THE REPORTER

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President's Message

While it is certain the educators will be debating evolution versus intelligent design and the real meaning of stickers, it is also almost as certain that the legislators will not be debating deed standards this session.

I reported in the last newsletter about a movement afoot to develop a statewide standard format for recording documents and to legislate the way the registers of deeds are to do their business. I invited comments from our members and I received many well thought out ideas.

Section President

Frederick B. Farmer
Lowe Farmer Bacon and Roe, Olathe

The comments I received followed along the lines of disagreement that were voiced by members of the Register of Deeds Association, the Title Standards Committee, the Kansas Bankers Association, Kansas Independent Oil and Gas Association (KIOGA), members of our subcommittee, and others.

As a result of these differences (some of which may be classified as culture clashes between east and west, big county and small county, and urban and rural), I do not anticipate any such legislation to be introduced this session.

The issue, however, will receive further study. As they say, "tune in again same time, same station next week."

For now, it's fair to say Kansas has 105 separate deed recording requirements. Although there will be those of you who disagree, Kansas recording requirements are not nearly as difficult to navigate as the tax code. However, each has their own little special interest groups that make simplifications and changes difficult. ■

ETA: June 9-11, 2005
Next Stop: Vail Cascade Resort & Spa

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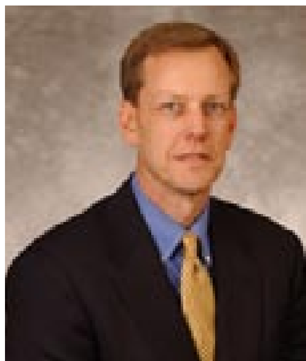
Estate Tax Notes

Author



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He provides a regular report on selected estate planning topics for the segment "Eye on Your Money," for KWCH-TV Channel 12, Wichita. Peare can be reached via e-mail at dpeare@hinklaw.com.

1. STATUTORY TAX RATES, EXEMPTIONS AND DEDUCTIONS FOR 2005

The following changes affect estate planners for transfers made, and estates of decedents dying, in 2005:

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

(b) The annual exclusion for gifts to a noncitzen spouse under Code Section 2523(i)(2) will be $117,000.

(c) The estate and generation-skipping transfer tax exemptions under Code Sections 2010 and 2631 will be $1.5 million.

(d) The aggregate amount that special use valuation of farm or business real estate may reduce an estate under Code Section 2032(A) will be $870,000.

(e) If an estate elects to defer payment of estate taxes under Code Section 6166, the amount of the business interest of an estate, the taxes of which are subject to a 2 percent interest rate under Code Section 6601(j), will be $1.17 million.

(f) The income tax rates for taxable income of an estate or trust will be 15 percent, but not more than $2,000; 25 percent for taxable income more than $2,000, but not more than $4,700; 28 percent for taxable income of more than $4,700, but not more than $7,150; 33 percent for taxable income more than $7,150 but not more than $9,750; and 35 percent for taxable income more than $9,750.

(g) The highest marginal estate tax rate under the code is 47 percent.

(h) The state death tax credit under Code Section 2011 was eliminated in 2005 and was replaced by a deduction for state death taxes under Code Section 2058.

2. SURVIVING SPOUSE'S INTEREST DOES NOT QUALIFY FOR ESTATE TAX MARITAL DEDUCTION

The decedent's revocable trust, as amended, gave a life estate in his property to his surviving spouse upon his death. The trust directed the trustee to pay to, or apply for the wife's benefit, all the net income of the trust as the trustee determined to be proper for the health, education, or support, maintenance, comfort, and welfare of the wife in accordance with her accustomed manner of living. The tax court held that the interest received by the surviving spouse did not qualify for the Code Section 2056(b)(7) exception to the terminable interest rule under Code Section 2056(b)(1), because the wife was not entitled to all of the income for life. The Ninth Circuit affirmed the decision of the tax court, holding that the phrase "all of the net income from the trust estate" was limited by the language that followed it and did not give the wife an unrestricted interest in any more income than was "proper for [her] health, education, or support, maintenance, comfort, and welfare ... in accordance with [her] accustomed manner of living." The fact that the decedent gave himself an unrestricted right to "all of the net income" from the trust estate without any limiting terms indicated that he intended to bequeath to his wife a more limited interest than he had during his own life. As a result, the decedent's estate was not entitled to claim a marital deduction under Code Section 2056(b)(7) for the interest passing in trust. *Davis v. Comm.*, 95 AFTR 2d 2005-667 (9th Cir.).

3. QUALIFIED DISCLAIMERS ; SURVIVING SPOUSE ELIGIBLE TO ROLL DISTRIBUTION FROM DECEDENT'S RETIREMENT PLAN OVER TO HER OWN IRA

The decedent had been a participant in a state salaried employees retirement system (SERS) prior to his death and had not yet attained the age of 70 and one half. At the decedent's death, the proceeds of his interest in the SERS became payable to his estate because he had previously revoked the *inter vivos* trust that was named as the designated beneficiary of the SERS. Under the decedent's will, the residue of his estate is to pass to a trust, which divides into two separate trusts for the benefit of his surviving spouse. At the wife's death, the remainder of the trusts are to pass to the decedent's then-living issue and, if none, to his sister and sister-in-law or their respective then-living issue. The decedent was survived by his wife, two children, two grandchildren, a sister, a sister-in-law, and various nieces and nephews.

The wife, and the decedent's children, grandchildren, sister, sister-in-law, and nieces and nephews, as the potential beneficiaries of the trust, plan to disclaim their respective interests

Continued on next page

in the trust. Under state law, the disclaimants will be treated as having predeceased the decedent, and the residue of his estate will be distributable to his heirs under the state intestacy laws. The decedent's children and grandchildren also plan to disclaim their intestate interests in the residue of the decedent's estate. As a result, the entire residue of the decedent's estate will pass to the wife, who then plans to roll over the distribution from the SERS to an individual retirement account set up and maintained in her name.

The IRS ruled that the proposed disclaimers by the trust beneficiaries of their interests in the trust, and the proposed disclaimers by the decedent's children and grandchildren of their interests in the decedent's estate residue will be qualified disclaimers under Code Section 2518, noting that the disclaimers will be made and filed with the appropriate parties within nine months of the decedent's death, and none of the disclaimants have accepted any income or other benefits from the property being disclaimed. The IRS also ruled that as a result of the disclaimers, the wife will be treated as receiving the decedent's interest in the SERS directly from the decedent for purposes of Code Section 402(c), and the wife will be eligible to roll the SERS distribution over to her own IRA. P.L.R. 200447040.

4. REFORMATION OF POWER OF APPOINTMENT DOES NOT REQUIRE INCLUSION OF TRUST IN SURVIVING SPOUSE'S ESTATE

The grantor's trust gave his surviving spouse, who was also the trustee, a testamentary power of appointment with respect to assets allocated to "Trust B," exercisable in favor of one or more persons or corporations, in the manner and proportions, outright or in trust, as she directs in her will. In her capacity as trustee, the surviving spouse petitioned a court to reform the power of appointment by inserting language that limits the potential appointees to persons other than her estate, her creditors, or the creditors of her estate. The absence of the language was caused by a scrivener's error that contravened the grantor's intent to eliminate any federal estate tax due on his death and minimize the federal estate tax due on his surviving spouse's death. As "Trust B" was essentially funded with assets to fully utilize the grantor's exclusion amount, the grantor did not intend for these assets to be included in his surviving spouse's estate. The court, thus, reformed the trust to add the limiting language.

The IRS held that the power of appointment, as reformed, would not constitute a general power of appointment under Code Section 2041(b). Thus, the assets of "Trust B" would not be includable in the surviving spouse's estate. Further, the IRS ruled that the reformation by the court did not result in the release of a general power of appointment under Code Section 2514(b) that would constitute a gift for federal gift tax purposes. P.L.R. 200450033.

5. APPORTIONMENT OF ESTATE TAX LIABILITY BASED ON TAXABLE ESTATE, NOT GROSS ESTATE

The decedent died intestate and had three life insurance policies in effect, the proceeds of which aggregated more than $2.1 million. The decedent's father received $2 million; his ex-wife received $125,000; and his wife received $30,000. The father filed a petition seeking a declaratory judgment from the chancery court that the administrator of the decedent's estate must first pay any estate taxes out of the estate, and that if the estate did not have enough funds to pay the taxes in full, only then could the administrator seek contributions from the life insurance beneficiaries. The chancellor held that the estate could recover from the insurance beneficiaries a portion of the tax liability, but not the full tax liability, and that each beneficiary's contribution would equal the proportion of that beneficiary's insurance proceeds to the value of the gross estate.

The Mississippi Supreme Court reversed the chancellor's decision to apportion tax liability to the life insurance beneficiaries based on the gross estate, rather than the taxable estate. Mississippi statutes provide that estate tax liability shall be apportioned in accordance with federal law when it results in a different outcome than under state law. Code Section 2206 provides that if an estate consists of assets which include the proceeds of life insurance policies, the beneficiaries of the proceeds are liable for a portion of the total tax paid as the proceeds of such policies bear to the taxable estate. Because federal law controls, the apportionment of the estate's tax liability should have been based on the value of the taxable estate, not the gross estate. The court further held that the equitable doctrine could not be used to apportion based on the gross estate because the statutory principle dictating apportionment based on the taxable estate is unambiguous. *Estate of Smith v. Smith, Miss.*, No. 2003-CA-02811-SCT, 01/20/2005.

6. QUALIFIED TERMINABLE INTEREST PROPERTY (QTIP) ELECTION NOT MADE; RELIEF UNDER REV. PROC. 2001-38 NOT AVAILABLE

The decedent was survived by his wife and three children. He had the following property that was to be distributed as follows: (i) insurance, jointly owned property, and an annuity, collectively valued at $s passed to the wife; (ii) cash, stocks, bonds, real estate, and oil royalties valued at $t passed to the three children, subject to the wife's life estate in one-half of the interests; and (iii) $u passed to family trust, a credit shelter trust. On the decedent's federal estate tax return, $w (the sum of $s and the actuarial value of the wife's interest in $t and $u) was reported under Part 1 of Schedule M, titled "Property Interests Which Are Not Subject to a QTIP Election." Nothing was listed under Part 2 of Schedule M, titled "Property Interests Which Are Subject to a QTIP Election." No reference to "QTIP," or "QTIP election" was made anywhere on the return.

The estate requested relief, pursuant to Rev. Proc. 2001-38, 2001-24C.B. 1335, that the IRS disregard the marital deduction taken with respect to the actuarial value of the wife's interest in $t and $u and treat it as null and void for purposes of Code Sections 2044(a), 2056(b)(7), 2519(a), and 2652 because the marital deduction was unnecessary to reduce the estate tax liability to zero. The IRS noted that where a QTIP election was not necessary to reduce the estate tax liability to zero, the IRS will disregard a QTIP election pursuant to Rev. Proc. 2001-38. However, it applies only when a valid QTIP election is made on a decedent's estate tax return. Because the estate did not make an unequivocal manifestation of an affirmative intent to make the election of QTIP treatment on the estate tax return, a QTIP election was not in fact made, and relief was not available under Rev. Proc. 2001-38. Consequently, the estate was required to file a supplemental federal estate tax return properly reporting the assets on Schedule M and correct beneficiaries and amounts. P.L.R. 200448038.

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Newsletter

To be successful and informative, a section newsletter needs articles or ideas that reflect the needs of its membership. If you would like to contribute to the newsletter, contact Calvin J. Karlin at ckarlin@beszm.com.

7. MARITAL DEDUCTION UNAVAILABLE; WIFE NOT ENTITLED TO ALL INCOME FROM TRUST

The decedent was survived by his wife and their children. Pursuant to the decedent's will, all his interest in his personal residence and all personal property passed to the wife. The rest of the decedent's property passed in trust to "Trust A," for the primary benefit of the wife. The provisions of "Trust A" required the trustee (a bank) to distribute the net income of "Trust A" to the wife in amounts and times as she shall desire for maintenance, education, health, or support. If the income is insufficient, the trustee may distribute portions of the principal. At the death of the wife, "Trust A" terminates, and any remaining assets pass to "Trust B" for the benefit of the decedent's children and their descendants. The decedent's will contains no reference to the estate tax marital deduction and no specific statement of intent that "Trust A" qualifies for the estate tax marital deduction. The IRS held that the property passing to "Trust A" does not qualify for the estate tax marital deduction. The terms of "Trust A" do not satisfy the requirements of Code Sections 2056(b)(5) or 2056(b)(7) because the wife is not entitled to all trust income payable annually or more frequently. Accordingly, the wife does not possess the right to receive all trust income, as required for qualification under either Code Section. T.A.M. 200505022.

8. ASSIGNMENT OF IRAS AND DEFERRED ANNUITY CONTRACTS TO CHARITY IN SATISFACTION OF SHARE OF RESIDUARY ESTATE

The decedent died owning IRAs and deferred annuity contracts, as to which his estate was the named beneficiary. None of the deferred annuity contracts had reached their annuity starting date as of the decedent's date of death, and the estate had not surrendered or cashed any of the IRAs or deferred annuity contracts. The executor proposed to assign the IRAs and deferred annuity contracts to a charity that was one of the residuary beneficiaries, in satisfaction of its share of the decedent's residuary estate. The decedent's will permits non-pro rata distribution of the assets. The IRS held that the assignment of the IRAs and deferred annuity contracts to the charity would not cause either the decedent's estate or any beneficiary of the decedent's estate to have any taxable income. Further, it would not cause the estate to include any amount in its distributable net income. P.L.R. 200452004.

9. SURVIVING SPOUSE'S DISCLAIMER IN JOINT BROKERAGE ACCOUNT QUALIFIED DESPITE WITHDRAWALS FROM ACCOUNT

A husband and wife opened a joint brokerage account with rights of survivorship. Each spouse contributed equally to the account, and each could unilaterally withdraw that spouse's contributions to the account. The husband subsequently died, and shortly thereafter, the stockbroker told the wife that the brokerage account could not be held under the social security number of a decedent. Consequently, the wife directed the stockbroker to transfer title from the husband's account to the wife's name. For eight months following the husband's death, the wife directed the stockbroker to sell some of the securities in the brokerage account and to purchase other securities for the account. The wife also made cash withdrawals from the account. In the nine months after the husband's death, the wife executed a disclaimer of her beneficial survivorship interest in the husband's share of the brokerage account. After the disclaimer was filed, the account was divided into three separate accounts: (i) the tenant in common (TIC) account (held as tenants in common between the wife and the husband's estate),that held assets that could not be evenly divided, excluding any proceeds from the securities sold in the eight months following the husband's death and securities purchased during that period; (ii) the wife's account, that held the assets attributable to the wife's contributions to the account as well as assets attributable to the husband's contributions with respect to which the wife directed sales or purchases after the husband's death; and (iii) the estate account that held assets attributable to the husband's contributions to the account with respect to which the wife had made no withdrawals and had directed no sales or purchases after the husband's death. Each of the three accounts also held the earnings from the date of the husband's death on the assets held in each account. The wife's disclaimed interest is represented by the estate account and the estate's one-half interest in the TIC account.

The IRS ruled that the wife's disclaimer of her survivorship interest in the brokerage account was qualified under Code Section 2518, noting that contributions to the account were incomplete gifts prior to the husband's death because each spouse could unilaterally withdraw his or her own contributions. Thus, the

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transfer creating the wife's survivorship interest in the husband's share of the account occurred at the husband's death, and the wife had nine months after the husband's death to disclaim any part of that interest. The IRS stated that transfer of the account's title did not result in acceptance by the wife of any benefits in the husband's share of the account. In addition, the wife's withdrawal of cash from the account did not prevent her from making a qualified disclaimer of other assets in the account and that the wife could disclaim certain securities in the account while accepting the benefits of other securities because the cash and securities were severable assets. P.L.R. 200503024.

10. DECEDENT'S IRA SUBDIVIDED INTO SEPARATE IRAS FOR TRUST BENEFICIARIES

The decedent was survived by her sister and two nieces. The decedent's revocable trust was named as the beneficiary of her IRA. Under the terms of the trust, the balance of the assets were to be held in trust for the benefit of the decedent's sister. Upon the sister's death, the remaining property was to be distributed to the two nieces, in equal shares. The sister disclaimed her interest in the decedent's IRA. The trust's co-trustees (the sister and the two nieces) propose to divide the IRA, by means of trustee to trustee transfers, into two distinct IRAs, each of which will be maintained in the name of the decedent, but each for the benefit of one of the nieces. Distributions from the IRAs will be made over the life expectancy of the older niece. After noting that neither the Code nor the final regulations under Code Section 401(a)(9) preclude the posthumous division of an IRA into more than one IRA, but that the final regulations do preclude "separate account" treatment for Code Section 401(a)(9) purposes, where amounts pass through a trust. The IRS held that the proposed trustee to trustee transfers would have no effect on either the timing or the amount of minimum required distributions because the nieces would receive distributions over the life expectancy of the older niece. Thus, the IRS allowed the decedent's IRA to be subdivided into separate IRAs for the benefit of each niece. P.L.R. 200444033.

11. TAX AVOIDANCE TRANSACTION NOT DISREGARDED AS A SHAM

In 1998, Black and Decker (BD) sold three of its businesses, generating significant capital gains. That same year, BD created Black and Decker Healthcare Management Inc. (BDHMI), to which BD transferred approximately $561 million, along with $560 million in contingent employee healthcare claims in exchange for the newly issued stock in BDHMI. BD sold its stock in BDHMI to an independent third party for $1 million. BD claimed approximately $560 million in capital loss on the stock sale, which it reported on its 1998 federal income tax return, believing that its basis in the BDHMI stock was $561 million. BD used a portion of the capital loss to offset its capital gains from selling the three businesses and used the remaining loss to offset gains in prior and future tax years. BD filed suit for a refund of more than $57 million in federal taxes, plus interest, which it contends were erroneously assessed and collected for tax years 1995 through 2000.

The United States argues that the BDHMI transaction was a tax avoidance vehicle that must be disregarded for tax purposes. BD counters that because the transaction had economic substance, it must be acknowledged. The IRS may ignore sham transactions that are designed solely to create tax benefits rather than to serve a legitimate business purpose. In the Fourth Circuit, a transaction will be treated as a sham if the court finds that the taxpayer was motivated by no business purposes other than obtaining tax benefits in entering the transaction, and that the transaction has no economic substance because no reasonable possibility of profit exists. BD does not dispute that the transaction was motivated solely by tax avoidance. However, it argues that the transaction has economic substance for the following reasons: (i) BDHMI assumed the responsibility for the management, servicing, and administration of BD's employee and retiree health plans; (ii) BDHMI has considered and proposed numerous healthcare cost containment strategies since its inception in 1998, many of which have been implemented by BD; and (iii) BDHMI has always maintained salaried employees. In addition, BDHMI became responsible for paying the healthcare claims of BD employees, and such claims are paid with BDHMI assets. Thus, the district court held that the transaction could not be disregarded as a sham because it had economic substance, despite the sole motivation for the transaction being tax avoidance. This case may, by analogy, be applicable to the formation of family limited partnerships for estate planning purposes. *Black & Decker Corp. v. U.S.*, 94 AFTR 2d 2004-6437, 340 F. Supp. 2d 621 (Dist. MD).

12. FINAL ESTATE ALTERNATE-VALUATION REGULATIONS

The IRS issued final regulations on the election to value a decedent's estate on the alternate valuation date, rather than on the date of death. The regulations reflect changes to the alternate valuation rules made by the Deficit Reduction Act of 1984 and the Tax Reform Act of 1986. One change made in the final regulations from the proposed regulations is that the determination of whether the alternate valuation election results in a decrease in the sum of the estate tax and GST tax liability is made with reference to the estate tax and GST tax payable by reason of the decedent's death with respect to the property includable in the decedent's gross estate, eliminating the need to account for the possible imposition of GST tax at some time in the future. Another change reflected in the final regulations is that the proposed regulations provided that no request for an extension of time to make the alternate valuation election would be granted if the request was submitted to the IRS more than one year after the due date of the tax return. In the final regulations, the IRS has determined that taxpayers may request an extension of time to make the alternate valuation election even after the expiration of the one-year period and that such relief may be granted provided that the return was filed no later than one year after its due date (including extensions of time actually granted). The regulations apply to decedents dying after Jan. 3, 2005. T.D. 9172 (01/04/2005).

13. ANNUITY CONTRACT HELD IN TRUST TAXED AS IF HELD BY NATURAL PERSON

The grantor created an irrevocable nongrantor trust for the benefit of his grandson. Under the terms of the trust, the grandson could request a distribution of one-quarter of the trust principal at age 30, one-third at 35, and the balance of the trust principal at 40. If the grandson died prior to 40, the trust would be distributed to his issue, or if none, then to certain other relations of the grandson. The IRS held that an annuity contract held by the trustee was taxed as if held by a natural person because the grandson, a natural person, was the beneficial owner of the policy. P.L.R.s 200449011; 200449013-200449017.

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14. NO CHARITABLE DEDUCTION FOR PROPERTY BEQUEATHED TO NUN

The decedent's sister was a member of a religious order and took vows of poverty, to which she has been subject at all times since that date. The decedent subsequently died testate, survived by his sister. Under the terms of the decedent's will, he bequeathed the residue of his estate to his sister, or if she did not survive him, then to the religious order. As executrix of the decedent's estate, the sister transferred title in the decedent's securities to the name of the religious order and transferred cash to the religious order. The transfers occurred more than nine months after the decedent's date of death.

The IRS held that the residuary bequest did not qualify for the charitable deduction under Code Section 2055. The estate contended that the sister's vow of poverty constituted a qualified disclaimer because it was an irrevocable and unqualified refusal to accept the bequest that was in writing. The estate further argued that because the sister was the executrix of the decedent's estate, the estate necessarily received the disclaimer within the nine-month period after the decedent's death. The IRS held, however, that the vow of poverty did not constitute a qualified disclaimer because it did not satisfy the state law requirements for a valid disclaimer. Further, the vow of poverty did not describe or designate the particular property being disclaimed, as required in Code Section 2518 and the Regulations promulgated thereunder. Therefore, a charitable deduction was not available for the residuary bequest. P.L.R. 200437032.

15. TRANSFER TAX VALUE OF FAMILY BUSINESS INTERESTS NOT DETERMINED BY BUY-SELL AGREEMENT

True was an entrepreneur who established six different oil and gas businesses. Each company was governed by a buy-sell agreement, providing that owners or partners could not transfer or encumber their interests in the business; each owner or spouse had to work in the business; failure to work in the business, any attempt to transfer an interest in the business, death, and disability were each treated as if the holder of the interest had notified the other owners of his intent to withdraw from ownership; and that when such an event occurred, the other owners had to buy the departing owner's interests at a formula price listed in the buy-sell agreement.

The formula price in the buy-sell agreements is derived from a calculation of the tax book value for the respective company, which would tend to be much lower than what would be calculated under generally accepted accounting principles and did not always represent the fair market value of the businesses. The tax value method occasionally resulted in a negative book value for some of the companies. (Note: Because the buy-sell agreements were created prior to Oct. 8, 1990, Code Section 2703 did not apply, and the agreements were instead subject to Regulation Section 20.2031-2(h) and case law).

In 1993, True sold some of his interests in the companies to his wife and sons at tax book value. True and his wife reported the transfers on their 1993 gift tax returns but treated them as sales, thereby not reporting any taxable gifts resulting from the transfers. The IRS subsequently issued notices of deficiency, contending that the values of the transferred interests were higher than the tax book values reported on the tax returns. The IRS also issued a notice of deficiency in response to the sale of True's remaining interests to his wife and sons at tax book value after his unexpected death in 1994. The estate tax return had reported the date of death value of the interests as equal to the proceeds the estate received under the buy-sell agreements. After True's death, his wife sold her interests to the sons at tax book value, and again, the IRS issued a notice of deficiency when the wife reported the transactions as sales on her 1994 gift tax return.

The tax court determined total deficiencies of more than $18 million and penalties of more than $3 million, finding that the buy-sell agreements did not control the transfer tax values at issue. Under Regulation Section 20.2031-2(h), the stated price in a buy-sell agreement will control, for estate purposes, where the following requirements are met: (1) the price is determinable from the agreement; (2) the terms of the agreement are binding throughout life and death; (3) the agreement is legally binding and enforceable; and (4) the agreement was entered into for bona fide business reasons and is not a testamentary substitute intended to pass on a decedent's interests for less than full and adequate consideration. At issue in this case was the fourth requirement. Although the tax court found, and the IRS agreed, that the buy-sell agreements were entered into for a variety of legitimate business reasons, the tax court determined that they served as testamentary substitutes.

The Tenth Circuit agreed with the tax court's analysis, noting that True sought only a limited amount of professional advice in deciding to use tax book value for the price terms in the buy-sell agreements, and that he did not substantially rely on any independent appraisals in doing so. Further, the agreements did not contain a mechanism by which to reevaluate the price terms listed in them, and when the sons entered into the agreements, there was no negotiation between them and True as to the terms of the agreements. Thus, a number of inferences supported the finding that the agreements served to fulfill True's testamentary plans. Consequently, the Tenth Circuit held that the tax court did not err in holding that the taxpayers failed to satisfy their burden of showing that the agreements represented adequate consideration for either estate or gift tax valuation purposes, and that the tax court properly determined the values of the transferred interests and properly imposed penalties. *Estate of True v. Comm.*, 94 AFTR 2d 2004-7039, 390 F.3d 1210 (10th Cir.). ■

Editor's note —
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Real Estate Cases

Kansas Court Of Appeals

SADDLEWOOD DOWNS V. HOLLAND CORPORATION
JOHNSON DISTRICT COURT
AFFIRMED
NO. 91,057 (99 P.3d 640) — OCTOBER 29, 2004
Construction Contracts; Alterations or Extras; Mechanic's Lien

FACTS: Holland received the bid for the construction of street improvements in the Saddlewood Downs Subdivision. Holland entered a written contract to provide all the necessary materials, tools, labor, and equipment for construction of the streets in accordance with the approved plans. The contract did not include any line item for fly-ash stabilization or mentioned it directly. After Holland completed the site grading for the streets, the city determined that additional stabilization of the subgrade material was necessary and application of fly ash was required. Holland stopped work and called a meeting to advise all parties of the fly ash requirement. At the meeting, the parties discussed and negotiated the price for the fly ash stabilization work. After the exchange of correspondence, Holland applied the fly ash in August 2000 and began sending periodic payment invoices to Saddlewood that included a specific line item for fly ash stabilization work. Saddlewood refused to pay all of Holland's invoices, claiming it did not owe money for the fly ash work. Holland filed a mechanic's lien. Saddlewood eventually paid Holland the amount of the mechanic's lien and reserved the right to challenge the validity of the lien. The district court granted judgment to Holland finding the fly ash stabilization work was not part of the original contract and that it constituted extra work by Holland for which it was entitled to compensation. The court stated that although there was no written authorization for the fly ash work, Saddlewood's actions or inactions constituted an authorization for the extra work and a waiver of the requirement in the original contract stating that extra work required written authorization. The court rejected Saddlewood's claim for slander of title finding the mechanic's lien was not maliciously filed.

ISSUES: Did the district court err in finding that the fly-ash work was not part of the original contract and that Holland was entitled to extra compensation even though there was no written authorization as required by the contract? Did the district court err in denying Saddlewood's claim for slander of title?

HELD: Court affirmed the district court's award to Holland. Court distinguished the case of *Green Const. Co. v. Kansas Power & Light Co.*, 717 F. Supp. 738 (D. Kan. 1989), concerning the risk of uncertainty of subsurface conditions. The Kansas Court of Appeals agreed with the trial court's conclusion that fly ash stabilization work was not part of the original contract and Holland was entitled to additional payment for the work. The court cited three factors: (1) fly ash work was not included in the bid package; (2) contract does not have a line item for fly ash work; and (3) the negotiations by the parties demonstrated the work was an additional item. The court also found that a pattern of disregarding the requirement of written authorization for changes to a contract is only one factor to be considered in determining if oral modifications are binding. The court also agreed with the district court that although Holland's mechanic's lien may have been technically defective, it was not maliciously filed, and that the absence of malice defeated the claim for slander of title.

STATUTES: No statutes cited.

RIVERSIDE DRAINAGE DISTRICT OF SEDGWICK COUNTY V. HUNT, ET AL.
SEDGWICK DISTRICT COURT
AFFIRMED IN PART, REVERSED IN PART, AND REMANDED WITH DIRECTIONS
NO. 91,752 (99 P.3d 1135) — OCTOBER 29, 2004
Property; Easement for Public Use; Abandonment

FACTS: Seneca Construction Company owned two lots with a 125-foot right-of-way dedicated to the public immediately north of the two lots. There also existed a flood control maintenance access easement that consisted of the north 15 feet of the two lots. Seneca installed a fence along the southern border of the drainage right-of-way and it encroached upon the easement. Hunt purchased lot one from Seneca without first having the property surveyed. Hunt believed the north boundary of the property was the existing fence line, which

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included the maintenance access easement area. Hunt acknowledged that mobile homes, flagpoles, light poles, and two signs were located in the easement area. Hunt stated the drainage district never expressed a desire or need to use the easement. After a survey by the drainage district, Hunt removed the fence from the right-of-way, but he refused to move the other property from the easement area. The drainage district filed a declaratory judgment seeking an order requiring Hunt to remove his property from the easement area. The district court found that while the drainage district's land was not subject to adverse possession, its actions in not using the easement since 1974 and permitting the area to be fenced off constituted an abandonment. The district court ordered title to the easement area be quieted in the name of Hunt. The drainage district appealed. Hunt appealed the district court's ruling that he could not obtain the land by adverse possession.
ISSUES: Did the district court err in finding the drainage district abandoned the property? Did the district court err in finding Hunt could not obtain the land by adverse possession?
HELD: Court found the general rule regarding abandonment of property set forth in *Botkin v. Kickapoo, Inc.*, 211 Kan. 107, 505 P.2d 749 (1973), does not control the disposition of an easement dedicated for public use and held by a public or quasi-public entity. Court stated that an easement for the maintenance of an adjacent drainage right-of-way dedicated to the public and held by a drainage district does not revert to the underlying fee owner unless its purpose, which is to facilitate maintenance of the drainage right-of-way, has become impossible or so highly improbable as to be practically impossible. Court held the district court erred in finding that the drainage district had abandoned the easement. At oral argument, the drainage district conceded that in order to preserve its easement Hunt need not be required to remove from the easement area the existing pavement or underground utility lines. Their presence will not interfere with the drainage district's future use of the easement area. Court stated that Hunt could continue to park vehicles or mobile homes on the easement area, so long as they can be moved whenever the drainage district needs access to the easement area to maintain the drainage ditch. On Hunt's cross-appeal, court rejected Hunt's position. Court stated that Hunt could not obtain the drainage district's maintenance easement by adverse possession because the drainage district is a quasi-municipal corporation and is not subject to possession by an individual or private entity.
STATUTES: No statutes cited.

IN RE EQUALIZATION APPEAL OF ANDOVER ANTIQUE MALL BOARD OF TAX APPEALS REVERSED AND REMANDED NO. 91,514 (99 P. 3d 1117) — OCTOBER 29, 2004

Taxation

FACTS: Antique mall sought judicial review of appraisals by Board of Tax Appeals (BOTA) in 1999 and 2001. District court consolidated action and overruled county's motion for recusal. District court determined new appraisal values, finding BOTA's appraisals were not supported by substantial evidence because appraisal evidence was improperly admitted in both tax appeals and because the appraisals were too distant in time to be credible. County appealed.
ISSUES: (1) Recusal and (2) judicial review
HELD: Although trial judge's statements regarding taxation statutes not being fair and equitable could cause concern of whether this judge was appropriate to consider case, county's failure to file affidavit of prejudice did not preserve the issue for appellate review. Proceedings before BOTA are controlled by Kansas Administrative Procedure Act, not Kansas Rules of Evidence. Evidence need not be excluded solely because it is hearsay. Trial court erred in finding that the appraisal evidence was inadmissible and in substituting its own conclusion on evidence credibility. Substantial evidence supports BOTA's appraisals. District court's decision is reversed and matter is remanded for entry of judgment affirming BOTA's determination of appraisal values.
STATUTES: K.S.A. 2003 Supp. 20-311d(a) and (b), 60-460(g), (h), and (i); K.S.A. 60-401 *et seq.*, 74-2426(a), 77-501 *et seq.*, -524(a) -601 *et seq.*, -621(c) subsections (7) and (8), 79-503a.

ALLIANCE MORTGAGE COMPANY V. PASTINE, ET AL. GEARY DISTRICT COURT REVERSED AND REMANDED WITH DIRECTIONS NO. 91,929 — JANUARY 14, 2005

Mortgage Foreclosure; Junior Lienholders

FACTS: Alliance sued to foreclose its first mortgage on property in Junction City. Alliance requested a money judgment against Leighty who had assumed and agreed to pay the debt owed to Alliance. Beneficial Mortgage, the second mortgagee, was named as a party defendant and claimed an interest in the property. Beneficial asked for proper relief, but did not cross-petition against the owner to foreclose its mortgage and failed to seek relief on its note and to set out the amount that was due under the note. The trial court foreclosed Alliance's mortgage and granted judgment for approximately $30,000 and determined that Beneficial had a valid lien on the property second in line to Alliance. The court ordered a sheriff's sale and granted a right of redemption from three months of the sheriff's sale. At a properly noticed sheriff's sale, 166 bids were received. The Coxes were the highest bidders and paid $85,001 for the property. $43,290.73 was paid to Alliance leaving excess proceeds of $41,710.27. Beneficial claimed it had no notice of the sale, otherwise it would have bid $117,500 for the property. Beneficial moved to set aside the sale or allow a substitute bid. The trial court denied the motion finding the following: proper notice was given, Beneficial had participated in the foreclosure proceedings, that Beneficial could have secured its interest by a money judgment, that the property had been sold for fair market value in a legitimate transaction, and the sheriff's sale was conducted according to law in all respects. On a motion for rehearing, the trial court found Beneficial, by not receiving notice of the sheriff's sale, had been denied the right to bid at the sale and denied a protected property right. Court granted Beneficial 10 days to redeem the property and Beneficial paid $117,500 into court for redemption. Trial court confirmed the redemption and repaid the Coxes the sale price and all costs, interest and expenses. The Coxes appealed.
ISSUES: Does Kansas law allow a trial court to refuse confirmation of a sheriff's sale that is for an adequate purchase price for reasons not supported by law and for reasons not in conformity with equity?
HELD: Court reversed. Court held because the sale to the Coxes was for an adequate price, the sale should have been confirmed if it was supported by the law and was in conformity with equity. Court stated that Beneficial received notice of the foreclosure action. Beneficial was properly served with a summons in Alliance's foreclosure action and filed an answer claiming a lien on the property. Court held the evidence established that Beneficial was given the opportunity

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to assert its rights in the property before judgment was entered in the foreclosure action and there was no due process violation. Court found proper notice was given for the sheriff's sale. Court also held the trial court abused its discretion by extending the redemption period for Beneficial. Court stated that Beneficial failed to make a good faith effort to redeem before the redemption period expired and Beneficial was in the same category as the Coxes and any other private citizen and there was no equitable reason to allow Beneficial to redeem the property out of time. Court found the Coxes did not acquiesce in the judgment because they were forced to let Beneficial buy back the property after Beneficial was allowed to redeem the real estate.
STATUTES: K.S.A. 60-2410(a), -2414(b), (c), (m), -2415(a), (b); K.S.A. 2003 Supp. 60-205(a), (b)
DISSENT: Judge Johnson dissented. Johnson stated that an adequate sale price does not mandate confirmation of a mortgage foreclosure sheriff's sale. As far as notice, Beneficial was entitled to receive notice of impending action as a participating litigant, not because of its status as a junior lienholder. Johnson stated that Beneficial was a creditor, and its claim had become a lien prior to the expiration of the redemption period and a plain reading of K.S.A. 60-2414(c) gives Beneficial standing to redeem. Johnson stated the court fashioned an equitable remedy extending the redemption period and the only detriment suffered by the Coxes was a missed opportunity to get a tremendous bargain.

BLOOM V. CITY OF OAKLEY
LOGAN DISTRICT COURT
AFFIRMED
NO. 92,305 — JANUARY 28, 2005

Improvements; Assessments; City and County Agreements

FACTS: Various landowners petitioned for improvement of Royal Avenue with landowners paying 85 percent and the city paying the rest. Bloom did not sign the petition. The portion of Royal Avenue that was subject to the improvement was entirely within the corporate limits of the city. Bloom's property ran alongside a lengthy portion of Royal Avenue, but his property lay entirely outside the city limits. The city limits terminated at the side of Royal Avenue adjacent to Bloom's property. The city passed a resolution to make the improvements to the property included in the petition, which included real estate located both within and outside the city limits. The city assessed Bloom $36,287.80 against his property for the improvements. The district court held that the city can form improvement districts that include land inside and outside the city limits, but pursuant to K.S.A. 12-693(b), the city must enter into an agreement with the Board of County Commissioners in order to initiate such improvements and assessments. The district court held the city failed to enter an agreement with the county and lacked authority to levy the assessment.
ISSUES: Whether the city has the power to create an improvement district that includes property both inside and outside the city limits.
HELD: Court affirmed. Court held the district court did not err in finding that Bloom's property was not properly included within the improvement district created by the city pursuant to K.S.A. 12-693, because the city failed to enter into an inter-local agreement with the county prior to assessing property located outside city boundaries for the cost of improving a boundary line road located entirely within the city.
STATUTES: K.S.A. 12-693, -6a01 *et seq.*, -6a02, -6a04; K.S.A. 60-907(a)

BARKER V. KRUCKENBERG, ET AL.
PRATT DISTRICT COURT
AFFIRMED IN PART
AND REVERSED IN PART
NO. 91,648 — FEBRUARY 4, 2005

Oil and Gas; Lease Termination

FACTS: Hirt farms entered into an oil and gas lease (Hirt lease) with B&N Enterprises (Kruckenberg's predecessor in title) and the property had one producing well. The lease provided that it would terminate if royalty was less than $5.00 per acre per annual year. Since the lease covered 160 acres, the minimum royalty was $800 per year, but there was no specific time by which the minimum royalty was to be paid to avoid a forfeiture. Barker acquired the lease in 1997. The Hirt lease did not pay the minimum royalty between 1997 and 1999 (1997 — $750.78, 1998 — $536.38, 1999 — $650.07). However, the $800 minimum royalty was exceeded for the years 2000, 2001, and 2002. In 2001, B and N paid $8,575.16 to several different contractors in order to increase production. Barker entered an oil and gas lease (Barker lease) in 2001 with Kruckenberg covering different property that contained the language, "If production is established, Lessor shall be paid a minimum royalty of $150 per month." The parties stipulated that Barker did not receive the royalty payment of $150 per month, but they received annual royalties that exceeded $1,800 per year. Barker sued to terminate both leases for failure to pay the minimum royalty. The district court terminated the Hirt lease finding the failure to pay the minimum royalty automatically terminated the lease. The district court did not terminate the Barker lease, even though the minimum royalty of $150 was not paid per month, because the lease did not contain a forfeiture provision and the annual royalty exceeded the total of the monthly royalties for the year.
ISSUE: Did the district court err in terminating the oil and gas leases?
HELD: Court reversed the termination of the Hirt lease and affirmed the refusal to terminate the Barker lease. Regarding the Hirt lease, the court stated that Barker knew about production under the Hirt lease when he purchased the real estate in 1997, and he surmised at that time that he was not properly receiving the royalty. Court found that if the lease is terminated, Barker would receive a windfall from the investment to improve the well. Court concluded it would be inequitable to allow Barker to terminate the Hirt lease in 2002 based upon lessee's failure to pay the minimum royalty three years earlier, especially since the lessee made an additional investment in the well during the interim. Barker failed to promptly assert his right of forfeiture and accordingly, he waived his right to terminate the Hirt lease. Court found forfeiture was unnecessary because money damages was a sufficient remedy. Regarding the Barker lease, the Court concluded the district court correctly explained that practicality dictates a flexible payment schedule for royalties and that a modest well does not produce enough oil to be sold on a monthly basis. Court held that the district court correctly held that the Barker lease should not be forfeited for failure to pay the royalties on a monthly basis since the yearly royalty average exceeded the combined total of the monthly payments.
STATUTES: No statutes cited.

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U.S. District Court
for the District of Kansas

TERRA VENTURE, INC. V. JDN REAL ESTATE-OVERLAND PARK, L.P.
CASE NO. CIV.A.02-2593-GTV
340 F. Supp. 2d 1189
OCTOBER 14, 2004

Joint Venture; Fiduciary Duty; "Time is of the Essence" Clause; Covenant of Good Faith and Fair Dealing; Promissory Estoppel; Unjust Enrichment; Statute of Frauds

FACTS: In March 1998, Terra Venture, Inc. (along with corporate sibling TV Realty, Terra Venture) entered into a written agreement to purchase approximately 100 acres of undeveloped property in Overland Park. Before closing that purchase agreement, Terra Venture entered into an agreement with JDN Overland Park (along with related business entities, JDN), in which Terra Venture assigned its rights and interests in the 100 acres to JDN. In addition, the parties entered into a fee agreement, providing that JDN would purchase the 100 acres, and that Terra Venture might earn fees by performing certain services in connection with the property's development. The fee agreement obligated JDN to reimburse Terra Venture for its earnest money deposits and pre-development expenses upon closing. JDN appointed Terra Venture as the exclusive selling and leasing agent for the project, and agreed to pay Terra Venture a development fee of $300,000, market commissions to be negotiated, and a conditional earnout fee. The earnout fee was set at 50 percent of the difference between the actual project value minus the project costs and interest, provided the difference was positive. JDN and Terra Venture agreed to present the project to the public as a joint venture between the two parties. Finally, while the fee agreement included a "time is of the essence" clause, it did not provide a date by which construction was required to begin or be completed. Terra Venture claims that, in oral negotiations between the parties, JDN represented that the project would be completed within two years, and that both parties expected Terra Venture to receive an earnout fee. Terra Venture also alleges that JDN agreed to transfer a portion of the property to Terra Venture for the development of an auto mall. However, JDN never signed the written agreement providing for the transfer of land that Terra Venture presented to JDN. Site work on the project began in late 1999 or early 2000. The project experienced numerous delays attributable to JDN, which was experiencing substantial internal turmoil. Terra Venture attempted to get leases negotiated with tenants, but it took JDN six months to a year to get letters of intent and leases negotiated, when the turnaround on letters of intent should have been 30 to 60 days. By November 2000, Terra Venture realized because of interest costs due to the delays, it had no chance of receiving an earnout fee from the project. Terra Venture claims that it is entitled to damages for several reasons: (1) JDN breached its fiduciary duty to Terra Venture; (2) JDN breached its contracts with Terra Venture; (3) JDN is estopped from denying its obligations to Terra Venture; and (4) JDN accepted services without compensating Terra Venture for their value. This memorandum and order is in response to JDN's motion for summary judgment.

ISSUES: (1) Whether the parties' relationship constituted a joint venture; (2) whether JDN owed any fiduciary duties to Terra Venture; (3) whether JDN had an obligation to develop the property in a timely manner; (4) whether JDN breached its covenant of good faith and fair dealing by not developing the property in a timely manner; (5) whether Terra Venture can recover the anticipated earnout fee under a theory of promissory estoppel; (6) whether Terra Venture can recover from JDN for services rendered in excess of the contract amount under a theory of unjust enrichment; (7) whether Terra Venture can enforce an alleged, unwritten agreement providing for the transfer of land.

HELD: The court granted JDN summary judgment on all of Terra Venture's theories. The court stated that an absent clear intent by the parties, an ordinary business relationship should not be converted into a fiduciary relationship. The court held that Terra Venture and JDN were not engaged in a joint venture, because none of the factors for determining whether a joint venture exists were present. The parties did not have joint ownership and control of the property. JDN and Terra Venture did not share equally in the expenses and profits, by virtue of the fact that JDN paid all expenses on the project, reimbursed Terra Venture for pre-development expenses incurred, and paid Terra Venture a $300,000 development fee regardless of whether the project lost money. Instead of there being community of control, JDN had the final say on all issues in the project. Although the parties agreed to hold themselves out to the public as a joint venture, the court found that they did not specifically agree that their legal relationship was a joint venture. Finally, the parties did not jointly agree to the fixing of salaries, as JDN only agreed to pay Terra Venture market commissions, not a salary, and Terra Venture had no control over the salaries paid to JDN. Based on the analysis of the above factors, the court concluded that the parties did not intend to form a joint venture, and that JDN did not consciously undertake a fiduciary duty to Terra Venture by way of being involved in a joint venture. The court also held that no fiduciary duty was imposed on JDN by law, as Terra Venture and JDN were merely parties engaged in business at arm's length. The court held that the "time is of the essence" clause was insufficient to impose an obligation of JDN to develop the property in a timely manner, when the agreement and the oral manifestations of the parties contained no specific deadlines. The court stated, under Kansas law, a party seeking to prevail under an implied duty of good faith and fair dealing theory must plead a breach of contract action and point to a term of the contract the defendant violated by failing to abide by the good faith spirit of the term. Because the implied covenant of good faith cannot create a contractual right, an obligation of JDN to develop the land could not be imposed when the contract itself did not impose such an obligation. The court held that Terra Venture could not recover its expectation damages under a theory of promissory estoppel, and because Terra Venture failed to present evidence of reliance damages, JDN was entitled to summary judgment on that theory. Also, because Terra Venture presented no evidence that it provided services worth more than the amount JDN had already paid, it could not recover on a theory of unjust enrichment. Finally, the court held that Terra Venture's claim for damages on the auto mall deal was barred by the statute of frauds, and the absence of evidence showing an agreed-upon price or other terms prevented Terra Venture from proceeding on equitable theories.

STATUTES: No statutes cited.

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U.S. Bankruptcy Court
District of Kansas

IN RE JAMES BRENT STANLEY
JAMES BRENT STANLEY v. HOUSEHOLD FINANCE CORP., III,
CASE NO. 02-20893-7 315 B.R. 602 (Bankr. D. Kan. 2004)
OCTOBER 8, 2004
Truth-In-Lending Disclosure Requirements; Right to Rescind; Voiding of Security Interest

FACTS: James Brent Stanley (plaintiff) and Household Finance (defendant) entered into a written agreement in March 2001, wherein the defendant loaned the plaintiff a sum of money in return for a security interest in plaintiff's home (The loan and mortgage events are hereinafter referred to as the "transaction."). On May 7, 2002, plaintiff notified defendant by letter of his intention to rescind the transaction claiming defendant failed to provide adequate disclosure of plaintiff's right to rescind pursuant to the truth-in-lending Act (TILA). Under TILA, a debtor has three days to rescind the transaction if the debtor is properly informed of such right to rescind by the creditor. When a creditor fails to provide the debtor with the proper disclosures required by the TILA regulations, known as Regulation Z, the debtor's right to rescind is extended for up to three years from the date of the transaction. TILA violations are measured by a strict liability standard, so even a technical or minor violation of the regulations result in the creditor's liability. If a rescission is timely, it immediately voids the security interest, and the debtor must pay the money or return the property to the creditor within a certain time period, unless the court otherwise orders. Plaintiff contends that defendant did not provide plaintiff with two copies of the notice of a debtor's right to rescind in violation of Regulation Z and filed an affidavit stating that only one copy of the notice of the right to rescind was received. Plaintiff also claims that defendant failed to disclose the effects of a rescission in a clear and conspicuous manner. To support this claim, plaintiff filed a copy of the notice of the Right to Cancel. Such a notice contains two alternate paragraphs, which when marked in a corresponding box, describe the effects of rescinding either a refinancing of an existing loan or a new loan transaction. Neither corresponding box was marked to show which paragraph applied. Plaintiff contends that as a result of the inadequate disclosure, plaintiff's right to rescind was extended; plaintiff timely rescinded; and, therefore, the security interest in plaintiff's dwelling is void. Although defendant acknowledges receipt of the plaintiff's rescission, defendant denies that it provided inadequate disclosure, and, thus claims that plaintiff failed to timely exercise his right to rescind within the three day time period. Defendant further argues that if the rescission was timely, rules of equity provide that the security interest should not be voided until the debtor returns the money or property. This Opinion is in response to plaintiff's motion for summary judgment.

ISSUES: (1) Whether the number of copies of the Notice of the Right to Cancel is a question of fact for the jury; (2) whether unmarked alternate paragraphs provide clear and conspicuous notice of the effect of rescinding a transaction; and (3) whether the court may equitably condition the voiding of a security interest in the debtor's dwelling.

HELD: The court determined that the amount of copies of the Notice of the Right to Cancel given or received is a question of fact for a jury to decide and is thus not appropriate for summary judgment. Regardless, the Notice of the Right to Cancel violates the TILA because such notice did not clearly and conspicuously disclose to the debtor the effects of rescinding the transaction. If a notice is subject to two or more sensible readings, and different results may arise depending upon which of the two readings is adopted, the notice of what the right to rescind entails is not clear and conspicuous. Here, the Notice of the Right to Cancel cannot be clear and conspicuous disclosure because two different outcomes may result from the selection of different unmarked boxes. As a result of Defendant's violation of TILA, Plaintiff's right to rescind was extended by three years, and Plaintiff timely rescinded the Transaction by letter in May 2002. Under normal circumstances, such rescission immediately voids the security interest in the dwelling as promulgated in regulations by The Board of Governors of the Federal Reserve System, which is charged with implementing and interpreting the TILA. One such regulation provides that the courts may modify when the debtor returns the property, but not the time when the security interest is voided. The court invalidates such regulation and interpretation of the statute proclaiming the regulation irrational because it may result in the debtor receiving the entire benefit while the creditor receives nothing. Therefore, the court may consider the equities and condition the voiding of the security interest upon the return of the money and/or property. The record in this case, however, was insufficient to determine whether conditioning the voiding of the security interest was justified by principles of equity, and an additional hearing will occur for such determination.

STATUTES: No statutes cited.

IN RE BOB J. ANDERSON and MARGARITA ANDERSON
CASE NO. 04-40685-13
JANUARY 14, 2005
Delivery of Deed; Escrow

FACTS: In February 1998, Bob J. Anderson and Margarita Anderson (the "debtors") filed a Chapter 12 bankruptcy petition. Later that month, Anderson Farms, the debtors' partnership, filed a voluntary Chapter 12 bankruptcy petition. The two cases were consolidated in May 1998. On June 15, 1999, the court confirmed debtors' Third Amended plan, incorporating the terms of a Jan. 4, 1999, stipulation as to Plan Treatment of Southwest Bank, N.A., now known as Western Kansas Bancshares (the "bank"). The stipulation provided that certain real and personal property owned by the debtors, in which the bank held a lien, would serve as collateral for the bank's secured claim, and separated the real and personal property into two separate amortization schedules with different interest rates. Under the stipulation, annual payments were due on Sept. 1 of each year, with a "drop dead" date of Dec. 1, after which the bank would be entitled to a deed and bill of sale for the collateral without giving notice of default. However, for four straight years, the bank did not receive payment by the "drop dead" date of Dec. 1, and for four straight years, the bank did not enforce the drop dead provision. On Dec. 3, 2003, the debtors, who had not yet made the payment due Sept. 1, 2003, executed a deed to the real estate to the bank as required by the terms of the original stipulation. The debtors claim they intended the deed to be held by the bank's counsel in escrow, believing that the bank was going to restructure the delinquent September 2003 payment, and that the instrument would be taken out of escrow only if the bank declined to restructure the payment. If the stipulation had not been modified by the parties, title to the real property would pass to the bank when it received delivery of the deed following the drop dead date. However, the debtors' claim that the stipulation

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has been modified by agreement of the parties. As of the date of the court's memorandum and order, the bank had not recorded the deed, commenced payment of real estate taxes on the property, exercised control over the property by evicting the debtors from the premises, or treated the deed as a credit against the amount due by the debtors on its own books. On March 29, 2004, the debtors filed the instant Chapter 13 bankruptcy case. The bank contends that it is the title owner of the real property as of Dec. 3, 2003, and filed a motion for summary judgment so that it could exercise its ownership interest in the property without the court's supervision. The debtors contend that the Bank is not the owner of the property because there was never effective delivery of the conveyance instrument, and likewise moved for summary judgment. This memorandum and order is in response to the motions for summary judgment.

ISSUE: Whether debtors made an effective delivery of the deed to the bank on Dec. 3, 2003; did the debtors intend to unconditionally divest themselves of all right, title and interest in the subject property on that date, and transfer such interest to the bank?

HELD: The court held that genuine issues of material fact existed regarding whether the debtors or the bank owned the real property on the date the debtors filed this Chapter 13. The court stated that the stipulation clearly required the debtors to tender a deed to the real estate to be held in escrow for the benefit of the bank in the event the debtors failed to make the required annual payment within the three-month grace period. If the terms of the stipulation were not modified by the parties, title to the land would pass to the bank upon receipt of delivery. However, the court held that genuine issues of material fact existed regarding whether the stipulation had been modified by an agreement of the parties, and as such, summary judgment was improper. The court stated that, while a deed did not have to be recorded in order to be valid between the parties, under Kansas law, a deed is not effective if the grantor does not intend to unconditionally deliver a deed. Because a grantor's intention is determined by examining all the facts and circumstances surrounding the transaction, the court held that the debtors' subjective belief is relevant evidence. While neither party was entitled to summary judgment on the issue of ownership, the court stated that the bank's inaction in asserting ownership rights supported the debtors' position that the parties intended the deed to be security for the debt, not an outright conveyance pursuant to the stipulation. In light of the genuine dispute of material facts, the court denied summary judgment to both parties.

STATUTES: K.S.A. 58-2223

Multi-State Issues

IRS Section 1031 Like-Kind Exchanges: Kansas practitioners, who engage in multi-state or out-of-state like-kind exchanges of real estate under Section 1031 of the Internal Revenue Code, should be aware of a growing trend among states to enact legislation that varies from state to state with respect to the ability of a taxpayer to defer income taxes on the state portion of gain. Until recently, most states that impose income taxes have mirrored the federal tax code in allowing the deferral of gain in a tax-deferred exchange under Section 1031. It used to be that you could sell relinquished property in just about any state with an individual income tax (*e.g.*, Kansas) and acquire replacement property in another state that had little or no individual income tax (*e.g.*, Florida, Nevada, Washington, etc.). Eventually, the out-of-state replacement property could be sold, the gain recognized, and the taxpayer would have effectively reduced or avoided the state income tax portion on the gain. A savings of 6 percent (or more) in state income taxes on a significant amount of taxable gain could save the taxpayer several thousands of dollars, making it worthwhile for the taxpayer to at least consider acquiring replacement property in a state with little or no individual income tax.

However, some states have enacted or are considering additional requirements and/or special reporting rules where the replacement property is located in another state. These additional requirements either prohibit or place special restrictions on a taxpayer's attempt to sell property and export the unrealized gain, at the state level (not the federal level), to another state under Section 1031, where that gain might someday be realized with little or no applicable state income tax. If the relinquished property is located in Kansas, then this should not be an issue. The problem arises, if at all, when the relinquished property is located in a state other than Kansas, and the taxpayer desires to acquire replacement property in Kansas (or some other state).

In Georgia, for example, to qualify at the state level for 1031 exchange tax treatment on the sale of <u>relinquished</u> property located in Georgia, the <u>replacement</u> property must also be located in Georgia (*Georgia Statute 48-7-27(b)(6))*. Mississippi has a similar law. Oregon has a law that requires the reporting and recapture of Oregon state level gain upon the ultimate disposition of the out-of-state replacement property. Other states have laws similar to Foreign Investment Real Property Tax Act (FIRPTA) and require withholding if the seller of real property is a nonresident of the State. A nonresident taxpayer exchanging out of property located in such a state must meet the particular state withholding requirements. California goes even further, and requires withholding on real estate transfers for resident individuals, even if they are exchanging out of and into California real estate. Although there is an exemption for like-kind exchanges, withholding is still required in California on any boot (i.e., cash or cash equivalent) received by the taxpayer. ■

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CLE Docket 2005

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MAY

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6 — **Ethical Challenges in Managing a Law Office**
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19 — **Family Law**
Telephone CLE
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20 — **Practical Skills**
Holiday Inn West - Topeka
8 CLE credit hours, Including 2 hours professional

Author

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Probate and Trust Cases

GARRETT V. READ
102 P. 3d 436
December 17, 2004

A lawyer's testimony that identical husband and wife wills were intended to be contractual was accepted by the Kansas Supreme Court. The wills did not recite or refer to an agreement between the testators. The district court admitted the testimony of the scrivener regarding the existence of an oral agreement between the testators and concluded that the wills were contractual. A constructive trust was thus imposed in favor of the first decedent's beneficiaries.

The Supreme Court set out the tests for a contractual will as: (1) a provision for distribution of property on the survivor's death; (2) a carefully drawn provision for the disposition of any share in case of a lapsed residuary bequest; (3) the use of plural pronouns; (4) joinder and consent language; (5) identical distribution of property upon the survivor's death; (6) joint revocation of former wills; and (7) consideration, such as mutual promises. The Court did not thoroughly analyze these factors and acknowledged that many of them were not present, but instead relied primarily on the scrivener's testimony.

The attorney testified that he explained joint and mutual wills to the testators and suggested including contractual language. Although they allegedly agreed they wanted contractual wills, they wanted the surviving spouse to be able to liquidate estate assets and spend all of the proceeds, if necessary. The attorney testified that when the surviving spouse executed a later will after her husband's death he informed her that she and her husband had an agreement and that she told the attorney she had taken care of her husband's children outside of the will with joint property.

In imposing a constructive trust in favor of all of the children of the blended family of the two testators the Kansas Supreme Court gave priority to the testimony of the attorney scrivener in the absence of contractual language. No showing of contractual ambiguity was required before testimony was admissible. It would certainly seem that it would be better to rely upon the writing to establish the contract and the attorney apparently tried to get the testators to include contractual language. Who would have suspected that a conscious decision not to include contractual language would nevertheless have resulted in a contract based upon the drafting attorney's testimony? Who among us would have expected that our testimony could be so determinative?

Phil Ridenour, an estate planner from Cimarron, has noted that the case avoided all discussion of the attorney-client privilege and the hearsay rule. He also noted that although the question remains unlitigated in Kansas as to whether the doctrine of contractual wills extends to contractual revocable trusts, there is nothing suggesting that this would not happen under similar circumstances.

BREWER V. SCHALANSKY
102 P.3d 1145
December 17, 2004

Brewer inherited stock upon her husband's death in 1991. In 1994, she added her two nieces, whom she had raised, as joint tenants on the stock. Seven years after creation of the joint tenancy, Medicaid was sought for Brewer by her niece, who had power of attorney. An administrative hearing was held at which Brewer's position was that only one-third of the stock value should be treated as an available resource since the transfer occurred beyond the three-year look back period. The Kansas Department of Social and Rehabilitation Services (SRS) maintained, and its hearing officer found, that since Brewer had inherited the stock, the full value nevertheless had to be included.

The evidence regarding Brewer's donative intent was conflicting. There was evidence that she placed her nieces' names on the stock to avoid probate and did not intend for her nieces to access the stock until her death. There was also evidence that the nieces could not sell the stock without Brewer's consent, but this was apparently due to a brokerage policy requiring all three joint tenants to consent. This was used to argue that Brewer had not effectively parted with ownership, but was also used by Brewer's niece to infer that she had given away sole ownership. There was also some evidence that Brewer had placed her nieces' names on the stock as compensation for support provided by the nieces.

Continued on next page

The district court reversed the SRS decision, ruling that Brewer was not obligated to file a lawsuit for partition since the cost of doing so would likely exceed any benefit Brewer would receive.

The Kansas Supreme Court reversed the district court and upheld the SRS decision. The Court noted the rebuttable presumption of equal ownership between joint tenants. The Court held, however, that there was substantial evidence supporting SRS's conclusion that the full value of the stock was an available resource because Brewer had contributed the full value and the evidence was conflicting as to a donative intent. The Court also indicated that the initial administrative decision was a factual one and that the district court should not have substituted its judgment for that of the agency. ■

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ETA: JUNE 9-11, 2005
NEXT STOP: VAIL CASCADE RESORT & SPA

ANNUAL MEETING AT-A-GLANCE

Thursday, June 9

Time	Event
10:30 a.m.	Golf tournament @ Eagle Vail Golf Club
11 a.m.	Sporting clays shoot
11 a.m.	Tennis tournament
5 – 7 p.m.	Welcome Reception
5 – 7 p.m.	Children's Welcome Reception

Friday, June 10

Time	Event
7 a.m.	Sunrise CLE
8:45 a.m.	President's Welcome
9 a.m.	Keynote Address – Jeffrey Benz, general counsel, U.S. Olympic Committee
10:15 a.m. – 5:10 p.m.	CLE Presentations
12:15 p.m.	Awards Luncheon
6 p.m.	President's Reception: cocktails and hors d'oeuvres
7 p.m.	"Changing of the Guard" dinner banquet and ceremony
8:30 p.m. – Midnight	"Mixer and Music" – Meet the new Board of Governors and Officers

Saturday, June 11

Time	Event
6:45 a.m.	5k legal runaround @ Vail Cascade trail
7 a.m.	Eggs & Issues membership forum breakfast
8:30 a.m. – 12:05 p.m.	CLE Presentations
9 a.m.	Board of Governors Meeting
12:30 p.m.	Law School Luncheons
1:30 p.m.	Board of Trustees Meeting
6 – 9:30 p.m.	Fellows Dinner

Price of rooms (if reserved before May 1, 2005): $169 single/double occupancy
Room reservations: Call (800) 420-2424 or e-mail groupres@vailcascade.com

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