KANSAS BAR ASSOCIATION
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KBA Real Estate, Probate & Trust Section Newsletter

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Section President's Message

By D. Michael Dwyer
Dwyer Dykes & Thurston LC, Overland

Another year is fast coming to a close and with it another round of legislative issues begins. I have been advised that the Judicial Council is proposing some changes to the Uniform Trust Code. I have not seen them as yet. In addition, we are going to again present Cal Karlin's proposed legislation relating to the several insurance coverage issues that arise when real or personal property is transferred into a Grantor Trust. The Executive Committee of the section has determined that, at least for the time being, there is no point in pursuing any additional estate tax reform and that the position of the Department of Revenue has been helpful in resolving concerns of practitioners relating to the interplay of the federal estate tax law and the Kansas estate tax. Finally, the study group that volunteered to look into Senate Bill 272, which addresses Medicaid issues, will hopefully be in a position to provide the legislators with informed reasons as to why they would not want to pass this piece of legislation in its present form.

Nancy Roush advises that she will be undertaking, with the cooperation of our section members, the project of updating the Kansas Estate Administration handbook. There have been a lot of changes since the last revisions, and this stands to be a challenging undertaking. Anyone who is interested in volunteering to assist with this project may call or e-mail Nancy, nroush@shb.com or me ddtlc@grapevine.net.

Best wishes for the holidays to all.

Probate and Trust Cases

Submitted by Calvin J. Karlin
Barber Emerson Springer Zinn & Murray LC, Lawrence

IN RE ESTATE OF MILWARD,
73 P.3d 155 (Kan. App. 2003)

In 1964, Roy and Alice Brecheisen executed a contractual will. The will left all of their property to each other and, upon the second death, to their grandson Bennett Brecheisen. Roy died in 1966; in 1995 Alice executed a codicil replacing Roy Cole (the attorney who drafted the original will) as executor with Bennett who was then an adult. Mr. Cole complained that the executor could not be changed since the original will was contractual. Although the Court of Appeals acknowledged that Mr. Cole had a legal right to attempt to set aside the will (because an executor has in interest in the estate arising from his entitlement to reasonable compensation), they held that the executor can be changed regardless of the contractual nature of the will.

Mr. Cole's second objection was that the testator signed only the self-proving affidavit on the codicil and failed to sign her signature on the separate line above that. This objection was also rejected. The court held that one signature by the testator (along with the witnesses' signatures) is enough. Although a single signature worked in this case, this is certainly not recommended as an intentional procedural shortcut, at least until there is a definitive ruling by the Supreme Court.

OFFERMAN V. ROSILE,
_____ P.3d ___ (Kan. App. 10-10-03)

In April 1990, Lester Banka prepared a revocable trust with the assistance of a stockbroker, who was not an attorney. The trust provided that upon Lester's death, "The income from the Lester C. Banka Trust will be paid to Carolyn Banka, *widow, the rest of her life or until she remarries.* Then all income goes back to the Trust for the surviving Trustees." (Emphasis added.)

Lester and Carolyn were married in May 1990, shortly after Lester's trust was executed. They were divorced in 1995. No mention was made in the divorce decree of the trust or any of the assets placed in the trust. The trust was not amended or revoked after the divorce. When Lester died in 2000, the surviving Trustees were Lester's daughters. They sought a declaratory judgment that Carolyn should be eliminated as the income beneficiary.

The trial court found that even after their divorce, Lester and Carolyn remained friendly. After a Hawaii trip in 1999, Lester told Carolyn that she was still in the trust and, although his daughters did not like it very much, Carolyn had been good to him. The Kansas Court of Appeals held that the trust was not ambiguous, and the trial court consequently erred in considering such parol evidence.

The court acknowledged a split of authority in other jurisdictions as to whether the widow is the person married to the settlor at the time the trust was prepared or the spouse at the time of death. Although Carolyn was not married to Lester at the time of the trust's execution, marriage was clearly anticipated and subsequently occurred. The key according to the court, however, was that they were not married at the time of Lester's death. The Court of Appeals held that Carolyn was never Lester's widow and was not entitled to any income under Lester's trust. The court noted that Lester was an intelligent businessman who amassed an estate of approximately $1 million, and he should have understood the meaning of the word "widow." Consequently, Carolyn was held not to be a "widow" because she was not married to Lester at the time of his death, so she took nothing.

The court did not explain how or why apparently intestate property (administered by the daughters as administrators, rather than executors) was added to the trust. Nor did the court mention K.S.A. 59-610 requiring revocation of all provisions in a will in favor of the testator's spouse upon a divorce.

One moral would be to use an attorney rather than a stockbroker to help with drafting of a will. Another moral would be to consciously deal with the trust assets and the trust terms at the time of a divorce.

Submitted by Dan C. Peare, Hinkle Elkouri Law Firm LLC, Wichita

1.IRS ACQUIESCES TO TAX COURT DECISION IN WALTON

The taxpayer established two grantor retained annuity trusts (GRAT) in 1993, each of which had a term of two years and was funded by transfers of Wal-Mart stock valued at approximately $100 million for each trust. Under the provisions of each GRAT, the taxpayer was to receive an annuity amount equal to 49.35 percent of the initial trust value for the first year and 59.22 percent of the initial value for the second year. In the event of the taxpayer's death prior to termination of the GRATs, the annuity amounts were to be paid to her estate. The taxpayer had two daughters, each of whom was named as the remainder beneficiary of one of the trusts. Under the terms of the annuity payment, and using IRS-assumed growth rates, the assets of each GRAT were projected to exhaust, leaving no property to be delivered to the remainder beneficiaries. The taxpayer filed a 1993 gift tax return valuing the remainder interest gifts in the GRATs at zero. The IRS asserted that the taxable value of each gift was approximately $3.8 million.

The IRS contended that the taxpayer created three interests upon establishing the GRATs: 1) the annuity payable to her during her lifetime, 2) the contingent interest of her estate to receive the annuity payments in the event of her death prior to termination of the trusts, and 3) the remainder interests granted to her daughters. The commissioner's position was that the contingent interest of the taxpayer's estate was not a qualified retained interest within the meaning of Code § 2702. As a result, in calculating the value of the taxable gift, the commissioner subtracted only the value of an annuity payable for the shorter of two years or the period ending upon the taxpayer's death.

The taxpayer's position was that only two interests were created upon establishment of the GRATs: 1) a retained annuity payable for a fixed term of two years, and 2) a remainder interest in favor of her daughters. The taxpayer asserted that the retained annuity interest was a qualified interest within the meaning of Code § 2702. Accordingly, the taxpayer valued the retained annuity as a simple two-year term annuity without regard to any mortality factor, resulting in a gift of $6,195 for each GRAT.

The U.S. Tax Court held that as a matter of law, the taxpayer could not have given an interest in property to her estate. Thus, by default, she retained all interests in the two-year term annuities. The Tax Court next looked at whether the retained annuities were qualified. Regulation § 25.2702-3(d)(3) requires that the permissible terms for a qualified annuity may be "for the life of the term holder, for a specified term of years, or for the shorter (but not the longer) of those periods." The commissioner argued that the taxpayer's annuities were for the longer of the periods, and, thus, were not qualified. In determining the validity of the regulation, the Tax Court looked to legislative intent and the principal objective of Code § 2702. The Tax Court noted that the purpose of the section was to prevent undervaluation of gifted interests and to restrict a donor's ability to calculate the amount of a gift by subtracting certain elements of actuarial value that would or might pass to the donee. It concluded that Congress meant to allow individuals to retain qualified annuity interests for a specified term of years and that the proper method for doing so would be to make any remaining payments due after the donor's death payable to the donor's estate. Accordingly, the Tax Court held that the taxpayer's annuities were qualified, and in so doing, invalidated Example 5 of regulation § 25.2702-3(e) as an improper extension of Code § 2702. *Walton v. Comm*., 115 T.C. 589 (2000).

In Notice 2003-72, the IRS issued its acquiescence in the Tax Court's decision. In so announcing, it stated that it would treat the fact situation presented in Example 5 of regulation § 25.2702-3(e) as a qualified interest payable for a 10-year term.

2. INCREASE IN DECEDENT'S ESTATE DUE TO PAYMENT OF WIFE'S GIFT TAX

In 1987, the decedent and his wife made an estimated income tax payment in excess of $1.4 million. After determining that they had overestimated their joint tax liability for the year, they instructed the IRS to apply a portion of the payment to the decedent's unpaid gift tax and the remainder to the decedent's wife's unpaid gift tax. At all times, the decedent and his wife maintained separate checking accounts, and the estimated tax payment was made from the decedent's checking account. The court held that the $700,000 applied to the decedent's wife's unpaid gift tax was required to be included in the decedent's gross estate under Code § 2035(b). *Estate of O'Neal v. U.S.*, 92 A.F.T.R. 2d 2003-6648 (N.D. Ala. 2003).

3. UNIFIED CREDIT RESTORED WHERE ERRONEOUSLY USED AGAINST GIFTS DECLARED NULL AND VOID

The decedent's will contained a spendthrift provision preventing any beneficiary from assigning any portion of the decedent's estate. The decedent's wife executed an assignment agreement prior to August 5, 1997, whereby she assigned her entire interest in the marital trust created upon the decedent's death to her three children. In doing so, she used her remaining unified credit and owed gift taxes on the transaction. Subsequent to signing the agreement, the decedent's wife commenced a lawsuit contending the transfers were not valid. The state court ruled the assignment null and void in light of the spendthrift provision in the decedent's will, invalidating the gifts.

Prior to amendment by the taxpayer Relief Act of 1997, Code § 2504(c) provided that if the valuation of a transfer for gift tax purposes for gifts made in a preceding calendar year or quarter was at issue, and if the statutory period within which an assessment could be made had expired and a tax had been actually assessed or paid for the prior calendar year or quarter, then the value of the gift for purposes of arriving at the correct amount of taxable gifts for preceding calendar years or quarters was the value used in computing the tax for the last preceding calendar year or quarter for which a tax was assessed or paid. In the present situation, the court determined the transfers to be null and void. Therefore, the erroneous inclusion of assets in taxable gifts arose from an issue other than valuation, and Code § 2504(c) (as it existed prior to amendment) did not bar the adjustment of prior reported gifts. Accordingly, the decedent's wife's erroneously utilized unified credit was restored to her for use in determining her gift tax liability on future transfers. P.L.R. 200334020.

4. USE OF CODE § 7520 TABLES NOT REQUIRED TO VALUE LOTTERY WINNINGS

The 2nd U.S. Circuit Court of Appeals reversed a U.S. Tax Court holding requiring use of the Code § 7520 actuarial tables to value the decedent's remaining installments of lottery winnings. The decedent and his wife won a lottery prize to be paid out in 20 equal annual installments. The decedent died with 18 installments remaining. Pursuant to state restrictions on lottery winnings, the annual payments could not be accelerated under any circumstances, and the decedent was forbidden from assigning or transferring his right to future installments to third parties. Accordingly, the decedent's estate valued the remaining installments using a risk-based market discount, based on the market that did exist for such unassignable winnings. The Tax Court held, as a matter of law, that marketability restrictions did not justify departure from the actuarial tables and did not override the policy favoring standardized actuarial valuation

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Submitted by Mark A. Andersen
Barber Emerson Springer Zinn & Murray LC, Lawrence

KANSAS SUPREME COURT

OWEN LUMBER COMPANY V. CHARTRAND
JOHNSON DISTRICT COURT — REVERSED AND REMANDED
NO. 89,476 - 19 PAGES - AUGUST 1, 2003
Mechanic's Lien

FACTS: Owen Lumber, subcontractor, filed an action to foreclose a mechanic's lien against property owned by the Chartrands. The action was filed prior to the effective date of amendments to K.S.A. 60-1103 passed by the 2000 Legislature. The district court granted summary judgment in favor of the Chartrands because Owen Lumber had failed to file a notice of intent to perform as required by K.S.A. 2002 Supp. 60-1103b and had failed to comply with the notice provisions of K.S.A. 60-1103(c). In Owen Lumber Co. v. Arthur Chartrand, 27 Kan. App. 2d 72, 998 P.2d 509 aff'd 270 Kan. 215, 14 P.3d 395 (2000) (Chartrand I), the Court of Appeals reversed ruling that Owen Lumber was not required to file a notice of intent because it filed the lien before the Chartrands took title, and the Supreme Court affirmed. The 2000 Kansas Legislature passed the amendments to K.S.A. 60-1103(c) to take effect on the date the Supreme Court affirmed the Court of Appeals or denied the petition for review. On remand, the district court found the 2000 amendments applied retrospectively and since Owen failed to serve notice on the Chartrands it was precluded from foreclosing the lien.

ISSUES: Did the 2000 amendments to K.S.A. 60-1103(c) apply retrospectively? Did the Chartrand's actual knowledge of the lien create substantial compliance with the additional requirements?

HELD: Where a mechanic's lienholder had complied with the notice requirements in existence at the time it filed an action to foreclose its lien, it would violate due process to retrospectively apply the additional notice requirements enacted by the 2000 Legislature (K.S.A. 2002 Supp. 60- 1103[c]) without giving the lienholder a reasonable time to comply with the new requirements. The Court held that strict compliance with the notice requirements of K.S.A. 2002 Supp. 60- 1103(c) are necessary and that Owen Lumber was entitled to a reasonable opportunity to comply with the amendments.

STATUTES: K.S.A. 20-3018; K.S.A. 58-2312; K.S.A. 60-304; K.S.A. 2002 Supp. 60- 1103(a)(3), (c), -1103b.

KANSAS COURT OF APPEALS

J.P. ASSET CO., INC. V. CITY OF WICHITA
SEDGWICK DISTRICT COURT — AFFIRMED IN PART, REVERSED IN PART
NO. 89,559 - 15 PAGES - JUNE 13, 2003
Contracts, Torts, Limitations of Actions

FACTS: In 1994, city condemned and removed building with a party wall that adjoined building purchased by J.P. Asset Co. Inc. (JP). JP discovered significant water and mold in the basement in August 1999 and filed suit in June 2001 alleging breach of party wall agreement. In August they sent 12-105b(d) notice to city claiming damages in tort caused by negligence and trespass. After city denied tort claim, JP amended petition to add tort claims. Trial court granted city's motion for summary judgment, finding city had no legal duty to repair or maintain party wall in manner alleged by JP, and finding JP's tort clams were time barred. JP appeals.

ISSUES: 1) Party Wall and 2) Statute of Limitations.

HELD: Legal obligations concerning a party wall are stated. Here, no evidence that exposure of party wall led to structural instability. No error in granting city's motion for summary judgment on contract claim. Statute of limitations governing JP's tort claims was extended by the 40 days it took the City to deny JP's tort claims. Amended petition was filed 30 days after City's denial, thus the amended petition was filed within statute of limitations. Call to Legislature for amendment of K.S.A. 12-105b(d) to conform with time frames in Federal Tort Claims Act statute, to have uniform time frames for filing tort claims against governmental entities in Kansas.

DISSENT: (Knudson, J.) Tort claims were not timely filed. Forty-day extension runs from date statute would have otherwise run, not from date city denied JP's claim. Interplay between 60-215(c) and 12-105b(d) is noted. Here, 12-105b(d) controls, and party intending to file tort claim against a governmental entity is not allowed end run under theory of relation back of claims.

STATUTES: K.S.A. 2002 Supp. 60-215(c); K.S.A. 12-105b(d).

WORLEY V. BRADFORD POINTE APARTMENTS, INC.
JOHNSON DISTRICT COURT — AFFIRMED
NO. 88,249 - 16 PAGES - JULY 18, 2003
Landlord and Tenant

FACTS: Worley injured in fall on icy sidewalk at his apartment complex (BPA). Slip and fall case went to jury, with 51 percent liability against BPA. BPA appeals, arguing district court erred in (1) scheduling arguments on motion for directed verdict and proposed jury instructions after jury began deliberations, (2) denying BPA's motion for a directed verdict, and (3) denying BPA's requested jury instruction.

ISSUES: (1) Scheduling of Arguments, (2) Directed Verdict, and (3) Jury Instructions.

HELD: No abuse of discretion by trial court. BPA was not prejudiced by trial court's decision to postpone arguments until after jury began deliberations, and BPA was never in jeopardy of being prevented from preserving the record. *Agnew v. Dillons Inc.*, 16 Kan.App.2d 298 (1991), is factually distinguished. Trial court was presented with conflicting testimony as to nature and extent of the storm, and there was evidence tending to show BPA had voluntarily assumed responsibility for clearing ice and snow even while storm was in progress. Resolving significant factual disputes in Worley's favor, trial court correctly denied BPA's motion for directed verdict. Instruction given to jury fairly and accurately stated the law. Trial court could have given the requested instruction concerning legal principle of Agnew, but no reversible error in failing to do so. Court also questions whether BPA's proposed instruction was sufficient.

STATUTES: None.

PERSIMMON HILL FIRST HOMES ASSN. V. LONSDALE
JOHNSON DISTRICT COURT — REVERSED AND REMANDED
NO. 89,410 - 13 PAGES - AUGUST 29, 2003
Property — Restrictive Covenants

FACTS: Property association had restrictive covenant of no fences unless approved by developer. The Lonsdales built a fence without approval. After refusing to remove the fence, the association filed a petition for permanent injunction ordering removal of the fence. District court denied injunction, finding no decreasing in economic value of association properties and association failed to establish irreparable harm if injunctive relief was not granted.

ISSUE: Did the district court err as a matter of law in denying injunctive relief for clear violation of restrictive covenants solely because the court perceived there was no independent demonstration of irreparable injury?

HELD: Court held the district court erred as a matter of law in denying injunctive relief. The Court remanded for further proceedings to determine whether any of the equitable defenses recognized in Kansas should preclude the mandatory permanent injunction sought by the association.

STATUTES: None.

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A&S RENTAL SOLUTIONS, INC., V. KOPET
DOUGLAS DISTRICT COURT —
REVERSED AND REMANDED
NO. 89,863 - 8 PAGES -
SEPTEMBER 19, 2003
Landlord/Tenant - Security Deposit

FACTS: Tenant subleased apartment with landlord's approval. At expiration of sublease, dispute arose over entitlement to security deposit. Within 30 days of property becoming vacant, landlord filed a petition for declaratory judgment requesting the court determine ownership of security deposit. Hearing was postponed, and at the time of the hearing, district court found landlord was liable for civil penalty for wrongfully withholding security deposit. Court stated the filing of the declaratory judgment action did not absolve landlord from responsibility to return security deposit.

ISSUE: Did the district court err in holding the landlord was subject to civil penalty for withholding a security deposit?

HELD: Court reversed and remanded. Court stated that by filing a petition for declaratory judgment within 30 days after termination of a tenancy, requesting the district court to determine ownership of a security deposition, the landlord substantially complied with K.S.A. 2002 Supp. 58-2550(b) and is not subject to a civil penalty for wrongfully withholding the security deposit. The Court distinguished Love v. Monarch Apartments, 13 Kan. App. 2d 341, 771 P.2d 79 (1989).

STATUTES: K.S.A. 2002 Supp. 58-2550(b), (c).

STONE V. U.S.D. NO. 222
WASHINGTON DISTRICT COURT —
AFFIRMED
NO. 90,317 - 14 PAGES - OCTOBER 10, 2003
Railroads, Deeds

FACTS: Case involving disputed ownership of land conveyed to railroad by warranty deed and later conveyed from railroad to USD 222 in 1986 quitclaim deed. When school district tried to clear brush and remove dirt from property, adjacent landowners (Stone) filed petition for trespass. District court found Stone gained title to land after it was abandoned by railroad as part of a functioning railroad. School district filed interlocutory appeal.

ISSUE: Ownership of land conveyed by railroad.

HELD: Where relatively small portion of land is conveyed to a railroad for railroad use, and that use is abandoned by the railroad, land reverts back to the original grantors or abutting owner. General "use it or lose it" rule in Abercrombie v. Simmons, 71 Kan. 538 (1905), is discussed and applied. Trial court correctly ruled the land reverted to the original grantors. Ruling is applicable to relatively small portions of land. Abandonment of large portions of land is not at issue.

STATUTES: None.

Office of the Attorney General State of Kansas

OPINION 2003-12
Mortgage Registration and Intangibles;
Mortgage Registration — Fee;
Affidavit to Limit Amount of Indebtedness

SYNOPSIS: For purposes of assessing the mortgage registration tax, unless incorporated by reference or otherwise made a part of the mortgage itself, an affidavit is insufficient to alter the provision in the mortgage stating the amount of debt or obligation being secured thereby.

STATUTES: K.S.A. 79-3102; K.S.A. 79-3105.

Missouri Court of Appeals Western District

COUNTRY CLUB DISTRICT HOMES ASSN. V. COUNTRY CLUB CHRISTIAN CHURCH
JACKSON COUNTY CIRCUIT COURT —
AFFIRMED
NO. WD61418 - SEPTEMBER 2, 2003
Restrictive Covenants

FACTS: Country Club Christian Church appeals from the court's judgment in favor of Country Club District Homes association and several residents of Hampstead Gardens, a subdivision within the Country Club District, (collectively "the association"). The court ruled in favor of the association and its petition to enjoin the church from building parking lots on its property in violation of a covenant restricting use of the property to "private residence purposes."

ISSUE: Interpretation of restrictive covenants. Do church parking lots violate a covenant restricting use of the property to private residence purposes?

HELD: (1) The court did not err in permanently enjoining the church from building parking lots on its property encumbered by the restrictive covenant. The plain and ordinary language of the restrictive covenant limits the use of the property to private residence purposes only, which are uses that are only for residential purposes, to the exclusion of all other purposes. Because the proposed use of the parking lot is not for a private residence purpose, the building of parking lots would violate the restrictive covenant. (2) The court did not err in enforcing the restrictive covenant and enjoining the church from building parking lots. The church failed to demonstrate that a radical change of circumstances had occurred such that the residential use restriction should no longer be enforced.

STATUTES: None.

United States District Court for the District of Kansas

WICHITA INVESTORS, L.L.C. V. WICHITA SHOPPING CENTER ASSOCIATES, L.P.
NO. CIV.A. 02-2186-CM - June 5, 2003
267 F.Supp.2d 1049
Landlord/Tenant — Contracts

FACTS: Landlord (plaintiff) filed contract action against tenants for back rent and contribution to construction of screening wall on leased property.

ISSUE: Is landlord entitled to back rent and contribution to construction of screening wall on leased property? Can successor landlord assert contractual rights that predecessor had waived?

HELD: On cross-motions for summary judgment, the district court held that: (1) parties did not intend consumer price index adjustments to rental amount, (2) overages subject to additional rent did not include increases in base rent, (3) tenants were responsible for construction of fencing required by city, and (4) prior owner's waiver of right to collect rent on lake-fill property bound landlord.

STATUTES: No Kansas statutes cited.

KBA CLE Calendar

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of annuities. In reversing the Tax Court, the 2nd Circuit held that application of the tables is not required where it would produce a substantially unrealistic and unreasonable result, which burden was met by the decedent's estate in this case. *Estate of Gribauskas v. Comm.*, 92 A.F.T.R. 2d 2003-5914 (2d Cir. 2003).

5. TRANSFER OF RESTRICTED STOCK TO CRUT

The taxpayer proposed to transfer company stock to a charitable remainder unitrust (CRUT), which stock would carry with it a right of first refusal in favor of the company should the CRUT decide to sell the stock. The test for determining whether the contribution of stock to the CRUT followed by a redemption of the stock from the CRUT should be respected in form or recharacterized as a redemption of the stock from the taxpayer followed by a contribution of the proceeds to the CRUT is whether the CRUT is legally bound or can be compelled by the company to surrender the shares for redemption. In the present case, the right of first refusal did not amount to a legal obligation for the CRUT to sell, or the company's ability to compel a sale. Therefore, the transfer of company stock to the CRUT followed by any subsequent redemption of the stock by the company would not be recharacterized as a redemption of the stock by company followed by a contribution of the proceeds to the CRUT by the taxpayer. P.L.R. 200321010.

6. ASSIGNMENT WHICH LIMITS THE FAIR MARKET VALUE OF A TRANSFER INVALID

The taxpayer executed an assignment stating "Assignor [taxpayer] desires to transfer as a gift to Assignee [Trust] that fraction of Assignor's Limited Partnership Interest in [Partnership] which has a fair market value on the date hereof of $[x]." The taxpayer transferred a percentage of his partnership interest to the trust and filed a gift tax return valuing the interest at $5,000 less than $x. The IRS held that the quoted language from the assignment was void as contrary to public policy because such a clause would discourage the collection of the tax in that it would only serve to invalidate that portion of the gift determined to be greater than $x. T.A.M. 200337012.

7. DISCLAIMER MORE THAN NINE MONTHS AFTER DECEDENT'S DEATH NOT QUALIFIED

The IRS held that a wife's relinquishment more than nine months after her husband's death of her beneficial interest in a Trust established upon her husband's death would constitute a transfer of property by gift under Code § 2501(a) to her three sons. Because the disclaimer would occur more than nine months following her husband's death, Code § 2518 would not apply. P.L.R. 200339021.

8. NON-PRO RATA TERMINATING TRUST DISTRIBUTIONS DON'T RESULT IN GAIN OR LOSS

The IRS held that neither a trust nor the beneficiaries of the trust would recognize gain or loss as a result of non-pro rata distributions from the trust under a plan of termination. Because non-pro rata distributions were allowed under state law, the transaction would not be treated as pro rata distributions followed by an exchange between the beneficiaries. Planning Pointer: The same conclusion could be reached where the document establishing the trust specifically allowed for non-pro rata distributions. P.L.R. 200334030.

9. UNIFORM PRINCIPAL AND INCOME ACT'S ADJUSTMENT POWER

Under the terms of a trust, son is the current beneficiary. Upon son's death, the trust assets will be distributed to son's issue, in equal shares, per stirpes. Son has two children, grandson 1 and grandson 2. Each of grandson has three children. The current trustees of the trust are grandson 1, grandson 2, B, C, and D.

State law allows for the adjustment between principal and income to the extent the trustee considers advisable to enable the trustee to make appropriate present and future distributions in accordance with risk and return objectives reasonably suited to the entire portfolio and where such adjustment would be fair and reasonable to all beneficiaries. However, adjustment may not be made by a trustee who is a current beneficiary or a presumptive remainderman of the trust. Further, a trustee who is not a current beneficiary or a presumptive remainderman may not make the adjustment if it would benefit that Trustee directly or indirectly.

The IRS held that B, C, and D were not presumptive remaindermen of the Trust because they were not presumptively entitled to the next eventual estate. Upon son's death, the Trust would pass to grandson 1 and grandson 2, making them the persons presumptively entitled to the next eventual estate. B and C each have an indirect contingent interest in the Trust. However, the IRS held that the adjustment would not benefit them directly or indirectly. Accordingly, B, C, and D could exercise the power of adjustment, and such adjustment would not result in gift tax consequences to Grandson 1 and grandson 2 under Code § 2501. P.L.R. 200334025.

10. EXERCISE OF POWER OF APPOINTMENT DISQUALIFIES SUBSEQUENT DISCLAIMER

Husband and Wife established a living trust, which terms provided for an allocation of trust assets between Trust A and Trust B upon the first of their deaths. Initially, all assets would pass to Trust A except those assets disclaimed by the surviving spouse. The surviving spouse was given a power of appointment over Trust A. Husband died, and shortly thereafter, Wife executed a document entitled "Power of Appointment" directing the disposition of Trust A assets. Wife died less than three months after Husband (approximately one month after executing the power of appointment). Wife's special administrator executed a disclaimer of Wife's interest in Trust A assets as of Husband's earlier death. The Tax Court held that execution of the power of appointment was acceptance of Wife's interest in the Trust A assets. Therefore, Wife's special administrator's subsequent disclaimer was not qualified, and the Trust A assets were includable in Wife's gross estate. Estate of *Engelman v. Comm.*, 121 T.C. No. 4 (2003).

11. MARITAL DEDUCTION ALLOWED FOR INITIALLY UNPRODUCTIVE TRUST ASSETS

The IRS held that where a marital trust was funded, in part, with stock that has never paid dividends, the entire trust qualified for the federal estate tax marital deduction under Code § 2056(b)(7). Although the stock comprised a portion of the trust assets, the terms of the trust allowed the spouse the right to require the trustee to make the trust assets productive or to convert the trust assets into productive assets. T.A.M. 200339003.

12. BENEFICIARY'S ESTATE NOT ENTITLED TO PENSION BENEFITS ACCRUING FROM DATE OF DISAPPEARANCE THROUGH DATE DECLARED DEAD

Upon her husband's death, wife began receiving surviving spouse benefits, which benefits she was allowed to receive during her lifetime. Approximately five years after her husband's death, wife disappeared. After learning of her disappearance, the plan trustees suspended her benefits, with the qualification that if she reappeared, the suspended payments would be disbursed. Fifteen years later, a Virginia court declared her to be presumed dead. The administrator of wife's estate thereafter submitted a claim to the trustees for the benefits that had accrued prior to her being declared presumed dead. The District of Columbia Circuit Court held that the presumption of death extended only to the fact of death and established no presumption as to the time when death occurred. It further held that once the presumption of death is triggered, the decedent is no

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longer presumed to have been alive during the seven years following disappearance. Accordingly, the trustees correctly denied the administrator's claim for accrued benefits. In reaching its opinion, the court recognized that other circuit courts have held that the presumption is that death occurred at the end of the seven-year period following disappearance. *Fuller v. American Federation of Labor*, 328 F.3d 672 (D.C. Cir. 2003).

13.TRANSFERS OF LLC INTERESTS NOT PRESENT GIFTS

Husband and wife created a limited liability company (LLC) and began gifting shares annually to their children, their children's spouses, and to a trust set up for their grandchildren. The LLC's operating agreement required members to obtain the manager's approval to withdraw from the LLC or to sell shares. Any share transfers without consent would transfer the economic rights but not any membership or voting rights. The 7th Circuit Court of Appeals affirmed the Tax Court's holding that the transfers of LLC interests were transfers of future interests, thereby disqualifying the transfers as Code §2503(b) exclusions. The court held that the LLC's operating agreement foreclosed the donees' ability to realize any substantial present economic benefit given the restrictions on share transfers. *Hackl, Sr., v. Comm*., 335 F.3d 664 (7th Cir. 2003).

14. CORPORATE EARNINGS AND ALTERNATE VALUATION DATE

The decedent owned 100 percent of the stock of Corporation. The decedent's executor elected to value the assets includable in the decedent's gross estate as of the date six months after death. During the six months following the decedent's death, the Corporation had a certain amount of earnings, a portion of which was declared as dividends. In determining the fair market value of the decedent's stock, the executor treated the undistributed Corporation earnings during the six-month period as excluded property under Treas. Reg. § 20.2032-1(d)(4). The IRS held that the earnings did not constitute excluded property. In so holding, it stated that a necessary prerequisite for corporate earnings accumulated during the alternate valuation period to be considered excluded property is that the earnings must be declared as a dividend or otherwise distributed during the alternate valuation period. The value of the stock on the alternate valuation date includes post-death appreciation and depreciation during the alternate valuation period, which is directly affected by profits and losses during that period. Therefore, such amounts are part of the corporate assets until severed from the corporate estate and passed to the shareholders. T.A.M. 200343002.

15. CHARITABLE REMAINDER TRUST RULES DISCUSSED

The taxpayer proposed to contribute corporation stock to a CRUT, which stock carried net unrealized appreciation as defined in Code § 402(e)(4), received by her from corporation's profit-sharing plan upon her retirement. The IRS confirmed that taxpayer would not recognize gain or loss as a result of her contribution of stock to the CRUT, noting that there was no indication of a pre-arranged plan involving disposition of the stock by the CRUT. The IRS also held that taxpayer's charitable deduction would not be subject to reduction under Code § 170(e) to the extent that there is no post-distribution gain in the stock, or to the extent that any such gain is long-term because taxpayer holds the stock for more than one year prior to contributing it to the CRUT. The IRS stated that taxpayer's charitable contribution deduction would be limited to 30 percent of her adjusted gross income for the taxable year. The IRS confirmed that the CRUT's basis in the stock would be the same as taxpayer's basis, and that the stock would be a long-term capital gain asset to the CRUT if the stock was a long-term gain asset in taxpayer's hands. Finally, the IRS ruled that any gain from sale of the stock by the CRUT would not be subject to tax unless the CRUT had unrelated business taxable income in the year of the sale. To the extent of the net unrealized appreciation, the sale would be characterized as long-term capital gain. Any gain in excess of the net unrealized appreciation would be characterized based on the holding period from the distribution date to the sale date. Pursuant to Revenue Procedure 2003-3, the IRS declined to rule on whether taxpayer's transfer of stock to the CRUT would qualify for gift tax purposes. P.L.R. 200335017.

16. MINORITY AND MARKETABILITY DISCOUNTS FOR FLP

In 1995, the taxpayer and her daughter formed a Georgia family limited partnership funded with marketable securities and Michigan real estate subject to a long-term lease. In 1996, the taxpayer gifted all of her interests in the partnership except for a one-percent general partnership interest. In ruling on appropriate minority discounts to apply in valuing the gifts, the Tax Court held that publicly-traded real estate investment trusts provided an appropriate starting point for applying such a discount to the partnership's real estate. The court calculated a 19 percent minority discount applicable to the real estate, and a 15 percent aggregate minority discount including real estate and marketable securities.

In calculating the marketability discount, the court held that private placements of publicly-traded stock provided an appropriate starting point, and rejected the taxpayer's use of a restricted stock approach. After averaging the discounts derived from two studies cited by the commissioner, the court obtained an initial marketability discount of 21 percent. It increased this number by three percent to incorporate the partnership's specific characteristics of being closely-held and requiring that it be offered a right of first refusal to purchase limited partnership interests at a 15 percent discount. *Lappo v. Comm*., T.C. Memo 2003-258.

17. TRUSTS AS S CORPORATION SHAREHOLDERS

The IRS issued final regulations explaining when various types of trusts may be S corporation shareholders. The final regulations clarify that a former qualified subpart E trust or a testamentary trust that continues to own S corporation stock after the allowed two-year period is not a permitted shareholder unless it is an otherwise qualified subpart E trust, an electing qualified subchapter S trust, or an electing small business trust. They also clarify that a testamentary trust includes a trust that receives S corporation stock from a trust electing to be treated as part of the estate under Code § 645.. T.D. 9078; Treas. Reg. § 1.1361-1.

18. NET GIFT TREATMENT FOR TRANSFER OF QTIP LIFE INTEREST

The IRS issued final regulations that provide for "net gift" treatment on a lifetime disposition by a donee spouse of the income interest in qualified terminable interest property, meaning that the amount treated as a transfer, or the value of the gift, is reduced by the amount the donee spouse is entitled to recover under Code § 2207A(b) for the gift tax attributable to the transfer from the person receiving the property. The amount of gift tax recoverable and the value of the remainder interest transferred are determined using the interrelated computation that otherwise applies for net gift transfers under Revenue Ruling 81-223. If the donee spouse fails to exercise the right of recovery, such donee spouse is considered to make a gift in the amount of the unrecovered gift tax to the person from whom recovery could have been obtained. T.D. 9077; Treas. Reg. §§ 20.2207A-1(a)(2); 20.2207A-1(b); 25.2519-a(c)(1); 25.2519-1(c)(4); 25.2519-1(g).

19. FINAL REGULATIONS ALLOW DEDUCTION FOR CHARITABLE UNITRUST OR ANNUITY

The IRS issued final regulations allowing income, estate, and gift tax deductions for a charitable unitrust or annuity interest created after a noncharitable interest in the same trust, confirming the result in *Boeshore v. Comm*., 78 T.C. 523 (1982). Treas. Reg. §§ 1.170A-6(c)(2); 20.2055-2(e)(2); 25.2522-3(c)(2).

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