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President's Message

As those of us who practice in the estate administration arena are aware the Kansas Estate Administration Handbook is in need of significant revision. The last revision occurred in 1997, and it was to some extent a "band-aid" awaiting a complete revision of the handbook. A couple of years ago Mike Dwyer and Chuck Andres undertook the yeoman task of serving as co-editors to the overhaul of the handbook. They lined up chapter authors, who were requested to rewrite the chapter they had been assigned, and incorporate into their chapter the provisions of the Kansas Uniform Trust Code. The newly written chapters have been submitted to Mike and Chuck, and await their final review and suggested revision.

Section President

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

The KBA plans to rollout the revised handbook at a seminar scheduled for Friday, May 9, in Salina. Those who attend the seminar will receive as their outline the newly revised handbook. In addition, the chapter authors will be speaking on the chapter they wrote and those changes of which we, as practitioners, should be aware. Please mark your calendars at this time so you can attend.

A very recent case that is of importance to those that advise bank trust departments, independent trust companies, and estate and trust fiduciaries is the U.S. Supreme Court opinion in *Michael J. Knight, Trustee v. Commissioner*, 552 U.S.______ (No. 06-1286, Jan. 16, 2008). The issue in this case is whether "trust investment advisory fees" are subject to the 2 percent floor in Internal Revenue Code (IRC) § 67.

IRC § 67 was added to the IRC in 1986 and allows a deduction for "miscellaneous itemized deductions" for any taxable year "only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income." However, an exception is set forth in IRC § 67(e)(1) in the case of an estate or trust 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 issue that almost immediately arose is whether the costs for investment advice incurred by trustees are subject to the 2 percent floor.

In *William J. O'Neill Jr. Irrevocable Trust v. Commissioner*, 994 F.2d 302 (6th Cir. 1993), the Sixth Circuit in reversing the Tax Court held that investment advisory fees were necessary to the continued growth of a trust and were caused by the fiduciary duties imposed on the trustee. However, in disagreeing with the Sixth Circuit, the Federal Circuit in *Mellon Bank N.A. v. United States*, 265 F.3d 1275 (Fed. Cir. 2001), held that "only those trust-related administrative expenses that are unique to the administration of a trust and not customarily incurred outside of trusts" are fully deductible. The court reasoned that investment advice and management fees are commonly incurred outside of trusts. Thus, they were subjected to the 2 percent floor.

In *Scott v. United States*, 328 F.3d 132 (4th Cir. 2003), the Fourth Circuit (similar to the Federal Circuit) held that "trust-related administrative expenses are subject to the 2 [percent] floor if they constitute expenses commonly incurred by individual taxpayers." As a result of the conflict in the circuits, the U.S. Supreme Court granted certiorari in *Knight*, *supra*.

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

VALUATION

1. *Estate of Jelke v. Comm.*, 100 AFTR 2d 2007-6694 (11th Cir. 11/15/2007) – Dollar-for-dollar discount allowed for built-in capital gains tax liability.

The decedent died in 1999 owning a 6.44 percent interest in a closely held corporation whose assets consisted primarily of marketable securities. The corporation had a relatively high rate of return in the form of annual dividends, coupled with capital appreciation of approximately 23 percent annually for the five-year period prior to the decedent's death. At the time of the decedent's death, the securities had a market value of approximately $178 million and a built-in capital gain tax liability of approximately $51 million if all the securities were to be sold on the valuation date. The net asset value of the corporation without consideration of the effect of the built-in capital gain tax liability was approximately $188 million. The decedent's estate contended that the $188 million value should be reduced by the entire $51 million before considering discounts for lack of control and marketability. The IRS contended that the built-in capital gain tax liability should be discounted to account for time because it would be incurred in the future rather than immediately. Under the IRS' approach, the reduction for built-in capital gain tax liability would be approximately $21 million.

At trial, the Tax Court held that because the decedent's 6.44 percent interest would be insufficient to cause liquidation, and because the corporation performed well and kept pace with the S&P 500, defying the notion that it was an underperforming company, an assumption of complete liquidation on the valuation date did not apply in this case. Accordingly, the Tax Court adopted the valuation methodology of the commissioner's expert witness and found use of a 13.2 percent discount rate to be reasonable when considering the built-in capital gain tax liability. In addition, the Tax Court found that the 6 percent per year turnover rate of the securities used in arriving at the discount rate was conservative and reasonable under the circumstances. Such turnover rate reasonably predicted a 16-year period of recognition for the tax liability attributable to the built-in capital gain. The Tax Court held that a discounted total liability of approximately $21 million was appropriate, resulting in a total undiscounted value of the corporation on the decedent's date of death of $167.5 million.

On appeal, the Eleventh Circuit vacated the judgment of the Tax Court with respect to the discount for the built-in capital gains tax liability and remanded with instructions that the Tax Court recalculate the net asset value of the corporation on the date of the decedent's death and his 6.44 percent interest therein using a dollar-for-dollar reduction of the entire $51 million built-in capital gains tax liability under the arbitrary assumption that the corporation is liquidated on the date of death and all assets sold. In so holding, the appeals court questioned why a hypothetical willing buyer of the corporation's shares would not adjust his or her purchase price to reflect the entire $51 million amount of the built-in capital gains tax liability when the buyer could just as easily acquire an identical portfolio of blue chip domestic and international securities in the open marketplace without any risk exposure to the underlying tax liability. The court held that the fact that the decedent's minority interest was insufficient to single-handedly force liquidation was not persuasive. Nor was the Tax Court's use of a 16-year period to reflect when the corporation would reasonably incur the tax. The court recognized that an appropriate valuation should consider hypothetical willing buyers, not strategic buyers. Accordingly, as a threshold assumption, the court held that the analysis should proceed under the arbitrary assumption that liquidation takes place on the date of death. The court held that this approach was better than resorting to present values and prophesies to determine value and provided certainty and finality to the discount issue surrounding built-in capital gains tax.

2. P.L.R. 200746012 – Formula price in option agreement not disregarded.

The taxpayer is an employee of a corporation that has currently outstanding voting and nonvoting common stock. Except for the voting rights, the shares are identical as to dividends and liquidation preferences. The corporation has maintained an executive stock purchase plan for more than 30 years, under which an executive at the management level may purchase shares of the corporation's nonvoting common stock at a formula price. All shares purchased under the plan are subject to restrictions set forth in a stock restriction agreement that gives the corporation the right to repurchase shares at a formula price upon certain triggering events. The specific triggering events vary depending on the date the stock was issued.

The taxpayer's stock is subject to an option agreement, which he and the corporation proposed to amend. The proposed amendment would give the corporation the exclusive option to purchase any or all of the taxpayer's shares at the formula price if the taxpayer desires to sell any or all of his stock. The corporation would also be granted an option exercisable upon the death of the survivor of the taxpayer and his spouse to purchase any or all of the shares at the formula price. The taxpayer and his family members do not own in the aggregate 50 percent or more of the corporation's stock and will not own more than 50 percent following the amendment.

Code Section 2703(a) provides that the value of any property shall be determined without regard to (1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or (2) any restriction on the right to sell or use such property. However, the IRS held that Code Section 2703(a) does not apply to the proposed amendment because it meets the exception set forth in Regulation Section 25.2703-1(b)(3), as more than 50 percent of the corporation's stock will be owned by individuals who are not members of the taxpayer's family after the proposed amendment is signed.

3. *Estate of Thompson v. Comm.*, 100 AFTR 2d 2007-5792 (2d Cir. 8/23/2007) – Tax Court not required to adopt estate's valuation upon shift in burden of proof to IRS.

At the time of her death in 1998, the decedent's estate included approximately 20 percent of the common shares of Thomas Publishing Co. Inc. (Company), a century-old private closely held corporation that produces business-to-business industrial and manufacturing directories and publications. Descendants of the Company's founder own almost 90 percent of the shares, none of which have ever been publicly traded. No stock sales had occurred in the 10 years prior to the decedent's death. In the six years preceding the decedent's death, the Company's net sales revenue grew 53 percent, but expenses kept pace, leaving operating income during that period around a constant $25 million.

The decedent's estate used the capitalization of income method to value the decedent's interest in the Company at $1.75 million. The estate projected the Company's annual income to be $7.9 million (the average from 1993 to 1997, minus $10 million in projected technology expenditures). It then used a capitalization rate of 30.5 percent based on the following: a 6 percent risk-free rate of return, a 7.8 percent equity risk premium, a 4.7 percent small stock risk premium, and a 12 percent internet and management risk premium. No non-operating assets were added. This yielded a valuation of $25.8 million for the Company, of which the estate's share was $5.3 million. This was further reduced by 40 percent to account for the minority ownership interest and another 45 percent to account for lack of marketability, to arrive at the final valuation of $1.75 million. The estate argued that the valuation reflected the grim prospects in 1998 and the internet's substantial threat to the Company's viability as a business.

The commissioner valued the estate's interest at $32 million using two independent methods: the comparable company method, which yielded a value for the Company of $260 million, and the discounted cash flow method, which was performed twice using different estimated future values, and which yielded values of $212.6 million and $158.8 million. The commissioner settled on $225 million, of which the estate's share was $46.3 million. It then discounted the value by 30 percent to account for lack of marketability, thus arriving at the final value of $32 million.

At trial, the Tax Court rejected both parties' valuations as deficient and unpersuasive. It rejected the commissioner's valuation because the comparable companies chosen were insufficiently similar to the Company, and the discounted cash flow analysis contained significant errors and suspect recalculations. It rejected the estate's valuation because it improperly included a 12 percent internet and management risk factor in the capitalization rate, erroneously omitted certain non-operating assets, and inflated the discounts for minority interest and lack of marketability. The Tax Court additionally criticized the estate's decision to hire an attorney and an accountant from Alaska, both with relatively little valuation experience, given that the estate, the executors, and the underlying company were all headquartered and based in the New York City metropolitan area. The Tax Court then undertook its own valuation, using the capitalization of income method. It adopted the estate's projected annual income of $7.8 million but used a capitalization rate of 18.5 percent, having eliminated the 12 percent Internet and management risk factor that had bumped the estate's capitalization rate to 30.5 percent. This yielded a value for the Company of $42.5 million, to which the Tax Court added $68 million in short-term investments, which the Tax Court considered non-operating assets but the estate had considered operating assets. Thus, the Tax Court arrived at a total value of $111 million for the Company. It reduced the estate's proportionate share of this value by 15 percent to account for the minority interest and 30 percent for lack of marketability, yielding the Tax Court's valuation of the estate's interest at $13.5 million. Based on the discrepancy in values, the Tax Court, citing the reasonable cause exception, declined to impose an accuracy-related penalty on the estate based on the following considerations: the valuation was particularly difficult and unique; the valuation involved a number of difficult judgment calls; the valuation was difficult and imprecise because of the difficult question as to how the Internet and the risks and opportunities associated therewith should be regarded as affecting the Company; and while the experts for the estate were aggressive in their relatively low valuation of the Company, the Tax Court's own valuation was closer to the estate's valuation than to the commissioner's valuation.

On appeal, the estate argued that under Code Section 7491, if a taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer, the secretary shall have the burden of proof with respect to such issue. The parties stipulated that the estate submitted credible evidence in support of its valuation, shifting the burden of proof to the commissioner on the issue of valuation. Accordingly, the estate argued that the Tax Court's rejection of the commissioner's valuation required the Tax Court to adopt the estate's competing valuation. The appeals court disagreed, stating that the Tax Court is not bound by the formulas or opinions proffered by expert witnesses and may reach a determination of value based upon its own analysis of all the evidence in the record. In the alternative, the estate argued that the Tax Court erred by including $68 million in short-term investments as non-operating assets and by omitting a technology-related risk factor in its capitalization rate. However, the appeals court noted that the Tax Court's valuation was a factual finding for which its review power was limited. It recognized that there was evidence to support both of the challenged features of the Tax Court's valuation and, therefore, affirmed such valuation in all respects but one. The parties agreed that the Tax Court made an error in calculation by including the income produced by the $68 million in non-operating assets in its capitalization of income calculation, thereby factoring in the $68 million twice. The appeals court, therefore, remanded for the Tax Court to correct the double counting error. The appeals court also vacated the Tax Court's holding on the accuracy-related penalty and remanded for a determination on whether the estate's reliance on the Alaska attorney and accountant was reasonable and in good faith, which the Tax Court failed to analyze in its original holding.

4. *Stone v. U.S.*, 100 AFTR 2d 2007-5512 – District court supplements its holding on the value of partial interest in art collection.

The district court in this case has issued a supplemental decision determining an appropriate discount for the decedent's undivided 50 percent interest in an art collection. In its previous decision, the court had instructed the parties to meet and confer to attempt to settle the case. The court had stated that if the parties were unable to reach an agreement, the court would decide on an appropriate discount somewhere between the 2 percent discount proposed by the government and the 51 percent cost-to-partition discount proposed by the plaintiffs. The parties were unable to reach an agreement and filed supplemental briefs in which the plaintiffs asserted that a total discount of at least 35 percent would be appropriate, while the government argued that no discount was appropriate but agreed to a 5 percent discount in the spirit of compromise. In its supplemental decision, the court determined that the plaintiffs were entitled to claim a 5 percent discount when valuing for estate tax purposes the estate's interest in the art collection at issue. It noted that the discount appeared to be relatively low, but that the plaintiffs had provided no evidence from which the court could reasonably base any larger discount. Therefore, any discount other than that to which the government had already agreed would be impermissibly arbitrary.

ESTATE INCLUSION

5. P.L.R. 200747002 – Parties to buy-sell agreement possess no incidents of ownership with respect to policies owned by LLC.

Prior to his death, the grantor created and funded a revocable trust (Grantor's Trust), the assets of which divided at his death into two separate trust shares, each benefiting one of his children. The grantor also created and funded two irrevocable trusts (collectively, Irrevocable

Trusts), each benefiting one of his children. In addition, the grantor's children each created a revocable trust (collectively, Children's Trusts). The Grantor's Trust and the Children's Trusts own the outstanding membership interests in a limited liability company (LLC), which manages the operations for a limited partnership (Partnership). Another company (Corporation) owns a 99 percent limited partnership interest in the Partnership. The outstanding stock of the Corporation is owned by the Children's Trusts and by an unrelated business associate of the grantor's children who acquired his shares under the terms of an employment agreement.

The grantor's children and the unrelated business associate own life insurance policies pursuant to the terms of a buy-sell agreement (Agreement) covering the Corporation and the LLC. Specifically, each child owns a policy on the other child and a policy on the unrelated business associate. A revocable trust created by the unrelated business associate owns a joint policy on the children, as well as a single life policy on each child. The terms of the Agreement require surviving shareholders to purchase the stock or interest of a deceased shareholder using proceeds from the insurance policies. The Agreement authorizes the establishment of an "Insurance LLC" to hold insurance on the life of one or more shareholders for the purpose of satisfying the obligations contained in the Agreement. The children and unrelated business associate propose to transfer their respective ownership interests in the seven life insurance policies to the Insurance LLC, which will be designated as the owner and beneficiary of the policies. Under the terms of the operating agreement, management of the Insurance LLC is vested in the manager and not in the members. A national banking association is designated as the initial manager. The members may remove or select a replacement manager by majority vote, provided any replacement must be a corporate trustee or an individual who is bonded and who is not a related or subordinate party with respect to the members or their assignees. Each member is required to make contributions to the Insurance LLC equal to the premium on the insurance policies contributed by the member. The IRS ruled that based on the facts submitted, neither the children nor the unrelated business associate would possess any incidents of ownership under Code Section 2042 with respect to the policies contributed to the Insurance LLC.

6. P.L.R. 200728015 – Partnership payments of policy premiums not gifts; Proceeds not includible in estates of insureds.

The taxpayers, a husband and wife, have four adult children, each of whom has established an irrevocable trust for the sole benefit of his or her respective descendants. The taxpayers have no beneficial interest in the irrevocable trusts, and an unrelated third party is the current trustee of the irrevocable trusts. Each taxpayer has renounced the right to serve as a trustee of the irrevocable trusts. Subsequent to creation of the irrevocable trusts, a testamentary trust created for the benefit of the taxpayer husband loaned money to each irrevocable trust. The taxpayers have made no contributions to the irrevocable trusts and will make no contributions to the irrevocable trusts in the future. The irrevocable trusts purchased a second-to-die life insurance policy on the lives of the taxpayers. The policy lists the four irrevocable trusts as joint owners, and each irrevocable trust is designated as the beneficiary of 25 percent of the policy proceeds.

The taxpayers and the trustees of the irrevocable trusts subsequently formed a limited partnership. The taxpayers each own a one percent general partnership interest and a 47 percent limited partnership interest. The irrevocable trusts each own a one percent limited partnership interest. On a date prior to Jan. 28, 2002, the partnership and the irrevocable trusts entered into a collateral assignment split-dollar life insurance agreement. Under the agreement, during the joint lives of the taxpayers, the irrevocable trusts will pay that portion of the annual premium due equal to the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. After the death of the first insured to die, the irrevocable trusts will pay the portion of the annual premium equal to the lesser of (i) the applicable amount provided in the Rev. Rul. 55-747 tables or (ii) the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. The partnership will pay the balance of any premium amount. The split-dollar agreement further provides that upon the death of the surviving taxpayer, the partnership is to be paid from the policy proceeds an amount equal to the greater of (i) the cash surrender value of the policy immediately prior to the death of the surviving taxpayer, or (ii) the net premiums paid by the partnership. In the event the agreement is terminated prior to the death of the surviving taxpayer, the partnership is entitled to receive an amount equal to the cash surrender value of the policy. To secure the partnership's right to repayment, the irrevocable trusts executed a collateral assignment of the life insurance policy to the partnership. Under the collateral assignment, the irrevocable trusts retain and possess all incidents of ownership. The split-dollar agreement was later terminated during the lifetimes of both taxpayers and at a time when the cash surrender value of the policy was zero. The insurance company waived the surrender charges with respect to the policy, and the policy was exchanged by the life insurance company for a new policy, which is fully paid up and has a significantly lower death benefit. The owners and designated beneficiaries of the new policy are the same as those of the old policy.

The IRS held that the payment of policy premiums by the partnership prior to termination of the split-dollar agreement did not result in a gift by the taxpayers under Code Section 2511, provided that the amounts paid by the irrevocable trusts for the life insurance benefit they received under the agreement were at least equal to the amount prescribed under Rev. Rul. 64-328, Rev. Rul. 66-110, and Notice 2002-8. The IRS further held that the taxpayers did not retain any interests in the irrevocable trusts that would cause the corpus of the irrevocable trusts to be included in their gross estates under Code Section 2036. Further, the partnership held no incidents of ownership in the policy under the agreement, so no incidents of ownership would be attributed to the taxpayers as a result of their ownership interests in the partnership. Accordingly, no portion of either policy would be includible in the gross estate of the surviving taxpayer.

7. P.L.R. 200747011 – Payments of policy premiums by insureds pursuant to split-dollar agreement not gifts; Portion of proceeds includible in estates of surviving insured.

The taxpayers, a husband and wife, have three adult children who purchased a second-to-die insurance policy insuring the lives of the taxpayers and paid the first annual premium due on the policy. The three children are designated as the owners of the policy, with each child owning a one-third undivided interest in the policy. On a date prior to Sept. 17, 2003, the children entered into a split-dollar insurance agreement with a revocable inter vivos trust previously established by the taxpayers. Under the agreement, during the joint lives of the taxpayers, the children will pay that portion of the annual premium due equal to the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. The trust will pay the balance of the annual premium. After the death of the first insured to die, the children will pay the portion of the annual premium equal to the lesser of (i) the applicable amount provided in the Rev. Rul. 55-747 tables or (ii) the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. The trust will pay the balance of any premium amount. The split-dollar agreement further provides that in the event the agreement is terminated during the lifetime of either taxpayer, the trust is to receive an amount equal to the cash surrender value of the policy, less the amount of the cash surrender value of the policy at the end of the first policy year. If the agreement is terminated by reason of the death of the surviving taxpayer, the trust is to receive an amount equal to the cash surrender value of the policy immediately prior to the death of the surviving taxpayer, less the amount of the cash surrender value of the policy at the end of the first policy year. To secure the trust's right to repayment, the children executed an assignment, pursuant to which they assigned to the trust their interest in the policy and the policy cash surrender value sufficient to return to the trust the amounts due under the agreement. The assignment provides that the children retain all other policy rights.

After the death of the first taxpayer, the trust will be divided into separate trusts, and rights under the agreement and assignment will pass to and be held by a survivor's trust, with respect to which the surviving taxpayer will hold a power of revocation, exercisable alone. The policy proceeds payable to the trust under the agreement and assignment will be paid to such survivor's trust.

The IRS held that the payment of the policy premiums each year by the trust pursuant to the terms of the agreement does not result in a gift by the taxpayers under Code Section 2511, provided that the amounts paid by the children for the life insurance benefit that each receives under the agreement is at least equal to the amount prescribed under Rev. Rul. 64-328, Rev. Rul. 66-110 as amplified by Rev. Rul. 67-154, and Notice 2002-8. The IRS additionally held that no portion of the policy proceeds payable to the children will be includible in the gross estate of the surviving taxpayer; however, the portion of the proceeds payable to the survivor's trust will be includible in the gross estate of the surviving taxpayer.

8. P.L.R.s 200733008, 200733009, 200733010, 200733011, and 200733012 – Beneficiary's power to remove and replace trustees not a general power of appointment.

The settlor created an irrevocable trust for the benefit of his wife and descendants prior to Oct. 21, 1942. The settlor and his wife are currently deceased, and their three children are all over the age of 35 years. Under the provisions of the trust, upon the death of the wife, the trust corpus was divided into three shares, one for each child. The trustee of the trust may distribute to each child, from such child's respective share, so much of the net income as the trustee deems wise and prudent, in the trustee's absolute discretion. For each child over the age of 35 years, the trustee may distribute so much of the principal and accumulated income of the trust as such child shall from time to time request in writing. Upon the death of a child, the trustee is directed to distribute the entire remaining principal and accumulated income of the child's separate share to or for the benefit of such of the descendants of the child as such child directs in his or her will. The settlor's three children anticipate exercising their respective limited testamentary power to appoint the principal and income of their respective shares.

Successor trustees of the trust are appointed by the following persons in the following order: (1) by a majority of trustees of a named trust company, (2) by the board of directors (Board) of a named corporation, and (3) by a majority in interest in the income beneficiaries who are under no disability. The trust company has ceased to exist, and the Board currently has the power to appoint successor trustees. After the death of the settlor's wife, the Board resolved to appoint as successor trustee such qualified bank or trust company as the beneficiary of such trust may appoint by a signed written instrument delivered to the Board no later than 30 days after the current trustee ceases to act. In the event the beneficiary fails to make an appointment, the Board has appointed three different banks, in succession, as successor trustees. Any bank or trust company appointed by a beneficiary cannot be related or subordinate to any beneficiary of the trust. The Board further resolved that a bank or trust company ceases to act as trustee of a trust upon the first to occur of (1) its resignation, (2) its removal as trustee by 30 days written notice signed by the beneficiary of the trust and delivered to it and the Board, or (3) its cessation to exist or to be qualified to accept trusts.

The IRS held that because the removal and appointment powers given to the three children were limited to the appointment of a replacement trustee that is not related or subordinate to the beneficiary, the children will not have general powers of appointment under Code Section 2041 or 2514 due to the removal and appointment powers. The IRS recognized that as provided in Regulation Sections 20.2041-1(c)(1) and 25.2514-1(c)(1), the same trust instrument may give a beneficiary two separate powers, one of which is a general power of appointment and one of which is not. The IRS held that if a child exercises only his or her respective limited testamentary power of appointment, and not his or her general power of appointment, the assets from such child's trust will not be included in his or her gross estate under Code Section 2041. If a child exercises his or her lifetime general power of appointment, the exercise will be considered to be a transfer under Code Section 2514 to the extent of the value of property with respect to which the general power of appointment is exercised. Finally, the IRS held that the implementation and operation of the Board's resolution will not cause the trust to lose its status as a trust exempt from the application of the generation-skipping transfer tax.

<u>CHARITABLE GIVING</u>

9. P.L.R. 200733014 – Commutation of charitable remainder trust not self-dealing.

The taxpayers created a net income charitable remainder unitrust pursuant to which they were to receive the unitrust amount during their joint lifetimes and during the lifetime of the survivor of them. Upon the death of the surviving taxpayer, the trust assets were distributable to a public charity. The trustee of the trust proposed to obtain a court order to terminate the trust early and distribute all trust property to the taxpayers and the charity. Under the proposed plan, the taxpayers would assign their interests in the trust to the charity in exchange for a one-time lump sum distribution equal to the present value of their right to receive unitrust or income payments for life. Any assets distributed in-kind would be distributed on a pro-rata basis among the taxpayers and the charity. Both taxpayers' personal physicians submitted a statement confirming there was no indication that either taxpayer's life expectancy was less than would otherwise be expected for a person of their respective ages.

The IRS held that early termination of the trust pursuant to court order would not cause the trust to be disqualified as a charitable remainder unitrust under Code Section 664. It further held that neither the distribution to the taxpayers of the unitrust termination amount, the final distribution of trust assets to charity, the taxpayers' consents to termination of the trust, nor the charity's consent to the termination constituted acts of direct or indirect self-dealing under Code Sections 4941 and 4947. In addition, the court-approved termination and related lump sum distribution to the taxpayers and final distribution to charity would not constitute a taxable termination under Code Sections 507 and 4947. Finally, the IRS held that the transaction was, in substance, a sale of the taxpayers' interest to charity, the remainder interest holder, and that the amount received by the taxpayers as a result of the termination was an amount realized from the sale or exchange of a capital asset.

10. P.L.R. 200746010 – Reformation of charitable lead trust qualified; Deduction permitted.

Under the terms of a decedent's will, the residuary estate is to be held in trust, and a portion of the income is to be distributed monthly among three individuals until the death of the survivor of them. During such time, the remaining monthly income is to be distributed among 12 charities. The aggregate distributions are to annually equal no less than 5 percent of the initial fair market value of the trust property. If the minimum required distribution exceeds the net income in any period, the distributions are to come from principal as necessary. On the death of the last to survive of the three individuals, the trust will continue, and the income will be distributed exclusively to the 12 charities.

Because the foregoing provisions do not meet the requirements for a charitable deduction under Code Section 2055(a), the executor for the decedent's estate and the trustee for the trust commenced a judicial proceeding to reform the trust. Under the proposed reformation, the trust will distribute annually an amount equal to 5 percent of the initial net fair market value of the trust as follows: (1) an annual annuity amount equal to 0.38 percent of the fair market value of the trust assets at the date of the decedent's death will be paid to the three individuals (or the survivor of them) until the deaths of all three or upon the expiration of a term of years, whichever is first to occur (Annuity Term); (2) an annual annuity amount equal to 4.62 percent of the fair market value of the trust assets at the date of the decedent's death will be paid to the 12 charities during the

Annuity Term (Charitable Lead Annuity); and (3) at the end of the Annuity Term, any property remaining in the trust will be held for the exclusive benefit of the 12 charities. The proposed reformation will be effective as of the decedent's date of death. The IRS held that the reformation, when judicially approved, will constitute a qualified reformation within the meaning of Code Section 2055(e)(3)(B), and a charitable deduction will be allowable under Code Section 2055(a) for the present value of the Charitable Lead Annuity.

11. P.L.R. 200747001 – Transfers of stock to irrevocable trust qualify for income tax charitable deduction.

The taxpayers, a husband and wife, propose to create an irrevocable trust intended to qualify as a charitable lead annuity trust as described in Code Section 2522(c)(2)(B). Upon creation of the trust, the taxpayers will each transfer voting common stock of a subchapter S corporation. Under the terms of the proposed trust, the trustee will pay an annuity amount equal to a fixed percentage of the initial fair market value of the trust assets to a charity. The initial trustee is a nonadverse party within the meaning of Code Section 672(b). The taxpayers are prohibited from serving as trustees, and successor trustees must be nonadverse within the meaning of Code Section 672(b), must be not related or subordinate to the taxpayers within the meaning of Code Section 672(c), and will be appointed by the management committee of the law firm representing the taxpayers. The trust will end on the earlier of the expiration of a five year period or upon the death of the surviving taxpayer. Upon termination, the trustee may distribute the remaining trust assets to one or more charitable organizations described in Code Sections 170(b)(1)(A), 2055(a), and 2522(a), as selected by the trustee, in such amounts and proportions as the trustee determines. Any trust assets remaining after any charitable distribution will be distributed outright to the then-living issue of the taxpayers. The trust contains other provisions required to qualify as a charitable lead annuity trust.

The IRS ruled that the transfers of stock to the trust by the taxpayers will constitute completed gifts under Regulation Section 25.2511-2(b) because the trust is irrevocable and the taxpayers will have retained no interest or reversion in it. The IRS also concluded that the amount paid to charity will be a determinable amount and the annuity interest will meet the definition of a guaranteed annuity interest within the meaning of Code Section 2522(c)(2)(B) and Regulation Section 25.2522(c)-3(c)(2)(vi), provided the trust is established and administered under the proposed trust agreement, and provided the trust is valid under state law. Accordingly, the IRS held that the transfers by the taxpayers will qualify for gift tax charitable deductions under Code Section 2522(a). Next, the IRS concluded that no portion of the trust assets or the assets transferred by the taxpayers to the trust would be included in the gross estate of either taxpayer under Code Sections 2035, 2036, 2037, 2038, or 2042. Assuming the trust meets the 5 percent test, the taxpayers will be treated as the owners of the trust under Code Section 674 due to the trustee's power of disposition over the trust assets at the end of the annuity term. Further, the taxpayers will be entitled to an income tax charitable deduction under Code Section 170(f)(2)(B) for the present value, on the date of contribution, of the guaranteed annuity interest. Finally, the IRS held that because the trust terminates and any stock held in it distributed no later than five years after the stock is contributed to the trust, the trust will not have excess business holdings and will not be subject to excise tax under Code Section 4943.

12. *Jones v. Comm.*, 129 T.C. No. 16 (11/1/2007) – Attorney for McVeigh not entitled to charitable deduction for donation of materials accumulated during trial.

From the date of his appointment by the U.S. District Court in May 1995 until his withdrawal in August 1997, Leslie Stephen Jones was lead counsel for the defense of Timothy McVeigh, who was prosecuted for and convicted of the April 19, 1995, bombing of the Alfred P. Murrah Federal Building in Oklahoma City. During the course of his representation of McVeigh and for use in the preparation of his legal defense, Jones was periodically provided with photocopies of documents and copies of certain tangible objects that were prepared, created, or compiled by agencies of the U.S. government for the purposes of investigating the Oklahoma City bombing and prosecuting that crime. None of the materials bore an original signature of or an original notation by McVeigh or any other person, and none of the original items were prepared personally by Jones or for him by anyone under his direction. Several interested entities, including the U.S. Department of Justice, the U.S. Department of the Treasury, the Oklahoma State Bureau of Investigation, the Oklahoma County District Attorney's Office, and the defense team of Terry Nichols, a convicted conspirator in the Oklahoma City bombing, were provided the same materials or a substantial part of the same materials that Jones received from the government in connection with his representation of McVeigh, as were McVeigh's attorneys on appeal.

Jones contacted the University of Texas at Austin to propose donation of the materials on Aug. 27, 1997, the same day that he was allowed to withdraw from representation of McVeigh. The transfer was memorialized by a document executed on Dec. 24, 1997. An appraiser valued the gift at nearly $300,000. Accordingly, Jones claimed an income tax charitable deduction of nearly $300,000 for donation of the materials. The IRS disallowed the deduction after determining that Jones did not personally own the donated materials.

At trial, the court recognized that state law controlled the determination of Jones' legal interest in the donated materials. Because the ownership of materials in the possession of an attorney that are related to the representation of a client had not previously been addressed under Oklahoma law, the court looked to Oklahoma law in related areas, as well as relevant cases decided by courts in other jurisdictions. The court held that possession of the property was not prima facie evidence of ownership due to the unique fiduciary relationship between an attorney and his client. Based on its review of related case law and the Oklahoma Rules of Professional Conduct, the court determined that the documents in issue properly belong to McVeigh, and not to Jones, who was merely the authorized and incidental custodian of the copies in issue. Therefore, the court held that Jones had no ownership rights in the donated materials sufficient to effect a gift or support a charitable contribution deduction under Code Section 170.

GENERATION-SKIPPING TRANSFER (GST) TAX

13. *Estate of Gerson v. Comm.*, 100 AFTR 2d 2007-6593 (6th Cir. 11/9/2007) – Exercies of power of appointment not grandfathered; Transfer subject to GST tax.

The decedent's husband created a revocable trust to benefit the decedent and made his last changes to the governing instrument in 1973, three days prior to his death. The trust gave the decedent a general power to appoint a beneficiary to receive the corpus of the trust at her death. In the absence of appointment, any remaining trust assets would pass to another trust for the benefit of the decedent's husband's children. The decedent died in 2000 with a will in which she exercised the power of appointment in favor of her grandchildren. After the decedent's executor filed a tax return for the estate, the IRS asserted a deficiency, claiming that the transfer triggered the GST tax. The estate brought an action in the Tax Court to challenge the deficiency, and the Tax Court ultimately agreed that the estate owed more than $1.1 million.

On appeal, the estate argued that the GST tax would ordinarily apply but cited an effective date provision that grandfathers certain transfers from any trust that was irrevocable on Sept. 25, 1985, but only to the extent that the transfer was not made out of corpus added after that date. The estate further argued that Regulation Section 26.2601-1(b)(1)(i), which provides that the grandfather exception does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer, was contrary to the plain language of the effective date provision.

On appeal, the court recognized that three other circuits had addressed the issue of whether the exercise of or failure to exercise a general power of appointment over a grandfathered trust resulted in a GST if the trust property passed to a skip person, on the grounds that the exercise or nonexercise of the power was a post-1985 addition to the trust. It noted that the Second Circuit had sided with the IRS, while the Eighth and Ninth Circuits had supported the taxpayers. Recognizing that Regulation Section 26.2601-1(b)(1)(i) was an interpretive regulation promulgated by the IRS after notice and comment pursuant to the Treasury Department's general authority to issue regulations under Code Section 7805(a), rather than under a specific statutory grant, the court stated that the standard developed in *Chevron U.S.A. Inc. v. Natural Res. Def. Council Inc.*, 467 U.S. 837 (1984), was applicable to determine the validity of such regulation. The *Chevron* standard required an analysis of whether Congress had directly spoken to the precise question at issue, and if not, whether the IRS offered a permissible construction of the statute. With regard to the first prong of the test, the court held that the statute did not have a plain meaning, as both parties offered plausible, contrary interpretations, the estate arguing that the trust instrument was the root of the skip power in question, and the commissioner arguing that the transfer was not pursuant to the irrevocable trust, but rather pursuant to the decedent's will. Recognizing the ambiguity, the court analyzed whether the Treasury reasonably construed the statute and held that it had. Accordingly, it affirmed the Tax Court's decision that the decedent's exercise of the power of appointment gave rise to a transfer subject to GST tax.

OTHER

14. P.L.R. 200731019 – Grantor not treated as owner of trust.

The taxpayer proposes to create a trust naming a corporate trustee. The terms of the trust would provide that during the taxpayer's lifetime, the trust assets are to be distributed to or for the benefit of the taxpayer, his spouse, and/or his descendants as the power of appointment committee unanimously appoints or as the taxpayer and one member of the power of appointment committee unanimously appoint. The taxpayer would have a testamentary limited power to appoint any assets remaining in the trust at the time of his death. In the absence of appointment, the remaining assets would be distributed outright to his children who are then living, or if none, then to his descendants, per stirpes. The power of appointment committee would consist initially of the taxpayer's two children, and must at all times consist of at least two persons (other than the taxpayer and his spouse) who are beneficiaries of the trust (or the parents or guardians of such beneficiaries if there are less than two adult beneficiaries).

The IRS concluded that an examination of the proposed trust revealed none of the circumstances that would cause the taxpayer to be treated as the owner of any portion of the trust under Code Sections 673, 674, 676, or 677. The IRS further held that the taxpayer's children would not have general powers of appointment by reason of the joint distribution power and would not be treated as making taxable gifts if trust income or corpus was distributed to the taxpayer under the terms of the trust.

15. *Estate of Hicks v. Comm.*, T.C. Memo 2007-182 (7/10/2007) – Loan from parent deductible by estate of special needs child.

While still a toddler, Kimberly Hicks was severely disabled in a collision at a railroad crossing. Litigation followed, and the largest part of the ultimate settlement was a lump sum to be allocated between Kimberly and her father. The local probate court had jurisdiction under Ohio law to review and approve the settlement, allocation, and distribution of the noneconomic compensatory damages in the civil case. As part of potential future Medicaid planning for Kimberly, the proposed allocation of the settlement was as follows: (1) $1 million would fund a special needs trust that complied with section 1396p(d)(4)(A) of the Medicaid Payback Trust Act, and would, thus, not be considered in determining Kimberly's eligibility for Medicaid; (2) $450,000 would fund a settlement trust to be available for Kimberly's support, maintenance, health, and education and would, thus, be considered in determining Kimberly's eligibility for Medicaid;

(3) $1.415 million to Kimberly's father, Clyde, for loss of services and loss of consortium; (4) $100,000 to Kimberly's mother and sister for their comparatively minor injuries; and (5) the balance of the $4.65 million settlement would be used for attorneys' fees and expenses. The proposed settlement further involved a loan from Clyde to the settlement trust equal to $1 million, pursuant to which Clyde would receive interest at 6 percent annually. The promissory note evidencing such loan would not be amortizing and would be callable on demand in only two circumstances: Kimberly's death or her failure to have available at reasonable premium charges a commercial medical indemnity contract once she turned 18 years of age. Kimberly died at the age of 11. Her estate reported the full amounts of the assets in both the special needs trust and the settlement trust and then claimed as a deductible debt under Code Section 2053(a)(3) and (4) the $1 million owed to Clyde under the promissory note.

The IRS first argued that the loan was not bona fide because Clyde never had control or possession of the $1 million since pursuant to the terms of the probate court order, the funds were transferred directly from the guardian's interim bank account to the settlement trust. The Tax Court rejected this argument because Ohio law required the probate court to approve any settlement agreed to by a minor's guardian before the settlement could take effect. The Tax Court, therefore, concluded that the funds belonged to Clyde because that is whom the probate court allocated them to. The IRS next argued that the allocation of the $1 million to Clyde was a sham because Clyde proposed the allocation, and Kimberly and Clyde did not have adverse interests with respect to how the settlement proceeds were to be allocated. The IRS contended that because the allocation to Clyde was a sham, the allocation should be ignored, and the $1 million should be considered for tax purposes as belonging to Kimberly at all times. The Tax Court rejected this argument, noting that the loan created an income stream in favor of Clyde that was capable of valuation and thus, it was erroneous as a matter of economics for the IRS to contend that the loan was valueless. The Tax Court held that the fact that the loan had value meant that the initial allocation of the $1 million by the probate court to Clyde could not be ignored. Further, if Clyde predeceased Kimberly, the present value of the note would be part of Clyde's taxable estate, leading the Tax Court to conclude that there was real economic substance to the loan. The court additionally concluded that Kimberly was in no danger of imminent death at the time of the settlement and held that the loan was not an attempt to dodge the imminent imposition of the estate tax. The court also found that Clyde had motivation to seek a large portion of the settlement for himself because under Ohio law, parents have a statutory obligation to provide support for their children. The court determined that given Clyde's obligation to support Kimberly until she was an adult, and in light of her enormously expensive care (approximately $30,000 per month), it was reasonable for Clyde to receive a significant portion of the settlement. The court also recognized that tax avoidance did not drive the allocation of the settlement because the settlement was entirely among various causes of action all of which produced nontaxable transfers to members of the Hicks family. Based on the foregoing, the court declined to upset the allocation approved by the probate court and held that the $1 million loan was bona fide and for adequate and full consideration under Code Section 2053(c)(1)(A) that was properly deductible from Kimberly's gross estate.

16. P.L.R. 200733023 – Hours spent by special trustees not counted toward material participation requirement.

In the year following establishment of a testamentary trust, the trust acquired an interest in a limited liability company (LLC) that is classified as a partnership for federal tax purposes. Initially, the trustees of the trust provided services to the LLC, including direct participation in operations, oversight of bond financings and borrowing activities, and approval of operating budgets. The following year, the trustees contracted with "special trustees" (as authorized in the will establishing the trust) to perform a number of tasks related to the LLC's business. The contract explicitly stated that the special trustees were being appointed as special trustees pursuant to the will and that their involvement in the LLC's business was intended to satisfy the material participation standard of Code Section 469(h)(1). The contract also provided that the special trustees would not possess the capacity to legally bind or commit the trust to any transaction or activity and that the trust acknowledged that it retained all decision making responsibilities related to the financial, tax, or business matters of the trust. Time logs submitted by the trust indicated that the special trustees spent most of their work hours during that year reviewing operating budgets, analyzing a tax dispute that arose among the partners, and preparing and analyzing other financial documents. The logs evidenced repeated contacts with the trustees relating to such issues. In addition, the special trustees appeared to have spent considerable hours negotiating the sale of the trust's LLC interest to a newly admitted partner. The trust submitted that, while the trustees relied heavily upon the recommendations of the special trustees, ultimate decision making authority remained vested solely with the trustees. For its tax return filed for that year, the trust reported a loss from the LLC, which it did not treat as a passive loss on the tax return.

The IRS first recognized that the proper standard to apply to trusts for purposes of Code Section 469 was that annunciated in the legislative history. Thus, the IRS held that the sole means for a trust to establish material participation was if its fiduciaries were involved in the operations of the business on a regular, continuous, and substantial basis. The IRS recognized that this was contrary to the holding in *Mattie K. Carter Trust v. U.S.*, 256 F. Supp. 2d 536 (N.D. Tex. 2003), which allowed the activities of the employees of the trust to be considered in determining whether the trust's participation was material. In applying the standard to the present facts, the IRS held that the special trustees were not fiduciaries of the trust in light of the limited power vested in them. Therefore, only the activities of the trustees counted toward the material participation requirement, and the hours of the trustees were limited and did not constitute involvement in the LLC's business that was regular, continuous and substantial. Accordingly, the IRS concluded that the trust did not materially participate in the LLC's business for the year in question, and the reported loss should be treated as a passive loss on the tax return.

17. P.L.R. 200744001 – Gain from sale of real property not income in respect of a decedent.

The taxpayer, a decedent's revocable trust, entered into a contract to sell a plot of real property with an intended closing date prior to the decedent's date of death. Prior to such intended closing date, however, a gas pipeline was discovered under the property, causing the parties to delay the sale until the taxpayer, the buyer and the pipeline's operating company could resolve a number of issues, including providing for an easement for the pipeline company to enter onto the property, as well as providing that the pipeline company would provide restitution for any damage to the property. The sale did not actually close until after the decedent's death.

The IRS recognized that the pipeline was not discovered until after the original contract was entered into, creating economically material contingencies that might have disrupted the sale prior to the decedent's death. Therefore, the IRS held that any gain realized from the sale of the property after the decedent's death did not constitute income in respect of a decedent within the meaning of Code Section 691. It further concluded that the basis of the property in the taxpayer's hands before the sale should be determined under Code Section 1014(a).

18. *Hartzheim v. Valley Land & Cattle Co.*, Cal. Ct. App., No. H030053 (7/17/2007) – Transfer not made pursuant to bona fide offer from third party; Right of first refusal not triggered.

Three brothers (all sons of Peter Rubino) formed a partnership, Valley Land & Cattle Co. (Valley Land), in which each brother owned a one-third share. Over many years, Valley Land acquired a number of parcels of real property, including a five acre parcel located in San Jose, Calif. Valley Land leased the San Jose property to Chrysler Realty Corp. (Chrysler) for the operation of a car dealership. Chrysler assigned the lease to Hartzheim Enterprises LLC (Hartzheim), which has operated a car and motorcycle dealership at the location ever since. There are approximately eight years left on the lease. The terms of the lease give the lessee a right of first refusal to purchase the San Jose property in the event the landlord obtains a bona fide offer from any third party that the landlord is willing to accept.

In 1992, Valley Land changed its name to Valley View Packing, Co. (Valley View). At such time, the current owners of Valley View were two wives and two children of the original brothers. Four grandchildren of the original brothers hold contingent interests in Valley View through trusts established by their parents or grandparents. As part of some estate planning and income tax planning transactions, the grandchildren's trusts exchanged their interests in the real property where the original Rubino family home had been located for interests in the San Jose property. For purposes of the exchange, the San Jose property was valued at its appraised value of $4 million. Hartzheim filed this lawsuit in 2003, believing that Valley View's transfer of the property to the grandchildren should have triggered the right of first refusal contained in the lease agreement. He sought cancellation of the deed to the grandchildren and the opportunity to purchase the property on the same terms and conditions as it was acquired by the grandchildren.

The trial court concluded that the undisputed evidence established that the right of first refusal was not triggered by the transfer to the grandchildren because it was part of the grandmothers' estate planning and, therefore, was not transferred pursuant to a bona fide offer from a third party as required in the lease. On appeal, Hartzheim argued that there was a bona fide offer from a third party because the transfer to the grandchildren was made pursuant to a contract of sale, which means that there must have been an offer to buy; the offer was bona fide since the exchange of properties was based upon the properties' appraised values; and the grandchildren are third parties because they are strangers to the lease agreement. Hartzheim further argued that the transfer to the grandchildren was not a gift and that the defendants are estopped from arguing otherwise because they reported the transaction to the taxing authorities as a sale. It conceded that the conveyance was part of a plan to minimize capital gains and estate taxes but argued that the purpose does not alter the character of the transaction. Valley View argued that it never obtained a bona fide offer for the purchase of the property because the exchange was not negotiated at arms' length, the grandchildren never made an offer, and the grandchildren are not third parties because they hold contingent interests in the partnership through their parents or grandparents. The appeals court upheld the decision of the trial court, stating that a bona fide offer from any third party for the purchase of property could not be interpreted to include Valley View's decision to convey the San Jose property to the children and grandchildren of its partners for tax and estate planning purposes.

19. Notice 2007-90, 2007-46 I.R.B. 1003 (10/29/07) – Necessity of security in connection with Code Section 6166; Election to be determined on case-by-case basis.

The IRS alerted taxpayers, practitioners, and other persons who represent estates that it is changing its policy and will now determine on a case-by-case basis whether security will be required when a qualifying estate elects under Code Section 6166 to pay all or a part of the estate tax in installments. The change in policy was made in light of the Tax Court's decision in *Estate of Roski v. Commissioner*, 128 T.C. 113 (2007), in which it held that the IRS had abused its discretion by requiring that all estates electing to pay the estate tax in installments must provide a bond. The court found that it was the intent of Congress that the IRS determine, on a case-by-case basis, that the government's interest is at risk prior to requiring security from an estate electing to pay the estate tax in installments. The Treasury Department and the IRS are in the process of establishing standards to be applied in such cases and intend to issue regulations implementing those standards and related procedures. Until then, the IRS stated that it will consider all relevant facts and circumstances, including the following: duration and stability of the business, ability to pay the installments of tax and interest timely, and compliance history. The notice is applicable to each estate (1) that timely elects to pay the estate tax in installments under Code Section

6166 and that timely files a return on or after Nov. 13, 2007; (2) whose return was being classified, surveyed, or audited by the IRS as of April 12, 2007; or (3) that is currently in the deferred payment period but that has not yet provided a bond or special lien if (a) the general federal estate tax lien will expire within two years from Nov. 13, 2007, or (b) the IRS reasonably believes that the government's interest in collecting the deferred estate tax and interest thereon in full is sufficiently at risk to require a bond or special lien.

20. REG-143326-05 (9/28/2007) – Proposed regulations detail new subchapter S corporation trust rules.

The IRS and the Treasury issued proposed regulations that explain the changes made to the rules for subchapter S corporation trusts by the American Jobs Creation Act of 2004 and the Gulf Opportunity Zone Act of 2005 and that replace obsolete references in the current regulations. The proposed regulations provide guidance on the subchapter S corporation family shareholder rules, the definitions of "powers of appointment" and "potential current beneficiaries" with respect to electing small business trusts, the allowance of suspended losses to the spouse or former spouse of a subchapter S corporation shareholder, and relief for inadvertently terminated or invalid qualified subchapter S subsidiary elections. Public hearing on the proposed regulations was held on Jan. 16, 2008.

21. Statutory tax rates, exemptions, and deductions for 2008.

The following changes affect estate planners for transfers made, and estates of decedents dying, in 2008:

(a) The gift tax annual exclusion under Section 2503 of the Internal Revenue Code of 1986, as amended (Code) remains at $12,000 per donee.

(b) The annual exclusion for gifts to a non-citizen spouse under Code Section 2523(i)(2) increases to $128,000.

(c) The generation-skipping transfer tax exemption under Code Section 2631 will be $2 million.

(d) The aggregate amount that special use valuation of farm or business real estate may reduce an estate under Code Section 2032A increases to $960,000.

(e) If an estate elects to defer payment of estate taxes under Code Section 6166, the amount of the business interest of an estate, the taxes of which are subject to a 2 percent interest rate under Code Section 6601(j), will be $1.28 million.

(f) The income tax rates for taxable income of an estate or trust will be 15 percent for taxable income not more than $2,200; 25 percent for taxable income more than $2,200 but not more than $5,150; 28 percent for taxable income more than $5,150 but not more than $7,850; 33 percent for taxable income more than $7,850 but not more than $10,700; and 35 percent for taxable income more than $10,700.

(g) The estate tax rate under the Code is a flat 45 percent for all taxable estates. ■

Mark Your Calendars!
KBA Annual Meeting
June 19-21, 2008

Capitol Plaza Hotel
Topeka, Kan.

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.

He received his J.D. from the University of Kansas School of Law and his B.A. from Bethany College.

He is a member of the KBA executive committee of the Real Estate, Probate, and Trust Law Section and serves as the KBA liaison to the Kansas Electronic Recording Commission.

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Real Estate Update

KANSAS SUPREME COURT

SMITH ET AL. V. KANSAS GAS SERVICE CO. ET AL.
RENO DISTRICT COURT
REVERSED AND REMANDED WITH INSTRUCTIONS
NO. 94,602 – OCTOBER 26, 2007
Injury to Real Property, Damages, and Nuisance

ATTORNEYS: James T. Ferrini and Barbara I. Michaelides, of Clausen Miller P.C., Chicago, and Charles D. Lee, of Martindell, Swearer & Shaffer LLP, Hutchinson, for ONEOK Inc. and Mid Continent Market Center Inc., appellants/cross-appellees. James P. Frickleton, of Bartimus, Frickleton, Robertson & Gorny P.C., Leawood, John F. Edgar and John M. Edgar, of The Edgar Law Firm LLC, Kansas City, Mo., Lee Thompson, of Thompson Law Firm, LLC, Wichita, and Rex A. Sharp, of Gunderson, Sharp & Walke LLP, Prairie Village, for appellees/cross-appellants. Daniel D. Crabtree, John C. Nettels Jr., and Angela G. Heppner, of Stinson Morrison Hecker LLP, Overland Park, for appellee/cross-appellant Westar Energy Inc. (formerly known as Western Resources Inc.).

FACTS: Reno County real property owners sued the owners/operators of the Yaggy Gas storage facility in Hutchinson after explosions occurred in 2001 as a result in a leak in the casing of a well that was part of the Yaggy facility. They claimed diminished property value. The district court denied the defendants' summary judgment motions finding that genuine issues of material fact existed, such as whether there was a physical intrusion of gas upon or under the plaintiffs' properties. The jury awarded $5 million in damages, assigning 80 percent fault to ONEOK, 20 percent to Mid-Continent Market Center, and zero percent fault to Western Resources. The jury found no punitive damages.

ISSUES: (1) Class action, (2) physical injury to real property, (3) interference with use of real property, (4) nuisance, (5) negligence, and (6) diminution in market value of real property

HELD: Court held that the plaintiff class failed to prove that the real property in the class suffered physical injury from the escaped gas, or that class-wide, the real property owners suffered an interference with the use and enjoyment of their property because of the gas contamination. Court held that a property owner cannot collect damages under either a negligence or nuisance theory for diminution in the property's market value caused by the stigma or market fears resulting from an accidental contamination where the property owner has not proved either a physical injury to the property or an interference with the owner's use and enjoyment of the property. Court reversed with instructions to entered judgment as a matter of law in favor of the defendants.

STATUTES: K.S.A. 20-3017 and K.S.A. 60-250

CITY OF ARKANSAS CITY V. BRUTON ET AL.
COWLEY DISTRICT COURT
AFFIRMED
COURT OF APPEALS – REVERSED
NO. 94,893 – SEPTEMBER 7, 2007
Easements and Improvements

ATTORNEYS: Robert D. Wilson, of Law Offices of Wilson & Brewer, Arkansas City, for appellants. Alvin D. Herrington, of McDonald, Tinker, Skaer, Quinn & Herrington P.A., Wichita, for appellee.

FACTS: Ronald and Rebecca Bruton own and reside upon a 5.4 acre plot of land that is located within the city of Arkansas City. Their property borders the Arkansas River and is subject to a 1935 easement granted to the city for flood protection. In 2000, the city attempted to enter the Bruton's property in order to make improvements to the dike. The city filed for a restraining order against the Brutons and an order declaring that the city had a lawful easement encompassing the Bruton's property, as well as the authority to construct and maintain the dike on that property. The district court issued the restraining order. The city completed improvement to the existing dike on the Bruton's property. The district court granted judgment in favor of the city finding the 2000-2001 levee improvements by the city did not breach the easement agreement because the change in the configuration of the levee was within the easement's stated purpose. The Court of Appeals reversed the district court's grant of summary judgment holding that the district court erred in finding the instrument ambiguous, focused exclusively on the stated purpose and ignored the specific express restrictions imposed on the scope and location of the easement, and failed to recognize that a genuine issue of material fact precluded summary judgment.

ISSUES: (1) Easements and (2) improvements

HELD: Court found that because the city's recent improvements to the dike did not involve any land other than the land used in the original easement and because the improvements constituted maintenance within the meaning of the easement, it held that the city's improvements in 2000-2001 did not exceed the scope and limitation of the easement. Court held the district court correctly granted summary judgment in favor of the city as to the Brutons' inverse condemnation and declaratory judgment counterclaims even though the district court's decision erroneously concluded that the 1935 easement was ambiguous. Court found the trial court was right for the wrong reason.

DISSENT: J. Luckert held that summary judgment should have been denied. A jury should weigh the evidence and determine whether the improvements constituted maintenance in accordance with the 1935 plans and specifications. J. Nuss and J. Beier joined in this dissent.

STATUTES: None

KANSAS COURT OF APPEALS

YOUNG V. HEFTON ET AL.
BULTER DISTRICT COURT – AFFIRMED
NO. 97,614 – DECEMBER 21, 2007
Real Estate Auction, Contract, and Statute of Frauds

ATTORNEYS: Jarrod C. Kieffer, Stinson Morrison Hecker LLP, Wichita, for appellant/cross-appellee. Norman G. Manley, Davis, Manley & Lane LLC, El Dorado, for appellees/cross-appellants.

FACTS: The Hefton family hired an auctioneer to sell five tracts of land at public auction and listed a minimum price on each tract. Young was the successful bidder on tracts 3 and 4, and the auctioneer called, "Mark it down." On tract 3, the bid was $925 per acre or $275 per acre under the minimum established by the Heftons. On tract 4, the bid was $780 per acre or $30 above the minimum of $750 per acre. Following the bidding, Young was told by the auctioneer that he could not buy tract 3 due to his bid being under the minimum of $1200 per acre, but that he could purchase tract 4. Young wanted both tracts, or none at all. Five days later, Young tendered a check for both tracts. The checks were returned. Young tried to purchase tract 4 at the auction bid price, but was rejected by a counteroffer of $1500 per acre, twice the original minimum. Young sued seeking specific performance of contract on both tracts. The district court found a meeting of the minds on tract 4, but not tract 3, and that Young was entitled to specific performance at the bid price on tract 4.

ISSUES: (1) Real estate auctions, (2) contract, and (3) statute of frauds

HELD: Court held that under the facts of this case, where the auction bill may be open to several interpretations, but one interpretation is that all contracts are subject to final approval of the seller for whatever reason; and where there were signs and indications before and during this auction that the seller was retaining some measure of final approval or control, the auction was conditional in nature and that no contracts were formed until the seller's acceptance of the highest bids. Court also held that the statute of frauds was satisfied as to tract 4 because the Exclusive Right to Sell Listing Agreement identified the tracts of land to be sold and was signed by the sellers, together with the Bid Sheet Information or bid receipt and check reflecting earnest money signed by the buyer. The land was adequately described in the Internet sales bill, the printed sales bill, and the listing agreement, and all terms and conditions of the sales were in the internet sales bill and printed sales bill.

STATUTES: K.S.A. 33-105, -106; and K.S.A. 84-2-328

BOARD OF COUNTY COMMISSIONERS OF SUMNER COUNTY ET AL. V. HON. BREMBY ET AL.
SHAWNEE DISTRICT COURT
REVERSED AND REMANDED
NO. 96,658 – OCTOBER 12, 2007
KDHE Landfill Permit and Standing

ATTORNEYS: Robert V. Eye, of Irigonegaray & Associates, Topeka, for appellant Board of County Commissioners of Sumner County, and Robert J. Vincze, of the Law Offices of Robert J. Vincze, Lone Tree, Colo., for appellants Tri-County Concerned Citizens Inc. (TCCCI) and Dalton Holland. Nancy L. Ulrich, of Kansas Department of Health and Environment (KDHE), for appellees secretary of KDHE and KDHE. Robert H. Epstein, of Gallup, Johnson & Newman L.C., St. Louis, and John Terry Moore, of Moore Martin L.C., Wichita, for appellee Waste Connections of Kansas Inc.

FACTS: In 2003, the KDHE held public hearings in Harper County, Kan., regarding a proposed permit to Waste Connections to construct and operate a municipal solid waste landfill. Members of the TCCCI and other groups submitted comments on the permit. KDHE formally responded to the comments. In 2005, KDHE granted Waste connections a permit to construct and operate the landfill. The Board of County Commissioners of Sumner County, TCCCI, and Donald Holland filed a petition for review in Shawnee County seeking to stay the effectiveness of and nullify the permit and later amended the petition alleging damages and procedural injuries had or would result from operation of the landfill. The district court dismissed the petition for lack of standing, finding none of the petitioners were parties to the agency proceedings under the Kansas Act for Judicial Review and Civil Enforcement of Agency Actions.

ISSUES: Landfill permit and standing

HELD: Court stated that under Kansas law, citizens are entitled to standing as a "party" based upon their opportunity to participate as a group or individually in the public hearing process preceding issuance of a permit. Consequently, the court concluded the district court erred and held that the petitioners were entitled to standing as "parties." Court also held that in prior cases it had determined that TCCCI meets the three-part standing test of *NEA-Coffeyville*, 268 Kan 384, and there was no reason to reconsider application of that criteria.

STATUTE: K.S.A. 77-501, -601, -611

LINDEN PLACE LLC V. STANLEY BANK
JOHNSON DISTRICT COURT – AFFIRMED IN PART AND REVERSED IN PART
NO. 97,252 – SEPTEMBER 21, 2007

Implied Fiduciary Relationship and Tortious Interference

ATTORNEYS: John E. Waldeck, Susan C. Hascall, and Michael E. Waldeck, of Waldeck, Matteuzzi & Sloan P.C., Leawood, for appellant. R. Scott Beeler and Jennifer M. Hannah, of Lathrop & Gage L.C., Overland Park, for appellee.

FACTS: Linden sold undeveloped lots to Williams and obtained a security interest on those lots. Linden willingly subordinated this interest so Williams could obtain loans from Stanley Bank to finance construction on the lots. Linden learned Williams was using some of Stanley Bank's loan proceeds to pay other obligations and alerted the bank's executive vice president. Linden learned of additional improper expenditures by Williams and again contacted Stanley Bank's vice president as well as its president. Linden did not receive payment as contemplated after the first of the lots sold. Linden sued Stanley Bank for breach of fiduciary duty and tortious interference with existing contractual relations. District court granted summary judgment to the Stanley Bank, finding no fiduciary relationship. Linden Place appealed.

ISSUES: (1) Breach of fiduciary duty and (2) tortious interference

HELD: Error to grant summary judgment on breach of fiduciary duty claim. Under circumstances of case and summary judgment standards, there exists the possibility of a brief fiduciary duty based on Stanley Bank's assurance that Linden Place should not be alarmed, and that expenditures would be monitored more carefully in the future. *Denison State Bank v. Madeira*, 230 Kan. 684 (1982), is distinguished. No error in granting summary judgment on the tortious interference claim. No evidence from which a jury could conclude that Stanley Bank intentionally and maliciously procured a breach by Williams of his contract with Linden Place.

CONCURRENCE AND DISSENT (Marquardt, J.): Concurs with affirming the dismissal of Stanley Bank's tortious interference with contract claim. Dissents from majority's reversal of summary judgment on breach of fiduciary contract claim. No evidence in record on appeal for a reasonable person to find Stanley Bank had any fiduciary duty to Linden Place.

STATUTE: K.S.A. 60-256(c)

OFFICE OF THE ATTORNEY GENERAL STATE OF KANSAS

OPINION NO. 2007-16

Cities and Municipalities — Planning and Zoning — Planning, Zoning and Subdivision Regulations; Cities and Counties — Same; Zoning; Downzoning or Rezoning, Amendments and Revisions; Procedure; Notice and Hearing; Notification of Property Owners Located Within 1,000 Feet of Area Proposed to be Altered.

SYNOPSIS: The 1,000 feet distance requirement of K.S.A. 12-757 should be calculated from the property that is the subject of an owner-initiated rezoning application — not from the larger tract of property owned by the applicant within which the subject property is located. Cited herein: K.S.A. 12-757.

STATUTE: K.S.A. 12-757

OPINION NO. 2007-18

Public Health — Solid and Hazardous Waste — Cities or Counties Authorized to Provide for Collection and Disposal of Solid Wastes or Contract Therefor; Fees; Use of Revenue from Fees.

SYNOPSIS: Revenue derived from fees imposed on real property within Reno County's solid waste and recyclables service area pursuant to K.S.A. 2006 Supp. 65-3410 may be expended for purposes that directly relate to statutorily specified purposes and not for purposes that are merely incidental to those primary purposes. Maintenance of a county road that services adjacent business and individual property owners, as well as landfill related traffic, is not sufficiently related to the statutory purposes specified by K.S.A. 2006 Supp. 65-3410 to warrant use of revenue derived from fees imposed pursuant to that statute. Cited herein: K.S.A. 2006 Supp. 65-3410.

STATUTE: K.S.A. 2006 Supp. 65-3410

UNITED STATES BANKRUPTCY APPELLATE PANEL TENTH CIRCUIT

IN RE RAFTER SEVEN RANCHES L.P.
CASE NO. KS-06-0137
SEPTEMBER 12, 2007

Interpretation of Contract

FACTS: Debtor transferred three one-quarter tracts of real property to WNL Investment LLC (WNL). Debtor was to pay WNL $240,000 on or before the specified date. If WNL received timely payment in full, it would deed all three tracts back to debtor; if not, WNL was authorized to sell as much of the property as necessary to recoup full payment. The terms of sale in the agreement provided that WNL "shall sell one quarter section of [r]eal [e]state at a time in the following order: [Tract 1], then [Tract 2], then [Tract 3]." Debtor failed to meet its payment obligation and WNL sold Tract 1. WNL then placed advertisements announcing the auction of the other two tracts to be held on the same date but specifying that "each quarter will sell separately." Debtor objected to the sale, however, Tracts 2 and 3 were sold. Debtor appealed the bankruptcy court's determination that "one at a time" unambiguously meant the three pieces of real estate were to be sold in parcels one at a time and not as a unit and nothing in the agreement required sales on different dates.

ISSUE: Whether WNL was required to sell each tract individually and on a different date.

HELD: Court agrees that the term "one at a time" was not ambiguous. However, construing the term in light of the contract as a whole, Court held the term required WNL to initiate and complete the sale process for each tract separately, before initiating the process for the next tract. That the sale of Tract 3 was inevitable for WNL to recoup the entire $240,000 could not alter the agreement's requirement for one sale at a time. The bankruptcy court's decision was not harmless error because correctly sequenced sales may have allowed Debtor a better opportunity to participate in the auction of Tract 3.

STATUTE: 28 U.S.C. §§ 158(a)(1), (b)(1), and (c)(1)

IN RE COLON
CASE NO. KS-07-023
SEPTEMBER 19, 2007
Constructive Notice and Reorganization Plan

ATTORNEYS: Thomas M. Franklin of The Franklin Law Firm, Kansas City, Mo., for defendant-appellant. Jan Hamilton, Topeka, pro se, and Teresa L. Rhodd, Topeka, for plaintiff-appellee.

FACTS: Debtors granted creditors a mortgage in Lot 79. The mortgage correctly identifies the property by address and Parcel ID number, but the legal description incorrectly identifies the property as Lot 29. The mortgage was recorded and indexed incorrectly under Lot 29. Debtors filed a voluntary Chapter 13 petition and their proposed plan contained a notation that the mortgage was improperly perfected and was avoidable by the trustee. The plan proposed that debtors pay their mortgage payment to the trustee, pending resolution of the mortgage perfection issue and this plan was confirmed. The bankruptcy court later ruled the mortgage was unperfected and avoided the mortgage under 11 U.S.C. § 544(a), which grants the trustee the status of a hypothetical lien creditor or a bona fide purchaser (BFP) with the power to avoid liens that a lien creditor or BFP could avoid subject to the applicable state's constructive notice law. The court also ruled creditors' claim was unsecured and denied its motion for relief from the automatic stay. Creditors appealed these findings and argued the confirmed bankruptcy plan was not res judicata because it violates § 1322(b).

ISSUES: (1) Whether the mortgage, recorded under an incorrect lot number, provides constructive notice to a BFP or judgment lien creditor under Kansas law; and (2) whether the plan confirmation order was res judicata.

HELD: Court held the bankruptcy court was correct in avoiding creditors' mortgage, in determining its claim was unsecured, and in denying its motion for relief from the automatic stay. The mortgage, recorded under an incorrect lot number, did not provide constructive notice to a BFP or judgment lien creditor under Kansas law. If a purchaser searched the records of the Register of Deeds by legal description (Lot 79), the mortgage would not be discovered. Kansas law permits a BFP to avoid a conveyance that is not recorded in accordance with Kansas statutes. The confirmed plan is res judicata as to its treatment of creditors' claim and distribution of the mortgage loan payments, whether or not that treatment violates § 1322(b).

STATUTES: 28 U.S.C. §§ 158(a)(1), (b)(1), and (c)(1); 11 U.S.C. §§ 544(a)(1) and (3); K.S.A. §§ 58-2222, 19-1205 (2006); and 11 U.S.C.S. § 1322(b)(2)

UNITED STATES BANKRUPTCY COURT
DISTRICT OF KANSAS

IN RE MCBRATNEY
CASE NO. 07-20222
SEPTEMBER 7, 2007
Homestead Exemption and Four-Plex

ATTORNEYS: Scottie S. Kleypas of Husch & Eppenberger LLC, Kansas City, Mo., for trustee. James M. Holmberg, Kansas City, Kan., for debtor.

FACTS: Debtor resides in and owns a single-family residence that has been converted into a four-plex. Debtor claims the entire property as his homestead under K.S.A. § 60-2301, even though he resides in only one of the units. Debtor rents the three units which he does not occupy on a month to month basis. Trustee objects to the exemption, asserting the business use of the property is so pervasive and debtor's personal use so limited that only the single unit occupied by debtor is entitled to the exemption.

ISSUE: Whether the entire four-plex is entitled to exemption or just the unit debtor occupies.

HELD: The homestead interest extends to debtor's entire property, not only the unit of the four-plex where he resides. Court noted possession or occupancy of the land by a tenant is not inconsistent with the homestead rights of the owner. Court also noted, under Kansas law, use of the property where the owner and his family reside to produce income does not automatically defeat the exemption so long as the business use of the property is "of an incidental character."

STATUTES: 28 U.S.C. §§ 157(a) and (b)(2)(B), 1334 (a) and (b); K.S.A. §§ 60-2301, -2312; and 11 U.S.C. §§ 522(b)(2) and (d)(10)

IN RE ANDERSON
CASE NO. 05-19222
OCTOBER 2, 2007
Homestead Exemption and Mortgage Payment

ATTORNEYS: Scott M. Hill of Hite, Fanning & Honeyman LLP, Wichita, for trustee. J. Michael Morris of Klenda, Mitchell, Austerman & Zuercher, Wichita, for debtor.

FACTS: Section 522(p) of the federal Bankruptcy Code caps the amount of interest in the homestead that can be claimed exempt under state or local law at $125,000 where that interest was acquired during the 1,215 days before filing bankruptcy. Debtor acquired his homestead, which is worth well over the $125,000 statutory cap, prior to the 1,215 day period. However, by making a $240,000 payment to mortgagee less than three months before filing for Chapter 7 relief, debtor significantly increased his equity in the residence shortly before the petition date. Trustee wishes to apply the $125,000 statutory cap to debtor's equity in his homestead.

ISSUE: Whether § 522(p)(1) applies to the situation where a debtor purchases his homestead well outside the 1,215 day period preceding the bankruptcy filing but pays down the mortgage in excess of $125,000 during the 1,215 day period.

HELD: Court held the provision is inapplicable to a debtor who purchases his homestead outside the 1,215-day look-back period. Court held the accumulation of equity during the look-back period by paying down the mortgage is instead limited by the operation of § 522(o). The debtor's increased equity was not an "interest" that he "acquired" within 1,215 days of the petition date, as those terms are used in the Code provision.

STATUTES: 11 U.S.C. §§ 522(b)(2), (d), (p) and (o), 544, 548; 28 U.S.C. §§ 157(a) and (b)(2)(B), 1334; and K.S.A. § 60-2301, -2312 (2005)

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF MISSOURI

IN RE NICKERSON
CASE NO. 07-41889
SEPTEMBER 7, 2007
Missouri Residency, Kansas Domicile, and Exemptions

ATTORNEYS: Drew Frackowiak, Overland Park, for debtor. Jerald S. Enslein, Gallas & Schultz, Kansas City, Mo., pro se.

FACTS: Chapter 7 debtor is currently a Missouri resident who previously lived in Kansas. Under the federal Bankruptcy Code § 522(b)(3)(A), debtor's domicile is Kansas so she may not take advantage of Missouri exemption laws. Debtor claims she is unable to take advantage of Kansas exemption laws either because Kansas does not allow non-residents to do so. As a result, debtor claims several federal exemptions. Trustee objects to debtor's use of the federal exemptions arguing debtor is required to use exemptions provided under the laws of the state of Kansas, which has opted out of the federal exemptions.

ISSUE: Whether a debtor "domiciled" in Kansas for purposes of federal bankruptcy law, but who is not currently residing in the state of Kansas, can claim Kansas exemptions in a bankruptcy case.

HELD: A debtor "domiciled" in Kansas for purposes of federal bankruptcy law, but who is not currently residing in Kansas, may not claim Kansas exemptions in a bankruptcy case. Pursuant to the "savings provision" added to the code's exemptions section by the Bankruptcy Abuse Prevention and Consumer Protection Act, a debtor who is unable to take advantage of a state's exemptions because he or she no longer resides in that state may elect to use the federal exemptions.

STATUTES: 28 U.S.C. § 157(a), (b)(1) and (b)(2)(B), 1334(b); 11 U.S.C.A. §§ 522(b)(3)(A) and (d); and K.S.A. §§ 60-2301, -2304, -2312(a) ■

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 B.A. and J.D. 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 KBA Executive Committee of the Real Estate, Probate, and Trust Law Section and serves as section editor.

Karlin can be reached via e-mail at ckarlin@barberemerson.com.

Probate and Trust Cases

IN RE ALIG
KANSAS SUPREME COURT
OCTOBER 26, 2007

ATTORNEYS: Stanton A. Hazlett, Disciplinary Administrator, Topeka. John J. Ambrosio, Topeka, for respondent, who also argued pro se.

Published censure was ordered as to David R. Alig. Alig was appointed by the District Court of Johnson County to administer a decedent's estate that was valued at approximately $4 million, including joint tenancy property and property passing by a probate avoidance trust. Alig informed the administrator and heirs that he expected to be paid monthly for his hourly charges. During his representation of the estate, Alig's law license was suspended for more than one year for failing to meet his CLE requirements. Alig collected approximately $100,000 from 2001-2005. When the Court was informed that Alig received attorney fees without court review or approval, pursuant to K.S.A. 59-1717, it removed the administrator (for having paid attorney fees without approval) and reported the matter to the Disciplinary Administrator.

Alig asserted that he was to be paid from non-probate assets, but all of the fees were actually paid by the administrator through the estate account (some of which came from non-probate assets contributed to the estate by the heirs). It was determined that Alig violated the following rules of professional conduct:

KRPC 1.1: It was found that Alig did not have significant experience to take on a complicated, contested probate case.

KRPC 1.5 (a): Although the hearing panel acknowledged that the evidence of unreasonableness of the fees did not meet the required "clear and convincing" standard, respondent Alig stipulated that his fees were unreasonable.

KRPC 5.5 (a) was violated by practicing law while his license was suspended.

KRPC 8.4 (d): Alig's conduct was "prejudicial to the administration of justice" because he "sought and obtained payment for attorney fees from the administrator of the estate without the court's review and approval."

Philip Ridenour, an American College of Trust and Estate Counsel member from Cimarron, inquired of Stan Hazlett, as to the need to obtain prior approval before payment is made. Hazlett indicated that it would not be a disciplinary violation if the attorney advises the executor or administrator in writing that the attorney will bill monthly and expects to be paid monthly and that payment of fees is subject to court approval when the Journal Entry of Final Settlement is filed, or at any earlier time when fee approval is sought by the fiduciary or attorney. The lesson is to be sure to ultimately get court approval (which Alig never did) as the court has ultimate control under K.S.A. 59-1717. In addition, the best practice would be to have the understanding with the client in writing.

IN RE EVANS
KANSAS SUPREME COURT
OCTOBER 26, 2007

ATTORNEYS: Janith A. Davis and Stanton A. Hazlett, Disciplinary Administrator, Topeka. Respondent did not appear.

Indefinite suspension was ordered as to Dorsey Evans, following suspensions in the District of Columbia (*see* 902 A.2d 56) and Maryland. Evans has been administratively suspended in Kansas since 1987 for failure to meet CLE requirements. The instant indefinite suspension results from the respondent's failure to represent his client competently as evidenced by filing ineffective renunciation statements, by permitting the personal representative to distribute estate assets without court approval, and by taking his own fees out of the estate without court approval. Respondent also owned a title company that collected a fee on a transaction involving real property that was in the estate and did not disclose his conflict nor obtain a proper waiver of the conflict. He also failed to appear at a hearing involving an alleged forged signature on one of the renunciations. The Court went beyond the D.C. and Maryland suspension terms due to his ongoing long term administrative suspension in Kansas.

IN RE KRAUSE
U.S. BANKRUPTCY COURT
CASE NO. 05-17429
ADVERSARY NO. 05-5775
AUGUST 14, 2007
NOVEMBER 13, 2007

ATTORNEYS: Edward Nazar of Redmond & Nazar LLP, Wichita, for debtor Gary Krause. Linda Parks of Hite, Fanning & Honeyman LLP, Wichita, trustee. Emily B. Metzger, assistant U.S. attorney, Wichita, for IRS. J. Michael Morris of Klenda, Mitchell, Austerman & Zuercher LLC, Wichita, for Drake and Rick Krause.

Judge Nugent denied intervener Drake Krause's motion to reconsider sanctions against his father (the debtor) entered in an adversary proceeding by the U.S. Trustee and the U.S. government. Gary Krause owed a tax debt in excess of $3 million. The government sought to impose its federal tax lien on various trusts and entities as to which the Bankruptcy Court had previously frozen their assets. Drake Krause was allowed to intervene because his uncle, Richard Krause, had abdicated his duty as trustee to defend the claims by the government and the U.S. Trustee when the court ruled that the frozen assets could not be used to pay his attorney fees. Drake graduated from high school in May 2007. He and his younger brother, Rick, are likely contingent, remainder beneficiaries of two of the trusts created by their father more than 15 years ago when their father was embroiled in tax litigation with the government.

Drake Krause's motion seeks reconsideration of the sanctions imposed by the court for his father's purposeful spoliation of computer data. Drake contended that it would be unjust to default him and his brother due to their father's misconduct. The court noted that it had not entered a default as to other trusts created by debtor, of which Drake and Rick are current beneficiaries; whereas Gary is the current beneficiary of the trusts created by debtors' father, Lawrence Krause, which are affected by the default sanctions entered against the debtor father for spoliation of trust and other records.

Nugent cited Judge Marten's decision in *U.S. v. Dawes*, 344 F. Supp. 2d 715, 721-22 (D. Kan. 2004) as to the standards for determining when federal tax liens may be placed on trusts or other property held as the alter ego of the taxpayer. These factors include: (1) the taxpayer's control over the nominee and its assets, (2) the use of trust funds to pay taxpayer's personal expenses, (3) the relationship between the taxpayer and the nominee, (4) the lack of internal controls and the lack of nominee oversight of taxpayer's actions, and (5) the lack of consideration for property transfers.

On Nov. 13, 2007, in two more unpublished decisions in this same case and adversary proceeding, Nugent denied the government's motion for summary judgment and denied motions for partial summary judgment by the debtor, Gary, and by his sons, Drake and Rick. These decisions primarily involved those trusts created by the debtor for his sons and will apparently result in a trial as to whether numerous transfers to these trusts by debtor and others can be recovered as fraudulent. ■

President's Message
(Continued from Page 1)

In a unanimous decision, the Court held that whether a particular type of cost incurred by a trust "would not have been incurred" if the property were held by a hypothetical individual, IRC § 67(e)(1) excepts from the 2 percent floor only those costs that it would be uncommon (or unusual, or unlikely) for such a hypothetical individual to incur. As such, the Court held that investment advisory fees were deductible only to the extent that they exceed 2 percent of the trust's adjusted gross income. However, the Court also noted that a trust may have an unusual investment objective or may require a specialized balancing of the interests of various parties, such that a reasonable comparison with individual investors would be improper. In that case the cost of expert advice would not be subject to the 2 percent floor.

Shortly after the Court granted certiorari in *Knight*, *supra*, the IRS released proposed regulations under IRC § 67(e), which adopt the view that only costs that are "unique" to a trust escape the 2 percent floor. An example of these "unique" costs would be fiduciary accountings, judicial filings, preparation of estate tax returns, distributions and communications to beneficiaries, will or trust contests, and fiduciary bonds. Items not "unique," and thus subject to the 2 percent floor, are investment advice, preparation of gift tax returns, and defense of claims by creditors of the decedent. The proposed regulations effectively require the trustee to "unbundle" the fiduciary fees in order to identify the portions attributable to activities and services that are not "unique" and are therefore subject to the 2 percent floor. At this time, the proposed regulations are only that — proposed; as proposed, the regulations do not become final until published in the Federal Register.

So, where does that leave us?

Knight is a Supreme Court decision — effective immediately. On the other hand, the proposed regulations are not yet final. Therefore, it appears at least for now there is still support for the position that fees paid to bank trust departments and trust companies should be deductible and not subject to the 2 percent floor. However, fiduciaries that incur separate investment advisory fees may only deduct such advisory fees to the extent they exceed 2 percent of the estate's or trust's adjusted gross income. But, stay tuned; it is likely the final regulations will require "unbundling" of the corporate fiduciary fees which would not be contrary to the holding in *Knight*. ■

CLE Docket

Thursday, February 7, Noon - 1 p.m. (Telephone seminar)
Nonprofit Governance, *Professor Janet Thompson Jackson, Washburn University School of Law, Topeka*

Friday, February 8, 1 p.m. - 4:45 p.m./Saturday, February 9, 9 a.m. - 4 p.m.
KBA YLS Hands-On CLE Series: Trial Techniques, Session I (Limited to 24 registrants)
Robert J. Dole U.S. Courthouse, Kansas City, Kan.
Participants can also purchase tickets at $30 each for "To Kill a Mockingbird" on Saturday, Feb. 9 at the Kansas City Repertory Theatre.

Tuesday, February 12, Noon - 1 p.m. (Telephone seminar)
Kansas Medicaid Subrogation Claims: KSA 39-719a, *Robert R. Hiller Jr., Kansas Health Policy Authority, Topeka*

Wednesday, February 13, Noon - 1 p.m. (Telephone seminar)
Nonprofit Update, *Bruce R. Hopkins, Polsinelli Shalton Flanigan Suelthaus P.C., Kansas City, Mo.*

Friday, February 22, 9 a.m. - 4:45 p.m.
Basic Auto Insurance 101, *Randall E. Fisher, Newton*
The Radisson, Lenexa

Tuesday, February 26, Noon - 1 p.m. (Telephone seminar)
Guardian ad Litem (GAL) 101, *Stephanie E. Goodenow, Law Office of Stephanie E. Goodenow LLC, Olathe*

Wednesday, February 27, Noon - 1 p.m. (Telephone seminar)
Representing the Child in Need of Care (CINC) and Termination of Parental Rights (TPR) Cases,
Stephanie E. Goodenow, Law Office of Stephanie E. Goodenow LLC, Olathe

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Tuesday, March 4, Noon - 1 p.m. (Telephone seminar)
An Overview of School Law Issues for the Private Practitioner, *Donna L. Whiteman and Cynthia L. Kelly, Kansas Association of School Boards, Topeka*

Wednesday, March 5, Noon - 1 p.m. (Telephone seminar)
Wrongful Death and Survival Claims, *Cynthia J. Sheppeard, Weathers, Riley & Sheppeard LLP, Topeka*

Tuesday, March 25, Noon - 1 p.m. (Telephone seminar)
Fair Labor Standards Act General Overview, *Kellie A. Garrett, Spencer Fane Britt & Browne LLP, Kansas City, Mo.*

Wednesday, March 26, Noon - 1 p.m. (Telephone seminar)
Recent Trends in Fair Labor Standards Act Litigation, *Kellie A. Garrett, Spencer Fane Britt & Browne LLP, Kansas City, Mo.*

Friday, March 28, 9 a.m. - 4 p.m.
Health Law
The Radisson, Lenexa

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