded an irrevocable trust with the following terms: trustee has discretion to make distributions of principal or income for the benefit of Settlor's child; the trust terminates when child reaches the age of 35 and the assets shall be distributed outright to child; if child dies prior to attaining age 35, the assets will be distributed to child's siblings, if any; otherwise child's half-sibling; otherwise Settlor's grandchildren, all subject to the same age 35 holdback provisions; otherwise Settlor's siblings. Settlor died and the law firm retained to assist in the administration of his estate noted that the accounting firm which initially prepared Settlor's Form 709 did not include with the Form 709 an election out statement to avoid the automatic allocation of Settlor's GST exemption to the transfer of property to the Trust. Settlor never made any additional transfers to the trust, and no taxable distributions or taxable terminations occurred with respect to the trust.

Section 26.2632-1(b)(2)(iii) of the Generation-Skipping Transfer Tax Regulations provides, in part, that to elect out, the transferor must attach a statement to Form 709 filed within the time period provided in Treasury Regulations Section 26.2632-1(b)(2)(iii)(C) (whether or not any transfer was made in the calendar year for which the Form 709 was filed, and whether or not a Form 709 otherwise would be required to be filed for that year). The election out statement must identify the trust (except for an election out under Treasury Regulations Section 26.2632-1(b)(2)(iii)(A)(4)) and specifically provide that the transferor is electing out of the automatic allocation of GST exemption with respect to the described transfer or transfers. The specific transfers, if not all, to which the election-out should apply must be described.

Settlor's estate requested an extension of time under Code Section 2642(g) of the Code and Section 301.9100-3 of the Procedure and Administration Regulations to elect out of automatic allocation. Section 2632(c)(1), effective for transfers subject to chapters 11 or 12 made after December 31, 2000, provides that the unused portion of an individual's GST exemption shall be allocated to property transferred by an indirect skip during the individual's lifetime to the extent necessary to make the inclusion ratio for such property zero. IRC Section 2632(c)(5)(A)(i)(I) provides that an individual may expressly elect out of automatic allocation on a timely filed gift tax return for the year of transfer. Section 301.9100-1(c) provides that the Commissioner has discretion to grant a reasonable extension of time for a taxpayer to make a regulatory election, or a statutory election. Requests for relief under Treasury Regulations Section 301.9100-3 will be granted when the taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the government. Treasury Regulations Section 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if he reasonably relied on a qualified tax professional who failed to make an election on behalf of the taxpayer. The Service determined that the Settlor reasonably relied on his preparer to make the Code Section 2632(c)(5)(A)(i)(I) election, and the preparer failed him. Therefore, the Service granted Settlor's Estate an extension of time to file a supplemental Form 709 and elect out of the automatic allocation rules.

Failure to File QSST Election Was Inadvertent, thus the IRS Allowed S Elections to be Filed within 120 days of ruling.

In **PLR 201444008 - 201444012** (October 31, 2014), the IRS provided a mechanism to retain S Corporation status where beneficiaries fail to file QSST elections. In PLR 201444008, the death of a shareholder and the transfer of S Corporation stock from a grantor, revocable trust to eligible S shareholder trusts resulted in the termination of the Corporation's S election where the beneficiaries of the trusts failed to file QSST elections. Because the failure to file QSST elections was inadvertent (the Corporation filed its returns consistent with an S corporation and the Trusts filed returns consistent with QSST Trusts), the IRS allowed the S elections to be filed within 120 days of the private letter ruling. The letter ruling

expresses no opinion with regard to the tax consequences of the transaction. *See also* PLR 201445001, 201445003 and 201445004 which discuss similar facts regarding an inadvertent termination for failure to make an ESBT election and for failure by the trust to qualify as an eligible S shareholder where the trust distributed the S corporation shares directly to individuals.

IRS Allows a 120-day Extension to Elect Out of Automatic GST Allocation.

In **PLR 201444019** (October 31, 2014), the IRS allows a 120-day extension to elect out of automatic GST allocation. The donor created and funded an irrevocable trust for the benefit of his child. Pursuant to the terms of the trust, the trustee had the discretion to make distributions of income and principal to or for the benefit of the child. Upon reaching the age of 35, the trust would terminate and its assets would be distributed outright to the child. If the child failed to live to age 35, assets remaining in the trust upon the child's death would be distributed to the child's living siblings, otherwise to the child's half-siblings, otherwise to the donor's grandchildren, otherwise to the donor's siblings, per stirpes. The donor engaged an accounting firm to prepare the Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, for the year in which the gift to the trust occurred. The accounting firm failed to elect out of automatic GST allocation with regard to gifts made to the trust. Soon thereafter, the donor died, and the executor of the donor's estate realized the failure to elect out. The donor's estate requested a ruling granting an extension of time to elect out of the automatic allocation rules with regard to the original gift to the trust. In accordance with Code Section 2642(g)(1)(B) and notice 2001 50, a taxpayer may seek an extension of time to make an allocation described in Code Section 2642(b)(1) or (b)(2) or an election described in Code Section 2632(b)(3) or (c)(5) under the provisions of Section 301.9100 3. Section 301.9100 3(a) provides that requests for relief will be granted when the taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the government. Taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional who failed to make or advise the taxpayer to make the election. Under PLR 201444019, the IRS concluded that the donor's executor met the requirements under Section 301.91003.

See PLR 201447013 which discusses a failure to allocate GST exemption to a trust when the taxpayer engaged an accountant to prepare the Form 709. *See also* PLR 201447008 which involved the severance of a marital trust and the reliance upon a qualified tax professional who failed to indicate an intent to sever the trust. The IRS allowed for an extension of time to sever the trust for generation-skipping purposes because the executor/spouse acted reasonably and in good faith on a qualified tax professional, and granting the extension would not prejudice the government's interests.

See also PLR 201447013 (November 21, 2014), where individuals were granted an extension of time to elect out of the automatic allocation rules as a result of relying upon a qualified tax professional who failed to allocate GST exemption to the trust and where no GST transfers had been made from the trust and the donors had sufficient GST exemption to allocate to the transfers.

IRS approves retitling of name of IRA and confirms such change will not constitute a payment or distribution.

In **PLR 201444024** (October 31, 2014), the decedent's will created a residuary trust which included two pecuniary bequests and the balance distributable to charity. The decedent owned an IRA which named the trust as the primary beneficiary. The estate and trust desired to transfer the IRA directly to charity after satisfying the pecuniary bequests with other assets of the trust. The IRS approved the change of title to the IRA to the charity and declared that the change would not constitute a payment or distribution out of the IRA to the estate, the trust or the charity and would not be a transfer within the meaning of Section 691(a)(2). The charity will include the amount of IRD of the IRA assigned and transferred to it in its gross income when the distributions from the IRA are actually received by charity.

IRS provides transition relief for the one-per-year limit imposed on tax free IRA rollovers.

In **IRS News Release 2014-107** (November 10, 2014), the IRS has provided transition relief for its change to the one-per-year limit imposed on tax free rollovers between IRAs announced in Announcement 2014-15, IRB 2014-16, 973, and scheduled to go into effect January 1, 2015. The clarification elaborates upon the application of the statutory one-per-year to rollovers between IRAs. Under the change, the one-per-year rule applies to each individual owner rather than to each IRA. However, under transition relief, a distribution from an IRA received during 2014 and properly rolled over to another IRA, will have no effect on any distributions and rollovers during 2015 involving any other IRAs owned by the same individual. This News Release provides IRA owners a fresh start in 2015 when applying the one-per-year rollover limit to multiple IRAs.

Transactions involving an estate, a revocable trust and a private foundation meet exception to self-dealing rules.

In **PLR 201446024** (November 14, 2014), the IRS has ruled that transactions subsequent to the death of the individual do not expose the estate or revocable trust or private foundation to the self-dealing excise tax. During his lifetime, the decedent sold an 85percent interest in his closely held company to an irrevocable trust in exchange for a promissory note. The decedent's Will distributed the note to the decedent's revocable trust, with the intent that the assets of the revocable trust would be distributed to several beneficiaries including the decedent's private foundation. The beneficiaries of the irrevocable trust were family members of the decedent, and their combined beneficial interests in the irrevocable trust exceeded 35 percent. Because the irrevocable trust was the obligor of the note and the foundation would have become a creditor of the note, the executor of the estate determined that an act of self-dealing would result when the note was transferred to the foundation.

The executor and trustee proposed to contribute the note to a new LLC for which the estate would receive 100 voting and 9,800 non-voting units. At the same time, the executor would contribute cash equal to 1percent of the value of the LLC in exchange for 100 non-voting units. The executor would also purchase 100 voting units in the LLC from the estate for cash and a purchase price determined by a qualified appraisal. In the end, the foundation would

receive cash and 9,800 non-voting units of the LLC instead of the note from the revocable trust. The executor would seek court approval from the probate court regarding the sale of the note to the LLC and the sale of voting units to the executor. The LLC would engage in only passive investment activities and at least 95 percent of its income would be from passive investments. The IRS ruled that the executor's actions would satisfy an exception to the self-dealing rules application to private foundations, the LLC's retention of the note, receipt of payments on the note and distributions of such payments would not constitute self-dealing, and the foundation's ownership of non-voting units in the LLC would not violate the prohibition against ownership of excess business holdings.

IRS allows rollover of inherited IRA into a new IRA through a trustee-to-trustee transfer.

In **PLR 201445031** (November 14, 2014), Decedent died prior to age 70½ owning an IRA. Decedent named his father as sole beneficiary of the IRA, but his father predeceased him. Decedent was married at the time of death. Decedent's Will left his estate entirely to his wife. Wife proposed to transfer the IRA directly into an IRA into her own name by way of a trustee-to-trustee transfer, or to distribute the assets of the IRA to herself and then rollover the distribution into a new IRA. The IRS ruled, generally, that if the proceeds of an IRA are payable to an estate, and the executor then pays those proceeds to the decedent's surviving spouse, the surviving spouse is treated as receiving the proceeds from the estate and not the decedent. Therefore, the surviving spouse is not eligible to rollover the distributed proceeds to his or her own IRA. However, the general rule will not apply where the surviving spouse is also the sole executor of the decedent's estate and the assets under the Will are distributed entirely to the surviving spouse. In such a case, the surviving spouse may rollover the proceeds into an IRA in the name of the surviving spouse. The IRA will not be treated as an inherited IRA with regard to the surviving spouse.

IRS approves extension of time to sever a marital trust into QTIP and non-QTIP Trusts, and to make the QTIP election.

In **PLR 201447008** (November 21, 2014), Decedent's surviving spouse and decedent's accountant served as co-executors of the decedent's estate. The accountant's own accounting firm was engaged to prepare the federal estate tax return. Another principal at the accounting firm represented the surviving spouse and the decedent's accountant. The surviving spouse and the decedent's accountant relied upon the estate planning expertise of the principal at the accounting firm. The accounting firm filed the Form 706 but failed to divide the marital trust into a QTIP trust and non-QTIP trust. The accounting firm also failed to allocate generation-skipping tax exemption with regard to the QTIP trust and therefore failed to sever the QTIP trust into an exempt QTIP and a non-exempt QTIP trust. The IRS ruled that the fiduciaries would be granted an extension of time of 120 days from the date of the letter ruling to file a supplemental Form 706 to sever the marital trust and then to also sever the QTIP trusts and apply GST exemption, because the decedent's surviving spouse and decedent's accountant acted reasonably and in good faith by relying on the principal at the accounting firm and the grant of relief will not prejudice the interests of the government.

IRS allows extension of time to allocate GST exemption where decedent's son was his attorney and failed to allocate exemption at the end of the ETIP.

In **PLR 201447026** (November 21, 2014), Decedent created a grantor retained income trust during his lifetime. The son of decedent was an estate planning lawyer. A Form 709 was filed to report the gift to the trust. No GST exemption was allocated to the trust as a result of the estate tax inclusion period (ETIP). The trust terminated at the end of its term, but the son failed to inform his father to allocate GST exemption at the conclusion of the ETIP period. Decedent and son then died. The IRS approved a 120-day extension of time to file and allocate the GST exemption from the date of the private letter ruling, because the taxpayer acted reasonably and in good faith by relying on legal counsel and the grant of relief will not prejudice the interests of the government.

North Carolina Case Law Developments

Exchange of Pledge and Promise to Pay by Donor Prior to Death Sufficient to Bring Claim for Breach of Contract against Trustee/Executor of Decedent's Estate.

In **East Carolina University Foundation, Inc. v. First Citizens Bank & Trust Co.**, No. COA 14-465 (November 18, 2014), the North Carolina Court of Appeals (in an unpublished opinion) addressed whether the trial court erred in granting defendant's motion to dismiss all of plaintiff's claims under Rule 12(b)(6). The court held that the trial court erred in granting the defendant's motion to dismiss as to plaintiff's claim for breach of contract, but affirmed the trial court's dismissal of plaintiff's claims asserting a completed gift and creation of an express trust. The facts of the case indicated that, prior to her death, donor had entered into discussions with the East Carolina University Foundation (the "Foundation") to establish an endowment for scholarships and other programs, which donor intended to fund with proceeds from the sale of specific real property. However, the donor never signed a written endowment agreement and died before delivering any funds to the Foundation. The Foundation sued the donor's estate and alleged that the donor's conduct manifested an intent to deliver the proceeds of the sale to the Foundation and that the donor had entered into an enforceable contract with clear and unambiguous terms for a charitable pledge with sufficient consideration. The court held that the allegations in plaintiff's complaint with respect to breach of contract, if taken as true, were sufficient to survive a 12(b)(6) motion on the basis that the Foundation had pled that there was an offer made by donor, acceptance of that offer by the Foundation and that the required element of consideration existed based on the Supreme Court's prior holding in **Rutherford College, Inc. v. Payne** that an exchange of a pledge and a promise to designate funds as directed constitutes sufficient consideration to support a contract. **Rutherford College, Inc. v. Payne**, 209 N.C. 792, 797, 184 S.E. 827, 830 (1936). The court upheld the dismissal of the Foundation's claim that the donor had made a completed gift to the Foundation prior to her death on the basis that there was insufficient evidence of actual or constructive delivery of funds to the Foundation that would have divested the donor of control

over the proceeds of the sale of the real property. The court also upheld the dismissal of the Foundation's claim that the donor had created an express trust in the Foundation's favor on the basis that the Foundation's complaint did not sufficiently allege words or circumstances showing the donor's intent to create a trust or a promise by any trustee to hold the property in trust for the benefit of the Foundation.

Class of Heirs to Receive Assets upon Death of Life Tenant Determined at Death of Testator, not Life Tenant.

In **Barnes v. Scull,** No. COA 14-264 (November 18, 2014), the court was asked to interpret the provisions of a will where testator devised a life estate in 146 acres to his wife and directed that upon her death, the real estate should be held in trust for one of the testator's six children, Hubert, for his life and upon his death, to Hubert's heirs if he had any; otherwise the property was to "revert to [testator's] heirs. The testator died in 1960; his wife died in 1969 at which time the trust for Hubert was created. Hubert died in 1980 without issue. Thus, the question was who were testator's "heirs" at the time of Hubert's death twenty years later. The instant litigation arose because one of Hubert's brothers (James) had predeceased Hubert. James had two children, but left his interest in the 146 acres to only his daughter and her husband. James expressly omitted his son. James's son also predeceased Hubert leaving three children who asserted that they owned an interest in the real estate. The assertion by James's grandchildren (Hubert's great-nephews) would be true if the determination of heirs occurred at Hubert's death but would not be true if the determination occurred at testator's death (since, in that instance, James's will would have been effective to devise his interest in the 146 acres to his daughter). Thus, the question before the court was whether the class of "heirs" was to be determined (i) at the time of the testator's death, or (ii) at the time of the death of the owners of the life estate. The court referenced that there is North Carolina case law to support both arguments, specifically the court analyzed the applicability of the holdings in **Lawson v. Lawson**, 267 N.C. 643 (1966) (class of heirs determined upon the death of the life tenant) and **White v. Alexander**, 290 N.C. 75 (1976) (class of heirs determined upon the death of the testator). The court held that the rule established in **White** applied to the present case, and that, to the extent **Lawson** and **White** are irreconcilable, **White** controls. The court noted that the rule of construction established in **White** is only to be followed in the absence of contrary intention clearly expressed in a testator's will. While in **Barnes** there was some evidence that the testator intended for the class to be determined upon the death of the life tenant, including the testator's desire to maintain family ownership of the property for as long as possible, the court did not find the evidence sufficient to overcome the plain language of the will and the prevailing rules of testamentary construction. Thus, the court affirmed the lower court's ruling defining the class of testator's heirs at the time of testator's death.

Allegations Sufficient to State a Claim for Breach of Fiduciary Duty Where Auditing Firm Sought Special Confidence Through Assurances Made to Client.

In **Commscope Credit Union v. Butler and Burke, LLP**, No. COA 14-273 (November 4, 2014), the court found that the trial court erred when it dismissed Plaintiff's claim for breach of fiduciary duty against a professional auditing firm. Plaintiff credit union had hired Defendant accounting firm to provide professional independent audit services. Each year from 2001-2009, Plaintiff's general manager failed to file a Form 990 with the IRS. In the course of its audits, Defendant never requested copies of the tax forms and, as a result, did not discover Plaintiff's failure to file. In April 2010, the IRS notified the Plaintiff of its filing deficiency and assessed a penalty of $424,000. Plaintiff sued Defendant based on a breach of a fiduciary relationship theory, among other theories. The trial court ruled that no fiduciary relationship existed and dismissed the case pursuant to Rule 12(b)(6). In reversing the trial court's decision the Court of Appeals held that while being an accountant for the credit union alone would not have given rise to a fiduciary relationship as a matter of law, the fact that the accountants were hired to plan and perform an audit created a higher burden on the defendant and thus stated a cause of action. The court specifically noted that Defendant had sought and received special confidence when it assured the Plaintiff that Defendant had expertise to "review financials statements to identify 'errors [and] fraud,' even by Plaintiff's own management and employees." *Id.*

North Carolina Department of Revenue – Interest Rate Announcement.

The interest rate on North Carolina tax assessments and refunds for the period January 1, 2015, through June 30, 2015, will remain at 5 percent.

Authorship and editing are provided by the Trusts and Estates Team of Womble Carlyle Sandridge & Rice, LLP as follows: Elizabeth K. Arias (Partner, Raleigh office); Elizabeth C. Coss (of Counsel, Charlotte office), Edward W. Griggs (Partner, Winston-Salem office), Megan R. Wilson (Associate, Winston-Salem office), Christopher N. Hewitt (Associate, Winston-Salem office), Lawrence (Larry) A. Moye IV (Associate, Raleigh office) and Kimberly H. Stogner (Partner, Winston-Salem office).

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