the will & the way

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The Chair's Comments

Craig Dalton

The Estate Planning & Fiduciary Law Section, through its Council and committees, devotes a large portion of its budget and the services of its members to providing continuing education to its members. A relatively new aspect of its continuing education program is providing scholarships to attend the Section's annual meeting held in Kiawah Island or Asheville. Two types of scholarships, each in the amount of $1,250, are offered to members of the Section. The scholarships are designed to cover the tuition for the program and a portion of the cost of accommodations. Recipients of the scholarships should be active members of the North Carolina Bar Association and local bar association, active in pro bono services, and be a solo practitioner or member of a small firm of less than five lawyers.

The first scholarship is offered to assist a long-time member of the Section who has suffered health issues, a catastrophic financial problem, loss of a spouse or child or other event that may affect the lawyer's ability to practice law. The applicant must have been in practice for more than eight years; focus more than half of his or her practice on estate planning, administration or fiduciary litigation; have been a member of the Section for the previous five years; and attended 20 or more hours of CLE in estate planning and/or administration or fiduciary litigation in the last three years. The second scholarship is offered to assist an attorney who was licensed in 2010 or later and who wants to focus his or her practice in estate planning, estate administration or fiduciary litigation. The recipient must be a current member of the Section and must have received two letters of recommendation from members of the Section confirming that the applicant already works in such area of law and would like to devote a greater portion of his or her practice. In addition, the recommending member must be mentoring or assisting the applicant with that endeavor.

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The Common Law Rule Against Accumulations No Longer Applies To Trusts

By James W. Narron

1. What Trusts Does The Repeal Affect?

We learned at the 34th annual meeting of the Estate Planning & Fiduciary Law Section that "the rule against accumulations of income is a common law rule, independent of the Rule Against Perpetuities ... [and that] in a jurisdiction that has enacted RAP reform, the reform's effect on the rule against accumulation of income is sometimes an interesting question." J. Spicer, Perpetuities in Estate Planning: *Perils and Opportunities for Estate Planners and Fiduciaries at the Confluence of the Common Law Statutory Reform and Federal Transfer Taxation,* Manuscript IX-1 at 4, Proceedings of the 34th Annual Meeting of the Estate Planning & Fiduciary Law Section of the N.C. Bar Association (July, 2013). The legislative response (presumably) was to amend paragraph (b) of N.C.G.S. Section 41-23(b) to read as rewritten:

> "(h) The provisions of G.S. 41-15, the common law rule against perpetuities, and the common law rule against accumulations do not apply to trusts created or administered in this State."

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The Chair's Comments, *continued from the front page*

I am pleased to announce that four members of our Section have been awarded scholarships under the program to provide assistance to attorneys licensed in 2010 or thereafter. To apply for a scholarship for 2016 or obtain more information, please contact Jeremy Williams at the Bar Center. His telephone number is 919-659-1451.

On behalf of our Section, I want to thank Rebecca Smitherman, Chair; and Linda Johnson, Vice-Chair; Elizabeth Arias and the other members of the Legislative Committee, as well as Kim Crouch, the Bar Association's legislative liaison, for their hard work with the Legislature and the General Statutes Commission. Many of our Section's bills have survived "cross-over" in the Legislature and have a good chance of being adopted. Rebecca, the Committee and Kim have devoted a great amount of time, energy and leadership to our legislative agenda. The number of bills submitted this year is one of the largest by any Section of the Bar Association.

Also, I am proud to announce that our Section has agreed to be a co-sponsor of the Chief Justice Convocation on the Future Delivery of Legal Services. This event, led by North Carolina Chief Justice Mark Martin, American Bar Association President William C. Hubbard and North Carolina Bar Association President Catharine Arrowood, will be held on May 27, 2015. That day, the many changes affecting the practice of law will be discussed: members of the public not being able to afford traditional legal services, high law school student debt, the trend of self-representation by members of the public, the future of the traditional law office and the increasing effects of technology. It will include Bar Association leaders and representatives from outside the legal profession.

I look forward to our Section's annual seminar in Kiawah. We have an excellent list of topics and speakers and on behalf of the Section, I thank Parrish Peddrick, Chair, and Holly Norvell, Vice Chair, as well as the other members of the CLE Committee, for their hard work in planning the seminar and identifying speakers. Also on behalf of the Council, I want to express the appreciation of our Section to Jeremy J. Williams, Assistant Director of Sections and Divisions of the North Carolina Bar Association, for his services in fundraising and in organizing our annual meeting.

-Craig G. Dalton Jr.

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The Common Law Rule, continued from page 1

S.L. 2014-107, s. 5.1. Per section 7.1 of the legislation, it is effective when it becomes law. (Approved Aug. 6, 2014). The provisions of N.C.G.S. Section 41-23, as amended in 2007, were made effective as to all trusts created before, on or after the effective date of that legislation.

Does the 2014 amendment apply to trusts created before the effective date of that legislation? This issue is not a new one. Where the courts construe a statute "with reference to an amendment it is presumed that the Legislature intended either (a) to change the substance of the original act or (b) to clarify the meaning of it." **Childers v. Parker's, Inc.**, 274 N.C. 256, 260, 162 S.E. 2d 481.483 (1968). A clarifying amendment, unlike an altering amendment, is one that does not change the substance of the law but instead gives further insight into the way in which the legislature intended the law to apply from its original enactment. *See* **Ferrell v. Dep't. of Transportation**, 334 N.C. 650, 659, 435 S.E. 2d 309, 315-16 (1993). As a result, in addition to applying to all cases brought after their effective date, such amendments apply to all cases pending before the courts when the amendment is adopted, regardless of whether the underlying claim arose before or after the effective date of the amendment. **Ray, Adm'x. v. N.C. Dep't. of Transportation**, 366 N.C. 1, 9, 727 S.E. 2d 675, 681 (2012) (citing cases).

Whether an amendment is clarifying or amending is a question of law for the courts, so the legislature's inclusion of an effective date does not alter the outcome. *Id.*

Ray dealt with an amendment to the State Tort Claims Act to provide that the public duty doctrine is an affirmative defense on the part of the state if and only if the injury of the claimant is the result of (1) alleged negligent failure to protect the claimant from the actions of others or an act of God by a law enforcement officer or (2) the alleged negligent failure of an agent of the State to perform a health or safety inspection. Both of these claims had been addressed in a manner consistent with the amendment in earlier Supreme Court cases. Paragraph (b) of the amendment listed exceptions under which the public duty doctrine as an affirmative defense could not be asserted. Such exceptions have been recognized by the courts since the time the duty was first acknowledged.

Here, plaintiff's decedent had been injured in 2002; the amendment limiting the public duty doctrine was not enacted until 2008. The amendment made clear that the doctrine was a more limited one than the common law would have found.

The court acknowledged that it had "previously held that even when the language of a statute is plain, 'the title of an act should be considered in ascertaining the intent of the Legislature.'" **Ray**, at 8, 727 S.E. 2d at 681.

The State Torts Claim Act had not addressed the application of the public duty doctrine to claims made under it, but the amendment specifically addressed use of the doctrine, strong evidence of the legislature's original intent, according to the majority opinion. The court held that the amendment was a clarifying one, correcting a lack of statutory guidance on the extent of the STCA which, before, had required a review of the state's common law, virtually all of which was left intact by the amendment. Because the claims came within the amendment, the claimants were allowed to prove their claim.

Essentially, the majority opinion holds that the initial Act, the STCA, allowed negligence claims against the state but did not specify whether and how the public duty doctrine was to apply. So, in the latest amendment the legislature reacted, speaking on a topic that it had not previously addressed and stating that while the Supreme Court had largely applied the doctrine, the doctrine is to be a limited one – the legislative intent was to clarify the role of the public duty doctrine with respect to the STCA, a clarification, not a substantive change.

The view of dissents in **Ray** was that the limitation of the public duty doctrine as an affirmative defense is a change in existing law – a substantive amendment, not a clarifying one. The dissents' position was that the amendment changed the law by limiting a pre-existing common law doctrine not mentioned in the original STCA. One dissent articulates the statutory construction issue with clarity:

> The doctrine operates as follows: When the legislature alters a statute, we presume that the legislature intended either to "(1) change the substance of the original act or (2) clarify the meaning of it." **Trs. of Rowan Technical Col. v. J. Hyatt Hammond Assocs.**, 313 N.C. 230, 240, 328 S.E.2d 274, 280 (1985) (citing **Childers**, 274 N.C. at 260, 162 S.E.2d at 483). If the legislature altered an *unambiguous* statute, a further presumption arises that the legislature intended to change the existing law. **Childers**, 274 N.C. at 260, 162 S.E.2d at 484. Alternatively, if the legislature altered an *ambiguous* statute, the presumption arises that the legislature only intended to "'clarify that which was previously doubtful.'" **Trs. of Rowan Technical Coll.**, 313 N.C. at 240, 328 S.E.2d at 280 (quoting **Childers**, 274 N.C. at 260, 162 S.E.2d at 484).

Whether the statutory change is clarifying or is a substantive change requires an understanding of the relationship of the Rule Against Perpetuities and the rule against accumulations.

2. The Common Law Rule Against Accumulations

a. L. Simes, *Law of Future Interests* § 148 (2nd ed. 1966):

> "In the absence of statute, provisions for the accumulation of income are restricted as follows:
> "(a) an otherwise effective provision for an accumulation is valid unless it is to continue for a period longer than the period of the rule against perpetuities;
> "(b) [deals with charitable accumulations, not contemplated by this paper]
> "(c) the cases tend to show that, if a provision for an accumulation, other than for charity, is to continue for a period longer than the period of the rule against perpetuities, it is void."

b. A. Scott, *The Law of Trusts* § 62.11 (Fratcher's 4th ed. 1987):

> "In England at common law a provision in the terms of the trust that the trustee should not pay out the income but

should accumulate it was valid, at least if the accumulation was not for a period longer than that of the rule against perpetuities, namely lives in being and 21 years. In other words, if a gift of the principal vested within the period, a provision that the income was to be added to and distributed with the principal at the termination of the trust was valid.

". . .

"In the United States in the absence of a statute it is held that a provision for accumulation for a period not longer than the period of lives in being and 21 years is valid."

c. *Restatement (2d) of Property*, § 2.2(l) (1979):

"An accumulation of trust income under a non-charitable trust created in a donative transfer is valid until the period of the rule against perpetuities expires with respect to such trust and any accumulation thereafter is invalid."

3. Is (or was) the Rule Against Accumulations part of the common law of North Carolina?

a. The only North Carolina case this writer has discovered which even tangentially refers to the Rule is **Griffin v. Graham**, 8 N.C. 96 (1820) where heirs contested testator's devise to create a Free School and fund it in perpetuity. On the facts, because there was a power of alienation a perpetuity was not created. The holding, per the last head note is "[T]he clauses in the bill of rights and constitution, were designed only to prevent dangerous accumulations of individual wealth, and referred to estates-tail alone: the establishment of a *permanent fund for charitable uses* does not come within the mischief, and is not prohibited by either of these clauses, nor by the common law."

b. N.C.G.S. Section 4-1. By statute:

"All such parts of the common law as were heretofore in force and use within this State, or so much of the common law as is not destructive of, or repugnant or inconsistent with, the freedom and independence of this State and the form of government therein established, and which has not been otherwise provided for in whole or in part, not abrogated, repealed, or become obsolete, are hereby declared to be in full force within this State."

The "common law" is the common law of England, **Resort Dev. Co. v. Parmele**, 235 N.C. 689, 71 S.E.2d 474 (1952)(reciting history, to 1711), overruled in part, **Gwathney v. State ex rel. Dep't of Env't, Health & Natural Resources**, 342 N.C. 287, 464 S.E.2d 674 (1995), as of the date of the signing of the Declaration of Independence, **Steelman v. City of New Bern**, 279 N.C. 589, 184 S.E.2d 239 (1971).

c. Was the rule against accumulations a part of the English common law, and, therefore, part of North Carolina law?

i. Peter Isaac Thellusson was a Swiss jeweler who fled to England to escape Napoleon. He prospered there and at his death left a fortune estimated to be £700,000, essentially to his youngest male grandchild who should reach age 21. He further provided that the interest should accumulate and be paid to the devisee with the principal. There was considerable hue and cry that the accumulation could ultimately exceed the national wealth of England (which ultimately proved entirely false as the accumulation over the following generations was very small indeed. 4A *Thompson on Real Property* § 2024A (Grimes ed. 1979)).

The contest of his will, **Thellusson v. Woodford**, [1799] 4 Ves. 227, led not only to the so-called Thellusson Act (1800) to limit the accumulation period to 21 years, but also to the famous case, **Thellusson v. Woodford**, [1805] 11 Ves. 112, the appeal of the will contest to the House of Lords. There, Lord Eldon observed, after disposing of the perpetuities issue: "[T]here is another question arising upon this will which is a pure question of equity, *viz*., Whether a testator can direct the rents and profits to be accumulated during that period for which he may so make the property inalienable? That he may do so I take to be most clear." **Thellusson v. Woodford** [1805] 11 Ves. 112, 146, 32 Eng. Rep. 1030, 1043 (1805). This is the principal articulation on the English Common Law on the subject of accumulations. Professor Simes points out:

"It has sometimes been regarded as holding that there is a common law rule in addition to the rule against perpetuities to the effect that a limitation providing an accumulation of income is not valid unless the period does not exceed that of the rule against perpetuities. But certainly the case actually held only that, if the period of an accumulation is no longer than that of the rule against perpetuities, the accumulation is permissible."

Simes, *supra*, at 321-22, *See*, Note 36 Ill.L.Rev. 567 (1941-44); Note, 54 Harv.L.Rev. 839 (1941) (tracing American statutes and cases); R. Sitkoff, *The Lurking Rule Against Accumulations of Income,* 100 Northwestern L.Rev. 501 (2006) (hereinafter, "Sitkoff").

ii. **Gertman v. Burdick**, 123 F.2d 924 (U.S. App. D.C. 1941), *cert den*., 315 U.S. 824 (1942), confronted squarely the issue of whether, in the District of Columbia, a provision that income be accumulated for lives in being plus 21 years was valid. The decision, because there was no statute or prior case law, turned on whether the British common law in effect on February 27, 1801, applied in the District. The District of Columbia law provided that the British common law in force in Maryland on that date was the law of the District. Relying on **Thellusson***,* the court concluded that the rule against accumulations limiting accumulations to the period of the Rule Against Perpetuities was the common law of England on that date and so was the law of the District of Columbia. The court upheld the will. This helpful case is probably required reading on the subject in that it reviews English and United States common law, statutory changes and collect state cases as of that time.

iii. Utility of Accumulations in light of Repeal of the Rule Against Accumulations.

(a.) Lessons from History.

(i.) The British were shocked by the prospect of compounding returns in the **Thellusson** case, and astonished at estimates that roughly £700,000 could grow to between £19,000,000 and £38,400,000. The family's counsel referred to the plan in the briefs as "posthumous avarice." Chancellor Kent spoke for many of his time:

> "This is the most extraordinary instance upon record of calculating and unfeeling pride and vanity in a testator, disregarding the ease and comfort of his immediate descendants, for the miserable satisfaction of enjoying in anticipation the wealth and aggrandizement of a distant posterity. Such an ironhearted scheme of settlement, by withdrawing property for so long a period from all the uses and purposes of social life, was intolerable. It gave occasion to the statute of 39 and 40 Geo. III. c. 98, prohibiting thereafter any person, by deed or will, from settling or devising real or personal property, for the purpose of accumulation, by means of rents or profits, for a longer period than the life of the settler, or twenty-one years after his death, or during the minority of any person or persons living at his decease, who, under the deed or will directing the accumulation, would, if then of full age, be entitled to the rents and profits."

4 Kent's Commentaries on American Law (1826-30), Lecture 59, of Executory Devises at n. 63, available at ***http://lonang.wm/library/references/kent-commentaries-american-law/kent-59/***.

History has taught that the fear of extraordinarily large accumulations was misguided. When Thellusson's trust ended at the death of his grandson in 1856, the trust had not increased by £1,000,000, much less £30,000,000. The most famous American charitable accumulation trust teaches the same lesson. When Benjamin Franklin died in 1790, he left two charitable trusts of £1,000 each to accumulate income for 100 years, then to spend most of the principal for public purposes in Boston and Philadelphia and then to accumulate for another 100 years. The Boston trusts had less than $5,000,000 in 1990 and the Philadelphia trust had less than half that amount. *See,* Sitkoff, *supra*, 505-06.

The clear lessons are: Require accumulation and (1) your friends and relatives will revile you, and (2) it will never work. But as the repeal which is the subject of this paper demonstrates, hope springs eternal. Consider, *e.g.*, **Marsh v. Frost Nat'l Bank**, 129 S.W.3d, 174 (Tx Ct. App. 13th Dis. 2004), *cert. den. subnom*, **Abbott v. Marsh** 2004 Tex. LEXIS 1006 (2004), where the holographic will provided:

> "I hereby direct my Executor to sell tract 3 of the V.M. Donigan 456.80 Partition for cash and to invest the proceeds in safe and secure tax-free U.S. government bonds or insured tax-free municipal bonds. This trust is to be called the James Madison Fund to honor our fourth President, the Father of the Constitution. The ultimate purpose of this fund is to provide a million dollar trust fund for every American 18 years or older. At 6% compound interest and a starting figure of $1,000,000.00, it would take approximately 346 years to provide enough money to do this. My executor will head the Board of Trustees . . . When the Fund reaches $15,000,000 my Executor's function will cease, and the money will be turned over to the Sec. of the Treasury for management by the federal government. The President of the U.S., the Vice-President of the U.S., and the Speaker of the U.S. House of Representatives shall be permanent Trustees of the Fund. The Congress of the United States shall make the final rules and regulations as to how the money will be distributed. No one shall be denied their share because of race, religion, marital status, sexual preference, or the amount of their wealth or lack thereof ..."

The case was remanded for reformation in that it violated the Rule Against Perpetuities because the trust was not charitable under Texas Law, not having the requisite public benefit.

b. Tax Laws

What we have witnessed from maybe two decades or more "is an interest group story of jurisdictional competition in trust law." Sitkoff, *supra*, at n.45. To attract trust monies, bankers and lawyers have lobbied for abolition of the Rule Against Perpetuities and now the rule against accumulations. But, as to the latter, in particular, the tax law is a decided impediment.

Trust marginal rates are compressed, hitting 39.6 percent for federal purposes when trust taxable income is over $12,300 for 2015. IRC Section 1 (e) (as adjusted for inflation). The net investment income tax will apply at 3.8 percent. IRC Section 1411. State income tax, if it applies, will drive the effective marginal rates to nearly 50 percent. If the trust is charitable (beyond the scope of this topic), the private foundation rules will apply. The Delaware Tax Trap will catch the unwary exercise of a limited power of appointment in a dynasty trust. IRC Section 2041(a)(3).

Notwithstanding the income tax bite, assuming it is not an erosion of principal as drastic as the transfer tax, there may, indeed, be an incentive to accumulate outside the transfer tax system. Cost and fees would have to be a consideration. See Sitkoff, *supra*, at n.53.

4. Conclusion

So, we come back around to initial inquiry: What trusts does the repeal affect? The practical inquiry is whether the appeal applies to trusts created prior to the effective date of the amendment in 2014. That inquiry, as set out above, turns on whether the 2014 amendment was "clarifying" or "substantive."

In **White v. Fleet Bank**, 739 A.2d 373 (Me. 1999), decedent's will left a substantial portion of his estate in trust, the income from which he divided into four parts: "Part One – to be invested annually for the increase of funds in the trust, Part Two to [his wife], Part Three to [his daughter], Part Four to [his daughter's di-

rect descendants]. He further provided that, ultimately, Part Four would receive Parts Two and Three and that when a descendant of his daughter died that share of Part Four would pass to his or her direct descendants, or if none, to other direct descendants of his daughter, "and so on, following the lines of direct descent, as long as the trust may be made to endure." The Court first addressed the Rule Against Perpetuities, holding that Maine had modified the common law rule with a "wait and see" statute and accepted the argument of the trustee that the language of the trust meant that the trust could last for whatever duration was allowed by the statute, at which time the "wait and see" statute would determine whether an invalid interest would arise, "at the date in the future when the last life in being dies."

The trustee then took the position that Maine's "wait and see" statute applied to both the Rule Against Perpetuities and the rule against accumulations. "However, although the two rules are related, they are separate rules, as demonstrated by those state statutes that address the rule against accumulations separately [citing statutes of California, Minnesota, Indiana, New York and Pennsylvania] … If the legislature intended to include accumulation clauses within the scope of the 'wait and see' statute, it would have so stated. As the legislature did not make such intention clear within the language of the statute, or in legislative history, we may not adopt such an inference." The court had earlier observed that "Maine's 'wait and see' statute is in derogation of the common law, and as such must be narrowly construed." The rule against accumulations was violated as to Part One and so would be held in a resulting trust for the decedent's remaining heirs. The case was remanded for that calculation and distribution (which predictably gave rise to additional controversy, 2005 Me. LEXIS 75 (June 17, 2005). *See*, Comment, *The Sleeper Has Awakened, The Rule Against Accumulations and Perpetual Trusts*, 76 Tul. L. Rev. 189 (2001).

Where the Rules Against Perpetuities has been abolished (as it presumably has been in North Carolina, **Brown Bros. Harriman Trust Co. v. Benson**, 202 N.C. App. 283, 688 S.E. 2d 752, *app. dismissed*, 364 N.C. 239, 698 S.E.2d 391 (2010)), it would seem that the allowed duration for accumulation would be infinite, unless the rules are held to be separate, as in **White**, *supra*.

Powell's real property treatise predicts the courts will rule: "The failure of a legislature to enact statutes for both rules most likely will result in a judicial determination that the changes of the period for one purpose also changed the period for the other purpose." 10 *Powell on Real Property* ¶ 831 at 76.22, citing and quoting *Restatement 2d of Property*, § 2.2, at n.10. See J. Dukeminier, *The Uniform Statutory Rules Against Perpetuities: Ninety Years in Limbo*, 34 UCLA L.Rev. 1012, 1041-42 (1987) for the same conclusion. Sitkoff, *supra*, at 512-13 makes the argument for tying the two rules together:

> "Consider again, Lord Eldon's opinion in **Thellusson**: '[A] testator may direct the rents and profits to be accumulated for that period, during which he may direct, that the title shall not vest, and the property shall remain inalienable.' If the testator can direct the title shall not vest for an infinite period, then it follows that he can likewise direct income to be accumulated for an indefinite period."

So, notwithstanding that the two rules, one against perpetuity, the other against accumulations, were at the common law separate, yet they were tied together by reference to the same duration limitation. The more persuasive argument is that the 2014 amendment was clarifying and so it applies to trusts before the date of enactment. Indeed, the title to the Act recites that it is to "Clarify That Common Law Rule Against Accumulation No Longer Applies To Trusts." To be sure, there is an argument on the other side, but the weight of reason and history is not on that side. Whether one would give an opinion letter is probably another question, especially in light of the vigorous dissents in **Ray v. N.C. Department of Transportation**, *supra*.

James W. Narron is a partner in Narron, O'Hale and Whittington, P.A., with offices in Smithfield, Benson and Raleigh.

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Managing Editors: Heidi Royal & Jessica Hardin

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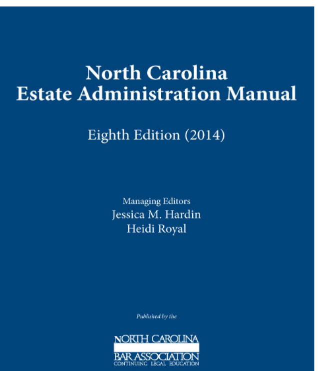

Leaving Junior The Farm? Make Sure He Can Get There

By Jason W. Wenzel

This article addresses a common issue that is often overlooked when formulating a client's estate plan: the future subdivision of real property and, specifically, the treatment of access, utility and other easements to reach the parcels.

Consider this example: Mom finally gets around to calling a lawyer to update her Will. Dad passed away some years back, and there's a farm that has been in the family for generations. Mom wants to leave the property to the children, but not all children will have access to their parcels if the land is divided. The trap for the unwary estate planner is to forget about access. The question of access also can arise when a devisee[1] has been left property and comes to his lawyer's office for advice.

One purpose of this article will be to refresh both a planner and an estate's lawyer's recollection as to the common forms of easements in North Carolina, both express and implied, and to highlight their importance in creating a cohesive estate plan. While an express easement works well, many estate planning clients neither wish to spend the money to obtain a survey nor wish to incur the ramifications of subdivision (loss of deferment through the Agricultural Use Program, creating separate tax parcels, etc.). Therefore, in addition to options associated with adequately describing access to a future subdivision without actually completing a division in conjunction with an estate plan, the following easements will be explored: (a) an implied easement by necessity; (b) an easement implied from prior use; (c) a quasi-easement, under the doctrine of visible easements; (d) an easement by estoppel; and (e) an easement by prescription.

A. Easements Generally

Most estate planners know more about the Internal Revenue Code than about easements. While they probably recall that an easement can generally be defined as a right to use or enjoy the land of another, simply including in a Will or trust that a testator or grantor directs property to be distributed "pursuant to an easement" is wholly insufficient and does not address several key questions such as: Is the easement exclusive? Is the easement in gross (for a specific individual, which terminates upon death of a grantee) or appurtenant (will it run with the land)? *See, generally,* **Skvarla v. Park**, 62 N.C. App. 482, 303 S.E.2d 354 (1983), **Gibbs v. Wright**, 17 N.C. App. 495, 195 S.E.2d 40 (1973). Is it limited in scope (i.e. only for pedestrian or vehicle ingress, egress, or regress) or unlimited (i.e. above-ground utilities)?

Remember that if there is no Will, then title to real property vests in the heirs at a decedent's death; however, if there is a Will, then it is upon probate of the Will that title vests in the devisees, and this relates back to the date of death. *N.C.G.S. § 28A-15-2(b)*. Thus, depending upon the type and location of certain property, property access can become an issue during the initial stages of an estate's administration.

B. Express Easements and Reservation of Easements

1. *Express*. An easement by express grant, as an interest in land, is subject to the Statute of Frauds. **Shingleton v. State**, 260 N.C. 451, 133 S.E.2d 183 (1963); *N.C.G.S. § 22-2*. Care should be given both to the dominant and servient estate, as well as to the exact size and location of the easement. Deeds of easement must also be recorded. *See N.C.G.S. § 47-27*. Written easements are construed pursuant to the rules governing contracts. **Higdon v. Davis**, 315 N.C. 208, 337 S.E.2d 543 (1985).

The importance of creating an express easement by an actual, physical survey drawn by a licensed professional land surveyor should not be underestimated. *See 21 NCAC 56.0701*. As with any subdivision of land, criminal penalties [i.e. a Class 1 misdemeanor] can be imposed for transferring lots in unapproved subdivisions. Such penalties are applicable even when a description is by metes and bounds. *N.C.G.S. § 153A-334(a)*. The ramifications to a client or the client's donees can extend even further in that "[b]uilding permits required pursuant to *G.S. 153A-357* may be denied for lots that have been illegally subdivided." *Id.* Certain items are excluded from a subdivision: (1) combinations or recombinations when the total number of lots is not increased; (2) division of land into parcels greater than 10 acres when no street right-of-ways are involved; (3) public acquisition for widening or opening streets; and (4) divisions no greater than two acres into not more than three lots, if no street right-of-ways are involved, and the lots exceed standards of county per its subdivision regulations. *N.C.G.S. § 153A-335*.

Be wary of preliminary sketches brought in by clients, for no property description should be drawn from a plat marked "Preliminary." *See 21 NCAC 56.1604*. A preliminary plat will likely not have taken into account set-backs and environmental health regulations and might not be in compliance with subdivision ordinances. While it is permissible to record a map or other non-approved plat as an exhibit to an instrument (such as an easement) for illustrative purposes, such exhibit must contain the following language: "THIS MAP IS NOT A CERTIFIED SURVEY AND HAS NOT BEEN REVIEWED BY A LOCAL GOVERNMENT AGENCY FOR COMPLIANCE WITH ANY APPLICABLE LAND DEVELOPMENT REGULATIONS." *N.C.G.S. § 47-30(n)*.

With certain conditions, one may incorporate an extrinsic writing – such as a survey – in a Will even though such extrinsic writing is not executed with the (self-proving) formalities required for a Will. **Watson v. Hinson**, 162 N.C. 72, 77 S.E. 1089 (1913). To incorporate such an extrinsic writing: first, the extrinsic document must be in existence at the time the Will is executed.[2] Second, an extrinsic writing must be identifiable with reasonable certainty. Third, a testator must intend to incorporate the writing, and such intent must appear in the Will.

Obtaining a survey – even if such survey is not meant to be recorded and is ordered after the execution of the Will – is an efficient way to express the testator's intent clearly, and can be effectuated by the act of republishing a Will through execution of a codicil for that purpose. If the testator can be convinced to allow his estate planner to address access directly, one may consider the following two (2) examples:

> 1. To my daughter, _______________, if she survives me, and if she does not, then to my son, _____________, my personal residence described in the deed of record in Book _____, page ____, _________ County Registry, and the curtilage to include the pack barn, the land between the row of cedars on the northwest side of the yard and [identify neighbor's] fence, and from the road to ___ feet below the shelter and again between the row of cedars and [neighbor's] fence. If it is necessary that such area be laid off, my Executrix is authorized to retain the services of a competent surveyor for that purpose and to execute and deliver an Executrix=s Deed for the purpose of defining on the public record the scope and extent of that area.
>
> 2. I give and devise that certain tract owned by me and described in the deed of record in Book __, page __, _________ County Registry, to my Executor and direct that my Executor distribute the same as follows:
>
> a. My Executor shall commission the services of a competent and licensed registered surveyor to lay off at the southwest corner at the intersection of [Road "x" and Road "y"], a parcel of ___ acres, excluding the highway right of way, such that the road frontage on each road is equidistant and that the lot has the basic appearance of a square (although I acknowledge that the highways are probably not perpendicular) and prepare and record a plat of the same. Based on such plat, my Executor shall convey this parcel of ___ acres by Executor's Deed to my daughter, ____, ...
>
> b. The balance of such parcel my Executor shall convey by Executor's Deed to my son, ________, ...

As the above examples show, we see how it is possible to provide the means for the personal representative after the testator's death to address access in an adequate fashion without forcing the testator to spend the money for a survey on the front end. Just do not fall into the trap of overlooking access in making a simple bequest. Take the time to search the title, and do not rely on the deed (what about the previous subdivision done 10 years ago?) or survey (often outdated) that your client provides to you.

2. Always "Reserve"; Never "Except". As cautioned in *Webster's*, one cannot "except" an easement in favor of himself, but rather may "reserve" an easement over a tract being conveyed. Patrick K. Hetrick & James B. McLaughlin Jr., *Webster's Real Estate Law in North Carolina* ' 15-10 (5th ed. 1994). An example in an estate planning context would be that out of a 50-acre tract, the testatrix may want to carve out a two-acre home site tract for her son, but needs to 'reserve' a 60-foot wide non-exclusive, easement appurtenant for access thereto.[3]

C. Use of Trust to Hold Title. Despite increased estate tax exemption amounts, many common reasons (confidentiality, probate avoidance, etc.) for utilizing separate revocable trusts still exist, and revocable trusts can be useful for holding title to real property as well. As with any trust, the key is identifying a reliable trustee. Assuming the grantor is comfortable with such a trustee appointment, the trustee can be authorized – in addition to the general *N.C.G.S. § 32-27* powers, especially subsection (8) – to manage real property as follows:

> **Administrative Powers of Trustee.** In addition to the powers conferred by law or elsewhere in this trust instrument and (subject to *North Carolina General Statutes Section 32-26*) those powers set forth in North Carolina General Statutes Section 32-27 (except *N.C.G.S. 32-27(29)*) which are hereby incorporated herein by reference, I grant to the Trustee with respect to the trust property the discretionary powers set forth below to be exercised without court order for any purpose that the Trustee may deem advisable:
>
> **a. Management of Property**. The power to take possession, custody, and control, and otherwise manage any real or personal property, including, but not limited to, the power (i) to protect, develop, subdivide, and consolidate such property, (ii) to lease such property upon any terms and conditions, including options to renew or purchase, and for any period or periods of time although such period or periods may extend beyond the duration of the trust, and to modify, renew, or extend any existing leases, (iii) to erect, repair, or make improvements to any building or other property and to remove existing structures, (iv) to establish and maintain reserves for the maintenance, protection, and improvement of such property and for other purposes, (v) to initiate or continue farming, mining, or timber operations on such property, (vi) to purchase and carry casualty and liability insurance, (vii) *to grant or release easements with respect to such property*, (viii) to dedicate or withdraw from dedication such property from public use, and (ix) to join with co-owners in exercising any such powers [*emphasis added*].

D. Implied Easements. As opposed to express easements, reservation of rights, and the declaration contexts addressed above, the more typical estate planning real property situation involves a testator who wants to divide his property in equal parts for his several children. Despite your best efforts at discussing the many *intervivos* benefits of the property being held by a limited liability company or trust, the client is adamant that title will not be transferred until after his death. Maybe the children do not get along. Maybe one is a spendthrift or another has a shaky marriage. But whatever the reason, your client wants Blackacre divided upon his death with one-third going to A, one-third going to B, and one-third going to C. Without thinking through the access issues surrounding such a

division in advance, unintended and costly consequences can occur.[4]

Fortunately, easements can be created by implication as follows:

1. *Easement by Necessity*. In certain circumstances, a landlocked property owner can gain access to his or her property through an implied easement by necessity. Such relief is afforded if there is no other outlet for ingress or egress.

An easement by necessity is created, if at all, at the time land is divided because when "a grantor conveys land entirely surrounded by his own land, and there is no outlet for ingress and regress, the law will imply an "easement by necessity" for the grantee to pass over the grantor's land so as to reach the public road. The same rule applies if the grantee's land is surrounded by the lands of the grantor and the lands of others." *Webster*, *supra* § 15-13.

> "[T]he easement must arise, if at all, at the time of the conveyance from common ownership." **Broyhill v. Coppage**, 79 N.C. App. 221, 226, 339 S.E.2d 32, 37 (1986). "Consequently, all elements required for the easement's creation must exist at the time of the severance of the alleged dominant and servient estates." *Webster's* § 15-13; **Woodring v. Swieter** *et al*, 180 N.C. App. 362, 637 S.E.2d 269 (2006). An implied easement of necessity cannot be presumed over the land of a stranger as privity of title must exist. If there is no grantor-grantee relationship and an owner has no access to a public road, the owner's remedy is a statutory cartway proceeding. *See* **Broyhill** at 225, 36.

As to the estate planning context, if your client does not want to spend the money to obtain a survey, she likely will not understand why it would be preferable to have her title searched. To the extent possible, include within the Will or trust as much title information as possible to allow the beneficiaries the benefit of the information Mom knew about the property. Often an estate planning client will ask what she needs to bring to her initial meeting with the lawyer; always suggest that she brings copies of the current *ad valorem* property tax bills, copies of her deeds, and any other information she may have regarding her real property. Do not forget to inquire about existing deeds of trust as having your client bring in copies of her historical records (i.e. cancelled mortgages, etc.) can alert you to subdivisions and title issues that can more easily and efficiently be handled while the client is alive then after her death.

Just as doctors are often reminded to treat the whole patient, and not just the disease, the same should be true for lawyers in the estate planning context. Frequently, a client will come to you thinking she knows what she wants, much like the patient who has self-diagnosed himself on the Internet. Always remember that your job is not just as scribe. A prudent estate planner is careful to look beyond the presenting symptoms and to anticipate issues (including those that may arise after death) that the client has failed to consider. The Offices of most Registers of Deeds are now online, and it is money well spent to perform a title search or update in conjunction with the preparation of estate planning instruments. Encourage the client to get a survey, especially of property that has been owned for decades. The survey does not have to be recorded, and can be an invaluable tool not only in planning, but also to ascertain whether there are matters that need to be addressed proactively rather than reactively. Remember that a primary purpose of estate planning is to eliminate hoops for the ultimate beneficiaries to have to jump through. Obtaining a boundary survey, and laying out the access to any future subdivision, solves one additional hurdle.

2. *Easement Implied from Prior Use.* In discussing your client's ownership of her land, perhaps she remembers walking down the path with her grandfather to go fishing at the river. Or perhaps she recalls other details about the property that would not otherwise appear in the public domain. If you are going to describe that "path" as where the easement should be located, include as much detail as possible.

It has often been said that "…the intent of the testator, as expressed by him, is to be ascertained from the four corners of the will … and that this intent is the guiding star which must lead to the ascertainment of the meaning and purpose of the language used." **Schaeffer v. Haseltine**, 228 N.C. 484, 489, 46 S.E.2d 463, 467 (1948). This is why you must include as much detail as possible. Do not open the door for a challenge after death in having to prove what a testator knew or may have said to someone.

But even if there is a proper written record of the easement, all is not lost. An easement may be implied from prior use when there is a conveyance of a portion of a grantor's land and prior to the conveyance there was a usage of the land in such a manner that if the two tracts had in fact been separate tracts, one tract would have been servient to the other in a way which looked like an easement appurtenant to the other tract. *See* **Woodring v. Swieter**, 180 N.C. App. 362, 637 S.E.2d 269 (2006). The prior usage must be necessary to the use of the part to which it would be appurtenant, and, further, the prior usage must be apparent or visible for an easement will be implied from prior use.

> To establish an easement by implication, a party must prove that: (1) there was a common ownership of the dominant and servient parcels and a transfer which separates that ownership; (2) before the transfer, the owner used part of the tract for the benefit of the other part, and that this use was apparent, continuous, and permanent; and (3) the claimed easement is necessary to the use and enjoyment of the claimant's land. **Tedder v. Alford**, 128 N.C. App. 27, 32-33, 493 S.E.2d 487, 490 (1997), *disc. review denied*, 348 N.C. 290, 501 S.E.2d 917 (1998).

Thus, the key is showing prior use *before* the severance, and the most efficient method of getting this information is to ask your client.

Such an easement is designed to address the probable expectations of a grantor and grantee that *an existing use* of part of land being conveyed would continue after the transfer (*emphasis added*). *See Id.* at 33, 493 S.E.2d at 490. To establish such an implied easement, one must show the "use of the purported easement existed prior to the severance of title . . . and that at the time of the severance, [the grantor] intended that the use would continue." **CDC Pineville, LLC v. UDRT of N.C., LLC**, 174 N.C. App. 644, 654, 622 S.E.2d 512, 519 (2005), *disc. review denied*, 360 N.C. 478, 630 S.E.2d 925 (2006). By describing in the Will the property not just by Book and Page, PIN number, or address, but by setting forth the testator's knowledge as to its history and prior use, you can create an invaluable record[5]

that can be used in the future. Further, and especially for the estate planning client who does not want her children to know of her plans until after her death, the oral history of the family that can be passed along in such a manner should not be discounted.

It should be noted that the majority of North Carolina cases that recognize an easement by prior use have required a period that exceeds 30 years. *See id.* (citing **Potter v. Potter**, 251 N.C. 760, 112 S.E.2d 569 (1960)); *see also* **Spruill v. Nixon**, 238 N.C. 523, 78 S.E.2d 323 (1953) (at least 35 years); **Biggers v. Evangelist**, 71 N.C. App. 35, 321 S.E.2d 524 (1984), *disc. review denied*, 313 N.C. 327, 329 S.E.2d 384 (1985) (30 years); **McGee v. McGee**, 32 N.C. App. 726, 233 S.E.2d 675 (1977) (60 years); **Dorman v. Ranch, Inc.**, 6 N.C. App. 497, 170 S.E.2d 509 (1969) (42 years). For most large tracts of family-owned land, this standard is usually easily met.

3. *Standard for Quasi-Easement/Doctrine of Visible Easements*. As a general rule, a vendee is presumed to have contracted to accept land subject to visible easements of an open and notorious nature. **Waters v. N.C. Phosphate Corp.**, 310 N.C. 438, 312 S.E.2d 428 (1984). "[W]here, during the unity of title, an apparently permanent and obvious servitude is imposed on one part of an estate in favor of another part, which servitude, at the time of the severance, is in use and is reasonably necessary for the fair enjoyment of the other part of the estate, then upon a severance of the ownership, a grant of the right to continue such use arises by implication of law." **Pritchard v. Scott**, 254 N.C. 277, 281, 118 S.E.2d 890, 893 (1961); s*ee also 17A Am. Jur., Easements § 41*.

If property has such "obvious" and "permanent" features, why should a prudent planner leave the so-called doctrine of visible easements to chance? Ask your client about the property: are there any special features? Is there direct access, and if not, how does she get to it? Before drafting the client's Will, have staff pull the property up on your county's Geographic Information Systems (GIS) map – often all that is needed is the client's name, property address, or tax or parcel number. Select the "orthophotos" overlay, if possible, and see what the most recent aerial photographs show. Use what is readily available as a discussion point with the client to ensure that any key property features are addressed whenever possible.

4. Standard for an Easement by Estoppel. In general, estoppel prevents a party from claiming a right to the detriment of another who was justified in relying on such conduct and acts accordingly. An easement by estoppel "'may arise where one cognizant of his own right keeps silent in the knowledge that another will be innocently and ignorantly induced to . . . expend money or labor in reliance on the existence of such an easement.'" **Delk v. Hill**, 89 N.C. App. 83, 87, 365 S.E.2d 218, 221 (1988) (quoting 1 *Webster, supra*, § 316 (rev. ed. 1981) [*see* §15-16 of 5th ed.]), *disc. review denied*, 322 N.C. 605, 370 S.E.2d 244 (1988). *See also* **Woodring**, 180 N.C. at 375, 637 S.E.2d at 280.

The equitable theory of estoppel relies on fact. Establish as many relevant facts as to the use by your client of her land, and incorporate them into her Will. A well-described parcel, the reason for a proposed division, and the specific location of the access thereto may act as a better deterrent to a wayward beneficiary than the effect any *in terrorum* clause may have.

5. *Standard for a Prescriptive Easement*. To establish an easement by prescription, a party must show: (a) a use adverse, hostile or under a claim of right; (b) the use has been open and notorious such that the true owner had notice of the claim; (c) the use has been continuous and uninterrupted for at least 20 years; and (d) that there has been a substantial identity of the easement claimed throughout the 20-year period. *See* **Concerned Citizens of Brunswick County Taxpayers Ass'n v. State**, 329 N.C. 37, 45, 404 S.E.2d 677, 682 (1991). An easement by prescription is akin to adverse possession, and the moving party bears the burden of showing each and every element thereof. Use of another's land is presumed to be permissive unless the contrary appears. *Id.*

A hostile use has been defined as "a use of such nature and exercised under such circumstances as to manifest and give notice that the use is being made under claim of right." **Dulin v. Faires**, 266 N.C. 257, 261, 145 S.E.2d 873, 875 (1966).

While often there is little question that a path exists, the size, condition, and scope of such path may have changed greatly over the years. Who has maintained the path over the years? Have all the necessary characteristics been shown, and for the necessary statutory period? Ask these questions, and more, of your client.

Remember that mere permissive use of a way over another's land cannot ripen into an easement by prescription no matter how long it continues. **Yadkin Valley Land Co. v. Baker**, 141 N.C. App. 636, 539 S.E.2d 685 (2000). Inquire if your client has given a neighbor the right to use a path, or if your client has been given such rights. Prescriptive easements are not favored under the law, and it can be expensive to prove an adverse, hostile, open, notorious, or continuous use for greater than a 20-year period sufficient to establish a prescriptive easement. Title can pass by express instrument, inheritance, operation of law, or by order of a court. Do not miss an opportunity to define definitively by testamentary document what would otherwise require a separate court action.

E. Declaratory Judgment

Sometimes it is altogether unclear what rights a devisee may have to access her property. If any interested parties cannot agree, and "an actual and justiciable" controversy has arisen, one should ask the court for a declaratory judgment in addition to any alternative theories of implied easements that may be pled. Generally speaking, a court has very broad discretionary powers in interpreting the rights of parties to any written instrument, and thus it is usually a relatively easy bar to achieve jurisdiction under the declaratory judgment standard.

F. Always Remember Scope: An Easement May Not Be Overburdened

"Generally, 'once an easement has been established, the easement holder must not change the use for which the easement was created so as to increase the burden of the servient tract.'" **Swaim v. Simpson**, 120 N.C. App. 863, 864, 463 S.E.2d 785, 787 (1995) (quoting 1 *Webster*, *supra* § 15-22, at 737 [reference updated to 5th ed.] (italics omitted)), *aff'd per curiam*, 343 N.C. 298, 469 S.E.2d 553 (1996).

Thus, general access by an individual may not give rise to commercial purposes. Use outside the historical scope may constitute activities beyond the original purpose of the easement, and then "such

use will constitute an excessive use and may be enjoined." **Hundley v. Michael**, 105 N.C. App. 432, 435, 413 S.E.2d 296, 298 (1992) (citing **Hales v. Atl. Coast Line R.R.**, 172 N.C. 104, 90 S.E. 11 (1916)).

However, the scope of an easement can be difficult to identify. For an express easement, North Carolina case law is clear that the established, applicable standard of review for construction of an easement is based on contract law:

> An easement deed, such as the one in the case at bar, is, of course, a contract. The controlling purpose of the court in construing a contract is to ascertain the intention of the parties as of the time the contract was made, and to do this consideration must be given to the purpose to be accomplished, the subject-matter of the contract, and the situation of the parties. **Weyerhaeuser Company v. Carolina Power & Light Company**, 257 N.C. 717, 719, 127 S.E.2d 539, 541 (1962).

A primary problem with implied easements, however, is that there are no express terms for a court to construe.

In **Stonecreek Sewer Ass'n v. Gary D. Morgan Dev.**, 179 N.C. App. 721, 730, 635 S.E.2d 485, 490-91 (2006), the N.C. Court of Appeals sets forth the well-settled North Carolina procedure for interpreting an easement:

> If the scope and extent of an easement is contested, the following rules apply:
>
> First, the scope of an express easement is controlled by the terms of the conveyance if the conveyance is precise as to this issue. Second, if the conveyance speaks to the scope of the easement in less than precise terms (i.e., it is ambiguous), the scope may be determined by reference to the attendant circumstances, the situation of the parties, and by the acts of the parties in the use of the easement immediately following the grant. Third, if the conveyance is silent as to the scope of the easement, extrinsic evidence is inadmissible as to the scope or extent of the easement. However, in this latter situation, a reasonable use is implied. **Swaim**, 120 N.C. App. at 864, 463 S.E.2d at 786-87.

Thus, a reviewing court must first determine whether a conveyance is specifically precise on its own terms, is ambiguous, or is silent as to its scope. The plain language and terms of the easement control when an instrument creating an express easement describes the extent of the easement with precision. *See* **Williams v. Abernethy**, 102 N.C. App. 462, 464-65, 402 S.E.2d 438, 440 (1991).

If an easement is less than precise, any ambiguity may be "...interpreted by reference to the attendant circumstances, to the situation of the parties, and especially to the practical interpretation put upon the grant by the acts of the parties in the use of the easement immediately following the grant." *Id* at 465, *citing* G. Thompson, *Commentaries on Modern Law of Real Property* ' 385 at 528 (repl. 1980). Further, "[t]he reasonable use and enjoyment of an easement is to be determined in the light of the situation of the property and the surrounding circumstances. What is a reasonable use is a question of fact." **Shingleton v. State**, 260 N.C. 451, 457, 133 S.E.2d 183, 187 (1963).

To the extent one beneficiary has historically borne the brunt of maintaining a path, whether in terms of time, money, materials, or proximity, he may have claim to the use of the path that other beneficiaries do not. The well-settled tenet is that "an easement holder may not increase his use so as to increase the servitude or increase the burden upon the servient tenement." **Hundley**, 105 N.C. App. at 435, 413 S.E.2d at 298; *see also* 1 *Webster*, *supra* § 15-21, at 734. Historical farm use may not give rise to pure commercial use. Injunctive relief is available to prevent use beyond an easement's scope. *See* **Shingleton**, 260 N.C. at 457, 133 S.E.2d at 187 ("The reasonable use and enjoyment of an easement is to be determined in the light of the situation of the property and the surrounding circumstances."); *see also* **Swaim**, 120 N.C. App. at 864, 463 S.E.2d at 786-87 (holding that where plaintiff was granted an easement for ingress and egress to tract, the trial court erred by construing the easement to permit installation of utility pipes, thus enlarging scope of easement); **Moore v. Leveris**, 128 N.C. App. 276, 495 S.E.2d 153 (1998) (easement to use neighborhood road would not allow defendant to place sewer line under road).

In both counseling your client in drafting and in advocating for your beneficiary client's rights, always keep in mind an easement's scope. Like most cases can be distinguished on their facts, many easements can be differentiated in their scope.

G. Cartways; Maintenance

What if all a beneficiary was left was a life estate in a parcel, or if one party was left timber or other rights? It may be that all that is needed is some limited access to remove crops, timber, minerals, or other materials from the property. Wagon ruts or a dirt and gravel roadbed may be sufficient. A cartway proceeding is created by statute, and as a special proceeding is often more efficient to establish than other types of implied easements. *N.C.G.S. § 136-69*.

Maintenance issues surrounding a non-exclusive easement can often prove problematic. Trash and other debris is one thing; substantial capital improvements to up fit or otherwise maintain a roadbed or bridge is another. Thought should be given when establishing one easement for the benefit of multiple beneficiaries, and the use of road maintenance agreement provisions or inclusion of other language directing the beneficiaries to share in the costs of upkeep and maintenance of an easement should be considered.

Conclusion

For many individuals, their real property constitutes a large part – if not a majority – of the value of their estate. Remember that the value of real estate – especially large tracts of property – includes not just an assessed or appraised value. Farms and parcels that have been in families for generations have meaning that transcend the value on paper.

What sets the estate planning Bar apart is the ability to foresee the potential for a problem (i.e. a concern with probate, issues with a special needs child or spendthrift, appreciating business interests or assets, income or estate tax consequences, etc.) and astutely formulate a vehicle to avoid or minimize the issue. In dealing with tracts of land passing to the next generation, always give the same attention to detail to one's ability to access the property as you do to the other competing concerns.

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(Endnotes)

1 At common law, the word "devise" referred to a gift of land or an interest in land; "bequest" referred to a gift of personal property. Today, by statute, "devisee" can mean a taker of either real or personal property. *See N.C.G.S. § 28A-1-1*.

2 *Practice Pointer*: The act of "republishing" one's Will by execution of a codicil, after the extrinsic writing comes into existence, satisfies this requirement.

3 *Practice Pointer*: The reason for a 60-foot width is that in order to obtain a building permit or certificate of occupancy for the property that the easement serves, many counties impose a minimum width requirement sufficient to satisfy the turning radii of emergency vehicles. Do not let your client talk you into a narrow (10-foot or 20-foot width) easement; this will create development issues in the future.

4 *Practice Pointer*: This analysis is equally applicable to your representation of a beneficiary under a Will or trust where the drafting attorney failed to address access in an adequate manner.

5 Once probated, a Will becomes a public record and within a chain of title.

Celebrity Estate Planning Lessons – Episode 2: Fame, Fortune, Family and Friends . . . a Recipe for an Estate Planning Failure?

By Andrea Chomakos and Melissa L. Kreager

With fame comes fortune, or so many of a celebrity's family, friends and even remote acquaintances seem to think. It is not uncommon for a celebrity to financially support an extensive number of people, putting them on the proverbial "payroll" or providing assistance by making loans, entering into business ventures or otherwise becoming financially obligated to support others. Many borrowers never intend to repay the "loans," thinking of the advance as a gift, and often the business partner believes their celebrity partner has limitless funds to advance to a business venture or otherwise represents "deep pockets." But the celebrity's view on these matters often is very different.

None of these life events are unique to the rich and famous, but how all of these financial matters are handled can have a significant impact at death. In the second episode of this series, we review some common ways celebrities assist their family, friends and others and we hope to learn from celebrity missteps in how their financial assistance was structured:

Lending Money, Evidencing the Debt and Planning for Repayment of the Loan | Before Whitney Houston made headlines for her own untimely death, she was embroiled in an estate planning nightmare involving the death of her father (i.e. the "insured") and arising out of a loan that Whitney made to him to purchase the house he lived in with her step-mother, Barbara Houston. Whitney received the proceeds of a $1 million life insurance policy upon her father's death, proceeds that Barbara alleged were to be used to satisfy the mortgage Whitney held on the house securing the loans made to her father. Barbara sued Whitney claiming the life insurance proceeds were meant to pay off the mortgage so she could live in the home free and clear of the debt. Whitney countered that the proceeds were to pay off other loans made by her to her father, not the advance for the purchase of the house. After a long protracted legal battle, with no direct evidence to support a written agreement between Whitney and her father documenting that the proceeds were to be used to pay off the mortgage, Whitney was victorious. The controversy fueling the lawsuit was that several accountants had written letters to Whitney's father advising him to purchase the life insurance policy to pay off the mortgage debt at his death, however, it appears that if the advice was followed, it was not memorialized properly.

One of the easiest ways for most people to prevent confusion like this from igniting turmoil is to properly document the repayment plan. A loan agreement should be entered into between the parties with specific terms for repayment and reciting any collateral in support of the obligation for payment. In this case, had Whitney's father collaterally assigned the life insurance policy to Whitney, as opposed to naming her beneficiary, then Whitney's receipt of the death benefit would have been credited for repayment of the debt/loan. However, as structured, Whitney was able to retain the death benefit proceeds, as beneficiary, as well as pursue collection on the mortgage.

It is also interesting to note that had Whitney's father's estate been taxable, then the structure also would have had adverse estate tax consequences. The death benefit proceeds of the life insurance policy are includable in the insured's gross estate,[1] and payment of the proceeds to Whitney, the insured's daughter, is a taxable transfer.[2] Whereas, had the death benefit been collaterally assigned to support the debt, payment of the proceeds would have been a deduction for estate tax purposes and inclusion of the death benefit proceeds in the insured's gross estate would not have had any estate tax consequences.[3]

A similar issue arises in spousal situations where a premarital agreement or divorce agreement requires the acquisition of life insurance to support the surviving spouse.

Ex-Spouses and Satisfying Spousal Support Obligations in the Estate Plan | Dennis Hopper initiated a divorce from his fifth wife, Victoria, after he was diagnosed with prostate cancer. His premarital agreement was drafted in such a way that his estranged wife would be entitled to 25 percent of his estate and a $250,000 life insurance policy if they were still ***living together*** at the time of his death. In the divorce proceeding, Hopper asked the divorce judge for permission to change his life insurance policy to remove Victoria and their young daughter as beneficiaries, however, his request was denied, and the judge deferred the issue until trial. He passed away before the trial and before the divorce was concluded. The issue in the aftermath was whether Hopper and Victoria were actually living together at the time of his death. In this case, the addition of a more accurate phrase in the premarital agreement that the spousal entitlement was only

valid if the parties were married and ***not legally separated*** at the time of death would have provided clarity to the right to receive the inheritance.

Atypical creditors such as estranged or ex-spouses are a trap for the unwary. As attorney for the estate, you will need to determine how to treat the creditor claim to determine which type of notice to give. In North Carolina, the personal representative does not have to deliver notice to a creditor with respect to any claim that the personal representative recognizes as valid. However, under the facts of Dennis Hopper's case, the personal representative should deliver a copy of the notice to creditors to Victoria if she could have an unsatisfied claim against the decedent and is actually known or could be reasonably ascertained within 75 days after the granting of Letters Testamentary/Administration.[4] On the flip side, Victoria's attorney should recognize that Victoria is a creditor of the estate and should act swiftly to preserve her creditor's claim. Generally, claims are forever barred if not submitted by the later of the date required in the creditor's notice or within 90 days of the date of delivery or mailing of the notice as required under N.C.G.S. Section 28A-14-1(b).[5]

Satisfying Judgments and Creditors and the Impact on Beneficiaries | As noted above, a spouse or former spouse may be a creditor of an estate – as opposed to a beneficiary. This is an important distinction for purposes of determining (1) the order or priority of payment[6] and (2) the estate tax implication of satisfying the debt (or bequest). For instance, with regard to a former spouse, a payment made to the former spouse as a ***beneficiary*** of the decedent's estate does not qualify for the marital deduction (as the recipient is not a spouse).[7] Thus, consideration should be given in any premarital agreement or divorce agreement that requires payment be made to a former spouse upon death. If the agreement sets forth that such payment be included as a bequest in the Will, then the payment of the devise will not qualify for the martial deduction. As a result, the payment will use the decedent's estate tax exemption and may result in the imposition of estate taxes on a greater portion of the decedent's taxable estate. However, if the obligation to make the payment to the former spouse is a debt, then the payment will be classified as satisfying a debt and deductible for estate tax purposes.[8] Additionally, it should be noted that payment of valid debts are made before distribution to beneficiaries, resulting in payment of a debt owed to a former spouse (or other creditor) before beneficiaries named in the decedent's estate planning documents.

Further, with regard to other creditors, such priority of payment may have an adverse effect on the distribution scheme of the decedent's estate. Take the case of the daredevil Evel Knievel. Several years prior to his death, Evel got into a heated argument with his former manager and business partner. The dispute escalated, and Evel broke the arm of his former manager and business partner, Shelley Saltman. Saltman sued Evel and was awarded a judgment of $12.5 million against Evel, which Evel failed to pay. At his death, Evel's estate was nominal, but Saltman's judgment was outstanding and created a lien against Evel's estate and (all of) its assets, leaving Evel's widow without any inheritance.[9] In this case, Evel could have undertaken some planning to provide for his surviving spouse, without subjecting her inheritance to the claims of Saltman's judgment. Specifically, death benefit proceeds from a life insurance policy are not subject to the claims of creditors.[10] Accordingly, Evel's wife could have obtained a policy insuring his life (assuming he was retired from his daredevil activities and considered insurable). The death benefit proceeds receivable by Evel's wife would not be subject to Saltman's judgment. Accordingly, asset protection planning may be an appropriate component in structuring an estate plan where creditors are an issue.

Conclusion | Once again, these cases make interesting tabloid headlines but for all the wrong reasons from the point of view of the attorneys and professionals involved. In order for estate planning attorneys to properly and favorably memorialize a client's wishes when it comes to the financial assistance or protection the client wants to give to their family and friends, the client and the "freeloader" need to both be on the same page as to the purpose and form of the assistance or protection. Communication is the key, and proper documentation can help keep your clients (and you) out of the tabloids.

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(Endnotes)

1 IRC Section 2042 includes in the gross estate of an insured the death benefit proceeds of a life insurance policy over which the decedent insured held incidents of ownership. In addition to outright ownership of a policy, "incidents of ownership" includes the right to name the beneficiary of the policy.

2 In this instance, the beneficiary of the policy was the insured's daughter. Accordingly, no deduction is available for the payment of the life insurance proceeds to the policy beneficiary and the payment is considered a taxable transfer for estate tax purposes. The taxable transfer will result in use of the decedent's estate tax exemption or payment of estate taxes if the estate is taxable (above the exemption amount).

3 IRC Section 2053 allows a deduction for payment of any valid debt of the decedent or estate. The mortgage on the property, evidenced by a note, would be considered a valid debt of the decedent and payment of it through the life insurance policy death benefit proceeds would be eligible for a deduction from the decedent's gross estate. However, if the note were executed by both Mr. and Mrs. Houston, and considered a debt of both of them, then state law would have to be analyzed to determine how much of the debt would have been considered a debt of the decedent for purposes of determining whether payment of the life insurance death benefit proceeds is deductible by the estate.

4 See N.C.G.S. § 28A-14-1(b).

5 See N.C.G.S. §§28A-19-1 and 28A-19-3.

6 See N.C.G.S. §§28A-19-6.

7 IRC Section 2056

8 See IRC Section 2053.

9 Pursuant to N.C.G.S. §§28A-22-1, distribution to beneficiaries may be made only after all creditors have been satisfied.

10 See North Carolina Constitution, Article X.

On Mandating Trustees' Duty to Inform and Report

By Trey Lindley

Twenty-three years ago, Clark "CB" Bagby Jr. assumed control of his father's already successful demolition and grading company and grew it into one of the largest in the Southeast. Only one of his four children showed any promise or passion for the family business, the others content to enjoy its fruits. CB, the sole shareholder of the eponymously named CBDG, Inc., is acutely aware of his need for succession planning and is equally determined to make it as painless for himself as possible.

"I want them to know I've taken care of them, but I don't want to be pestered about what I gave them, whether it's enough, or where or how it's invested. They can fight about that when I'm gone."

Among the myriad considerations requiring your counsel, CB wants to relieve the trustee of any reporting obligations for any trusts created for his children's benefit. What would be your advice?

As a threshold matter, you certainly can accomplish CB's request. The duty to inform and report is a default provision codified in North Carolina's version of the Uniform Trust Code ("UTC") at N.C.G.S. Section 36C-8-813. It is limited to qualified beneficiaries and can ordinarily (i.e., absent special circumstances or specific requests for information) be satisfied by furnishing annual reports. Because it only applies when the terms of the trust are silent, however, it may be freely waived.

The 12 mandatory rules governing North Carolina trusts are found at N.C.G.S. Section 36C-1-105(b). Among them, the only compulsory duty imposed on trustees is "to act in good faith and in accordance with the terms and purposes of the trust and in the interests of the beneficiaries." N.C.G.S. §36C-1-105(b)(2) (2015). A trustee's inalienable duty of good faith, unmoored from any concomitant duty to apprise beneficiaries of the trust's administration, creates a tension that may (rather foreseeably) erupt in conflict and spawn litigation.

Such was the case in **Wilson v. Wilson**, 203 N.C. App. 45, 690 S.E.2d 710 (2010). Lawrence A. Wilson Jr. established two irrevocable trusts, one for each of his two children, and appointed his father to serve as trustee. The trust instruments waived any requirement that the trustee "prepare or file for approval any inventory, appraisal or regular or periodic accounts or reports with any court or beneficiary." *Id.* at 46, 690 S.E. 2d at 711. Alleging the trustee effectively surrendered control of the trust assets to the settlor who, in turn, invested in his own highly speculative business ventures, the beneficiaries sued for breach of fiduciary duty.

Since North Carolina's UTC does not require trustees to report to beneficiaries, the trial court entered a protective order precluding the children from receiving documents requested in discovery. On appeal, the Court of Appeals reviewed the UTC and reversed. In addition to the trustee's mandatory duty of good faith, the appellate panel recognized N.C.G.S. Section 36C-1-105(b)(9) conferred upon courts the power "to take any action and exercise any jurisdiction as may be necessary in the interests of justice." Noting that any notion of a trust without accountability is a contradiction in terms, the Court of Appeals concluded the duty of good faith would be completely eviscerated if beneficiaries had no means to hold the trustee to account. "[W]e hold the information sought by Plaintiffs was reasonably necessary to enforce their rights under the trust, and therefore *could not legally be withheld*, notwithstanding the terms of the trust instrument." **Wilson** at 55, 690 S.E.2d at 716 (emphasis added).

Albeit sound, the Court of Appeal's reasoning could have treaded a simpler, more direct path. North Carolina Rules of Civil Procedure 26 and 34 govern discovery methods generally and the production of relevant documents in particular. Parties are permitted to request documents and information reasonably calculated to lead to the discovery of admissible evidence – even if the yield from those requests is inadmissible at trial. It seems axiomatic, then, that parties should be entitled to gain production of documents undeniably essential to their claims, irrespective of any waiver of the duty to inform and report. Stated differently, there is a clear distinction between requiring a trustee to *prepare* accountings and reports pursuant to the trust instrument and requiring the trustee to *produce* bank account statements or other relevant documents during litigation. Approaching the issue another way by analogy, it is hard to imagine our courts honoring a provision in CBDG's grading contracts that waives its obligation to participate in discovery or produce relevant documentation.

In the five years since *Wilson*, the North Carolina legislature has not amended the UTC to impose any reporting requirements on trustees. The net effect of the dissonance between the UTC and *Wilson* is plain: While settlors may waive trustees' obligation to inform and report to the beneficiaries, beneficiaries are nonetheless entitled to the production of relevant documents through discovery. A trustee's recalcitrance to share information could stoke beneficiaries' suspicions, and the current dichotomy between the UTC and **Wilson** leaves affected beneficiaries with no recourse but to file suit. This can, and likely will, increase litigation and unnecessarily burden the courts with potentially avoidable disputes.

CB's situation provides a prime example. He may intend to distribute a controlling interest in CBDG to the one child involved in its daily operations. Perhaps he wants to distribute other property unevenly as well. Jealousy and strife among the offspring could transmute into distrust of the trustee. Absent some mechanism to assuage their fears about the trust's administration, one or more of them could resort to litigation. CB's best efforts to avoid discord may have precisely the opposite effect. Unless and until the UTC is amended to mandate some reporting requirements for trustees, CB would be wise to impose his own lest the trust corpus be consumed by litigation expenses.

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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

Taxpayers' grant of conservation easement did not qualify for charitable deduction because of retained right to substitute property subject to easement.

In **Belk v. Comm'r of Internal Revenue**, 2014 WL 7140386 (4th Cir. Dec. 16, 2014), the Fourth Circuit affirmed the Tax Court's holding which held that the taxpayers' grant of a conservation easement on real property did not qualify for a charitable contribution deduction because it was not a valid charitable contribution. The taxpayers claimed a charitable deduction of $10,524,000 that was disallowed. The key problem with the conservation easement granted by the taxpayers was the fact that the taxpayers reserved the right to "substitute an area of land owned by [them] which is contiguous to the Conservation Area for an equal or lesser area of land comprising a portion of the Conservation Area." This substitution provision permitted the taxpayers to swap land in and out of the easement. The court ruled that this swap power meant that the real property on which the original conservation easement was placed was not subject to a use restriction in perpetuity. As such, the court held that the easement does not constitute a "qualified conservation contribution" under Code Section 170(h). In so holding, the court noted that the Treasury Regulations offer one single, exceedingly narrow, exception to the requirement that a conservation easement impose a perpetual use restriction — in the event that subsequent unexpected change in the conditions surrounding the property … make[s] impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by a judicial proceeding. In the present case, the taxpayers' swap power went far beyond this narrow exception. The court expressly disagreed with the taxpayers' assertion that the Code requires only a restriction in perpetuity on *some* real property, rather than the real property originally governed by the easement. In issuing its opinion, the court also declined to give effect to the savings provision in the conservation easement that stated that the holder of the conservation easement shall have no right to agree to any amendments that would result in the conservation easement failing to qualify as a qualified conservation contribution under Code Section 170(h). The court ruled that the taxpayers could not rely on that savings provision to negate a right clearly articulated in the easement.

In determining valuation, Tax Court improperly presumed a percentage chance that partnership would be liquidated where limited partner had no unilateral right to liquidate the partnership.

In **Estate of Giustina v. Comm'r**, 2014 WL 6845795 (9th Cir. Dec. 5, 2014), reversing and remanding T.C. Memo. 2011-141, the Ninth Circuit reversed a valuation determination by the Tax Court, finding that the Tax Court could not validly presume that there was a 25 percent chance that a partnership would be liquidated by a hypothetical purchaser of a limited partnership interest where, under the partnership agreement, a limited partner had no unilateral right to liquidate the partnership. In **Giustina**, the Tax Court assigned a value of $27,454,115 to the Estate's 41.128 percent interest in a timber limited partnership. The estate had valued the interest at $12,678,117. In arriving at its valuation, the Tax Court concluded that there was a 25 percent likelihood of liquidation of the partnership and therefore, gave a 25 percent weight to an asset-based valuation and only a 75 percent weight to the valuation of the partnership as a going concern. The Ninth Circuit lambasted the decision of the Tax Court to give any weight at all to an asset-based valuation, stating that the conclusion was contrary to the evidence in the record. The Ninth Circuit stated that in order for liquidation to occur, the court would have to assume that (i) a hypothetical buyer would somehow obtain admission as a limited partner, (ii) the buyer would then turn around and seek dissolution of the partnership or removal of the general partner who just approved his admission, and (iii) the buyer would manage to convince at least two other limited partners to go along with dissolution despite the fact that no limited partner had ever asked for or discussed the sale of an interest. In making such a finding, the Ninth Circuit wrote that the Tax Court engaged in "imaginary scenarios as to who a purchaser might be, how long the purchaser would be willing to wait without any return on his investment, and what combinations the purchaser might be able to effect." Such a conclusion was clear error, and the Ninth Circuit remanded the case back to the Tax Court to recalculate the value based solely on the partnership's value as a going concern.

Summary judgment granted against personal representative who distributed assets from estate rendering estate unable to pay tax liabilities; foreclosure against property owned by personal representative permitted.

In **United States v. Stiles**, 2014 WL 6775263 (W.D.Pa. Dec. 2, 2014), the United States District Court for the Western District of Pennsylvania granted summary judgment against the personal representative of an estate where the personal representative who had knowledge of the estate's tax liabilities, including federal estate taxes and federal fiduciary income taxes, distributed assets that rendered the estate unable to pay those tax liabilities. In so holding, the court rejected the possibility of a defense that the personal representative, in making the distributions, relied on the advice of counsel. The court also allowed the government to foreclose on a lien it had filed against property owned by the personal representative.

Claim for refund barred when filed after statutory three-year time limitation and remittance of estate taxes by Executors deemed a tax payment.

In **Winford v. United States**, 2014 WL 6985906 (5th Cir. Dec. 12, 2014), the Fifth Circuit affirmed *per curiam* a district court decision granting the United States' motion for summary judgment

that the remittance of estate taxes by the Executors of an estate was a tax payment and not a deposit. The key facts are as follows: Decedent died in 2002; nine months after decedent's death, the Executor filed a Form 4768 Application for Extension of Time to File a Return and attached a check for $230,884; in 2008, after estate litigation was resolved, the Executor filed the estate tax return and sought a refund of $136,268; the Service disallowed the claim because it was filed outside of the statutory three-year time limitation. In holding that the Service's decision to deny the claim was appropriate, the district court refused to adopt a *per se* rule that all remittances sent in with a request for an extension of time in which to file a return is a payment as a matter of law. Instead, the district court applied a facts and circumstances test to determine that the remittance at issue was a payment. Because it was properly classified as a remittance, the statute of limitations on refunds applied to the remittance and the taxpayer's claim for refund was barred.

IRS agent abused discretion by pursuing a levy action without granting estate a fair collection due process hearing.

Estate of Sanfilippo v. Comm'r, T.C. Memo. 2015-15 (Jan. 22, 2015) arises from an Executor's petition for review of the Service's determination to proceed with a proposed levy for failure to timely pay estate tax owed. The decedent, a California resident, died testate on July 14, 2004. The decedent had interests in and powers of appointment over various trusts. The decedent's Will provided that certain real properties or interests in real properties held in the trusts should pass to the decedent's son, who happened to owe the decedent or the trusts over $21 million at the time of the decedent's death. The decedent's Will forgave these debts. The decedent's Executor obtained an extension of time to file Form 706 and an extension of time to pay estimated estate tax liability under Code Section 6161. The Executor remitted two timely installment payments, and ultimately filed Form 706. The Service assessed the $14 million tax liability reported on the Form 706. The Estate proceeded to submit seven additional Forms 4768 requesting extensions of time to pay tax, because the Estate was illiquid. The Service granted six of these requests but denied the seventh. The Estate, the decedent's son, and the Service then entered into a three-way security agreement, by which the son pledged to the Service a first priority security interest in and lien on one of his business interests, as security for the Estate's prompt payment of tax owed. The agreement also contemplated that the son would provide additional collateral if requested by the Service.

The Service held the case open for nine months pending resolution of potential real estate sales, during which time a new agent was assigned to the matter. The new agent, upon undertaking to understand the Estate's assets and facts of the matter, protested the Executor's distribution of an interest in a shopping center to the decedent's son. The decedent's son immediately used the property to secure a nearly $10 million loan. The Service notified the Estate of its intent to levy on its security with respect to now $15 million in unpaid estate tax liability. The Estate responded with an offer-in-compromise (OIC) since it did not have cash to pay the tax liability. The Executor complied with the Service's request for documents and financial information. Without commanding an understanding of the facts of the case and the Service's prior negotiations with the Executor, the new officer determined that the Estate was, in fact, able to make payments on its liability. The Service therefore denied the Executor's offer-in-compromise and pursued a levy action under Code Section 6331(a). On appeal, the Tax Court found that the new agent had become so focused on potential asset undervaluation – a fractional interest in a shopping center listed on Form 706 at a value of $1.78 million, and then distributed to the decedent's son and immediately used by the son to secure a $9.75 million loan – that the agent never commanded a complete understanding of the Service's previous negotiations with the Executor. The agent did not consider that the decedent's son already owned a 65.7 percent majority interest in the shopping center before being distributed another 10 percent interest from the Estate. And the Service had already reviewed and approved the Estate's Form 706, before the new agent took the case and began questioning valuations on the 706. The Tax Court determined the Estate had submitted a legitimate written OIC under Code Section 7122, and provided the Service everything the two assigned agents had requested. The Tax Court held that while an agent of the Service is under no duty to negotiate indefinitely regarding a taxpayer's ability to pay, the Appeals office is still under a duty to provide a fair hearing on proposed collection alternatives, and the Estate in this case had proposed a reasonable collection alternative and been responsive to all of the Service's requests. The court found that the agent assigned to the matter abused his discretion in pursuing a levy without a hearing, and remanded the case for consideration of the proposed collection alternatives.

Executor's failure to timely file estate tax return and pay tax was not due to reasonable cause where Executor relied on attorney to timely file return.

In **Specht v. U.S.**, 115 AFTR 2nd 2015-1 (D.C. Ohio)(Jan. 6, 2015), the United States District Court for the Southern District of Ohio, Western Division, granted defendant's motion for summary judgment. The plaintiffs brought the lawsuit as co-fiduciaries of the estate of Virginia Escher seeking to recover nearly $1.2 million in penalties and interest imposed by the Service on the estate as a result of the failure to timely file the estate tax return and pay the estate tax owed. The issue before the court was whether the plaintiff's failure to timely file the return and pay the estate taxes was due to reasonable cause and not willful neglect.

Ms. Escher died on Dec. 30, 2008, at the age of 92, with a gross estate of approximately $12,506,462. The plaintiff, Ms. Specht, was asked to be the Executor of the estate. The plaintiff was 73 years old, a high school-educated homemaker who had never served as an Executor and never been in an attorney's office. Ms. Specht chose to engage Ms. Escher's attorney to assist her with the estate administration. Unbeknownst to Ms. Specht, the estate planning attorney was battling brain cancer.

Additional facts regarding this case are as follows:

(1) The estate's federal estate tax return was due on Sept. 30, 2009, but the return was not filed until Jan. 26, 2011.

(2) The lawyer for the estate informed Ms. Specht in January of 2009 that the estate owed approximately $6 million in federal estate tax. The lawyer also told the Executor that the estate's federal estate tax return needed to be filed by Sept. 30, 2009.

(3) No federal estate tax return was filed on or before Sept. 30, 2009, nor was an extension sought.

(4) Prior to Sept. 30, 2009, Ms. Specht received four notices from the probate court warning her that her lawyer was failing to perform her duties and that the estate had missed probate deadlines. The lawyer told Ms. Specht that they had extensions and that she was handling the issues.

(5) In August of 2010, Ms. Specht received a notice from the Ohio Department of Taxation warning her that the estate's state tax return had not been filed and was delinquent. Assets of the estate were not sold until November 2010 to generate equity to pay estate tax. The Service assessed mandatory penalties against the estate for failure to file the return and pay the tax due. Interest also accrued after the tax deadline.

The plaintiffs argued that reasonable cause existed for failure to file the Form 706 and pay estate taxes due to their reliance on their attorney who was trusted to handle the estate. The Commissioner argued that the courts have longed recognized a nondelegable nature of the duty to make tax filings timely and have held that reliance on counsel is not sufficient to constitute reasonable cause for the failure to file a return or pay a tax.

The estate did not contest that it failed to timely file or pay the estate tax. The only issue before the court was whether these failures were due to reasonable cause and not due to willful neglect. Reasonable cause requires the estate to demonstrate that it exercised ordinary business care and prudence but nevertheless was unable to file the return within the prescribed time. Although the taxpayer may rely on advice received from an attorney on a matter of tax law, one does not have to be a tax expert to know that tax returns have fixed filing dates and that taxes must be paid when they are due. In this case, Ms. Specht argued that she lacked the sophistication to complete and file the tax returns; however, there was no evidence to suggest she lacked the sophistication to understand the importance of the tax deadlines and to ensure that deadlines were met. The court, citing other Supreme Court and Sixth Circuit rulings, affirmed that the reasonable cause analysis looks at the party with ultimate responsibility for satisfying the tax liabilities, not the actions or medical conditions of their agents. There was no evidence to support a finding that the Executor, Ms. Specht, was without the ability to control whether the deadline was met.

With regard to willful neglect, the estate must meet a heavy burden of proving that the late filing and payment did not result from willful neglect. Willful neglect is a conscious, intentional failure or reckless indifference. Mere carelessness is enough for a taxpayer to be denied a refund based on willful neglect. A taxpayer seeking a refund must therefore prove that his failure to file on time was the result neither of carelessness, reckless indifference nor intentional failure. Ms. Specht was aware that the estate tax return needed to be filed and the tax paid within nine months of Ms. Escher's death. She also knew the approximate amount of the tax liability and the need to sell estate assets to generate liquidity. Ms. Specht received multiple notices from the probate court with regard to missing probate deadlines, as well as notices from the Ohio Department of Taxation. The court ruled in favor of the government and did not refund the penalties.

IRS computer error informing taxpayer that estate tax due was less than actual amount owed did not bar Service from assessing additional tax and interest after error was discovered; Executor personally liable for amount paid to creditor of estate before estate tax satisfied.

In **U.S. v. The Estate of Mabel Hurd, et. al.**, 115 AFTR 2nd 2015 (D.C. Calif.) (Jan. 8, 2015), the court addressed the United States government's pursuit of a judgment against an estate for unpaid estate taxes from the transferees and surviving joint tenants of property under Code Section 6324(a)(2) and from the Executor under Code Section 3713.

Mabel E. Hurd died on May 1, 2001. Albert O. Maddox was appointed the Executor of Mrs. Hurd's estate. On Aug. 1, 2002, Mr. Maddox filed a federal estate tax return reporting the value of the gross estate as $1,688,053 and net estate tax liability of $274,447.13. On Sept. 23, 2002, the Service assessed an estate tax of $274,447.13 against the estate. Along with the estate tax return, the Service received a payment of $123,341.07 from the estate. In April of 2009, the estate made an additional payment of $4,237.63. In August 2008, the Service and the estate's attorney agreed on an installment payment for the remaining estate tax liability. Due to a computer error, the Service informed the estate's lawyer that the balance due was less than the actual balance due. As of May 23, 2014, the outstanding balance was $83,476.46. During Mrs. Hurd's lifetime, multiple individuals owned property jointly with her and Mrs. Hurd made gifts of real estate to individuals. The original amount of estate tax owed was undisputed, but the parties disagreed as to the amount currently owed. The defendants argued that the Service was time-barred from twice assessing a failure-to-pay penalty, contending that the estate tax had been paid in full which was reflected in the Service's records showing a credit balance in favor of the estate in November 2008. The defendants contend, therefore, that subsequent assessments for tax and interest were invalid.

The defendants first pointed to Code Section 6501(a), which provides that the amount of any tax imposed shall be assessed within three years after a tax return is filed. However, the court rejected this argument as the penalty itself takes 50 months to accrue, and a three-year statute of limitations would therefore prevent the penalty from fully accruing. The defendants also argued that the Feb. 25, 2013 assessment was time-barred by Code Section 6502(a)(1). This section provides that where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, the tax may be collected by a proceeding in court but only if the proceeding is began within ten years after the assessment of the tax. This argument was not sustained because Code Section 6502(a)(1) does not impose a limitations period on when the Service must assess the failure to pay penalty. Accordingly, the government's 2009 and 2013 assessments of a failure to pay penalty were not time-barred.

With regard to interest, the estate argued that the Service was barred from assessing interest due as a result of the Service's error. Code Sections 6601 and 6622 provide that interest is imposed on tax due and that the interest may be assessed and collected at any time. An assessment is essentially a bookkeeping notation and is made by recording the liability of the taxpayer in the Office of the Secretary in accordance with rules and regulations prescribed by the Secretary. The Service is not required to make a separate assessment of

interest on an assessed tax liability in order to collect that interest.

The government provided evidence that a manual correction was made to its tax module for the estate which caused the computer system to stop computing interest and penalties automatically. Two lists of liabilities were provided to the estate, one which included principal only and the second which included interest only. The court stated that once a court validates a tax assessment, awarding statutory interest is mandatory. There was no dispute in this case with regard to the accuracy of the Service's initial tax assessment and the government was therefore entitled to statutory interest.

The government also sought to hold the defendants jointly and severally liable for the unpaid tax liability of the estate. Citing Code Section 6324(a)(2) where personal liability for federal estate taxes is imputed upon beneficiaries, the court ruled that the defendants were personally liable for the unpaid tax. The defendants argued that the government should be equitably estopped from enforcing the judgment and that the government violated their due process rights. Courts within the Ninth Circuit consistently have rejected applications of the doctrine of equitable estoppel against the Service. When estoppel is sought against the government, there must be affirmative misconduct and a serious injustice outweighing the damage to the public interest of estopping the government. The court determined that the defendants did not present evidence to demonstrate that the Service's actions constituted affirmative misconduct rather than mere negligence. While the Service's financial data was not up to date when the defendants discussed settlement and payment schedules with the Service, there was no evidence to support that the Service deliberately or knowingly lied about the amount of remaining tax liability. The evidence suggests the Service merely made a mistake by relying on the Service's computer system which had ceased to calculate the interest and the failure to pay penalty. Therefore, the court ruled that equitable estoppel was unavailable. With regard to the due process claim, the defendants argued the government is not entitled to summary judgment because it failed to meet the due process requirements required when it seeks to collect from a taxpayer by levy. Code Section 6330 provides that no levy may be made on any property unless the Secretary has notified such person in writing of their right to a hearing before such levy is made. If the person requests a hearing in writing and states the grounds for the requested hearing, the hearing shall be held by the Internal Revenue Service Office of Appeals. The government did not dispute that the defendant requested a hearing and that no hearing was held. Instead, the government stated that the defendant's request for a hearing was irrelevant based on **Agarunov v. U.S.** (Eastern District of New York, April 4, 2014). In the **Agarunov** case, the court noted that the Tax Court had exclusive jurisdiction to review a hearing officer's determination. However, in the present case, there was no determination because there was no hearing. Review of an officer's decision is categorically different from review of a refusal to grant a hearing. Nevertheless, the court agreed with the government that the refusal to grant a hearing is not a defense to liability under Code Section 6324(a)(2). The court noted that there was no evidence that at the time of the hearing request the Service had issued a notice to the defendants that it planned to levy against the defendants' property. The defendants put forward no argument as to how a refusal to grant a hearing request would shield the defendant from the defendants' responsibilities to pay the estate tax liability under 6234(a)(2). Thus, the court found the due process arguments could not defeat summary judgment.

The court also addressed the personal liability of Albert O. Maddox. Mr. Maddox wrote a check from the estate to pay the California State Treasurer. The Service noted that under Code Section 3713, a representative of the estate is liable to the extent he pays a claim of a creditor prior to paying the U.S. government. The court held Mr. Maddox' payment to the California State Treasurer was a violation of the law and thus Mr. Maddox was personally liable for the improper payment.

Pursuant to Federal Rules of Civil Procedure 8(b)(6), the court accepted certain allegations as true because they were unanswered in the complaint and in the statements declared by the defendants. Code Section 6324(a)(2) imputes personal liability for estate taxes to certain individuals who receive property from an estate at the time of a decedent's death. The court declared the defendants who received assets of the estate as liable for the estate taxes. One defendant failed to respond to the Motion for Default Judgment and failed to respond to the original Complaint, thus, the court declared that defendant to be in default and owing on the estate tax liability attributable to the asset the defendant inherited.

Mortgage must be subordinated to conservation easement when charitable deduction claimed regardless of the likelihood of foreclosure.

In **Mitchell v. Comm'r**, 115 AFTR 2d 2015-346 (10th Cir. 2015) (Jan. 6, 2015), the taxpayer claimed a charitable deduction for a conservation easement granted to the Montezuma Land Conservancy. The underlying property was subject to a deed of trust at the time the easement was granted and the holder of the deed of trust did not subordinate the deed of trust until two years after the taxpayer claimed a charitable deduction for the conservation easement.

Code Section 17(h)(1) defines a qualified conservation contribution as a qualified property interest donated to a qualified organization exclusively for conservation purposes. Code Section 170(h)(5)(A) further provides that a conservation easement is not exclusively for conservation purposes unless the conservation purposes are protected in perpetuity. Treasury Regulations Section 170A-14(g)(2) specifically provides that no deduction is allowed for a conservation easement on property subject to a mortgage unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes.

The taxpayer first argued that the deduction should be allowed because the statute and regulations do not contain a specific timeframe for subordinating the mortgage. The court held that although the statute does not contain a specific timeframe for subordinating the mortgage, the plain language of the statute provides that subordination is a prerequisite to allowing a deduction. Because the mortgage was not subordinated at the time a deduction was claimed for the conservation easement, the taxpayer was not entitled to a deduction.

Next, the taxpayer argued that she was still entitled to a deduction because the deed granting the easement contained ample safeguards to protect the conservation easement in perpetuity. The court held that the taxpayers must strictly comply with the mortgage subordination requirement for transfers occurring after 1986, as required by the statute. Furthermore, the alternative deductibil-

ity requirements for transfers occurring prior to 1986 do not apply to transfers occurring after 1986 and cannot be considered in determining the deductibility of any transfer occurring after 1986. Here, the transfer occurred after 1986 and the subordination requirement was not met. Thus, the deduction could not be allowed.

Finally, the taxpayer argued that the remote likelihood of foreclosure should override the lack of subordination. The taxpayer relied on a provision in Treasury Regulations Section 170A-14(g)(3) that provides that a deduction will not be disallowed "merely" because conservation purpose may be defeated by a future event that is "so remote as to be negligible." The taxpayer argued that the remote future event provision was an exception to the mortgage subordination requirement. The court held that the remote future event provision was not an exception to the mortgage subordination requirement and that even if it were, the possibility of a foreclosure was not "so remote as to be negligible." Accordingly, the taxpayer's charitable deduction was denied.

Service allowed to reduce assessments to judgment and foreclose tax liens against four parcels of real property owned by sham trusts created by delinquent taxpayers.

In **United States v. O'Shea**, 115 AFTR 2d 2015-887 (D. W. Va.) (Feb. 20, 2015), the Service sought to reduce to judgment assessments for unpaid taxes against a husband and wife and a trust created by the husband and wife. The Service also sought to foreclose tax liens against four parcels of real property, including the taxpayers' primary residence and the lot where their business was located, owned by two trusts created by the taxpayers. The Service argued that the two trusts that owned the real property were sham trusts (the "Sham Trusts"), that the Sham Trusts were the nominees or alter egos of the taxpayers and that the Sham Trusts should be set aside. The court determined that the assessments against the taxpayers were valid and were properly reduced for judgment.

In determining whether the Sham Trusts were in fact shams, the court examined the following factors: (i) the taxpayer's treatment of the assets as his own, (ii) the taxpayer's control over the alleged nominee or a close relationship between the taxpayer and the nominee, (iii) the taxpayer's use of the alleged nominee's funds to pay the taxpayer's expenses, (iv) the transfer of the property to the nominee for a nominal amount; (v) "the fact that the [alleged nominee] supported the taxpayer," (vi) whether the taxpayer spent his own funds for the property, (vii) whether the taxpayer retains the benefit and enjoyment of the property, and (viii) whether the titleholder interfered with the taxpayer's use of the property. The court found that the taxpayers still held the benefits and burdens of ownership of the underlying real property. The taxpayers directly paid for maintenance expenses, taxes and insurance while living in one of the parcels as their primary residence and using another parcel for their business. In addition, the taxpayers transferred the property to the Sham Trusts for inadequate consideration. The taxpayers did not deny that they continued to control the real property and continued to benefit from the parcels. Thus, the court found that the Sham Trusts were nominees and ordered that the Service could foreclose against the underlying parcels.

No charitable deduction allowed for a set aside where portion of set aside funds used to pay foreseeable litigation and administrative expenses.

In **Estate of Belmont v. Commissioner**, 144 T.C. No. 6 (Feb. 19, 2015), the Service claimed that the Estate's deduction for a charitable set aside under Code Section 642(c)(2) was improper because a portion of the funds that were set aside were used for the payment of litigation and administrative expenses and the possibility that those funds would need to be used to pay those expenses was not so remote as to be negligible. The decedent's residuary clause in her Will left $50,000 to the decedent's brother and the remainder to a charitable foundation. The assets in the Estate included $243,463 from a pension fund that was deemed income in respect of a decedent. After taking into account various expenses, the Estate claimed $219,580 as a charitable deduction for a set aside for the foundation.

The decedent also owned a condominium in California that was used by her brother as his principal residence. He attempted to negotiate with the Estate to swap his $50,000 bequest for a life estate in the condominium. After the Estate informed the brother that the foundation did not want to hold real estate as an investment and that they would not accept the swap, he filed a creditor's claim against the Estate in California. The brother secured an attorney and filed a Lis Pendens on the condominium. After having his claim against the Estate rejected, the brother filed a Petition to Confirm Interest in Real Property with the Probate Court asserting a life tenancy interest in the condominium. The Estate hired counsel in California to fight the brother's claim and eventually lost. The Estate incurred significant expenses in defending against the brother's claim and at the end of the action the Estate only had $185,000 remaining in its checking account. All of the claims by the brother were filed or made known to the Estate prior to its filing of the Estate's Form 1041 claiming the charitable deduction.

A charitable deduction is proper under Code Section 642(c)(2) when an amount is permanently set aside for a charitable purpose. An amount is not deemed permanently set aside "unless under the terms of the governing instrument and the circumstances of the particular case the possibility that the amount set aside, or to be used, will not be devoted to such purpose or use is so remote as to be negligible." The court held that the facts and circumstances known to the Estate prior to its filing of the Form 1041 were sufficient to put the Estate on notice that it would be undertaking additional expenses, such as legal expenses and administrative expenses to keep the Estate open for a number of additional years, to defend against the brother's claims. Thus, the amount was not permanently set aside and the Estate was not eligible to take the charitable deduction.

Federal Administrative Developments

Proposed judicial reformation of trust that did not qualify for estate tax charitable deduction at taxpayer's death would be a qualified reformation, and reformed trust would qualify for federal estate tax charitable deduction.

In **PLR 201450003** (Dec. 12, 2014), the taxpayer sought a ruling from the Service that a trust, which did not qualify for the estate tax charitable deduction under Code Section 2055(a) at the time of the decedent's death because it was not a CRAT or a CRUT, could be judicially reformed under Code Section 2055(e)(3) in order to qualify as a CRUT described in Code Section 664(d)(3). The Service ruled that the proposed judicial reformation would be a qualified reformation within the meaning of Code Section 2055(e)

(3), provided the reformation is effective under local law, and further provided that the trust, as reformed, meets the requirements for a CRUT under Code Sections 664(d)(2) and (3). If those requirements were met, the decedent's estate would be allowed a federal estate tax charitable deduction under Code Section 2055(a) for the present value of the charitable remainder interest of the CRUT.

Provisions of pooled income fund's governing instrument that varied from the sample provisions in Rev. Proc. 88-53 would not adversely affect qualification as a pooled income fund if provisions were consistent with Code Section 642(c)(5).

In **PLR 201450016** (Dec. 12, 2014), the taxpayer, a tax-exempt organization described in Code Section 170(b)(1)(A)(iii), created a pooled income fund. The pooled income fund, which operated as a valid trust under local law, would raise funds from investors to purchase real estate, including a building, from the taxpayer. The taxpayer would then lease back the real estate for 25 years on a "net-net" basis (i.e., the taxpayer will pay property taxes and insurance in addition to rent). The payments by the taxpayer to the pooled income fund would produce a fixed net rate of return for the fund's investors. The taxpayer sought several rulings from the Service, including (i) that the differences between the fund's governing instrument and the sample trust agreements for pooled income funds provided in Rev. Proc. 88-53 would not cause the fund to fail to be a pooled income fund within the meaning of Code Section 642(c), (ii) that the fund would be treated as a split-interest trust under Code Section 4947(a)(2), and (iii) whether the sale-leaseback transaction would give rise to a self-dealing transaction. The Service held that the sample trust agreements in Rev. Proc. 88-53 were not intended to preclude other permissible provisions in governing instruments and provisions that vary from the sample provisions will not adversely affect a fund's qualification as a pooled income fund if those provisions are consistent with the requirements of Code Section 642(c)(5). The Service found that the four provisions that varied from the sample forms in this PLR request were permissible — those provisions stated (i) a donor may retain in the donor agreement the power to revoke or terminate the income interest of any designated beneficiary other than the charity, (ii) income for the taxable year in which death occurs that is attributable to those units as to which the decedent was a beneficiary shall be prorated to the date of his/her death, (iii) the Trustee has the authority to set up and maintain depletion or depreciation reserves for any fund property (i.e., the Trustee of the pooled income fund was not prohibited from investing in depreciable or depletable assets), and (iv) the Trustee could amend the governing instrument for broader reasons than the sample forms allowed. The Service also ruled that the fund was a split-interest trust under Code Section 4947(a)(2) and that the provisions of the fund agreement conformed to the requirements of Code Section 508(e) imposed on private foundations. And, finally, the Service ruled that the transaction between the taxpayer and the fund was not direct or indirect self-dealing within the meaning of Code Section 4941.

President signed tax extender for charitable contribution deductions.

H.R. 5771, 113th Cong., 2nd Sess. (2014) preserved through 2014 several key expiring tax deductions, credits and exclusions. Two of the provisions that are continued: (i) the tax deduction for charitable contributions of real property interests for conservation purposes; and (ii) the tax-free distributions from IRAs for charitable purposes.

Termination of election to be treated as an S corporation inadvertent; thus, corporation would continue to be treated as an S corporation.

In **PLR 201505034** (Jan. 30, 2015), the Service addressed whether the termination of a corporation's election to be treated as an S corporation was inadvertent within the meaning of Code Section 1362(f). The corporation was established on Date 1 and treated as an S corporation as of Date 2. On Date 3, husband and wife created a joint revocable trust (Trust 1). On Date 4, one of the spouses died. Pursuant to the deceased spouse's will and Trust 1, shares of the S corporation were transferred to Trust 2 on Date 5. Trust 2 continued to qualify as an S shareholder until Date 6, two years after Date 5. However, Trust 2 continued to hold S corporation stock. As a result, the corporation's S election terminated on Date 6 when Trust 2 ceased to be an eligible S corporation shareholder. The surviving spouse died on Date 7, at which point Trust 2 terminated.

The corporation and each of its shareholders filed consistently with the Service as an S corporation and as shareholders of an S corporation since Date 2. The corporation represented to the Service that the failure to properly file the QSST election for Trust 2 was not motivated by tax avoidance or retroactive tax planning. In addition, the corporation and its shareholders agreed to make any adjustments that the Internal Revenue Service required in order for the corporation to be treated as an S corporation. Code Section 1362(f) provides that if (i) an election under 1362(a) by any corporation was not effective for the taxable year for which it was made by reason of a failure to meet the requirements of Code Section 1361(b) or to obtain shareholder consents, or was terminated under Code Section 1362(d)(2) or (3), (ii) the Secretary of the Treasury determines that the circumstances resulting in the effectiveness or termination were inadvertent, (iii) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination were steps taken so that the corporation is a small business corporation or to acquire the shareholder consents, and (iv) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to Code Section 1362(f) agrees to make such adjustments as required by the Service, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation nonetheless.

Based on the facts admitted and the representations made, the Service concluded that the corporation's election to be treated as an S corporation terminated on Date 6 but that the termination was inadvertent within the meaning of Code Section 1362(f). The Service further concluded that the corporation would continue to be treated as an S corporation from Date 6 and thereafter, provided the corporation is otherwise eligible to be an S shareholder and provided that the election was not otherwise terminated under Code Section 1362(d). The ruling was conditioned upon the Trustee of Trust 2 filing a QSST election effective Date 6 for Trust 2. The QSST election was required to be filed within 120 days following the date of the private letter ruling.

See also PLR 201505016, PLR 201503004 and 201505008 for other rulings similar to the above.

Tax-exempt status revoked where substantial assets of organization used to pay personal expenses of founders.

In **PLR 201503021** (Jan. 16, 2015), the Service addressed the revocation of the tax-exempt status of a foundation recognized as exempt from federal income taxation under Code Section 501(c)(3). The foundation was classified as a private foundation. The foundation was established by the CEO and CFO of a for-profit organization. The CEO and CFO had been the only donors to the foundation since inception. The CEO and CFO were husband and wife. The assets of the foundation had been used to pay expenses of the CEO and CFO, namely travel, conference and meeting expenses, insurance expenses, office expenses, luncheon expenses and religious activity expenses, purportedly for exempt purposes. The foundation reported grants to a nonprofit organization and a church in a particular tax year. The foundation also claimed donations to other organizations in subsequent years.

Code Section 501(c)(3) provides for exemption from tax for "corporations . . . organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual . . . ." Section 1.501(c)(3)-(1)(c) of the Treasury Regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in Code Section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

During the audit of the foundation, the Service inquired as to various expenses charged by the foundation. The founders of the foundation were unable to demonstrate that the expenses were used for exempt related purposes. In addition, the founders were unable to produce insurance policies related to expenses incurred by the foundation. Also, the Service determined that the foundation's assets were being used to pay for maintenance materials related to the founder's rental properties. The CEO stated that the foundation used a portion of a personal residence as its office for conducting its tax exempt purposes. Hence, the foundation's utility bills were associated with the personal residence as were homeowner's association dues. Several other expenses could not be proven by provision of dates, amounts and payees' names. The foundation also could not prove that various meetings actually took place and that expenses related to those meetings were related to exempt purposes.

The Service concluded, since substantial amounts of the foundation's assets were used to pay personal expenses (and, by inference, for the benefit of a for profit organization) and the officers failed to exercise taxable expenditure responsibility, that the foundation's tax exempt must be revoked.

Alternate valuation election permitted where Form 706 not timely filed because Executor acted in reasonable reliance on qualified professional who failed to make the election.

In **PLR 201503003** (Jan. 16, 2015), the Service addressed whether an Executor would be allowed to extend the date to make an alternate valuation election under Code Section 2032. The Executor argued that he should be permitted to extend the date to make an alternate valuation election because he acted reasonably and in good faith in relying on a qualified professional who failed to make the election, and the grant of relief would not prejudice the government's interests.

The decedent died on Date 1. The due date for filing the Form 706 was Date 2. After the due date passed, the estate's Executor consulted with an attorney who advised him of the need to file the estate tax return. The return was filed on Date 3, which was within one year after the due date including extensions. In the private letter ruling request, the Executor requested an extension of time to elect alternate valuation under Code Section 2032. Code Section 2032(a) provides that the value of the gross estate may be determined if the Executor so elects by valuing all the property included in the gross estate as follows:

(1) In the case of property distributed, sold, exchanged, or otherwise disposed of, within six months after the decedent's death such property shall be valued as of the date of distribution, sale, exchange or other disposition.

(2) In the case of property not distributed, sold, exchanged, or otherwise disposed of, within six months after the decedent's death such property shall be valued as of the date six months after the decedent's death.

Code Section 2032(c) provides that no election may be made under Code Section 2032 unless such election will decrease the value of the gross estate and the sum of tax due. The election is to be made by the Executor on the Form 706 and shall be irrevocable. Under Code Section 2032(d)(2), no election may be made under Code Section 2032 if the return is filed more than one year after the time prescribed by law for filing the return. Treasury Regulations Section 20.2032-1(b)(3) provides that a request for an extension of time to make the alternate valuation election will not be granted unless the estate tax return is filed no later than one year after the due date of the return, including extensions. Treasury Regulations Section 301.9100-(1) through 9100-(3) provides the standards the Commissioner of the Treasury will use to determine whether a grant of extension of time to make an election is allowed. The Commissioner may grant a reasonable extension of time to make a regulatory election or statutory election under all subtitles of the Internal Revenue Code (with some exceptions) if the taxpayer demonstrates to the satisfaction of the commissioner that the taxpayer acted reasonably and in good faith, and granting the relief will not prejudice the interest of the government. The taxpayer must provide evidence to establish that the taxpayer acted reasonably and in good faith. Treasury Regulations Section 301.9100-(3)(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make or advise the taxpayer to make the election.

Based on the facts presented in the private letter ruling, the Service concluded the standards of Treasury Regulations Sections 301.9100-(1) and 9100-(3) had been satisfied. The Executor was

granted an extension of time of 120 days from the date of the PLR to make the alternate valuation election.

Scholarships awarded by non-exempt charitable trust in accordance with Code Section 4945(g)(1) are not taxable and are excluded from recipient's gross income.

In **PLR 201501017** (Jan. 2, 2015), the Service addressed a non-exempt charitable trust's procedures for awarding scholarships to individuals. The organization requesting approval of scholarship procedures was a non-exempt charitable trust described in Code Section 4947(a)(1) of the Internal Revenue Code and administered as a private foundation. It requested approval of a scholarship program to fund the education of certain qualifying students. The trust provided scholarships to graduating seniors who wished to attend college or vocational school at an accredited institution. The number of scholarships awarded each year and the amount of each scholarship varied based on the amount of funds available. The trust distributed the greater of the net income of the trust or the amount required under Code Section 4942. To be eligible, an applicant must have a minimum grade point average of 3.0 after seven semesters of high school, plan to attend an accredited college or vocational school, and complete an application. The application requires students to submit an essay, two letters of recommendation, transcripts with ACT test scores, and a list of extracurricular activities, work experience and financial information. Applications are submitted to the superintendent of the school district, and the trust's scholarship selection committee selects the recipients. The selection committee is made up of the mayor of the town, the superintendent of the school district and one other individual. The scholarship award is paid directly to the university or college that the recipient will attend.

Based on the foregoing, the Service determined that the scholarship procedures comply with Code Section 4945(g)(1) and that expenditures made in accordance with those procedures would not be taxable. In addition, the Service determined that the scholarship awards are excludable from the recipient's gross income if they use them for tuition and related expenses, subject to Code Section 117(c).

See also PLRs 201501018, 201501019, 201501020, 201501021, 201501022, 201501023 and 201501024 for similar scholarship award procedures rulings.

Taxpayer's reliance on counsel for foundation did not satisfy requirement for abatement of first-tier excise tax under Code Section 4962.

In **TAM 201503019** (Jan. 16, 2015), the Service addressed whether the first-tier excise tax due under Code Section 4958 on the taxpayer's automatic excess benefit transaction for the year at issue qualified for abatement in accordance with Code Section 4962.

A foundation was an organization recognized as tax exempt under Code Section 501(c)(3) and classified as a supporting organization under Code Section 509(a)(3). The taxpayer was a limited liability company treated as a partnership. A former director of the foundation owned more than a 35 percent interest in the taxpayer (the LLC) as of Date 1. The individual that owned more than a 35 percent interest in the taxpayer resigned from the foundation's board less than five years from the date of the taxable event. The transaction involved the purchase of a promissory note by the taxpayer from the foundation. Concurrently with the purchase of the promissory note from the foundation, the foundation loaned the taxpayer the funds necessary to enter into the purchase with "limited recourse." On Date 2, the taxpayer sold the promissory note to an unrelated third party. On Date 3, the foundation's accountants informed the foundation that the loan to purchase the note resulted in an automatic excess benefit transaction under Code Section 4958 because the taxpayer was a disqualified person with respect to the foundation. Less than 30 days after discovering the excess benefit transaction, the taxpayer returned all interest and principal to the foundation (Date 4). On Date 5, the foundation filed Form 4720, return of certain excise taxes under Chapter 41 and 42 of the Internal Revenue Code, for the taxable year at issue to report the excise tax on taxable expenditures under Code Section 4958 and to request abatement of the first-tier tax on the basis that the taxpayer reasonably relied upon the legal advice of counsel which turned out to be erroneous. Nearly six months after discovering the excess business transaction and reporting it on the Form 4720, legal counsel who had represented the foundation since its inception provided a letter on Date 6 describing the advice given by that counsel regarding the transaction on Date 1. Counsel stated specifically that shortly before Date 1 he provided oral advice to the foundation that the pending transaction involving the taxpayer did not create an excess benefit transaction. Counsel stated that neither the taxpayer nor the individual who owned more than 35 percent of the taxpayer was a disqualified person with respect to the foundation because the individual was a former board member. Counsel states in his letter that this advice was erroneous because he failed to consider the five year look back rule under Code Section 4958(f)(1)(a) for determining who was a disqualified person in the treatment of loans from a supporting organization under Code Section 4958(c)(3). Under those sections, the individual owner of the taxpayer and the taxpayer itself were disqualified persons. Of important note, the taxpayer provides no additional facts and circumstances showing that it relied on the advice of counsel or that the advice was reasonable. No notice of deficiency with respect to the first year tax had been issued at the time of the filing of the **TAM**.

Code Section 4958(a)(1) imposes on a disqualified person a tax of 25 percent of the excess benefit for each excess benefit transaction. Code Section 4958(c)(3) provides for organizations described in Code Section 509(a)(3), the term excess benefit transaction includes any loan by such organization to a disqualified person and the term excess benefit includes the amount of the loan. *See* Code Section 4958(c)(3)(A). Code Section 4958(f)(1)(A) provides that the term disqualified person means any person who was, at the time during the five year period ending on the date of the transaction, in a position to exercise substantial influence over the affairs of the organization. Paragraph (C) provides that disqualified persons also include any 35 percent controlled entity. Code Section 4962(a) provides that if it is established to the satisfaction of the Secretary of the Treasury that: (1) a taxable event was due to reasonable cause and not willful neglect, and (2) such event was corrected within the correction period for such event, then any qualified first-tier tax imposed with respect to such event shall not be assessed and, if assessed, the assessment shall be abated. Code Section 4963(a) provides that the term first-tier tax includes taxes imposed under Code Section 4958. Code Section 4963(e)(1) provides that

term correction period means the period beginning on the date on which the taxable event occurred and ending 90 days after the date of mailing under Code Section 6212 of a notice of deficiency with respect to the second tier tax imposed on such taxable event.

In **United States v. Boyle**, 469 U.S. 241 (1985), the Supreme Court described willful neglect as a conscious, intentional failure or reckless indifference. To show reasonable cause, the taxpayer must demonstrate that he exercised ordinary business care and prudence. *See* Treasury Regulations Section 301.6651-1(c)(1). **Haywood Lumber and Mining Company v. Commissioner**, 178 F.2d 769 (2d Cir. 1950), provides that when a corporate taxpayer selects a competent tax expert, supplies him with all necessary information, and requests him to prepare proper tax returns, the taxpayer has done all that ordinary business care and prudence can reasonably demand. In **Hayle v. Commissioner**, 44 TCM (CCH) 1116 (1982), the Tax Court states that the taxpayer bears the burden of showing reasonable cause to avoid penalties. In **Eli v. Commissioner**, 19 TCM (CCH) 743 (1960), the Tax Court noted that reliance upon the advice of reputable counsel may constitute reasonable cause for failure to file a tax return but reliance upon the advice of counsel does not constitute reasonable cause where the record fails to show that such advisor was qualified and fully informed of all the facts.

Code Section 4962(a) provides discretionary authority to the Service not to assess, or to abate or refund, any qualified first-tier tax if the foundation establishes to the satisfaction of the Service that the violation: (1) was due to reasonable cause; (2) was not due to willful neglect; and (3) has been corrected within the appropriate correction period. With regard to the issue of whether the taxpayer corrected the taxable event within the correction period, the Service determined that the taxpayer did indeed correct the taxable event within the correction period. The correction period began with the date on which the taxable expenditure occurred and ended 90 days after the mailing of a notice of deficiency with respect to the second tier tax. The evidence reflects that after the foundation was informed of the excess benefit transaction, the taxpayer returned to the foundation both principal and interest less than 30 days after discovering the excess benefit transaction.

With regard to willful neglect, the Service noted that Code Section 4962 does not actually define "willful neglect." However, Code Section 6653(3) defines "negligence" for purposes of the negligence penalty as including any failure to make a reasonable attempt to comply with the provisions. Willful is defined in several places in the Code, for example, in Treasury Regulation Treasury Regulations Section 53.4945-1(a)(2)(iv) as voluntary, conscious and intentional. No motive to avoid the foundation requirements is necessary to make an act or failure to act willful, but an act or failure to act is not willful if the foundation does not know that it is an act to which the foundation rules apply.

The Service noted that the terms willful neglect imply a voluntary, conscious and intentional failure to exercise the care that a reasonable person would observe under the circumstances to see that the standards were observed, despite knowledge of the standards or rules in question. The Service stated that it had no evidence in the present case that the taxable events occurred due to a voluntary, conscious and intentional failure on the part of the taxpayer to exercise the care that a reasonable person would observe. Accordingly, no willful neglect was found that would preclude abatement of the first-tier tax.

With regard to reasonable cause, Treasury Regulations Section 53.4958-1(d)(6) defines reasonable cause with respect to foundation managers as exercising "ordinary business care and prudence." The Supreme Court also used this "ordinary business care and prudence" definition of reasonable cause in determining whether the taxpayers were entitled to relief from failure to file penalties. Generally, reliance in good faith on the advice of counsel may establish reasonable cause and not show willful neglect where the taxpayer obtained advice from a competent tax professional on the specific tax matter and the taxpayer provided the advisor with all the necessary and relevant information to make a determination.

In the TAM, the Service noted that the taxpayer failed to offer any evidence showing that its reliance on the advice of counsel was reasonable, for the following reasons: (1) the taxpayer provided no evidence or information of the counsel's expertise; (2) the taxpayer provided no evidence that it provided necessary and accurate information to counsel (noting that the letter from counsel stated he represented the foundation but did not state that he represented the taxpayer, and he did not state whether the taxpayer specifically sought his advice as to the particular issue at hand); (3) no evidence existed that the taxpayer actually sought the advice of counsel; (4) assuming the taxpayer sought counsel's advice, the taxpayer provided no information indicating that it considered the advice when deciding whether to enter into the transaction; (5) assuming the taxpayer sought counsel's advice, the taxpayer provided no evidence or information about the circumstances under which it sought the advice of counsel.

Based on the foregoing facts, the Service found that the taxpayer did not satisfy the requirements of Code Section 4962(a) for the abatement of first-tier taxes assessed under Code Section 4958 on the automatic excess benefit transaction. The taxpayer did not exercise ordinary business care and prudence when it relied on the oral advice of the foundation's counsel, and therefore it did not establish that the taxable event was due to reasonable cause. The request to abate the assessed first-tier tax was denied.

Arms-length, negotiated sale of a farm by two trusts did not result in deemed gifts by the beneficiaries, loss of GST exempt status, or inclusion of trust assets in beneficiaries' estates.

In **PLR 201509002** (Feb. 27, 2015), the Service addressed whether the sale of farm property owned by two trusts resulted in the loss of the trusts' GST exempt status, in deemed gifts by the beneficiaries or in inclusion of the trusts' assets in the beneficiaries' estates. The relevant trusts included (i) an irrevocable trust established for the benefit of Grantor, Grantor's spouse ("Spouse") and Grantor's lineal descendants (the "Irrevocable Trust") and (ii) a revocable trust established by Spouse's father for the benefit of Spouse and Spouse's brother (the "Father's Trust"). Spouse's father renounced his right to revoke the Father's Trust and the trust was subsequently divided into separate irrevocable trusts for Spouse ("Spouse's Trust") and Spouse's brother. The Irrevocable Trust and Spouse's Trust were irrevocable prior to September 25, 1985.

The Irrevocable Trust and Spouse's Trust owned contiguous acreage of farm property. Given the nature of the land, the Trustees of the trusts determined that it would be in the best interests of the two trusts to sell the property together. The Purchaser of the property was a Limited Partnership, which was solely owned by a

descendant of the grantors. The descendant was also a current beneficiary of the Irrevocable Trust, and a contingent beneficiary of Spouse's Trust. The Agreement of Sale was negotiated by the Trustees of the Irrevocable Trust and Spouse's Trust with the assistance of counsel. Purchaser was represented by separate counsel. The sale price was consistent with two independent appraisals and recent land sales in the area. The sale was contingent on (i) the trusts receiving court approval of the sale, (ii) the beneficiaries performing certain conditions if the Irrevocable Trust terminated prior to the sale, (iii) the beneficiaries approving and ratifying the Agreement of Sale and (iv) the trusts receiving a favorable private letter ruling.

The GST tax does not apply to trusts that were made irrevocable prior to Sept. 25, 1985 and no addition has been made to the trust after that date. Treasury Regulations Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of a governing instrument of an exempt trust that is valid under state law will not terminate the exempt status of the trust if the modification does not (i) shift a beneficial interest in the trust to a beneficiary who occupies a lower generation than the person who held the beneficial interest prior to the modification or (ii) extend the time for vesting of a beneficial interest. A modification shifts a beneficial interest to a lower generation when the modification results in either an increase in the amount of a GST transfer or the creation of a new GST transfer. An administrative modification that only indirectly increases the amount transferred is not considered to be a shift of a beneficial interest. Here, the execution and implementation of the Agreement of Sale is administrative in nature and will not result in the shift of a beneficial interest in either trust to a beneficiary in a lower generation or extend the time of vesting of a beneficial interest. The Irrevocable Trust and Spouse's Trust would not lose their exempt status and distributions would not be subject to the GST tax if no further additions were made to the trusts.

The Agreement of Sale was negotiated at arms-length, the parties to the transaction were represented by separate counsel, the sale price was supported by two independent appraisals and local comps, and the transaction was subject to approval by the local court and the beneficiaries. For those reasons, the transaction would not result in a deemed gift by any of the beneficiaries.

The sale will not result in the inclusion of the assets of the trusts in the beneficiaries' estates under Code Section 2035. The beneficiaries were not transferring property to the trusts and are not transferors in the sale transaction.

See also **PLR**s 201511002, 201511003, 201511004, 201511005, 201511006, 201511007, 201511008, 201511009, 201511010, 201510009, 201510010, 201510011, 201510012, 201510013, 201510014, 201510015, 201510016, 201510017, 201510018, 201510019, 201510020, 201510021, 201510022 and 201510023 for similar rulings addressing the effect of sale transactions on the GST exempt status of trusts created before Sept. 25, 1985.

Transfers by Grantor with retained powers are incomplete gifts, and subsequent distributions by a Power of Appointment Committee caused gifts by Grantor to be complete.

In **PLR 201510001** (Feb. 20, 2015), the Service addressed whether (i) the trust at issue was a Grantor trust, (ii) the contribution to the trust would be a completed gift by Grantor, (iii) the distribution of property to the Grantor would result in a completed gift made by the Power of Appointment Committee (the "Committee"), (iv) the distribution of property to any other beneficiary would result in a completed gift made by the Committee and (iv) the Committee members had a general power of appointment that would cause the inclusion of the trust assets in the members' estates. Grantor created an irrevocable trust for the benefit of himself and others, including his spouse and his issue, during his life. The Trustee is directed to make distributions of income or principal as follows: (i) at any time a majority of the Committee, with the written consent of the Grantor, directs (the "Grantor's Consent Power"); (ii) at any time the Committee directs by unanimous action (the "Unanimous Member Power"); and (iii) as the Grantor directs in his discretion for the beneficiary's health, education, maintenance and support (the "Grantor's Sole Power"). Grantor also retained a limited power of appointment over the trust property to be exercised at his death (the "Grantor's Testamentary Power").

After an examination of the trust provisions, the Service determined that circumstances did not exist that would render Grantor the owner of the trust property. The Service also concluded that there were no circumstances that would cause administrative controls to be considered exercisable primarily for the Grantor's benefit under Code Section 675. The Service, however, stated that the actual circumstances surrounding the operation of the trust would determine whether the Trustee or any other individual would be deemed to be the owner of the trust. Such a determination, the Service explained, would have to be made upon the filing of the annual federal income tax returns of the involved parties.

The Service further held that the donor's transfer was incomplete for gift tax purposes. Treasury Regulations Section 25.2511-2(e) provides that a donor is deemed to have a power that would render a gift by the donor as incomplete if it is exercisable by him in conjunction with an individual who does not have a substantial adverse interest in the disposition of the transferred property or the income from the transferred property. Since the Committee members are not takers in default, do not continue to have a power after the Grantor's death and are merely co-holders of the power, the members do not have an interest that is substantially adverse to the Grantor. The Grantor's Consent Power thus causes the transfer of property to be wholly incomplete for gift tax purposes. The Grantor's Sole Power and the Grantor's Testamentary Power also give the Grantor the ability to change the interest of the beneficiaries, rendering the gift wholly incomplete. The Unanimous Member Power does not counteract the Grantor's numerous powers. Any distribution to the Grantor is simply a return of his own property and is not a gift by the Committee members.

The authority given to the Committee under the Grantor's Consent Power is only exercisable with the consent of the Grantor, so that authority is not tantamount to a general power of appointment. The Unanimous Member Powers are also not general powers of appointment because the members have substantial adverse interests in the property subject to that power. The Service ruled that any transfers to beneficiaries subject to these powers are not completed gifts by the Committee members but are completed gifts by the Grantor.

Trust treated as a grantor trust and transfers by Grantor with retained powers are incomplete gifts; thus, subsequent distributions by the Distribution Advisor caused gifts by Grantor to be complete.

In **PLR 201507008** (Feb. 13, 2015), the Service determined that the trust at issue was a grantor trust under Code Section 671, that contribution of property to the trust was not a completed gift, that the distribution of income by the Distribution Advisor is a completed gift at the time of distribution and that the trust assets were includible in the Grantor's estate. Grantor proposed to create an irrevocable trust during her life for her benefit and the benefit of her issue. The Distribution Advisor, who could not be related or subordinate to the Grantor, was authorized to direct the independent Trustee to distribute income and principal among the Grantor's issue in the Distribution Advisor's discretion but only upon obtaining the Grantor's consent ("Grantor's Consent Power"). Further, during the Grantor's lifetime the Distribution Advisor may direct the independent Trustee to distribute income and principal to the Grantor in the Distribution Advisor's discretion. If a Distribution Advisor is not serving, the Trustee would have the same powers with the same restrictions. Grantor would retain the power, with the consent of the Trust Protector, to appoint during her lifetime or in her last will any part of the accumulated net income and principal to the foundation or Grantor's father's issue. The independent Trustee, Distribution Advisor and Trust Protector could have no interest in the trust and could not be benefited by the exercise or nonexercise of any power. Those individuals would also alone possess and exercise their powers without causing income, accumulated income or principal of the trust fund of such trust to be attributable to any beneficiary of such trust for income, gift tax or estate tax purposes. Grantor would also have the authority to borrow any part of the net income and principal of the Trust. The Trustee would determine the interest rate, which would not be less than a reasonable market rate of interest, and would determine whether or not the loan should be secured. The Trustee would also have the authority to make loans with adequate collateral and interest to any person.

The Service determined that the Trust was a grantor trust under Code Sections 671, 674(a), 675(2) and 677(a). Treasury Regulations Section 25.2511-2(e) provides that a donor is deemed to have a power over the disposition of transferred property if it is exercisable by the donor in conjunction with an individual who does not have a substantial adverse interest in the disposition of the transferred property. Since the Distribution Advisor and the Trustee (in the event there is not a Distribution Advisor) are not takers in default, do not have an interest in the Trust and are merely co-holders of the power, neither party would have an interest that is substantially adverse to the Grantor. The Grantor's Consent Power thus causes the transfer of property to be incomplete for gift tax purposes.

Under Treasury Regulations Section 25.2511-2(c), a gift is incomplete if and to the extent that a reserved power gives the donor power to name new beneficiaries or to change the interest of the beneficiaries. Grantor would have a lifetime limited power of appointment. The lifetime limited power of appointment could only be exercised in conjunction with the Trust Protector's consent, but the Trust Protector would not have a substantial adverse interest in the disposition of the assets transferred by the Grantor. The retention of the lifetime limited power of appointment causes the transfer of property to the Trust to be wholly incomplete. Likewise, under Treasury Regulations Section 25.2511-2(b), the retained testamentary power to appoint the remainder of the trust causes the transfer of the remainder interest in the transferred property to be a wholly incomplete gift. The Grantor retains dominion and control over the income and principal of the Trust until the Distribution Advisor, or the Trustee, exercises his or her distribution power. Since the Grantor's powers over the income and principal are presently exercisable and not subject to a condition precedent, even third party actions that may defeat the Grantor's ability to change beneficial interests do not change the incomplete nature of the transfers.

Any distribution of income or principal to a beneficiary other than the Grantor will be a completed gift. Additionally, the fair market value of the trust is includible in the Grantor's estate.

Spouse eligible to roll over IRA proceeds where spouse is sole Trustee of beneficiary trust and holds power to distribute IRA assets to herself.

In **PLR 201507040** (February 13, 2015), the Service addressed the eligibility of a spouse to roll over IRA proceeds received from a trust, rather than directly from a deceased spouse. The decedent was married to the taxpayer at his death. The decedent's IRA designated Trust as the beneficiary of the IRA. The taxpayer became the sole Trustee of the Trust at the decedent's death. At the decedent's death, the Trust was divided into three trusts, a Survivor's Trust, a Marital Trust and an Exemption Trust. The Survivor's Trust was to be funded by payment of all net income and as much of the principal as the Trustee considered necessary for the surviving spouse's health, support and enjoyment. The Trustee is given the right to withdraw all assets from the Survivor's Trust and to revoke the Survivor's Trust. The taxpayer, as Trustee, allocated all retirement accounts to the Survivor's Trust. In addition, the taxpayer, as Trustee, revoked the Survivor's Trust and withdrew the Survivor's Trust's right to the IRA. Under the Trust, the IRA would pass to the beneficiary of the trust, the taxpayer, upon the revocation of the trust. The taxpayer wished to roll over all of the IRA assets into her own IRAs.

The Service cited the general rule that a spouse may elect to roll over the proceeds from an IRA owned by a deceased spouse if those proceeds are paid directly to the surviving spouse. If the proceeds of an IRA are distributable to a trust and those proceeds are then distributed to the surviving spouse, it is treated as if the surviving spouse received the proceeds from the trust rather than the deceased spouse. Thus, the surviving spouse would be unable to roll over the proceeds. That general rule, however, does not apply when the surviving spouse is the sole Trustee of the beneficiary trust and has the sole power to distribute the IRA proceeds. For that reason, the Service ruled that the IRA was not an inherited IRA and that the taxpayer was eligible to roll over the proceeds within sixty days of the distribution of the IRA assets.

Trust is United States person where United States court has primary supervisory authority over trust and at least one United States person has authority to control substantial decisions regarding trust.

In **CCA 201509035** (Feb. 27, 2015), the Service provided guidance on determining when a trust is a United States person. Under Treasury Regulations Section 301.7701-7(a)(1), a trust is a United States person when (i) a court in the United States has primary supervisory authority over the administration of the trust (the "Court Test") and (ii) at least one United States person has authority to control all substantial decisions of the trust (the "Control Test"). Primary supervisory authority is present when a court

has the authority to determine substantially all issues regarding the administration of the trust. A safe harbor for the Court Test exists under Treasury Regulations Section 301.7701-7(c)(1), which provides that the test is satisfied if (i) the trust agreement does not direct that the trust be administered outside of the United States, (ii) the trust is administered exclusively in the United States and (iii) the trust is not subject to an automatic migration provision. The trust at issue provided that the trust was not intended to be a foreign trust, that the place of administration would be the state of residence of the Trustee, who is a United States person, and that if that person is no longer a Trustee, that the place of administration would be the state of residence or domicile of the Trustee who is a resident in the same country as majority of the beneficiaries. The Trust Agreement also did not contain an automatic migration provision. Thus, the Court Test was met.

The Trust also met the Control Test. The phrase "substantial decisions" means the decisions that are authorized or required to be made under the agreement and that are not ministerial, such as if and when to make distributions, the amount of distributions, and the addition or removal of Trustees. "Control" means having the power to make all of the substantial decisions of the trust. All parties having control over the trust, including individuals who are not fiduciaries, must be considered. Although there was previously a foreign Trustee, the trust agreement provided that the Trustee domiciled in the same country as the settlor had the authority to make all decisions without the joinder of the remaining Trustee. Thus, the United States Trustee had complete control over the trust. Furthermore, at the time the guidance was issued, the foreign Trustee was no longer serving. Having satisfied the Court Test and the Control Test, the trust was considered a United States person.

North Carolina Case Law Developments

Clause in trust agreement stating that income distributions to beneficiary would terminate upon beneficiary's divorce from grantor not void as contrary to public policy; husband owed wife fiduciary duty to disclose material information in the creation trust where husband asked wife to serve as grantor of trust.

In **Ward v. Fogel**, No. COA 14-417 (filed Dec. 2, 2014), the North Carolina Court of Appeals addressed the issue of whether a "divorce clause" in an irrevocable trust agreement is void as contrary to public policy and whether an irrevocable trust could be set aside as a result of fraudulent inducement. In **Ward**, husband and wife were involved in a contentious equitable distribution proceeding in Florida. The parties were married in 1987, but separated in 2009. Prior to separation, in 2005 and 2006, two irrevocable trusts were created — husband was the grantor of one (the "REW Trust") and wife was the grantor of the other (the "WF Trust"). The attorney who prepared both trust agreements represented only the husband. The wife was not represented by any attorney when she was asked to sign the WF Trust (prepared by the husband's attorney). The REW Trust provided income to the wife but contained a clause stating that the income distributions would terminate upon divorce. The wife did not participate in the drafting of the REW trust and never knew about the divorce clause until after her separation. The WF Trust provided income to the husband for life and did **not** contain a divorce clause. The wife did not participate in the drafting of the WF Trust, never saw any drafts of the trust, was unrepresented and did not know the WF Trust was a grantor trust and that she would be liable for the income tax on the trust assets. Based on these facts, the court affirmed the ruling of the superior court that a "divorce clause" in a trust agreement does not run afoul of public policy, noting that the divorce clause did not encourage divorce but actually incentivized the wife to remain married. The court also affirmed the superior court's grant of summary judgment with respect to the wife's claim of fraudulent inducement as applied to the REW Trust. In so holding, the court stated that there is no authority for the proposition that the grantor of a trust owes a duty to the beneficiary of a trust to refrain from including clauses that may divest the beneficiary's rights upon the happening of a certain event (even if the grantor is the husband and the beneficiary is the wife). However, the court reversed the superior court's grant of summary judgment with respect to the wife's claim of fraudulent inducement as applied to the WE Trust. In so holding, the court stated that the husband misrepresented to the wife that the WE Trust and the REW Trust were merely the inverse of each other. In addition, the court held that the husband owed his wife a fiduciary duty to disclose all material information in the creation of the WF Trust since she was asked by him to be the grantor of the WF Trust. The transaction that generated this fiduciary duty was the husband's act of transferring his LLC interests to his wife and directing her to transfer the interests to the WE Trust as grantor. The court further noted that the question of whether the misrepresentations were calculated or intended to deceive is a question of fact generally left for the jury. As part of its holding, the court also held that the superior court (and not the district court) is the proper jurisdiction for resolving claims involving constructive fraud and breach of fiduciary duty with respect to the creation and funding of a trust regardless of whether a separate equitable distribution claim is pending in district court.

No breach of fiduciary duty where custodian of UTMA accounts used account funds to reimburse expenses paid out-of-pocket by custodian.

In the Matter of Alessandrini, No. COA 14-850 (filed Feb. 17, 2015), the North Carolina Court of Appeals affirmed the order of the superior court granting summary judgment to a defendant father who had been sued by the mother, on behalf of the minor children, for withdrawing funds from custodial accounts he had created for the children. The facts showed that the father had established UTMA accounts for his minor children and named himself as the custodian of the accounts. The accounts were created in the 1990s. On Sept. 1, 2009, the father withdrew $5,000 from his daughter's custodial account. On July 22, 2010, the father withdrew $22,749.97 from the son's custodial account. The father submitted an affidavit stating that he had withdrawn the $5,000 from the daughter's account to reimburse himself for part of her college tuition expenses and that he had withdrawn the $22,749.97 from the son's account to reimburse himself for travel expenses, computer expenses and automobile expenses incurred by his son. The mother did not dispute the father's statement of why the money was withdrawn and did not dispute that the father had paid all of the expenses itemized in his affidavit. Rather she argued that his

reimbursement for those expenses that he had paid out-of-pocket was a *per se* breach of fiduciary duty. The court disagreed and held that North Carolina's Uniform Trust Code and case law involving trusts is persuasive in resolving issues regarding custodial accounts under the UMTA. The court then held that the standard applicable to a trustee making a discretionary distribution from a trust set forth in **Woodard v. Mordecai**, 234 N.C. 463, 67 S.E.2d 639 (1951) (and codified in G.S. 36C-8-814) should also be applicable to a custodian under the UTMA. That standard states that a trustee abuses his discretion in making a discretionary distribution only if he acts dishonestly, with an improper motive, fails to use his judgment or acts beyond the bounds of a reasonable judgment. Applying this standard, the court held that the father did not breach a fiduciary duty because there was no evidence he acted dishonestly, with an improper purpose or unreasonably in reimbursing himself for reasonable expenses paid by him on behalf of his minor children.

Portion of N.C.G.S. § 105-160.2 providing that a trust may be taxed on income "that is for the benefit of a resident of this State" unconstitutional as to plaintiff where sole basis for imposition of tax is beneficiaries' residence in North Carolina.

On April 23, 2015, in the case of **Kaestner Family Trust v. N.C. Dep't of Revenue**, 12 CVS 8740 (Wake County), the North Carolina Business Court ruled in favor of the plaintiff's motion for summary judgment, concluding that the plaintiff had shown, beyond a reasonable doubt, that the portion of North Carolina General Statutes Section 105-160.2 providing that a trust may be taxed on income "that is for the benefit of a resident of this State" is unconstitutional under the Due Process and Commerce Clauses of the United States Constitution and Article 1, Section 19 of the North Carolina Constitution as applied to the plaintiff where the only basis for imposition of the tax is the beneficiaries' residence in the State of North Carolina. The Opinion is available on the North Carolina Business Court website, accessible here: ***http://www.nc-businesscourt.net/TCDDotNetPublic/default.aspx?CID=3&caseNumber=12CVS8740***.

A full summary of the Order and the scope of its application will be included in the next issue of the Will and the Way.

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