KBA Real Estate, Probate & Trust Section Newsletter

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Section President's Message

By D. Michael Dwyer
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This is our second issue of the cycle. Please review the case summaries prepared by Cal Karlin, Dan Peare and Mark Anderson.

The Section has been working on monitoring and making input to various pieces of legislation of interest to our Section. Specifically, there have been suggested changes or input to the Uniform Trust Code, the adoption of a new Durable Power of Attorney Act, the repeal of the Succession Tax, and a new Estate Tax Act. As of this writing, it appears that the new Durable Power of Attorney Act will pass the legislature. The repeal of the Succession Tax has apparently been held up by some concerns from the Department of Revenue about fiscal issues and currently this piece of legislation is in limbo. It is also reported that the amendments to the Uniform Trust Code apparently will not make it to the floor for a vote. The new Estate Tax Act has had several hearings and presently is still under consideration. If you are interested in following up on the status of any of these bills, you may access the Kansas Legislature website through www.accesskansas.org, go to the Kansas government site and then highlight the Kansas Legislature site. In addition, you may access legislative status by going to the Kansas Bar site which is www.ksbar.org and then go to the Members Only section and search under the Legislative Updates section.

In addition to the case summaries in this issue, you will also find a memo by Tim O'Sullivan regarding a case recently decided by the Supreme Court, *Miller v. SRS*, docket number 88,761, which addresses interesting issues concerning the creation of a testamentary Credit Shelter Trust and a Consent to the Will. The focus of the case deals with the impact of the Consent and the Credit Shelter Trust on a surviving spouse's ability to obtain Medicaid. This memo will serve as a basis for an Amicus Brief authorized by the KBA to be filed in support of a motion for a rehearing.

A reminder that the annual meeting for the Kansas Bar Association is June 8-10 in Wichita.

Get out and enjoy the spring weather!

Important Changes for Estate Planners to Know

By Dan C. Peare,
Hinkle Elkouri Law Firm LLC, Wichita

1. Statutory Tax Rates, Exemptions and Deductions For 2003.

The following changes affect estate planners for transfers made, and estates of decedents dying, in 2003:

(a) The gift tax annual exclusion under § 2503 of the Internal Revenue Code of 1986, as amended (the "Code") remains at $11,000 per donee.

(b) The annual exclusion for gifts to a non-citizen spouse under Code § 2523(i)(2) will be $112,000.

(c) The generation-skipping transfer tax exemp tion under Code § 2631 will be $1,120,000.

(d) The aggregate amount that special use valua tion of farm or business real estate may reduce an estate under Code § 2032(A) will be $840,000.

(e) If an estate elects to defer payment of estate taxes under § 6166, the amount of the business interest of an estate, the taxes of which are sub ject to a 2% interest rate under Code § 6601(j), will be $1,120,000.

(f) The income tax rates for taxable income of an estate or trust will be 15% for taxable income not over $1,900; 27% for taxable income over $1,900 but not over $4,500; 30% for taxable income over $4,500 but not over $6,850; 35% for taxable income over $6,850 but not over $9,350; and 38.6% for taxable income over $9,350.

(g) The highest marginal estate tax rate under the Code is 49%.

(h) The state death tax credit under Code § 2010 is reduced by 50% in 2003.

2. No Valuation Discount For Income Tax Liability of IRA.

The IRS denied a discount for estate tax purposes to reflect income taxes that will be payable by the beneficiaries upon their receipt of IRA distributions. The IRS also indicated that a lack of marketability discount was not available. TAM 200247001.

3. Distribution From Charitable Remainder Trust to Trust For Incompetent Person.

A trust may qualify as a charitable remainder trust under Code § 664 where unitrust or annuity amounts are paid to a separate trust for an individual who is "disabled," as defined in Code § 6511(h)(2)(A). The property in the recipient trust must be included in the disabled beneficiary's gross estate at death, except to the extent of any state reimbursement for governmental assistance. Rev. Rul. 2002-20, 2002-17 IRB 794.

4. Two-Life Annuity Value May Be Used to Reduce Value of GRAT Gift.

A husband and wife each created separate GRAT's, which provided for fixed annual annuity payments to be paid to the grantor, and ending 15 years later, or, if sooner, on the date of death of the grantor. If the grantor died before the end of the 15-year term, the annuity was to be paid to the spouse for the balance of the term, unless this right had been previously revoked by the grantor. If the grantor died before the end of the 15-year term, and the spouse did not survive the grantor, or the grantor had revoked the interest of the spouse, the annuity payments would cease, and the remaining GRAT property would be held in trust for the surviving spouse or for the descendants of the grantor. The Tax Court had previously held that an annuity measured by two lives was unqualified because the annuity could extend beyond the life of the termholder.

The Ninth Circuit, reversing the Tax Court, held that a two-life annuity, based on the lives of the grantor and the grantor's spouse, with a limit of 15 years, falls within the class of easily valued rights that Congress intended to qualify under Example 7 of the Regulations. *Schott v. Commissioner*, 91 AFTR 2d, 2003-915 (9th Cir. 2003).

5. Self-Canceling Installment Note Executed by Decedent's Son, a Bona-fide Transaction.

The decedent sold his restaurant and real estate properties to his son in exchange for a promissory note. A mortgage fully securing the obligation was recorded shortly thereafter. The note, which provided for payment in monthly installments over a period of 11 years, contained a cancellation- upon-death provision. The dece-

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dent's life expectancy upon the time he executed the note was between 5 and 13.9 years. The decedent's son made the first three monthly payments before the decedent's death. The estate tax return identified the note as an estate asset, but claimed that the note had no value to the estate due to the cancellation-upon-death provision. The Tax Court previously ruled that the sale was not a bona-fide transaction, that the note provided no consideration for the restaurant and properties, that the full value of the restaurant and properties, minus the three payments deposited by the decedent's son, was a taxable gift from the decedent to his son.

The Sixth Circuit reversed the Tax Court, stating that the Tax Court clearly erred in concluding that the execution of the note was not a bona-fide transaction. A note signed by family members is presumed to be a gift and not a bona-fide transaction. However, this presumption may be rebutted by an affirmative showing that there existed at the time of the transaction a real expectation of repayment and intent to enforce the collection of the indebtedness. The Court stated that the estate rebutted the presumption against the enforceability of an inter-family note by affirmatively showing that there existed at the time of the transaction a real expectation of repayment and intent to enforce the collection of the indebtedness. The case was remanded to the Tax Court for the purpose of resolving the proper value of the transferred properties and the self-canceling premium. *Costanza v. Commissioner*, 6th Cir. No. 01-2207, February 19, 2003.

6. Assets Transferred to Limited Partnership Included in Gross Estate.

A District Court has held that assets an individual transferred to a limited partnership were includable in her gross estate under Code § 2036(a) because she retained the right to the income from the property and there was no bona-fide sale for full and adequate consideration. Two months before her death, Ruth Kimbell established a Texas limited partnership and a Texas limited liability company. Ms. Kimbell retained a 99% limited partner interest in the limited partnership and a 50% interest in an LLC, which was the 1% general partner. Upon audit, the IRS found that the value of Ms. Kimbell's 99% interest in the limited partnership was $2.463 million, not $1.257 million as reported on her federal estate tax return. The Court noted that under the partnership agreement, Ms. Kimbell, as a limited partner with a 99% interest in the partnership, could, at any time, remove the general partner and either appoint herself or someone else of her choosing to be the new general partner, who could then distribute the income back to Ms. Kimbell. Thus, Mrs. Kimbell retained the right to the income from the property. *Kimbell v. U.S.*, 91 AFTR 2nd 2003-585 (ND Tex. January 15, 2003).

7. Non-Qualifying Marital Deduction Gift Subject to Gift Taxes, Despite Lack of Donative Intent.

The Tenth Circuit held that a gift to a qualified terminal interest property trust for which no timely election was made to deduct the gift was subject to federal gift tax. The donor argued that the transfer was incomplete under state law because it lacked donative intent. The Court refused to allow this argument. *Wells Fargo Bank of New Mexico, N.A. v. U.S.*, 91 AFTR 2nd 2003-857 (10th Cir. 2003).

8. Estate May Not Deduct Payments to Charity Made as Part of Settlement of Will Contest.

The IRS stated that a decedent's estate could not deduct amounts passing to a qualified charity as a result of a settlement of litigation contesting the decedent' will, because only one of the decedent's last seven (7) wills and codicils had left anything to the charity. PLR 200306002.

9. IRS Rejects Formula Gift Valuation Clause.

The IRS has refused to give weight to a clause in a sales agreement that purported to transfer a percentage of partnership interest equal to a specific value. The donor first gave a 0.1% limited partnership interest to a trust for his children and then sold to the trust an additional amount of limited partnership interest equal to a specific dollar amount. The IRS stated that such clauses will be ignored in determining the amount of a taxable gift because enforcing them would violate the public policy by rendering audits and cases irrelevant. TAM 200245053.

10. Estate Denied Discount for Lack of Marketability for Income Taxes Due on Interest that Accrued on Series E U.S. Savings Bonds.

Decedent held Series E U.S. Savings Bonds in his name. Decedent died and the date of death value of the bonds was the purchase price and accrued interest on the bonds from the date of purchase. On a supplemental estate tax return, the decedent's personal representative included an amount in the decedent's gross estate, representing the date of death value minus a discount for lack of marketability. The National Office advised that in determining the fair market value of the bonds for estate tax purposes, the estate should not calculate a discount for lack of marketability for the income taxes due on the interest that accrued on the bonds from the date of purchase. The National Office concluded that Series E Savings Bonds are includable in the gross estate at their redemption value. The National Office stated that Rev. Rul. 55-278 does not contravene the definition of the willing buyer-willing seller test. The National Office stated that the hypothetical willing buyer in this case would not take the seller's income tax liability into consideration in determining the purchase price of the bonds because the only willing buyer was the U.S. Government. TAM 200303010.

11. IRS Issue Final Regulations Regarding Qualified Revocable Trust.

Final Regulations were issued expanding the definition, scope and usefulness of qualified revocable trusts (QRT's). When an estate and a QRT make a Code § 645 election, the trust is treated and taxed as part of the estate during the election period. This allows the trust to take advantage of favorable tax treatment. Traditionally, the IRS has narrowly defined a QRT. If a decedent could only exercise a power with the approval of a non-adverse party, the trust was not a QRT. The final Regulations take a more flexible approach. A power, exercisable by the decedent with the approval of a non-adverse party, does not prevent the trust from being treated as a QRT. Under earlier Regulations, a QRT also had to be a domestic trust and the election had to be made under a domestic estate. The IRS jettisoned the domestic trust and estate requirements. The final Regulations also clarified when to file Form 1041 for the estate. The election period ends on the earlier of the date on which the trust and estate have distributed all of their assets or the day before the "applicable date." T.D. 9032.

12. Proposed Regulations on Split Dollar Life Insurance Arrangements.

New Regulations regarding the taxation of split dollar life insurance arrangements are broadly construed. A split dollar life insurance arrangement is any arrangement between an owner and a non-owner of a life insurance contract where one party pays all or any portion of the premiums on the life insurance contract and is entitled to recover those premiums from the proceeds of the life insurance contract.

The proposed Regulations provide two mutually exclusive tax regimes, namely, an economic benefit regime and a loan regime. Under the economic benefit regime, the owner of the life insurance contract is treated as providing economic benefits to the non-owner of the contract. The economic benefit regime generally will govern the taxation of endorsement agreements.

Under the loan regime, the non-owner of the life insurance contract is treated as loaning premium payments to the owner of the contract. Except for specified arrangements, the loan regime applies to any split dollar agreement. The loan regime generally will govern the taxation of collateral assignment agreements. The proposed Regulations will apply not only in the employer-employee context, but also in company-shareholder and donor-donee situations. Positions taken in the proposed Regulations (including changes made in Notice 2002-8) are as follows:

1. The equity will be taxed annually, whereas Notice 2002-8 provided that it would not be taxed until the termination of the split dollar arrangement;
2. Any amount paid by the non-owner to the owner for the economic benefit provided to the non-owner is included in the owner's income without any deduction for such bene fit;
3. Premiums paid by a non-owner are not added to his basis in the contract, except where the policy is later transferred to the non-owner;
4. Any amount received during the life of the insured from the policy by a non-owner is taxed with an offset for amounts paid to keep in-force his interest in the policy in excess of amounts paid for insurance protection; and

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5. Code § 101 protects amounts received at the death of the insured by a beneficiary other than the owner only to the extent such amounts are allocable to current life insurance protection (not the equity portion of the death benefit). Significant changes in final regulations are expected. Reg. 164754-01 IRB 2002-30.

13. Reg. Invalidated Regarding No Deduction for Charitable Unitrust Interest Proceeded by a Non-charitable Interest.

Proposed Regulations have been issued under Code §§ 170, 2055 and 2522 that conform with Estate of Boeshore, 78 T.C. 523 (1982). In Boeshore, the decedent transferred the residue of her estate to a charitable remainder unitrust. Under the terms of the trust, a 60% unitrust amount was to be paid annually from the trust. During the life of the decedent's surviving spouse, 70% of the distribution was to be paid to the surviving spouse and the remaining 30% to the decedent's daughter and two grandchildren. Upon the surviving spouse's death, 58% of the unitrust amount was to be paid to the decedent's daughter and two grandchildren for their lives, and the remaining 42% was to be paid to a qualifying charity. Upon the death of the last to die of the four individuals, the remainder interest was to be paid to a charity. The decedent's estate claimed an estate tax charitable deduction for the present values of the charitable remainder interest and the charitable unitrust interest that was to begin upon the spouse's death.

Under Regulation Section 20.2055-2(e)(2)(vi)(e), the IRS disallowed the deduction for the present value of the charitable unitrust interest, because it was preceded by a non-charitable unitrust interest. Since all the non-remainder interest in the Boeshore trust, both charitable and non-charitable, were in the form of unitrust interests, the IRS stated that any incentive to manipulate the income interest was removed. Under the circumstances, the Court was unable to find any Congressional intent to preclude a charitable deduction for an otherwise qualified charitable unitrust interest. Accordingly, the Court held Regulation Section 20.2055-2(e)(2)(vi)(e) invalid insofar as the Regulation disallowed a deduction for the charitable unitrust interest under the facts presented. Reg. 115781-01, IRB 2002-33.

14. Minority Discount Applicable to 50% Partnership Interest, But Denied on Facts.

This case involves the estate tax valuation of a 50% interest in five general partnerships. The Tax Court rejected a lack of control discount and the estate appealed to the Fourth Circuit. The estate argued that a minority interest discount was required because the decedent could not compel liquidation or make any "major decision" without the affirmative vote of 75% of the partnership shares. The Fourth Circuit agreed that a minority discount is appropriate where a partner does not enjoy the variety of rights associated with control. However, based upon the facts present in this case, the Court held that there was little to be gained by having control of these partnerships and no risk in holding a minority interest. Given the passive nature and the almost certain prospect of steady above-market rents, the Court reasoned this would make it unlikely an investor would desire to liquidate or withdraw from the partnership. In short, the Court stated that the rights given to the decedent under the partnership agreements, including the right to receive an annual distribution of income, and the likelihood of future profits, negated any additional discount for a partner's inability to compel liquidation or withdraw from the partnership. *Estate of Fred O. Godley*, 286 F.3d 210 (4th Cir. 2002).

15. Birfurcation of Controlled Stock Under Co-sections 2033 and 2041.

The issue in this case was whether property included in a decedent's gross estate under Code §§ 2033 and 2041 should be merged for valuation purposes. Property in which a surviving spouse had a life interest was included in the surviving spouse's estate under Code § 2056(b)(5), providing the surviving spouse with a general power of appointment relating to such property. Code § 2041(a) generally requires that the value of all property over which the decedent at death possesses a general power of appointment be included in such person's estate.

The Tax Court held that separate property interests under §§ 2033 and 2041 should be merged for valuation purposes because a general power of appointment is viewed as essentially identical to outright ownership of property. The Tax Court cited legislative history in stating that "the possessor of the power has full authority to dispose of the property at his death, and there seems to be no reason why the privilege which he exercises should not be taxed in the same degree as the other property over which he exercises the same authority." *Estate of Fontana v. Commissioner*, 118 T.C. 318 (2002). Contrast, *Estate of Mellinger v. Commissioner*, 112 T.C. 26 (1999), wherein the Tax Court held § 2044 property pursuant to a QTIP trust not be aggregated with other property in the surviving spouse's gross estate for valuation purposes, because the surviving spouse does not have any power of disposition over QTIP property.

16. Tax Affecting Subchapter S Corporation Cashflows Denied.

This case involved the valuation of a controlling interest in a Subchapter S corporation that was a small insurance agency in western North Carolina. The estate's valuation expert argued that the prospective net cashflows of the corporation are before corporate tax, and a hypothetical corporate tax should be applied to measure the value of the corporation. The Court held that the estate's expert improperly tax-affected the cashflows of the company in its valuation, holding that it is appropriate to use a zero corporate tax rate to estimate net cashflows when the stock being valued is stock of an S corporation. The result here of a zero corporate tax on estimated prospective cashflows and no conversion of the capitalization rate from after-corporate tax to before-corporate tax is identical to the result in *Gross v. Commissioner*, T.C. Memo. 1999-254, aff'd 272 F.3d 333 (6th Cir. 2001); *Estate of William G. Adams, Jr.*, T.C. Memo. 2002-80 (2002).

KBA CLE Calendar

APRIL

18 — **Annual Criminal Law Institute**
Topeka — Capitol Plaza Hotel
6.0 hours CLE, including 1.0 hour professional responsibility credit

25 — **Litigation All-Stars**
Wichita — Hyatt
7.0 hours CLE, including 1.0 hour professional responsibility credit

26 — **Juvenile Law Video Cast**
20 sites across the state
4.0 hours CLE, including 1.0 hour professional responsibility credit

MAY

2 — **Workers Compensation**
Wichita — Hyatt Regency
6.0 hours CLE, including 1.0 hour professional responsibility credit

2 — **Construction Law**
Overland Park — Doubletree
6.0 hours CLE, including 1.0 hour professional responsibility credit

9 — **Views from the Federal Bench: Technology in the Courts (morning)**
Kansas City, Mo. — Downtown Doubletree
3.0 hours CLE, including 1.0 hour professional responsibility credit
Ethics Jeopardy (afternoon)
3.0 hours CLE, including 3.0 hour professional responsibility credit

23 — **Intellectual Property Institute**
Overland Park — Ritz Charles
6.0 hours CLE, including 1.0 hour professional responsibility credit

30 — **Insurance Law Institute**
Overland Park — Marriott
6.0 hours CLE, including 1.0 hour professional responsibility credit

JUNE

7 — **Estate Planning**
Wichita — Hyatt
8.0 hours CLE, including 1.0 hour professional responsibility credit

8-10 — **KBA Annual Meeting**
Wichita — Hyatt
12.0 hours CLE, including 2.0 hour professional responsibility credit

13 — **Legislative and Case Law Institute, Sessions I & II**
Topeka — Overland Park — Wichita
8.0 hours CLE, including 2.0 hour professional responsibility credit

For more information or to register, please call the KBA at (785) 234-5696 or check out the KBA website for a complete listing **www.ksbar.org**

By Calvin J. Karlin
Barber, Emerson, Springer, Zinn & Murray, L.C., Lawrence

IN THE MATTER OF THE ESTATE OF LUCY G. PETESCH, DECEASED
62 P. 3d 674
(February 7, 2003)

The executor of a farm estate of less than $75,000.00 sought $29,034.31 in executor's fees and expenses. The executor sought $15 per hour for 982 hours, mileage reimbursement for 7,710 miles at 32¢ per mile and interest on the executor's advances to the estate. The executor also sought his attorney fees on appeal.

The trial court found the hourly rate of $15 to be reasonable but indicated that after the farm was sold the executor had no need to make daily trips there. The trial court reduced the executor's total reimbursement to $11,115.96, which the Court of Appeals noted still exceeds 10% of the total estate.

The executor argued that K.S.A. 59-2249 obligates the court to award all requested fees and expenses. The Court of Appeals cited K.S.A. 59-1717 to the effect that fiduciary compensation must be "just and reasonable".

The executor also sought reimbursement for dog and cat food purchases. Although the executor did not include the decedent's domestic animals in the estate inventory and valuation, the Court of Appeals acknowledged the appropriateness of this expenditure through the date of the farm's sale three months after decedent's death.

The executor personally paid certain estate expenses due to insufficient estate cash. The Court of Appeals rejected the executor's claimed 19% interest and held that he should have obtained prior court approval to self-deal and personally profit from the advancements. The Court of Appeals blamed the executor for delay in consummating the sale of the estate's cattle to his brother (by returning his brother's $14,500 check and not depositing that amount until seven months later).

Finally, the executor asserted that if the district court allowed any attorney fees then his fees on appeal also must be allowed. The Court of Appeals rejected this position and indicated that the appeal was pursued for the executor's personal benefit not for the benefit of the decedent's estate.

The Court of Appeals reiterated the statement from *In re Estate of Eyth*, 157 Kan. 268, 139 P.2d 378 (1943) that the determination of a reasonable fee "rests largely in the sound discretion of the trial court." The scope of appellate review is "limited to determining whether the trial court abused its discretion, i.e., whether the decision was arbitrary, fanciful or unreasonable." The executor's uncontested appeal was denied.

IN THE MATTER OF DAVID L. POLSLEY
61 P.3d 715
(January 24, 2003)

Attorney David L. Polsley was publicly censured by the Kansas Supreme Court for filing an action against the sole heir and her attorneys for dismissing a survival action by the estate of Nancy Green against the City of Prairie Village, its Police Chief and two policemen. Since the estate of Nancy Green had sufficient assets to pay all of the estate's creditors, the effect of any recovery by the estate from its only heir would be to re-route funds from the sole heir to the estate to be reduced by Mr. Polsley's attorneys' fees and then returned (after reduction by the attorney fees) to the heir. The lawsuit was dismissed after it was determined that Nancy Green died instantaneously. The district court found that the petition against the sole heir was filed in bad faith and granted sanctions in the amount of $50,000 for the defendant's attorney fees. The Kansas Board for Discipline of Attorneys found that Mr. Polsley's claim on behalf of the estate was lacking in essential evidence and was only brought so Mr. Polsley could recover fees on any recovery.

The Kansas Supreme Court held that Mr. Polsley engaged in conduct that was "prejudicial to the administration of justice" in violation of Kansas Rule of Professional Conduct 8.4(g) and ordered that he be publically censured.

IN RE LUCAS ORVEY R. COUSATTE, ADMINISTRATOR OF THE ESTATE OF IMOGENE COLLIER V. VIOLA CAROLYN LUCAS
Bankruptcy Case No. 01-12092
Adversary No. 01-5116
(Judge Nugent, 12-5-02)

The half brother (Orvey Cousatte) of the decedent (Imogene Collier) sought to recover assets transferred to the decedent's neighbor (Viola Carolyn Lucas) as co-trustee and primary remainder beneficiary. Proceedings involving the decedent's estate have had a tortured history in Sedgwick County District Court and at least three appeals to the Kansas Court of Appeals (see the latest in the Real Estate section of this newsletter). The Bankruptcy Court was called upon to decide if the half-brother's claims against the neighbor are non-dischargeable in bankruptcy under the exceptions for fiduciary fraud, embezzlement or larceny under 11 U.S.C.§523(a)(4) or willful and malicious injury under 11 U.S.C. §523(a)(6). The Bankruptcy Court held that there was insufficient evidence by collateral estoppel from the state district court findings, or otherwise, to except the neighbor/trustee/beneficiary's debts from discharge.

IN RE NEIL LEE ROTH, SR.
Bankruptcy Case No. 01-13378
(Judge Karlin, 2-10-03)

Although property passing by "bequest, devise or inheritance" within 180 days of filing bankruptcy is property of the debtor's bankruptcy estate under 11 U.S.C. §541(a)(5)(A), property passing by an inter vivos trust was held not to be included.

The Court acknowledged that the trust was a valid spendthrift trust under 11 U.S.C.§541(c)(2) excludible under 11 U.S.C. §541(a)(1), but still had to address whether the trust property could be bankruptcy estate property under 11 U.S.C. §541(a)(5)(A).

The Chapter 7 bankruptcy trustee's motion for turnover of approximately $150,000 (which the debtor was entitled to receive from his father's living trust due to his father's death within 180 days of the bankruptcy filing) was denied.

IN RE JUDY ANN SEMMEL
Bankruptcy Case No. 01-14433
(Judge Nugent, 2-27-03)

A debtor in bankruptcy was entitled to receive income from a testamentary trust. The income interest was not subject to an express or implied spendthrift provision. The debtor disclosed the income interest in her bankruptcy schedules and claimed it exempt. The Court acknowledged that the income should not have been exempt as compensation for personal services but the bankruptcy trustee's failure to make a timely objection caused the claimed exemption to be upheld. The debtor was therefore entitled to all of the income distributions.

By Mark A. Andersen,
Barber, Emerson, Springer, Zinn & Murray, L.C., Lawrence

KANSAS COURT OF APPEALS

STATEWIDE AGENCIES, INC., V. DIGGS
Reno District Court - Reversed and Remanded with Directions
NO. 87,987 - 20 Pages - February 7, 2003
Landlord/Tenant - Conversion of Personal Property

FACTS: Debra Diggs failed to pay rent to Statewide Agencies, Inc. Statewide properly evicted Diggs and sold some of Diggs' personal property and appliances, and filed judgment for damages. Diggs counterclaimed for conversion of personal property and punitive damages. District court awarded judgment to Statewide for past rent and damages. However, the court found that although Statewide acted properly in selling Diggs' property, Statewide had wrongfully converted Diggs' property since Diggs had requested removal of her personal property the day of, and within days following, her eviction. Statewide refused unless she paid expenses and past-due rent. The court awarded damages for wrongful conversion.

ISSUE: Whether a landlord who has lawfully obtained possession of a tenant's personal property is guilty of conversion by refusing to deliver possession to the tenant without the tenant first paying landlord's expenses and past-due rent.

HELD: Trial court erred in its interpretation of K.S.A. 2001 Supp. 58-2565(d) and reversed the district court's judgment awarding Diggs damages on her conversion claim. Statewide acted properly and no conversion occurred. Statewide's judgment for past rent and damages reinstated.

STATUTES: K.S.A. 2001 Supp. 58-2565(d); K.S.A. 61-2311; K.S.A 2001 Supp. 61-3801 *et seq* 58-2567.

COUSATTE V. COLLINS
Sedgwick District Court - Reversed and Remanded
No. 88,089 - 12 Pages - January 24, 2003
Lis Pendens

FACTS: Action filed by Cousatte to quiet title in residence sold to Collins in 1999 pursuant to a trust that Cousatte challenged in 1997 and eventually found to be null and void in 2000. District court found warranty deed to Collins was void because Cousatte's 1997 petition adequately described the realty for *lis pendens* to apply, or alternatively, the mortgage company investigation title record would have discovered Cousatte's lawsuit.

ISSUES: 1) Lis Pendens, 2) Agency.

HELD: Application of *lis pendens* in Kansas requires a much more specific description of subject real estate than found in this case, where petition in pending lawsuit said only that plaintiff did not know nature of assets placed in a questioned trust. Judgment in favor of Cousatte on *lis pendens* is reversed. No facts to support holding that mortgage company acted in interest of Collins in its investigation of title. Record too thin to determine whether it acquired actual knowledge of Cousatte's pending lawsuit. Case remanded for further factual and legal development.

STATUTES: K.S.A. 60-1102, -2201(a).

IN RE ESTATE OF LASATER
Harvey District Court - Affirmed
NO. 88,218 - 4 Pages - Sept. 6, 2002
Deed - Joint Tenancy

FACTS: The trial court determined that title to Ruth Lasater's home passed to her son outside her probate estate by virtue of his right of survivorship as a joint tenant. The Estate Recovery Unit of the Department of Social and Rehabilitation Services (SRS) appealed. On September 28, 2000, Ruth I. Lasater signed a Quit Claim Deed, which transferred real estate from Ruth I. Lasater, individually, to Ruth I. Lasater and E. Bruce Lasater (her son) as joint owners. The son paid $680 or approximately 1% of the value of the property at the time of deed execution. The deed conveying these interests reads: *"It is the intent of the grantor that as a result of such conveyance the ownership interest in the above-described property of Grantee, RUTH I. LASATER, shall be ninety-nine percent (99%) and the ownership interst [sic] in the above-described property of the other grantee, E. BRUCE LASATER, shall be one percent (1%). Such ownership interests shall govern all aspect [sic] of the joint tenancy ownership of the Grantees in said property, including but not limited to, right to income and ownership rights upon any later sale of, or partition or severance of such joint tenancy ownership interest in said property. This recitation of intent shall be interpreted so as to conclusively rebut any presumption under the law of equal joint tenancy ownership by the Grantees in the aforesaid property. Such recitation shall not be interpreted, however, in a manner which would defeat the survivorship rights of the surviving joint tenant to succeed to a predeceased joint tenant's ownership interest in said property."*

ISSUES: Grantor's intention to create a joint tenancy.

HELD: SRS claims Ruth's intent to create a joint tenancy was insufficiently clear to satisfy statutory requirements, and that her interest in the home should have been administered in her estate subject to the claims of creditors, rather than passing directly to her son outside of probate. Further, SRS claims her deed created different percentage interests in Ruth and her son, violating the unity of interest required of joint tenants. Due to these alleged flaws, SRS claims Ruth created a tenancy in common. The court found that the quitclaim deed of September 28, 2000, established a joint tenancy with right of survivorship, and the title to Ruth's home passed to her son as surviving joint tenant at the time of her death. The deed's grant language is more consistent with a tenancy in common. Ruth failed to use the "magic words" for the usual creation of a joint tenancy. However, the habendum language of the deed is sufficiently clear to construe her intent to create a joint tenancy with the right of survivorship. Further, Ruth's deed satisfied the "four unities" doctrine. Ruth created a joint tenancy with right of survivorship between herself and her son.

STATUTES: K.S.A. 58-501.

FEDERAL COURT OPINIONS

INDY LUBE INVESTMENTS, L.L.C. V. WAL-MART STORES, INC.
199 F.Supp2d (D. Kan. 2002) - Motions Granted in Part, Denied in Part

Seller's Alleged Misrepresentation to Buyer

FACTS: This case arises from a failed commercial real estate transaction. It involves common law contract and tort claims. Wal-Mart agreed to sell Indy Lube some Garden City real estate. Wal-Mart did not own fee simple to all of the real estate, but claimed to have the contractual right to purchase the remainder pursuant to Wal-Mart's agreement with the fee owner. The fee owner subsequently informed Wal-Mart that it would not honor its contract with Wal-Mart. Wal-Mart determined it would be cheaper for Wal-Mart to breach the Indy Lube contract and, instead, negotiate a lease buyout with the fee owner. Wal-Mart sent a letter to Indy Lube terminating their contract.

ISSUES: Claims against Wal-Mart include breach of contract, negligent misrepresentation, civil conspiracy, and fraud. Claims against the fee owner include civil conspiracy, interference with contract, breach of contract as third-party beneficiary, and fraud.

HELP: On defendants' motions to dismiss, the District Court held that (1) seller did not commit fraud, (2) buyer adequately pled claim for tortious interference with contract, and (3) buyer was not intended beneficiary of real estate purchase agreement between Wal-Mart and the fee owner.

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IN RE GINTHER
282 Bankr. 16 (D. Kan. 2002) - Sustained
Kansas Homestead Exemption

FACTS: The debtors sought to exempt proceeds from the sale of their Kansas homestead, which they intended to reinvest in Colorado real estate. The chapter 7 trustee objected to the Kansas homestead exemption claimed by the debtors in proceeds from the sale of their residence prior to relocating to Colorado. The trustee claimed that Kansas does not recognize an extraterritorial homestead. This is an issue of first impression in Kansas.

ISSUES: Whether the Kansas homestead exemption applies when a debtor intends to reinvest the Kansas homestead proceeds in real estate outside of Kansas.

HELP: Under Kansas law, proceeds from sale of Kansas homestead, which are designed in good faith to be reinvested in another homestead within a reasonable time, are exempt from any and all processes invitum. The Bankruptcy Court ruled that while, as a general rule of Kansas law, the debtors will be entitled to homestead exemption in proceeds from sale of Kansas homestead, as long as the debtors intend in good faith to reinvest proceeds in another homestead within reasonable time, the new homestead in which debtors intend to reinvest proceeds must be one which is located in Kansas. Where the debtors had no intention, following the sale of their Kansas homestead, to again take up residence in Kansas but admittedly held proceeds for reinvestment in Colorado homestead, proceeds were not exempt under Kansas homestead exemption law, which had effect only in Kansas.

STATUTES: K.S.A. Const. Art. 15, Section 9; K.S.A. 60-2301.

MISCELLANEOUS

WEST V. EVERGREEN HIGHLANDS ASSN.
55 P.3d 151 (Cert. Granted Sept. 23, 2002)
Colorado Court of Appeals, Div. 1

Homeowners Restrictive Covenants

FACTS: This Colorado opinion is of general interest to anyone drafting restrictive covenants. A subdivision lot owner sought a declaration that an amendment to restrictive covenants was invalid. The covenants stated that the owners of seventy-five percent of the lots which are subject to these covenants *"may change or modify any one or more of said restrictions."* Several years after plaintiff purchased his lot the Homeowner's Association ("**HOA**") recorded an amendment to the covenants, which was signed by seventy-five percent of the subdivision lot owners, but not by plaintiff. This amendment purported to add a new article requiring all lot owners in the subdivision to be members and pay dues to the HOA, and subject the subdivision lots to liens for nonpayment of dues.

ISSUES: Interpretation of restriction covenants.

HELD: Any doubt relative to the meaning and application of the covenant must be resolved in favor of the unrestricted use of property. The court held that the amendment provision only allows changes to the existing covenants, not the creation and addition of new covenants that have no relation to the existing covenants. To authorize a new covenant not contemplated in the original restrictive covenants, the amendment language should have provided something to the effect that the covenants could be *"waived, abandoned, terminated, modified, altered or changed."* The actual revision language contained in the covenants was too narrow to contemplate the addition of new matters that had no relation to the existing covenants.

REVENUE RULING 2002-83
Internal Revenue Service
Related Party Like-Kind Exchanges

FACTS: Under the facts described, a taxpayer who transfers relinquished property to a qualified intermediary in exchange for replacement property formerly owned by a related party is not entitled to nonrecognition treatment under section 1031(a) of the Code if, as part of the transaction, the related party receives cash or other non-like-kind property for the replacement property.

ISSUES: Acquisition of replacement property from a related party.

HELD: With this Revenue Ruling, the IRS has effectively ruled on the practice of basis shifting between related parties. Section 1031(f) of the IRC is intended to deny nonrecognition treatment for transactions in which related parties make like-kind exchanges of high basis property for low basis property in anticipation of the sale of the low basis property. In ruling that section 1031(f)(4) applied to the transaction, the IRS applied the step transaction doctrine's end result test. The end result of the transaction is the same as if the taxpayer had exchanged property with the related party followed by a sale from the related party to an unrelated party. This series of transactions allow the taxpayer to effectively cash out of the investment without the recognition of gain. Therefore, the nonrecognition provisions of section 1031 do not apply to the exchange under the facts described.

COMMENT: Notwithstanding the effect of this recent Revenue Ruling, a taxpayer may be able to structure a partial nonrecognition build-to-suit exchange involving a related party's existing land. A taxpayer may choose to structure a build-to-suit exchange while the related party is the beneficial owner of the land on which improvements will be constructed, utilizing only the value of the new improvements as replacement property. First, the taxpayer must ensure that the related party constructs the improvements in contemplation of the exchange, so that there is no basis shifting or cashing out with respect to the new improvements. Second, the taxpayer must bifurcate the transaction in order to exclude the value of the underlying land to be acquired from the related party, and only include the value of the new improvements to be constructed as replacement property. If the taxpayer can establish these two elements, the gain triggered under section 1031(f) should apply only to the value of the underlying land acquired from the related party before the exchange was arranged, and not to the value of the new improvements constructed as replacement property in contemplation of the exchange.

TO: KBA Real Property, Probate and Trust Section

FROM: Timothy P. O'Sullivan for the Executive Committee

DATE: March 31, 2003

RE: *Miller v. SRS* (No. 88,761 dated March 7, 2003)

In a decision of first impression that left many Kansas estate planners' jaws agape, the Kansas Supreme Court has reversed a Sedgwick County district court decision and determined that a surviving spouse's failure in 1995 to exercise an elective-share right she no longer possessed (due to having consented to her husband's will in 1978) nonetheless constituted a transfer for Medicaid purposes by her of such deemed elective-share amount to the testamentary trust her husband created for her under the terms of his will. The legal consequence of this "deemed transfer" was that the phantom elective-share portion of the testamentary trust thereby constituted a Medicaid Qualifying Trust and thus an available resource to her for Medicaid purposes to the extent the Trustee had any discretion to distribute trust assets for her benefit.

The term "Medicaid Qualifying Trust" was given to most types of self-settled trusts and trusts created by the spouse of a beneficiary (except by will) under 1986 federal legislation. The assets of Medicaid Qualifying Trusts were statutorily considered to be a resource to a trust beneficiary to the full extent the trustee had any discretion to distribute assets to the trust beneficiary under the provisions of the instrument. The term was somewhat misleading, as meeting the requirements of a Medicaid Qualifying Trust meant that the deemed availability of trust resources disqualified the beneficiary from Medicaid benefits. Although conceptually unchanged by 1993 federal legislation, proscribed self-settled trusts under the 1993 legislation were no longer given a moniker. Despite such omission, for convenience purposes such term as used in this Memo will reference such types of trusts.

In the absence of such deemed transfer by the surviving spouse of her assets to her husband's testamentary trust, applicable provisions of federal law allowing testamentary trusts to be created for a surviving spouse would have required SRS to honor the discretionary nature of distributions of trust principal under the provisions of the testamentary trust for the surviving spouse's "care, support, health and well-being." Thus, SRS would have otherwise been precluded from considering the assets in her husband's testamentary trust in determining her Medicaid eligibility.

The Executive Committee of the KBA Real Property, Probate & Trust Section (the "Committee") has unanimously concluded that the Court erred in that determination.

DID THE SPOUSE MAKE A TRANSFER TO A TRUST FOR HER BENEFIT?

Such determination first required the Court to conclude that the passive act of not exercising an elective-share right was statutorily equivalent to a transfer by the surviving spouse to a testamentary trust that received the predeceased spouse's property subject to the elective-share. In support of its decision, the Court relies on judicial decisions in two states, Wisconsin and New York, which, following a rather abbreviated analysis, determined that the failure of a surviving spouse to assert elective-share rights is functionally indistinguishable from transfers or disclaimers of property rights which are statutorily deemed to be transfers for Medicaid purposes. Consequently, such deemed transfers would result in a disqualification period. None of those decisions involved a determination that a surviving spouse's failure to exercise an elective-share right resulted in the creation of a self-settled trust for the surviving spouse's benefit. Although the Court states that a treatise, *Advising the Elderly or Disabled Client*, is in agreement with its position, it is difficult to discern how the Court came to that conclusion. The position of the treatise italicized by the Court providing that "[A]n applicant is considered to have established a trust whenever the applicant's assets were used to fund the all or part of the Trust" merely paraphrases the governing Medicaid statute as to what constitutes a self-settled trust. There is no conclusion therein that a barred elective share right would constitute property of the surviving spouse, let alone that the failure to exercise an elective share right constitutes the establishment of a self-settled trust by the surviving spouse. As such, quoting that treatise appears to simply beg the issue and furnish no more support for the Court's position than the underlying statute the Court was required to construe. Moreover, the non-italicized quoted portion of the treatise specifically notes the statutory exception from self-settled trust treatment for trusts created by wills.

This issue in *Miller* is directly analogous to that which arises in other areas of the law when an individual fails to exercise a property right, e.g., a right to withdraw assets from a trust and such right under the terms of the trust lapses if not exercised within a stated time period. Such withdrawal rights are termed general powers of appointment under federal transfer tax law (e.g., gift and estate tax purposes). Debtor/creditor law and transfer tax law are equally harsh in their treatment of self-settled trusts. In such situation, the trust assets normally will remain exposed to the claims of the settlor's creditors and the trust assets will also be includible in the settlor's taxable estate. The public policy interest in such situations in protecting creditor claims and ensuring transfer taxation would appear to be quite similar to those applicable under the Medicaid statues. The analogous issue in these similar contexts is whether the lapse of the withdrawal right results in a "deemed transfer" such that the amount of trust assets previously subject to such power would constitute a self-settled trust following the lapse.

With respect to the lapse of a withdrawal right in the debtor/creditor context, a literal reading of most state statutes addressing this issue, including K.S.A. 33-101 (which it should be noted was not modified despite Kansas' enactment in 2002 of provisions of the Uniform Trust Code which specifically provide for self-settled trust status with regard to certain lapses of withdrawal rights), would seem to require an affirmative act (such as a disclaimer) rather than a passive act (such as a failure to make an elective-share) to create a self-settled trust. There certainly are legitimate policy reasons for not deviating from a "plain meaning" construction of such statutory provisions. The interest created by a general power of appointment is created by a person other than the power holder with property other than that owned by the power holder. Consequently, the lapse of withdrawal right is simply not the same circumstance from a public policy perspective as an individual transferring an outright ownership in property to an irrevocable trust while retaining the benefits of the property as a beneficiary under the provision of the trust. In addition, adverse consequences could ensue on the part of a withdrawal right power holder who was unaware of such power or simply failed to take the steps legally necessary to exercise such right. Given the high frequency of withdrawal rights given under trust provisions, one would certainly expect there to be a substantial body of case law with respect to this issue if there was a reasonably arguable position that the failure to exercise a withdrawal right in a trust is tantamount to a transfer to the trust. Nonetheless, absent a statutory provision which specifically provides for self-settled trust treatment with respect to trust property subject to a lapsed withdrawal right (such as under the UTC with certain exceptions), there appears to be a paucity of judicial support for the position under debtor/creditor law that the lapse of a withdrawal right is legally tantamount to the transfer of the property previously subject to the withdrawal right to a self-settled trust.

In the federal gift and estate tax context, Congress specifically provided that certain lapses of general powers of appointment are to be treat-

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ed in the same manner as actual transfers of property. Had that concept already been included in the concept of a transfer, such additional statutory provisions would have been unnecessary. Even with such specific provisions applicable to lapses of general powers of appointment, the Committee is unaware of any substantive case law finding that the failure of a surviving spouse to exercise an elective-share right constitutes a gift for federal gift tax purposes. No similar provisions are found under the Medicaid statutes.

It is interesting to note that even when legislation has been enacted which specifically treats the lapse of withdrawal rights or general powers of appointment as transfers (such as under the UTC and federal transfer tax statutes), exceptions normally have been included. Nonetheless, the Court, in substantially departing from the plain meaning of the Medicaid statutes in determining that Congress intended for the lapse of a property right to be treated in the same manner as a transfer, had to have further assumed that Congress did not intend for there to be any exceptions to such treatment.

Consequently, *Miller* appears to have relied on rather tenuous judicial support in concluding that the failure to exercise a spousal elective-share right is tantamount to a transfer resulting in the creation of a self-settled trust for Medicaid purposes. Not following the plain meaning of the Medicaid statutes at issue would only appear to be warranted under the rules of statutory construction if there was either an evinced legislative intent to the contrary (e.g., Committee Reports) or following the literal wording of the statutes would lead to irrational or unreasonable results. The Committee Report cited in *Miller* in support of its position does not merit a departure from a "plain meaning" construction. It clearly relates only to self-settled trusts created to enable an "affluent" settlor to qualify for Medicaid. The Court also based its determination of legislative intent on federal statutory enactments in 1986 and 1993 designed to restrict the types of trusts, primarily self-settled trusts, the assets of which would otherwise have been precluded from being considered a resource for Medicaid purposes. Although these statutes do not address the issue of the failure to exercise an elective-share right or the effect of a consent barring such election, nor do they envelop most third party created trusts, the Court relied on the constraining tenor of these enactments and the general public purpose of Medicaid benefits in providing for the "truly needy" in justifying its failure to follow the plain meaning of the governing statutes.

The obvious problem with the Court's rationale is that it would be equally applicable to all "third party" discretionary or "supplemental needs" trusts, the vast majority of which remain statutorily sanctioned under Medicaid law. The Court's statement that finding that the *Miller* trust was not a resource to the surviving spouse would mean that Mrs. *Miller* "could have her cake and eat it too" is not relevant and could similarly be said with respect to all third party discretionary or "supplemental needs" trusts. The same could be said for the Court's statement that Medicaid is for the "truly needy." Equally of no relevance is the Court's statement that its interpretation "reduces the temptation of her [Mrs. Miller's] daughter to make her slice of the cake larger at the expense of taxpayers."

The fact is Congress has already established public policy in sanctioning the legitimacy of most third party created discretionary and "supplemental needs" trusts. It would appear that the sole issue for the *Miller* Court to determine with respect to the Medicaid resource issue was whether a Medicaid recipient has created a self-settled trust by failing to exercise a legally barred statutory elective-share with respect to assets that were placed in a trust for her benefit under the provisions of her husband's will.

The strong tenor of the Court's opinion might easily lead the uninitiated to conclude that Congress intended to require the assets of all discretionary or "supplemental needs" trusts, such as the testamentary trust at issue, to be considered an available resource to trust beneficiaries. The Court's citing of judicial decisions for the position that the 1986 amendment was designed to protect "anyone, regardless of affluence, from gaining eligibility by placing assets in a trust that might eventually fall to the settlor's heirs," would do little to dissuade one from this perspective. However, such amendments were primarily addressed at self-settled trusts, and not trusts created by third parties, even though the heirs of the settlor may have a beneficial interest in such trusts. The Court in *Myers v. SRS*, 254 Kan. 467 (1993) and the Kansas Court of Appeals in *Simpson v. SRS*, 21 Kan. App. 2d 680(1995), both cited in *Miller*, realized the limitations in using public policy arguments to construe Medicaid statutory provisions affecting trusts in stating that public policy does not override the intent of a settlor of a discretionary trust and that there is no judicial disposition to disallow the use of discretionary trusts as a matter of public policy. However, the tenor of the Court in *Miller* does not appear to be similarly trammeled.

The Court also failed to give proper deference to other truly appropriate public policy considerations. If public policy could somehow demand that statutory provisions be construed in a manner which would subject all beneficial interests in trusts which could provide for support and maintenance needs of a beneficiary to being considered a resource for Medicaid purposes, a significant percentage of settlors and testators would simply decide to disinherit disabled beneficiaries rather than leave assets in a "supplemental needs" trust. This would not only be contrary to the public purpose of permitting a settlor or testator to be able to determine the purposes for which the assets they place in trust are to be expended for other persons, it would require the government to satisfy all needs of disinherited disabled persons. These undoubtedly are precisely the public policy reasons most discretionary and "supplemental needs" trusts remain statutorily sanctioned despite the 1986 and 1993 federal Medicaid enactments.

The Court's statement in support of its public policy rationale that the "Granny Goes to Jail" law and its successor, "Send Granny's Adviser to Jail" law (which the Court did not note has been judicially determined to be unconstitutional), demonstrated Congress' strong feeling "about trusts harmful to Medicaid" is incorrect. Such laws instead principally addressed transfers of property to third parties other than a spouse which result in a disqualifying period for Medicaid qualification purposes. Consequently, rather than accurately reflecting the mood of Congress, one might more readily conclude that such statement reflects the Court's palpable uneasy accommodation with statutory precepts sanctioning the use of discretionary and "supplemental needs" trusts.

In support of its position that the Court's construction of the governing Medicaid statutes is logical and reasonable, the Court appears to have "bootstrapped" this conclusion substantially to its public policy rationale. However, there appear to be a myriad of unreasonable consequences that would result from the Court's construction of the Medicaid provisions at issue.

Assume that a predeceased spouse leaves all of his or her assets in a discretionary "supplemental needs" trust for the health, education, support and maintenance needs of his or her surviving spouse. Due to an understandable concern that a non-consenting spouse would actually exercise such elective-share rights, the trust provisions further provide that a surviving spouse's exercise of the elective-share claim will result in the termination of the surviving spouse's discretionary distribution rights with respect to all remaining assets not needed to satisfy such claim. Under Kansas' elective-share law, the maximum amount of the augmented estate to which a surviving spouse is entitled is 50% of the augmented estate (which occurs upon the completion of 15 years of marriage), reduced (depending upon the term of the marriage) by a percentage of the surviving spouse's property. The first problem would be determining whether the discretionary distribution rights would reduce the elective-share amount. If so, the value of the discretionary interest might fully offset the elective-share right, thereby, despite *Miller*, precluding any trust assets from being considered a resource for Medicaid purposes. If not based on

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the rationale that any amount attributable to such discretionary interest would be purely speculative (albeit enforceable by the beneficiary), and further assuming that the surviving spouse's property is less than that of the predeceased spouse such that there is a significant elective-share amount, *Miller* would deem the elective-share portion to be a self-settled trust. That result would ensue even though had that elective-share right been enforced, the surviving spouse would have thereby given up the discretionary distribution rights to the entire remaining portion of the trust. In short, the surviving spouse would be deemed to have exercised an elective-share right which in a high percentage of circumstances would have been economically inadvisable and which would have resulted in a substantial reduction in the amount of trust assets available to satisfy the surviving spouse's needs.

Similar irrational results would occur in situations in which a predeceased spouse created a testamentary trust for a surviving spouse who at the time of the predeceased spouse's death had no foreseeable need for long term care. Many testamentary trusts are created to achieve other estate planning objectives, e.g., property management, death and income tax reduction, and creditor protection. In those circumstances, surviving spouses would jeopardize such benefits by exercising any elective-share rights. Should a surviving spouse decide to not enforce any such rights and need long term care many years later, despite the absence of Medicaid considerations in the estate planning process, the *Miller* rationale would require that the surviving spouse nonetheless be deemed to have created a self-settled trust at the time of the surviving spouse's death. Although the 1993 amendments made no exception to Medicaid Qualifying Trust status based upon the purpose for which it was created, no public purpose would appear to be furthered in going beyond the plain meaning of the Medicaid provisions in these types of circumstances. In addition to the seeming incongruity of this result, the task of determining what would have been the elective-share amount many years previously in the absence of adequate financial records would not only be daunting, it would be frequently irresolvable.

The effect of *Miller* is to force a surviving spouse, irrespective of any foreseeable need for long term care, to choose between what *Miller* has determined to be immiscible estate planning objectives. One option would be for a surviving spouse to forego the exercise of an elective-share right. Although this would permit the full attainment of beneficial non-Medicaid estate planning objectives of a predeceased spouse, it would compromise trust assets from being excluded as a resource with respect to any subsequent Medicaid eligibility. Alternatively, the surviving spouse could decide to compromise other beneficial estate planning objectives by choosing to exercise an elective-share right solely for Medicaid purposes, i.e., to establish the amount of the elective-share right with some degree of certainty if needed at some future date and provide greater flexibility in implementing other appropriate and statutorily authorized Medicaid planning strategies (e.g., gifting and converting non-exempt resources into exempt resources) by virtue of having outright ownership of elective-share property. Even should a surviving spouse decide to exercise an elective-share right, nothing under the *Miller* rationale would prevent SRS from challenging the calculation of such elective-share amount at any future time.

There is also a logistical trust administration problem resulting from the *Miller* rationale. If the surviving spouse is deemed to have transferred assets to the predeceased spouse's testamentary trust by virtue of a failure to exercise an elective-share, would not a proportional amount of the testamentary trust equal to the portion of the trust represented by the deemed transfer constitute the self-settled trust portion of the trust? As there is only a single testamentary trust, trust law principles would suggest that this inquiry be answered in the affirmative. If so, the entire trust would have to be spent down to zero prior to the surviving spouse qualifying for Medicaid. This would put the surviving spouse in a worse position than had the elective-share right actually been exercised. Alternatively, even if each distribution for the benefit of the surviving spouse could legally be deemed to be solely from the self-settled portion under some type of "LIFO" method, would not the trust assets need to be revalued periodically to take into account trust earnings, as well as gains and losses, in order to properly determine the changing amount of the self-settled portion?

The Court's position that the failure to make an elective-share right constitutes a transfer also results in disturbing consequences in circumstances where a surviving spouse, unlike those in *Miller*, makes no provisions for the benefit of a surviving spouse. If a predeceased spouse leaves assets directly to the predeceased spouse's descendants in accordance with either a premarital agreement or a consent of the surviving spouse to the estate plan, is the surviving spouse going to be deemed to have made a disqualifying transfer to the predeceased spouse's descendants for Medicaid purposes at the time of the predeceased spouse's death? There is nothing in the sweeping import of the *Miller* rationale which would indicate that such question would be answered in the negative, irrespective of the duration in time between the premarital agreement or consent and the predeceased spouse's death. If so, the surviving spouse in such circumstance would have no enforceable right to the predeceased spouse's augmented estate, yet could be left with no available resources to provide for support and maintenance needs following a denial of Medicaid eligibility resulting from such deemed disqualifying transfer. Moreover, *Miller* would appear to accord the same treatment to the situation of a premarital agreement executed, or consent given, when the couple was living in another state having no or limited spousal elective-share rights.

The Court's apparent position that the failure to exercise an elective share right constitutes a transfer of an amount equal to the amount of the elective share also apparently fails to consider the legal cost of both exercising such right and pursuing elective share claims against both probate and non-probate transfers. Often, such costs would be prohibitive and claims unable to be satisfied.

The *Miller* rationale also would likely adversely impact upon "Crummey" power irrevocable trusts, in which trust beneficiaries are given temporary withdrawal rights solely for the purpose of qualifying trust contributions for the federal gift tax annual exclusion. Under *Miller*, the lapse of such withdrawal rights would likely constitute a transfer to the trust for Medicaid resource purposes, despite the fact that such lapse normally would not result in a gift for federal gift tax purposes, nor deem the assets of the trust formerly subject to such power to the claims of a power holder's creditors under governing debtor/creditor law principles. It would also present tremendous logistical problems in determining at any given time which portion of the trust was a self-settled trust to a beneficiary for Medicaid purposes.

In short, the determination of the Court that the failure to exercise an elective-share right is the equivalent of a transfer is not supported by the plain meaning of the governing statutes, any evinced legislative intent, appropriate public policy considerations or by gauging the validity of such interpretation against its consequences.

When Did a Transfer Occur?

Assuming arguendo that the Court was correct in departing from the literal language of governing statutory provisions in holding that the failure to exercise an elective-share right is tantamount to a transfer, the Court had an additional hurdle to overcome in reaching its decision. Because Mrs. Miller had consented to her husband's will in 1978, the issue arises as to whether any transfer resulting from such consent occurred in 1978 when the consent which barred the exercise of her elective-share was executed, or in 1995, when her husband died. Yet, as there was no trust in existence in 1978, unless the transfer occurred in 1995, it is axiomatic that no transfer could have occurred to a self-settled trust by virtue of such consent. The Court did not more than obliquely

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address this issue in coming to the conclusion that the transfer and creation of the self-settled trust occurred in 1995, when she failed to exercise her barred elective-share right. The Court apparently did not find it relevant that she had given her consent prior to the enactment of any federal laws providing uniform rules for Medicaid eligibility or that there was no indication in the underlying facts that governmental resource eligibility was even a factor in consenting to her husband's estate plan.

In reaching its conclusion, the Court did not give proper deference to the efficacy of the Mrs. Miller's consent in stating that "As the surviving spouse of a decedent who died a resident of Kansas, she had a right to take an elective-share amount of the augmented estate." The Court went on to state that "Her agreement to the terms of the 1978 will, which her husband could have changed with or without her approval, together with her decision to not make a claim against his probate estate in 1995, essentially resulted in her spousal elective-share partially funding the trust after his death." This sentence is internally inconsistent. The surviving spouse could not have made a decision not to make a claim with respect to a right which she had legally waived. Moreover, the factual assertion that her husband could have changed his will (although probably not in a manner which altered provisions for Mrs. Miller without invalidating her consent) following its execution would appear to have no relevance to the underlying legal issues. Obviously, any testator can change a will following its execution. It is the surviving spouse's actions or inactions which were at issue, not those of her predeceased husband.

Had the Court concluded the transfer of her elective-share property right had occurred 17 years previous to the predeceased spouse's death at the time Mrs. Miller gave her consent, such transfer could not have resulted in the creation of a self-settled trust and thus there would have only been a "three year look back" on prior transfers in determining her Medicaid eligibility. If a failure to make an existing elective-share is equivalent to a transfer of property at the time of the death of a predeceased spouse, then a spouse's consent to a will which effectively negates such elective-share arguably is equivalent to a transfer of property at the time of the consent. Whether any transfer of the property could be deemed to have occurred in such circumstance is certainly debatable. Any such transfer would relate to an inchoate right rather than an existing property interest. Moreover, by releasing an inchoate right, the spouse arguably would be releasing such right in favor of a spouse. Transfers to spouses do not result in disqualifying transfers for Medicaid purposes. Even if such transfer is viewed as a transfer to parties of the predeceased spouse's choosing (i.e., the parties who would take in default of the exercise of spousal elective-share rights under the predeceased spouse's estate plan), such transfer would have occurred both prior to the "look back" period and any resultant disqualification period would have long since expired.

Finally, if a transfer is deemed to have occurred by virtue of the consent, the time of the consent arguably would also be the appropriate time in determining whether there has been a transfer for insufficient consideration for Medicaid purposes. For purposes of illustration, let's assume that at the time of the wife's consent in *Miller*, both spouses had consented to the provisions of each other's wills, the provisions of both wills were identical to those in *Miller*, both spouses life expectancies were roughly equal and the amount of the husband's estate at that time was less than that of his wife. In that event, the wife theoretically should have received more in the bargained for consents than she gave up in consenting to her husband's will. As such, even if the giving of such mutual consents could be appropriately deemed to have resulted in any transfer for Medicaid purposes, the consent of the wife arguably should be deemed to have been given for full consideration.

In short, if any transfer is deemed to have occurred by virtue of a consent, consistency would seem to demand that both the transfer and the amount of the transfer be determined as of the date the consent was given and property rights effectively relinquished, not at the time of the predeceased spouse's subsequent death at a time such elective-share right did not even exist.

Unreasonable Consequences Of Court's Apparent Categorical Disregard Of Spousal Consents And Waivers Of Elective-Share Rights

Based upon the Court's failure to give any credence to the import of Mrs. Miller's consent to her husband's will with respect to either the timing of any deemed transfer or the deemed transfer itself to her husband's testamentary trust, one would have to conclude that the Court would have deemed any waiver of spousal rights to be of no legal consequence in such circumstances. Thus, the *Miller* rationale would appear to logically require the judicial disregard of premarital agreements waiving elective-share rights before they even existed. In the unlikely event the *Miller* Court would honor premarital waivers despite ignoring consents, premarital agreements would thereby be encouraged solely for the purpose of obviating the *Miller* consequence in circumstances where no premarital agreement would otherwise be entered. In addition to possibly dampening marriage prospects, the Court would have created a trap for the unwary. Alternatively, in what would appear to be the more likely situation that the Court would view premarital agreements as anticipatory waivers having no efficacy for Medicaid purposes, marriage would be discouraged, particularly for older couples for whom long term care considerations are often predominant. The *Miller* rationale would also have the effect of encouraging married couples to divorce or enter decrees of separate maintenance solely in order to protect property division rights for Medicaid purposes. Only in that manner could a predeceased spouse (or former spouse) having a greater portion of the augmented estate leave assets in a "supplemental needs" testamentary trust for the surviving spouse (or former spouse) without such trust being considered a resource for Medicaid purposes. In short, the *Miller* rationale would appear to exact a Medicaid penalty for couples who are considering marriage, couples who marry, and couples who stay married.

Illogical Etensions Of Williams Decision

The Court's reasoning that its position is a "logical extension" of *Williams v. SRS*, 258 Kan. 161 (1995), does not appear to follow. That case dealt with a "supplemental needs" trust created by a guardian ad litem for the benefit of a plaintiff to receive the settlement proceeds in a lawsuit. The Kansas Supreme Court determined that the creation of a trust by the guardian ad litem on behalf of the plaintiff as the plaintiff's legal representative for the purpose of receiving settlement proceeds to which the plaintiff was legally entitled (and which otherwise would have been paid outright to the plaintiff) was tantamount to the creation of a self-settled trust by the plaintiff for Medicaid purposes. In *Miller*, neither the surviving spouse nor any agent on her behalf created the testamentary trust, the surviving spouse had no elective-share property right with regard to her husband's property at the time of his death which could be subject to a transfer, and neither she nor any agent of hers undertook any affirmative act with respect to a transfer of assets to such trust. The Court's conclusion that "Mrs. Miller essentially established her own trust with her own funds for her own benefit" tortuously strains both the underlying facts and the normal rules of statutory construction.

Sole Arguable Basis For Court's Determination

It would appear that the only reasonably arguable basis for the Court's rationale would be that the sequence of transactions was tantamount to a surviving spouse "bargained away" elective-share rights in consideration of the predeceased spouse leaving assets in a discretionary trust for her benefit. Following her husband's death, the result in this circumstance would be identical to that of a surviving spouse who had exercised elective-share rights and then contributed the elective-share amount to an inter vivos trust having the same provisions. Viewed in that context, the surviving spouse would have given a conditional consent. Rather than the husband being able to

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change his will at any time as was stated by the Court in *Miller*, the husband would be bound to so provide or vitiate the consent. However, this is far from the normal circumstance in which most consents are given. The "substance over form" argument the Court employed without "connecting the dots" leading to its conclusion presumes that the form of the transaction has been arranged in a manner to belie its substance. Consents are normally given to further the purpose of a testator or settlor in limiting a surviving spouse's claim to a predecease spouse's property, not to provide a mechanism to circumvent self-settled trust status with respect to the consenting spouse's assets. Such circumstances are hardly a "hot bed" for potential Medicaid abuse. It would appear to be presumptuous to conclude that Congress would have even included such circumstance within the ambit of Medicaid Qualifying Trust status had it statutorily addressed the issue.

There simply appears to be no evinced legislative intent or legitimate public policy objective which would justify disregarding the plain meaning of the subject Medicaid statutory provisions in this circumstance. The Court disregarded such plain meaning in two contexts. It first disregarded the statutory requirement for there to be a Medicaid Qualifying Trust, the trust must be created with the beneficiary's own assets. Secondly, even if such trust is created with the beneficiary's own assets, the governing statute excepts trusts created under the will of the predeceased spouse.

In any event, the "substance over form" argument could not be extended to a circumstance in which a spouse, prior to a predeceased spouse's death, has waived all elective-share property rights, be it in a premarital agreement, post-marital agreement or in the consent itself. In that situation, the surviving spouse would have no elective-share property right to "bargain away" or transfer to a trust and the predeceased spouse would be free to totally disinherit the surviving spouse. Thus, even assuming the Court could permissibly use this rationale to disregard the plain meaning of the governing statutes, the Court would have had to have made the further assumption that Congress intended to treat spouses who had totally waived their elective-share rights differently than those whose rights had only been conditionally waived.

The fact that the Court did not articulate its arguments in this context would tend to indicate that the import of the statutory provisions do not readily or logically lend themselves to such a construction. Complex mental machinations are necessary to divine a rationale to "collapse the transaction." Consequently, judicial rules of statutory construction would appear to dictate that the plain meaning of the Medicaid statutory provisions be honored. The Court appeared to judicially depart from these rules based upon a purely speculative assumption that Congress must have intended that self-settled trust status be accorded the failure of a surviving spouse to enforce an elective-share right barred by a consent given by her some 17 years previously.

CONCLUSION

The Court's overarching focus on what it considered to be governing public policy considerations, its understandable difficulty in articulating a cogent nexus between statutorily proscribed self-settled trusts and the facts in *Miller*, its discussion of facts and positing of arguments not appearing to be germane to the central issue, its inclusion of authority which does not seem to support its conclusion, its lack of discussion of other appropriate public policy considerations, and the weakness of its rationale when tested against permutations of the *Miller* scenario, have lead many Kansas estate planners to conclude that the principal girding for the *Miller* decision was a judicial perspective antithetical to discretionary and "supplemental needs" trusts in a governmental resource context. Admittedly, the fact that the decedent in *Miller* left assets in trust for the benefit of his spouse, which would have provided for her needs even in the absence of Medicaid benefits, made it enticingly easy for the Court to reach an incorrect result. However, despite its well-intentioned goal of protecting the public coffers, the Court simply reached the wrong conclusion by in essence relying on general public policy arguments which provide no legal basis for the Court's substantial deviation from the plain meaning of the governing statutes.

Such goal is more properly within the purview of the legislative branch. For other obvious public policy reasons, Congress has specifically sanctioned the use of most third-party created discretionary and "supplemental needs" trusts to protect trust assets from the otherwise applicable "spend down" requirements of Medicaid benefits. Congress even created an exception in the same 1993 legislation for certain self-settled trusts, the assets of which can be made supplemental to Medicaid benefits. Such legislation has been enacted despite the consequence of incurring significantly greater Medicaid expenditures. Given that discretionary and "supplemental needs" trusts have been sanctioned by Congress in a broad variety of contexts, including certain self-settled trusts, it is difficult to discern how the Court in *Miller* could have possibly determined from the authority cited in the opinion that Congress did not intend for such sanctioning to encompass the facts in *Miller*. The plain meaning of the Medicaid statutes indicates that it did.

Had Congress desired for the *Miller* rationale to be governing law, it could easily have done so. The 1986 and 1993 enactments afforded ample opportunity for Congress to provide that the failure of a surviving spouse to exercise an elective-share right will be deemed to constitute a transfer for Medicaid purposes and that any waiver of such right, whether by premarital agreement, post-marital agreement, or consent, would have no legal effect. Alternatively, Congress could have simply provided in its sanctioning of the "testamentary trust for spouses" exception to Medicaid Qualifying Trust status that the elective-share portion of a surviving spouse with respect to a predeceased spouse's assets under governing state law would not fall within such exception. It clearly did not do so. Such failure may well have been for the foregoing reasons or simply because Congress was mindful that giving any consideration to spousal elective-share rights, which vary significantly among the states, would detract from the Congressional goal of providing uniformity in Medicaid eligibility rules. However, speculating as to why Congress did not address this issue is just as inapposite as departing from the plain meaning of the governing statutes to conclude that it did. The proper application of rules of statutory construction, even under the penumbra of presumed public policy considerations, simply can not fill this vacuity.

The Committee understands that the attorney for the appellee, John Jordan, has filed a Motion for Rehearing. In the event that Motion is granted, the KBA Board of Governors has authorized the Real Property, Probate and Trust Section to file an amicus curiae brief consistent with the Committee's position. The Committee is hopeful that such Motion will be granted and the Court subsequently will revise its opinion consistent with both that of the district court and what the Committee believes is required by governing law.

NEED FOR CLARIFICATION SHOULD COURT SUSTAIN ITS POSITION

The *Miller* decision has cast a pall over the efficacy in a Medicaid context of estate planning techniques involving elective-share waivers in a broad range of situations, resulting in undue uncertainty with regard to individuals who are either married or contemplating marriage. Thus, in the event the Court should uphold its decision, the Committee believes it would be desirable that the Court clarify its rationale by limiting it strictly to traditional consents, i.e., conditional waivers, in which the testamentary document leaves assets in trust for a surviving spouse "in lieu of" elective-share rights. The Committee believes such clarification is clearly warranted, as there appears to be no sustainable legal basis whatsoever to the conclusion that the failure to exercise an elective-share right which has been unconditionally waived prior to a predeceased spouse's death constitutes a transfer at the time of a predeceased spouse's death whether to other beneficiaries of a predeceased spouse's estate or to a testamentary trust created by the predeceased spouse for the benefit of a surviving spouse.