THE REPORTER

Published by the Kansas Bar Association • Real Estate, Probate, & Trust Law Section

SUMMER 2008

President's Message

The KBA Annual Meeting is once again upon us, with this year's meeting scheduled for June 19-21 at the Capitol Plaza Hotel in Topeka. Our section will have its meeting on Friday, June 20 as part of the "Brown Bag and Bull" luncheon. I look forward to meeting section members and those interested in becoming section members at the luncheon. The members of the executive committee appreciate input from its members on how we can better serve the section. This year our section is providing two presentations. David Newbery is speaking on Creditor Protection Trusts in Kansas — An Estate Planner's Perspective, and I am speaking on Estate Planning and Tax Aspects of Divorce.

Section President

Robert M. Hughes
Bever Dye L.C., Wichita

It is also at the Annual Meeting that the new officers are elected. Vern Jarboe will assume the duties as president of the section for a two-year term. Vern has been a very active member of the executive committee, providing valuable input and leadership. The section is fortunate to have Vern as its incoming president.

As president I have had the good fortune to be able to look not only to Vern for assistance, but also Kevin Conley and Cal Karlin. I believe that our section has the best newsletter of all KBA sections, which is due to the tireless efforts of Cal and the contributions of Dan Peare and Mark Andersen. These individuals, along with the efforts of the KBA staff, have provided a consistent quality newsletter.

In my last column I stated that the Kansas Estate Administration Handbook was in the process of being revised with a seminar scheduled at the time the handbook is released. The date of the seminar has been moved to Oct. 19 in Salina. Those that attend will receive as their outline the newly revised handbook.

Finally, thank you for allowing me to be your section president these last two years. It has been a truly enjoyable experience. ■

In This Issue ...

About the Author

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He received his juris doctorate from the University of Kansas School of Law and his master's and bachelor's degrees in finance from Wichita State University (WSU).

He is a member of the executive committee of the Real Estate, Probate, and Trust Section and serves as the committee's liaison to the KBA Continuing Legal Education Committee. He is a member and past director of the Wichita Estate Planning Council and the Wichita Estate Planning Forum. He is on the WSU Foundation Board of Directors, where he serves as chairman of the Foundation's Giving Committee, and is a member of the National Advisory Council for WSU. Peare is also a member and past chairman of WSU Foundation's Planned Giving Professional Advisory Committee.

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Estate Tax Notes:
Tax Cases and Rules Affecting the Estate and Business Succession Planner

GENERATION-SKIPPING TRANSFER TAX

1. T.D. 9348 (8/2/2007); REG-128843-05 (8/2/2007) – Qualified severance of trust for generation-skipping transfer (GST) tax purposes

The Internal Revenue Service (IRS) issued final and proposed regulations providing guidance regarding the severance of a trust for GST tax purposes under Code Section 2642(a)(3). The final regulations reflect changes made based on comments received on Proposed Regulation 145987-03. The IRS noted that pursuant to Code Section 2642(a)(3), a qualified severance may facilitate the most efficient and effective use of a transferor's GST tax exemption.

The IRS explained that the final regulations do not supersede Regulation Section 26-2654-1(b). However, the IRS also issued proposed regulations that amend Regulation Section 26-2654-1(b). Additionally, the final regulations provide rules for the qualified severance of a trust, regardless of its inclusion in the transferor's gross estate, when the severance is effective prospectively from the publication date. Further, the IRS noted that while the words "Qualified Severance" should appear at the top of the appropriate notice form, the IRS no longer requires filers to stamp or write "Qualified Severance" in red ink.

The final regulations also provided guidance regarding a qualified severance of the Chapter 13 portions of these trusts. While the final regulations do not require trusts to report a severance to secure qualified severance status, the IRS recommended reporting each severance so Chapter 13 of the Code could be properly applied to these trusts. In addition, the IRS expanded the category of severances to which Regulation Section 1.1001-1(h)(1) applies.

The proposed regulations address the tax consequences of a severance of a trust that is effective under state law, but does not meet the requirements of a qualified severance under Code Section 2642(a)(3). Under the proposed regulations, a severed trust that is recognized under state law as a separate trust will be treated as a separate trust for GST tax purposes. However, because the severance is not a qualified severance, the separate trust will have the same inclusion ratio immediately after the severance as the original trust had before the severance. Any GST tax exemption may be allocated to one or more of the resulting trusts.

Further, the proposed regulations provide for an additional type of qualified severance, in which a trust with an inclusion ratio of zero to one is divided into three or more resulting trusts. However, such a severance is bound by specific regulations, which should be reviewed. Finally, the proposed regulations clarify Regulation Section 26.2642-6(d)(4), which requires that resulting trusts be funded with a fraction or percentage of the original trust. Specifically, the proposed regulations provided that no discounts or reductions from the value of an asset owned by the original trust arising by reason of the division may be used in calculating the value of the asset after severance. Instead, the value of the asset must be calculated by multiplying its fair market value on the severance date with the fraction or percentage of the asset held by the resulting trust.

GIFT TAX

2. *Estate of Christiansen v. Comm.*, 130 T.C. No. 1 (1/24/2008) – Failure to disclaim contingent remainder interest prevents disclaimer from being qualified

A mother and daughter were active in their community and desired to permanently fund local education and economic development projects. To do so, after being advised by a local attorney, the mother and daughter created an estate plan with several interrelated parts. First, they established a charitable foundation. Additionally, the mother's estate plan created a 20-year charitable lead trust that would begin making annual distributions to the foundation after her death and provided that the remaining principal and income would be distributed to the daughter at the end of the 20-year term if she was then living. Third, as part of the estate plan funding, the attorney advised the mother to reorganize her farming and ranching businesses into family limited partnerships. Fourth, the attorney drafted a will that gifted the entire estate to the daughter. If she disclaimed any testamentary property, 75 percent of the value of the disclaimed property would pass to the trust and the balance would pass to the foundation.

After the mother's death, the daughter executed a written disclaimer in which she retained an amount that would allow the family farming and ranching businesses to continue and would provide for her and her family. The partial disclaimer, however, did not address the daughter's remainder interest in the 20-year trust.

The commissioner challenged the estate's claimed charitable deduction on the amount passing to the trust by asserting that the disclaimer was not qualified within the meaning of the Code. Additionally, the commissioner challenged any increased charitable deduction on property passing to the foundation through a savings clause provision in the disclaimer.

The court agreed with the commissioner that the disclaimer was not qualified. The court noted that the problem with the daughter's disclaimer was that there was a contingent possibility that the disclaimed property passing to the trust would return to her after the termination of the trust. Pursuant to Regulation Section 25.2518-2(e)(3) and its example, the court held that the partial disclaimer was not qualified, and thus, the estate was not entitled to a charitable deduction in the amount passing to the trust.

The Tax Court further rejected the estate's arguments that the savings clause language rescued the disclaimer's qualified status. The court held that the savings clause would either operate more than nine months after the transfer date, making it ineffective under the requirements of Code Section 2518, or the savings clause was so broad that it did not sufficiently identify the property being disclaimed. Specifically, the court stated, "Such contingent [savings] clauses — contingent because they depend for their effectiveness on a condition subsequent — are as ineffective as disclaimers as they are for revocable spousal interests ... and gift adjustment agreements ..." [Citations omitted.]

Nonetheless, the court held that the estate was entitled to increase its charitable deduction amount for property passing to the foundation based on the disclaimer and the parties' stipulation that the decedent's gross estate was larger than initially reported. Based on the savings clause, the court held that any additional property beyond that fixed by the formula in the disclaimer passed to the foundation. Because the daughter did not have a contingent remainder interest in the foundation, there was no hurdle that prevented the disclaimer from meeting the definition of a qualified disclaimer.

CHARITABLE GIVING

3. P.L.R. 200813006 – Qualification and tax treatment of charitable remainder unitrust

The taxpayers, a husband and wife, sought guidance from the IRS on a proposed charitable remainder unitrust (CRUT) that they intended to fund with stock. Under the terms of the CRUT, the trustee was required to pay 25 percent of the unitrust amount to the taxpayers or the survivor of them, and had discretion to pay 75 percent of the unitrust amount to the taxpayers, jointly or separately, and any qualified charitable organization as the special trustee directed. The special trustee retained the absolute discretion to direct where the 75 percent of the unitrust amount went. At the second spouse's death, the trustee would pay the remaining income and principal to a foundation.

The taxpayers retained the joint power, and after the first spouse's death the survivor retained the sole power, to change the charitable remainder beneficiary to one or more qualified charitable organizations by a written instrument delivered to the trustee. The CRUT agreement further designated the initial and successor special trustees and provided that in no event would the husband, wife, or any party related or subordinate to the taxpayers act as the special trustee. Additionally, as the initial trustees, the taxpayers retained the right to remove and replace the special trustee with another party, provided that the appointed special trustee was not the husband, wife, or a party related or subordinate to the taxpayers.

The IRS refused to answer most of the taxpayers' questions regarding whether the proposed trust would qualify as a CRUT and instead directed the taxpayers to Revenue Procedure 2005-55 and its sample CRUT provisions. The IRS assured the taxpayers that any CRUT following those sample provisions would qualify as a CRUT.

However, the IRS agreed to address the portions of taxpayers' questions that were not covered by Revenue Procedure 2005-55. The IRS held that where an independent trustee has the authority to distribute trust income among charitable and noncharitable beneficiaries, but must distribute some of the trust income to a noncharitable beneficiary, the trust remains a qualified CRUT. Additionally, the IRS held that because the proposed trust agreement prevented the taxpayers from becoming or from appointing a subordinate party as the special trustee, their retained power to remove and appoint the special trustee did not disqualify the trust as a CRUT.

Further, the IRS concluded that both spouses were treated as making a gift to the other spouse of one-half the trust property that each had contributed to the trust; and thus, neither spouse was subject to the gift tax under Code Section 2523(g). Finally, the IRS held that because the surviving spouse was the only noncharitable beneficiary of the income interest after the first spouse's death, that the transfer of the full income interest from the deceased to the survivor qualified for the marital deduction under Code Section 2056(b)(8).

4. P.L.R. 200808018 – Tax consequences of proposed division of charitable remainder trusts

Several years ago, the taxpayer created a net income with makeup charitable remainder unitrust (NIMCRUT) and named himself and a family trust as beneficiaries of the unitrust amount. The taxpayer requested rulings on whether a proposal to divide the NIMCRUT into two separate trusts and assign the unitrust amount from one trust to the charitable remainder beneficiary would disqualify the remaining trust (Trust A) as a NIMCRUT. The taxpayer asserted that by transferring his unitrust interest to the charitable remainder beneficiary, the NIMCRUT (Trust B) would terminate and result in a completed gift under state law. The taxpayer further represented that he did not divide the NIMCRUT to avoid the partial interest rules. The taxpayer also requested rulings on whether he was entitled to charitable deductions and whether the transfer of the unitrust interest, which included appreciated stock, would require him to report capital gains income by reason of his transfer of the interest to a charitable organization.

The IRS concluded that the division of the NIMCRUT into two trusts would not cause the "surviving" trust (Trust A) to lose its qualified NIMCRUT status assuming the following conditions were met. First, the two resulting trusts must be bound by the same terms of the original trust. Second, the assets allocated to both trusts must be fairly representative of the aggregate adjusted bases of the original trust assets for each major class of investments held on the division date. Additionally, within each class of assets, the overall appreciation or depreciation of the assets must also be fairly representative of the appreciation and depreciation in the original trust.

Based on these assumptions, the IRS concluded that the taxpayer would be entitled to a charitable deduction, subject to the limitations of Code Section 170, equal to the present value of the right to receive unitrust payments as provided in Trust B from the date the trustee divided the trusts until the taxpayer's death. If the taxpayer transferred his entire Trust B unitrust interest to the qualified charity, the taxpayer would be entitled to a gift tax charitable deduction under Code Section 2522(a) for the present value of the unitrust interest transferred. Finally, the IRS noted that no amount would be included in the taxpayer's gross income for any capital gains realized due to the unitrust interest transfer to charity.

5. P.L.R. 200803002 – Assignment of annuity from trust before distribution is not a transfer of income in respect of decedent

When the taxpayer died, he owned a nonqualified deferred annuity contract, which named his trust as beneficiary. At the taxpayer's death, he had not yet begun receiving annuity payments because the annuity contract had not reached its start date. The trustee did not include any annuity amounts in the trust's income and did not take any income tax deduction for any annuity amounts in any taxable year. Instead, the trustee fulfilled charitable distributions, required by the trust agreement, by assigning the annuity contract to the named charities. While the trust agreement did not provide the trustee with the authority to make in-kind or pro-rata distributions, state law provided such powers. The trustee requested a ruling on whether the assignment of the annuity contract to the chairty was a transfer within the meaning of Code Section 691(a)(2), which would include the amount of the transferred annuity in the trust's gross income.

Pursuant to Regulation Section 1.691(a)-4(b), the IRS held that the assignment of the residual interest of the annuity to the charities was not a transfer under Code Section 691(a)(2) and therefore, the trust was not required to include the value of the annuity contract as gross income. Rather, the IRS stated that only the charities were required to include the amounts of the distributed annuity payments as income in respect of decedent in their gross income.

6. Revenue Ruling 2008-16 – Amount of shareholder charitable deduction for S corporation making charitable contributions of appreciated property for tax years after Dec. 31, 2005, and before Jan. 1, 2008

An S corporation made a charitable contribution of unencumbered real property with a basis of $100 and a fair market value of $190 to a qualified charity, pursuant to Code Section 170(c). The limitations in Code Section 170(e)(1) did not apply. In the same year, the S corporation had Code Section 1363 taxable income of $30 and a long-term capital loss of $25.

The IRS held that the amount of the charitable contribution deduction the shareholder may claim cannot exceed the sum of (i) the shareholder's pro rata share of the fair market value of the contributed property over the contributed property's adjusted tax basis ($90), and (ii) the amount of the Code Section 1366(d) loss limitation amount that is allocable to the contributed property's adjusted basis under the formula provided in Regulation Section 1.1366-2(a)(4) ($64), for a total claimed deduction of $154. Any disallowed portion of the charitable contribution ($36) retains its character and is treated as being incurred by the S corporation in the S corporation's first succeeding taxable year, and subsequent taxable years, with respect to the shareholder.

7. *Derby v. Comm.*, T.C. Memo 2008-45 (2/28/2008) – Physicians denied charitable deduction for intangible assets "donated" to charitable programs of acquiring corporation

As part of a merger, a group of physicians associated as a medical group entered into negotiations with a regional health care system. The regional health care system acquired medical groups in the area and managed the interconnected groups through a professional service agreement. The regional health care system offered the physicians more autonomy and did not require the physicians to sign broad noncompete agreements as had a previous potential acquirer. The negotiations between the medical group and the regional health care system began in 1993 and extended through 1994. According to the court, the negotiations were at times acrimonious. The notable sticking point was the refusal of the regional health care system to pay the physicians for their intangible business assets, i.e., their goodwill and patient lists. However, as a further inducement to enter the contracts, the regional health care system agreed to provide each physician a substantial signing bonus.

The medical group hired an attorney during the negotiation process who recommended that the physicians donate the value of their intangible business assets to the regional health care system's 501(c)(3) subsidiary and claim the value of the intangible assets as a charitable deduction. The attorney based his plan on the favorable written determination he received on behalf of another client and on a continuing professional education technical instruction manual.

To carry out the plan, the medical group hired an investment bank to appraise the "business enterprise value" of a to-be-formed medical group and an entity unrelated to the business valuator to appraise the medical group's tangible assets. Further, the investment bank agreed to value the medical group's intangible assets.

However, the value of the intangible assets was determined not by the investment bank, but by one of the doctors in the medical group. The doctor determined the intangible asset value by subtracting the assessed value of the tangible assets of the medical group and the aggregate accounts receivable as calculated on the transfer date from the assessed business enterprise value. The medical group allocated the difference among the physicians, each of whom claimed a charitable contribution deduction for his or her portion of the intangible assets donated to the regional health system's 501(c)(3) subsidiary. Each of the physicians documented their contributions using the appropriate form. However, the exempt subsidiary did not report the donation of the intangible assets from the medical group as contributions.

Subsequently, the IRS denied the doctors' charitable deductions and assessed penalties. The doctors sought a redetermination from the court.

At trial, the doctors claimed that they made completed gifts at the time of the merger because they transferred their intangible assets to the 501(c) subsidiary without compensation and thus, had the requisite donative intent to make a charitable donation. Further, the doctors claimed that the IRS was bound by a prior written determination approving a similar, previous transaction. The IRS contended that the physicians received other benefits in return for the value of the intangible assets and that the doctors had failed to show that the value of the intangible assets transferred exceeded the value of the consideration they received as part of the merger.

The court agreed with the IRS and determined that the doctors were not entitled to a charitable deduction because they had received benefits, such as a guaranteed minimum salary, greater autonomy, and a relaxed noncompete clause, in return for their intangible assets. The court noted that the doctors had considered the noncash benefits in the merger agreement valuable based on their rejection of a prior bid from an HMO for more cash. The court also dismissed the doctors' claim that the IRS was applying the law inconsistently by distinguishing the facts underlying the prior written determination and noting that prior written determinations do not have precedential value. Nonetheless, the court denied the IRS's request for overvaluation penalties because there was an independent reason to deny the physicians' deductions.

RETIREMENT BENEFITS

8. **PLR 200811028 – Required minimum distributions under qualified plan for nonspousal beneficiary**

The decedent, age 66, named the taxpayer, his only living child, as beneficiary of two individual retirement accounts (IRAs). The decedent was unmarried both at the creation of the IRAs and at his death. No distributions were made from the IRAs before the decedent's death, and the decedent died before the required beginning date of distributions. The taxpayer took the required minimum distributions for 2003, 2004, and 2005 all in 2005 and based on the distribution period provided in Regulation Section 1.401(a)(9)-5, Q&A-5(c)(1). The taxpayer paid the additional tax for failure to timely receive the required minimum distributions for years 2003 and 2004 in 2007. Further, the taxpayer did not elect to take the five-year distribution for either IRA.

The IRS concluded that when an employee dies before a required minimum distribution date, the life expectancy rule in Code Section 401(a)(9)(B) is the default rule unless the plan provided or the designated beneficiary elected to take the alternative five-year distribution. Under the current facts, because the taxpayer took the required minimum distributions and was a designated beneficiary, she was not required to follow the five-year distribution rule. Further, although the taxpayer failed to take the required minimum distributions in 2003 and 2004, she satisfied the required distribution rules by taking both the 2003 and 2004 required minimum distributions along with her 2005 required minimum distribution and paying the imposed excise tax. Therefore, she was not required to adhere to the five-year distribution rule for failing to elect.

9. **Notice 2008-42, 2008-15 I.R.B. (3/28/2008) – Nonmaterial modifications of split-dollar life insurance arrangements**

The IRS issued guidance regarding the application of Code Sections 101(j) and 264(f) to life insurance contracts that are subject to split-dollar life insurance arrangements. Regulation Sections 1.61-22, 1.301-1(q), and 1.7872-15 provide rules for the taxation of participants in split-dollar life insurance arrangements. If an arrangement is materially modified, the arrangement is treated as a new arrangement entered into on the date of the modification. Section 1.61-22(j)(2)(ii) provides a nonexclusive list of changes that are not considered material modifications. Generally, a split-dollar arrangement is not considered a life insurance contract, as that term is defined in Code Section 7702. Therefore, if the parties to a split-dollar life insurance arrangement modify the terms of the arrangement, but not the terms of the life insurance contract, the modification is not considered a material change for purposes of Code Sections 101(j) and 264(f).

10. Notice 2007-86, 2007-46 I.R.B. 990 (11/13/07) – Notice 2007-78, 2007 I.R.B. 780 (9/10/2007) Section 3 revoked and modified

The IRS issued a new notice in response to comments that Notice 2007-78 did not adequately address the need for additional time for service recipients and providers to bring their nonqualified deferred compensation plans into compliance. The notice provides additional transition relief for the application of Code Section 409A from Dec. 31, 2007, to Dec. 31, 2008. The IRS revoked Section 3 of Notice 2007-78, and also modified the relief provided in section 4, but did not change the guidance provided in section 4 or section 6. For 2008, taxpayers are not required to comply with the final regulations. However, taxpayers must operate a nonqualified deferred compensation plan in compliance with the plan's terms to the extent the terms are consistent with Code Section 409A and previous guidance, including Notice 2005-1. The IRS further provided that "[w]here a provision of Notice 2005-1 is inconsistent with the final regulations, taxpayers may rely upon either Notice 2005-1 or the final regulations." Issues that are not addressed should be resolved by applying a reasonable, good faith interpretation of the statute. The IRS will consider taxpayers who rely on the final regulations in interpreting inconsistent provisions as applying a reasonable, good faith interpretation of the statute.

PARTNERSHIPS

11. *Estate of Rector et al. v. Comm.*, T.C. Memo. 2007-367; No. 20860-05 (12/13/2007) – Estate subject to accuracy-related penalty where creation of family limited partnership did not have legitimate and significant non-tax business purpose

A mother, who was the beneficiary of a marital and bypass trust funded through her late husband's estate, created a revocable trust and funded it with the assets of her husband's marital trust. The trustees of the revocable trust were the mother and one of her sons, John. Her second son, Frederic, was named as successor trustee. John was a licensed investment broker and held a securities license, a commodities license, an insurance license, an options license, and a registered investment advising license. John actively managed his mother's finances.

Several years before her death, John proposed that his mother create a limited partnership and gift limited partner interests to her sons and grandchildren to protect her assets from creditors and reduce the value of her gross estate based on lack of marketability and lack of control discounts. The mother and sons agreed to form a family limited partnership (FLP) but did not negotiate any of the terms of the FLP. The mother contributed all of the assets to the FLP by transferring approximately $8.7 million dollars of cash and marketable securities from her revocable trust to the FLP in exchange for a 98 percent limited partnership interest. In the FLP agreement, the mother was listed as a 2 percent general partner and John was listed as a zero percent general partner. However, according to the court, John was not in fact a general partner. Further, the FLP agreement provided that the partnership's net cash flow would be distributed according to the partnership interests; yet, the mother also retained the right to direct payments from the FLP.

The mother subsequently transferred limited partnership interests to her sons and transferred her two percent general partnership interest to her revocable trust. According to the court, the FLP operated without a business plan or identified investment strategy; did not trade or acquire investments; did not issue balance sheets, income statements, or other financial statements; and did not hold formal meetings.

After the mother's death, her estate timely filed a federal estate tax return. Although the mother had filed gift tax returns during years she made gifts in excess of the annual gift tax exclusion amounts, the estate did not include these amounts on the federal estate tax return. John, as co-executor of the estate, signed the return.

The mother's estate filed for redetermination of the IRS deficiency determination and accuracy related penalty. The estate claimed that the value of the assets the mother transferred to the FLP were not includible in her estate under Code Section 2036(1) because she either relinquished the enjoyment and right to income from the transferred assets or because she had received adequate and full consideration for the assets in a bona fide sale.

The court rejected the estate's arguments, and accepted the commissioner's argument that the FLP was created as a testamentary substitute and did not have a legitimate nontax business purpose. The court noted that the facts presented demonstrated an understanding that the mother retained the possession, enjoyment, and right to income from the assets. In rejecting the estate's claims, the court focused on the mother's failure to retain sufficient liquid assets to pay her annual living expenses after transferring all of her assets into the FLP. Moreover, as the mother was living in a convalescent hospital, she and her sons knew the amount of her annual living expenses. Further, instead of using the bypass trust principal to pay mother's living expenses that exceeded her bypass trust income interest, she and her sons directed funds from the FLP to pay the overages. Based on John's significant financial and investment background, the court rejected the estate's arguments that these oversights were oversights.

Furthermore, the court rejected the estate's bona fide sale theory explaining that the property transferred to the FLP did not change the type of assets or the likelihood of profit from the assets, which suggested that the transfer of the assets to the FLP was not conducted in good faith. Based on the lack of a nontax business purpose for the FLP, the failure of the mother and her sons to negotiate the terms of the FLP, and the failure of other general partners to contribute assets to the FLP as contemplated by the FLP agreement, the court held that evidence did not support the estate's claim that the transaction was entered into in good faith.

Finally, the court approved the requested accuracy related penalty assessed against the estate. The court found that the estate was negligent in failing to report the amount of the gifts that the mother had reported on gift tax returns in the estate's tax filings. The court cited John's extensive financial experience to support its conclusion that John knew or should have known about the omission of the gift tax amounts from the estate's tax return. This negligent omission supported the accuracy based penalty.

12. *Estate of Mirowski et al. v. Comm.*, T.C. Memo. 2008-74 (3/26/08) – Limited liability company interest not included in decedent's estate

The decedent was the widow of a co-inventor of the automatic implantable cardioverter defibrillator (ICD). In the co-inventor's will, he transferred his ICD royalty interest from patent licensing agreements to his wife. Approximately two years after her husband's death, decedent created irrevocable spendthrift trusts for her three daughters. She named all three daughters as co-trustees of each of the trusts, with the intention that in managing the trusts, the daughters would form a close working relationship. The decedent funded these trusts by transferring a percentage of the ICD royalty to each trust. After several different funding transactions, the decedent retained a 51.09 percent interest in the royalties, and the daughters each held a 7.2616 percent interest in the royalties through their respective irrevocable trusts. The remaining royalty interest was held by the other co-inventor.

After the decedent's husband's death, the decedent invested her money and kept track of her own finances until her various holdings became too diverse to keep track of and the royalty payments increased significantly. Based on the suggestion of one of her daughters, the decedent consolidated her investments with Goldman Sachs. Goldman Sachs representatives routinely gave the decedent investment advice. The decedent followed and rejected this investment advice, but at all times remained an active participant in her investment decisions. Additionally, throughout this time, the decedent regularly made gifts to her children, grandchildren, and made other various charitable donations. When required, the decedent filed the necessary gift tax returns.

The decedent subsequently created a limited liability company (LLC) with the purpose of (1) providing for joint management of the family's assets by her daughters and eventually her grandchildren, (2) maintaining the family's assets in a single pool to allow for investment opportunities not otherwise available through Goldman Sachs, and (3) to provide for each of her daughters and grandchildren on an equal basis.

The decedent filed the applicable Gift Tax and Generation-Skipping Transfer Tax forms reporting her transfers of LLC interests to her daughters and her grandchildren. Additionally, the decedent's estate accounted for these transfers in its return. Subsequently, the IRS determined that the decedent's gross estate was approximately $43 million larger than reported and issued a deficiency notice to the estate. The IRS based its increase on the determination that all of the assets the decedent transferred to the LLC were includible in her estate. The estate filed for a redetermination of deficiency and claimed that the decedent's transfers to the LLC, managed by the decedent and her family, were completed at arm's length and were therefore not part of her estate.

At trial, the court found that the decedent made bona fide, arm's length transactions when she transferred her approximately 51 percent interest in the ICD royalties and her Goldman Sachs investment account to the LLC in exchange for a 100 percent ownership interest in the LLC. After funding the LLC, the decedent transferred a 16 percent interest in the LLC to each of her daughters and understood that such a transfer would create a significant gift tax obligation. Additionally, the court found that at no time was there an express or implied agreement or understanding that the LLC would pay the substantial gift tax liability arising from the transfer of LLC interests to the decedent's daughters. The court noted that the decedent retained substantial personal assets, expected income distributions from the LLC for the royalty payments, and could have secured a loan using the ICD royalty payments as collateral to pay any outstanding gift tax debt. Further, at no time were decedent's remaining personal assets commingled with the LLC's assets.

Shortly after creating and funding the LLC, the decedent died unexpectedly due to complications related to a diabetic foot ulcer. Notably, the decedent, her daughters, and the decedent's doctors did not expect the decedent to die as a result of her diabetic foot ulcer. The court concluded that based on the decedent's unexpected death, the decedent and her daughters would not have had an opportunity to discuss how the decedent was going to pay the substantial gift tax. After the decedent's death, the LLC distributed cash to the decedent's estate to pay the substantial gift tax and other estate obligations of the decedent.

Based on the preceding facts, the court rejected the commissioner's deficiency claim that the LLC assets were includible in the decedent's estate. The court noted that there were substantial legitimate nontax reasons for creating the LLC, that the LLC held regular meetings, that the LLC managed the business issues surrounding the ownership of the ICD royalty interests, and that the unified investment pool provided additional opportunities for profit not otherwise available. Thus, the court concluded that the estate tax return did not underreport its estate taxes on its submitted tax return.

OTHER

13. Notice 2007-73, 2007-36 I.R.B. 545 (9/4/2007) – Transaction of interest: Toggling grantor trusts

The IRS placed "toggling" grantor trusts with the following attributes on its list of "Transactions of Interest." The IRS provides two examples of "toggling" trusts. In each example, the taxpayer creates a grantor trust that provides a short-term unitrust interest, a noncontingent remainder interest, and also a substitution power that becomes effective on a later date certain. The taxpayer retains the noncontingent remainder interest and the substitution power. The taxpayer assigns the short-term unitrust interest to a beneficiary. The retained noncontingent remainder interest creates a grantor trust.

After creating and funding the trust, but before the substitution power becomes effective, the taxpayer/grantor sells the remainder interest to an unrelated party for the fair market value of the remainder interest, "toggling" off the grantor status of the trust. The trust and the remainder interest exchange are structured to permit the taxpayer to claim that no gain is recognized on the sale of the remainder interest. On the date that the substitution power is activated, the taxpayer/grantor claims that the grantor status "toggles" back on. The taxpayer/grantor then buys the unitrust interest back from the beneficiary, terminates the trust, by holding both the present and future interests, and claims either a loss or minimal gain over the series of transactions. The series of transactions typically occur over a short period of time, usually within 30 days.

While the transactions are not currently illegal, the IRS believes that the transactions have the potential for tax avoidance or evasion but does not currently have sufficient information to make such a determination. Individuals may have certain responsibilities arising from their involvement in these transactions. Grantors, buyers, and beneficiaries participating in these types of transactions after Nov. 2, 2006, must disclose the transactions pursuant to Regulation Section 1.6011-4. Material advisors also have reporting obligations.

14. REG-127391-07 (3/7/2008) – Guidance under Code Section 664 regarding the effect of unrelated business taxable income on charitable remainder trusts

The IRS issued proposed regulations to provide guidance on Code Section 664 and its taxation of unrelated business taxable income (UBTI) on charitable remainder trusts, either annuity or unitrust trusts, that have UBTI after Dec. 31, 2006. The regulations reflect changes made pursuant to the Tax Relief and Health Care Act of 2006 (Act).

Previously, a charitable remainder trust that had UBTI in a taxable year lost its exemption from federal income tax and was instead taxed as a nonexempt, complex trust. As of Jan. 1, 2007, and pursuant to the Act, a charitable remainder trust with UBTI does not lose its exemption, but instead must pay a 100 percent excise tax on any UBTI. A charitable remainder trust's amount of UBTI is calculated under Code Section 512 and includes the $1,000 deduction. As an excise tax, a charitable remainder trust must adhere to the excise tax rules governing private foundations and other tax-exempt organizations.

Additionally, the proposed regulations provided that the excise tax is reported and payable with the current Form 4720, "Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code." Further, the proposed regulations provide several examples illustrating the tax effects of UBTI on charitable remainder trusts under the proposed regulations.

15. Notice 2008-12, 2008-3 I.R.B. (1/2/2008) – Preparer signature requirements under code section 6695(b), as amended by the Small Business and Work Opportunity Tax Act of 2007

The Small Business and Work Opportunity Tax Act of 2007 (Act) extended the application of the income tax return preparer penalties to all tax return preparers by replacing "income tax preparer" with "a tax return preparer." A tax return preparer who fails to sign a return or claim for refund after it is completed and before presenting it to the taxpayer for signature can be fined $50 for each failure to sign and up to a maximum penalty of $25,000. Where more than one tax preparer worked on a return or claim for refund, the primary responsible preparer for overall accuracy shall sign the return. The notice also provides a list of which forms must be signed by the tax preparer.

16. *Sun Life Assurance Co. of Canada v. Paulson*, __ F. Supp. 2d __, Civ. No. 07-3877 (DC Mn 2/15/2008) – Lack of well-pleaded facts thwarts insurance company's attempts to rescind life insurance policies

A life insurance company filed suit to rescind or void several policies it had issued to Paulson. The insurance company claimed that Paulson did not have an insurable interest at the time he purchased the insurance on his own life because he intended to sell the life insurance contracts to a third party after the two-year contestability period expired. Paulson moved to dismiss the counts for failure to state a claim.

The district court, sitting in diversity, determined that state law would find the contracts void ab initio for lack of an insurable interest at the time of purchase. However, the court dismissed the claim, because although the complaint alleged that Paulson had the general intent to sell the contracts to a third party when he purchased them, there was no evidence to support the allegation that a third party had agreed to buy the contracts when Paulson purchased them. Without some alleged evidence that would support this prior arrangement, Paulson had an insurable interest when he purchased the contract. Thus, the insurance company was precluded from pursuing any claim other than nonpayment after the expiration of the two-year noncontestability period.

17. *Eisenbach v. Schneider*, 140 Wash. App. 641, 166 P.3d 858 (Wash. Ct. App. 9/10/2007) – State law governs how federal estate tax apportioned among beneficiaries and estate

A mother and father, who had community property, created a revocable trust naming their two sons, Larry and Roy, among their beneficiaries. The father died first, and his assets were divided to create a credit shelter trust and a qualified terminable interest property trust (QTIP trust). Additionally, at the father's death, the mother's one-half of the marital community property assets funded her revocable trust. After their parents' deaths, Larry and Roy liquidated the assets of their father's credit shelter trust without a problem. Both Roy and Larry were named as co-executors of their mother's will, and Roy was also named as trustee of his mother's revocable trust. The mother's will provided that all assets she owned at death poured over into her revocable trust.

Roy excluded Larry during the preparation and execution of the mother's federal estate tax return. Despite contrary language in the trust documents, Roy allocated the paid estate taxes pursuant to Code Section 2207A, which permits the QTIP to recover estate taxes paid with QTIP funds. Eventually Larry sued Roy and Roy's attorney for failure to provide him information regarding his mother's estate and for the allocation of paid estate taxes in a manner inconsistent with the trust agreement. The trial court determined that the trust language clearly and unambiguously directed the trustee to pay the estate taxes ratably among the taxable portions of the trust, meaning that part of the tax burden was to be paid from the income of the QTIP trust and not recovered pursuant to statute.

The appellate court affirmed the trial court's interpretation. The appellate court noted that while the federal statute specifies a default allocation scheme, it also permits the testator to waive any right of recovery under the statute provided that the will or trust specifically indicates the testator's intent to waive the statutory right to recovery. The court held that it was not necessary for the testator to express this intent by using magic words if the trust language indicated a clear intent to apportion the tax liability differently. Furthermore, the court stated, where the federal government would not be effected by the application of the trust language and as long as the correct amount of total tax was paid, it was indifferent to how the tax is apportioned among the beneficiaries and the estate. Thus, based on the testators' clearly expressed intent, the appellate court affirmed the trial court's order directing a pro rata allocation of estate taxes among the trust assets.

18. *Knight v. Comm.*, 101 AFTR 2d 2008-544 (U.S. 1/16/2008)

A trustee hired an investment advisor to comply with the state's prudent investor rule. The trustee paid the investment advisor approximately $22,000. On the trust's tax return, the trustee reported approximately $625,000 in income but deducted the full amount of the fees paid to the investment advisor. The IRS subsequently audited the trust and denied the trust's deduction for fees paid to the investment advisor except that portion that exceeded the 2 percent floor for itemized deductions.

The trustee appealed the assessed deficiency arguing that because his fiduciary duties required him to comply with the prudent investor rule, he was also required to hire an investment advisor. Thus, the trustee argued, the investment advisor expenses were subject to the exception provided in Code Section 67(e)(1) that permits "deductions for costs, which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate ..." The Tax Court rejected the trustee's argument, instead holding that investment fees are regularly incurred by individuals outside the trust setting and therefore the exception did not apply.

(Continued on Page 19)

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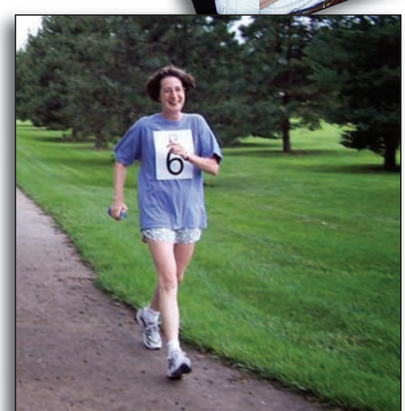

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About the Author

***Mark A. Andersen**, Lawrence, is a member attorney with Barber Emerson L.C. His practice includes real estate, like-kind exchanges, and banking law.*

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Real Estate Update

KANSAS SUPREME COURT

SCHUCK V. RURAL TELEPHONE SERVICE CO. INC.
NORTON DISTRICT COURT – AFFIRMED
NO. 98,098 – APRIL 4, 2008
Eminent Domain

ATTORNEYS: Daniel C. Walter, of Ryan, Walter & McClymont Chtd., Norton, for appellant. James M. Caplinger Jr., of James M. Caplinger Chtd., Topeka, and Karen L. Griffiths, of Sebelius & Griffiths, of Norton, for appellee.

FACTS: When Schuck discovered that Rural Telephone had installed cable on his land outside the 40-foot easement he had negotiated with the company, Schuck filed action for ejectment and trespass after negotiations failed to resolve the dispute. Rural Telephone responded with petition for eminent domain seeking a permanent easement to keep its cable in its present location. Schuck then filed petition to temporarily and permanently enjoin Rural Telephone from proceeding with its eminent domain proceeding. District court denied the injunction, finding Rural Telephone's violation of the negotiated easement was a good-faith mistake, and that Schuck failed to prove Rural Telephone acted fraudulently, in bad faith, or in abuse of its discretion when it buried its cable on Schuck's land. District court also found Rural Telephone has power of eminent domain under K.S.A. 17-618 and K.S.A. 17-1903. Schuck appealed.

ISSUE: Eminent domain

HELD: Schuck properly filed an independent injunction action challenging the necessity of Rural Telephone's taking, but Schuck failed to show that Rural Telephone concealed facts or acted in bad faith, and failed to establish prerequisites for injunctive relief. Although it may not originally have been necessary to place cable in its present location, Rural Telephone provided sufficient evidence to support its claim that it is now necessary for cable to stay there. Court's holding is limited to facts of this case. Rural Telephone's failure to conform to the easement it freely negotiated is not condoned, but under facts, district court's determination that Rural Telephone has power of eminent domain and that the taking was necessary to its lawful corporate purposes is sound. District court complied with requirements of the Eminent Domain Procedure Act.

STATUTES: K.S.A. 2007 Supp. 26-501 to 516, -501(b), -504; and K.S.A. 17-618, -1903, 26-502, -503

GENESIS HEALTH CLUB INC. V. CITY OF WICHITA
SEDGWICK DISTRICT COURT – AFFIRMED
NO. 97,486 – MARCH 28, 2008
Revenue Bonds; Contracts; Economic Development

ATTORNEYS: Ken M. Peterson and Richard A. Kear, of Morris, Laing, Evans, Brock & Kennedy Chtd., Wichita, for appellants. Arthur S. Chalmers and Randy J. Troutt, of Hite, Fanning & Honeyman LLP, Wichita, and Gary Rebenstorf, Wichita city attorney, for appellee.

FACTS: In 2004, Genesis Health Club Management, LLC requested approval by the governing body of the City of Wichita of a "Letter of Intent" to issue taxable industrial revenue bonds (IRBs) in an amount not to exceed $11.85 million to finance the cost of acquiring, constructing, and equipping three health club facilities to be leased to Genesis. Genesis sued the city for failure to issue IRBs and for failure to grant ad valorem property tax abatements pursuant to an alleged contract between these parties. The district court granted summary judgment to the city finding the city lacked power to issue IRBs without complying with the Economic Development Revenue Bonds Act and without compliance, the city lacked the power to enter into a contract to do so.

ISSUES: (1) Revenue bonds, (2) contract, and (3) economic development

HELD: Court held under the facts of this case, a city's approval of a letter of intent to issue industrial revenue bonds and to grant ad valorem property tax abatements to an applicant is void because of the city's failure to comply with the requirement in K.S.A. 12-1749c of providing prior notice to the affected unified school district. Court stated that the fact that the other party to the contract has fully performed its part of the agreement, or has expended money in reliance of its validity, does not estop a city from asserting ultra vires, nor is a municipality estopped to aver its incapacity to make a contract because it received benefits under it. That is, a city or municipality cannot be made liable either on the theory of estoppel or implied contract, where it had no capacity to make the contract or where it was made in express violation of law. Court held under the facts of this case, the plaintiffs could not maintain promissory estoppel as a cause of action against a city.

STATUTE: K.S.A. 74-4914(5), -4957(5)

KANSAS COURT OF APPEALS

JOHANNES ET AL. V. IDOL ET AL.
BROWN DISTRICT COURT – AFFIRMED
NO. 97,156 – APRIL 25, 2008
Inter Vivos Gifts; Delivery of Deeds

ATTORNEYS: Jack R. Euler, Joel R. Euler, and Charles D. Baskins, of Euler Law Offices LLP, Troy, for appellants. Stephen W. Cavanaugh, of Cavanaugh, Smith & Lemon P.A., Topeka, for appellees.

FACTS: In the 1960s, Margret Johannes gave warranty deeds to four parcels of property to two of her sisters, Isabel and Hazel. They placed the deeds in a safety deposit box in their names. The deeds were signed and notarized. After being diagnosed with a terminal illness, Hazel removed the deeds and gave them to Isabel who placed them in a plastic box at her residence and forgot or misplaced them until 2002. The deeds were recorded with the register of deed in February 2002. The heirs of Margret sued to determine Margret's heirs and to set aside the four deeds. The district court ruled that the appellants had not identified any dispositive facts sufficient to controvert the presumption that Margret had made a valid delivery of the deeds to the appellees and consequently granted partial summary judgment to the grantees of the deeds and their successors in interest.

ISSUES: (1) Inter vivos gifts and (2) delivery of deeds

HELD: Court held, among other things, that (1) an unsupported challenge to a witness's credibility is not sufficient to create a genuine issue of a material fact, (2) the grantor executed and had her signature acknowledged on the four deeds and manifested the intent to divest herself of title and vest title in the grantees, (3) delivery of the deeds into the possession of two of the grantees created the presumption that they were delivered, and (4) the reservation of a life estate by the grantor and her lack of control over the deeds result in the law presuming that she delivered the deeds during her lifetime.

STATUTES: K.S.A. 33-106; K.S.A. 58-2201, -2203, -2204; and K.S.A. 60-256(e)

IN RE TAX APPEAL OF GODDARD
KANSAS BOARD OF TAX APPEALS – AFFIRMED
NO. 97,332 – APRIL 4, 2008
Taxation; Farming Exemption

ATTORNEYS: Glenn H. Griffeth, Topeka, for appellant. Robert A. Walsh, county attorney, for appellee.

FACTS: The Goddards harvest cottonwood trees and operate a sawmill in Cloud County for the sole purpose of cutting the harvested cottonwood logs into rough boards for shipment to a manufacturer of shipping pallets and wooden crates. When the Cloud County Appraiser sought to assess ad valorem taxes on their machinery and equipment, taxpayers filed their application for an exemption on their sawmill equipment and yarding tractor pursuant to the statutory exemption for farm machinery and equipment. The Board of Tax Appeals (BOTA) denied the Goddard's exemption finding the sawmill operation is not "farming" under the exemption statute. BOTA granted an exemption for the yarding tractor.

ISSUES: (1) Taxation and (2) farming exemption

HELD: Court held that taxpayers' sawmill operation does not constitute farming and the associated machinery and equipment is not exempt. A sawmill is not a farming operation. Rough-cut lumber, even in its early stages, must be regarded as a manufactured article and a sawmill is a processing or manufacturing establishment.

STATUTES: K.S.A. 17-5903(h); K.S.A. 77-621(c); and K.S.A. 79-201j(a), -201i, -1476, -3606

IN RE TAX APPEAL OF THE CITY OF GARNETT
BOARD OF TAX APPEALS – AFFIRMED
NO. 97,619 – MARCH 14, 2008
Ad Valorem Property Tax

ATTORNEYS: Victor W. Miller, Topeka, for appellant Anderson County. J. Eugene Balloun and Toby J. Crouse, of Shook, Hardy & Bacon LLP, Kansas City, Mo., and Scott W. Anderson, of Gilmore & Bell P.C., Kansas City, Mo., for appellee City of Garnett/East Kansas Agri-Energy LLC.

FACTS: Anderson County appealed the Board of Tax Appeals' (BOTA) decision granting the city of Garnett's application for exemption from ad valorem taxation of an ethanol manufacturing plant leased by the city to East Kansas Agri-Energy LLC. County did not raise substantive issues about the merits of BOTA's decision, but only raised procedural issues concerning the city's notice of public hearing to discuss the proposed tax exemption and whether the city failed to properly notify county of the public hearing and that the published notice of the public hearing failed to properly identify the purpose of the hearing.

ISSUES: (1) BOTA and (2) notice of public hearing

HELD: Court held that the published notice of the public hearing to discuss a proposed property tax exemption properly identified the purpose of the hearing. Court concluded that county was entitled to notice for reasonable amount of time to prepare for the hearing and that, under the facts of this case, one day before the hearing was reasonable by the fact that two of three commissioners attended public hearing. Court also agreed with BOTA's reasoning that the statutes do not provide how the county's "governing body" should be notified of the public hearing, and it is appropriate to conclude that the county may be served with notice by serving the county clerk.

STATUTES: K.S.A. 12-1744a, -1749d; K.S.A. 60-304(d)(1); K.S.A. 74-2426(c); K.S.A. 77-601 *et seq.*, -621; and K.S.A. 79-201a

KATZENMEIER V. OPPENLANDER
RILEY DISTRICT COURT – AFFIRMED
NO. 98,025 – MARCH 14, 2008
Contracts; Misrepresentation; Seller Disclosures

A**TTORNEYS:** Richard H. Seaton, of Seaton, Seaton & Gillespie LLP, Manhattan, for appellants. William J. Bahr, of Arthur-Green LLP, Manhattan, for appellee.

FACTS: Katzenmeiers purchased eightplexes from Oppenlander who gave sellers' disclosure statement that represented no knowledge or history of drainage or flood problems, and both parties signed a buyers acknowledgment and agreement. Katzenmeiers hired inspectors who found no evidence of water damage but discovered problems, which could cause water and drainage issues. Fifteen months after closing, Katzenmeiers sued Oppenlander for intentional and reckless misrepresentations with the intent to deceive, alleging Oppenlander knew of and concealed serious leaking and moisture problems. District court granted Oppenlander's motion for summary judgment pursuant to *McLellan v. Raine*s, 36 Kan. App. 2d 1 (2006), and Katzenmeiers' failure to set forth in writing that specific representations in the disclosure statement they relied on in signing the contract.

ISSUE: Seller's disclosure form

HELD: *McLellan* is discussed and applied to Katzenmeiers' tort claim. Under facts of case, the right to rely on representations made in the disclosure statement does not exist where a purchaser chooses to inspect the property before purchase and, in making such inspection, learns of a defect. Trial court properly granted summary judgment.

CONCURRENCE (Leben, J.): Concurs with majority based on *McLellan* precedent, because Katzenmeiers could not show any reasonable reliance on any of the seller's representations without some additional writing beyond the sellers' disclosure form. But if writing on a clean slate, would reverse the grant of summary judgment. Under facts of case, Katzenmeiers should have had a right to rely upon representations in sellers' disclosure form, and those representations were material to the transaction. Supreme Court invited to consider this issue.

STATUTES: None

ESTATE OF KIRKPATRICK V. CITY OF OLATHE ET AL.
JOHNSON DISTRICT COURT – REVERSED
NO. 96,229 – MARCH 7, 2008
Inverse Condemnation

ATTORNEYS: Leonard A. Hall, assistant city attorney, and Diane S. Mills, of Law Offices of Donald B. Balfour, Kansas City, Mo., for appellant. Nancy J. Crawford, of Smithyman & Zakoura Chtd., Overland Park, for appellee.

FACTS: Kirkpatrick owed property in Johnson County and, via eminent domain for a roundabout, the city took 355 square feet of Kirkpatrick's property for a permanent road right-of-way and 426 square feet for a temporary construction easement. Kirkpatrick did not appeal the compensation awarded in the eminent domain proceeding. After Kirkpatrick began experiencing water in his basement, he sued the city of Olathe under the Tort Claims Act for damage to or taking of his property due to the construction improvements. After a full trial, the district court concluded that the city conformed to the necessary standard of care in designing the roundabout, that no party had negligently deviated from the approved plan, and thus, no party negligently caused damage to Kirkpatrick's property. The court then analyzed the inverse condemnation claim and concluded that the city partially took Kirkpatrick's property by damaging it without paying just compensation for its taking. The trial court also awarded Kirkpatrick attorney fees.

ISSUE: Inverse condemnation

HELD: Court stated a claim of inverse condemnation does not lie unless there is a taking and that mere damage to an adjoining property is not a compensable taking unless the damage was necessary to the completion of the public use project. Court concluded that the city did not need to divert water in order to complete its construction of the roundabout because there was no such contention by the Estate nor was there any such finding by the district court. Here, the city excavated adjacent land and changed the grade in constructing the roundabout, but no property or property right was taken. The city may have caused more water to invade Kirkpatrick's property than before the construction, but any such invasion or diversion of water was not necessary to the public improvement. Court also held that Kirkpatrick did not allege or present authorities providing for a common law property right that was taken by the city. Court held that the estate failed to state an inverse condemnation claim as a matter of law, and the district court erred in concluding otherwise. There was no need to analyze the city's potential tort liability, because the district court held against the estate on its claim of negligence, and no appeal had been taken from this judgment. Court stated that because it reversed the judgment against the city, the award of fees must also be reversed.

STATUTES: K.S.A. 26-513(a); K.S.A. 58-3502; and K.S.A. 75-6101

BUCHANAN V. OVERLEY ET AL.
SEDGWICK DISTRICT COURT – REVERSED
NO. 97,329 – MARCH 7, 2008
Mechanic's Lien

ATTORNEYS: Todd A. Luckman, of Stumbo, Hanson & Hendricks, L.L.P., Topeka, for appellants. James R. Gilhousen, of Crockett & Gilhousen, Wichita, for appellee Douglas Buchanan.

FACTS: Jerry and Carol Overley contracted with Douglas Buchanan for the construction of a single-family home on land owned by the Overleys in Wichita. There was an arbitration agreement as part of the construction contract. During the course of construction the Overleys objected to the quality of Buchanan's work. Buchanan refused to make repairs satisfactory to the Overleys, and the Overleys stopped their progress payments. Buchanan gave the Overleys written notice of default pursuant to the contract. When the Overleys refused to cure the default, Buchanan initiated arbitration proceedings and filed his mechanic's lien statement. The parties participated in arbitration proceedings, resulting in an award in favor of Buchanan in the amount of $49,542.64. Buchanan immediately filed an action in the district court to confirm the award. The Overleys objected and sought to vacate or modify the award. The district court denied relief to the Overleys and confirmed the arbitration award. The Overleys then sought relief by filing their petition in bankruptcy. The parties later agreed that Buchanan could pursue a state mechanic's lien foreclosure action as an exception from the bankruptcy automatic stay. Buchanan filed a petition to foreclose his mechanic's lien. The Overleys unsuccessfully moved to dismiss the petition as untimely. They then moved for summary judgment, claiming that Buchanan's mechanic's lien statement was defective and had been filed untimely. The court denied summary judgment, and subsequently granted Buchanan's motion to strike the Overleys' defenses and ordered foreclosure of the mechanic's lien.

ISSUE: Mechanic's lien

HELD: Court stated that the mechanic's lien statute requires that the claimant verify the truth of the facts asserted in the mechanic's lien statement. The mechanic's lien statement asserted that the labor and materials supplied to the project were set forth in the attached Exhibit A. Buchanan verified this fact: The labor and materials supplied to the project were set forth in Exhibit A. He did not state, nor did he verify, his address for purposes of service of process, as required by the statute. Accordingly, Buchanan failed to comply with the requirements of the statute for perfection of a mechanic's lien. Because Buchanan failed to strictly comply with the requirements of K.S.A. 60-1102 by not verifying his address sufficient for service of process, the district court erred in holding that the lien was valid. Based on this outcome, the Court did not address the claim that Buchanan's mechanic's lien statement was not filed in a timely manner.

DISSENT: Judge Greene dissented and held that Buchanan's lien statement complied with the statute, that the provisions of K.S.A. 60-1103 are inapplicable to this case, and that his action to enforce the lien was timely filed based upon applicable bankruptcy law.

STATUTES: K.S.A. 2007 Supp. 60-2102(a)(4); and K.S.A. 22-3602, 60-1507

CITIFINANCIAL MORTGAGE CO. INC. ET AL. V. CLARK ET AL.
JEFFERSON DISTRICT COURT – VACATED AND REMANDED WITH DIRECTIONS
NO. 98,216 – FEBRUARY 29, 2008
Foreclosure and Sheriff's Sale

ATTORNEYS: Jeff A. VanZandt, of VanZandt & Associates Chtd., Wichita, for appellant. Matthew H. Hoy, of Stevens & Brand LLP, Lawrence, for appellee Lorin G. Brunsvold.

FACTS: Citifinancial initiated residential real estate foreclosure proceedings in December 2005 and received a judgment of foreclosure in April 2006 for $70,481.83 plus interest, including an order for sale at sheriff's auction. Brunsvold was the highest bidder at the sale for $6,050. Due to a communications error between Citifinancial's counsel, there was no appearance at the sale to protect Citifinancial's interest. Brunsvold acquired an assignment of redemption rights from the mortgagor and filed a motion to confirm the sale. Citifinancial filed a motion to substitute bid and confirm sheriff's sale at upset price or in the alternative set aside the sale under K.S.A. 60-2415(b) due to a substantially inadequate bid. After a bench trial, the district court concluded that 60-2415(b) equitable protections applied only for the benefit the mortgagor and that Citifinancial was not entitled to equity because of its failure to appear at the sale. The sheriff's sale was confirmed.

ISSUES: (1) Foreclosure and (2) sheriff's sale

HELD: Court rejected the district court's apparent belief that the equity powers of K.S.A. 60- 2415 should be invoked only to protect the mortgage and that clearly the Legislature could have so limited the court's equity powers in the statute, but court discerned no such language or intent within the statute itself. Court also held that Citifinancial was not barred from equitable relief at confirmation solely by reason of its failure to participate in the foreclosure sale. Court also rejected the buyer's argument that Citifinancial acquiesced in the judgment. The buyer cited no specific benefits accepted or burdens assumed by Citifinancial that would serve as acquiescence, nor did the buyer cite any authority for the proposition that acquiescence may be found solely by reason of failing to stay execution of a judgment. Court vacated sale and remanded for district court to consider invocation of the equitable powers of K.S.A. 60-2415(b).

DISSENT: Judge McAnany agreed with the majority's conclusion that Citifinancial did not acquiesce in the judgment by its failure to stay execution. However, Judge McAnany would save for another day the issue of whether the equitable considerations described in K.S.A. 60-2415(b) are solely for the benefit of the mortgagor.

STATUTE: K.S.A. 60-2103(d), -2414, -2415

ISELY ET AL. V. CITY OF WICHITA
SEDGWICK DISTRICT COURT – REVERSED AND REMANDED
NO. 97,417 – JANUARY 25, 2008
Inverse Condemnation

ATTORNEYS: Martin W. Bauer and Adam T. Pankratz, of Martin, Pringle, Oliver, Wallace & Bauer LLP, Wichita, for appellant. Douglas J. Moshier, deputy city attorney, Gary E. Rebenstorf, city attorney, for appellee.

FACTS: Isely, the lessor, is the successor in interest to land in which a 99-year lease was granted to College Hill Development Corp. Inc. in 1959. Starr Holdings, the lessee, is the successor in interest to this developer. On Oct. 25, 2000, the lessee signed a Public Street and Utility Easement, which the parties stipulated "purports to grants the city a permanent right-of-way and easement for the purpose of construction and maintenance of a roadway and utilities along and under" the land. The easement covers about 8,000 square feet along the north and west sides of the land. The city constructed "acceleration/deceleration/turn lane improvements" on the burdened portion of the land. Prior to filing this action the lessors demanded that the city either initiate condemnation proceedings or provide compensation. The district court granted summary judgment in favor of the city. The district court stated that the law permits the lessee to grant an easement for the period of the lease. The lessor is not currently entitled to possession of the property until 2058, absent a default or abandonment by the lessee. The district court held there is no taking until the lessor is entitled to possession and unless the city refuses to relinquish possession of the property covered by the expired easement.

ISSUE: Inverse condemnation

HELD: Court stated that a landowner need not hold all of the sticks in the bundle of fee simple rights to establish a property interest under the Fifth Amendment. Court held that under the facts of this case, present possessory rights were not necessary. A paradigmatic taking requiring just compensation is a direct government appropriation of physical invasion of private property. Court held that the city's limited authority to occupy the land for the 51 years remaining on the lease does not alter the facts on the ground the city's roadway currently occupies a portion of the lessor's land. Court reversed the summary judgment, remanded for entry of partial summary judgment in favor of the lessors and for a trial on the issue of damages.

STATUTE: K.S.A. 26-513

GILMORE V. BEACH HOUSE INC. ET AL.
SEDGWICK DISTRICT COURT – AFFIRMED
NO. 97,858 – JANUARY 11, 2008
Premises Liability; Insurance; Duty to Defend

ATTORNEYS: Mark T. Schoenhofer, of Wichita, and Scott J. Gunderson, of Nelson, Gunderson & Lacey, Wichita, for appellant. Scott R. Schillings and Geron J. Bird, of Hinkle Elkouri Law Firm LLC, Wichita, and E. Wayne Taff, of Sherman Taff Bangert Thomas & Coronado P.C., Kansas City, Mo., for appellees.

FACTS: In January 2005, Gilmore left Beach House, a gentleman's establishment. Gilmore was intoxicated, and upon leaving the club, he was intentionally shoved from behind by another individual. He slipped and fell on the club's icy steps, hitting his head on the concrete. Gilmore successfully sued Beach House for his personal injuries. Colony had issued a liability insurance policy for the Beach House premises but declined to defend the action or indemnify any obligation based on an assault and battery exclusion in the policy. Judgment was entered against Beach House for $250,000. Under an assignment and covenant not to execute between Gilmore and Beach House, garnishment proceedings were commenced against Colony. The trial court granted summary judgment to Colony finding that Gilmore's injuries arose out of the battery and as such were excluded from the insurance policy.

ISSUE: Duty of insurer to defend and assault and battery exclusion

HELD: Court held that under the uncontroverted facts of this case, where injuries occurred when the intoxicated injured party standing on icy steps was subject to a battery that caused him to slip and fall, the assault and battery exclusion of the insuring agreement applies and there is no coverage afforded for the resulting loss. Consequently, Colony had no duty to defend Beach House in the underlying action.

STATUTES: None

UNITED STATES BANKRUPTCY COURT DISTRICT OF KANSAS

IN RE ANDERSON
CASE NO. 05-19222
APRIL 11, 2008
Homestead; Conversion of NonExempt Assets

ATTORNEYS: Central Plains Steel appeared by Lawrence D. Greenbaum of McAnany, Van Cleave & Phillips P.A.; Salina Steel appeared by Larry G. Michel and Chris J. Kellogg of Kennedy, Berkley, Yarnevich & Williamson Chtd.; debtor appeared by J. Michael Morris of Klenda, Mitchell, Austerman & Zuercher LLP; and the trustee, Linda S. Parks, appeared by Scott Hill of Hite, Fanning & Honeyman LLP.

FACTS: Creditors Central Plains Steel Inc. and Salina Steel Inc. object to debtor's homestead exemption. They assert that debtor enhanced the value of his homestead by paying down his home mortgage with the proceeds of property that he disposed of with intent to hinder, delay, or defraud his creditors within 10 years of the date of his petition. Debtor and his wife purchased a large home that abuts the north golf course at Crestview Country Club in East Wichita. Shortly before this case was filed, debtor paid Capitol Federal $240,000 to reduce a loan secured by a mortgage on the debtor's homestead. Central Plains has a judgment for $162,392 against two companies owned by debtor, but no personal guaranty. Any standing that Central Plains has in this case is predicated on its being able to pierce the corporate veil of these entities. Salina Steel has a judgment for $188,232 against one company owned by debtor, and asserts an individual claim against debtor based upon his execution of a guaranty.

ISSUE: Conversion of nonexempt assets into homestead exemption three months prior to bankruptcy filing.

HELD: Nonexempt assets of $240,000 were converted to debtor's exempt homestead. In order to be a creditor in this case and to have standing in this contested matter, Central Plains must successfully pierce the corporate veil. Kansas courts are to exercise the power to pierce "reluctantly and cautiously." The court is not willing to pierce the corporate veil here and, therefore, Central Plains lacks standing to object to the exemption of his homestead. Salina Steel objects to the exemption of debtor's homestead under new 11 U.S.C. § 522(o), and has the burden of proving the exemption is improperly claimed. In the absence of direct or circumstantial evidence demonstrating fraudulent intent by a preponderance of the evidence based upon the presence of the badges of fraud, this court cannot sustain Salina Steel's objection. The court concludes that the debtor did nothing more than take advantage of an exemption to which he is entitled. While his actions were intentional, the court cannot find that they were done with the intent to hinder, delay, or defraud.

STATUTES: 11 U.S.C. 522(b)(3)(A), 522(o), 548(a), 727(a)(2)(A); and K.S.A. 60-2301

IN RE KOPP JR.
CASE NO. 04-23171
FEBRUARY 28, 2008
Fraudulent Transfers

FACTS: Debtor pleaded guilty to attacking his ex-wife and was sentenced to prison. The day before he entered his guilty plea, the debtor transferred his Shawnee residence, a Lenexa commercial property, and a Gardner commercial property to his mother, for $3. Debtor also gave all of his stock in his business, Don Kopp Interiors Inc. to his mother for no consideration. Trustee seeks to avoid the debtor's transfers as fraudulent.

ISSUE: Fraudulent transfers

HELD: Court finds numerous facts constituting badges of fraud, and that the undisputed evidence does not collaborate an honest reason for the transfers. The trustee is entitled to prevail without showing actual fraudulent intent if he proves the debtor transferred property for less than adequate value. The facts show that the debtor received no consideration for transferring substantially all of his property on the eve of pleading guilty to a violent crime.

STATUTE: 11 U.S.C. 350(b), 542, 543, 544, 546, 550

IN RE ANDROES
CASE NO. 06-12375
FEBRUARY 1, 2008
Mortgage; Defective Notary

FACTS: Trustee seeks to avoid lender's recorded real estate mortgage on the debtor's homestead as unperfected because the notary's certificate of acknowledgment of the debtor's signature was undated. The certificate of acknowledgment failed to state the date of the notarial act but indicated only that the notary had affixed his seal on "the day and year last above written" in the mortgage, a date, which happened to be the mortgage note's maturity date, a date more than a decade into the future. The mortgage was recorded with the Sedgwick County Register of Deeds office. After this adversary proceeding was filed, the lender caused to be filed with the Register of Deeds an "addendum" correcting the notary's certificate of acknowledgment.

ISSUE: May a trustee in bankruptcy avoid a recorded mortgage with a defective notary acknowledgment as a hypothetical lien creditor?

HELD: Recorded mortgage whose acknowledgment failed to specify date was improperly recorded and provided no notice to trustee. Under Kansas law, as predicted by a bankruptcy court in Kansas, a notary's acknowledgment of a Chapter 7 debtor's signature on a mortgage that he had executed prepetition was patently defective and incomplete. Accordingly, the mortgage was not entitled to be recorded and was avoidable by the trustee in the exercise of the trustee's strong-arm powers as a hypothetical lien creditor.

STATUTES: 11 U.S.C. 362(b)(3), 544, 546,547, 550; and K.S.A. 53-502(a), 53-508, 53-509, 58-2216d, 58-2214, 58-2216, 58,2221, 58-2222

OFFICE OF THE ATTORNEY GENERAL STATE OF KANSAS

OPINION NO. 2007-38

Taxation—Property Exempt From Taxation—Newly Constructed Residential Property Which Has Never Been Occupied.

SYNOPSIS: A statute that provides for different rates of taxation, based upon a distinction between whether the real property is owned by a private resident versus a commercial home builder, violates the uniform and equal provisions in the Kansas Constitution, Article 11, Section 1. 2007 House Bill No. 2543, as currently written, makes such a distinction and is therefore unconstitutional.

STATUTES: Cited herein: Kansas Constitution, Art. 11, §§ 1, 12; 2007 H.B. 2543.

KANSAS 2008 LEGISLATIVE HIGHLIGHTS

House Substitute for Senate Bill 379 – Indemnification Clauses in Construction Contracts. This bill amends the law on an indemnification provision in construction contracts, motor carrier transportation contracts, dealer agreements, or franchise agreements. The bill prohibits a provision that requires the first party to secure against damages or losses caused by the second party's intentional acts or omissions. Such provision is against public policy and would be void and unenforceable. The bill also prohibits a provision in a covered contract that would require a party to provide liability coverage to another party, as an additional insured, for the other party's negligence, intentional acts, or omissions. Such provision is against public policy and would be void and unenforceable. The bill identifies several exceptions. The bill expressly states that the laws of Kansas will govern every contract to be performed in the state. Any litigation, arbitration, or other dispute resolution arising from such contracts would be conducted in the state and any contract provision, covenant, or clause that conflicts with these provisions would be void and unenforceable. The provisions of the bill would be effective on and after Jan. 1, 2009.

Senate Bill 417 – Housing Development Grant Program. This bill provides $4 million annually for housing grants, initially targeting cities and counties that suffered recent disasters and later expanding eligibility in 2010 to include rural cities and counties. The Kansas Housing Resources Corporation of the Kansas Development Finance Authority is designated to implement and administer a grant program for cities. The program is incorporated into the Rural Housing Incentive District Act. The bill initially limits grants to cities and counties in designated disaster areas until June 30, 2010. On and after July 1, 2010, grant funds are available for rural cities and counties meeting a population requirement. In order for a city or county to be eligible to receive a grant, it would have to provide matching funds of at least 10 percent for construction or rehabilitation of infrastructure projects as defined in the bill and at least 50 percent for any other type of projects. The bill would limit grant awards to $25,000 for single-family residential dwellings.

Senate Bill 423 – Notice of Foreign Judgment. This bill amends existing law on notice of filing of a foreign judgment. The bill requires the judgment creditor or the judgment creditor's lawyer to mail a notice of filing of the foreign judgment to the judgment debtor. The same notice may be filed with the clerk of the district court along with a proof of mailing. Under current law, it is the responsibility of the clerk of the district court to mail the notice of filing of the foreign judgment to the judgment debtor.

Senate Bill 449 – Uniform Commercial Code. This bill amends the Uniform Commercial Code (UCC) to eliminate from statute the forms for financing statements. The bill also would authorize the Kansas Secretary of State to prescribe the forms to be used when filing a financing statement pursuant to the UCC. In addition, the bill would provide that all rules and regulations of the secretary, in existence on June 30, 2007, would continue to be effective and deemed to be duly adopted until revised, amended, revoked, or nullified.

Senate Bill 467 – Manufactured Homes. This bill amends current law to allow a lender 30 days, rather than 10 days, after the sale or delivery of a manufactured home to the owner, to file a notice of security interest with the Department of Revenue, Division of Vehicles.

Senate Bill 518 – DeSoto/Johnson County Riverfront Authority. This bill creates the DeSoto/Johnson County Riverfront Authority (Authority), the purpose of which is to encourage private capital investment by fostering the creation of recreational, retail, entertainment, economic development, and housing within the riverfront. The Authority will be governed by a six-member board and is granted broad power to acquire and develop property but is prohibited from taking property by eminent domain.

Substitute for Senate Bill 535 – Credit Union Branches. This bill enacts new law and amends existing statutes governing field of membership and the mergers, branching, and other procedures associated with the regulation of state-chartered credit unions. The bill would create new requirements for the establishment and operation of a credit union branch and relocation of an existing branch, in accordance with the credit union's stated field of membership and geographic areas.

Substitute for House Bill 2018 – State Court of Tax Appeals. This bill renames the State Board of Tax Appeals (BOTA) as the State Court of Tax Appeals (COTA) and makes a number of other changes relative to the composition and duties of that entity, which would be construed to be an administrative law court within the executive branch of government. Various sections provide for the transfer of all jurisdiction, rights, powers, duties, and functions of BOTA to COTA. In addition to the three board members, who are renamed as "tax law judges," the bill creates a new position, chief hearing officer. The chief hearing officer, serves as a judge pro tempore of the court and will be appointed by the governor and subject to Senate confirmation, as are members of BOTA under current law and as would be judges of COTA under the bill. A current requirement prohibiting more than one member from any congressional district would be retained. The current small claims division of BOTA would be renamed the Small Claims and Expedited Hearings Division of COTA. The chief hearing officer would be responsible for appointing hearing officers of this division. A current prohibition against filing fees being imposed for certain single-family residential cases is relaxed such that a filing fee of up to $35 may be charged for appeals of decisions of the small claims and expedited hearings division to the full COTA. The Kansas Court of Appeals has jurisdiction for review of most final COTA orders, except for certain no-fund warrant proceedings. Votes of two judges are required for any final order of COTA. This bill only applies to those cases whose final order is issued after July 1, 2008.

Senate Substitute for House Bill 2295 – Residential Real Estate Contracts. As a reminder, this bill was adopted last year by the 2007 Kansas Legislature. Section 5 of the bill requires, effective July 1, 2008, that each contract for the sale of residential real estate shall contain as part of such contract the following language: "Kansas law requires persons who are convicted of certain crimes, including certain sexually violent crimes, to register with the sheriff of the county in which they reside. If you, as the buyer, desire information regarding those registrants, you may find information on the homepage of the Kansas Bureau of Investigation (KBI) at http://www.kansas.gov/kbi or by contacting the local sheriff's office."

Substitute for House Bill 2505 – Title Insurance. This bill amends a statute governing the unearned premium reserves of title insurance companies. The bill removes a requirement that a foreign title insurance company maintain unearned premium reserves in an amount no less than the amount that would be required of a domestic title insurance company.

House Bill 2520 – Property Tax — Liability for Certain Convertible Land. This bill clarifies that condominium developers, as opposed to owners of previously built units, are responsible for property taxes owed on "convertible land" that is to be utilized to develop future units.

Substitute for House Bill 2634 – Aboveground Storage Tanks. This bill creates two new laws that concern nonfuel flammable or combustible liquid aboveground storage tanks. The bill defines the terms "facility" and "nonfuel flammable or combustible liquid." The latter term excludes new and used motor oil, transmission fluid, hydraulic oil, grease and lube oil, asphalt or asphalt emulsions, road oil, crude oil, mineral oil, processed fat, food grade oil, vegetable oil, or ethylene glycol, but does include solvents. On or before July 1, 2009, the state fire marshal is to conduct an on-site inspection of any facility in existence on the effective date of the bill to determine compliance. If the facility is in compliance, a reinspection is required at least once every three years. If a facility is not in compliance, any necessary changes are required to be made as soon as practicable, but no later than July 1, 2012. Any facility constructed after the effective date of the proposed legislation shall meet standards specified in the bill and applicable rules and regulations adopted by the state fire marshal. The bill also creates a fund in the state treasury to be known as the Nonfuel Flammable or Combustible Liquid Aboveground Storage Tank System Fund into which any fines assessed under the law would be deposited.

House Bill 2656 – Cemeteries and Cemetery Corporations. This bill allows a not-for-profit cemetery corporation, established before 1909, to sell excess land that has not been platted into burial plots and will not be needed for cemetery purposes. The district court of the county where the cemetery is located or any court that has assumed jurisdiction and the attorney general are required to approve the sale of any excess real estate. The proceeds of such a sale may be used only for maintenance, reserve requirements, and obligations to beneficiaries of a trust deed.

House Bill 2746 – Real Estate Brokers' and Salespersons'. This bill amends the Real Estate Brokers' and Salespersons' License Act regarding licensure, prohibited acts and definitions and creates a new section concerning advertising. The bill contains a provision that will increase the civil fine imposed for violations of prohibited acts and creates measures that will allow the commission to recover its actual costs and attorney fees incurred while investigating and prosecuting a disciplinary case. Additionally, the bill sets out the prohibitions and guidelines for advertising by a licensee.

House Bill 2772 – Radon Gas Disclosure; Real Estate Appraisers. This bill enacts new language regarding radon notification that would require each contract for sale of residential real property to contain language notifying the buyer that the property may contain radon gas, the cancer risks of exposure to radon, and the Kansas Department of Health and Environment (KDHE) recommendations to test for such gas. Another provision requires KDHE to provide their Web site at www.kansasradonprogram.org. The bill also contains provisions regarding real estate appraisers and prohibits persons who are not state certified or licensed appraisers from (i) engaging in any written appraisal in connection with a real estate-related financial transaction and (ii) advertising or otherwise representing in any manner that such person is a state certified or licensed appraiser. The Real Estate Appraisal Board may recognize, on a temporary basis, the certification or license of an appraiser from another state if the property to be appraised is part of a real estate-related financial transaction. The bill exempts qualified attorneys, employees of the Kansas Department of Transportation, individuals licensed as insurance agents while acting within the scope of the Kansas Insurance Code, and certified public accountants from the prohibition regarding a written appraisal.

House Bill 2824 – Railroad Track Leases. This bill amends the Railroad Leasing Act. The bill amends the definition of "lease," an agreement between a railroad and a tenant, to include track leases when the railroad is a class II or a class III railroad as defined by federal regulations.

House Bill 2847 – Contractor Licensure and Examination. This bill amends the law regarding licensing examinations for plumbing contractors, electrical contractors and heating, ventilation, and air conditioning contractors to provide for the use of standard examinations from either the International Code Council, the International Association of Plumbing and Mechanical Officials, or Prometric, a subsidiary of Educational Testing Services.

MULTI-STATE ISSUES

Like-Kind Exchanges of Vacation Homes. On March 10, 2008, the Internal Revenue Service released Rev. Proc. 2008-16, which sets forth the guidelines for completing a Section 1031 like-kind exchange on a vacation home. To avoid any challenge to your vacation home exchange, you have to meet certain requirements during the 24 month period preceding the sale of your vacation home, or the 24 months after the purchase of your vacation home, or both if they both are vacation home properties: (i) You must have rented the property, at a fair rental price, for at least 14 days during each 12-month block of the 24-month period; and (ii) you did not use the property personally for more than the greater of 14 days, or 10 percent of the days rented, during each 12-month block of the 24-month period. This revenue procedure is effective for taxable years beginning after Dec. 31, 2006. ■

About the Author

Calvin J. Karlin, Lawrence, is a member of Barber Emerson L.C. His practice includes estate and trust planning and litigation.

He received his bachelor's degree and juris doctorate from the University of Kansas, where he was Phi Beta Kappa, Order of the Coif, and Kansas Law Review *note and comment editor.*

He is a member of the American College of Trust and Estate Counsel.

Karlin is a member of the Kansas Bar Association Executive Committee of the Real Estate, Probate, and Trust Law Section and serves as section editor.

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Probate and Trust Cases

IN RE ESTATE OF HJERSTED
KANSAS SUPREME COURT
FEBRUARY 1, 2008
285 KAN. 559

ATTORNEYS: Michael R. Ong and Michelle M. Burge, of Michael Ong P.A., Leawood, for appellant. Terence J. Campbell, Byron E. Springer, William N. Fleming, and Cheryl L. Trenholm, of Barber Emerson L.C., Lawrence, for appellee.

This case concerns a dispute between a widow, Maryam Hjersted, and her stepson, Lawrence Hjersted, over the value of her spousal elective share of her deceased husband's estate under K.S.A. 59-6a201 *et seq*. There is no dispute about the percentage share to which she is entitled. The parties simply disagree on the value of two particular assets transferred to Lawrence within two years of the death of Maryam's husband, Norman: (1) Norman's interest in the family limited partnership and (2) Norman's life estate in Nebraska farmland, which was sold.

The Supreme Court held that the district court erred in determining the value of Norman's family limited partnership interest. It therefore reversed the decision of the district court and the court of appeals, and remanded with directions, as to asset (1). The Supreme Court affirmed the district court and court of appeals as to asset (2).

Following an extensive discussion of law review and other commentary, and case law from Kansas and other jurisdictions, the Court indicated that a "minority discount" is appropriate to reflect "lack of control" and that a "marketability discount" is appropriate to reflect "lack of liquidity," due to a limited supply of potential purchasers of the particular interest.

The Nebraska farmland was jointly sold by the life tenant, Norman, and remainderman, Lawrence, to the United States in a nonjudicial sale. Following extensive discussion of various treaties as to "forced" versus "voluntary" sales, and whether the life estate should be considered separate from the remainder, the Court upheld the district court's determination of the decedent's life estate value, for ultimately determining the spousal share, according to the federal gift tax section 7520 standardized valuation tables.

The Court also awarded attorney fees to appellee to be taxed as costs pursuant to a motion under Supreme Court Rule 7.07(b).

RECTOR V. TATHAM
KANSAS COURT OF APPEALS
JANUARY 11, 2008
38 KAN. APP. 2D 933

ATTORNEYS: Ronald Schneider, Lawrence, for appellant. Molly M. Wood and Christopher F. Burger, of Stevens & Brand LLP, Lawrence, for appellees.

Following mediation a handwritten agreement was executed that Rector would purchase her mother's home, with the proceeds to be held by her mother's conservatorship for her mother's care and any remaining funds at her mother's death would be paid to Rector. The agreement was signed by all of Rector's siblings except one. The signatures were not acknowledged. The mediation agreement was not a family settlement agreement under K.S.A. 59-102(8) because one sibling did not sign and it was not acknowledged.

After her mother's death and distribution of the assets for her mother's conservatorship and estate, Rector filed a Chapter 60 civil action for breach of contract against her siblings for failure to transfer their inheritances to Rector. The district court granted the defendant's motion to dismiss, but the court of appeals reversed. The court of appeals held that for standard of review purposes for reviewing dismissal, Rector's allegations must be accepted as true, including Rector's allegation that the nonsignatory sister affirmed the mediated written agreement among the others. The court of appeals indicated that "Kansas law explicitly allows the assignment of an expected inheritance (to be transferred after distribution)." The court of appeals also stated that there could be an independent cause of action for "promissory estoppel or detrimental reliance" on which she should also be able to proceed on remand.

IN RE WEST
WILLIAMSON V. WHITEMAN
U.S. BANKRUPTCY COURT
FEBRUARY 21, 2008

ATTORNEYS: Darcy D. Williamson, Trustee, Topeka, pro se. Tom Barnes, of Stumbo Hanson LLP, Topeka, for defendant Pearson.

Winnie Pearson died in 2001 and her will was thereafter admitted to probate in the state of Washington. In 2005 one of her daughters filed for bankruptcy in Kansas showing her expected inheritance as a bankruptcy asset. The bankruptcy trustee filed an action to recover embezzled property (cash and Beanie Babies) from another daughter who was caring for Pearson at her death. The bankruptcy court denied the trustee's motion for summary judgment for failure of the record to establish the necessary facts, such as a taking after death, rather than before, and motive under the Wyoming statute.

IN RE WONDER
KANSAS SUPREME COURT
MARCH 28, 2008

ATTORNEYS: Frank D. Diehl for Stanton A. Hazlett, disciplinary administrator. John J. Ambrosio, of Ambrosio & Ambrosio Chtd., Topeka, for Robert E. Wonder.

Respondent was publicly censured for seeking and obtaining appointment of one executor without informing a co-executor or advising the district court at the ex parte proceeding of the naming of a co-executor.

IN RE KRAUSE
U.S. BANKRUPTCY COURT
CASE NO. 05-17429
ADVERSARY NO. 05-5775
APRIL 21, 2008

ATTORNEYS: Debtor Gary Krause appeared pro se. F. James Robinson, of Hite, Fanning & Honeyman LLP, for trustee Linda Parks. Jon Val Wachtel, of Klenda, Mitchell, Austerman & Zuercher LLC, Wichita, for Drake and Rick Krause. United States appeared by Hilarie E. Snyder and Thomas W. Curteman, of the U.S. Department of Justice, Tax Division.

Judge Nugent's 112-page opinion follows a nine-day trial in which the Internal Revenue Service and bankruptcy trustee seek to unravel various corporations, partnerships, and trusts to collect from Gary Krause. The court concluded that the irrevocable children's trusts established by Krause are subject to turnover as bankruptcy assets and the federal tax liens. This was based upon the following factors from *U.S. v. Dawes*, 344 F. Supp. 2d 715, 721-22 (D-Kan. 2004): (1) taxpayer's control over the nominee and its assets, (2) use of trust funds to pay taxpayer's personal expenses, (3) relationship between the taxpayer and the nominee, (4) lack of internal controls and the lack of nominee oversight of taxpayer's actions, and (5) lack of consideration for property transfers. All five factors were found to exist.

MCCABE V. DURAN
KANSAS COURT OF APPEALS
APRIL 18, 2008

ATTORNEYS: Trish Rose, of Forker, Suter & Rose, Hutchinson, for appellant Duran. Russel B. Prophet, of Hampton & Royce L.C., Salina, for appellee trustee.

The double-damages provision of K.S.A. 58a-1002(a)(3) does not apply to trustee's acts of embezzlement or knowing conversion before the Jan. 1, 2003, effective date of the Kansas Uniform Trust Code. The case was remanded to determine what portion of the $20,556 of misappropriation damages found by the jury occurred before Jan. 1, 2003.

2008 PROBATE & TRUST LEGISLATION

SB 412 continues to require a discretionary trust to clearly state an intention that it is to be supplemental to public assistance (which includes, but is not limited to, Medicaid, medical assistance, or Title XIX of the Social Security Act) in order not to be considered an available resource to the beneficiary. The statute replaces the requirement that such a trust could only be established by "a person who, at the time of the *creation* of the trust, owed no duty of support to the applicant or recipient" with a requirement that at the time of *funding* the person funding it owed no such duty of support "or is funded not more than nominally from resources of a person while that person owed a duty of support to the applicant or recipient of medical assistance." So, while the magic language is still required, this does seem to expand the persons who may establish such a trust that will not jeopardize the beneficiary's public assistance. If funding occurs after the funder's death, it would seem that the duty to support no longer exists, which could further avoid treating the trust as an available resource.

SB 431 increases the amount available for transfer by affidavit under K.S.A. 59-1507b from $20,000 to $40,000. The legislation also increases the K.S.A. 59-2287 limit for refusal to grant letters from $35,000 to $50,000 (which change is necessary to make this worthwhile above the $40,000 affidavit amount). It also increases the K.S.A. 59-403 allowance for spouses and minor children from $35,000 to $50,000, and increases the spouse's alternative homestead allowance under K.S.A. 59-6a215 by the same amount.

SB 432 includes a "security account" as a "security" in the Uniform Transfer on Death Security Registration Act at K.S.A. 17-49a01 *et seq*.

SB 433 enacts the Uniform Prudent Management of Institutional Funds Act to replace the Uniform Management of Institution Funds Act, effective July 1, 2008. Kansas joins at least 14 other states in enacting this uniform legislation covering the management, investment, and expenditure of endowment funds held by charitable organizations.

HB 2644 requires that petitions for the appointment of a guardian or conservator after July 1, 2008, include the age, birthdate, gender, and place of employment of the proposed guardian or conservator. It also requires the petition to disclose any personal or agency interest of the proposed guardian or conservator "that may be perceived as self-serving or adverse to the position or best interest" of the proposed ward or conservatee. This disclosure "shall include, but not be limited to, details of any financial, agency or other transactions" between a proposed or actual guardian or conservator and his or her ward or conservatee.

"If the proposed guardian or proposed conservator is a person who provides care or other services, or is an employee of an agency, partnership or corporation, which provides care or other services to persons with a disability similar in nature to the condition or conditions which contribute to the impairment of the ward or conservatee, then that person or employee may be appointed as the guardian or conservator only when the person or employee:

(A) Is the spouse, parent, grandparent, child, grandchild, sibling, niece, nephew, aunt, or uncle of the ward or conservatee, and the court is satisfied that the person or employee is aware of issues of conflict of interest ... ;

(B) Does not personally provide nor supervise the providing of care or other services to the ward or conservatee, and the person or employee is not in a position to be called upon to advocate for the agency, partnership, or corporation, in opposition to the interests of the ward or conservatee; or

(C) Is the only person readily available to be appointed and the court is satisfied that the person or employee is aware of issues of conflict of interest."

An "employee" includes "any student, trainee, or other classification of persons providing services to any agency, partnership, or corporation, whether compensated or not." The statute states that it is not the intent of these changes to prohibit a stipend for those associated with the Kansas guardianship program or a reasonable fee for any guardian or conservator.

Special reports will also be required if there is a change in circumstances that may constitute a conflict of interest (defined as "some personal or agency interest that could be perceived as self-serving or adverse to the position or best interest of the ward or conservatee").

After Jan. 1, 2009, every individual appointed as a guardian or conservator must file with the court "evidence of completion of a basic instructional program concerning the duties and responsibilities of a guardian or conservator prior to the issuance of guardianship or conservatorship." Courts may also require those appointed before Jan. 1, 2009, to provide evidence of completing such a program. The Judicial Council is to prepare the materials comprising the basic instructional program.

HB 2698 increases docket fees by $9 effective July 1, 2008, to help fund increased compensation for nonjudicial court officers and employees. ■

Estate Tax Notes

(Continued from Page 8)

The trustee appealed to the Second U.S. Circuit Court of Appeals. The appellate court also rejected the trustee's argument but based on a different interpretation of the statute. The appellate court held that the exception did not apply because the investment advisor expense was an expense an individual could incur, and therefore the investment advisor expense was subject to the 2 percent floor.

The trustee took his appeal to the U.S. Supreme Court and argued that the statute provided a strict causation test, and that any expense incurred by the trust for purposes of administration was fully deductible and not subject to the 2 percent floor. The Court rejected the trustee's argument based on its interpretation of the statute, in which it rejected the appellate court's interpretation as being inconsistent with the plain language of the statute. The Court reasoned that if Congress intended "would" to mean "could" it would have drafted the statute differently. Instead, the Court explained, an expense was subject to the 2 percent floor if the expense was one commonly incurred by individuals. Applying this interpretation to the investment advisor expense, the Court concluded that because individuals routinely hire investment advisors, the trust's similar expense was subject to the 2 percent floor.

NOTE: The IRS provided interim guidance on bundled fiduciary fees effective Jan. 1, 2008, in Notice 2008-32. Trustees will not be required to unbundle those fees that are fully deductible and those fees which are subject to the 2 percent floor during 2007. Essentially, the notice provides that *Knight* is effective prospectively and not retroactively. The IRS posited that the final regulations may, depending on comments received, include safe harbor provisions.

19. A.O.D. 2008-001, 2008-9 I.R.B. (3/3/2008) - IRS announces that it will not acquiesce in the Tax Court's decision in *Kohler*

The IRS announced that it will not follow the holding of *Kohler v. Comm.*, T.C. Memo. 2006-152 (7/25/06). In *Kohler*, the Tax Court rejected the commissioner's higher valuation of stock in a closely held company subsequent to a reorganization of the stock to push out nonfamily member shareholders. An announcement of nonacquiescence means that the IRS will not appeal the issue, but does not agree with the holding of the court and will not follow the decision in disposing of cases involving other taxpayers. ■

CLE Docket

Live Seminars

Thursday, June 19 – Saturday, June 21 *Capitol Plaza, Topeka*

KANSAS BAR ASSOCIATION
ANNUAL 2008 MEETING
Celebrating Our Past, Present, and Future

Videocast Seminars

Friday, June 13, 8:25 a.m. – 12:25 p.m. (Session I); 1:25 – 5:25 p.m. (Session II)
Legislative & Case Law Institute Video Debut
(Featuring the 2008 Kansas Annual Survey as seminar materials)
Lenexa, Topeka, Wichita

Tuesday, June 24 – Monday, June 30
Video Replay Week – Brown Bag Ethics, Environmental Law, & Legislative & Case Law Institute
Multiple sites statewide

Thursday, July 10, 8:25 a.m. – 12:25 p.m. (Session I); 1:25 – 5:25 p.m. (Session II)
Legislative & Case Law Institute Video Replay
(Featuring the 2008 Kansas Annual Survey as seminar materials)
Topeka & Shawnee County Public Library, Topeka

Wednesday, July 16, 8:30 a.m. – 12:15 p.m.
The Many Sides of Environmental Law Video Replay
Topeka & Shawnee County Public Library, Topeka

Thursday, July 17, 9 – 10:40 a.m. and 1 – 2:40 p.m.
Brown Bag Ethics Video Replay
(Featuring Professor Michael Hoeflich, Legal Ethics & E-Lawyering and Hon. Stephen D. Hill, The Three Roles of the Ethical Lawyer) *Topeka & Shawnee County Public Library, Topeka*

Thursday, July 24, 9 – 10:40 a.m.
Brown Bag Ethics Video Replay
(Featuring Professor Michael Hoeflich, Legal Ethics & E-Lawyering and Hon. Stephen D. Hill, The Three Roles of the Ethical Lawyer) *Topeka & Shawnee County Public Library, Topeka*

Thursday, July 24, 12:30 – 4:15 p.m.
The Many Sides of Environmental Law Video Replay
Topeka & Shawnee County Public Library, Topeka

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