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The Joseph Trachtman Lecture—Estate Planning for the Next Generation(s) of Clients: It’s Not Your Father’s Buick, Anymore

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Estate planning will adapt to changing client demographics, as we redesign planning that was developed for prior generations. For example, Baby Boomer clients reflect attitudes that differ from their World War II generation parents—about wealth; about the role and abilities of women; about marriage, divorce, remarriage, and family; about education; and about work, retirement, and inheritance. Our professional challenge is to reflect the desires of a generation that is just beginning to seriously consider estate planning, as they inherit wealth, retire, and begin to die of natural causes.

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My Thesis

My thesis is that estate planning as I learned it 35 years ago has not changed in meaningful ways. Sure, the formulas that we use (like dividing a taxable estate into marital and nonmarital portions) that are driven by tax-informed results are different, because the tax results have changed. And there are some techniques and strategies that are common today that changes in the tax laws have spawned (like GRATs and QPRTs). I’m actually pretty bored with much of that, and I have grown very tired of planning that someone trumped up (and sometimes patented) primarily for marketing purposes (to say nothing of race-to-the-bottom state law changes that represent state-legislated trolling for local trust business). What I mean about the lack of change is that the basic estate planning “boxes”1 that we tend to put clients into, and the structure of the basic dispositive provisions that we use, have not changed much since they were developed for the clients estate planners served before I became a lawyer, more than three decades ago.

Back then, most of those clients were men in my father’s generation, the World War II (referred to herein as the G.I.) generation. Our planning options today essentially reflect what those G.I. men wanted. I stress what the men wanted because, back then, the planning was driven by the breadwinner, not by the bread server, and largely the plans we crafted did not give the surviving spouse—almost always the

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1 I thank Dennis Belcher for this terminology. What I mean by it is that estate planners identify client problems, evaluate the planning options (boxes) that might best address the situation, select the boxes that they expect to produce the best results, and then tailor those solutions to fit the client’s needs.
widow—any control to make meaningful changes. Demographically, virtually all the men in the G.I. generation are gone now, so our planning today, especially for married couples, is for the next several generations. My observation is that it hasn’t really adapted for those subsequent generations.

The G.I. generation had children who we know as the Baby Boomers (usually considered to be those born between 1946 and 1964). The generation between these two has defined definition. Some call it the “Silent” generation, because they didn’t make much of a fuss about anything. A war era analog makes them the Korean War generation. My favored term is the “Elvis” generation (named for its most famous icon; you may prefer the “Sandra Day O’Connor” generation). Call it what you want, its members were born between about 1927 (too young to be involved in World War II) and 1945 (pre-Baby Boomer). They are the other group that is most likely to seek estate planning today (although they don’t have the same wealth as the G.I. generation’s beneficiaries—the Boomers).¹

Now, regarding my thesis: I’m confident that Baby Boomer clients are very different than their G.I. generation parents, for whom most of our current estate planning boxes were developed and refined. Boomer attitudes about wealth; about the role and abilities of women; about marriage, divorce, remarriage, and family; about education; and about work, careers, retirement, and about inheritance are all (remarkably) different than that of their parents in the G.I. generation. And I suspect that Boomers may not resonate with planning options that estate planners developed for the G.I. generation. This remains to be seen, because Boomers are only starting to become serious about estate planning as they finally inherit wealth. Most Boomers have not yet become orphans, in the sense that over 75% still have not lost their mothers.⁴ And their need for estate planning is just beginning to become clear, as they reach an age at which alumni newsletters report classmates who have died of natural causes. My suggestion is that estate planners have not yet reconsidered the planning boxes that were developed for a prior generation of clients.

I’m less sure about whether the Silent generation of married clients differs from the G.I. generation. True to their name, they are less vocal than the Boomers, and they are a much smaller cohort than the Boomers (having been born during the lean years of the depression and World War II). Little has been written about them, and the demographic studies are pretty sparse. We know that they are not nearly as well educated as the Boomers. Women in the Silent generation were not as work-experienced,⁴ and they may not be as financially facile. Some studies suggest that they

² This statement is not true to the extent a marital distribution trust gave the surviving spouse a general power of appointment—before § 2056(b)(7) qualified terminable interest property (QTIP) trusts were legislatively created in 1981—but almost all of those powers were testamentary and seldom were they exercised, or meant to be. After 1981 we pretty much stopped giving even that much control to the surviving spouse, because we grew enamored with QTIP trusts, which did not require the general power of appointment. The G.I. generation of men liked that, and in the main their surviving widows did not object.

³ A survey of estate planners conducted in 2007 reports that their client base was 43% individuals in their 60s, 34% individuals in their 50s, and 13% individuals in their 70s. See 2007 Industry Trends Survey at wealthcounsel.com.


Specific citation of authority for various demographic “facts” is not attempted and, in some cases, it is not directly available, the data being an extrapolation or interpretation of various sources. In that regard the representations herein are not scientific and should be regarded as only generally descriptive.

⁵ Less than half of the Silent generation has a high school diploma, versus 87% of the Boomers. Fifty-three percent of Boomers have some college and 31% have a degree. For Silents, it was 38% having some college and 21% having a degree. For the G.I. generation it was 7% and 10%, respectively.

⁶ In only 50% of Silent marriages do both spouses work; Boomers exceed 70%.
resemble the G.I. generation much more than they reflect Boomer attitudes, and perhaps their notions about wealth, family, control, and inheritance are similar to the G.I. model. This might make the existing planning boxes appropriate for this cadre. To the extent this is true, estate planners may need two sets of boxes for these two different generations of clients being served today.

My observation is simply that the need for change is coming. Indeed, for what little we know, it may be upon us already. Either way, we have not really embraced it. My sense is that estate planners have not paid much attention to this demographic development.

I’d like to explore that notion in a number of ways in this monograph. I say “It’s Not Your Father’s Buick, Anymore” because the estate planning vehicle that my father thought was appropriate or desirable is not what I expect today’s generation of clients to embrace.

Another reality that informs this topic is that estate planners bring certain biases to their work. We all have presumptions, predilections, and prejudices that influence our representations, the recommendations that we make, and the documents that we draft. As proof, consider whether you believe that the “right” form of representation among descendants is the traditional common law per stirpes, or is it per capita or per capita at each generation? I’ll bet that every estate planner has a personal sense about this, and it would surprise me if the typical planner’s basic documents include a different form of representation than the one the drafter personally believes is best. Surely a good planner would change that preferred approach in a given situation, but I wonder how many planners really delve into this topic and try to educate their clients about the differences in approach, or why one approach may be better for a client’s situation than another. My point is only that we make implicit recommendations to clients by the drafting choices that we make and by the planning boxes that we present as basic solutions. So an important element in this discussion is knowing our presumptions, predilections, and prejudices, and the extent to which these are a function of our generation, upbringing (in general, and in the law practice), and sensitivity to client situations. And while my intent is to challenge you to consider the thesis, I encourage you to be circumspect about various specifics. Because I too am a merchant of various presumptions, predilections, and prejudices.

In this regard, please consider when you last undertook to identify and then to challenge your assumptions about what is appropriate or best for your clients. I see my role here as asking you to consider whether certain estate planning “wisdom” still is good advice today, for new generations of clients. I confess that I don’t have many answers to recommend, and you correctly will remind me that my inclinations are not formed with the benefit of extensive client interaction—I am the pin-headed academic, speaking from my cloistered ivory tower.

So, I seek your help to ground this in reality. I hope that collectively we will advance the estate planning endeavor in ways that are appropriate for the next

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7 We have seen demographic data on issues relating to elder-law or the graying of America, but not on the next generation planning aspects of this topic. LIMRA retirement studies, available at limra.com, and other retirement studies are not as useful as would be information about preferences or prejudices in terms of inheritance, the role of women, concerns about predators, fears about exhausting resources, altruism, desires regarding dynasty planning or incentive trusts, financial and investment acumen, business succession, and clients’ sense of family and the change in demographics (like providing for in-law children, the new biology, nonmarital tals, step children, and adoption).

8 Although I don’t intend this discussion to result in any kind of marketing frenzy, we know that the “It’s Not Your Father’s Buick” phrase actually came from an ad campaign about change in cars. There is much to be said about the client satisfaction element of this discussion. Cline, The Fault, Dear Brutus, Is Not in Our Stars, But in Ourselves. Some Thoughts on the Estate Planning Profession, 33 ACTEC JOURNAL 34 (2007), reflects an introspection by estate planners regarding their role in the planning endeavor. But it is not primarily what I have in mind here—reflection on the client base instead of what we do for them. Stating that “we need to reinvent ourselves...to cope with [a] new environment” and that “lawyers in private practice are all salespeople” is a reality that only indirectly considers the core of my thesis. Cline does address a portion of the question here when he speaks about one principle that clients care about these days. “How much money does it take to ruin a child” is a question that informs incentive trust planning. Yet Cline recognizes that “few trust agreements for minors address such possibilities” as “go-to-school or get-a-job” kinds of provisions. According to Question 13 in the summary of the JPMorgan study in Appendix H, incentive trust provisions are used quite infrequently (94% of the respondents in that survey report seeing this planning less than 25% of the time). And when Cline correctly states that “saving transfer taxes is not the most important issue to clients, even when they say that it is” he is reflecting a reality that does not appear to have changed with the generations.

9 Please note that this is not meant to be a criticism; it is simply a reality that there are too many issues for a typical client to digest, given the time and cost that would be involved in raising and explaining each, and then teasing out the client’s preferences. Clients in all legal endeavors rely on advisors to make judgments or choices, based on a variety of criteria that include the particular client and situation, as well as experience about clients in similar situations. The hard aspect in each of these endeavors is whether the planner made the right choice in distinguishing between issues that are important enough to raise specifically and those that admit to the planner’s informed judgment. It may be fair to suggest that all lawyers suffer from becoming wedged to particular approaches and may not re-evaluate their judgment as often as changing circumstances may require.

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client and not just for the last. I also hope that we will begin a discussion of various firmly held traditional concepts (whether they be presumptuous, predilective, prejudicial, or well-informed decisions) that may benefit from careful (re)examination. But I note that there is no ACTEC committee, task force, or list serve that has such an endeavor as part of its focus or charge.\footnote{10} There is no way to delve into all the different planning choices that estate planners make in implicit and not so secret ways for their clients when directing them into the estate planning approaches that we use. But here follows a discussion of a few, along with a list of some of the questions that I have been asking myself. But first, a few demographic nuggets may be of interest.

A Few Demographic Factoids

- The average ages for first marriage and for first birth have been rising.\footnote{11} Were it not for two other factors, these might predict that surviving children will be a bit younger when their surviving parent dies. Contraindications are the number of nonmarital births—before the parents marry—and longer life expectancies.\footnote{12} All of which raises the really important question, which is the likely age of surviving children when they become orphans and inherit. My observation is that the typical surviving parent dies later in life than ever before, due to improved life expectancy. Thus, children are more likely to be a good bit older when they inherit than the ages (like 25, 30, and 35) for delayed distribution that we routinely witness in trust provisions. Unless a subsequent marriage is involved and the children from a prior relationship are not made to wait for the surviving spouse to die (which is not very common), do these ages for distribution seem sensible? In fact, where did they come from, and when did you last consider them?

- 83% of Boomers have children. For Silents that was 89%. Boomers have 2.1 children on average. Silents had 3.6 (the G.I. generation had 3.8 on average), which means that the “old-fashioned” support network (children as caregivers) for Silent generation clients is larger. But so is the group (Generation X) potentially fighting for the wealth.\footnote{13} Also note that, with fewer children these days, a Boomer surviving spouse will need more wealth to live on than did a G.I. generation surviving parent. But fewer claimants will vie for it. Overall, will our notions about sharing the credit shelter trust change much, on this score?

- The number of married couples with children declined by about 40% between 1970 and...
2000. The year 2000 census shows that fewer than 25% of all households are married couples with children. Meanwhile, children in mother-only households rose from 8% to 27% between 1960 and 1999, as did the number of women (with or without children) who never married. This is consistent with a rise in the number of nonmarital births—now consistently over 30% of all births (with little variation among the races). Note that the racial and economic aspects of various demographic trends have not been addressed by the estate planning community, nor has there been any notable change in the lack of racial representation in the ranks of estate planners. Where are wealthy racial minorities in America getting quality estate planning services, and is that going to change?

- The number of children in grandparent-headed households also has increased, by 30% since 1990. What changes in dispositive patterns will this generate? Maybe none, because these households don’t tend to be at the wealthy end of the spectrum? This is a new dynamic that may influence how clients think about the proper role of women; about parenting (for example, a potential backlash about child rearing); a sense of entitlement and perhaps a concomitant feeling of guilt, and the need to provide an inheritance; and so on. Will generation-skipping transfer tax planning and adoption of grandchildren increase?

- The number of divorces rose significantly in the 1970s and then leveled out, as did the incidence of remarriage. So, overall, families look different for both the Silent and Boomer generations, in comparison to the G.I. generation. Much more interesting is the pattern of divorce and remarriage as between the generations. For example, Boomers divorced their first spouse much earlier in their marriages than did their parents, for whom divorce didn’t become “acceptable” really until the 1970s, when they had been married for decades. Many of their children were grown and out of the nest by then, and the divorce was likely much more polarizing. The men who remarried probably selected much younger women than did Boomers who divorced early in a bad marriage and remarried someone closer to their age. Even more important, when a G.I. man remarried a younger woman and they had a family together, those children by the subsequent marriage were likely much younger than children of his first marriage, while Boomers who remarried may have come to the marriage with children of each prior relation and they were much younger, living all together in a blended family, to which their parents may have added more of them. The point is that the conflict among the children and their step-parents likely was different than what we think of in terms of the G.I. phenomenon. Simply put, children of blended families are likely different than children of separate families and marriages later in their parents’ lives.

- It is no great surprise that more Boomer women report having depression than any generation before—both due to more work place and family obligations, and probably due to more accurate reporting. Studies suggest that the two most significant trends in the late 20th century were an increase in women in the labor force and the decline of marriage—over two-thirds of women with children under age six are in the work force today. That would account for a lot of depression! Quaere what impact it may have on the dispositive provisions these women will want in their estate plans.

- The social scientists also report lower self-esteem among women today. How should we understand that, and what planning might it predict? My own sense is that women have been treated less equitably: often they spend less time in leisure pursuits and, notwithstanding that they work more than men, they are paid less. I still cling to the notion that we are going to see an explosion in the number of surviving widows who reject a deceased husband’s estate plan in favor of a state law elective share, even if the monetary value may be

14 Most of that increase was among women of color (African-American and Latina).
15 70% of Boomers are married. Over half of them (38%) have been divorced.
16 Also consider that Gen X children grew up with divorce—they think it is normal—and their parents were the Silent generation. Gen Y children are offspring of second marriages in the Silent generation—maybe between a Silent father and a Boomer mother—or they are children of two Boomers. Their generation likely reflects differences among their parents, and may alter planning with the children and conflict in mind.
less, because that forced heir share is received outright and the spouse is going to want control and freedom. Curiously, I also doubt that dissatisfaction with a decedent’s estate plan will be gender specific: I suspect that as more men become surviving spouses we will see a similar rejection of estate plans. Because the two most dangerous drugs are testosterone and adrenaline, and guys who get agitated and upset about the way they were treated by their deceased wife are not going to be passive. This is not a concern in states that do not provide an elective share (the community property jurisdictions, and Georgia) but elsewhere planning for (or to defeat) the elective share impresses me as having merit. Estate planners in these situations might consider how to protect the plan against defeat by the forced share election. Do you still think such planning is taboo—as not politically correct?

- As the population ages, another interesting dynamic is that more generations are alive at any given time (albeit with fewer members in each generation). Known as “co-survivorship between generations,” this means that more individuals will be looking to share an inheritance at any given time. It may seem counter-intuitive but I question whether this means that plans should limit the number of beneficiaries who line up to enjoy wealth during the surviving spouse’s overlife, to eliminate intergenerational conflict. Making everyone wait (or receive benefits only through the surviving spouse) may work better than having a trustee parcel discretionary distributions out while the surviving spouse is still alive.

- Also more critical may be planning for the least costly way of transferring benefits during the surviving spouse’s overlife. I think especially of the § 2503(e) ed/med and § 2503(b) annual exclusions as good ways for clients with “modest” wealth to avoid the generation-skipping transfer tax during the overlife of a surviving spouse. See § 2642(c). In much more wealthy situations I wonder if sheltering more than “just” the credit shelter amount is advisable. All of this may recommend planning that gives the surviving spouse the ability to transfer monies that qualified for the marital deduction by making tax free gifts during the spouse’s overlife. We tend instead to draft to accelerate distribution of the nonmarital funds, which impresses me as backwards in a tax sensitive situation.

- Along these lines, the Pew Research Center reports that 50% of all Boomers have dependent children—not all minors—and that 67% of Boomers who have children are supporting at least one child, 20% of Boomers with children are supporting a parent, and 13% are doing both at the same time. Also note: some are supporting a step-parent who plays an important role in their life. That really is different. Moreover, almost 70% of Boomers with adult children are financially supporting at least one adult child. For 33%, the Boomer parent is the primary source of that adult child’s support. That tells us a lot about the children—beneficiaries—of Boomers (as well as about their debt service for tuition, mortgages, and credit cards), and perhaps also about notions of the proper use of a bypass trust during a surviving spouse’s overlife. It especially makes us wonder about planning to benefit dependent ancestors, because the “sandwich” period is being extended by (1) parents living longer and (2) multiple sets of children, children born later in life, and children taking longer to mature and leave the nest.

- Boomers are reported to not fear debt the way their predecessors did—it is a fact of life for them. A higher percentage of Boomers have pensions, and they are said to care more about leaving an inheritance to their children than

17 In that regard, consult Pennell, Minimizing the Surviving Spouse’s Elective Share, 32 U. MIAMI INST. EST. PLAN. 9-1 to 9-53 (1998). There is plenty that can be done to effectively disfranchise a surviving spouse’s elective share, and I don’t think any part of it is unethical (perhaps even if you purport to represent both spouses). It is more likely that a 20 year old alive today has a living grandmother than that a 20 year old 100 years ago had a living mother.

18 Pew reports that over 70% of Boomers have a living parent, which is up 10% since the same question was asked by Pew in 1989.

19 For example, by creating a trust that provides a lifetime benefit to a surviving dependent parent, with the remainder to the decedent’s surviving spouse. That remainder will qualify for the marital deduction (it is not a terminable interest, much less a non-deductible version thereof). Also viable may be insurance on the life of the client, funded by the client but owned by and payable to the dependent parent.
In general, has been how to adapt to the change and aspect of that topic of great concern to estate planners. Since 2001, an aspect of this topic has really got me thinking. But for some Fellows the reality is that some of what follows is garbage all the time, and for most Fellows some of it is garbage some of the time. In some cases, however, some of the following is actually more relevant for the superwealthy. For example, notions about equality, about group trusts, about the structure of a nonmarital trust, about support and the sandwich generation phenomenon.22

The point of these snippets of data is that we never used to consider demographics whatsoever. Perhaps because the data was not available, or because it didn’t matter (as much). What do we learn that is useful when we see data that says Gen X is a bigger saving generation than the Boomers, just to pick an example? Gen X distrusts Social Security and will have greater retirement benefits from their own savings as a result. Will their planning choices differ? And when we’re told that Gen X invests much more heavily in mutual funds than do the Boomers, is that useful either—perhaps in terms of knowing the network of advisors on the client’s team, knowing whether professional advisors and fiduciary services will be needed or valued, or what? The point is that we haven’t really focused on the notion that the generations are changing, much less on what it means.

Oh, say, would it surprise you to learn that most of the data collected here was compiled by LIMRA and MetLife—the insurance industry? That ought to tell us something too.

Marital Bequest and Nonmarital Trust Planning22

This long introduction was more than throat clearing, but it did delay my saying more about the nonmarital trust topic that really got me thinking about this topic. I have written and spoken extensively about marital deduction planning. Since 2001, an aspect of that topic of great concern to estate planners in general has been how to adapt to the change and uncertainty of the rise in the applicable exclusion amount, elimination of the state death tax credit and corresponding rise in decoupled state death taxes, and the potential for either reform or absolute repeal of the federal estate tax. In working my way through various aspects of the planning implications of all that uncertainty and change I came to a conclusion about what I think wise planners will provide in these times of uncertainty. But it is very different from what most planners do. And as I thought about why most planners recommend a more classic alternative, it struck me that most planners produce the same plan today that they did 35 years ago. Even though the generations of clients have changed and the married couple clients who are the primary object of marital deduction planning today are different from the clients for whom this planning was developed.

Recall that it is my overwhelming sense that, as a profession, we haven’t really considered the demographic dynamic, nor have we focused on other changes that are not a function of changed tax or state laws. These demographic and other changes have been occurring, seemingly without notice, while we have been preoccupied with the agenda Congress wrote for us with constant tax law changes (or, to a much lesser extent, by state legislatures and the Uniform law mavens). My thesis is that we might do well to consider the demographic changes now, particularly if we benefit from an extended hiatus from the tax agenda, once Congress finally resolves the end story of the 2001 “repeal.” As it is, the current hiatus in tax law changes is the longest in nearly 40 years—making the recent gridlock in Congress a good thing in this respect (albeit our slumber has been disturbed by the automatic phase-in of the 2001 changes).

In terms of the marital planning endeavor, the most common form of marital and nonmarital trust drafting entails a relatively simple structure, that we all know well. The nonmarital trust receives the largest amount of a married decedent’s gross estate that can pass with the least amount of federal estate tax (with a potential state death tax cost in some “decoupled” jurisdictions—that part of this planning has not yet been resolved by most planners). In 2008 this means the first $2 million goes into the nonmarital trust.23 The balance of the estate typically qualifies for the marital deduction.

22 Some of the following discussion will differ for high net worth clients. I’m assuming that few fellows’ practice is so limited. But for some Fellows the reality is that some of what follows is garbage all the time, and for most Fellows some of it is garbage some of the time. In some cases, however, some of the following is actually more relevant for the superwealthy. For example, notions about equality, about group trusts, about the structure of a nonmarital trust, about support and the sandwich generation phenomenon all may differ. So might adult adoption and the new biology.

23 That figure will jump to $3.5 million in 2009, after which it is anyone’s guess whether Congress will alter the promised one-year repeal in 2010 and the restoration of 2001 law in 2011—I’m still guessing that we will end up with an exclusion amount of the same $3.5 million that will be the law in 2009. Putting this in perspective, in 2000 the top 1% of U.S. households each held personal net worth exceeding $2.7 million. That represented 35% of the
The traditional marital deduction bequest passes into a QTIP trust that provides the surviving spouse with nearly the minimum entitlement required by law—a naked life estate (which is the absolute minimum enjoyment required) and typically a right to receive corpus distributions in the trustee’s discretion. The typical nonmarital trust (which may hold the decedent’s entire estate, depending on the size of the exclusion amount in the year of death) provides income and corpus in the discretion of the trustee, for needs such as health, education, maintenance, and support in reasonable comfort (a classic ascertainable standard), distributable among a class of beneficiaries that includes the surviving spouse and a host of other family-member beneficiaries (sometimes just dependent children, in other cases all descendants of the decedent, in rare situations descendants of the surviving spouse if that is a separate group, and virtually never a surviving parent of the decedent). Although this is changing, the typical plan does not provide much added control to the surviving spouse, who might be named a (but usually not the sole) trustee or may be given various levels of power of appointment, depending on the tax consequences sought and the extent to which the decedent trusted the surviving spouse.

My recommendation differs regarding marital bequest and nonmarital trust planning. In most cases my strongest recommendation is to combine traditional marital deduction “reduce-to-zero” tax planning with the use of marital and nonmarital trusts that are as nearly identical as possible. That is, my default recommendation (all other things being equal) would be (to the extent the client is willing and the spouse is able) to begin with a template or recommended plan that would

(a) mandate annual distribution to the spouse of all income from both trusts,
(b) provide a power in the surviving spouse to withdraw the QTIP trust (or some portion of it) and a nongeneral inter vivos power to appoint the nonmarital trust,
(c) provide for no other beneficiaries of either trust during the surviving spouse’s overlife, and
(d) make the spouse trustee of each trust.

By my lights, the first advantage to this approach is that it makes little (if any) difference to the spouse whether the decedent’s wealth is in the marital or nonmarital trust—the spouse’s enjoyment is nearly the same either way. Thus, the spouse has little incentive to object to or elect against the decedent’s plan (nor must the plan change every time Congress alters the size of the applicable exclusion amount). I think this is critically important because I expect Boomer surviving spouses—men and women alike—to be very much less passive than their mothers in accepting a plan that is offensive to the surviving spouse.

The most deviant of these recommendations is mandatory income to the surviving spouse from the nonmarital trust, and making the spouse the sole beneficiary of that trust during the spouse’s overlife. There are a number of reasons for this departure from the “accepted wisdom.”

1. One reason is that the mandatory income serves a § 2013 credit planning objective, which also makes adding a five or five withdrawal power for the spouse in the nonmarital trust wise planning. See Appendix A for an illustration, if you are not familiar with the tax benefits of this approach.
2. It also may avoid the need to comply with the income tax separate share regulations. 24
3. In addition, the withdrawal right in the QTIP trust 25 and the nongeneral power in the nonmarital trust allow the surviving spouse to incur the lowest wealth transfer taxes possible by making inter vivos gifts, in the process generating valuation opportunities such as by making fractional or minority interest gifts during the surviving spouse’s overlife. See Appendix B for an illustration, if you are not familiar with the tax benefits of this planning.
4. The nonmarital trust is QTIPable for state death tax purposes, meaning that the federal unified credit will shelter the entire trust and a state marital deduction may be available by partial election for state death tax purposes as to any portion that otherwise would not avoid a decoupled state death tax with a lower exemption.
5. In addition to reducing the likelihood of the spouse rejecting the decedent’s plan in favor of an elective share, it also should minimize

total wealth in America. The top 10% held nearly 70% of America’s wealth. Sometimes referred to as “the carriage trade,” this is an estate planner’s primary target client base. Leaving aside the slightly distasteful elements of that characterization, the point is that tax is less important to a growing slice of this population: at $2.7 million, after this year 2008, being in the top 1% would not necessarily make a client subject to the estate tax.

24 Treas. Reg. § 1.663–1(a). My surmise is that it does not matter how the separate share rule would allocate DNI between the two trusts so long as the spouse receives all income from both trusts.
25 A client might create separate QTIPs, one with a power of withdrawal and one with no power of withdrawal, the latter to hold assets as to which a fractional interest valuation discount would be preserved in the spouse’s estate or to guarantee a minimum entitlement for remainder beneficiaries.
the potential for conflict during the spouse’s overlife, by making the spouse the sole beneficiary. It gives the spouse total discretion whether and how to benefit any other individuals, particularly by using taxable marital deduction wealth before invading a sheltered (and generation-skipping transfer tax exempt) nonmarital trust.

6. This plan also avoids the need to use disclaimers as an affirmative postmortem planning device. And it similarly avoids the potential that partial QTIP elections might generate gift tax issues if nonelected marital property passes into a nonmarital trust that is less beneficial to the spouse than the marital bequest.

If the income generated by such a plan runs the risk of over-inflating the spouse’s gross estate at death, it may be possible under total portfolio investment standards (another change since estate plans for the G.I. generation were crafted) to configure the investment portfolio to favor growth over income, and to avoid making principal and income act adjustments that favor the income beneficiary.

But note: this plan may not satisfy if the spouse and other intended beneficiaries are at war with each other. In that case, a different approach may be required if the client wants some form of peaceful coexistence with enjoyment by concurrent but contentious beneficiaries. Quaere whether you would want to be the fiduciary of such a shared-enjoyment plan, however, such as with discretion to distribute income and principal from the nonmarital trust. Also quaere whether divorce and remarriage among Boomers and Silents are enough different from our G.I. generation experience that we should not base the template plan on a presumption of conflict.

Also note that my suggestion gives the surviving spouse vastly more control than is common. If you think back, QTIP was enacted in 1981, along with adoption of the unlimited marital deduction, I believe because men like members of the House Ways and Means Committee that crafted this legislation did not want their widows to have control over that much of their estates. And didn’t we embrace QTIP predominantly because of its “handcuff” nature? Now quaere whether that desire to hobble surviving spouses is appropriate in crafting your template marital and nonmarital plans today, over a quarter century later.

**Do You Trust Your Spouse?**

One of my primary concerns in the context of traditional marital deduction and nonmarital trust planning is the message that we send to surviving spouses about issues of trust, and the ability to deal with wealth. It has been my custom to ask audiences of estate planners the following question, about themselves: “Do you trust your surviving spouse to have control over marital deduction qualified wealth, to make gifts following your death”? The response usually is overwhelmingly “yes.” This was true among ACTEC Fellows at the 2008 annual meeting as well. Then I ask whether these planners ask their clients the same question, and make it possible in the plan for the surviving spouse to take advantage of the incredible opportunities that are available for transfer tax minimization by making inter vivos transfers. The response usually is that hardly anyone empowers the surviving spouse in this manner.26 (ACTEC Fellows in 2008 outperformed the norm in this regard, but remember that many of them attended this lecture accompanied by their spouse and my guess is that this skewed both responses). The customary response makes me wonder why planners think their clients trust their spouses less than planners trust their own spouses. Our traditional planning boxes assume that the client does not trust the surviving spouse. Many planners don’t even ask the question.27

More than any other element of traditional estate planning, I believe this presumed distrust—the lack of control over the marital bequest—reflects the thinking of the G.I. generation of men about their widows. The most frequently heard response is that the propertied man fears that the surviving spouse will remarry and disinherit their children in favor of that new spouse.28 As confirmed by statistics (and probably also undeniable in practice experience), the likelihood of a surviving widower remarrying after the death of his wife is much greater than the likelihood of a surviving widow remarrying.29 Do you believe this will change, and in what direction, in the Silent and Boomer generations?

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26 See the lukewarm response to Question 3 in the summary of the JPMorgan study in Appendix H regarding planning that allows a surviving spouse to make gifts out of QTIP marital deduction wealth.

27 One ACTEC Fellow and friend, in a fit of candor, said to me that the answer might vary if both spouses were present at the time of asking, which made me ask why joint representation with a share-all-secrets form of confidentiality agreement makes sense—yet that also is the “industry standard” among estate planners.

28 Some would say that they trust their spouse, but not predators of their spouse. Quaere whether those responses are consistent. Does the trust question imply that the surviving spouse will stiff arm potential predators?

29 A 1989 study cited by Waggoner, *Tribute to William F. Fratcher: Marital Property Rights in Transition*, 59 Mo. L. Rev. 21, 49 n.71 (1994), reveals that only 8% of all surviving widows remarry and that they wait an average of 8 years before doing so, whereas over 20% of all widowers remarry and in less than 4 years
More importantly, has our profession been thinking and writing about such questions, and planning accordingly? Curiously, the 2008 ACTEC annual meeting experience suggests that Fellows have been thinking about this, in a more robust manner than among planners in general. But note that this is not borne out in the usual form book documents that are produced for general consumption, often by ACTEC Fellows for their corporate fiduciary clients to disseminate.

I do not have a statistic that shows how often remarried spouses disinherit their own children by a former marriage in favor of a new spouse. But most estate planners of any experience will confirm that surviving remarried widows seldom engage in disinheritance planning, whereas surviving remarried widowers do so with much greater frequency. So, if control over the wealth of the first spouse to die is a problem, it ought to be the wife who articulates the concern, and then only if the husband is likely to be the survivor and has the smaller estate (meaning there is logic in using a marital deduction bequest), which was not a normal paradigm for planning purposes in the G.I. generation. Instead, in the more common but opposite situation, the statement of fear about remarriage probably is a manifestation of what the husband would do if he survived, rather than a legitimate fear of what the wife is likely to do if she survives and has the power to withdraw corpus to make gifts. Do you reflect these gender differences in your normal husband-wife planning? And how do you think Boomer or Silent survivors—male or female—will resonate with the plan we traditionally recommend, with its message of distrust? Although the annual meeting responses suggest that this is changing, the empirical results in Question 3 of the JPMorgan survey summarized in Appendix H belie that suggestion generally.

It is hard to predict what we will find in the Boomer or the Silent generations. So, why not let the clients decide? In that regard, do you ask your married clients the trust question, and then draft accordingly? I wonder how many planners are reluctant, because they don’t know what answer they will get if both spouses are together when they pose the question. And I wonder whether they are reluctant to meet with either spouse separately—because of their mutual representation engagement agreement regarding secrets. You may know that I think a share-all-secrets approach is corrosive and, more important, that by my lights it appears that the ethics discussion has not yet reflected the change in the generations either.

This is so important because until (or unless) everything changes with repeal of the estate tax (and preservation of the gift tax) the better mechanism for moving property to the next generation at the lowest aggregate tax cost to spouses is to give the surviving spouse the full optimum marital deduction amount needed to avoid tax in the estate of the first to die, and then have the survivor immediately make gifts to the same beneficiaries who otherwise might be the intended beneficiaries of a larger nonmarital bequest. This is true because, even if the survivor is in the highest marginal bracket for gift tax purposes, the effect of the tax exclusion calculation of the gift tax means that the effective tax rate on gifts is almost one-third less than the lowest rate that could be incurred on the same property in either spouse’s estate.

With the advantages to be gleaned from inter vivos giving by a surviving spouse, it pays to explore the notion of giving the surviving spouse the discretion to make gifts. Unfortunately, no one, including the spouse, may have an inter vivos power to appoint QTIP property away from the spouse. Thus, this form of planning cannot be accomplished with an inter vivos nongeneral power of appointment. Instead it requires either that the trustee make distributions to the spouse (without condition on how the spouse may use that wealth) or that the spouse be given the authority to withdraw corpus from the trust and, in either case, independently make a gift to anyone. Empirical data shows that the latter approach is uncommon. Quaere whether we are on the cusp of a change in that regard, driven (perhaps) by the change in generations.
The previous discussion illustrated just one of several advantages traditionally associated with inter vivos giving: the tax exclusive computation of the gift tax. Other advantages routinely noted for inter vivos transfers are the gift tax annual exclusion, the powerful ed/med exclusion, shifting future growth, and shifting future income. Shifting appreciation will not make sense if the tax remains a flat rate proposition, but those other opportunities will remain—none will be offset by the improper time value of money notion. Moreover, there is a much greater advantage to inter vivos transfers of wealth, being valuation differences between the estate and gift taxes. Those differences inform yet another topic of concern among married clients.

Effective valuation discount planning is accomplished if a marital deduction is generated prior to division of property but subsequent wealth transfer tax inclusion is delayed until after division of property, assuming the loss of control that is represented by a division occurs without incurring a tax on the lost value. For our purposes the whole planning issue comes down to whether your married couple clients trust each other to permit the surviving spouse to exercise the control needed to effect these results. The G.I. generation largely did not—or so our historic planning would suggest. Do we know whether Silent and Boomer spouses are different, or do we just assume that they all are the same? I don’t hear discussions or read about studies that address these kinds of questions. Notwithstanding multiple marriages, blended families, and all that, my overwhelming sense is that times, and trust issues, have changed. Enough at least that we should not presume that my father’s estate plan (and conclusions regarding trust) are right for current clients. From our unscientific empirical inquiry at the 2008 ACTEC annual meeting, on this I may be preaching to the choir. As a profession, however, I’m not so sure we don’t have a way to go yet.

**Group Trusts**

Another illustration about changing paradigms that might be useful relates to a form of drafting that experience and a few empirical studies suggest is not very common. The typical estate plan anticipates a fund large enough to justify division of the family trust (typically after both spouses have died) into separate shares for lineal lines of descent—living children and descendants of deceased children. The alternative illustrated in Appendix D anticipates a single “group trust” that will be held until some time after the death of the surviving spouse (or after the death of the settlor, if the trust is not to be held for the benefit of a surviving spouse).

In some circumstances the family trust will be held as a group trust but never divided into shares, either for immediate distribution or to be separately held until a child reaches an older age. A good illustration of when this might be appropriate is a family with many children whose ages are quite disparate, or with children all beyond the age at which an inheritance would be meaningful (and so the trust will be held into the next generation), or some combination of these factors. Perhaps a blended family, as discussed earlier—in which his, hers, and theirs need to share a fund created by both spouses—although such a combination and sharing of their collective wealth traditionally has been very uncommon. The reflected reality is that separate shares may be uneconomical or unfair, because older children benefited from receiving their education and payments for other major expenses prior to the family wealth being divided into equal shares, while younger children will consume their separate shares to pay for similar items that arise after division. This is particularly relevant if the age spread among children is substantial.

A group trust also may be appropriate if some children have extraordinary needs, which ought to take priority above all else. And it might effect the desire of clients with a traditional or blended family to empower a trustee to continue providing for all in a way that reflects different needs and abilities without what might be perceived as the “unfairness” of creating equal shares for individuals who are anything but homogenous or “equal.” Finally, it can avoid one group of children benefiting substantially more than others, just because their parent was the more wealthy spouse. With a changing paradigm of marriage, remarriage, and blended families, G.I. generation notions of division and separate inheritances may not make sense in some Silent and Boomer situations. Nevertheless, both empirical and apocryphal responses reveal the very suggestion here is very bold.

In this regard, it is impressive that, absent the special circumstance of a special needs child (who needs

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35 For example, if S’s wealth totals $2x and the flat tax rate is 45%, a tax of $.90x could be paid presently, leaving $1.10x. If the $2x were to triple in value before tax is incurred, $6x would incur $2.7x of tax, leaving $3.3x after S’s death. Had the tax been paid earlier (that is, if an estate freeze had been performed when it was worth $2x), the remaining $1.10x would have tripled to the same $3.3x, making the freeze a zero sum game in terms of shifting appreciation.

36 See Appendix C for an illustration, if you are unfamiliar with the tax benefits of fractional interest planning.

37 Question 17 in the summary of the JPMorgan study in Appendix H shows a response that separate shares are created for children in over 95% of the cases the respondents normally review.
added protection) or a black sheep (who is being disinherited), the G.I. generation of parents were nearly unanimous in saying that they wanted to treat their children equally, albeit that isn’t what they did when they were alive. Instead, most parents treat their children equitably—maybe communistically is a more accurate (albeit a more hot button term)—in providing for their children inter vivos. But they still think, and they say, that they intend to treat (and love) all their children equally at death. Why does being a good provider, in an appropriately equitable (not necessarily equal) manner, change when the client talks about their postmortem intent? My mentor was a very wise and vastly experienced and sensitive estate planner who used to say that an effective estate plan is an extension of the decedent’s pocketbook. And if the observation is correct that most decedents don’t make equalizing distributions when providing for children during life, it seems odd that this changes at death. What accounts for this dissonance—between what people do while alive and what they call for in their estate plan?

One estate planner who I deeply respect suggests that group trusts are not realistic (they “sound great in theory”) because most children want independence, they have different financial needs and, consistent with that, different investment perspectives and risk tolerance, all making consensus difficult. Further, children may accept that their parent favored some over others, but they are reluctant to accept the judgment of a trustee. Worse, discretionary distributions generate resentment and manipulation (money “is all about keeping score” in some families), and beneficiaries “are pretty adept at rationalizing” why they deserve more and others should get less. So the next suggestion is very wise: “When I have done a pot trust long term, I usually give the trustee or someone the ability to split the trust per stirpes so the families can go their own way at some point, which they almost certainly will do eventually to keep peace.”

My personal sense is that this may boil down to fiduciary selection: I suspect we would find sharing more acceptable if we believed that a trustee would be efficient and insightful in discriminating between legitimate need and ineptitude or lack of ambition. Unfortunately, experienced fiduciaries think that discretion like this is the devil.

A Fellow at the 2008 ACTEC annual meeting recommended creation of a group trust that eventually

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38 A variety of empirical studies suggest this dissonance, between inter vivos transfers and bequest behavior at death, yet none has posited a good explanation for why it occurs. For example, Light & McGarry, Why Parents Play Favorites: Explanations for Unequal Bequests, econ.ohio-state.edu/pdf./light/wp03-01.pdf, suggests data showing that 75% of parents make inter vivos transfers that are unequal, but only as many as 20% do so at death. The results to Question 17 in the summary of the JPMorgan survey in Appendix H is nearly identical.

One explanation for unequal bequests is an “altruism” model—that parents seek to equalize marginal utility among children by giving the most to the least wealthy of their children, to put them all on a level playing field. The fact that unequal bequests occur more often among older children suggests that parents have more information about the relative wealth of older children, and then more reliably embrace this “balancing” or leveling of wealth.

Some researchers posit an “exchange related” inequality, that repays extra efforts expended during a parent’s life by one or more children.

And finally, a small cohort suggest that there is a biological prejudice to benefit natural children over step-children and adopted children.

Ohlsson, in a study titled The equal division puzzle—empirical evidence on intergenerational transfers in Sweden, nek. uu.se/pdf/wp2007_10.pdf, suggests that inter vivos gifts are private while testamentary gifts are public, leading parents to make equal divisions at death to preserve their reputation. He and others suggest that bequests “signal parental affection” such that “[p]arents wish children to believe that they love them equally [so as] not to hurt their feelings.”

No study yet reveals the full measure of inequality, or explains it. Many estate planners suggest that equality is the key to minimizing postmortem conflict among beneficiaries. But quere why failing to even out inter vivos inequities is not as likely to yield conflict postmortem.

Two other matters may affect this. One is that state laws default to equal distribution (albeit they differ on what they think “equal” means—per stirpes equality among blood lines, or per capita equality among similarly related beneficiaries) and—in Sweden (Ohlsson’s social laboratory) and most civil law jurisdictions—legitime affects the extent to which inequality is permitted. The other is the fact that the estate planning boxes that we use typically predict a desire to make equal dispositions—making it more difficult for a client to select otherwise.

39 Note also that, regarding grandchildren, clients also say that they love them all equally and want to treat them all the same, yet surveys like that done by Ray Young to support the Uniform Probate Code per capita alternative to the traditional per stirpes division show that estate planners routinely do not follow that approach. See Young, Meaning of “Issue” and “Descendants,” 13 ACTEC J. 225 (1988), and authorities cited therein. Indeed, the Uniform Probate Code got this reform “wrong” back in 1969, a reality that it admitted when it modified the rule to what is now known as per capita at each generation, as adopted in the 1990 revisions to § 2-106(b). Still, estate planners routinely reject that form of equality, in favor of a different variety of equality (among blood lines, rather than across or among similarly related beneficiaries). See Question 14 in the summary of the JPMorgan study in Appendix H, which shows that the use of per stirpes is the overwhelming drafting preference. My only point is that we dither over these notions of “equality” while clients tell us by their lifetime appointment of wealth that they don’t really want equality at all—or instead, they want equity.
passes a portion of a client’s wealth to grandchildren, per capita, whereas the bulk of the client’s wealth is held in traditional separate shares for children. I wonder how clients with enough wealth might regard creating one “extra” share, to be held as a group trust, to do something similar. And what percentage of the total wealth should go into that fund—an equal portion as if this was another child, or a larger or smaller chunk? I think this is a useful reminder that our vision tends to be black-and-white—either we do one thing (separate shares) or we do another (a group trust), rather than doing a little of each.

Quaere also whether issues of equality only need to be addressed if there isn’t enough wealth to satisfy all the needs that exist. That is, if there is more than enough money to go around, is there less need to parcel the wealth based on artificial restrictions such as equality? To wit, would Bill Gates’ daughters care that one got (even as much as) $1 million more than the other? And if there really is not enough to go around, then might there be even more of an incentive to use what little there is to maximum advantage—without “wasting” any on those who have lesser or no needs? Note how odd these suggestions sound to experienced estate planners with high net worth clients (and recall that those are not the vast majority of clients). Note also that gifts to charity in lieu of family may be the result when no one has a need for the money. I wonder why a safety net to charity in lieu of family may be the result when no one has a need for the money. I wonder why a safety net group trust is any less acceptable, in such a situation.

When a family does need the money, however, we might give added thought to the notion of sharing in a less artificial manner than “equal” shares. In some situations a group trust until the last child dies might be appropriate. In other cases the client ultimately will want the children to be able to go their separate ways, and it may be unwise to make older children wait for distribution until their younger siblings have reached the age for distribution, because there is too wide a spread in their ages. In such a case an alternative compromise, illustrated in Appendix E, permits each child to “peel-off” a share as the child reaches a specified age. In each of these cases, adapting our traditional planning boxes may be wise, because changing family dynamics make these options more important and acceptable. In all of these cases exploring creative solutions that are outside our traditions will pay dividends. Unfortunately, in my experience we have not shared wisdom in matters such as these nearly as much as we have collaborated in dealing with tax law or state law changes.

Withdrawal Right versus Force Out Distribution

Appendix F contains an illustration that is designed to address a planning issue that has always made better sense to me than the traditional approach and, truth be known, I wonder whether I’m reflecting a Boomer sensibility or just being different. I don’t have any reason to think that this may change with the generations, other than that it always has resonated with me. I’m not sure why the traditional plan ever made sense, however, and I don’t know what informs the “accepted wisdom.” So, I ask you to consider: most planners provide that entitlement to a share that is not held forever (e.g. it is not in a dynasty trust) will occur after a certain age (I refer to “the age of maturity”) by a force-out distribution. My preference is to allow withdrawal after the specified age, and my simple question is: why would anyone force a distribution rather than allow withdrawal? Empirics show that the approach illustrated in Appendix F is very rare. Is that a function of “old thinking” that could benefit from a re-evaluation?

The New Biology

Your father’s Buick did not have a variety of bells and whistles that today are standard equipment (like air bags, a voice activated GPS, or coil-on-plug ignition and electronic fuel injection). In a similar way plans drafted today need to reflect some realities that were not historically relevant or that have evolved rather substantially. An important illustration of this is “the new biology.” Notwithstanding the Uniform Parentage Act and the Uniform Status of Children of Assisted Conception Act (which provide that the donor of genetic material will not be treated as the parent of a child conceived after the donor’s death), caselaw in related areas generally is agreeable (but not uniform) to establishing an inheritance right in a child who is the product of artificial conception. Therein study in Appendix H.

60 Although it would be more complex, the peel-off approach could make a fraction of a child’s share subject to a power of withdrawal and hold the balance under a plan like a more traditional group trust. It even could give a child a testamentary power of appointment if death occurs before distribution. Administrative and valuation problems in identifying the relative shares of the various children may make these approaches undesirable in most cases, however.

61 See Questions 4 and 5 in the summary of the JPMorgan study in Appendix H.


lies the issue. State law may say that an artificially conceived birth is treated as natural, and the husband of the birth mother is treated as the natural father, even if there is positive proof that his paternity is a biological impossibility. Presumably this means that a man who provided the sperm or a woman who provided the egg would not be the parent of the resulting child unless the woman carried the child to birth and the man was the birth mother’s husband. Nevertheless, state law may deviate from that seemingly straightforward result.

The easy question is whether a DNA provider wishes for any child subsequently conceived and born alive to be regarded as the DNA provider’s heir. Presumably leaving the deposit (not in an anonymous manner) is pretty good evidence of the depositor’s intent that a child, even one conceived and born after the depositor’s death, will have inheritance rights.

A much harder question arises if a client’s child was the DNA provider. In thinking about posthumous conception, imagine your client’s child has died and thereafter the child’s surviving spouse uses the child’s genetic material to produce a DNA offspring of the child. Does your client want to give a blank check to an in-law child to make more beneficiaries in this way, to share in the client’s estate plan, after the child’s death? And do you think your client might answer differently if it was a daughter-in-law using a son’s sperm to become artificially inseminated, as opposed to a son-in-law using an egg or fertilized embryo to implant in a surrogate mother? Like the stranger to the adoption rule, this is a much more controversial issue, about which it might be wise to ask your clients the question and, in either direction, make a specific provision about intent. Do you ask your clients their intent regarding such matters, or is this another of those “ancillary” issues about which we do not feel the need to concern the client or generate added fees to garner an informed response? Is a one-size-fits-all answer likely to be correct—whether you draft it in your normal documents or it is provided by a uniform state law?

Note that a client who allows products of posthumous conception to benefit is giving an in-law child more control as the child’s surviving spouse than if the plan just included that surviving in-law child (the “forbidden beneficiary”) as a trust beneficiary until death or remarriage (or shacking up), which seldom is done. The new biology is going to infect this, because allowing an in-law survivor to have more grandchildren who are beneficiaries may be even worse than allowing the in-law survivor to enjoy benefits as a trust beneficiary.

Also consider surrogate motherhood. In these cases the wife of the natural father may not be the mother, without a formal adoption, and the law will need to wrestle with the historical notion that motherhood is the easy side of most questions of status. In “the old days” the natural mother typically could prove the parent/child relationship and historically it was the natural father’s paternity that was uncertain of proof. That issue has not been made any easier in cases of assisted conception involving implants or transplants of embryos. Today the risk of multiple “mothers” exists and raises questions of status that historically were reserved for fathers. Indeed, there is a potential for five parents in some of these situations: the two who provided genetic material, the two who adopted or treated the child as their own, and the one who was the birth mother. A well drafted estate plan presumably addresses these questions of status as well—which definitely is not your father’s Buick (or grandchild)! Plus, what would you guess: will a G.I. generation intent be the same as a Silent or a Boomer reaction to these kinds of issues? As rapidly as this development has occurred, I would not assume to know the answer, or whether a provision drafted even half a decade ago might still be the “right” approach.

**Adoption**

Adoption statutes since the 1950s in most jurisdictions generally treat adopted children as natural born, thereby abrogating the common law “stranger-to-the-adoption” rule. This has created problems with respect to strategic adoptions, often of an adult, usually to engineer an inheritance result and, unlike mar-

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44 See Question 6 in the summary of the JPMorgan study in Appendix H. It is odd to me that a child and the child’s spouse are allowed to enjoy a life style funded with trust income while the child is alive, but when the child dies the in-law surviving spouse’s life style declines immediately as their descendants instead become instantly rich. This does not occur if a child’s share was distributed to the child before the child died, and the child therefore was able to provide for the in-law surviving spouse out of that wealth. Or if the trust granted a withdrawal power and a corresponding power of appointment, allowing the child to leave the wealth in the trust but still provide for the in-law surviving spouse by exercise of that power. But a dynasty trust that will continue for the full period allowed under state law (which may be forever) poses the issue, which will become much more important as more perpetual trusts are created. In that regard see Question 16 in the summary of the JPMorgan study in Appendix H, showing the insurgence of this planning as more states alter or repeal their Rule Against Perpetuities.

45 Historically an adopted child was treated as natural born to the adopting parent, but under the stranger-to-the-adoption rule that adopted child was not treated as a natural born descendant of the adopting parent’s ancestors. In most regards, that result has changed, albeit not necessarily for the better.
riage, it is a bell that cannot be un-rung. So, a child (for example) who adopts with the intent to create a descendant with an inheritance right cannot later un-adopt if that act proved to be a mistake.

By statute, in most jurisdictions today, another consequence is that natural parents are treated as nonexistent (except, as discussed below, in the step-parent adoption context) and the adopting parents take their place for all purposes, making the adopted child the same as a natural born for all purposes, even to inherit through the adopting parents from their relatives. Overlooked or overturned are rights vis-à-vis natural grandparents, about which few drafters appear to make special provisions.

Looking at a different set of issues, in some jurisdictions there are statutory provisions directed at cases such as grandparent (or other relative) adoptions, in which the intent is to limit the beneficiary to only one share of a decedent’s estate.

Example. Assume child (C) bears a child (G) and then dies, leaving G to be raised by C’s parents, who adopt G. If C’s parents die intestate the question is whether G should inherit from the adopting parents as a child, as a grandchild representing C, or as both. Adoption statutes typically cause G to inherit only as a child of C’s parents.

Typically, a special rule also applies if a natural parent is married to an adopting parent. Many of the most thoughtful statutes provide that adoption in this context does not cut the child off from either natural parent, or from their ancestors. Such statutes allow the child to “triple-dip,” in the sense that the child could inherit from and through both natural parents and the adopting step-parent as well. With respect to the converse situation (and only with the natural parent who is not the spouse of the adopting parent), however, the parent/child relationship may be terminated by the adoption. That natural parent, and their ancestors or other relations, may be cut off from each other. In addition, the UPC more broadly disallows either natural parent, or their kindred, from inheriting from or through the child, unless the natural parent openly treated the child as his or her own and did not refuse to support the child.

Example. Father and Mother (natural parents of Child) divorce. Under the UPC, in such a case Child—and Child’s descendants—may inherit from and through Father but neither Father nor his relatives may inherit from or through Child. In some states the result may depend on whether the adoption occurred after Father’s death, instead of after a divorce. Again, the reason for the different treatment is that an adoption of Child by Husband following a divorce typically would require Father’s consent, whereas an adoption by Husband after Father’s death would not. In the divorce context, Father’s consent to the adoption may be regarded as significant in precluding Father (and his relatives) from enjoying any status as a relative of Child following the adoption. Thus, in some states, if the adoption by Husband occurs after Father’s death (and Father did not consent to the adoption or otherwise had his parental rights terminated), Father’s kindred could still inherit through Father from Child.

Application of these rules on inheritance rights can yield inappropriate and inequitable results when an adoption follows the deaths of natural parents.

Example. Father and Mother die in an automobile accident. Mother’s sibling adopts Child. The unfortunate reality is that, in many states (and under UPC § 2-114(b)), this will cut off Child from inheriting from Father’s family and they from Child, which probably is an unintended and thoroughly inappropriate result. Further, had the adoption been by someone not related to Mother, Father, or their families, in many states (including those that have adopted the UPC) Child would be cut off from both natural lines and they from Child.
The simple question here is whether these state laws have motivated planners to draft documents to produce different results. Especially as illustrated in the next section, empirics suggest otherwise. Quaere whether this too is just a function of these state laws “getting it right” or inattention to the more recent of these changes.

**Adult Adoption**

Few state laws specifically address the difficult question of adult adoption and its effect on an estate planning document such as a will or trust agreement that already is in force.\(^1\)

**Example.** Assume Grandparent created a trust for the benefit of Child for life, remainder to Child’s descendants, and Child adopts Child’s spouse to give Child’s spouse inheritance rights under the trust remainder provision. Under UPC § 2-705(c), an adopted child will not be treated as a child of the adopting parent for purposes of someone else’s dispositive instrument unless the adopted child lived while a minor (either before or after the adoption) as a regular member of the adopting parent’s household. Thus, Child’s spouse probably would not take as a beneficiary of the trust created by Grandparent if the UPC applied to this example.

The question for an estate planner today is whether to embrace state law, override it instead, or say nothing at all. Further, in the context of demographic change, is adoption different for Boomers or Silents than it was for the G.I. generation? Certainly there are more step-parent adoptions, and probably more divorces following step-parent adoptions. In that regard it is easier to get away from a spouse than it is from that spouse’s child, which may inform more and better targeted drafting. Yet that does not appear to be happening.

**Half-Bloods and Steps**

In regard to all of this consider a real case that is ripped from the headlines, involving wrestler Chris Benoit, who allegedly killed his wife and their son before killing himself. Will her property pass to their son and through his estate to his half-blood siblings (Chris’ children), which may include nonmaritals? Quaere whether treating half-bloods the same as whole-blood relatives is the right result in that case—or any? And surely it is a bigger issue today than in the past. The law that regards a blended family differently based on whether various children are of the half-blood or have no common ancestor may be the exact opposite of what a married couple may intend for their children of different relations. Adult adoption rules also may be very wrong. Yet not many drafters’ documents address these issues.\(^2\) Isn’t it time to do so?

**Nonmaritals**

Nonmarital (out of wedlock, illegitimate, or bastard) children are an even greater issue today, because National Vital Statistics Reports show that one-third of total births are nonmarital, as is 30% of the total American population under the age of 18. Consider first how you would find out whether a client has a nonmarital child (or grandchild), particularly if other affected parties (such as the client’s spouse) are unaware of the existence of the nonmarital. Worse, you can’t assume that this is a gender specific issue. Women have secrets too—among them being that some are mothers of nonmarital children that their husbands don’t know about. Sometimes that child was raised by someone else (including the not infrequent happenstance that a very young unwed mother’s family raised her child as if it was her sibling)—raising interesting generation-skipping transfer tax issues because there was no formal adoption. Most importantly, unlike the G.I. generation of men, not all natural parents of nonmarital children want to exclude the child.

It is relatively easy to write a provision that disinherits any individual not mentioned by name in the document, effectively dealing with an unwanted nonmarital child (or grandchild) without mentioning that heir by name. But how do you provide for a nonmarital, without tipping off other parties? All of these are issues that we really didn’t address in the way back—even as little a 30 years ago. Today it is anyone’s guess what a client might intend. Do you ask? Especially in a joint representation with a share-all-secrets confidentiality agreement? Surely the mutual representation agreement and the incidence of nonmaritals both have increased geometrically since I began the prac-

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\(^1\) See UPC § 2-705(c). Notice that § 2-705(c) has no counterpart in § 2-114 dealing with intestate succession, probably because the phenomenon of adoption to affect intestacy inheritance rights from a living person is not very common. Many states don’t have a rule dealing with the adult adoption issue at all, under any circumstance.

\(^2\) See Question 10 in the summary of the JPMorgan study in Appendix H.
tice of law, 35 years ago. But has the planning response kept pace with those changes?

Lapse

One final illustration of changes in the law about which it makes sense to draft today in a way that may not have been relevant previously is a state law reform that many regard as counterproductive. So you may need to override it.

A gift fails if it “lapses,” which applies if a named beneficiary predeceases the testator or, increasingly, dies before some designated future event. Lapse in a will results because the common law implies a condition of survivorship on the beneficiary taking the bequest—even if the document is silent regarding the need for the beneficiary to be alive to inherit. Thus, if the decedent’s will provides “Blackacre to A,” without specifying whether A must survive the testator to take, the common law interprets the will as if it read “Blackacre to A if living at my death” or “Blackacre to A if A survives me,” and not as if it read “Blackacre to A, or to A’s heirs or devisees if A does not survive me.” The gift lapses if A is required to survive and does not. The drafting alternative is to give it to A’s estate (i.e., A’s heirs or devisees) or to A’s descendants, by representation.

The issues in a lapse case are whether a beneficiary who predeceases nevertheless is entitled to a share and, if so, where does it go. No well drafted document leaves either issue unresolved: it will specify whether survivorship is required and, if so, what happens if the devisee does not survive. If survivorship is not required, the document could so specify and not address who takes if the devisee does not survive. If survivorship condition is required and does not, the drafting alternative is to give it to A’s estate (i.e., A’s heirs or devisees) or to any other designated beneficiary’s descendants, by representation.

Typical antilapse statutes apply only to dispositions that are made by will at the death of a testator; they usually do not apply to transfers under will substitutes, including inter vivos trusts, even if distribution occurs under the will substitute at the testator’s death. This, however, is subject to exceptions, which treat will substitutes and future interests the same as wills for anti-lapse purposes. All of which informs careful drafting in all documents because, any more, you just don’t know whose law will apply or what it will address, or how.

Antilapse statutes supply default rules that apply only if the document does not effectively say what happens to a gift that otherwise would fail. There is no lapse gift on which the statute can operate if the document addresses that possibility with a gift over to another beneficiary. And historically an express requirement that a beneficiary be alive to take was enough to override the statute. Thus, a survivorship condition would override or negate the need for the antilapse statute. But UPC §§ 2-603(b)(3), 2-706(b)(3), and 2-707(b)(3) now specify that survivorship conditions alone do not override the antilapse statute, absent additional sufficient indications of a contrary intent (such as an alternative disposition). These controversial provisions of the UPC inform the need to specifically provide for the contingency of a named beneficiary predeceasing distribution by providing an alternative gift over. This is another “not your father’s Buick” kind of development, albeit not one tied directly to demographics (although it is magnified by the increased probability of a parent surviving a child, both dying of natural causes, all due to increases in life expectancy).

The UPC results are widely criticized for being both illogical and complex. The good news? The criticism of the UPC provisions (which took their unpopular form in 1990) is so widespread that your documents can and should do better. Don’t leave this to state law, even if your standard documents previously did not address the issue. Things have changed since…“your father’s Buick” estate planning documents were developed for the G.I. generation.

Conclusion

Some of this topic/discussion is driven by demographics, which we haven’t really studied. Some of it is just keeping up with change—a propos a question in the margin about computer drafting of wills and

53 The most notable being UPC §§ 2-706 and 2-707.
54 An illustration is provided in Appendix G.
55 Consider the computer literate cohort of clients with less than enough wealth to be taxable: will they eschew the traditional sources of estate planning and do their own, using the internet and software drafting systems made available to the public at large? Is their use of technology sufficiently different than any generation before, such that if they perceive the plan to be simple enough, they may do it themselves? After all, they use tax preparation software (such as TurboTax), and rely on the internet for much of their medical care information too. Will our profession address that phenomenon? Will we litigate to cure the problems created, attempt to educate potential clients about the hazards, work to make the on-line advice and the software products more reliable, ignore the issue and focus solely on high-net-worth clients, seek to provide reasonably priced traditional planning available in competition with these developments, or what? Note that over 99% of the decedent population is nontaxable. And one recent study showed that over 50% of
trusts by lay people using software developed for use without the involvement of a lawyer. And some reflects planning approaches that are unchanged and not a function of these demographic developments or other changes but that, frankly, have never made much sense (at least, not to me).

So much of our work has been overshadowed by the agenda that Congress has written for us, in the form of tax law change over the past 32 years (since 1976 to be sure, and maybe since 1969). To a lesser extent the same might be said about the uniform laws (although many who plan estates ignore those legislative developments as either irrelevant or as commanding no special response).

My purpose here is simply to suggest that mainstream estate planners will benefit from a focus that considers more than just the tax agenda, and to encourage consideration of whether planning and drafting has kept up. I don’t intend to say that I know the right answers to so many of the questions, or even to know how a typical client would elect if given a choice. As a profession we have given others a free reign in dealing with some of these issues, perhaps with speckled success. And with respect to some others of these issues, as a profession we haven’t even begun the conversation about what a new generation of clients would prefer. I hope we can do that.

What follows is just a list of various topics that might provide a foundation for setting a new agenda. It certainly is not complete, nor will anyone resonate with every item. It may just help to begin a conversation:

1. Marital bequests and nonmarital trust drafting:
   a. Should the surviving spouse be the sole overlife beneficiary of the nonmarital trust?
   b. Does the spouse have a power to make inter vivos gifts?
   c. If the marital bequest is not outright, is the spouse the (or a) trustee, or possess other appropriate and desirable forms of control?

2. Family trusts after the surviving spouse dies (or perhaps after remarriage):
   a. Do you create a group trust versus division into separate (equal?) shares, and what is the impact of having blended family beneficiaries?
   b. Should you asset protect the wealth for the life of certain beneficiaries, or provide for distribution?
   c. Do you force out distributions or provide powers to withdraw?
   d. Especially to add flexibility, particularly in dynasty trusts, do you include inter vivos and testamentary powers of appointment (and is there ever a legitimate use of a general power to appoint today)?
   e. Trustee selection: do you use family members, professional individuals, corporate fiduciaries, or some other option(s)?
   f. What is the appropriate use of agents, investment advisors, trust protectors, and cofiduciaries?
   g. Do you provide for the “forgotten” beneficiaries: surviving in-law descendants—at least until they remarry?
   h. How should provisions address higher life expectancy (children now inherit near their own retirement age), the new biology, (adult) adoption (in or out of the family), stepchildren, lapse, and the likely existence of nonmaritals?
   i. What special dynasty and other generation-skipping trust provisions are desirable?
   j. Are your trusts designed to make advancement-style down-payment or seed-money distributions versus asset protected trust ownership of homes and businesses held for beneficiaries, potentially for life?

The estate planning clientele possess between $500,000 and $2 million, making them wealthy enough to consider sophisticated planning albeit not sufficiently wealthy to incur federal estate tax. How many of these individuals will be do-it-yourselfers? See 2007 Industry Trends Survey at wealthcounsel.com. It might be interesting to know what the medical profession is doing about/against the Web MD trend. Are lawyers in a similar state as medical-providers; are clients the same as patients, as service-consumers? What other analogs are there—accountants and tax preparation software? And is there demographic data on those consumers, and information about results?

~56 My Emory colleague, at the Business School, is Prof. Jag Sheth, who has done path breaking research into climate, culture, and consumption patterns that puts our concepts about equality in a different light. He suggests that the commonly articulated desire “to treat all my children equally” is a northern/cold climate notion. He says:

Northern Europe features very high individualism, high equality, low uncertainty avoidance, and low focus on material achievement as compared to Southern Europe… The Northern European climate is highly variable and dynamically uncertain compared to the Mediterranean or tropical climates. It is, therefore, important to avoid uncertainty, as it literally can impact survival…. Similarly, in colder climates, rugged individualism… would be valued highly…. Equality prevails because each person in the family (both men and women) is equally valuable in extracting scarce resources from unforgiving nature.

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k. What about incentive trust provisions (other than mere attainment of age)?
3. The use of charitable split interest trusts, and lead versus remainder interests.77
4. Changes relating to economic factors and differences in wealth accumulations:
   a. Estate freezing—yesterday’s game in a flat tax environment.
   b. First to die insurance instead of survivor life.
   c. Deferral versus acceleration of state or federal death taxes.
   d. Use of tenancy in common (especially to garner valuation discounts) versus joint tenancy with right of survivorship (or tenancy by the entirety).

If Sheth is right, however, would we expect primogeniture to be a creature of English common law, or a hold over from some other construct (such as Roman law)? And what differences in inheritance laws would we find if we did a cross-climate comparison? See, e.g., Foster, Linking Support and Inheritance: A New Model From China, 1999 Wis. L. Rev. 1199 (1999); and Foster, Towards a Behavior-Based Model of Inheritance: The Chinese Experiment, 32 U.C. Davis L. Rev. 77 (1998), exploring the Chinese concept of inheritance. Again, quoting Sheth:

Given that most of the Northern terrain is rugged, with very limited land for habitation, it is natural to assume that people will become territorial as a means to survive. On the other hand, when land is plentiful with significant potential for habitation, it is likely that people will be willing to share…. It is interesting to note that the expression “good fences make good neighbors” is a saying of Northern Europe and not Southern Europe.

I wonder whether a cold versus temperate climate study of prejudices and predilections about wealth would reveal important differences about such things as equality and equity. See further my ruminations about how we divvy wealth among natural objects of a client’s bounty, at text accompanying note 38.

77 Note from the executive summary of a 2007 Northern Trust Company survey based on 2006 Federal Reserve data:

High-net-worth households in 2006 reported charitable contributions of $17,400, on average, up from $14,400 in 2005. Going forward, however, current attitudes toward philanthropy suggest a modest pull-back by wealthy households. Entering 2007, fewer millionaires feel it is important to donate time and money to charitable causes, fewer want to be personally involved in their charities and fewer plan to increase their charitable donations in the coming year. With regard to specialized giving vehicles, charitable bequests are by far the most popular, being utilized by nearly one in four millionaire households.

northerntrust.com/content//media/attachment/data/white_paper/0702/document/wealth_america2007.pdf. Decamillionaires, however, are said to be “more philanthropically inclined than their less wealthy counterparts and, because of the complexity of their finances and their greater concern with their legacy, are much more likely to utilize specialized giving vehicles such as private foundations and charitable trusts.” It is not clear whether these giving differences also show variation between the generations—the Northern Trust survey, based on Federal Reserve data, was not looking for such indicators.

Curiously, this study also shows that the desire to generate more wealth to leave a larger inheritance is very small (3%). And the goal of protecting their estate from taxes is even smaller (2%).

One JP Morgan regional survey reports that 12% of decamillionaires intend to use a charitable lead trust. But in the survey in general, charitable remainder trusts were used in 7% of all cases, and charitable lead trusts were used in just 2%. According to Schervish, Today’s Wealth Holder and Tomorrow’s Giving: The New Dynamics of Wealth and Philanthropy, 9 J. GIFT PLANNING, 15 (2005), decamillionaires (435,000 households with more than $10 million in investable assets) gave $14 billion to charity in 2001—about 7% of all charitable giving. Modeling the numbers out to year 2052, Schervish predicts charitable giving of somewhere between $21 and $55 trillion in 2002 spending power, making charitable giving a “growth” industry for estate planners. What he doesn’t discuss is how this will interact with family demographics and whether new donors will give as have those donors studied to date. 18 Nonprofit World 10 (November 1, 2000), reported that baby boomers are more cynical and disillusioned donors than their ancestors, and more demanding of tangible results from their charities. See 2000 WLNR 7380767.
Appendix A

For any who may be unfamiliar, the following example is illustrative of the planning technique alluded to in item 1 at page 9:

§ 2013 Credit Maximizing Example:
Postmortem planning of the size of the marital deduction should consider the effect of a § 2013 credit for previously taxed property, if the surviving spouse may be expected to die within 10 years of the death of the decedent (and especially in the unfortunate case in which the spouse already has died before the marital deduction has been claimed on the decedent’s Form 706). For example, in Technical Advice Memorandum 8512004, D left a will that bequeathed to S an amount equal to the maximum marital deduction allowable to D’s estate, and bequeathed D’s residuary estate to a nonmarital trust that gave S an income interest for life. S died three months after D, from causes not foreseeable at D’s death. S’s personal representative disclaimed the marital deduction bequest, with the result that D’s entire estate passed under the residuary clause to the nonmarital trust. This meant that no marital deduction was available to D’s estate. Aggregate estate taxes over both estates were minimized, however, because the estate tax generated in D’s estate increased the amount of the § 2013 credit available in S’s estate. This was because S’s income interest in the nonmarital trust was sufficient to qualify for a § 2013 credit notwithstanding that no part of that trust was includible in S’s estate at death (and notwithstanding the nondeductible terminable interest rule for marital deduction purposes).

Under the actuarial tables, the value of S’s life income interest (and the § 2013 credit based thereon), was far in excess of the income actually received by S during the three months that S survived D. Nevertheless, because the actuarial tables must be used (because S’s death was not clearly imminent due to an incurable physical condition that was known at D’s death), S’s estate was able to maximize the credit at a nominal cost. The same result would be reached today under the final § 7520 regulations. This tax minimizing opportunity may exist even if income is payable only in the trustee’s discretion rather than as an absolute entitlement of the surviving spouse.60 However, Technical Advice Memoranda 8717006 and 8944005 denied the credit for discretionary income interests, so the better approach is to guarantee income to the survivor.

This being the case, some planning choices need to be made inter vivos, such as whether the death of both spouses within 10 years of each other is sufficiently likely that planning the nonmarital trust to maximize the value of the surviving spouse’s income interest is better than use of an accumulation or spray trust. This will become even more true as the exclusion amount of the unified credit grows the amount that can be sheltered in a nonmarital trust (but use caution—this will not matter if the unified credit will make S’s estate nontaxable). Addition of a five or five withdrawal power

59 In a less well planned manner, essentially this is what generated a sizeable savings in Estate of Howard v. Commissioner, 91 T.C. 329 (1988), and was the opportunity at stake in the simultaneous death cases of Estate of Carter v. United States, 90-1 U.S. Tax Cas. (CCH) ¶60,003 (E.D. La. 1989), rev’d, 921 F.2d 63 (5th Cir. 1991), and Estate of Marks v. Commissioner, 94 T.C. 720 (1990), these three cases involving tax savings of approximately $600,000, $300,000 and $200,000, respectively.
60 Estate of Weinstein v. United States, 820 F.2d 201 (6th Cir. 1987), and Technical Advice Memorandum 8608002.
will further maximize the value of a nonmarital trust interest in the surviving spouse for § 2013 planning. In a recent calculation with a 77 year old surviving spouse the five or five power added over 22% in value to the life estate calculation.

Example: D has an estate of $3.5 million and S has an estate of $1.5 million. S dies within nine months after D’s death but, because S was not terminally ill when D died, valuation of S’s life estate in D’s property is based on the actuarial tables, as required by § 7520 and Treas. Reg. § 20.7520-3(b)(3). Using 2008 rates and credits:

<table>
<thead>
<tr>
<th>Optimum Marital</th>
<th>§ 2013 Maximizing Marital</th>
</tr>
</thead>
<tbody>
<tr>
<td>$3,500,000</td>
<td>D’s gross estate</td>
</tr>
<tr>
<td>(1,500,000)</td>
<td>marital deduction</td>
</tr>
<tr>
<td>2,000,000</td>
<td>D’s taxable estate</td>
</tr>
<tr>
<td>0</td>
<td>D’s federal estate tax</td>
</tr>
<tr>
<td>3,000,000</td>
<td>S’s taxable estate</td>
</tr>
<tr>
<td>450,000</td>
<td>S’s tax before § 2013 credit</td>
</tr>
<tr>
<td>0</td>
<td>§ 2013 credit</td>
</tr>
<tr>
<td>450,000</td>
<td>S’s tax after § 2013 credit</td>
</tr>
<tr>
<td>450,000</td>
<td>tax over both estates</td>
</tr>
</tbody>
</table>

The § 2013 credit was computed based on S’s life estate being worth 40% ($957,141.40) of the $2,392,853.45 nonmarital trust after paying $321,425.55 in tax. The assumptions underlying this computation will change monthly with the § 7520 interest rate and annually with S’s age. To make this hypothetical computation the assumptions made were that S is age 87, the § 7520 rate is 6.0%, and S is given a five or five power of withdrawal over the nonmarital trust.

In this case D and S saved $128,570 in tax paid over both estates, representing a 28% tax saving (in this case, over 2.5% of the aggregate wealth of D and S). This planning requires some balancing, however, to insure that S has sufficient assets to generate enough tax to consume the § 2013 credit produced from the tax on D’s estate, and D’s estate is large enough to produce enough tax to generate the necessary credit. Several computations may be needed to strike the proper balance, and more computational complexity will be encountered if a state death tax is involved. Software is available to do the calculation.

See, e.g., Estate of Shapiro v. Commissioner, 66 T.C.M. (CCH) 1067 (1993) (91 year old surviving spouse died within five months of decedent; five or five power added 13.5% to value of lifetime annuity).

No state death tax, nor the § 2058 state death tax deduction, is reflected in the sample calculation of S’s tax liability, on the theory that there would be no state death tax if there is no federal estate tax payable after the § 2013 credit is applied. That concept is not universally accepted, but was recognized as proper in a § 2011 pick-up tax environment by Comptroller v. Phillips, 865 A.2d 590 (Md. 2005), Riethmann Trust v. Director of Revenue, 62 S.W.3d 46 (Mo. 2001), and In re Estate of Lacks, 662 N.W.2d 54 (Mich. App. 2003). With state tax variations in the wake of repeal of § 2011 after 2004 it is impossible to generalize about how state death tax might be affected by such planning.
Appendix B

To illustrate the tax benefits of lifetime giving rather than incurring estate tax in either spouse’s estate, assume the surviving spouse receives $1 million more property than needed, and is willing to part with that amount in the form of a taxable gift and the gift tax thereon. Even if the marginal gift tax bracket is today’s maximum 45%, the spouse could transfer $689,655 (after 2006) from the $1 million that is not needed; at 45% the tax on this gift would equal the remaining $310,345 that the survivor would pay to the government (assuming for illustration purposes that no unified credit is available). This 31.03% tax rate on the $1 million that the survivor was willing to part with is significantly less than the 45% flat estate tax (after 2006) that could have been incurred in either estate, and the differential would be even greater if the gift tax bracket is lower than the maximum 45%.

The risk to consider is that the spouse may not live three years after making the gift, in which case the gross up rule of § 2035(b) will apply. Like other aspects of postmortem planning to minimize the aggregate tax burden imposed on spouses, this concept also requires a little crystal ball gazing. If living three years appears to be a bad gamble, however, the alternative to seriously consider is § 2013 planning of the ilk illustrated in Appendix A.

To confront these risks, the plan that makes sense for family and tax planning purposes is to create a QTIPable nonmarital trust that pays all income to the surviving spouse so that, if a postmortem partial QTIP election is made to incur some tax in the estate of the first to die, a full § 2013 credit will be available based on the income interest. And to permit gifting by granting a power to withdraw from the QTIP marital trust. The withdrawal power creates the ability to make the inter vivos gifts, which is the second aspect of the plan that makes sense.

Granted, there is a capital gain issue if the surviving spouse makes gifts of appreciating property rather than holding them until death to permit a § 1014 basis adjustment, but pushing the pencil will show that the new basis at death (avoiding a typical, potential worst case 20% capital gain tax) may not make up for the tax saving attributable to making the gift. Saving the differential in tax will be a minimum benefit of 13.97% after 2006—between a 45% estate tax and a 31.03% maximum effective gift tax. The saving could be even greater—between the maximum estate tax and the minimum effective gift tax rate. The gift may fall behind holding property until death if death occurs within three years after making the gift, § 2035(b) therefore applies, and low basis assets must be sold to generate liquidity to pay the estate tax generated by that event. Usually the assets used to pay the tax attributable to that event receive a basis adjustment at death, so this would be relevant only if transferee liability is imposed on the donees who hold low basis property—not a very likely scenario. Otherwise, holding property until death to garner the new basis under § 1014 may be a fool’s errand—it may not compensate for the gift tax saving otherwise available.

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63 The formula to make this computation is: transfer ÷ (1 + tax rate) = taxable gift. So: $1 million ÷ 1.45 = $689,655

64 Beginning after some delay—making this a QTIP trust and not a § 2056(b)(5) trust, which would not affect the marital deduction but it might deny the partial QTIP election ability if the power were available immediately (because then the (b)(5) marital is automatic).
Assume that your client’s estate includes a control block of corporate stock. Because the ultimate destination of the stock is irrelevant for inclusion valuation purposes, the stock will be valued under § 2031 as a single block and, if a control portion of it is transferred to a marital deduction trust (or to the surviving spouse outright), case law confirms that a control block premium is available in determining the amount of marital deduction satisfied. If corporate control does not change during the overlife of the surviving spouse and the stock is includible in the survivor’s estate, the amount taxable will reflect the same control premium. But a significant valuation swing can be generated by a potentially small inter vivos transfer (itself with a minority interest discount) if the surviving spouse is given the power to make a gift just large enough to reduce the amount includible in the second estate to a minority interest.

Consider: assume D owns 75% of Family Corporation stock and makes an inter vivos gift of just over one-third of that interest to D’s spouse, S. Both the gift tax value and the gift tax marital deduction generated by the gift of that minority interest would be the same, reflecting a minority interest discount. When the slightly less than 50% interest remaining in D’s hands is subject to tax (either at death or on a subsequent gift), it too would be valued at a discount to reflect its lack of control in the corporation. Assuming D is not reluctant to part with absolute control over a portion of the stock during life, this division would insure that no greater value would be subject to gift or estate tax in D’s hands than would qualify for the marital deduction. A similar plan would entail a 100% owner giving 49% to S, giving a child 2%, and holding the remaining 49% to be taxed at death, all with appropriate minority discounts.

Assume, however, that D is unwilling to part with any of the stock during life. A second alternative that guarantees a marital deduction in the same amount as the value subjected to tax is for D to bequeath a control block of the stock to S (or a marital deduction trust), followed by S making an inter vivos gift of a minority interest that will leave a minority interest to be included in S’s estate, both valued at a discount. This postmortem division of a control block of stock requires, however, that S be given some inter vivos control over the ultimate destination of the stock. For example, in a QTIP marital deduction trust, S would need an inter vivos power to withdraw the stock to make a gift thereof. Alternatively, D could create a § 2056(b)(5) marital deduction trust that grants S an inter vivos nongeneral power of appointment to make the same division of the stock. If either alternative is acceptable to D, then the value subject to gift tax would be discounted to reflect its minority status, and the remaining minority interest includible at S’s death similarly would be discounted, meaning that D’s controlling interest would be subjected to wealth transfer tax at a net minority discount.

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67 An issue might arise if that remaining block were given to S, although traditional valuation principles appear to hold that destination of the stock is not relevant for this valuation purpose. See, e.g., Technical Advice Memorandum 9432001, in which the decedent died owning 48% of the stock of a family corporation; the decedent’s legatee was the 52% shareholder and the government held that the stock should be valued without reference to the number of legatees or the stock they already held.
68 Because § 2056(b)(7)(B)(ii)(II) precludes anyone, including S, from possessing a power to appoint assets from a QTIP trust to a third party during S’s overlife.
Appendix D

The excerpts in Appendices D, E, and F are from my Wealth Transfer Planning and Drafting classroom text, with forms that were reproduced with permission from The Northern Trust Company. The annotations are my comments, not typical footnotes—and reflect alternatives and explanations about the forms themselves rather than just legal references or asides.

5.05 Group Trust: After the death of my spouse, or after my death if my spouse does not survive me, the Family Trust, including any amounts added thereto from the Marital Trust, shall be held and disposed of as hereafter provided.

5.06 Income and Principal Distributions: Until the time hereafter fixed for division into shares, the trustee shall pay so much or all of the income and principal of the Family Trust to any one or more of my children and descendants of a deceased child of mine from time to time living, in equal or unequal proportions and at such times as the trustee deems appropriate, for the health, education (including postgraduate), maintenance, and support in reasonable comfort of my children and those descendants, individually and as a group, considering their needs, other income and means of support, and any other circumstances and factors that the trustee deems pertinent, adding to principal any income not so paid. No payment made for a child or other descendant of mine shall be charged against the share hereafter provided for the child or descendant or his or her ancestor or descendants.

5.07 Division into Shares: If upon or whenever after the death of the survivor of my spouse and me there is no living child of mine under the age of ** years, the trustee shall divide the Family Trust into equal shares to create one share for each then living child of mine and one share for the then living descendants, collectively, of each deceased child of mine.

5.08 Distribution of Descendants’ Shares: Each share created for the descendants of a deceased child shall be distributed per stirpes to those descendants, subject to postponement of possession as provided below. Each share created for a living child shall be held as a separate trust and disposed of as hereafter provided.

Here the provisions of a typical trust (one that divides immediately into shares) would appear and be used for the balance of the trust provisions.

* The gray tone background represents deletions to make this an all-descendants trust. Note that this form might be appropriate for a blended family, with the trustee making critical choices about relative needs. To open the class of beneficiaries might require reference to “my descendants and descendants of my spouse” or such. Also consider adding the “forgotten” children—in-law surviving spouses—as potential recipients. In that regard, is providing for in-law children different if there are grandchildren involved? And if a power to withdraw is given to a child, as illustrated in Appendix F, the beneficiary really should be given a power to appoint at death, that would include the spouse as a permissible appointee, because otherwise the powerholder is forced to withdraw and leave the trust property to that spouse, if that is the powerholder’s intent. Finally, what is the fear of providing for the forgotten children—if the surviving in-law spouse has an estate for life or until remarriage, is the notion of bleeding family wealth to outsiders really true?

* I admire how elegantly this provision anticipates division regardless of the order of deaths of the settlor and the settlor’s spouse and the ages of the children at the death of the survivor. It also does not describe the “youngest living child” reaching the specified age, thus reflecting the possibility that the youngest child may never reach that age or (even more unlikely but still possible) that no child will reach that age. This provision applies when all living children have reached the designated age or if all children have died. In either case, no living child would be under the specified age.

The age you select is a function of why you used a group trust. For example, if the motivation was equality of treatment in paying for education, most folks would select an age such as 25. That is not too low as to thwart graduate school education or to hamper a child on “the extended plan,” but not so high as to delay everyone while a “perpetual student” continues to defer getting on with their life. If the rationale for the group trust was to provide a safety net for a disabled child, however, it may be that division or distribution should not occur until that child’s death. Note that with an older age it might be wise to include descendants and surviving spouses of deceased children. Also consider how these criteria inform selection of trustee, the size for a small trust termination provision, and other elements in the draft.

All of this likely has ripple effects of a variety of elements—including the role of women, their education and experience in the working and financial world, the appropriate age for children to inherit or take a share outright relative to the plans being created, and so on. None of which appears to have been studied or reflected in our day-to-day estate planning. Inheritance, and the “people aspect” of estate planning, is bound to change with these changes.

* Substitute the following if distribution is to occur immediately upon division, rather than having the shares held for children until a later age:

5.07 Distribution of Shares: If upon or whenever after the death of the survivor of my spouse and me there is no living child of mine under the age of ** years, the trustee shall distribute the Family Trust per stirpes to my then living descendants, subject to postponement of possession as provided below.

Notice that such a plan could disfranchise the surviving spouse of a deceased child, who might become destitute at the same time as the settlor’s grandchildren become independently wealthy. Also note that a per stirpes distribution need not be selected; other alternatives are available.

* A predeceased child could be given a power to appoint this share, effective immediately upon division. Such a power might be a good way to finesse the in-law child surviving spouse problem, although consider the default provision to the extent the child does not effectively exercise the power.
5.05 Group Trust with Peel-Off Provision: After the death of my spouse, or after my death if my spouse does not survive me, the Family Trust, including any amounts added thereto from the Marital Trust, shall be held and disposed of as hereafter provided.

5.06 Income and Principal Distributions: Until complete distribution of the Family Trust, the trustee shall pay so much or all of the income and principal of the Family Trust to any one or more of my children from time to time living (exclusive of any children to whom or to whose descendants distribution has been made pursuant to the following provisions), in equal or unequal proportions and at such times as the trustee deems best, for their health, education (including postgraduate), maintenance, and support in reasonable comfort, considering the needs, other income and means of support, and best interests of my children, individually and as a group, and any other circumstances and factors that the trustee deems pertinent, adding to principal any income not so paid. No payment of income or principal to a child of mine shall be charged against the share hereafter provided for the child or his or her descendants.

5.07 Distribution of Shares: If upon or whenever a child has reached the age of ** years, the trustee shall distribute to the child that fraction of the then principal of the Family Trust of which the numerator is one and the denominator is the number of children of mine then living and then deceased leaving one or more descendants then living, exclusive of any child or children to whom or to whose descendants a distribution previously has been made.

5.08 Share of Deceased Child: If a child dies before reaching the age of ** years, then upon the death of the last to die of my spouse, the child, and me, the share of the principal of the Family Trust that the child would have received if the child had then reached the age of ** years shall be distributed per stirpes to his or her then living descendants or, if none, then per stirpes to my then living descendants, subject to postponement of possession as provided below, except that the share otherwise distributable to a child of mine who has not then reached the age of ** years shall be retained as a part of the principal of the Family Trust and except further that any share distributable to a descendant other than a child of mine for whom a share of the Family Trust then is being held hereunder shall be added to that share.

Here typical provisions like postponement of possession and facility of payment could be used for the balance of the trust provisions. And, again, in-law surviving spouses of deceased children could be provided for.

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This parenthetical is essential to preserve the pattern of this plan that a child benefits only until distribution of the child’s portion of the trust. This parenthetical might be deleted if a hybrid plan were used by which a child did not receive a full share by peel-off distribution, although distributions to such a child probably should be only for extraordinary purposes and then only if other funds are not available to that child. And the sentence to which this note is attached could be altered to expand the group of current beneficiaries to descendants of all degrees, and in-law surviving spouses as well.

This age probably needs to be higher than in the group trust illustration in Appendix D, so as to hold more of the wealth for the younger beneficiaries, but not so high as to deny benefits while a child is most in need of the money. That notion itself may be silly, if the surviving spouse is likely to be quite old and the class of beneficiaries therefore also will be quite advanced in age upon creation of this trust. A consideration of age is another demographic change that has not been studied. E.g., my mother is 85 and I expect her to live another decade. If that’s correct, I’m going to be nearly 70 when I become an orphan. Boomers and Silents were older at their first child, but will live longer. G.I. generation parents were delayed by the war in having their children—my father was 30 when I was born—so maybe all this is going to wash out. In which case I wonder if the traditional ages ever were right.

To understand how this provision works, consider a trust with three children: the oldest will receive one-third of the corpus upon reaching the specified age, the next child will receive half, and the last will receive the balance. A withdrawal right could be used instead of mandatory distribution, but the accounting and valuation problems this would raise probably dictate against it in most cases. Again, this could be tailored for a situation involving in-law surviving spouses.

This terse but understandable triggering provision will operate regardless of the order of the three possible deaths.

Work an example to persuade yourself that this distribution of the deceased child’s peel-off share is essential and properly crafted to make certain the entire trust is distributed if the last child dies before reaching the specified age and, on the death of any other child, to preserve equality to those children to whom (or to whose descendants) a distribution previously has been made. A predeceased child could be given a power to appoint this share, effective immediately upon division. Again, this could be tailored for a situation involving in-law surviving spouses.

The net effect of this provision is to give a share of the deceased child’s peel-off entitlement to those children (or their descendants) who already have received distributions, while retaining the balance of the deceased child’s share for those children to whom distribution has not yet occurred. Again, work an example, only now assume it was the second child of three who died, childless, after one received distribution and while the third child still is a beneficiary of the trust. Half of the second child’s “share” would go to the oldest child and the other half would remain in the trust for the youngest child, awaiting final distribution when that child reaches age. Again, this could be tailored for a situation involving in-law surviving spouses.
Appendix F

5.05 Division into Shares: Upon the death of my spouse, or upon my death if my spouse does not survive me, the trustee shall divide the Family Trust, including any amounts added thereto from the Marital Trust, into equal shares to create one share for each then living child of mine and one share for the then living descendants, collectively, of each deceased child of mine.

5.06 Distribution of Descendants’ Shares: Each share created for the descendants of a deceased child shall be distributed per stirpes to those descendants, subject to postponement of possession

A very common drafting error is the assumption that the settlor’s spouse will survive the settlor. This simple clause avoids the dispositive glitch that otherwise would exist if division were dictated only “upon the death of my spouse.” Another, more terse, way to state the time for division would be “upon the death of the survivor of my spouse and me.”

The typical pattern would be to combine both spouses’ property in this one trust following the surviving spouse’s death. Even if the surviving spouse wishes to plan separately, this form combines all the wealth of the first spouse to die in this one trust after the survivor’s death.

If the settlor does not wish to divide into shares for descendants the language following the death of the surviving spouse needs to be a little different, but the model is not that difficult. Consider the following template:

...divided into as many equal shares as needed to distribute * share(s) to X if (s)he survives me, * share(s) to Y if (s)he survives me and * share(s) to Z if (s)he survives me. [The share that would have been distributed to a named individual if he or she had survived me shall be distributed to his or her descendants by right of representation or, if there are none, the bequest to that individual shall lapse.]

Another common drafting error is failure to anticipate death of a child before division of the trust into shares for children, especially if the deceased child left descendants who should represent the child. Or a spouse who should be provided for.

Another important issue is dealing with survivorship and “simultaneous” death (which is the term used loosely to refer to the situation in which two people die under circumstances such that the order of their deaths cannot be established by proof). State law often addresses this issue as between a testator and a beneficiary, but in this context the issue can be important as between one beneficiary (the second spouse to die, for example) and another (children), because the disposition of property could change if, for example, a child was deemed to have survived the division event and died immediately thereafter or died an instant before the time for division. One way to address this issue is to require that the child survive the division event by a period of time (such as 120 hours under the Uniform Probate Code or, probably preferable for a number of reasons, 30 days). A second approach is to include a simultaneous death provision such as the following, geared to the order of deaths between beneficiaries:

In all events notwithstanding any state law to the contrary, if the order of deaths between my spouse and me cannot be determined by sufficient evidence my spouse shall be treated as [surviving/predeceasing] me, and if the order of deaths between any other individuals cannot be determined by sufficient evidence the order of their deaths shall be treated as the younger of them having died first.

The presumption adopted in this provision is probably the exact opposite of what most folks would predict and is informed predominantly by tax motives. Consider the net result, for example, if a child and a grandchild were to die in a common disaster and the order of their deaths could not be determined. The grandchild will be presumed not to have survived, which makes the dispositive document govern disposition of the share the grandchild would have received if living rather than any estate plan of the grandchild (or state law intestacy if the grandchild had no other estate plan). That likely is what the average client would prefer if they thought about the issue. In a case like the grandchild it probably would send the grandchild’s share to other grandchildren if the grandchild died without descendants, and that probably produces the same result as if the grandchild survived long enough to take and died intestate. But perhaps not (for example, if the grandchild was married it might preclude the grandchild’s surviving spouse from benefitting—which may or may not be appropriate), and drafting for those uncertainties is what this endeavor is all about! If there was only the one grandchild who was the child’s descendant it likely would send the property to the child’s siblings, which would be a taxpay-er-preferable result because it would reduce or eliminate the generation-skipping transfer tax that otherwise would apply if the property went to the grandchild for an instant and then passed from the grandchild’s estate to potentially the same individuals. Avoiding such a tax result is the true motivation for this provision. With longevity on the rise, this is more important than in the past.

In this plan division into shares for the children is postponed until death of the surviving spouse, on the assumption that the typical client wants to provide first for the spouse, making the children wait until the survivor’s death before being in line to take a share outright. In some circumstances this will be contrary to the client’s intent, especially if the children are from a former marriage or the client wants the children to receive some property during the years of their greatest need, regardless of whether a surviving spouse still is alive. In such a case, the following provision would be substituted for the normal provision that would benefit the surviving spouse during his or her overlife and the succeeding paragraphs would be renumbered accordingly.

5.02 Division into Shares: The trustee shall forthwith divide the Family Trust into equal shares to create one share for each child of mine living at my death and one share for the then living descendants, collectively, of each deceased child of mine.

In addition, the first clause of the contingent disposition paragraph would be altered to read “If upon my death, or at...” to account for the possibility that it might apply while the surviving spouse still was alive. Furthermore, the marital deduction pour over provision would be altered to provide for addition: proportionately to the shares into which the Family Trust has been divided, provided that, if any share has been distributed in whole or in part, the property directed to be added thereto shall be distributed in the manner and to the extent provided with respect to the share as if it or the part or parts thereof were then being distributed.
as provided below. Each share created for a living child shall be held as a separate trust and disposed of as hereafter provided.

5.07 Income Distributions From Child’s Share: The income from a child’s share shall be paid in convenient installments, at least quarterly, to the child until complete distribution of the share or his or her prior death, except that, while the child is under the age of ** years, the trustee shall pay to or for the benefit of the child so much or all of the income from the child’s share as the trustee deems necessary or advisable from time to time for the child’s health, education (including postgraduate), maintenance, and support in reasonable comfort, adding to principal any income not so paid.

5.08 Principal Distributions From Child’s Share: The trustee shall pay to the child such sums from the principal of his or her share as the trustee deems necessary or advisable from time to time for the child’s health, education (including postgraduate), maintenance, and support in reasonable comfort, considering the income of the child from all sources known to the trustee.

5.09 Right of Withdrawal: After division of the Family Trust into shares and after a child has reached the age of ** years, the child may with-
draw any part or all of the principal of his or her share at any time or times, but not to exceed in the aggregate one-half in value thereof prior to reaching the age of ** years.\(^1\) The value of the share shall be determined as of the child’s first exercise of this withdrawal right, plus the value of any additions made thereafter (determined at the time of the addition). The trustee shall make payment without question upon the child’s written request. This right of withdrawal shall be a privilege that may be exercised only voluntarily and shall not include an involuntary exercise.\(^1\)

5.10 Testamentary Power of Appointment;\(^*\)
Upon the death of the child before receiving his or her share in full, the child’s share shall be held in trust hereunder and distributed to or in trust for such appointee or appointees, with such powers and in such manner and proportions as the child may appoint by his or her will making specific reference to this power of appointment, except that any part of the child’s share not subject to withdrawal prior to the death of the child may be appointed only to or for the benefit of any one or more of the child’s surviving spouse, the child’s descendants and their respective spouses, and my descendants (other than the child) and their respective spouses. For purposes of this provision, the term “spouse” shall include a widow or widower, regardless of remarriage.\(^*\)

5.11 Default Distribution: Upon the death of a child any part of his or her share not effectively appointed shall be distributed per stirpes to his or her then living descendants, or if none, then per stirpes to my then living descendants, subject to postponement of possession as provided below, except that each portion otherwise distributable to a descendant of mine for whom a share of the Family Trust is then held hereunder shall be added to that share.\(^*\)

\(^{1}\) This age typically is five to ten years older than the age when the first withdrawal right became exercisable, the expectation being that the beneficiary will learn a few lessons from any mistakes that were made with respect to earlier withdrawals, without risking his or her entire inheritance. If the child’s share will be large enough to justify withdrawal in three stages, substitute the following for the provision prior to this point:

5.09: Right of Withdrawal: After division of the Family Trust into shares and after a child has reached any one or more of the following ages, the child may withdraw from the principal of his or her share at any time or times not to exceed in the aggregate:

One-third in value after ** years of age;
Half in value (after deducting any amount subject to withdrawal but not actually withdrawn) after ** years of age; and
The balance after ** years of age.

Notice that allowing withdrawal of “one-third” of the share following each triggering date will not permit withdrawal of the entire share, making the declining denominator the necessary drafting method. If you don’t believe this just run a simple illustration: the trust is $30 to begin and the child withdraws $10. When it is worth $20 the child should be able to draw down $10, not one-third of $20.\(^*\)

This provision is similar to a spendthrift clause, which otherwise might not apply to this withdrawal right. This provision may not be effective, but what is to be lost for inclusion?\(^*\)

This is a general testamentary power of appointment for wealth transfer tax purposes, but only to the extent the child is treated for tax purposes as the owner of the trust because of the power of withdrawal in paragraph 5.09. In some cases it will be preferable for this power to be available inter vivos as well. Furthermore, for generation-skipping transfer tax purposes some drafters make the entire trust subject to § 2041 inclusion in the child’s estate at death by granting a general power of appointment over the entire trust even if death occurs before the age specified for withdrawal. That approach is not recommended here because, generally, the generation-skipping transfer tax is the more attractive (and more malleable) of the two taxes. Another method of causing inclusion is appropriate exercise of a nongeneral power of appointment to trigger the Delaware tax trap of § 2041(a)(3), as explained in Blattmachr & Pennell, Adventures in Generation-Skipping, or How We Learned to Love the “Delaware Tax Trap,” 24 REAL PROP., PROB. & TRUST J. 75-94 (1989), abridged in Using “Delaware Tax Trap” to Avoid Generation-Skipping Taxes, 68 J. TAX’N 242-248 (1988).

Why does this form not provide similar breadth elsewhere? For example, a child’s descendants become beneficiaries after a child’s death, even if the child’s surviving spouse is still alive. If the child and spouse were dependent on this trust the child’s death could be devastating to the spouse’s well being. The standard trust does not provide for the child’s surviving spouse unless the child does so through exercise of this power of appointment, which is just one of several reasons why powers are so important. As is a general reconsideration of that basic planning decision.

Notice that this provision refers to a failure to effectively exercise the power, not to a mere failure to exercise the power, making this default provision applicable if the beneficiary exercised in violation of the Rule Against Perpetuities or in favor of impermissible appointees or otherwise in violation of the power of appointment.

If a mandatory distribution of the child’s share is dictated, substitute the following for the foregoing: “If a child dies before receiving his or her share in full, then upon the death of the child his or her share....”\(^*\)

This “add to shares” provision is designed to avoid a multiplicity of shares for any particular descendant.
The following examples come from the Comment to Uniform Probate Code § 2-603.

G’s will devised “$10,000 to my surviving children.” G had two children, A and B. A predeceased G, leaving a child, X, who survived G. B also survived G.

This is a class gift. At common law, B—as the only surviving member of the class—would have taken the entire $10,000. If an antilapse statute is in effect, and if it covers class gifts (as does the UPC and most other state antilapse statutes), the question is whether the word “surviving” in the devise negates application of the antilapse statute. In many jurisdictions it does (in which case B still would take the entire $10,000); under UPC § 2-603 it does not, so B and X each receive $5,000. Which result would your client intend?

Implicit in the language used—“to my surviving children”—is an equal division; without some added indication that G would prefer the survivor to take everything, the UPC antilapse statute assumes to accomplish equality by bloodline. The survivorship condition alone is viewed as expressing no intention as to how the $10,000 should be distributed if one or both of the children predeceased G, and the UPC antilapse statute therefore applies. (Note that the antilapse statute will not apply if there is additional evidence that the survivorship language was intended to defeat application of the antilapse statute, such as a designated alternative disposition of a deceased child’s entitlement.)

G’s will devised $10,000 “to my two children, A and B, or to the survivor of them.” Again assume that A predeceased G but A’s one child, X, survived G; B also survived G. Does X take the $5,000 A would have received if A had survived, or does B take the entire $10,000?

Unlike the prior example, the UPC Comment states that B takes the entire $10,000. The gift is viewed not as a class gift, but as a gift of $5,000 to A and $5,000 to B, with the contingency of either of them dying before G addressed with an alternative gift to the other (“or to the survivor of them”). The alternative gift provision overrides the antilapse statute; the will is deemed to state G’s intention that the antilapse statute not apply if either of A or B survives G.

G’s will made preresiduary bequests of “$5,000 to my child A if living at my death; if not to my child B” and “$7,500 to my child B if living at my death; if not, to my child A.” A and B both predeceased G, both leaving descendants who survived G. Who takes what?

With respect to each gift, G provided for an alternative disposition; the problem is that neither of the alternative dispositions (A’s $5,000 to B and B’s $7,500 to A) can be given effect, and there are no additional alternative takers named. Does the antilapse statute apply in the face of G having named alternative takers if they do not survive? In some jurisdictions it would not (in which case the $12,500 would fall into the residue of G’s estate); under UPC § 2-603, it does—A’s descendants take $5,000 and B’s descendants take $7,500. Is that your client’s intent?

G’s will devised “…to my child A if living at my death; if not, to A’s children (X and Y).” A and X predeceased G. Y and X’s children (M and N) survived G.

X and Y each would have received $5,000 if both had survived G. As it is, Y takes $5,000, and it may seem clear that X’s $5,000 should go to M and N as X’s representatives. But the $5,000 X would have received if living was first left to A. It would be divided $2,500 to Y and $1,250 to each of M and N (giving Y a total of $7,500 and X’s descendants $2,500) if A’s descendants, by representation, are substituted under the antilapse statute for A with respect to that $5,000. That inequitable result is not reached under the UPC: § 2-603(c)(2) takes the $5,000 to X’s representatives rather than § 2-603(b)(1) taking it to A’s representatives.
Appendix H

The following responses of interest were extracted from JPMorgan surveys conducted at events in Florida, New York and Connecticut, and reflect responses from approximately 120 JPMorgan Private Bank clients (unless otherwise noted):

28% said they want to provide for their descendants in perpetuity

52% want just two generations of trust duration

32% said they would limit a child’s outright share to $5 million

51% said they would limit a child’s outright share to $10 million

20% said they did not know how much was appropriate for a child’s outright share

26% said they worry most about spoiling their children

42% said they worry most about others taking advantage of their children

12% said they worry most that their children will not be able to manage their money

0% said their children did not deserve the money

To an “age-of-maturity” question asked in NY only, 43% said by age 35, 42% said over age 35. JPMorgan said “from our experience, clients seem most comfortable with the age range of 30 to 45” and suggests that all income begin at age 30—not age 21 found elsewhere.

In the survey responses on the following page reflect a JPMorgan survey done of 67 employees acting as senior fiduciary officers or wealth advisors. This survey asked these individuals to identify trends they see in their client base. Several notable items deserve explanation:

Question 2, about the nonmarital trust providing for both the surviving spouse and children, shows surprising results, in that 30% of the respondents say they find these multiple beneficiaries together in a nonmarital trust less than 60% of the time, which seems high. The probable explanation is that the spouse may not be a beneficiary of the nonmarital at all, either in high net worth situations, or in cases of a second marriage with children by a prior relation. Mostly these responses indicate that the spouse is not the sole beneficiary.

In Questions 4 and 5, the apparent dissonance between the responses for withdrawal power after a certain age and mandatory distribution at a specified age may reflect trusts that will not distribute ever.

In Question 11, the very low response to inter vivos asset protection trust use is surprising, but not due to the lack of a Delaware presence—JPMorgan does have a local presence. I have been told two things, which may be questioned by others: (1) JPMorgan does not promote this planning, and (2) Wilmington Trust’s numbers are not significantly different.

In Question 13, regarding incentive trust provisions, it was said that more settlors use a letter of intent/wishes instead.
## JPMorgan Survey Results

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<thead>
<tr>
<th>Question</th>
<th>Frequency Seen</th>
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<tr>
<td><strong>Tax Payment Burden on Residue</strong></td>
<td>4% 12% 31% 52%</td>
</tr>
<tr>
<td><strong>Nonmarital: Spouse &amp; Children</strong></td>
<td>30% 24% 36% 10%</td>
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<td><strong>Marital Trust Withdrawal Power</strong></td>
<td>48% 21% 19% 12%</td>
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<td><strong>Mandatory Distribution at Age</strong></td>
<td>31% 24% 28% 16%</td>
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<tr>
<td><strong>Withdrawal Power after Age</strong></td>
<td>25% 31% 21% 22%</td>
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<td><strong>In-Law Children Until Marriage</strong></td>
<td>63% 25% 6% 6%</td>
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<tr>
<td><strong>GST Trusts for &gt;$10 m</strong></td>
<td>34% 27% 22% 15%</td>
</tr>
<tr>
<td><strong>GST Trusts for &lt;$10 m</strong></td>
<td>18% 33% 39% 10%</td>
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<tr>
<td><strong>Address New Biology/Surrogacy</strong></td>
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<tr>
<td><strong>Exclude Adult Adopted Takers</strong></td>
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<td><strong>Spendthrift Trusts</strong></td>
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<td><strong>Incentive Trust Provisions</strong></td>
<td>73% 21% 3% 1%</td>
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<td><strong>Deviate from Per Stirpes</strong></td>
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<td><strong>Address Nonmarital Descendants</strong></td>
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<td><strong>Perpetual Dynasty Trusts</strong></td>
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<td><strong>Separate Shares (No Group Trust)</strong></td>
<td>1% 3% 13% 82%</td>
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Extensions of Time to Make Timely GST Exemption Allocations and Reverse QTIP Elections

by Lloyd Leva Plaine

Washington, D.C.*

This article discusses various procedures by which a taxpayer may seek an extension of time to make a timely GST exemption allocation under Sections 2642(g)(1) and 2632 of the Internal Revenue Code of 1986, as amended, (“IRC”), and by which an estate may seek an extension of time to make a “reverse” QTIP election.¹

ALLOCATION OF GST EXEMPTION

The rules relating to the generation-skipping transfer (“GST”) tax and the allocation of GST exemption are complex, and the forms on which the GST exemption is allocated, United States Gift (and Generation-Skipping Transfer) Tax Return (“Form 709”) and United States Estate (and Generation-Skipping Transfer) Tax Return (“Form 706”), are not user-friendly. As a result, there have been many errors made by taxpayers with respect to the allocation of their GST exemptions. The majority of these errors (which are far too easy to make) have included the following: failure to make any allocation, failure to make a timely allocation, allocation on an incorrect schedule of the Form 709 or Form 706, allocation of an incorrect amount (including incorrectly reducing the amount of the required allocation by the amount of the annual exclusion from gift tax), and allocation to the wrong trust. Such missed or erroneous allocations create significant potential GST tax liability and can lead to lawsuits.² Thus, IRC Section 2642(g)(1), which was enacted as part of the Economic Growth and Tax Relief Reconciliation Act (“EGTRRA”),³ authorizes the IRS to grant extensions of time to allocate GST exemption, and to make elections under IRC Section 2632(b)(3) (elections out of automatic allocations to lifetime direct skips) and IRC Section 2632(c)(5) (elections with respect to automatic allocations to indirect skips), was a needed and welcome addition to the IRC.⁴ Since the enactment of IRC Section 2642(g)(1), two different procedures with different eligibility requirements and levels of complexity have become available to taxpayers seeking extensions of time to allocate their GST exemptions. Further, on April 17, 2008 proposed regulations were issued as Section 26.2642-7 describing circumstances and procedures under which the IRS will grant extensions of time under IRC Section 2642(g)(1). Those proposed regulations apply to requests for private letter rulings filed on or after the date of publication of the proposed regulations as final regulations.

As part of Congress’ recognition that, because of the complexity of the GST tax rules, there were many taxpayers whose GST exemptions were not allocated when they should have been, it included IRC Section 2632(c) as part of EGTRRA. This section causes a taxpayer’s GST exemption to be allocated automatically in many of the cases where errors were occurring. Under IRC Section 2632(c)(5), the taxpayer can elect out of this automatic allocation of his or her GST exemption or elect to treat a trust as a GST Trust to which the automatic rules would apply. As a result of the enactment of IRC Section 2632(c), some taxpayers found that their GST exemptions had been allocated

¹ A reverse QTIP election is an election under IRC Section 2652(a)(3) to treat property that is qualified terminable interest property (“QTIP”) under IRC Section 2056(b)(7) as if, for GST tax purposes, no QTIP election had been made with respect to such property.

² PLR 9736032 describes a settlement of such a lawsuit.


⁴ For a discussion of all the GST tax changes made by EGTRRA, including the one that is the subject of this article, see Carol A. Harrington, Carlyn S. McCaffrey, Lloyd Leva Plaine and Pam H. Schneider, Generation-Skipping Transfer Tax Planning After the 2001 Act—Mostly Good News, J. TAX’N, Sept. 2001, at 143. For a comprehensive discussion of the GST tax, see CAROL A. HARRINGTON, LLOYD LEVA PLAINE AND HOWARD M. ZARITSKY, GENERATION-SKIPPING TRANSFER TAX (2d ed. 2001, with supplements).
without their knowledge and when the allocation of exemption was not intended. Relief is available for these taxpayers as it is for those whose GST exemptions were not allocated when they should have been.

**Requirements for Section 9100 Relief**

Treasury Regulations Section 301.9100-3 provides the standards used by the Internal Revenue Service (“IRS”) to determine whether to use its discretion to grant extensions of time to make certain tax elections in those situations where “the time for making the election is not prescribed by statute” (“9100 relief”). Prior to EGTRRA, the IRS took the position that the time to allocate GST exemption was prescribed by statute. Thus, it had ruled that it could not grant discretionary extensions of time to make timely allocations of GST exemption.5

IRC Section 2642(g)(1) directs the Treasury Secretary “by regulation [to] prescribe such circumstances and procedures under which extensions of time will be granted” (1) to make a timely allocation of GST exemption to gifts and to transfers at death, (2) to make elections out of the automatic allocation of GST exemption to lifetime direct skips (IRC Section 2632(b)(3)), and (3) to make elections in and out of the automatic allocation of GST exemption to indirect skips (IRC Section 2632(c)(5)).

IRC Section 2642(g)(1) provides that, in determining when to grant relief, the IRS is to consider “all relevant circumstances, including evidence of intent contained in the trust instrument or instruments of transfer and such other factors as the [Treasury] Secretary deems relevant.” In addition, the provision states “[f]or purposes of determining whether to grant relief under this paragraph, the time for making the allocation (or election) is treated as if not expressly prescribed by statute.” This latter provision was added specifically to enable the IRS to grant 9100 relief.

If the relief authorized by IRC Section 2642(g)(1) is granted, then the gift tax or estate tax value of the transfer to a trust is used for determining the amount of GST exemption to be allocated.6 In Notice 2001-50,7 the IRS confirmed that 9100 relief will be available in connection with GST exemption allocation. The Notice also stated:

[R]elief will be granted if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith and that the grant of relief will not prejudice the interests of the government. Taxpayers requesting relief should follow the procedures for requesting a private letter ruling under § 301.9100 contained in section 5.02 of Rev. Proc. 2001-1 (or its successor), 2001-1 I.R.B. 1, 13.

The proposed regulations (if finalized in their present form) would also amend Treasury Regulations Section 301.9100-3 by adding Section 301.9100-3(g) providing that the procedures under Sections 301.9100-1 and 301.9100-3 are not applicable for requests for relief under IRC Section 2642(g)(1) with respect to private letter ruling requests filed on or after the date of publication of final regulations. Automatic relief under Treasury Regulations Section 301.9100-2(b), in the narrow cases to which it applies, will continue to be applicable. Until such regulations are finalized, taxpayers seeking extensions of time (under IRC Section 2642(g)(1)) to make timely allocations and elections would continue to follow the procedures for requesting a private letter ruling under Treasury Regulations Section 301.9100-3, described below.

*Acting reasonably and in good faith.*

Treasury Regulations Section 301.9100-3(b)(1) sets out five circumstances, any one of which is sufficient, under which the taxpayer will be deemed to have acted reasonably and in good faith:

1. The taxpayer’s application for relief is made prior to discovery by the IRS of the missing election.

2. The taxpayer failed to make the election because of certain intervening events beyond the taxpayer’s control.

3. The taxpayer failed to make the election because, after exercising reasonable diligence (taking into account the taxpayer’s experience

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5 See PLRs 9827032, 9813013, 9226014. In contrast, both prior to and after EGTRRA, automatic extensions of time to allocate GST exemption were and will be granted under Treas. Reg. § 301.9100-2 if a Form 709 or Form 706 was timely filed and a corrective return is filed on which the allocation of GST exemption is made within 6 months of the due date of the Form 709 or 706 (without extensions). The corrective return must contain the statement “FILED PURSUANT TO § 301.9100-2”. See PLR 9718020.


7 2001-2 C.B. 189.
and the complexity of the return or issue), the taxpayer was unaware of the necessity of the election.

(4) The taxpayer reasonably relied on the written advice of the IRS.

(5) The taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

Not all reliance, however, will be deemed to be reasonable. The taxpayer will not be considered to have reasonably relied upon a tax professional if the taxpayer knew or should have known that the tax professional was not competent to render advice on the election, or if the taxpayer knew or should have known that the tax professional was not aware of all relevant facts.

Regardless of whether the application for relief is made before or after discovery by the IRS, there are two circumstances under which the taxpayer will not be considered to have acted reasonably and in good faith and, therefore, the taxpayer would be ineligible for relief for the failure to allocate GST exemption. First, no taxpayer will be deemed to have acted reasonably and in good faith if the taxpayer was fully informed of the required election and related tax consequences and chose not to file the election. Second, a taxpayer will not be considered to have acted reasonably and in good faith if the taxpayer “uses hindsight” in requesting relief. The regulations make clear that, absent strong proof that the decision to seek 9100 relief did not involve hindsight, when specific facts have changed since the original due date of the election that make an election advantageous to a taxpayer, the IRS will not ordinarily grant relief.

*Interests of government prejudiced.*

Treasury Regulations Section 301.9100-3(c)(1) describes the two circumstances under which the interests of the government are deemed to be prejudiced. First, such prejudice arises if granting relief “would result in a taxpayer having a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made (taking into account the time value of money).” If the tax consequences of the election affect more than one taxpayer, the determination of whether the interests of the government are prejudiced must be made by looking at the tax liability of all the affected taxpayers, in the aggregate. Second, the interests of the government will ordinarily be considered to be prejudiced when the tax year in which the regulatory election should have been made, or any tax year affected by the election had it been made timely, is closed by the statute of limitations before the taxpayer’s receipt of a ruling granting 9100 relief.

With respect to allocations of GST exemption, the statute of limitations (on gift or estate tax returns) should not be used as a bar to relief. The legislative history of IRC Section 2642(g)(1) states that extensions of time are to be granted “without regard to whether any period of limitations has expired.” Specifically, the Conference Report, at page 202, provides:

“[T]he Treasury Secretary is authorized and directed to grant extensions of time to make the election to allocate generation-skipping transfer tax exemption and to grant exceptions to the time requirement, without regard to whether any period of limitations has expired. If such relief is granted, then the gift tax or estate tax value of the transfer to trust would be used for determining generation-skipping transfer tax exemption allocation.”

It is the author’s understanding that, in response to a few letter ruling requests, the gift tax statute of limitations has been raised as a bar to 9100 relief—particularly where the gift was of an asset valued at a discount or such an asset was purchased by the trust. This unfortunate development is contrary to the intent of IRC Section 2642(g)(1) and its legislative history.

While the IRS has granted many requests for relief, as discussed below, informal discussions had indicated that the IRS was considering formally limiting 9100 relief for allocations of GST exemption, particularly where discounts were applied in valuing gifts and the statute of limitations has expired with respect to the gift tax return filed reflecting the gift. Limiting 9100 relief in these circumstances would be inconsistent with the purpose behind IRC Section 2642(g)(1) and the legislative history of the section which, as noted above, states that extensions are to be granted “without regard to whether any period of limitations has expired.” In letter ruling 200746006, the IRS denied an extension of time to allocate where transfers

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8 Treas. Reg. § 301.9100-3(c)(1)(i).
9 See Treas. Reg. § 301.9100-3(c)(1)(ii). However, the IRS may nonetheless grant relief to the taxpayer in such circumstances.
of interests in a limited partnership (funded with cash and marketable securities) were made to trusts and the accounting firm which determined the valuation discount prepared the gift tax return but failed to allocate GST exemption.

The Treasury / IRS 2007-2008 Priority Guidance Plan contains an item dealing with extensions of time to make allocations of GST exemption. As mentioned, proposed regulations were promulgated on April 17, 2008. Those proposed regulations are described later in this article. Donald Korb, the Chief Counsel of the IRS, in a June 20, 2007 letter to former Commissioner Mortimer Caplin, in describing the project, said:

“[t]he project will provide the criteria the IRS will use for granting extensions to make GST allocations. After the regulation is issued, we will use these criteria (rather than those under Treas. Reg. section 301-9100-3) in determining if relief should be granted.”

His letter also said:

“Generally, a timely allocation of GST exemption is made on a timely filed gift tax return reporting the transfer. Initially, we had decided to deny relief if the gift tax statute of limitation had expired and discounts were claimed in initially reporting the value of the gift; or the case presented a questionable fact situation, for example, after an initial transfer of a nominal amount of cash, the value of the trust corpus inordinately appreciated to the extent it was worth millions of dollars at the time relief was requested.

Currently, however, rather than denying relief if any discounts are claimed, we are reviewing each request on a case by case basis and will grant relief if we conclude that the case does not involve excessive discounts or does not present an abusive or questionable fact situation.”

Procedural requirements for granting of discretionary relief.

Treasury Regulations Section 301.9100-3(e) sets out numerous procedural requirements that must be complied with when requesting discretionary relief through a letter ruling request. The purpose of these requirements is to provide written evidence that the taxpayer acted reasonably and in good faith and that the interests of the government will not be prejudiced. This information includes:

(1) Information concerning when the applicable return, form or document used to make the election was required to be filed and when it was actually filed (and the taxpayer must submit a copy of any documents referring to the election);10

(2) Disclosure of any IRS examination by a district director or appeals officer of any return for the tax year in which the election should have been made or which would be affected by a timely made election and of any federal judicial proceeding involving the return (and the IRS must be notified if an examination of any such return is opened while the request for 9100 relief is pending);11

(3) The sworn affidavit of the taxpayer (or his or her representative with respect to tax matters) must set out in detail the events that led to the failure to make a valid regulatory election and the discovery of the failure, and the affidavit must also describe the engagement of any qualified tax professional, the responsibilities of the professional, and the extent of the taxpayer’s reliance on the professional;12 and

(4) Sworn affidavits from individuals having knowledge or information about the events that led to the failure to make a valid regulatory election and to the discovery of the failure, including the taxpayer’s tax return preparer, any individual (including an employee of the taxpayer) who made a substantial contribution to the preparation of the return, and any other accountant or attorney, knowledgeable in tax

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10 Treas. Reg. §§ 301.9100-3(e)(4)(ii) and (iii). Also see Rev. Proc. 2006-1, 2006-1 I.R.B.1, which sets forth the procedures for requesting a private letter ruling.

11 Treas. Reg. § 301.9100-3(e)(4)(i).

12 Treas. Reg. § 301.9100-3(e)(2). In addition, the affidavit must include the name, current address, and taxpayer identification number of the affiant and must be signed and accompanied by a dated declaration stating that, under penalties of perjury, “I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all relevant facts relating to the request, and such facts are true, correct, and complete.”
matters, who advised the taxpayer in connection with the election.\textsuperscript{13}

In addition, because the regulations make clear that the request for 9100 relief does not suspend the statute of limitations, the IRS may, as a condition to granting the requested relief, require the taxpayer to consent to an extension of the statute of limitations for the assessment of taxes in accordance with IRC Section 6501(c)(4) for the tax year in which the election should have been made and all tax years affected by a timely made election.\textsuperscript{14}

\textbf{Proposed Regulations Under IRC Section 2642(g)(1)}

In general, proposed regulations Section 26.2642-7 identify the standards to be applied by the IRS in determining whether to grant the transferor or a transferor’s estate an extension of time under IRC Section 2642(g)(1).

The transferor or the transferor’s executor requesting relief needs to file a private letter ruling request following the procedures set forth in Proposed Regulations Section 26.2642-7 and meeting the circumstances described therein.

Consistent with seeking relief under Treasury Regulation Section 301.9100-3, it continues to be the fundamental requirement that the transferor or the transferor’s estate must provide evidence to establish to the satisfaction of the IRS that the transferor or the transferor’s estate acted reasonably and in good faith and that the grant of relief will not prejudice the interests of the Government. However, when compared to the requirements of Treasury Regulation Section 301.9100-3, the list of factors necessary to establish this requirement has been tailored to the GST tax and factors have been added or given more detail and the submission of additional information is required.

\textit{Nonexclusive List of Factors to determine if transferor or transferor’s estate acted reasonably and in good faith}

The following nonexclusive list of factors are to be considered to determine whether the transferor or the transferor’s estate acted reasonably and in good faith:\textsuperscript{15}

(1) The intent of transferor or of the executor of the transferor’s estate to make a timely allocation or election—including evidence in the trust, the instrument of transfer, other relevant documents contemporaneous with the transfer, such as correspondence and Federal estate and gift returns. Evidence as to the intended GST tax status of the transfer or the trust is relevant (e.g., exempt, partially exempt) and more explicit evidence of intent with regard to the allocation or election.

(2) Intervening events beyond the control of the transferor or of the executor of the transferor’s estate as the cause of the failure to allocate or failure to elect.

(3) Lack of awareness by the transferor or the executor of the transferor’s estate of the need to allocate GST exemption to the transfer, despite the exercise of reasonable diligence, taking into account the experience of the transferor or the executor of the transferor’s estate and the complexity of the GST issue.

(4) Consistency by the transferor with regard to the allocation of the transferor’s GST exemption (for example, the transferor’s consistent allocation of GST exemption to new transfers to skip persons or to a particular trust, or the transferor’s consistent election not to have the automatic allocation of GST exemption apply to transfers to one or more trusts or skip persons.) This may be less relevant if there has been a change of circumstances or change of trust beneficiaries. Consistency is a new factor which is not contained in Treasury Regulations Section 301.9100-3.

(5) Reasonable reliance by the transferor or the executor of the transferor’s estate on the advice of a qualified tax professional retained or employed by one or both of them and, in reliance on or consistent with that advice, the failure of the transferor or the executor to allocate GST exemption to the transfer or to make an election. Reliance on a qualified tax professional will not be considered to have been reasonable if the transferor or the executor of the transferor’s estate knew or should have known that the professional either-

(a) was not competent to render advice on the GST exemption; or

(b) was not aware of all relevant facts.

\textsuperscript{13} Treas. Reg. § 301.9100-3(e)(3). These affidavits must also describe the engagement, the responsibilities of the affiant, and the advice provided to the taxpayer. Additionally, each such affidavit must be accompanied by a declaration similar to that described in the preceding note.

\textsuperscript{14} Treas. Reg. § 301.9100-3(d)(2).

\textsuperscript{15} Most of this description is drawn directly from the proposed regulation.
Prejudice to the interests of the Government

The following nonexclusive list of factors are to be considered to determine whether the interests of the Government would be prejudiced:

(1) The interests of the Government would be prejudiced to the extent to which the request for relief is an effort to benefit from hindsight. Is it an attempt to benefit from hindsight rather than to achieve the result the transferor or the executor of the transferor’s estate intended at the time when the transfer was made? The regulations provide that a factor relevant to this determination is whether the grant of the requested relief would: (a) permit an economic advantage or other benefit that would not have been available if the allocation or election had been timely made; or (b) permit an economic advantage or other benefit that results from the selection of one out of a number of alternatives (other than whether or not to make an allocation or election) that were available at the time the allocation or election could have been timely made, if hindsight makes the selected alternative more beneficial than the other alternatives. Further, in a situation where the only choices were whether or not to make a timely allocation or election, prejudice would exist if the transferor failed to make the allocation or election in order to wait to see (thus, with the benefit of hindsight) whether or not the making of the allocation of exemption or election would be more beneficial.

(2) The timing of the request for relief will be considered in determining whether the interests of the Government would be prejudiced by granting relief under this section. The interests of the Government would be prejudiced if the transferor or the executor of the transferor’s estate delayed the filing of the request for relief with the intent to deprive the IRS of sufficient time to challenge the claimed identity of the transferor or the value of the transferred property for Federal gift or estate tax purposes. However, as stated above, the fact that the statute of limitations may have run or that a discount is used is not determinative.

(3) The occurrence and effect of an intervening taxable termination or taxable distribution will be considered in determining whether the interests of the Government would be prejudiced by granting relief under this section. The interests of the Government may be prejudiced if a taxable termination or taxable distribution occurred between the time for making a timely allocation of GST exemption or a timely election and the time at which the request for relief under this section was filed.

Situations in which the standard of reasonableness, good faith, and lack of prejudice to the interests of the Government has not been met.

The following situations provide illustrations of some circumstances under which the standard of reasonableness, good faith, and lack of prejudice to the interests of the Government has not been met, and as a result, in which relief under this section will not be granted:

(1) Timely allocations and elections. Relief will not be granted under this section to decrease or revoke a timely affirmative allocation of GST exemption as described in §26.2632-1(b)(4)(ii)(A)(1) (timely lifetime allocation) or to revoke an election under section 2632(b)(2) or (c)(5) made on a timely filed Federal gift or estate tax return. The sections referred to do not cover affirmative allocations at death, yet it refers to “Federal gift or estate tax return”.

(2) Timing. Relief will not be granted if the transferor or executor delayed the filing of the request for relief with the intent to deprive the IRS of sufficient time to challenge the claimed identity of the transferor or the valuation of the transferred property for Federal gift or estate tax purposes. However, as stated above, the fact that the statute of limitations may have run or that a discount is used is not determinative.

(3) Failure after being accurately informed. Relief will not be granted under this section if the decision made by the transferor or the executor of the transferor’s estate (who had been accurately informed in all material respects by a qualified tax professional
(4) Hindsight. Relief under this section will not be granted if the IRS determines that the requested relief is an attempt to benefit from hindsight rather than an attempt to achieve the result the transferor or the executor of the transferor’s estate intended when the transfer was made. One factor that will be relevant to this determination is whether the grant of relief will give the transferor the benefit of hindsight by providing an economic advantage that may not have been available if the allocation or election had been timely made. Thus, relief will not be granted if that relief will shift GST exemption from one trust to another trust unless the beneficiaries of the two trusts, and their respective interests in those trusts, are the same. (Query what this means as relief, especially with respect to allocations of death, may shift the allocation to a different trust than would have been the case with an automatic allocation at death.) Similarly, relief will not be granted if there is evidence that the transferor or executor had not made a timely allocation of the exemption in order to determine which of the various trusts achieved the greatest asset appreciation before selecting the trust that should have a zero inclusion ratio.

Procedural Requirements

(1) Affidavits must be submitted by the transferor or the executor of the transferor’s estate which satisfy the following requirements:

(a) The affidavit must describe the events that led to the failure to timely allocate GST exemption to a transfer or the failure to timely elect and the events that led to the discovery of the failure. If the transferor or the executor of the transferor’s estate relied on a tax professional for advice with respect to the allocation or election, the affidavit must: describe the scope of the engagement; the responsibilities the transferor or the executor of the transferor’s estate believed the professional had assumed, if any; and the extent to which the transferor or the executor of the transferor’s estate relied on the professional.

(b) Attached to each affidavit must be copies of any writing (including, without limitation, notes and e-mails) and other contemporaneous documents within the possession of the affiant relevant to the transferor’s intent with regard to the application of GST tax to the transaction for which relief under this section is being requested. This requirement is not explicit in the Treasury Regulations Section 301-9100-3.

(c) The affidavit must be accompanied by a dated declaration, signed by the transferor or the executor of the transferor’s estate that states: “Under penalties of perjury, I declare that I have examined this affidavit, including any attachments thereto, and to the best of my knowledge and belief, this affidavit, including any attachments thereto, is true, correct, and complete. In addition, under penalties of perjury, I declare that I have examined all the documents included as part of this request for relief, and, to the best of my knowledge and belief, these documents collectively contain all the relevant facts relating to the request for relief, and such facts are true, correct, and complete.”

(2) Affidavits must be submitted from individuals who have knowledge or information about the events that led to the failure to allocate GST exemption or to elect and/or to the discovery of the failure. These individuals may include individuals whose knowledge or information is not within the personal knowledge of the transferor or the executor of the transferor’s estate. The individuals who must submit affidavits include:

(a) Each agent or legal representative of the transferor who participated in the transaction and/or the preparation of the return for which relief is being requested;

(b) The preparer of the relevant Federal estate and/or gift tax return(s);

(c) Each individual (including an employee of the transferor or the executor of the transferor’s estate) who made a substantial contribution to the preparation of the relevant Federal estate and/or gift tax return(s); and

(d) Each tax professional who advised or was consulted by the transferor or the executor of the transferor’s estate with regard to any aspect of the transfer, the trust, the allocation of GST exemption, and/or the election under section 2632(b)(3) or (c)(5).
(e) Each affidavit must describe the scope of the engagement and the responsibilities of the individual as well as the advice or service(s) the individual provided to the transferor or the executor of the transferor’s estate.

(f) Attached to each affidavit must be copies of any writing (including, without limitation, notes and e-mails) and other contemporaneous documents within the possession of the affiant relevant to the transferor’s intent with regard to the application of GST tax to the transaction for which relief under this section is being requested.

(g) Each affidavit must be accompanied by a dated declaration, signed by the individual that states: “Under penalties of perjury, I declare that I have personal knowledge of the information set forth in this affidavit, including any attachments thereto. In addition, under penalties of perjury, I declare that I have examined this affidavit, including any attachments thereto, and, to the best of my knowledge and belief, the affidavit contains all the relevant facts of which I am aware relating to the request for relief filed by or on behalf of [transferor or the executor of the transferor’s estate], and such facts are true, correct, and complete.”

(h) If an individual who would be required to provide an affidavit has died or is not competent, the affidavit of the transferor or of the executor of the transferor’s estate must include a statement that the individual has refused to provide the affidavit, a description of the efforts made to obtain the affidavit from the individual, the information or knowledge the transferor or the executor of the transferor’s estate believes the individual had about the transfer, and the relationship between the individual and the transferor or the executor of the transferor’s estate.

These two last requirements (h) and (i) are not contained explicitly in the Treasury Regulations Section 301-9100-3.

**Letter Rulings Granting 9100 Relief**

The IRS has issued many private letter rulings granting taxpayers an extension of time under Treasury Regulations Section 301.9100-3 to make timely allocations of their GST exemptions.16 Under these rulings, the taxpayer is to file a supplemental return and allocate the GST exemption (within the period of the extension granted—often 60 days from the date the ruling is issued).17 The allocations are to be effective as of the date of the original transfer, and the amount of GST exemption to be allocated is determined by the gift or estate tax value of the transfer (whichever is relevant).

Private letter rulings have been issued granting extensions of time to make a timely allocation of GST exemption or elect out of the automatic allocation of GST exemption under IRC Section 2632(c)(5) in all of the following situations in each of which the taxpayer relied on a “qualified tax professional” and acted reasonably and in good faith:

**Time of filings.**

- Forms 709 were timely filed but gifts were reported on the wrong schedules and no GST exemption was allocated on the returns. Although not set forth in the ruling, it is the author’s understanding that, about four years after the gift tax returns were filed, supplemental returns were filed attempting to confirm that timely allocations had been made on the original

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16 In fact, there have been so many requests for letter rulings that the IRS and Department of the Treasury created an alternate procedure by which to grant extensions of time to allocate GST exemption. Rev. Proc. 2004-46, 2004-31 I.R.B. 142, discussed below, provides for a less time-consuming process that taxpayers who meet the requirements can choose. The letter ruling process remains available to other taxpayers.

17 A current year’s Form 709 should not be used as a supplemental return pertaining to a prior year’s gifts, as the IRS has in at least one such case returned it—erroneously mistaking it for an early filing of a Form 709 for the current year. Instead, the return should be filed as a Form 709 for the year in which the relevant transfer was made.
returns, and, if timely allocations had not in fact been made, then the supplemental returns provided that late allocations were to be made. The extension applied both to the gift made by the spouse who was still living as well as to the gift previously made by the deceased spouse.

- Forms 709 were timely filed but no GST exemption was allocated on them.
- Forms 709 were filed for a transfer to a trust made in Year 1, but no GST exemption was allocated. Forms 709 were filed for a transfer to the same trust in Year 2. No GST exemption was allocated on the Year 2 returns, but GST exemption was allocated automatically under IRC Section 2632(c)(1).
- Form 709 was filed late by a law firm and no GST exemption was allocated on it.
- Form 709 was not filed.
- Form 709 was not filed, and Form 706 was filed without Schedule R (the schedule on which GST exemption is allocated).
- Form 709 was filed, but no GST exemption was allocated due to secretarial error. The gift was treated in the bank trustee’s database as a gift not subject to GST tax and as a gift made one-half by each spouse (when in fact the gift was made by one spouse and the spouses gift-split).
- Forms 709 were filed, but the amounts of the transfers were incorrectly reported, and an insufficient amount of GST exemption was allocated.
- Forms 709 were not filed, because the accountant incorrectly believed that they were not required.
- Form 709 was timely filed, but GST exemption was incorrectly allocated in an amount equal to the actuarial value of a grandchild’s interest instead of an amount equal to the value of the property transferred to the trust.
- Forms 709 were timely filed but no GST exemption was allocated because the accountant mistakenly believed that the transfers were direct skips in trust that had a zero inclusion ratio.
- Form 709 was timely filed to reflect gifts to pooled income funds under which a grandchild was to receive income for life. The accountant did not allocate GST exemption because the accountant believed each transfer had a zero inclusion ratio due to the transfer’s qualification for the gift tax annual exclusion and likewise incorrectly believed that the transfer qualified under IRC Section 2642(c).
- Form 709 was not filed because, although it was not a permissible reduction, the tax professional incorrectly subtracted gift tax annual exclusion amounts in determining the amount of GST exemption to allocate and erroneously concluded no GST exemption needed to be allocated.
- Form 709 was timely filed, but no GST exemption was allocated, and then a late allocation was made.
- Forms 709 were timely filed, but no GST exemption was allocated. A taxable termination occurred.
- Form 709 was timely filed, but no GST exemption was allocated. A taxable termination occurred, and GST tax was paid.
- Form 709 was timely filed to report a gift that was subject to an estate tax inclusion period (“ETIP”). No Form 709 was filed to allocate

18 PLR 200212024.
19 PLR 200212025 (the request was filed after the decedent’s death but prior to the filing of the Form 706).
20 PLRs 200637011, 200633014, 200626008, 200616022, 200613021, 200604005, 200603023, 200324049.
21 PLR 200702014.
22 PLRs 200614025, 200218010.
23 PLRs 200633014, 200620003, 200616022, 200608004, 200606034, 200606002, 200229032.
24 PLR 200618001.
25 PLR 200218001.
26 PLR 200620003.
27 PLRs 200636091, 200629016.
28 PLR 200236019.
29 PLR 200618006.
30 PLR 200303053.
31 PLRs 200236019 and 200229032.
32 PLR 200308037. See also PLRs 200238018, 200407003 and 200407005. Although one cannot tell from the face of PLR 200238018, it is that author’s understanding that a late allocation of GST exemption was made prior to seeking relief. These letter rulings show that a transferor who has made a late allocation during life (described in IRC Section 2642(b)(3)) should be treated no worse than a transferor who had not attempted to cure the missed or flawed allocation before requesting relief under IRC Section 2642(g)(1). Because the allocation pursuant to a grant of relief under IRC Section 2642(g)(1) is treated as creating the inclusion ratio as of the date of the gift, i.e., as though the allocation was timely made, the inclusion ratio, should (where the gift did not exceed the available GST exemption), in light of the relief granted, be zero. Therefore, the late allocation should be void (except with respect to a charitable lead annuity trust), because, under Treas. Reg. § 26.2632-1(b)(4)(i), “an allocation of GST exemption to a trust is void to the extent the amount allocated exceeds the amount necessary to obtain an inclusion ratio of zero with respect to the trust.”
33 PLRs 200625013, 200619015, 200608008.
34 PLR 200240019.
GST exemption at the end of the ETIP. Child died during the ETIP, and a GST occurred at end of the ETIP. An extension was granted to make a timely allocation of GST exemption at the end of the ETIP and was effective as of the end of the ETIP.35

- Form 709 was timely filed, and GST exemption was allocated to cash and other assets that were transferred to a trust. The transfer of an insurance policy to the trust was not reported. The GST exemption was allocated on the incorrect line of the Form 709, and no Notice of Allocation was attached. An amended Form 709 was filed that changed the amount of the transfer and the amount of GST exemption to be allocated, but otherwise made the same errors. The IRS found that the allocation of GST exemption was effective because the taxpayer substantially complied with the GST exemption allocation requirements and granted an extension of time to make a timely allocation of GST exemption to the transfer of the life insurance policy.36

- Form 709 was timely filed but did not reflect all gifts, and no allocation of GST exemption was made. The IRS informed taxpayers that earlier Form 709 was being examined.37

- Form 709 was timely filed, but the accountant failed to allocate GST exemption. The attorney discovered the error prior to the return’s being audited. Pursuant to the audit of the return, the taxpayer agreed to increase the value of the gift and pay gift tax deficiency. It is unclear when the request for relief was filed, but it was granted after the audit was completed.38

- Forms 709 were timely filed by a husband and wife (who lived in a community property state) after making equal transfers to each of two trusts, one for the benefit of their son and his descendants and one for the benefit of their daughter and her descendants. No GST exemption was allocated on the returns. The wife died and her GST exemption was allocated to the transfers by her executor on Form 706. The husband made another transfer and timely filed Form 709, but no GST exemption was allocated. The husband died when the GST exemption was equal to $1,120,000. His executor allocated $120,000 to the daughter’s trust and attached a statement allocating $1,000,000 to the daughter’s trust if the extension of time to make a timely allocation was not granted. The daughter died prior to the date on which the ruling request was filed. The husband’s estate was granted an extension of time to make allocations of his GST exemption to the portion of both the son’s trust and the daughter’s trust for which he was the transferor, but the ruling stated the GST exemption had to be allocated equally between the trusts.39

- Form 706 was filed, but no GST exemption was allocated due to an administrative error.40

- Form 706 was filed and a QTIP election was made, but the trust was not severed, nor was a reverse QTIP election made. An extension was granted to sever the trust and make the reverse QTIP election. GST exemption would then be allocated automatically under IRC Section 2632(e)(1).41

- Form 706 was timely filed and an effective QTIP election was made, but the trust was not severed, nor was a reverse QTIP election made. An extension was granted to sever the QTIP trust, make the reverse QTIP election, and allocate GST exemption.42

- Form 706 was filed late, and effective QTIP and reverse QTIP elections were made, but the attempt to allocate GST exemption on the late return was ineffective.43

ELECTING OUT OF AUTOMATIC ALLOCATION

- Forms 709 were timely filed, but the taxpayers did not elect out of automatic allocation under IRC Section 2632(c)(5). Amended Forms 709 that were subsequently filed did not include the election out of automatic allocation.44

- Form 709 was timely filed to report a transfer to a grantor retained annuity trust (“GRAT”) and other generation-skipping transfers. GST exemption was allocated affirmatively to the other transfers. Based on the advice of the taxpayer’s law firm, the taxpayer did not want GST exempt
exemption to be allocated automatically to the GRAT under IRC Section 2631(c), but the accountant who prepared the Form 709 did not realize that a written election out of automatic allocation was required. The estate tax inclusion period (“ETIP”) of the GRAT closed the next year, but the accountant failed to include on the Form 709 a written election out of automatic allocation with respect to the GRAT.49

- Form 709 was timely filed with respect to a transfer to a qualified personal residence trust (“QPRT”). IRC Section 2632(c)(5), providing for the automatic allocation of GST exemption, was enacted between the date of the transfer and the date of the close of the ETIP. GST exemption was automatically allocated.46

- Forms 709 were timely filed with respect to transfers to an insurance trust, but, in preparing the returns, the taxpayer’s tax advisor failed to elect under IRC Section 2632(c)(5) not to have the automatic allocation rules apply. The tax advisor failed to advise the taxpayer to file Forms 709 for transfers to the insurance trust in other years, and the election under IRC Section 2632(c)(5)—to have the automatic allocation rules of IRC Section 2632(c)(1) not apply—was not made in those years. The taxpayer also established four irrevocable trusts: the Education Trust, the Irrevocable Trust, the Son’s Trust, and the Daughter’s Trust. The taxpayer made transfers to those trusts in multiple years. Two of the trusts, the Education Trust and the Irrevocable Trust, are considered “GST trusts” under IRC Section 2632(c)(3)(B). The Son’s Trust and the Daughter’s Trust do not meet the requirements for a GST trust, but a generation-skipping transfer may occur with respect to those trusts. The taxpayer did not intend for GST exemption to be allocated to the Irrevocable Trust but intended that it be allocated to the Education Trust, the Son’s Trust, and the Daughter’s Trust. The taxpayer’s tax advisor failed to advise the taxpayer to file Forms 709 in order to make the election under IRC Section 2632(c)(5) with respect to the Irrevocable Trust—to have the automatic allocation rules of IRC Section 2632(c)(1) not apply—and to allocate GST Exemption to the Son’s Trust and the Daughter’s Trust.47

Reliance on qualified tax professionals.

- Taxpayer’s legal counsel and his tax attorney discussed allocation of GST exemption with the taxpayer and intended that GST exemption be allocated to the trust. However, when the attorney conveyed documents to the taxpayer’s accountant to prepare the return, the attorney did not tell the accountant to allocate, so no allocation was made.48

- The taxpayer’s attorney wrote a letter advising the taxpayer to allocate, but the taxpayer’s accountant incorrectly advised the taxpayer not to allocate because the transfers qualified for the gift tax annual exclusion.49

- As a result of an oversight, the taxpayer’s attorney did not timely file a gift tax return and allocate. The attorney then filed Form 709 late, but no GST exemption was allocated on it “because of the uncertainty as to the proper procedure for making late allocations.”50

- The taxpayer’s attorney advised the taxpayer to allocate, but no allocation was made, as the attorney incorrectly assumed that the taxpayer’s accountant would make the allocation.51

- The taxpayer’s attorney advised the taxpayer of need to allocate, but, when the attorney prepared relevant Forms 709, the attorney inadvertently failed to allocate.52

- The taxpayer’s attorney advised the accountant to allocate, but the accountant failed to allocate due to administrative problems.53

- The taxpayer’s accountant and the bank that was serving as trustee inadvertently failed to communicate, and Forms 709 were filed but no GST exemption was allocated.54

- The attorney who drafted the trust and the accountant who prepared the Forms 709 inadvertently failed to allocate. Upon a later review of the returns, the attorney noticed the omission.55

- The taxpayers’ attorney advised them of the GST nature of the trust. An accounting firm was engaged to prepare Forms 709 that were reviewed by the law firm. No GST exemption was allocated on the Forms 709. While updat-

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45 PLR 200644001.
46 PLR 200613006.
47 PLR 200703002.
48 PLR 200240019.
49 PLR 200229032.
50 PLR 200218010.
51 PLR 200243042.
52 PLR 200324032.
53 PLR 200243037.
54 PLR 200618005.
55 PLR 200324044.
ing the taxpayers’ estate plans, one of their attorneys discovered the error.56

- The taxpayer hired a law firm to draft a trust agreement and prepare the gift tax return. The new attorney noticed that the former attorney had failed to allocate the taxpayer’s GST exemption. Affidavits from the taxpayer and the former attorney discussed the taxpayer’s goal of achieving “full estate plan advantages.” The attorney admitted that he made a mistake by not allocating.57

- Letter ruling silent as to whether any qualified tax professional was involved.58


Revenue Procedure 2004-46, 2004-31 I.R.B 142 (August 2, 2004) was issued in response to the large number of private letter ruling requests received by the IRS after the enactment of IRC Section 2642(g). The proposed regulations issued on April 17, 2008 under IRC Section 2642(g)(1) provide in the Preamble that the procedure in this Revenue Procedure will remain effective even after the regulations are finalized. It allows extensions of time to allocate GST exemption to be granted through a less time-consuming process and without charging the taxpayer a user fee; however, the alternate method is available only in limited situations.59

The Revenue Procedure states:

[T]he Service has issued several letter rulings under §301.9100-3 granting an extension of time to make a timely allocation in situations in which a transfer to a trust qualified for the gift tax annual exclusion under §2503(b), but was not deemed to have a zero inclusion ratio because the trust did not meet one or more of the requirements of §2642(c)(2) (for example, because there was more than one beneficiary of the trust). In most of these cases, the transferor failed to allocate GST exemption to the trust on a timely filed gift tax return because the transferor was not aware of the need to affirmatively allocate the exemption to the transfers.60 The Service believes that in these cases, it is appropriate to provide an alternate simplified method to obtain an extension of time to make an allocation of GST exemption, provided that certain requirements (set forth in sections 3 and 4 of this revenue procedure) are met. In such a case, the transferor’s GST exemption remaining at the time the gift tax return is filed pursuant to this revenue procedure may be allocated to the transfer based on the value of the property as of the date of the transfer.

The Revenue Procedure applies only to a taxpayer who satisfies the following requirements:

“(1) On or before December 31, 2000, the taxpayer made or was deemed to have made a transfer by gift to a trust from which a GST may be made;

“(2) At the time the taxpayer files the request for relief under this revenue procedure, no taxable distributions have been made and no taxable terminations have occurred;

“(3) The transfer qualified for the annual exclusion under §2503(b), and the amount of the

56 PLR 200703022.
57 PLR 200324049.
58 PLR 200237021.
59 It is the author’s understanding that the Revenue Procedure was intended to apply to a situation that was present in many ruling requests filed for extensions of time to allocate GST exemption—annual exclusion gifts to life insurance trusts. Although the Rev. Proc. applies only to annual exclusion gifts, it is not limited in its applicability to transfers to insurance trusts.
60 Under IRC Section 2642(c)(2), direct skip transfers to certain trusts where the transfer qualifies for and utilizes the gift tax annual exclusion have an inclusion ratio of zero without using any GST exemption. Further, other transfers that are direct skips receive an automatic allocation of GST exemption even if they do not qualify for or utilize the gift tax annual exclusion (IRC Section 2632(b)).
61 In PLR 200303053, Form 709 was timely filed to reflect gifts to pooled income funds under which grandchild was to receive income for life. The accountant did not allocate the taxpayer’s GST exemption, believing each transfer had a zero inclusion ratio due to its qualification for the gift tax annual exclusion and incorrectly believing the transfer qualified under IRC Section 2642(c). In PLR 200236019 and PLR 200229032, Form 709 was not filed because, although it was not a permissible reduction, the tax professional incorrectly subtracted annual exclusion amounts when determining the amount of GST exemption to allocate and erroneously concluded that no GST exemption needed to be allocated.
transfer, when added to the value of all other gifts by the transferor to that donee in the same year, was equal to or less than the amount of the applicable annual exclusion for the year of the transfer;\(^{62}\)

“(4) No GST exemption was allocated to the transfer, whether or not a Form 709 was filed;\(^ {63}\) and

“(5) At the time the taxpayer files a request for relief under this revenue procedure, the taxpayer has unused GST exemption available to allocate to the transfer.”\(^{64}\)

In addition, the following requirements must be met:

“(1) File a Form 709 for the year of the transfer to the trust, regardless of whether a Form 709 had been previously filed for that year. State at the top of the Form 709 that the return is ‘FILED PURSUANT TO REV. PROC. 2004-46.’

“(2) Report on the Form 709 the value of the transferred property as of the date of the transfer.

“(3) Allocate GST exemption to the trust by attaching a statement to the Form 709 entitled ‘Notice of Allocation.’ The notice of allocation must contain the following information:

“(a) clear identification of the trust, including the trust’s identifying number, as defined in § 6109 and the regulation thereunder, when applicable;

“(b) the value of the property transferred as of the date of the transfer (adjusted to account for split gifts, if any);

“(c) the amount of taxpayer’s unused GST exemption at the time this Notice of Allocation is filed (taxpayers are reminded that they must have unused GST exemption at the time this Notice of Allocation is filed);

“(d) the amount of GST exemption allocated to the transfer;

“(e) the inclusion ratio of the trust after the allocation; and

“(f) a statement that all of the requirements of section 3.01 of this revenue procedure have been met.”\(^ {65}\)

Further, the Revenue Procedure requires that the Form 709 must be filed on or before the date prescribed for filing the federal estate tax return for the transferor’s estate (determined with regard to any extensions actually obtained), regardless of whether an estate tax return is required to be filed.\(^ {66}\)

Upon receipt of a request for relief, the Service Center will determine whether the requirements for

\(^ {62}\) This requirement presumably is made for simplicity reasons; however, in the author’s view it narrows the application of the Revenue Procedure unnecessarily. There was no need to require gifts to qualify for the annual exclusion. However, given that this is listed as a requirement it is expressed in too restrictive a fashion. Specifically, because gifts qualify for the annual exclusion in chronological order (Treas. Reg. §25.2503-2(a)), it should have been necessary only that gifts to the donee made earlier in the calendar year than the gift in question plus the gift in question did not exceed the annual exclusion.

\(^ {63}\) It is unclear why a taxpayer who recognized an error and made a late allocation to an annual exclusion transfer should not be allowed relief under the Revenue Procedure. A transferor who has made a late allocation during life (described in IRC Section 2642(b)(3)) should be treated no worse than a transferor who had not attempted to cure the missed or flawed allocation before requesting relief under the Revenue Procedure and should be permitted to apply for relief under the Revenue Procedure to have the GST exemption allocation effective as of the date of the gift. Because the allocation pursuant to a grant of relief under the Revenue Procedure should be treated as creating the inclusion ratio as of the date of the gift, i.e., as though the allocation had been timely made, the inclusion ratio, should, in light of the relief granted, be zero. Therefore, the late allocation should be void (except with respect to a charitable lead annuity trust), because, under Treas. Reg. § 26.2632-1(b)(4)(i), “an allocation of GST exemption to a trust is void to the extent the amount allocated exceeds the amount necessary to obtain an inclusion ratio of zero with respect to the trust.” This has proven to be the case in letter rulings issued under IRC Section 2642(g)(1) (PLRs 200238018, 200308037, 200407003 and 200407005), but such situations are not covered by the Revenue Procedure.

\(^ {64}\) These five requirements are specified by Section 3.01 of the Revenue Procedure. Section 3.01 states that the requirements of Section 4 of the Revenue Procedure must also be met.

\(^ {65}\) These three requirements are specified by Section 4 of the Revenue Procedure.

\(^ {66}\) It is unclear why a taxpayer’s estate is not allowed to apply for relief under this Revenue Procedure if the federal estate tax return due date has passed. The Revenue Procedure could have granted relief which would then also have the effect of nullifying any automatic allocation of GST exemption that had already occurred at death to the transfer in question in a sufficient amount so there was enough GST exemption to apply to the annual gifts at issue. Such an approach has been sanctioned in letter rulings under IRC Section 2642(g)(1). See PLR 200407005. It is the author’s understanding that the Revenue Procedure was structured in this fashion to reduce work the Service Center would have to do since GST exemption would already have been automatically allocated.
granting relief to make a GST exemption allocation under the Revenue Procedure have been satisfied and will notify the taxpayer of the result of this determination. If the Service Center determines that the requirements for granting relief to make a GST exemption allocation have been satisfied, the allocation will be effective as of the date of the transfer.67

The Revenue Procedure provides that "[t]axpayers who are denied relief or who are otherwise outside the scope of this revenue procedure may request an extension of time to allocate GST exemption by requesting a letter ruling under the provisions of §301.9100-3. The procedural requirements for requesting a letter ruling are described in Rev. Proc. 2004-1, 2004-1 C.B. 1 (or its successors). If a letter ruling is requested after relief has been denied under this revenue procedure, the letter ruling request must indicate that relief was requested and denied under this revenue procedure. Rev. Proc. 2004-1, Appendix C, 2004-1 I.R.B. 70."

**REVERSE QTIP ELECTIONS**

Revenue Procedure 2004-47, 2004-2 C.B. 169 (August 9, 2004), provides a greatly simplified procedure “for certain executors of estates and trustees of trusts to request relief to make a late reverse qualified terminable interest property (QTIP) election” under IRC Section 2652. This method may be used as an alternative to the normal letter ruling process, and no user fee is charged.

To be eligible for relief under the Revenue Procedure, the following requirements, which are set forth in Section 4.02 of the Revenue Procedure, must be met:

1. A valid QTIP election under IRC Section 2056(b)(7) was made for the property or trust on the Form 706 for the decedent’s estate;

2. A reverse QTIP election was not made on the estate tax return as filed because “the taxpayer relied on the advice and counsel of a qualified tax professional and that qualified tax professional failed to advise the taxpayer of the need, advisability, or proper method to make a reverse QTIP election”;

3. The decedent has sufficient unused GST exemption, after the automatic allocation of the GST exemption under IRC Section 2632(e) and Treas. Reg. §26.2632-1(d)(2), to result in a zero-inclusion ratio for the reverse QTIP trust or property;68

4. The estate is not eligible under Treasury Regulations Section 301.9100-2 for the automatic six-month extension;

5. The surviving spouse has not made a lifetime disposition of all or any part of his or her income interest in the QTIP; and

6. Either the surviving spouse is alive or no more than six months have passed since the death of the surviving spouse.

The simplified procedure is expressly not available if:

1. The transfer is an inter vivos transfer;

2. The transfer is to a qualified domestic trust for the benefit of a non-citizen spouse;

3. The request for relief is made in conjunction with a request to extend the time to sever the trust or to allocate GST exemption to it.

Under the simplified procedure, the estate must file with the Cincinnati Service Center a request for an extension of time to make a reverse QTIP election. The request should have a cover sheet requesting relief that states at the top: “REQUEST FOR EXTENSION FILED PURSUANT TO REV. PROC. 2004-47.”

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67 A grant of relief under the Revenue Procedure does not preclude a subsequent determination that the transfer is a transfer covered by the ETIP provisions of IRC Section 2642(f), i.e., that it is an inter vivos transfer the value of which would have been included in the transferor’s gross estate under chapter 11 (other than by reason of IRC Section 2035) if the transferor had died immediately after making the transfer. If it is determined that the transfer is one described in IRC Section 2642(f), the GST exemption allocated pursuant to this Revenue Procedure would not be changed. The effective date and effect of that allocation of GST exemption would be governed by Treas. Reg. §26.2632-1(c) so that the allocation would be irrevocable but would not be effective until the end of the ETIP and would use the value of property at the end of the ETIP in determining the inclusion ratio.

68 As a practical matter, the simplified procedure of Rev. Proc. 2004-47 is available only if GST exemption was allocated to the entire QTIP on the estate tax return or the rules for allocating unused GST exemption in IRC Section 2632(e) will allocate sufficient GST exemption to the trust to produce an inclusion ratio of zero.
The following items must be attached to the request for relief:

(1) Copies of Parts 1 through 5 and Schedule M of the original estate tax return;

(2) A properly completed Schedule R of Form 706 as required to make the reverse QTIP election;

(3) A statement explaining why the reverse QTIP election was not made on the estate tax return as filed;

(4) A statement affirming that all of the requirements in section 4.02 of Rev. Proc. 2004-47 have been met;

(5) A dated declaration, signed by the executor, that states: “Under penalties of perjury, I declare that, to the best of my knowledge and belief, the facts presented in support of this election are true, correct, and complete. In addition, all attachments provided in support of this request for relief are true and correct copies of the original documents”;

(6) A signed statement from the qualified tax professional on whom the taxpayer relied when preparing the original estate tax return. The statement must establish the tax professional’s qualifications as a qualified tax professional and must include a dated declaration that states: “Under penalties of perjury, I declare that, to the best of my knowledge and belief, the facts presented in support of this request for relief are true, correct, and complete.”

The proposed regulations state that, if the Service Center determines that the requirements for granting relief under Rev. Proc. 2004-47 have been satisfied, the decedent remains, for GST tax purposes, the transferor of the QTIP trust or property. As a result, the decedent’s remaining GST exemption will be automatically allocated pursuant to IRC Section 2632(e) and Treas. Reg. §26.2632-1(d)(2) to the QTIP trust or property for which the reverse QTIP election was made, based on the value of the trust or property as finally determined for federal estate tax purposes. The Service Center will notify the taxpayer of this determination. A grant of relief does not:

(1) Extend the time for allocating GST exemption;

(2) Grant permission to allocate retroactively the decedent’s remaining GST exemption; or

(3) Grant permission to make a late severance of a trust included in the gross estate.\(^69\)

If relief is denied under the simplified procedure, the taxpayer may still seek relief under Treas. Reg. §301.9100-3, but the letter ruling request must indicate that relief was denied under Rev. Proc. 2004-47.

**CONCLUSION**

Filing a private letter ruling request for an extension of time to make a timely allocation of GST exemption (or elect in or out of automatic allocation) is a valuable tool in curing errors that often occur with respect to the allocation of GST exemption, but, before filing a ruling request, the taxpayer should determine if relief under Rev. Proc. 2004-46 is available. Likewise, for taxpayers seeking an extension of time to make the reverse QTIP election, Rev. Proc. 2004-47 presents a desirable alternative to requesting a private letter ruling.

\(^{69}\) It is possible to make a QTIP and a reverse QTIP election for a trust that will be included in the surviving spouse’s gross estate for a reason other than IRC Section 2044. In such event the reverse QTIP election should not prevent the transferor from changing to the surviving spouse at the surviving spouse’s death. However, the proposed regulations do not appear to recognize this possibility.
This article discusses qualification for an extension of time to pay estate tax attributable to closely held business interests under Internal Revenue Code Section 6166. The article also discusses recent developments with respect to extensions for real estate interests and security for payment of the tax.

I. INTRODUCTION

When the estate of an owner of a closely held business is subject to federal estate tax, liquidity often is a problem because there may not be enough liquid assets in the estate to pay the tax. A sale of the business will often result in a considerable loss in value because the estate must pay the estate tax nine months after the decedent’s death. Since 1958 there have been one or more provisions in the Internal Revenue Code (“Code”) that permit an estate that consists of a substantial amount of closely held business interests to pay the estate tax attributable to that business in installments rather than all at once. Recently, the Internal Revenue Service (“IRS”) made it easier to satisfy the trade or business requirement under Code section 6166, the latest provision allowing installment payments, when the estate consists of substantial amounts of real estate. In addition, thanks to a recent court case and the IRS’ response, satisfying the bond or lien requirement has become more rational. This article will provide an overview of Code section 6166 and will discuss these recent developments.

II. PROVISIONS PROVIDING FOR DEFERRING THE PAYMENT OF ESTATE TAX

There are three provisions permitting a taxpayer to defer the payment of estate tax. First, under Code section 6161(a)(1), the IRS may extend the time for payment of the estate tax, or any installment of the estate tax, for a reasonable period not to exceed twelve months from the due date. In addition, under Code section 6161(a)(2), an extension may be granted for reasonable cause with respect to any part of the estate tax or any part of any installment under Code section 6166, for up to ten years from the due date of the return or twelve months after the due date of the last installment.

Second, under Code section 6163, the payment of estate tax attributable to a reversionary or remainder interest included in a decedent’s gross estate may, at the election of the executor, be postponed until six months after the termination of the preceding interest or interests in the property. An additional postponement for up to three years may be granted for reasonable cause.

Third, under Code section 6166, the federal estate tax attributable to closely held businesses may be paid over two to ten equal installments. In most cases, the installment payments of the estate tax must begin on or before the fifth anniversary of the due date of the estate tax return. Interest is paid on the unpaid estate tax in annual installments beginning one year after the estate tax return was due. The interest rate on the estate tax on the first $1,280,000 in 2008 (which is adjusted for inflation) of closely held business interests (after taking into account the applicable exclusion amount, $2,000,000 in 2008) is two percent. The interest rate on the balance is forty-five percent of the interest rate charged on underpayments of tax under Code section 6621, which is 3.15% for the calendar quarter beginning January 1, 2008. The amount of the federal estate tax that can be paid in installments is an amount that bears the same ratio to the estate tax, reduced by the credits against such tax, as the closely held business amount bears to the amount of the adjusted gross estate. The closely held business amount is the value of the interests in closely held businesses that qualify under Code section 6166(a)(1).

III. PURPOSE OF CODE SECTION 6166

The purpose of Code section 6166 is summarized in Parrish v. Loeb: 1

Section 6166 was designed by Congress to create a safety valve to protect the integrity of closely held business interests of a decedent against destruction because of the demands of

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the estate tax provisions of the Code. It provides, in summary, that in those instances in which a substantial part of a decedent’s gross estate consists of a closely-held business venture, which the decedent had conducted in his lifetime, his personal representative may elect to pay that portion of federal estate tax which is attributable to that venture in equal annual installments over a period of time not to exceed ten years. The Section also provides that a personal representative may elect to defer payment of the first annual installment for a period not to exceed five years. During that deferment period, interest on the deferred tax is payable annually at a nominal rate fixed by the statute.

IV. QUALIFYING FOR CODE SECTION 6166 TREATMENT

In order to elect to pay the estate tax attributable to closely held business interests included in the estate in installments, the value of closely held business interests must exceed thirty-five percent of the value of the decedent’s adjusted gross estate. The determination of whether the thirty-five percent requirement is met is made immediately before the decedent’s death, although the value may be determined at either the date of death or the alternate valuation date, and real property held as an asset in a closely held business will be valued under Code section 2032A if the estate satisfies that section’s requirements. The adjusted gross estate is the value of the gross estate reduced by the sum of the amounts allowable as a deduction under Code sections 2053 and 2054, based on the facts and circumstances existing on the due date, including extensions, for filing the estate tax return, or, if earlier, on the date the return is filed. Because the statute refers to “allowable” deductions, such amounts reduce the gross estate for purposes of the thirty-five percent requirement regardless of whether they are actually claimed as a deduction on the estate tax return (in other words, they are claimed as deductions on the estate’s income tax return instead). The decedent must be a citizen or a resident of the United States at the time of death and the executor must make an election on a timely filed estate tax return.

An interest in a closely held business is:

a. An interest as a proprietor in a trade or business carried on as a proprietorship;

b. An interest as a partner in a partnership (including a limited liability company (LLC) treated as a partnership for federal tax purposes) carrying on a trade or business if twenty percent or more of the total capital interest is included in determining the decedent’s gross estate or the partnership has forty-five or fewer partners; or

c. Stock in a corporation carrying on a trade or business if twenty percent or more of the value of the voting stock of the corporation is included in determining the decedent’s gross estate or the corporation has forty-five or fewer shareholders.

In determining whether the thirty-five percent requirement has been satisfied and the amount of the estate tax attributable to closely held businesses that may be deferred, the value of an interest in a closely held business does not include the portion of the interest attributable to passive assets held by the business. A passive asset is an asset other than an asset used in carrying on a trade or business. A passive asset includes stock in another corporation unless the stock is treated as owned by the decedent because the executor has made an election to treat the stock held by a holding company as business company stock under Code section 6166(b)(8).

However, if a corporation owns twenty percent or more of the value of the voting stock of another corporation or the other corporation has forty-five or fewer shareholders and eighty percent or more of the value of the assets of each corporation (not taking into account the stock held in the other corporation by the first corporation) is attributable to assets used in a trade or business, both corporations will be treated as one corporation for this purpose. While not entirely clear, this treatment should apply to more than one subsidiary as long as the requirements are satisfied. These holding company rules should apply to partnerships and LLCs treated as partnerships.

The Economic Growth and Tax Relief Reconciliation Act of 2001 added Code section 6166(b)(10), which treats stock in a qualifying lending and finance business as stock in an active trade or business and any asset used in such business as an asset used in carrying on a trade or business. The five-year deferral is not available in this case, and the tax must be paid in five (and not ten) installments.

For purposes of determining whether an interest is an interest in a closely held business, special rules apply for determining the number of owners to satisfy the forty-five owner test.

a. Interests held by a husband and wife as community property, joint tenants, tenants by the entirety, or tenants in common are treated as owned by one of them.

b. The property owned directly or indirectly by or for a corporation, partnership, estate, or
trust is considered as being owned proportionately by or for its shareholders, partners, or beneficiaries. A person is treated as a beneficiary of a trust only if the person has a present interest in the trust.

c. Any stock or partnership interests held by the decedent’s family are treated as owned by the decedent. Members of the family include the decedent’s spouse, brothers and sisters, ancestors, and descendants.

For purposes of the twenty percent tests for determining whether an interest qualifies as a closely held business interest and whether two or more closely held businesses are treated as a single entity, an executor may elect to treat a capital interest in a partnership and any non-readily-tradable stock treated as owned by the decedent under these constructive ownership rules as owned by the decedent. If this election is made, the special two percent interest rate and the five-year deferral are not available.

For purposes of the thirty-five percent requirement, a farming business includes the value of residential buildings and related improvements on the farm that are occupied on a regular basis by the owner or lessee of the farm or by persons employed by such owner or lessee for purposes of operating or maintaining the farm.

If an executor elects, holding company stock will be treated as business company stock to the extent it represents direct or indirect ownership (through one or more other holding companies by the holding company) in a business company. A holding company is any corporation holding stock in another corporation. A business company is any corporation carrying on a trade or business. If the election is made, the special two percent interest rate and the five-year deferral are not available. The stock of the holding company must be non-readily-tradable. If the stock of the business company is readily-tradable, the installments must be paid over five years. For purposes of the twenty percent voting stock requirement, holding company stock deemed to be business company stock because of the election is treated as voting stock to the extent that the holding company owns directly, or through one or more other holding companies, voting stock in the business company.

Interests in two or more businesses will be treated as one business if twenty percent or more of the value of each business is included in the value of the decedent’s gross estate. Interests held by a surviving spouse in property held by the decedent and surviving spouse as community property, or as joint tenants, tenants by the entirety, or tenants in common are treated as having been included in the decedent’s gross estate for this purpose. As noted above, an executor may elect to have other attribution rules apply, but the special two percent interest rate will not apply and the five-year deferral is not available.

V. TRADE OR BUSINESS TEST

The IRS position on whether a business was a “closely held business” for purposes of Code section 6166 has become much more liberal in the last few years. In Rev. Rul. 61-55, the IRS interpreted the term “closely held business” then contained in Code section 6166(c). The IRS ruled that, whereas working interests in oil and gas properties, which the decedent owned, operated, explored and developed, constituted a Code section 6166 trade or business, mere royalty interests in such properties did not. Accordingly, the IRS concluded that the estate tax attributable to working interests included in the gross estate could be paid in installments if the estate otherwise qualified under Code section 6166, but that it did not apply to the portion of the estate consisting of royalty interests.

The IRS discussed the distinction between passive ownership and active participation in three revenue rulings and a technical advice memorandum. However, as discussed below, Rev. Rul. 75-365 and part of Rev. Rul. 75-367 were revoked two years ago. In Rev. Rul. 75-365, the IRS ruled that a decedent’s management through his business office of commercial and farm rental properties and certain notes receivable derived in connection with these properties did not constitute a business for Code section 6166 purposes. Conceding that such activities might constitute a “business” for other Code sections, such as Code sections 162 or 355, the IRS explained in Rev. Rul. 75-365 that the meaning of “business” in other sections does not determine its meaning in Code section 6166:

[W]hat amounts to a “trade or business” within [§6166] … should be found in keeping with the intent of the legislature in enacting §6166. Although the management of rental property by the owner may, for some purposes, be considered the conduct of business in the case of a sole proprietorship, §6166 was intended to apply only with regard to a business such as a manufacturing, mercantile, or service enterprise, as distinguished from

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1 1961-1 C.B. 713.
management of investment assets .... 
[T]he mere grouping together of income-producing assets from which a decedent obtained income only through ownership of the property rather than from the conduct of a business, in and of itself, does not amount to an interest in a closely held business within the intent of the statute.

The IRS found the decedent’s activities to be a “business,” however, in Rev. Rul. 75-366, where the decedent owned farms that were operated by tenant farmers under agreements giving the decedent forty percent of the crops and requiring him to bear forty percent of the expenses. The decedent played an active role in the farming operation, which the IRS considered to be “a productive enterprise which is like a manufacturing enterprise as distinguished from management of investment assets.”

In Rev. Rul. 75-367, the decedent was a builder who: (1) built homes through a wholly-owned small business corporation and through a proprietorship; (2) conducted a real estate development and sales operation; (3) owned a business office and warehouse both of which were used by the corporation and the development and sales operation; and (4) owned and rented out several houses that he had built. The IRS ruled that, while the rental activity consisted of mere investment assets and did not represent a business for Code section 6166 purposes, the other three activities had the requisite status. Furthermore, because the decedent owned more than a fifty percent interest in each activity (as the statute then required), the IRS ruled all three could be aggregated and treated as an interest in a single closely held business.

Fortunately, in Rev. Rul. 2006-34, the IRS updated and made more liberal its published ruling position on real estate interests, revoking Rev. Rul. 75-365 and the part of Rev. Rul. 75-367 that held that eight homes that were owned by the decedent and rented to tenants and for which the decedent collected rents, made the mortgage payments, and performed necessary repairs and maintenance, did not constitute an interest in a closely held business because the decedent’s interest in those homes merely represented an investment.

Under this new standard, when determining whether a decedent’s interest in real property is an interest in an asset used in an active trade or business, the IRS will now consider all the facts and circumstances, including the activities of agents and employees, the activities of management companies or other third parties, and the decedent’s ownership interest in any management company or other third party. The ruling contained the following nonexclusive list of factors that the IRS would consider:

1. The amount of time the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) devoted to the trade or business;
2. Whether an office was maintained from which the activities of the decedent, partnership, LLC, or corporation were conducted or coordinated, and whether the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) maintained regular business hours for that purpose;
3. The extent to which the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) was actively involved in finding new tenants and negotiating and executing leases;
4. The extent to which the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) personally made, arranged for, performed, or supervised repairs and maintenance to the property (whether or not performed by independent contractors), including without limitation, painting, carpentry, and plumbing; and
5. The extent to which the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) handled tenant repair requests and complaints.

No single factor is dispositive of whether a decedent’s activities with respect to the real property (or the activities of a partnership, LLC, or corporation through which decedent owns the real property) constitute an interest in a closely held business for purposes of Code section 6166.

The ruling applied these factors to five fact patterns or situations. In each situation, the real property interests are included in the decedent’s gross estate and aggregate in value more than thirty-five percent of the decedent’s adjusted gross estate within the meaning of Code section 6166 (b)(6). Further, in each situation the only assets that might be part of a closely held business are the interests described. In each situation, the eligibility requirements of Code section 6166(b) regarding the number of partners, members, or shareholders or the percentage of capital interest in the partnership or LLC or voting stock in the corpora-

tion are satisfied. The ruling applied the factors discussed above in reaching its conclusion about whether the particular interest constituted an interest in a closely held business under Code section 6166.

In Situation 1, A died on January 1, 2005. At the time of death, A owned a ten-store strip mall titled in A’s name. A personally handled the day-to-day operation, management and maintenance of the strip mall. A also personally handled most repairs. When A was unable to personally perform a repair, A hired a third party independent contractor. A selected the contractor and reviewed and approved the work performed. Under these circumstances, the use of independent contractors on occasions when A could not personally perform the work does not prevent A’s activities from rising to the level of the conduct of an active trade or business. Because A provided significant services to the strip mall tenants, A’s ownership of the strip mall qualified as an interest in a closely held business. The result would be the same if the strip mall had instead been held in a single-member LLC owned by A, and the LLC was disregarded as an entity that is separate from its owner.5

In Situation 2, B died on February 1, 2005. At the time of death, B owned a small office park titled in B’s name. The office park consisted of five separate two-story buildings, each of which had multiple tenants. B hired DEF Management Corporation (DEF), a property management company in which B had no ownership interest, to lease, manage, and maintain the office park, and B relied entirely on DEF to provide all necessary services. The primary duties of DEF’s employees consisted of advertising to attract new tenants, showing the property to prospective tenants, negotiating and administering leases, collecting the monthly rent, and arranging for independent contractors to provide all necessary services to maintain the buildings and grounds of the office park, including snow removal, security, and janitorial services. DEF provided a monthly accounting statement to B, along with a check for the rental income, net of expenses and fees. Because B’s reliance on DEF to perform all necessary services, B’s lack of any significant participation in the management or oversight of the property, and B’s lack of any ownership interest in DEF were all factors that weighed heavily against a finding that the office park was used by B in an active trade or business, B’s interest in the office park did not qualify as an interest in a closely held business.

The facts in Situation 3 are the same as in Situation 2, except that B owned twenty percent in value of the stock of DEF. Because B owned a significant ownership interest in DEF (twenty percent), the activities of DEF with regard to the office park allow B’s interest in the office park to qualify as an interest in a closely held business.

In Situation 4, C died on April 1, 2005. At the time of death, C’s assets included the one percent general partner interest and a twenty percent limited partnership interest in a limited partnership. The limited partnership owned three strip malls that, collectively, constituted eighty-five percent of the value of the limited partnership’s assets. The partnership agreement required C, as the general partner, to provide the limited partnership with all services necessary to operate the limited partnership’s business, including daily maintenance to and repairs of the strip malls. From 1992 until death, C received an annual salary from the limited partnership for C’s services as general partner. In performance of C’s obligations under the limited partnership agreement, C (either personally or with the assistance of employees or agents) performed substantial management functions, including collecting rental payments and negotiating leases, performing daily maintenance and repairs (or hiring, reviewing and approving the work of third party independent contractors for such work), and making decisions regarding periodic renovations of the three strip malls. Because of the activities of the general partner, the limited partnership carried on an active trade or business. Because the strip malls were used in carrying on the partnership’s trade or business, they are not passive assets. Because C owned twenty percent of the limited partnership interests, C’s interest in the partnership qualified as an interest in a closely held business, regardless of whether C was the general partner.

In Situation 5, D died on May 1, 2005. At the time of death, D owned 100% of the stock in MNO Corporation (MNO), a dealership in the business of selling automobiles, automotive parts and related supplies, and repair services. D made all decisions regarding MNO, including the approval of all advertising and marketing promotions, management and acquisition of inventory, and matters relating to dealership personnel. D also supervised all employees of MNO. In addition to the stock of MNO, D directly owned Real Property P. Real Property P was constructed for MNO and contained unique features tailored to an automobile dealership, including a showroom and office space and areas for servicing automobiles and storing inventory. D leased Real Property P to MNO under a net lease, and MNO’s employees performed all maintenance of and repairs to Real Property P. Because MNO was conducting an active trade or business at the time of D’s death, D’s 100% ownership stock interest in MNO qualified as an interest in a closely held business. Because Real

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5 As provided under Treas. Reg. §§301.7701-1 - 3
Property P was used exclusively in the business of MNO under a net lease from D, and D owned a significant interest in MNO, whose activities with regard to Real Property constituted active management, D’s interest in Real Property P also qualified as an interest in a closely held business.

VI. JUDICIAL REVIEW OF DENIAL OF CODE SECTION 6166 ELECTIONS

After an election under Code section 6166 has been filed, the IRS will review the election to determine whether it is in accord with the requirements of Code section 6166. If the IRS determines that the election is in accord, no notice is issued. Thus, a personal representative should assume that the election is acceptable if not advised to the contrary. Where the IRS after examination finds that an election under Code section 6166 does not meet the Code section 6166 requirements, the personal representative will be given the opportunity of an appeals conference. If the personal representative loses at appeals, the personal representative may seek a declaratory judgment in the Tax Court as to whether the estate qualifies for Code section 6166 treatment or whether the extension no longer applies because of an acceleration event, discussed below.

VII. ACCELERATION OF DEFERRED TAX

Pursuant to Code section 6166(g), a distribution, sale, exchange or other disposition of fifty percent or more of the value of decedent’s interest in a closely held business that was subject to an extension under Code section 6166 will accelerate all unpaid tax deferred under Code section 6166. Note that it is fifty percent or more in value of the interest in closely held business as of the date of the decedent’s death. A withdrawal of fifty percent or more of the value of the closely held business will also accelerate the unpaid tax. Although the transfer of property to a beneficiary does not accelerate the payment of unpaid tax deferred under Code section 6166, a subsequent transfer by the beneficiary does accelerate payment. The failure to pay any unpaid tax within six months from the date the late payment is due accelerates the payment of the unpaid tax. If the payment of the late interest and principal is made within six months of the due date, there will be no acceleration, but the two percent interest rate will be lost with respect to the late payment, and a penalty of five percent per month is assessed on the late payment.

VIII. BOND OR LIEN TO SECURE THE CODE SECTION 6166 DEFERRED ESTATE TAX

Code section 6165 authorizes the IRS to require the taxpayer to post a surety bond in order to secure the payment of estate tax for which a Code section 6166 extension has been obtained. The surety bond may not be in an amount which is more than twice the extension amount. In lieu of providing a bond, the IRS may require a lien under Code section 6324A, thereby relieving the personal representative of any personal liability for the deferred tax.

The IRS’s position on whether to require either a bond or a lien has vacillated over the years. One concern of the IRS is that the general estate tax lien under Code section 6324 expires ten years after the decedent’s death. Consequently, if an estate is paying the estate tax over fourteen years and nine months, there will be no security for the payment of the deferred tax after the tenth year absent some type of collateral other than the general estate tax lien. Because of a recommendation by the U.S. Treasury Inspector General that was based on the number of unsecured outstanding estate tax balances and the number of overdue and uncollectable estate taxes, the IRS adopted a bright line bond requirement in 2002; the estate had to either provide a surety bond or agree to Code section 6324A lien.

However, the Tax Court recently held that the IRS had abused its discretion by requiring that all estates electing to pay the estate tax in installments under Code section 6166 must provide a surety bond (or alternatively a special lien). The court found that it was Congress’s intent 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 under Code section 6166.

In response, the IRS issued Notice 2007-90 to provide interim guidance and to describe a change in IRS policy regarding Code section 6166, that, in light of the Tax Court decision, the IRS will now determine on a case-by-case basis whether security will be required when a qualifying estate elects to pay all or a part of the estate tax in installments. The notice states that the Treasury and IRS intend to issue regulations establishing standards and guidelines in determining when a bond or lien will be required. In the meantime, the notice lists the following factors that the IRS will consider in determining whether deferred installment payments of estate tax under Code section 6166 pose a sufficient credit risk to the government to justify the requirement of either a bond or special lien: (1) duration and stability

of the business; (2) ability to pay the installments of tax and interest timely; and (3) the taxpayers history or complying with the tax laws. Other factors may be considered and no single factor will be determinative.

Under Code section 6324A, if the executor makes a Code section 6324A(a) election in lieu of furnishing a bond and files an agreement under Code section 6324A(c), the deferred amount of estate tax is a lien in favor of the U.S. on the “Code section 6166 lien property.” Code section 6324A(b) defines “§6166 lien property” as “interests in real and other property to the extent such interests—(A) can be expected to survive the deferral period, and (B) are designated in the agreement referred to in subsection (c),” which is the agreement that must be signed by the owners of the property.

IX. CLOSELY HELD CORPORATION STOCK AS COLLATERAL FOR THE CODE SECTION 6324A LIEN

The IRS has privately addressed a number of issues it will consider when deciding whether to accept stock in a closely held corporation as collateral for the special estate tax lien under Code section 6324A. First and foremost, the IRS stated that if three requirements under Code section 6324A are met, the Code section 6324A special lien arises and the collateral must be accepted by the IRS. The IRS can not reject the closely held stock as collateral because it would be burdensome to determine the value of the stock, because the IRS would prefer other collateral, or because that the stock might decline in value. The three requirements are: (1) the stock must be expected to survive the deferral period; (2) the stock must be identified in the written agreement described in Code section 6324A(b)(1)(B); and (3) the value of the stock as of the agreement date must be sufficient to pay the deferred taxes plus the required interest.

However, the memorandum points out that the IRS, in order to protect its lien, may require an estate to provide annual reports or certified financial statements each year, and if the estate refuses to provide the information, the IRS may demand additional collateral or may accelerate the deferred tax if estate refuses to provide the additional collateral. Furthermore, the IRS may demand additional collateral if it determines that the closely held stock is not sufficient collateral because it has declined in value. Again, if the estate refuses to furnish the additional collateral, the IRS may accelerate the payment of the deferred tax. In the event the IRS treats the Code section 6166 election as terminated, the personal representative would then have a right to an appeals conference, and, if unsuccessful at appeals, may petition the Tax Court for a declaratory judgment with respect to whether the estate’s Code section 6166 election had terminated because of the decline in the value of the collateral: i.e., the closely held stock.

X. CONCLUSION

Several recent developments have made the Code section 6166 deferral of estate taxes an easier benefit to obtain. First, it will be easier to treat real property that is used in a trade or business as a closely held business asset for purposes of Code section 6166 treatment regardless of how it is owned. In other words, it is not necessary that the real property be in the same entity as the operating assets. Second, a company will be treated as engaged in a trade or business even though a separate management company performs all the services for the company as long as the decedent owns at least twenty percent of the equity of the management company. Finally, it may be possible in certain circumstances to avoid the requirement of a surety bond or a lien, and, if a lien is required, the interest in the closely held business should usually suffice as collateral.

1 Chief Counsel Memorandum 200747019.