51st ANNUAL

ESTATE PLANNING CONFERENCE

LSU Continuing Legal Education

The 51st Annual Estate Planning Conference

November 18, 2021 – November 19, 2021

Thursday, November 18, 2021		
	7:45 AM - 8:45 AM	Check-in/Registration
1.0 hr.	8:45 AM - 9:45 AM	**Post-SECURE Act Estate Planning for Retirement Benefits in Trust (with Forms)** Rebecca Luster Radford - Blanchard, Walker, O'Quin & Roberts
1.0 hr.	9:55 AM - 10:55 AM	**Professionalism** Angela White-Bazile - Louisiana Judges and Lawyers Assistance Program
1.0 hr.	11:05 AM - 12:05 PM	**Settling Difficult Successions** Tyler Rench - Jones Walker LLP Miriam Henry - Jones Walker LLP Allen Miller - Phelps Dunbar, LLP
1.25 hr.	1:00 PM - 2:15 PM	**Recent Developments in Taxation of Interest to Estate Planners** Rebecca Hinton - Taylor, Porter, Brooks & Phillips, LLP
1.0 hr.	2:25 PM - 3:25 PM	**Managing the Transition of Closely-Held Companies** Katelyn Gunn - Jones Walker LLP
1.0 hr.	3:35 PM - 4:35 PM	**Estate Planning Strategies for Individuals with Moderate Wealth including Tax Considerations** Jacob White - Ayres, Shelton, Williams, Benson & Paine, LLC
Friday, November 19, 2021		
	8:15 AM - 8:45 AM	Check-in/Registration
1.0 hr.	8:45 AM - 9:45 AM	**Ancillary Successions** Joseph Wilson - Liskow & Lewis
1.0 hr.	9:55 AM - 10:55 AM	**Ethics** Betty Raglin - Legacy Estate & Elder Law of Louisiana
1.25 hr.	11:05 AM - 12:20 PM	**Recent Developments in Successions & Donations** Elizabeth Carter - LSU Law Center
1.0 hr.	1:15 PM - 2:15 PM	**Practical Drafting Under the Trust Code; 2020 Revision Considerations** Leon Rittenberg III - Baldwin Haspel Burke & Mayer, LLC
1.0 hr.	2:25 PM – 3:25 PM	**How Far Reaching is Warne v. Commissioner, T. C. Memo. 2021-17** Laura Fine - Lehmann Norman & Marcus LC
1.0 hr.	3:35 PM – 4:35 PM	**Testamentary Planning in Louisiana: Tax & Non-Tax Considerations** R. Fritz Niswanger - Niswanger Law LLC

SPEAKER BIOGRAPHIES

PROFESSOR ELIZABETH R. CARTER is the A.N. Yiannopoulos Professor of Law and the Judge Anthony J. Graphia & Jo Ann Graphia Professor of Law at the Louisiana State University Law Center, where she teaches and writes in the areas of estates, trusts, taxation, Louisiana civil law, family law, and community property. She is the author of numerous articles and two text books in those areas. Professor Carter also oversees LSU's Successions/Title Clearing law clinic. In addition to her teaching responsibilities at the Law Center, Professor Carter teaches the course in federal gift and estate tax in the University of Alabama's LL.M. program in taxation. Professor Carter earned a B.S. in Biology and a B.A. in Spanish from the University of Memphis, magna cum laude. She earned her J.D. from Tulane University Law School, magna cum laude. She was elected Order of the Coif, and awarded a Civil Law Certificate. While at Tulane, Professor Carter served as an articles editor of the Tulane Law Review, Volume 81, worked as a research assistant to Professor A.N. Yiannopoulos, and was a founding member of the Tulane Civil Law Society. Professor Carter was awarded the 2006 Dean Rufus C. Harris Award for the Best Writing on a Civil Law Subject by the Tulane Law Review. Upon graduation, Professor Carter was awarded the 2007 Louisiana Bar Association Civil Law Award for attaining the highest grade in civil law studies. She earned her LL.M. in Tax from the University of Alabama. Before joining the LSU faculty, Professor Carter worked at the New Orleans law firm of Lugenbuhl, Wheaton, Peck, Rankin & Hubbard.

LAURA E. FINE is a partner of the law firm of Lehmann Norman & Marcus, LC. Laura received her Bachelor's degree in psychology at Centenary College of Louisiana in her hometown of Shreveport in 2001. Laura graduated with her J.D. from Thomas Jefferson School of Law in San Diego, California in 2006. She then attended Tulane University Law School and received her LL.M degree in Comparative and International Law in 2007. She joined Lehmann, Norman, & Marcus in August of 2008. Her concentration is in the fields of estate planning, estate administration, and business law. She is admitted to practice in California and Louisiana. She is board certificated as a specialist in Estate Planning and Administration from the Louisiana State Bar Association, a Fellow of the American College of Trust and Estate Counsel, a Chartered Advisor in Philanthropy through the American College, and an Accredited Estate Planner through the National Association of Estate Planning Councils. She is a Legal Advisory board member of Lift Louisiana, a board member of the Human Relations Commission for the City of New Orleans, a board member of the New Orleans Planned Giving Council, and a board member of the New Orleans Estate Planning Council. She was also named a SuperLawyers Rising Star in 2016 and 2017.

KATELYN GUNN practices in the area of estate planning, assisting clients with the preparation of wills, trusts, marital property agreements, and powers of attorney. She also works with clients in succession matters and is involved in the preparation of US estate tax returns. Before joining Jones Walker, Katelyn's legal experience included advising single-employer and multi-employer clients on issues related to qualified pension and welfare plans. Katelyn continues to assist with the preparation of plan documents, summary plan descriptions, and other documents necessary for plan administration. While in law school, Katelyn served as a judicial extern to the Honorable Kurt D. Engelhardt at the US District Court for the Eastern District of Louisiana. Katelyn also serves on the Board of Directors of HandsOn New Orleans, a local non-profit dedicated to promoting and facilitating volunteerism in the Greater New Orleans community.

MIRIAM WOGAN HENRY is a partner in the Tax Practice Group and a member of the firm's board of directors. She focuses on estate planning, including family wealth transfer plans, charitable planning, and business succession planning, along with advising clients regarding fiduciary litigation and transfer tax controversy matters. Miriam advises on trust and estate planning matters such as drafting wills, trusts, powers of attorney, and marital property agreements. Advising clients in connection with gift and estate tax returns is part of Miriam's practice, which includes representing clients before the Internal Revenue Service in connection with gift, estate, and generation-skipping tax audits. She works closely with members of the firm's Litigation Practice Group in connection with fiduciary litigation and transfer tax controversies. Miriam is a fellow of the American College of Trust and Estate Counsel and currently serves as the Louisiana State Chair for ACTEC. She has been certified by the Louisiana Board of Legal Specialization as a Board-Certified Estate Planning and Administration Specialist. Prior to joining the firm, she served as a law clerk to Judge Frank J. Polozola of the US District Court for the Middle District of Louisiana from 1997 to 1998. Committed to civic engagement and community service, Miriam has served on the boards of Trinity Episcopal School and the Louisiana SPCA.

REBECCA M. HINTON represents individuals and businesses in the areas of federal, state and local taxation; tax controversies; estate planning; business matters; successions; and trusts. Rebecca is ranked by her peers among Best Lawyers® in tax law. She is an adjunct professor at Louisiana State University Paul M. Hebert Law Center, and frequently presents at CLE and other seminars on the topics of federal estate and gift taxation, estate planning, and federal taxation. Rebecca serves as secretary of the Estate & Business Planning Council of Baton Rouge. In the community, she is a board member of the nonprofit SportsBR, dedicated to uniting sports and the Baton Rouge community.

ALLEN C. MILLER is a trial lawyer with extensive experience in the areas of commercial and tort litigation. He concentrates his practice in the areas of general business torts, casualty litigation, professional malpractice, construction litigation, banking and lender liability, class-action litigation, bankruptcy litigation, products liability, trade secrets litigation and a variety of other corporate litigation matters. Allen has extensive experience in complex commercial matters. His professional liability practice involves litigation and trial defense of errors and omissions (E&O), directors and officers (D&O), and professional malpractice claims. Allen's professional and quasi-professional subject matters include insurance agents and brokers; attorneys; real estate and title agents; accountants/CPAs; architects, engineers and design professionals; and directors and officers. Allen has experience representing owners, contractors, subcontractors and design professionals in all aspects of construction including claim drafting and counseling during construction and claims resolution in state and federal courts. He has handled construction disputes involving both private and public entities. Allen has represented owners, tenants, contractors and sub-contractors in state and federal courts in Louisiana, Texas, Alabama and Mississippi. He regularly represents clients in matters involving various aspects of the construction process, including delay claims, claims involving construction and design defects, lien claims, and claims involving performance and payment bonds. Allen has litigated claims involving breach of contract, breach of warranty, construction and/or design defects, negligence, unjust enrichment and construction liens. He has handled a substantial number of cases from inception through resolution at trial, appeal and alternative dispute resolution where appropriate. His experience includes, without limitation, first chair litigation counsel in many successful bench and jury trials in state and federal court. Allen is solely responsible for the litigation strategy and handling of cases for several institutional firm clients and regularly supervises commercial litigation associates and paralegals. He regularly represents national Fortune 500 companies, privately held companies and educational institutions in federal and state litigation and disputes throughout the Gulf Coast. In the community, Allen is a graduate of the New Orleans Regional Leadership Institute, a former Chairman of the St. Augustine High School Board of Directors, as well as a member of Benjamin Franklin High School Board of Directors. He is also a member of the CASA New Orleans Board of Directors and previously served as Board Chair for the City of New Orleans' Ethics Review Board.

R. FRITZ NISWANGER is the managing attorney of Niswanger Law LLC in West Monroe, Louisiana. Fritz focuses his practice in the following areas: federal income and transfer tax planning; business entity formations and reorganizations; mergers and acquisitions; trust and estate planning; and asset protection. He is certified as a tax law specialist by the Louisiana Board of Legal Specialization, holds a JD and an MBA from Tulane University in New Orleans, and holds a BA from Louisiana State University in Baton Rouge.

REBECCA S. LUSTER RADFORD is an associate at Blanchard, Walker, O'Quin & Roberts (A Professional Law Corporation) in Shreveport. Rebecca's practice primarily involves taxation, estate planning, successions, trusts, and business and commercial transactions. Rebecca is a frequent speaker on estate planning and taxation topics and is a co-author of Estate Planning in Louisiana, which is part of the Louisiana Practice Series. She received a Bachelor of Arts in Economics and Business Administration, cum laude, from Rhodes College in 2008 and a Master of Science in Accounting from the University of Virginia in 2009. Rebecca earned a J.D. and a Graduate Diploma in Comparative Law from LSU's Paul M. Hebert Law Center in 2012, cum laude. Subsequent to her studies at LSU, Rebecca earned a Master of Laws in Taxation from the University of Florida in 2013.

BETTY A. RAGLIN is a Louisiana attorney practicing in the areas of Estate Planning, Estate Administration, Elder Law, Trusts, Business Planning, Taxation and Civil Litigation. Board Certified by the Louisiana Board of Legal Specialization as a Specialist in the areas of Tax Law and Estate Planning and Administration, she is a Fellow of the American College of Trust and Estate Counsel, and a co-author, beginning with 2010-2011 Supplement, of "Estate Planning in Louisiana" (Thomson West, 1991). Betty graduated from Louisiana State University's Paul M. Hebert Law Center and received her Master of Laws in Taxation from Southern Methodist University. Betty is a frequent presenter at CLE events, a former Chair of the Estate Planning Advisory Committee of the Louisiana Board of Legal Specialization, and former President of the Southwest Louisiana Bar Association. After relocating to New Orleans this year, she is still in search a Kiwanis Club in the Crescent City. Any suggestions would be welcome!

TYLER J. RENCH is a partner in the Litigation Practice Group. He focuses on defending class actions and civil RICO cases, and also handles oil and gas and banking disputes. Tyler has broad-based experience representing clients in federal and state courts, as well as in alternative dispute resolution. Before joining Jones Walker, Tyler worked at the US District Court for the Eastern District of Louisiana as an extern to the Honorable Sarah S. Vance. Additionally, he collaborated with Loyola College of Law Interim Dean, Kathryn Venturatos Lorio, on updating her Louisiana Civil Law Treatise on Successions and Donations. While in law school, Tyler was an oralist on Loyola's National Moot Court Team. Tyler is active in the Louisiana legal community and is involved in local non-profit and civic organizations.

LEON RITTENBERG III is a New Orleans native. He attended the Wharton School of Business of the University of Pennsylvania where he studied economics and graduated magna cum laude. He returned home to attend Tulane University School of Law where he graduated magna cum laude. Leon was a summer associate at the Internal Revenue Service's Office of Chief Counsel in Washington, D.C. and also served as a law clerk to the Honorable Will Garwood of the U.S. Fifth Circuit Court of Appeal. Leon joined the firm in 1994 and became a partner in 2000. His practice focuses on serving the needs of small and mid-sized businesses and their owners; including philanthropy and non-profit law, taxation, finance, private equity, estate planning, probate, real estate, mergers and acquisitions and related matters. Leon represents the interests of a number of private investors, oil service businesses, marine transportation companies and physician groups. He is a Board Certified Tax Specialist and Board Certified Estate Planning & Administration Specialist, as certified by the Louisiana Board of Legal Specialization. He frequently lectures in areas such as taxation, estate planning and maritime transactions. Leon is a Fellow of the American College of Tax Counsel. He has been recognized by Chambers USA (Louisiana Corporate/M&A: Tax section; 2017), Super Lawyers (Tax, Estate Planning & Probate and Business/Corporate) and Best Lawyers in America (Non-Profit/Charities Law and Trusts & Estates) since 2007, and by New Orleans Magazine as one of their "Top Lawyers of New Orleans" for his work in Equipment Finance Law, Mergers & Acquisitions Law and Tax Law. New Orleans City Business selected him for their Leadership in Law class of 2014, which "identifies and honors 50 outstanding legal professionals whose successes in law and contributions to the community have set the pace for the legal community." Leon is active in the New Orleans community, serving on the Boards and Executive Committees of numerous non-profit organizations. In 2015, he served as chairman of the Louisiana Board of Legal Specialization's Tax Law Advisory Committee. He enjoys spending time with his wife and three children.

JACOB CARTER WHITE is a partner at Ayres, Shelton, Williams, Benson & Paine, LLC in Shreveport and is engaged in a transaction-focused practice covering all facets of Louisiana and Texas business and estate planning and operations, from initial planning, structuring, and negotiation stages through closing, with an emphasis on federal income (including corporate and partnership), estate, and gift taxation. In addition to serving as general outside counsel for various businesses, representative matters include formation, amendment, governance, and recapitalization of various business entities; representation of both purchasers and sellers in taxable stock, membership interest, and asset sales and non-taxable mergers and reorganizations; tax free property exchanges; and structuring multi-tiered estate plans, integrating limited liability companies, family limited partnerships, trusts , and private non-profit foundations. In addition to his primary transactional practice, Jacob assists clients in Louisiana succession and ancillary succession proceedings, both complex and simple, and in litigation focusing on business and estate related matters, including contested succession, fiduciary, and commercial proceedings. Jacob has been listed in Super Lawyers® for Louisiana as a Rising Star for his practice in the field of tax law since 2018. Jacob is a Board Certified Tax Law Specialist by the Louisiana Board of Legal Specialization and currently serves as a member of the Tax Law Advisory Commission of the Louisiana Board of Legal Specialization. In 2008, Jacob received his undergraduate degree from Millsaps College in Jackson, Mississippi, where he obtained a Bachelor of Arts in History and Spanish, with a Concentration in American Studies. In 2011, Jacob graduated from the Louisiana State University Paul M. Hebert Law Center and was admitted to practice in Louisiana in 2011 and in Texas in 2013. Jacob received his LL.M. in Taxation from New York University School of Law in 2014.

DR. ANGELA WHITE-BAZILE is a graduate of University of Southwest Louisiana in Lafayette, Louisiana now known as University Louisiana at Lafayette. She received her juris doctorate from Southern University Law Center in Baton Rouge in 1996. She also received her Doctorate of Psychology & Counseling. Dr. Bazile has been a practicing attorney for over 20 years. She has held positions such as Judicial Law Clerk/Research Attorney for Civil District Court, the Fourth Circuit Court of Appeals, & the Louisiana Supreme Court; Associate Attorney; and a Professor of the law. She was an In-house counsel for Prudential Life Insurance in Jacksonville, Florida. She is a proud member of Delta Sigma Theta Sorority, Inc., New Orleans Alumnae Chapter. She is a member of various legal organizations, including but not limited to Louisiana State Bar Association, National Bar Association, American Bar Association, Louis Martinet Society, A.P. Tureaud Inns of Court, St. Tammany Parish Bar Association, National Association of Realtors, etc. Prior to being named the Executive Director of the Louisiana Judges and Lawyers Assistance Program, Dr. Bazile was the Executive Counsel to the Louisiana Supreme Court under the 25th Chief Justice, Chief Justice Bernette Joshua Johnson. She was the Secretary of the Louisiana Human Trafficking Prevention Commission and the Louisiana Judicial Liaison for human trafficking. She is a recipient of various awards: the 2020 National Bar Association's Hidden Figure Award; the 2018 Southern University Law School's Distinguished Alumna Award; and the 2017 Louisiana State Bar Association's President's Award. She has been a presenter for various Continuing Legal Education seminars and is a well-sought after motivational speaker.

JOSEPH T. WILSON is a business and trust and estates lawyer with a practice concentrated in the areas of estate planning and trust and estate administration, as well as real estate, finance and commercial transactions. Joe assists private clients and corporate fiduciaries with various estate planning and probate needs, including the drafting and administration of wills and trusts, and development and implementation of tax minimization plans. Joe further advises real estate clients, such as real estate holders, managers and developers, and manufacturing and industrial facilities owners and operators, in matters relating to the acquisition, development, leasing and sale of commercial real estate, including all associated title matters. Joe earned his undergraduate degree from the University of Dallas and J.D. from Louisiana State University's Paul M. Hebert Law Center.

Post-SECURE Act Estate Planning for Retirement Benefits in Trust (with Forms)

The 51st Annual Estate Planning Conference
November 18, 2021

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Post-SECURE Act Estate Planning for Retirement Benefits in Trust (with Forms)

By: Rebecca S. Luster Radford

I. Relevant Changes Under the SECURE Act for Inherited IRAs and Impact on Existing Law

a. Eligible Designated Beneficiary vs. Designated Beneficiary vs. Not a Designated Beneficiary

i. The Setting Every Community Up for Retirement Enhancement Act of 2019 ("**SECURE Act**") as incorporated in the Further Consolidated Appropriations Act, 2020 fundamentally changed the way inherited IRAs must be distributed after the death of the participant.

ii. Subsequent to the SECURE Act, for account holders that die after December 31, 2019, the recipient of the IRA[1] must be categorized into the following:

1. Not a designated beneficiary
2. Designated Beneficiary ("**DB**")
3. Eligible Designated Beneficiary ("**EDB**")

iii. In some cases, it must be determined whether the participant died before his required beginning date ("**RBD**") for required minimum distributions ("**RMD**").

1. Generally, a participant (other than a "5% owner" [See I.R.C. § 416]) in a qualified plan must begin to receive RMDs by the *later* of April 1 of the calendar year following:
   a. Either:
      i. the year in which the participant reaches age 70 ½ (if such participant attains the age of 70 ½ in or before 2019); or
      ii. the year in which the participant reaches age 72 (if such participant attains the age of 70 ½ in 2020 or later) or,
   b. The year in which the participant retires.

iv. If the beneficiary is not a Designated Beneficiary

1. The SECURE Act did not change the rules for those who do not qualify as a DB.

[1] The rules regarding IRAs also apply to other 401(k) plans, 403(b) plans & to some extent Roth IRA plans & some qualified defined contribution plans.

2. Look to whether or not the participant died before his RBD

   a. If the participant died before his RBD, then the 5-year rule of I.R.C. § 401(a)(9)(B)(ii) is applied by requiring the distribution of the participant's "entire…by the end of the calendar year which contains the fifth anniversary of the date of the [participant]'s death."[2] ("**5-Year Rule**")

   b. If the participant died on or after his RBD, then the benefits are distributed over the remaining life expectancy of the deceased participant.[3]

v. If the beneficiary is a Designated Beneficiary but not an Eligible Designated Beneficiary

1. I.R.C. § 401(a)(9)(E)(i): "The term "designated beneficiary" means any individual designated as a beneficiary by the employee."

2. All EDBs are DBs but not all DBs are EDBs.

3. There is no need to determine whether the participant died before his RBD if the beneficiary is a DB but not an EDB.

4. The 5-Year Rule was modified to create a 10-Year Rule pursuant to I.R.C. § 401(a)(9)(H)(i) for DBs that are not EDBs.

5. The distributions of the entirety of the interest of such DB must be made within *ten years* after the account holder's death ("**10-Year Rule**").[4]

6. We have limited guidance on this new 10-Year Rule (and on the impact of the SECURE Act generally); the IRS published Publication 590-B *Distributions from Individual Retirement Arrangements* (IRAs) on May 31, 2021, which provides a preview of what the regulations may ultimately include but is not law.[5] Publication 590-B clarified that:

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[2] Treas. Reg. § 1.401(a)(9)-3 A-2.
[3] Treas. Reg. § 1.401(a)(9)-5 A-5(a)(2) & (c)(3).
[4] I.R.C. § 401(a)(9)(H)(i).
[5] Natalie B. Choate, *Estate Planning for Retirement Benefits in a Post-SECURE World*, August 23, 2021, p. 6.

"The 10-year rule requires the IRA beneficiaries who are not taking life expectancy payments to withdraw the entire balance of the IRA by December 31 of the year containing the 10th anniversary of the owner's death. For example, if the owner died in 2020, the beneficiary would have to fully distribute the plan by December 31, 2030. The beneficiary is allowed, but not required, to take distributions prior to that date."

7. "For a beneficiary receiving life expectancy payments who is either an eligible designated beneficiary or a minor child, the 10-year rule also applies to the remaining amounts in the IRA upon the death of the eligible designated beneficiary or upon the minor child beneficiary reaching the age of majority, but in either of those cases, the 10-year period ends on the 10th anniversary of the beneficiary's death or the child's attainment of majority."[6]

8. The imposition of the 10-Year Rule has drastically reduced the attractiveness of holding retirement benefits in trust for DBs who are not EDBs, and particularly in conduit trusts which would require complete payout within 10 years for those DBs who are not EDBs.

vi. Eligible Designated Beneficiaries

1. There are **5 categories of EDBs** under pursuant to I.R.C. § 401(a)(9)(E), with such determination occurring as of the date of the account holder's death:
    a. The surviving spouse of the participant ("**Survivng Spouse**" or "**SS**");
    b. A child of the account holder who has not reached the age of majority ("**Non-Major Child**");
    c. a disabled beneficiary within the meaning of I.R.C. § 72(m)(7) ("**Disabled Individual**");
    d. a "chronically ill individual (within the meaning of [I.R.C. §] 7702B(c)(2), except that the requirements of subparagraph (A)(i) thereof shall only be treated as met if there is a certification that, as of such date, the period of inability described in such subparagraph with respect to the individual is an indefinite one which is reasonably expected to be lengthy in nature)"[7] ("**Chronically Ill Individual**")

[6] I.R.S. Publication 590-B, *Distributions from Individual Retirement Arrangements (IRAs)* (May 31, 2021), p. 11.
[7] I.R.C. § 401(a)(9)(E)(ii)(IV).

(EDBs under c and d are collectively referred to as "**Disabled or Chronically Ill**" or "**D/CI**" herein), and

e. an individual who is not more than 10 years younger than the participant ("**NoMoTTY**").

2. Pursuant to I.R.C. § 401(a)(9)(E)(ii), "the determination of whether a designated beneficiary is an eligible designated beneficiary shall be made as of the date of death of the employee."

3. Surviving Spouse of the participant as the named DB

   a. The SS's options for the Applicable Distribution Period:

      i. Spousal Rollover or Election to Treat IRA as Own: The Surviving Spouse may roll the benefits into their own IRA or (if an inherited IRA), elect to treat the inherited IRA as his or her own. This rule is unaffected by the SECURE Act.[8]

      ii. If the Surviving Spouse does not rollover the benefits or elect to treat the IRA as his or her own, then compare whether the participant reached his or her RBD:

         (1) If the participant died before his RBD, then Surviving Spouse can choose between:
            A. The special Surviving Spouse version of the life expectancy payout; or
            B. 10-Year Rule; or

         (2) If the participant died on or after his RBD, then the Surviving Spouse can choose between:
            A. The special Surviving Spouse version of the life expectancy payout; or

[8] Natalie B. Choate, *Estate Planning for Retirement Benefits in a Post-SECURE World*, August 23, 2021, p. 54; See I.R.S. Publication 590-B, *Distributions from Individual Retirement Arrangements (IRAs)* (May 31, 2021), (5/13/2021).

B. Life expectancy of the participant.

b. These options are not mutually exclusive, the Surviving Spouse could continue to hold the assets in the participant's account and then roll it over into her name after her RBD and may want to do so in instances where the Surviving Spouse is able to delay the RBD.

c. The special Surviving Spouse version of the life expectancy payout

i. Delayed commencement of RMDs: "if the owner died before the year in which he or she reached age 72 (age 70½ if the owner was born before July 1, 1949), distributions to the spouse don't need to begin until the year in which the owner would have reached age 72 (or age 70½, if applicable)"; if the Surviving Spouse dies before this date is reached, then the IRA is treated as if it were the owner of the IRA[9]; and

ii. The Applicable Distribution Period is based on the spouse's life expectancy, which is recalculated annually rather than a fixed term due to the usage of different tables for the surviving spouse.[10]

4. The Surviving Spouse generally has the best options subsequent to the SECURE Act and is the most favored DB or EDB.

vii. Non-Major Child of the participant as an eligible designated beneficiary

1. A Non-Major Child is an EDB until he or she reaches majority. Thereafter, the 10-Year Rule applies unless the Non-Major Child also qualifies as a Disabled or Chronically Ill Individual upon reaching majority. See I.R.C. § 401(a)(9)(E)(iii).

[9] I.R.S. Publication 590-B, *Distributions from Individual Retirement Arrangements (IRAs)* (May 31, 2021), p. 10.
[10] *Id.*, p. 11.

2. "For a beneficiary receiving life expectancy payments who is…a minor child, the 10-year rule also applies to the remaining amounts in the IRA…upon the minor child beneficiary reaching the age of majority, but…the 10-year period ends on the 10th anniversary of…the child's attainment of majority."[11]

3. We do not have a relevant definition of majority yet so the presumption is that state law applies currently.[12] Hopefully, the IRS will give guidance on this.

4. In Louisiana, majority is attained at the age of 18.

5. To determine the Applicable Distribution Period:

    a. If participant died before RBD, then either:
        i. Life expectancy payout until Non-Major Child reaches majority and then 10-Year Rule; or
        ii. Elect 10-Year Rule

    b. If participant dies on or after RBD, then life expectancy payout until Non-Major Child reaches majority and then 10-Year Rule.

viii. Disabled individuals and chronically ill individuals as an eligible designated beneficiary

1. Disabled individuals and chronically ill individuals are technically two separate categories of EDBs; however, the distribution rules are the same for both and both are entitled to the use of a special type of accumulation trust after the SECURE Act so we are addressing them simultaneously herein.

2. Pursuant to I.R.C. § 72(m)(7), "an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration."

[11] *Id.*at p. 11.
[12] *See* Natalie B. Choate, *Estate Planning for Retirement Benefits in a Post-SECURE World* (8/23/2021), p. 56.

3. A recipient of social security disability is considered a disabled individual and thus an EDB.[13]

4. The definition of "chronically ill individual" under I.R.C. § 7702B(c)(2) is used in the long-term care provisions of the Health Insurance Act.

5. With regard to the definition of a chronically ill individual, I.R.C. § 7702B(c)(2), with the additional requirement noted in I.R.C. § 401(a)(9)(E)(ii)(IV) provides as follows:

> "(c) Qualified long-term care services.--…
> (2) Chronically ill individual.—
>
> (A) In general.--The term "chronically ill individual" means any individual who has been certified by a licensed health care practitioner as--
>
> > (i) being unable to perform (without substantial assistance from another individual) at least 2 activities of daily living for a period of at least 90 days due to a loss of functional capacity) [with, as noted in I.R.C. § 401(a)(9)(E)(ii)(IV), 'the requirements of [this] subparagraph (A)(i)…only…treated as met if there is a certification that, as of such date, the period of inability described in such subparagraph with respect to the individual is an *indefinite one which is reasonably expected to be lengthy in nature*'],
> > (ii) having a level of disability similar (as determined under regulations prescribed by the Secretary in consultation with the Secretary of Health and Human Services) to the level of disability described in clause (i), or
> > (iii) requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment.
>
> Such term shall not include any individual otherwise meeting the requirements of the preceding sentence unless *within the preceding 12-month period a licensed health care practitioner has certified that such individual meets such requirements*.

[13] *Id.*, p. 57.

(B) Activities of daily living.--For purposes of subparagraph (A), each of the following is an activity of daily living:

(i) Eating.
(ii) Toileting.
(iii) Transferring.
(iv) Bathing.
(v) Dressing.
(vi) Continence."

6. To determine the Applicable Distribution Period:

    a. If participant died before RBD, then either:
        i. Life expectancy payout; or
        ii. Elect 10-Year Rule

    b. If participant dies on or after RBD, then either:
        i. Life expectancy payout of the Disabled or Chronically Ill Individual or;
        ii. Life expectancy payout of the participant.

ix. An individual who is not more than 10 years younger than the account holder as an eligible designated beneficiary

1. I.R.C. § 401(a)(9)(E)(ii)(V) provides that a designated beneficiary that is "an individual who is not more than 10 years younger than the account holder" is an EDB.

2. To determine the Applicable Distribution Period:

    a. If participant died before the participant's RBD, then either:
        i. Life expectancy payout of the NoMoTTY; or
        ii. Elect 10-Year Rule

    b. If participant dies on or after the participant's RBD, then either:
        i. Life expectancy payout of the NoMoTTY or;
        ii. Life expectancy payout of the participant.

II. Is a trust appropriate under your circumstances?

Trusts are not appropriate vehicles for holding retirement benefits in every situation, particularly subsequent to the SECURE Act with the imposition of more limited circumstances when a beneficiary will be able to hold assets in trust for more than five or ten years beyond December 31 of the year of the participant's death (depending on the type of trust and its terms).

Due to the shortened time period for distributions that may be required both from the IRA and from the trust itself (depending on the type of the trust), the tax implications of holding assets in trust, particularly if there are sizable distributions, and the administrative costs associated with a trust must be more carefully considered post-SECURE Act.

In order to maintain the advantages of holding funds in retirement benefit accounts, trusts must be carefully crafted. For example, factors such as the type and age of beneficiary, the status as a designated beneficiary or as an eligible designated beneficiary, the maturity of the beneficiary with regard to handling funds, the value of the retirement benefits and income tax implications must be taken into consideration.

In particular, the "rollover" allowed to a surviving spouse is not allowed if the benefits are held in trust.

a. Alternatives

There are alternatives to holding retirement benefits in trust, some of which may achieve some or all of your client's goals:

i. Individual Retirement Trusts (also known as Trusteed IRAs)

1. An individual retirement trust is a trust in compliance with I.R.C. § 408(a). In the case of trusteed IRAs, the IRA *is* the trust.

2. The function of an individual retirement trust is to combine the substantive terms of a trust with the tax characteristics of a traditional or Roth IRA.[14]

3. I.R.S. Form 5305 may be used as a basis for drafting a Traditional Individual Retirement Trust Account. I.R.S. Form 5305-R may be used as a basis for drafting a Roth Individual Retirement Trust Account.

[14] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE* (8/31/2021), p. 18; Natalie B. Choate, *Life and Death Planning for Retirement Benefits*, Ataxplan Publications, Boston, MA (7th Ed. 2011), p. 407.

ii. IRA Annuity with restricted payout options

Certain IRA companies will allow you to include a provision in the contract that restricts distributions after the participant's death to Required Minimum Distributions.[15]

iii. Designate beneficiary outright

If you intend for the beneficiary to receive all current distributions and trust the beneficiary not to cash in the retirement benefits early, it may be advisable to designate the individual as the beneficiary rather than a trust for his or her benefit.

This option is increasingly more attractive subsequent to the SECURE Act.

A life insurance policy may be better suited for satisfying your client's goals with the retirement benefits paid to an EDB or charity.

III. What type of trust is appropriate for your client?

If you have decided that a trust is appropriate for your client, the next step is to determine which type of trust is appropriate to achieve your clients' goals.

a. What are your client's goals?

Discuss in detail what your client hopes to achieve with his retirement benefits and whether his retirement benefits are appropriate vehicles for achieving these goals.

b. Who does your client want the retirement benefits to benefit?

i. An EDB?

1. A surviving spouse?

2. A Non-Major?

3. A Disabled or chronically ill individual?

4. A NoMoTTY?

ii. Younger individuals?

iii. A charity?

[15] Edwin P. Morrow, III, *How to Draft IRA Trusts*, National Business Institute (May 7, 2015).

iv. A mix between the surviving spouse, younger individuals, and/or a charity?

c. What is the maturity level of the proposed beneficiaries? Are they able to handle funds?

d. Are the retirement benefits Roth or traditional? Is its tax status suitable for achieving your client's goals or would other sources of funds be more suitable?

Work in tandem with a financial advisor regarding the investments put into the trust to ensure that they are compatible.

e. Has your client reached the RBD for distributions?

f. For what purposes are the funds to be used? Do you want a lump sum payment or to stretch out the payments for deferral to the extent possible subsequent to the SECURE Act?

If your client wants a lump sum payment, then any of the trust methods will work.

If the trust is the beneficiary but does not meet the requirements to be a see-through trust, the Applicable Distribution Period for the retirement benefits will be those discussed above in Section (I)(a)(iv) when a Beneficiary is not a Designated Beneficiary.

The determination of whether a trust beneficiary is a designated beneficiary, an eligible designated beneficiary, and what type of eligible designated beneficiary, is key in determining your client's preferred option under the particular circumstances.

Generally, only individuals may be designated beneficiaries.[16] However, if a trust qualifies as a see-through trust, the trust may be listed as the beneficiary and the beneficiaries of the trust will be treated as having been designated beneficiaries or eligible designated beneficiaries for purposes of determining the distribution period under the Minimum Distribution Rules discussed below.[17]

[16] Treas. Reg. § 1.401(a)(9)-4 A-3.
[17] Treas. Reg. § 1.401(a)(9)-4 A-5(a). Note that Treasury Regulations have not been released subsequent to the SECURE Act and thus, existing Treasury Regulations must be analyzed to determine whether they continue to be applicable or whether they are no longer correct subsequent to the SECURE Act.

If the trust qualifies as a see-through trust, the Applicable Distribution Period will be determined in accordance with the type of beneficiary of the trust and thus the applicable set of Applicable Distribution Period Rules.

The application of the requirements in order for the trust to qualify as a see-through trust is vital for achieving your client's desired effect. ***Merely following a form will not ensure that trust is properly drafted***.

g. Types of trusts

i. See-through trusts: See-through trusts satisfy the 5 requirements discussed below.

ii. Non-see-through trusts: Non-see-through trusts or nonqualified trusts are any trusts that are not see-through trusts.

h. Types of see-through trusts

Practitioners divide see-through trusts into two types:

i. Conduit Trusts; and

ii. Accumulation Trusts.

IV. See-through trust requirements

In order to determine whether a trust qualifies as a see-through trust, five requirements must be satisfied.

a. First four requirements

Treas. Reg. § 1.401(a)(9)-4, A-5(b) contains the first four requirements for a see-through trust:

> (1) The trust is a valid trust under state law, or would be but for the fact that there is no corpus.
>
> (2) The trust is irrevocable or will, by its terms, become irrevocable upon the death of the [participant].
>
> (3) The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the [participant]'s benefit are identifiable within the meaning of A–1 of [Treas. Reg. § 1.401(a)(9)–4] *from the trust instrument*.

(4) The documentation described in A–6 of [Treas. Reg. § 1.401(a)(9)–4] has been provided to the plan administrator. [18]

b. Fifth requirement

Natalie Choate adds a fifth requirement to ensure that the beneficiaries of the trust would qualify as Designated Beneficiaries themselves:

(5) "All trust beneficiaries must be individuals."[19]

c. Date of application of requirements

There are three main dates to remember as deadlines for the satisfaction of these requirements:

i. Date of death of participant

The trust must be valid under state law, with the exception of funding, at this date.

The trust must be irrevocable at this point.

An individual must be a beneficiary as of this date to qualify as a designated beneficiary.

ii. September 30 of the calendar year following the calendar year of the participant's death

[18] Treas. Reg. § 1.401(a)(9)-4, Q & A–5(a) provides:

> Q-5. If a trust is named as a beneficiary of [a participant], will the beneficiaries of the trust with respect to the trust's interest in the [participant]'s benefit be treated as having been designated as beneficiaries of the [participant] under the plan for purposes of determining the distribution period under section 401(a)(9)?
>
> A–5. (a) If the requirements of paragraph (b) of this A–5 are met with respect to a trust that is named as the beneficiary of an [participant] under the plan, the beneficiaries of the trust (and not the trust itself) will be treated as having been designated as beneficiaries of the [participant] under the plan for purposes of determining the distribution period under section 401(a)(9).
>
> (b) The requirements of this paragraph (b) are met if, during any period during which required minimum distributions are being determined by treating the beneficiaries of the trust as designated beneficiaries of the [participant], the following requirements are met—[SEE 4 REQUIREMENTS ABOVE]

[19] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE* (8/31/2021), p. 23; Natalie B. Choate, *Life and Death Planning for Retirement Benefits*, Ataxplan Publications, Boston, MA (7th Ed. 2011).

This is the Beneficiary Finalization Date—the date at which the beneficiaries of the trust must be finalized for purposes of applying these requirements.

Treas. Reg. § 1.401(a)(9)-4, Q & A-4 provides as follows:

> Q–4. When is the designated beneficiary determined?
>
> A–4. (a) General rule. In order to be a designated beneficiary, an individual must be a beneficiary as of the date of death. Except as provided in paragraph (b) and § 1.401(a)(9)–6, the [participant]'s designated beneficiary will be determined based on the beneficiaries designated as of the date of death who **remain beneficiaries as of September 30 of the calendar year following the calendar year of the [participant]'s death**. Consequently, except as provided in § 1.401(a)(9)–6, any person who was a beneficiary as of the date of the [participant]'s death, but is not a beneficiary as of that September 30 (e.g., because the person receives the entire benefit to which the person is entitled before that September 30), is not taken into account in determining the [participant]'s designated beneficiary for purposes of determining the distribution period for required minimum distributions after the [participant]'s death. Accordingly, if a person disclaims entitlement to the [participant]'s benefit, pursuant to a disclaimer that satisfies section 2518 by that September 30 thereby allowing other beneficiaries to receive the benefit in lieu of that person, the disclaiming person is not taken into account in determining the [participant]'s designated beneficiary.
>
> (Emphasis added).

iii. October 31 of the calendar year immediately following the calendar year in which the participant died

The trustee must turn in the paperwork required to the plan administrator by this date.

Treas. Reg. § 1.401(a)(9)–4, A-6(b) provides:

> (b) Required minimum distributions after death. In order to satisfy the documentation requirement of this A–6 for required minimum distributions after the death of the [participant] (or spouse in a case to which A–5 of § 1.401(a)(9)–3 applies), **by October 31 of the calendar year**

> **immediately following the calendar year in which the [participant] died**, the trustee of the trust must [turn in the required paperwork.]
>
> (Emphasis added).

d. Easier requirements to apply

i. Application of Requirement 1

The first requirement is relatively straight forward. It must be determined whether the trust at issue either:

(1) is valid under state law or
(2) would be valid under state law but for the fact that there is no corpus.

ii. Application of Requirement 2

The second requirement is also easily achieved if the participant is the settlor of the trust. It requires that the trust either (1) is irrevocable or (2) will, by its terms, become irrevocable upon the death of the participant.

Louisiana Trust Code § 2041 provides the general rule that:

> Except as otherwise provided in this [Trust] Code, a settlor may revoke a trust in whole or in part *only if* he has reserved the right to revoke the trust or an unrestricted right to modify the trust.
>
> (Emphasis added).[20]

Thus, the default rule is that trusts are irrevocable in Louisiana, except where the Louisiana Trust Code provides otherwise.

Furthermore, in Louisiana, trusts automatically become irrevocable upon the death of the settlor.[21]

However, it may be wise to include language in the trust document providing that the trust is irrevocable or will become irrevocable at the death of the settlor/participant.

[20] The Louisiana Trust Code is located in Title 9 of the Louisiana Revised Statutes.
[21] See Louisiana Trust Code § 2021, et. seq.

iii. Application of Requirement 4

The fourth requirement states that the documentation described in A–6 of Treas. Reg. § 1.401(a)(9)–4 be provided to the plan administrator.

Treas. Reg. § 1.401(a)(9)–4, Q & A-6(a)-(b) provides:

> Q–6. If a trust is named as a beneficiary of an [participant], what documentation must be provided to the plan administrator?
>
> A–6. (a) Required minimum distributions before death. If an [participant] designates a trust as the beneficiary of his or her entire benefit and the [participant]'s spouse is the sole beneficiary of the trust, in order to satisfy the documentation requirements of this A–6 so that the spouse can be treated as the sole designated beneficiary of the [participant]'s benefits (if the other requirements of paragraph (b) of A–5 of this section are satisfied), the [participant] must either—
>
>> (1) Provide to the plan administrator a copy of the trust instrument and agree that if the trust instrument is amended at any time in the future, the [participant] will, within a reasonable time, provide to the plan administrator a copy of each such amendment; or
>>
>> (2) Provide to the plan administrator a list of all of the beneficiaries of the trust (including contingent and remaindermen beneficiaries with a description of the conditions on their entitlement sufficient to establish that the spouse is the sole beneficiary) for purposes of section 401(a)(9); certify that, to the best of the [participant]'s knowledge, this list is correct and complete and that the requirements of paragraph (b)(1), (2), and (3) of A–5 of this section are satisfied; agree that, if the trust instrument is amended at any time in the future, the [participant] will, within a reasonable time, provide to the plan administrator corrected certifications to the extent that the amendment changes any information previously certified; and agree to provide a copy of the trust instrument to the plan administrator upon demand.
>
> (b) Required minimum distributions after death. In order to satisfy the documentation requirement of this A–6 for

required minimum distributions after the death of the [participant] (or spouse in a case to which A–5 of § 1.401(a)(9)–3 applies), **by October 31 of the calendar year immediately following the calendar year in which the [participant] died**, the trustee of the trust must either—

(1) Provide the plan administrator with a final list of all beneficiaries of the trust (including contingent and remaindermen beneficiaries with a description of the conditions on their entitlement) as of September 30 of the calendar year following the calendar year of the [participant]'s death; certify that, to the best of the trustee's knowledge, this list is correct and complete and that the requirements of paragraph (b)(1), (2), and (3) of A–5 of this section[, which are Requirements 1, 2, and 3,] are satisfied; and agree to provide a copy of the trust instrument to the plan administrator upon demand; or

(2) Provide the plan administrator with a copy of the actual trust document for the trust that is named as a beneficiary of the [participant] under the plan as of the [participant]'s date of death.

(Emphasis added).

e. More complicated requirements to apply:

Requirements 3 and 5 are more complicated to apply than Requirements 1, 2, and 4. Both involve addressing the identity of the beneficiaries of the trust.

i. Application of Requirement 3

Requirement 3 provides as follows:

The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the [participant]'s benefit are identifiable within the meaning of A–1 of this section from the trust instrument.[22]

Treas. Reg. § 1.401(a)(9)-4, Q & A-1 provides:

Q–1. Who is a designated beneficiary under section 401(a)(9)(E) ?

[22] Treas. Reg. § 1.401(a)(9)-4, Q & A–5(b)(3).

> A–1. A designated beneficiary is an individual who is designated as a beneficiary under the plan. An individual may be designated as a beneficiary under the plan either by the terms of the plan or, if the plan so provides, by an affirmative election by the [participant] (or the [participant]'s surviving spouse) specifying the beneficiary. A beneficiary designated as such under the plan is an individual who is entitled to a portion of an [participant]'s benefit, contingent on the [participant]'s death or another specified event. For example, if a distribution is in the form of a joint and survivor annuity over the life of the [participant] and another individual, the plan does not satisfy section 401(a)(9) unless such other individual is a designated beneficiary under the plan. A designated beneficiary need not be specified by name in the plan or by the [participant] to the plan in order to be a designated beneficiary so long as the individual who is to be the beneficiary is identifiable under the plan. The members of a class of beneficiaries capable of expansion or contraction will be treated as being identifiable if it is possible, to identify the class member with the shortest life expectancy. The fact that an [participant]'s interest under the plan passes to a certain individual under a will or otherwise under applicable state law does not make that individual a designated beneficiary unless the individual is designated as a beneficiary under the plan.

This test is applied on the date of death; however, if it is not satisfied at that time, it may be remedied (if possible) prior to the Beneficiary Finalization Date.

The I.R.S. has expressed this requirement, as combined with the fifth requirement, as follows:

> Finally, the identities of the beneficiaries of Trust T, each of whom is a human being, may be determined by perusing its terms.[23]

More commonly, it has described this requirement as follows:

> Finally, the identities of the beneficiaries of Trust T may be determined by perusing its terms.[24]

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[23] I.R.S. Priv. Ltr. Rul. 200708084 (Feb. 23, 2007).
[24] I.R.S. Priv. Ltr. Rul. 200620026 (May 19, 2006).

If the trust is valid under Louisiana law, it should satisfy this requirement. Louisiana Trust Code § 1802 provides that:

> A beneficiary must be designated in the trust instrument, except as otherwise provided in this [Trust] Code. The designation is sufficient if the identity of the beneficiary is objectively ascertainable solely from standards stated in the trust instrument.

Louisiana Trust Code § 2011, in relevant part, provides as follows:

> A revocable trust instrument need not designate the beneficiaries upon the creation of the trust but may instead provide a method whereby they are determined at a later date, but *no later than the date when the trust becomes irrevocable*. A beneficiary thus determined may be a person who is not in being when the trust is created, as long as he is in being when the beneficiaries are determined.
>
> (Emphasis added).

ii. Application of Requirement 5

Requirement 5 provides that all trust beneficiaries must be individuals.

Choate bases this requirement on the necessity of the beneficiaries of the trust to qualify as Designated Beneficiaries, enabling the trust to base the Applicable Distribution Period on their life expectancy.

I.R.C. § 409(a)(9)(E) provides as follows:

> (a) Requirements for qualification.--A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his [participant]s or their beneficiaries shall constitute a qualified trust under this section--
> (9) Required distributions.—
> (E) Designated beneficiary.--For purposes of this paragraph, the term "designated beneficiary" means any ***individual*** designated as a beneficiary by the [participant].

As noted in Section III(e)(i) of these materials, Treas. Reg. § 1.401(a)(9)-4, Q & A-1 delves further into this definition but maintains the requirement that a Designated Beneficiary be an individual.

Treas. Reg. § 1.401(a)(9)-4 Q & A-3 provides the following:

> Q–3. May a person other than an individual be considered to be a designated beneficiary for purposes of section 401(a)(9)?
>
> A–3. No, only individuals may be designated beneficiaries for purposes of section 401(a)(9). A person that is not an individual, such as the [participant]'s estate, may not be a designated beneficiary. If a person other than an individual is designated as a beneficiary of an employee's benefit, the employee will be treated as having no designated beneficiary for purposes of section 401(a)(9), even if there are also individuals designated as beneficiaries.

f. Which beneficiaries are tested?

i. This inquiry is where the application of Requirements 3 & 5 become more difficult—which trust beneficiaries "count" for purposes of this requirement?

ii. The wording of the regulations indicates that if the trust agreement specifies that only certain beneficiaries receive the retirement benefits, these beneficiaries "with respect to the trust's interest in the benefits" are the beneficiaries that "count."[25]

iii. If a subtrust under a funding trust is to hold the assets, it would be wise to name the subtrust as the Designated Beneficiary, rather than the funding trust to avoid any confusion as to which beneficiaries "count."[26]

iv. Treas. Reg. § 1.401(a)(9)-4, A-1, in relevant part details a couple ways to remove beneficiaries from "counting" as a Designated Beneficiary:

> Consequently, except as provided in § 1.401(a)(9)–6, any person who was a beneficiary as of the date of the [participant]'s death, but is not a beneficiary as of that September 30 (**e.g., because the person receives the entire benefit to which the person is entitled before that September 30**), is not taken into account in determining the

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[25] Natalie B. Choate, *Life and Death Planning for Retirement Benefits*, Ataxplan Publications, Boston, MA (7^{th} Ed. 2011), p. 424.
[26] Natalie B. Choate, *Life and Death Planning for Retirement Benefits*, Ataxplan Publications, Boston, MA (7^{th} Ed. 2011), p. 425.

[participant]'s designated beneficiary for purposes of determining the distribution period for required minimum distributions after the [participant]'s death. Accordingly, if a person **disclaims entitlement to the [participant]'s benefit, pursuant to a disclaimer that satisfies section 2518** by that September 30 thereby allowing other beneficiaries to receive the benefit in lieu of that person, the disclaiming person is not taken into account in determining the [participant]'s designated beneficiary.

v. Thus, a qualified disclaimer prior to the Beneficiary Finalization Date is one way to remove beneficiaries for purposes of qualifying as a Designated Beneficiary under these rules.

vi. Another method of removing unfavorable beneficiaries is to distribute assets *prior to the Beneficiary Finalization Date* under one of three methods:

1. Distribute the benefits to which he is entitled to the beneficiary you seek to remove from the beneficiaries.

2. Distribute assets other than the retirement benefits to the unfavorable beneficiary as his share of the trust.

3. Transfer the retirement benefits to the beneficiaries out of the trust.[27]

V. Conduit trusts

a. Definition of conduit trust

"Under a conduit trust, the trustee is required, by the terms of the governing instrument, to distribute to the individual trust beneficiary any distribution the trustee receives from the retirement plan (1) after the participant's death and (2) during the lifetime of such beneficiary. The trustee has no power to retain inside the trust ("accumulate," in IRS terminology) *any* plan distribution that is made after the donor's death during the lifetime of the individual conduit beneficiary."[28]

b. Example

[27] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE* (8/31/2021), p. 18; Natalie B. Choate, *Life and Death Planning for Retirement Benefits*, Ataxplan Publications, Boston, MA (7th Ed. 2011), pp. 430-431.

[28] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE*, (8/31/2021), p. 41; Natalie B. Choate, *Life and Death Planning for Retirement Benefits*, Ataxplan Publications, Boston, MA (7th Ed. 2011), pp. 433-434.

Treas. Reg. § 1.401(a)(9)-5, a-7(c)(3), Ex. 2 provides the following example of a conduit trust:

> **Example 2.** (i) The facts are the same as Example 1 except that the testamentary trust instrument provides that all amounts distributed from A's account in Plan X to the trustee while B is alive will be paid directly to B upon receipt by the trustee of Trust P. [Employer M maintains a defined contribution plan, Plan X. Employee A, an employee of M, died in 2005 at the age of 55, survived by spouse, B, who was 50 years old. Prior to A's death, M had established an account balance for A in Plan X. A's account balance is invested only in productive assets. A named a testamentary trust (Trust P) established under A's will as the beneficiary of all amounts payable from A's account in Plan X after A's death. A copy of the Trust P and a list of the trust beneficiaries were provided to the plan administrator of Plan X by October 31 of the calendar year following the calendar year of A's death. As of the date of A's death, the Trust P was irrevocable and was a valid trust under the laws of the state of A's domicile. A's account balance in Plan X was includible in A's gross estate under § 2039… Under the terms of Trust P, all trust income is payable annually to B, and no one has the power to appoint Trust P principal to any person other than B. A's children, who are all younger than B, are the sole remainder beneficiaries of the Trust P.]
>
> (ii) In this case, ***B is the sole designated beneficiary*** of A's account in Plan X for purposes of determining the designated beneficiary under section 401(a)(9)(B)(iii) and (iv). No amounts distributed from A's account in Plan X to Trust P are accumulated in Trust P during B's lifetime for the benefit of any other beneficiary. Therefore, ***the residuary beneficiaries of Trust P are mere potential successors*** to B's interest in Plan X. Because B is the sole beneficiary of the testamentary trust's interest in A's account in Plan X, the annual required minimum distributions from A's account to Trust P must begin no later than the end of the calendar year in which A would have attained age 70 ½, rather than the calendar year immediately following the calendar year of A's death.
>
> (Emphasis added).

c. While a conduit trust drafted for one individual beneficiary is a safe harbor, to create a conduit trust with multiple beneficiaries, Choate maintains that the following additional requirements must be satisfied:

i. All distributions the trust receives from the retirement plan must be immediately paid out to one or more of the conduit beneficiaries; and

ii. As long as *any member* of the conduit group is living, no plan distributions can be accumulated in the trust for possible distribution to *other* beneficiaries.[29]

VI. Accumulation trusts

a. Definition of accumulation trusts

Choate defines an accumulation trust as “[a]ny trust that is not a conduit trust…meaning that the trustee has the power to accumulate plan distributions in the trust. Under an accumulation trust (except, possibly, in the case of a 100% grantor trust…) some or all of the potential remainder beneficiaries *do* ‘count’ (i.e. they are not disregarded) for purposes of the [Minimum Required Distribution] trust rules…

While a conduit trust is guaranteed to pass the IRS trust rules, an accumulation trust may or may not pass the trust rules.”[30]

b. Example

Treas. Reg. § 1.401(a)(9)-5(c)(3), Ex. 1 offers an example of an accumulation trust:

> **Example 1.** (i) Employer M maintains a defined contribution plan, Plan X. Employee A, an employee of M, died in 2005 at the age of 55, survived by spouse, B, who was 50 years old. Prior to A's death, M had established an account balance for A in Plan X. A's account balance is invested only in productive assets. A named a testamentary trust (Trust P) established under A's will as the beneficiary of all amounts payable from A's account in Plan X after A's death. A copy of the Trust P and a list of the trust beneficiaries were provided to the plan administrator of Plan X by October 31 of the calendar year following the calendar year of A's death. As of the date of A's death, the Trust P was irrevocable and was a valid trust under the laws of the state of A's domicile. A's account balance in Plan X was includible in A's gross estate under § 2039.
>
> (ii) Under the terms of Trust P, all trust income is payable annually to B, and no one has the power to appoint Trust P principal to any person

[29] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE* (8/31/2021), pp. 42 & 44; Natalie B. Choate, *Life and Death Planning for Retirement Benefits*, Ataxplan Publications, Boston, MA (7th Ed. 2011), p. 438.
[30] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE*, (8/31/2021), p. 45.

other than B. A's children, who are all younger than B, are the sole remainder beneficiaries of the Trust P. No other person has a beneficial interest in Trust P. Under the terms of the Trust P, B has the power, exercisable annually, to compel the trustee to withdraw from A's account balance in Plan X an amount equal to the income earned on the assets held in A's account in Plan X during the calendar year and to distribute that amount through Trust P to B. Plan X contains no prohibition on withdrawal from A's account of amounts in excess of the annual required minimum distributions under section 401(a)(9). In accordance with the terms of Plan X, the trustee of Trust P elects, in order to satisfy section 401(a)(9), to receive annual required minimum distributions using the life expectancy rule in section 401(a)(9)(B)(iii) for distributions over a distribution period equal to B's life expectancy. If B exercises the withdrawal power, the trustee must withdraw from A's account under Plan X the greater of the amount of income earned in the account during the calendar year or the required minimum distribution. However, under the terms of Trust P, and applicable state law, only the portion of the Plan X distribution received by the trustee equal to the income earned by A's account in Plan X is required to be distributed to B (along with any other trust income.)

(iii) Because some amounts distributed from A's account in Plan X to Trust P may be accumulated in Trust P during B's lifetime for the benefit of A's children, as remaindermen beneficiaries of Trust P, even though access to those amounts are delayed until after B's death, A's children are beneficiaries of A's account in Plan X in addition to B and B is not the sole designated beneficiary of A's account. Thus the designated beneficiary used to determine the distribution period from A's account in Plan X is the beneficiary with the shortest life expectancy. B's life expectancy is the shortest of all the potential beneficiaries of the testamentary trust's interest in A's account in Plan X (including remainder beneficiaries). Thus, the distribution period for purposes of section 401(a)(9)(B)(iii) is B's life expectancy. Because B is not the sole designated beneficiary of the testamentary trust's interest in A's account in Plan X, the special rule in 401(a)(9)(B)(iv) is not available and the annual required minimum distributions from the account to Trust M must begin no later than the end of the calendar year immediately following the calendar year of A's death.

c. Three types of accumulation trusts

Choate discusses three types of accumulation trusts:

i. See Through Accumulation Trusts ("**STAT**"):

1. Choate summarizes the approach utilized in I.R.S. Priv. Ltr. Rul. 2004-38044 (Sept. 17, 2004) in testing the trust's beneficiaries as follows:

> [Y]ou test an accumulation trust by "counting" all successive beneficiaries down the 'chain' of potential beneficiaries who could take under the trust, until you come to the beneficiary(ies) who or which will be entitled to receive the trust property *immediately* and *outright* upon the death of the prior beneficiary(ies). That "immediate outright" person, entity, or group is (or are) the last beneficiaries in the "chain" that you need to consider. If the immediate outright beneficiary(ies), and all prior beneficiaries in the 'chain,' are individuals, then the trust qualifies as a see-through trust, with the life expectancy of the oldest member of that group serving as the [Applicable Distribution Period]. Any beneficiary who might receive the benefits as a result of the death(s) of the immediate outright beneficiary(ies) is ignored as a 'mere potential successor.'
>
> These tests are applied at the time of the participant's death, 'as if' the first trust beneficiary died immediately after the participant, and the next beneficiary died immediately after the first beneficiary, and so on until you reach the first 'immediate outright' beneficiary, where you stop.
>
> The tests are *not* re-applied at the later actual death of any beneficiary. It makes not difference who *in fact* inherits the benefits when the first beneficiary later dies. Rather, the "snapshot" of beneficiaries is taken once and only once, at the time of the participant's death, based on the identities of beneficiaries *who actually survived the participant* and on the *hypothetical death of each of these beneficiaries* immediately after the participant's death or immediately after the death of the prior beneficiary of the "chain."[31]

2. Unborn issue are not counted.

[31] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE*, (8/31/2021), p. 47.

3. The SECURE Act has removed the necessity for finding *younger* principal beneficiaries to avoid shortening the applicable distribution period for those accumulation trusts that are now subject to the 10-Year Rule; now the focus under such circumstances is on finding an individual principal beneficiary.[32]

4. Applicable Multi-Beneficiary Trust ("**AMBT**")

   a. The SECURE Act added special provisions for disabled or chronically ill individuals who qualify as EDBs which allows for the use of a STAT with special provisions.

   b. I.R.C. § 401(a)(9)(H)(iv)-(v) defines an AMBT as follows:

      i. (v) Applicable multi-beneficiary trust.--For purposes of this subparagraph, the term "applicable multi-beneficiary trust" means a trust--

         (I) which has **more than one beneficiary**,
         (II) all of the beneficiaries of which are treated as **designated beneficiaries** for purposes of determining the distribution period pursuant to this paragraph, and
         (III) **at least one of the beneficiaries** of which is **[a disabled or chronically ill] eligible designated beneficiary** described in subclause (III) or (IV) of subparagraph (E)(ii).

      (Emphasis added).

   c. I.R.C. § 401(a)(9)(H)(iv) provides:

      (iv) Special rule in case of certain trusts for disabled or chronically ill beneficiaries.--In the case of an applicable multi-beneficiary trust, if under the terms of the trust—

         (I) it is to be **divided immediately upon the death of the employee**

[32] *Id.*

into separate trusts for each beneficiary, or

(II) no individual (other than a [a disabled or chronically ill] eligible designated beneficiary described in subclause (III) or (IV) of subparagraph (E)(ii)) has any right to the employee's interest in the plan until the death of all such eligible designated beneficiaries with respect to the trust,

for purposes of a trust described in subclause (I), clause (ii) [regarding an EDB's exception from the 10-Year Rule] shall be applied separately with respect to the portion of the employee's interest that is payable to any [disabled or chronically ill] eligible designated beneficiary described in subclause (III) or (IV) of subparagraph (E)(ii); and, for purposes of a trust described in subclause (II), subparagraph (B)(iii) [regarding the exception to the 5-Year Rule for amounts payable to a Designated Beneficiary] shall apply to the distribution of the employee's interest and any beneficiary who is not such an eligible designated beneficiary shall be treated as a beneficiary of the eligible designated beneficiary upon the death of such eligible designated beneficiary.

(Emphasis added).

d. Note that the provisions state that it qualifies for the life expectancy payout—but the party upon whose life expectancy it is based is not clarified. Hopefully, the IRS will issue guidance on this but in the interim, should you draft an AMBT, it is advisable to select principal beneficiaries that are not significantly older older than the disabled or chronically ill individual.[33]

e. These provisions allow for a special needs trust to be crafted to hold retirement benefits with accumulation of income in an AMBT but still receive the preferential ADP for a disabled or chronically ill individual that is an EDB.

f. Do not include a provision that would terminate the trust if the AMBT causes the disabled or chronically ill individual to lose his or her benefits. This would cause the trust to flunk the test outlined in I.R.C. § 409(a).[34]

ii. "Circle" Trust

1. Also known as the "last man standing approach"

2. A "circle trust" is a trust that is drafted in a way so that there are no beneficiaries that you need to disregard.

3. This type of trust includes an accelerated termination *if* only one member of the beneficiaries survives the others and provides immediate outright distribution to that individual.[35]

iii. Grantor Trust

1. The trust may be a grantor trust as to the beneficiary for purposes of federal income tax under I.R.C. § 678(a)(1).

2. In theory, the retirement benefits should be deemed paid to that beneficiary for purposes of applying these requirements.[36]

d. Implications of Louisiana law

Louisiana law includes restrictions regarding substitute beneficiaries that should be taken into consideration when applying

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[33] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE*, (8/31/2021), p. 59.
[34] *Id.*
[35] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE* (8/31/2021), p. 49; Natalie B. Choate, *Life and Death Planning for Retirement Benefits*, Ataxplan Publications, Boston, MA (7th Ed. 2011), p. 443.
[36] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE* (8/31/2021), p. 49-50; Natalie B. Choate, *Life and Death Planning for Retirement Benefits*, Ataxplan Publications, Boston, MA (7th Ed. 2011), p. 443-44.

the requirements for a see-through trust. The implications of these rules should be taken into consideration when drafting the trust.

i. Substitute beneficiaries

Louisiana restricts the ability to name substitute principal beneficiaries.

1. Louisiana Trust Code § 1973 provides:

> A. (1) Except as to the legitime in trust, the trust instrument may provide that the interest of an original or a substitute principal beneficiary of an **irrevocable trust** vests in **one or more of his descendants upon the death of the beneficiary** either during the term of the trust or at its termination. The trust instrument may provide that the interest vests in **another person if the beneficiary dies without descendants**.
>
> > (2) With respect to the **legitime** in trust, the trust instrument may provide that the interest of an original or a substitute principal beneficiary vests in **another person** upon the death of the beneficiary either during the term of the trust or at its termination, **only if a beneficiary dies intestate and without descendants**.
>
> B. The trust instrument may provide that the interest of a designated principal beneficiary of a **revocable trust** shifts to **another person**, ***if*** the substitution occurs **no later than the date when the trust becomes irrevocable**.[37]

[37] The 1989 Comment to La. Rev. Stat. Ann. § 9:1973 provides:

> This change is meant to clarify the Code and overrule the statement in the official comment to Act 160 of 1974 that only one substitution can occur. Allowing successive substitutions makes it possible for all of a beneficiary's interest in trust principal to be treated uniformly. For example, in the case of a trust for several children, if one child dies intestate and without descendants and his interest vests in his siblings, upon the subsequent death intestate and without descendants of one of those siblings the settlor should be able to direct in the trust instrument that the full interest of that second deceased sibling, not just the second sibling's original interest in the trust, vests in the other surviving siblings.

The 2016 Comment (a) to La. Rev. Stat. Ann. § 9:1973 provides:

2. Louisiana Trust Code § 1974 provides as follows:

> The interest of a substitute beneficiary may be conditioned upon his surviving the principal beneficiary. The trust instrument may provide for one or more alternative substitute beneficiaries if a substitute beneficiary does not survive the principal beneficiary.

3. Louisiana Trust Code § 1976 provides that:

> Upon a substitute beneficiary's death, his interest, if not conditioned on survival, vests in his heirs or legatees subject to the trust.

4. Louisiana Trust Code § 1978 provides that:

> The trust instrument may provide that the substitute beneficiaries under R.S. 9:1973 are **one or more of settlor's descendants** who are **in being and ascertainable on the date of death of the principal beneficiary**.

5. Louisiana Trust Code § 1979 provides:

> A person who will be a principal beneficiary of a trust only if a substitution occurs under R.S. 9:1973 is not considered a principal beneficiary until the substitution occurs.

ii. Legitime in trust

There are restrictions regarding a forced heir whose interest is held in trust as well.

1. Louisiana Trust Code § 1841 provides:

> The legitime or any portion thereof may be placed in trust provided:

(a) This revision reorganizes, modifies, and clarifies prior law. It expands prior law by enlarging the category of allowable parties to whom a principal interest can be shifted at the death of an original or substitute principal beneficiary. It allows for a settlor to provide that if a principal beneficiary dies with descendants his interest passes to one or more of the beneficiary's descendants. As under prior law, a settlor can shift to any other person the principal interest of a beneficiary who dies without descendants. If the legitime is affected, however, the shifting of principal is allowed only if the beneficiary dies intestate and without descendants.

(1) The trustee after taking into account all of the other income and support to be received by the forced heir during the year shall distribute to the forced heir, or to the legal guardian of the forced heir, funds from the net income in trust sufficient for the health, maintenance, support, and education of the forced heir.

(2) The forced heir's interest is subject to no charges or conditions except as provided in R.S. 9:1843, 1844, 1891 through 1906 and Subpart B of Part III of this Chapter.

(3) Except as permitted by R.S. 9:1844, the **term of the trust, as it affects the legitime, does not exceed the life of the forced heir**; and

(4) **The principal shall be delivered to the forced heir or his heirs, legatees, or assignees free of trust, upon the termination of the portion of the trust that affects the legitime**.

2. Louisiana Trust Code § 1842 provides:

   A provision of a trust instrument that is incompatible with the provisions of this Sub-part shall be reformed to comply herewith.

iii. Class trusts

1. The Louisiana Trust Code provides for the creation of class trusts, under Louisiana Trust Code § 1891:

   A. Notwithstanding the provisions of R.S. 9:1803, R.S. 9:1831 through 1835, and R.S. 9:1841 through 1847, but subject to the restrictions stated in this Subpart, a person may create an inter vivos or testamentary trust in favor of a class consisting of some or all of the children, grandchildren, great grandchildren, nieces, nephews, grandnieces, grandnephews, and great grandnieces and great grandnephews of the settlor or of the settlor's current, former, or predeceased spouse, or any combination thereof, although some members of the class are not yet in being at the time of the creation of the trust, **provided at least one member of the class is then in being**. Such a trust is called a class trust. If the trust instrument so provides, the interest of each beneficiary in the class shall be held in a separate trust after the class has closed.

B. [T]he class includes members related to the settlor's current, former, or predeceased spouse who are not also related to the settlor, the interests of those members shall be determined as if they were related to the settlor in the same manner as they are related to the settlor's current, former, or predeceased spouse, unless the trust instrument provides otherwise.

C. Unless the trust instrument provides otherwise, the interests of the class members shall be determined in the following manner:

(1) Before application of R.S. 9:1894, if the class consists solely of descendants of the same degree, the interests of the members of the class shall be determined by roots.

(2) In all other cases, the interests of the members of the class shall be determined by heads.

2. Louisiana Trust Code § 1894 provides that:

If a person dies before the creation of the trust, who would have been a member of the class if he had not died, his descendants shall be considered members of the class by representation unless the instrument otherwise provides. In all cases in which representation is permitted, the division is made by roots. If one root has produced several branches, the subdivision is also made by roots in each branch, and the members of the same branch take by heads.

3. Louisiana Trust Code § 1895 provides that:

A. An interest of a member of the class who dies during the term of the trust vests in his heirs or legatees, unless the trust instrument provides any one of the following:

(1) That the interest of a member of the class who dies intestate and without descendants during the term of the trust vests in the other members of the class.

(2) Except as to the legitime in trust, that the interest of a member of the class who dies without descendants during the term of the trust or at its termination vests in the other members of the class.

(3) Except as to the legitime in trust, that the interest of a member of the class who dies leaving one or more descendants vests in the beneficiary's descendant heirs.

B. For this purpose the term "other members of the class" shall include the successors to the interests of any members of the class who predecease such deceased class member, unless the trust instrument provides otherwise.

4. Louisiana Trust Code § 1896 provides that:

The trust instrument may state a date or a method for defining a date on which the class shall close. Unless the trust instrument provides otherwise, the class shall close when, because of the definition of the class, members may no longer be added to it.

VII. Non-See-Through Trusts (or Nonqualifying Trusts)

a. Subsequent to the addition of the 10-Year Rule for DBs that are not EDBs, non-see-through trusts are more attractive if an accumulation trust does not achieve your goals.

b. Under the ADP rule for non-designated beneficiaries discussed above, the term of the trust would be determined based on whether the participant reached his or her RBD—meaning the distributions either would be subject to the 5-Year Rule or annual distributions over the remaining term of the participant's life expectancy. Number crunching may determine whether this may even be better than the 10-Year Rule in some cases where the participant has surpassed his or her RBD.

c. If you elect to hold assets in a non-see-through trust, the tax implications and fiduciary accounting income definitions should still be considered closely.

d. Note that a non-see-through trust may not transfer an inherited qualified plan into an inherited IRA so the terms of the assets should be considered carefully.[38]

e. Furthermore, the client may elect to leave the retirement benefits to a more favored EDB and fund a non-see-through trust with assets other than retirement benefits.

f. Charitable Trust

   i. Charitable Remainder Trusts

      1. In particular, a charitable remainder trust, which does not qualify as an accumulation trust since a charity is not an individual, may be of assistance in income tax planning—not because I.R.C. § 401(a)(9) but because of its tax favored status

      2. You don't necessarily get more money under a CRT but it can fulfill your client's desires to be charitable and is now more attractive as the other trust options have become less attractive.

   ii. In drafting, note that if a charity is to receive assets from the trust, it is better to transfer the asset itself rather than to liquidate the asset and then transfer cash. There is not a DNI deduction for payments to a charity, which is not an individual, so the trust may end up on the hook for income taxes that otherwise could have been avoided.

VIII. Trust options available to the different types of trust beneficiaries

   i. Non-DB

      1. A non-DB can either be:
         a. A principal beneficiary of a conduit trust or
         b. Can be a beneficiary of a non-see-through (or nonqualifying trust)

[38] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE*, (8/31/2021), p. 55.

2. Charities, Estates, and other non-individuals are not designated beneficiaries.

3. For the relevant Applicable Distribution Period, see Section (I)(a)(iv)(2).

ii. DBs that are not EDBs

1. Conduit trust

a. With the applicable 10-Year Rule, this will cause all benefits to be paid out by December 31 of the year containing the 10th anniversary of the owner's death. As a result, the income tax implications of potentially large distributions should be carefully analyzed as they have made this option less attractive.

2. Accumulation trust

a. Subsequent to the SECURE Act, accumulation trusts are more attractive for DBs that are not EDBs because all are subject to the 10-Year Rule.

3. Non-see-through trust

a. See the ADP rule for non-DBs and determine whether the participant reached his or her RDB:
   i. If did not reach RDB, then 5-Year Rule or
   ii. If reached RDB, then ADP is annual distributions over the remaining term of the participant's life expectancy.

iii. EDBs

1. Surviving Spouse

a. Conduit

i. If the Surviving Spouse is to receive retirement benefits held in trust, then a conduit trust is the most attractive option.

ii. If the trust qualifies as a conduit trust then the ADP is as determined above in Section (I)(a)(vi)(3)(a)(ii).

iii. Qualified Terminable Interest Property (“**QTIP**”) Trusts

(1) Not all QTIP trusts are conduit trusts and not all conduit trusts are QTIP trusts. If you want a conduit trust for a Surviving Spouse to qualify for the marital deduction, it must be crafted so that it satisfies the requirements of *both* types of trusts.

(2) If the trust is to qualify as a marital trust *and* as a conduit trust, these purposes should clearly be stated in the trust agreement.

b. STAT

i. The typical QTIP trust would be an accumulation trust; if this is the case with principal beneficiaries that are DBs but not EDBs, then the 10-Year Rule is applicable. The benefits of a typical QTIP trust must be weighed against the income tax consequences of large distributions under the 10-Year Rule.

c. Non-see-through trust

i. See the ADP rule for non-DBs and determine whether the participant reached his or her RDB:

(1) If did not reach RDB, then 5-Year Rule or

(2) If reached RDB, then ADP is annual distributions over the remaining term of the participant’s life expectancy.

2. Non-Major

a. Conduit

i. This allows for the Applicable Distribution Period to be calculated based on the Non-Major’s life expectancy; once majority is reached, the 10-Year Rule (modified from date of majority) applies. A

ii. See Section (I)(a)(vii)(5) regarding the relevant Applicable Distribution Period.

iii. Benefits must be transferred out to Non-Major, which means they may receive sizable distributions once they have attained majority (although there is no requirement for annual distributions under the 10-Year Rule) which must be balanced against the income tax consequences.

iv. With the age of majority not established by the IRS, presumably state law applies; however, there may be clarification from the IRS in the future on this point. Draft your trust accordingly.

b. STAT

i. The 10-Year Rule applies in this case.

ii. This allows delay in distributing to beneficiaries but it must be weighed against the income tax considerations.

iii. Because of the changes under the SECURE Act, these are now more attractive since the "stretch IRA" previously available for conduit trusts of Non-Majors is now limited to the period during which they are not Majors. If you have an older child, the period of "stretch" may not justify the child receiving the assets outright at such an early age.

iv. The value of the retirement benefits should be analyzed to determine whether this option is appealing.

c. Non-see-through trust

i. See the ADP rule for non-DBs and determine whether the participant reached his or her RDB:
   (1) If did not reach RDB, then 5-Year Rule or
   (2) If reached RDB, then ADP is annual distributions over the remaining term of the participant's life expectancy.

3. Disabled or Chronically Ill Individual

a. Conduit

i. This is not advisable if the Disabled or Chronically Ill Individual receives government benefits or if the Disabled or Chronically Ill Individual is not competent to handle the funds that must be distributed (without a party to legally handle such benefits on their behalf).

ii. There will be limited circumstances when this option is appealing to a Disabled or Chronically Ill Individual.

iii. ADP is that shown in Section (I)(a)(viii)(6) above.

b. STAT

i. If this qualifies as an AMBT, then the ADP is the life expectancy, but as noted above, it is not clear whose life expectancy that is so care should be taken in selecting the principal beneficiaries of the trust.

ii. An AMBT should be used to draft a typical special needs trust and allow for the Disabled or Chronically Ill Individual to qualify for government benefits.

iii. If the STAT does not qualify as an AMBT and there is a DB that is not an EDB as a beneficiary of the trust, then then 10-Year Rule applies.

c. Non-see-through trust

i. See the ADP rule for non-DBs and determine whether the participant reached his or her RDB:
(1) If did not reach RDB, then 5-Year Rule or
(2) If reached RDB, then ADP is annual distributions over the remaining term of the participant's life expectancy.

4. NoMoTTY

a. Conduit

i. For the relevant Applicable Distribution Period, see Section (I)(a)(ix)(2).

ii. All distributions are passed out to the beneficiary.

iii. This typically is the preferable option under the current rules.

b. Accumulation

i. 10-Year Rule applies here.

ii. You should compare the "stretch" allowed under the conduit trust and tax implications with the 10-Year Rule under the particular circumstances to determine if this is an attractive option.

c. Non-see-through trust

i. See the ADP rule for non-DBs and determine whether the participant reached his or her RDB:

(1) If did not reach RDB, then 5-Year Rule or

(2) If reached RDB, then ADP is annual distributions over the remaining term of the participant's life expectancy.

ii. Under certain circumstances, if the NoMoTTY is older, a charitable remainder trust may work well for your client—although, as always, there is a trade off.

IX. Items to consider for drafting

a. Does the trust need to qualify for the Marital Deduction?

b. Does the trust need to include special provisions as to the portion that represents a legitime of a forced heir?

c. Do you need to include special provisions with regard to a special needs beneficiary and take advantage of the new AMBT?

d. What are that income tax ramifications of the proposed trust?

i. Subsequent to the SECURE Act, many trusts that formerly would have been entitled to a stretch, now fall under a 10-Year Rule wherein potentially large sums will be subject to cash.

ii. It is imperative to understand the implications of higher tax brackets for trusts vs. individuals and how income taxation of trusts works, including Distributable Net Income ("**DNI**") deductions and to consider these implications in how the trust is crafted and in determining which type of trust is most suitable for the needs of your client (or if a substitute asset such as life insurance should be utilized instead of retirement benefits for individuals who are designated beneficiaries but not eligible beneficiaries.

iii. 2021 Income Tax Rate Tables for Trusts—Rev. Proc. 2020-45, Section 3.01.

"If Taxable Income Is:	The Tax Is:
Not over $2,650	10% of the taxable income
Over $2,650 but not over $9,550	$265 plus 24% of the excess over $2,650
Over $9,550 but not over $13,050	$1,921 plus 35% of the excess over $9,550
Over $13,050	$3,146 plus 37% of the excess over $13,050"

iv. In comparison, an unmarried individual must have over $523,600 of taxable income before hitting the top tax bracket and a couple that is married filing jointly must have over $628,300 of taxable income before hitting the top tax bracket.

v. Capital gains income tax rates for trusts high levels at lower figures as well. "For taxable years beginning in 2021, the Maximum Zero Rate Amount under § 1(h)(1)(B)(i) is $80,800 in the case of a joint return or surviving spouse…, $40,400 in the case of any other individual (other than an estate or trust [or head of household or married filing separately]), and **$2,700 in the case of a…trust**. The Maximum 15-percent Rate Amount under § 1(h)(1)(C)(ii)(l) is $501,600 in the case of a joint return or surviving spouse…, $445,850 in the case of any other individual (other than an estate or trust [or head of household or married filing separately]), and **$13,250 in the case of a…trust.**" Rev. Proc. 2020-45, Section 3.03 (Emphasis added). Thus, the 20% income tax rate applies for amounts over $13,250 for a trust.

vi. Note that the additional net investment income tax also applies to trusts. I.R.C. § 1411(a)(2) provides:

> "(a) In general.--Except as provided in subsection (e)—
>
> (2) Application to…trusts.--In the case of a…trust, there is hereby imposed (in addition to any other tax imposed by this subtitle) for each taxable year a **tax of 3.8 percent** of the lesser of--
>
>> (A) the undistributed net investment income for such taxable year, ***or***

(B) the excess (if any) of--

(i) the adjusted gross income (as defined in section 67(e)) for such taxable year, over

(ii) the dollar amount at which the highest tax bracket in section 1(e) begins for such taxable year [over $13,250 in 2021]."

(Emphasis added).

vii. DNI is a complicated tax deduction for trusts based on income that is distributed to individual beneficiaries, with exceptions. This allows trusts to pass income through to beneficiaries of the trust, which may be utilized to equalize the tax brackets between the trust and the beneficiary.

viii. One also should consider the implication of the trust distributing Income with Respect to a Decedent ("**IRD**") as part of DNI.

ix. You should review the implications of income taxation of trusts and the DNI deduction prior to crafting your trust, particularly if you are subject to the 10-Year Rule, to ensure that there unwanted tax consequences are minimized, to the extent possible.

x. The trustee of the trust also should be made aware of the implications of income taxation of trusts and the DNI deduction so that he or she may plan to minimize income tax consequences, to the extent possible.

xi. Your client may wish to enter into Roth conversions currently in order to take advantage of income tax planning and minimize the income tax consequences if a beneficiary that is subject to the 10-Year Rule will be the designated beneficiary.

e. Fiduciary Accounting Income

i. It would be wise to include a definition for fiduciary accounting income with respect to retirement benefits in the trust agreement itself rather than rely on the default rules for purposes of ensuring that the Required Minimum Distribution is distributed to the beneficiary and also for purposes of calculating the DNI deduction.

ii. Fiduciary accounting income or trust accounting income is not the same as taxable income. Fiduciary accounting income is

iii. Acts 2020, No. 17, § 1 revised Louisiana law with regard to the allocation to income and principal.

iv. Louisiana Trust Code § 2142, revised in Acts 2020, No. 17, § 1, details that the terms of the Trust may override the Louisiana Trust Code provisions with regard to the allocation of items to income or principal:

> A trust receipt or expense shall be allocated to income or principal or partly to each:
>
> > (1) **In accordance with the terms of the trust instrument**, including any provision giving the trustee discretion, notwithstanding contrary provisions of this Subpart.
> >
> > (2) In accordance with the provisions of this Subpart, in the absence of contrary provisions of the trust instrument.
> >
> > (3) If no rule is provided in the trust instrument or this Subpart, in accordance with what is reasonable and equitable in view of the interests of those entitled to income as well as of those entitled to principal.

v. Louisiana Trust Code § 2144 provides the general rule that:

> Receipts paid or delivered in return for the use of property forming a part of principal are income, unless this Subpart expressly provides to the contrary.
>
> Receipts paid or delivered in consideration for the sale or other transfer of property forming a part of principal or as the replacement of property forming a part of principal are principal unless this Subpart expressly provides to the contrary.

vi. A more specific rule regarding deferred compensation, annuities, and similar payments is now given in Louisiana Trust Code § 2152.2(a)(2) and (b):

> A. Payments made in money or other property to a trustee over a period of years or during the life of an individual from an annuity, an individual retirement account, an employee-benefit plan, a pension plan, a profit-sharing plan, a deferred

compensation plan, or any similar arrangement created pursuant to income-tax incentives to fund for retirement are allocated as follows:…

> (2) If no part of a payment is characterized as interest, a dividend, or an equivalent payment, and all or part of the payment is required to be made, a trustee shall **allocate to income ten percent of the part that is required to be made during the accounting period and the balance to principal**. If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the **entire payment to principal**. To the extent that a trustee exercises a right of withdrawal, a payment is not considered to be required to be made.

B. If, in order to qualify for a marital deduction, a trustee must allocate more of a payment to income than provided for in this Section, the trustee shall allocate to income the additional amount necessary to qualify for the marital deduction.

vii. The 2020 Revision Comments (c) – (e), in relevant part, provide as follows:

1. (c)…Paragraph (A)(2) applies to required payments from an IRA or similar arrangement.

2. (d) Paragraph (A)(2) of this Section differentiates between payments that are required to be made and all other payments. To the extent that a payment is required to be made (either under federal income tax rules, or, in the case of a plan that is not subject to those rules, under the terms of the plan), 10% of the amount received is allocated to income and the balance to principal. The right to receive payments under this Paragraph is a type of liquidating asset and therefore is treated similarly to property subject to depletion under R.S. 9:2154. All other payments are allocated to principal because they represent a change in the form of the principal asset. To that extent, this rule follows the general policy of R.S. 9:2144, which provides that property received in replacement of property shall be allocated to principal.

   (e) Under Revenue Ruling 2006-26, the Internal Revenue Service declared that the **10% allocation** provided in

Section 409 of the UPIA [on which this provision is based, in part,] **did not qualify for the IRS's safe harbors, as 10% of a required minimum distribution is not a reasonable apportionment of the total return of the trust between income and principal**. Under the ruling, the trustee is required to make available to the beneficiary the income of an IRA or defined contribution plan in order to qualify. To comply with the ruling, Section 409 of the UPIA was amended in 2008 to provide separate rules for determining the income of a marital trust that is the beneficiary of an IRA or similar arrangement. This revision simplifies the provisions of the UPIA while, at the same time, allowing the preservation of the marital deduction.

viii. If you are drafting a conduit trust, you must include a provision that overrides the Louisiana Trust Code provision that would only allocate 10% of this amount. If you're drafting an accumulation trust or even a non-see-through trust, it still is wise to draft your own provision regarding what is considered income with regard to the retirement benefit. This should be drafted keeping in mind your client's goals with regard to the appropriate proportions the income beneficiaries vs. principal beneficiaries should receive.

ix. Choate notes that "[w]ith respect to IRAs, the IRS has blessed two methods of determining "trust accounting income," namely, defining it as the retirement account's internal income, or a "unitrust" approach based on 3%–5% of the annual value of the account."[39]

f. Consider the ages of the beneficiaries.

i. This consideration is of less importance subsequent to the SECURE Act and the imposition of the 10-Year Rule.

ii.

g. Separate Shares Rule

h. State the material purpose of the trust as to qualify (or not qualify) under I.R.C. § 401(a)(9) and the Treasury Regulations thereunder.

i. Other purposes of the trust should be included as well, including whether the trust is to qualify as an AMBT or if the trust is to qualify for a marital deduction as a QTIP trust. This gives the trustee some leverage if a modification of the trust is required in the future in order to satisfy the purposes of the trust.

[39] Natalie B. Choate, *Estate Planning for Retirement Benefits in a Post-SECURE World* (8/23/2021), pp. 14-15. *See* Rev. Rul. 2006-26, 2006-1 CB 939.

j. Include the requirements with which the trustee must comply in the trust agreement.

k. Take care to avoid gain under *Kenan v. Comm'r of Internal Revenue*, 114 F.2d 217 (2d Cir. 1940).

   i. The use of a pecuniary formula may inadvertently cause the recognition of *Kenan* gain if it refers to a dollar amount funding an AB trust.

   ii. Solution: Specify to which trust the retirement benefits go and list that trust as the designated beneficiary.

l. Beneficiary designation forms

   i. If you set up a funding trust with subtrusts, name the subtrusts as the designated beneficiary.

   ii. Review matrimonial agreements for any implications regarding the retirement benefits.

   iii. Ensure that any rights of the spouse to the retirement benefits under ERISA are waived.

   In light of *United States v. Windsor*, 133 S. Ct. 2675, 186 L. Ed. 2d 808 (2013), if you are dealing with a same-sex married couple, you should ensure that the spouse waived their rights for purposes of ERISA. If the benefits account was opened prior to either *Windsor* or the marriage, there likely was no waiver.

   iv. Keep a copy of the Beneficiary Designation Form and Spousal Waivers in your file.

X. Forms for provisions in the trust

a. Introductory Provisions

   i. Purpose: [Insert Settlor's history regarding his or her retirement benefits. E.g. Settlor is retired from ____________________ and upon retirement did withdraw the pension funds available to him, rolling such amounts over into certain Individual Retirement Accounts ("IRAs")]. It is Settlor's intention to designate this trust as the beneficiary of his various [insert relevant benefits]. Settlor intends for the trust and the beneficiaries of this trust to satisfy the requirements of Section 401(a)(9) of the Internal Revenue Code and the Treasury Regulations thereunder, such that beneficiary __________ qualifies as a Designated Beneficiary. The provisions of this trust shall be interpreted and applied with such stated purposes and objectives.

ii. Trust Property: [Insert statement regarding nominal amount funding the trust if it is an inter vivos trust.] The properties of this trust shall initially consist of the cash funds delivered to the Trustee as hereinabove set forth; however, it is contemplated that additions to this trust property will be made through the payments to this trust of amounts from Settlor's [insert relevant benefits].

iii. Irrevocable: This trust shall become irrevocable upon the death of the Settlor.

b. Distribution of income provision for conduit trust

Payment of Income: So long as the Income Beneficiary is living, the Trustee shall pay all of the income of the trust to him at such time and in such amount as the Trustee determines appropriate; however, all such income (less administrative expenses) shall be distributed to the income beneficiary at least as often as annually. Such distributions may be made directly to the Income Beneficiary or to third persons other than trusts for his benefit, as the Trustee, in his sole discretion, shall determine. Upon receipt of any distribution of Retirement Benefits, such Retirement Benefits (less administrative expenses) shall be distributed directly to the Income Beneficiary. The Trustee shall not accumulate any distributions of Retirement Benefits.

c. Distribution of income provision for QTIP for conduit trust

i. Include your typical QTIP distribution language but add that the trustee must withdraw from the Retirement Benefits the greater of the income and the RMD.[40]

d. Because RMD rules change (such as in 2020 under the CARES Act where no distribution was required and with the imposition of the new 10-Year Rule where no distribution is required before the end of the 10th anniversary), your distribution language should not be tied too closely to RMDs.[41]

If prior trusts you drafted ran afoul of this, it would be wise to revise these estate plans if the trusts are not yet in effect or to modify the trusts to the extent needed.

[40] Natalie B. Choate, *Making Retirement Benefits Payable to a Trust Post-SECURE*, (8/31/2021), p. 56.
[41] *Id.*

e. Administrative provisions

The Trustee hereunder shall be subject to all the duties imposed upon trustees, and shall have to the fullest extent possible all of the powers granted to trustees under the Trust Laws of the State of Louisiana as the same may, from time to time, be amended. Without limitation upon any of the Trustee's other powers given by law, the Trustee is expressly given the power to do and perform any of the following in his discretion and without the necessity of any order or authorization of court:

i. To make any and all decisions afforded to the beneficiary of any employee benefit plan or Individual Retirement Account, including specifying the time and manner of distributions therefrom;

ii. To make distributions or division of property held hereunder, including Retirement Benefits, at values fairly and equitably determined by the Trustee, and to make payment, division or distribution, wholly or partly in kind by allocating and transferring particular movable or immovable property, including Retirement Benefits, or undivided interest therein, as part or as the whole of any one or more shares or payments, at current values of such interest or properties. The Trustee may distribute an undivided interest in any interest in property not divisible in kind, or if the Trustee deems it advisable to do so, retain any property indivisible in kind for a reasonable time and then deliver such property, or its proceeds, in order that no diminution of value may be suffered by the trust, or the beneficiaries thereof, from a division and distribution of trust property;

iii. Notwithstanding any statute or other rule for distinguishing income from principal, to the extent that this Trust receives distribution from any retirement plan, policy, trust or system, or any IRA which is less than or equal to the minimum distribution required by the plan, account, the Internal Revenue Code, Employee Retirement Income Security Act or applicable regulations thereunder, such amounts shall be classified as income of the trust.

iv. Additional Powers of Trustee With Respect To Pension Plan and IRAs: Without otherwise limiting the above general powers of the Trustee, or those provided by law, the Trustee is expressly given the power to do and perform any of the following in its discretion and without the necessity of any order or authorization of court with respect to Settlor's [insert relevant benefits] or other plans ("the Accounts"):

1. If during any period the applicable law does not require any payment to be made to the Trustee from one or more of the Accounts, the Trustee shall have the power to withdraw an amount equal to all of the income earned by each of the Accounts during that calendar year, less all amounts actually distributed to the Trustee from that account during such calendar year, and such amount so withdrawn shall be classified as income of the Trust;

2. If the account balance of one or more of the Accounts is paid to the Trustee in installments pursuant to applicable law that requires a minimum amount to be distributed from such account each year, and if the income earned by any such account in any calendar year is more than the required distribution from such account for that year, the Trustee shall have the power to withdraw an amount such that the total amount of the income earned by each account for such year has been distributed to the Trustee; and

3. The Trustee shall have the power to change any installment payment schedule to one that is more rapid than that required by applicable law, and shall have the power to withdraw all or any portion of the account balance at any time.

v. The Trustee shall comply with Treasury Regulation Section 1.401(a)(9)–4, Q & A-6 by providing the plan administrator with a copy of this Trust Agreement, as amended, by October 31 of the year following the Settlor's death.

vi. Subsequent to September 30 in the calendar year following the calendar year in which the Settlor dies, the Settlor's debts, expenses of estate administration or estate taxes shall not be paid from the proceeds of the Retirement Benefits.

vii. Subsequent to September 30 in the calendar year following the calendar year in which the Settlor dies, the Trustee may not make any payments of Retirement Benefits subject to the rules of Section 401(a)(9) of the Internal Revenue Code and the Treasury Regulations thereunder to any non-individual, including, but not limited to, an estate or a charity.

viii. The Trustee may, but is not required to, deduct the administrative fees of the trust, including, but not limited to all costs incurred in its administration such as a trustee's fee, from the distributions of Retirement Benefits, including Required Minimum Distributions.

f. Definitional provisions

   i. Retirement Benefits: This term shall mean any asset subject to the rules in Section 401(a)(9) of the Internal Revenue Code and the Treasury Regulations thereunder.

   ii. Issue: [Use your standard definition of issue with the following addition:] This term shall not include an individual that became “issue” of an individual through legal adoption if the adopted individual is older than the otherwise oldest beneficiary under this trust.

J·L·A·P

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"LEAVING A LASTING LEGACY"

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- JUDGES & LAWYERS ASSISTANCE PROGRAM, INC.
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- JLAP@LOUISIANAJLAP.COM
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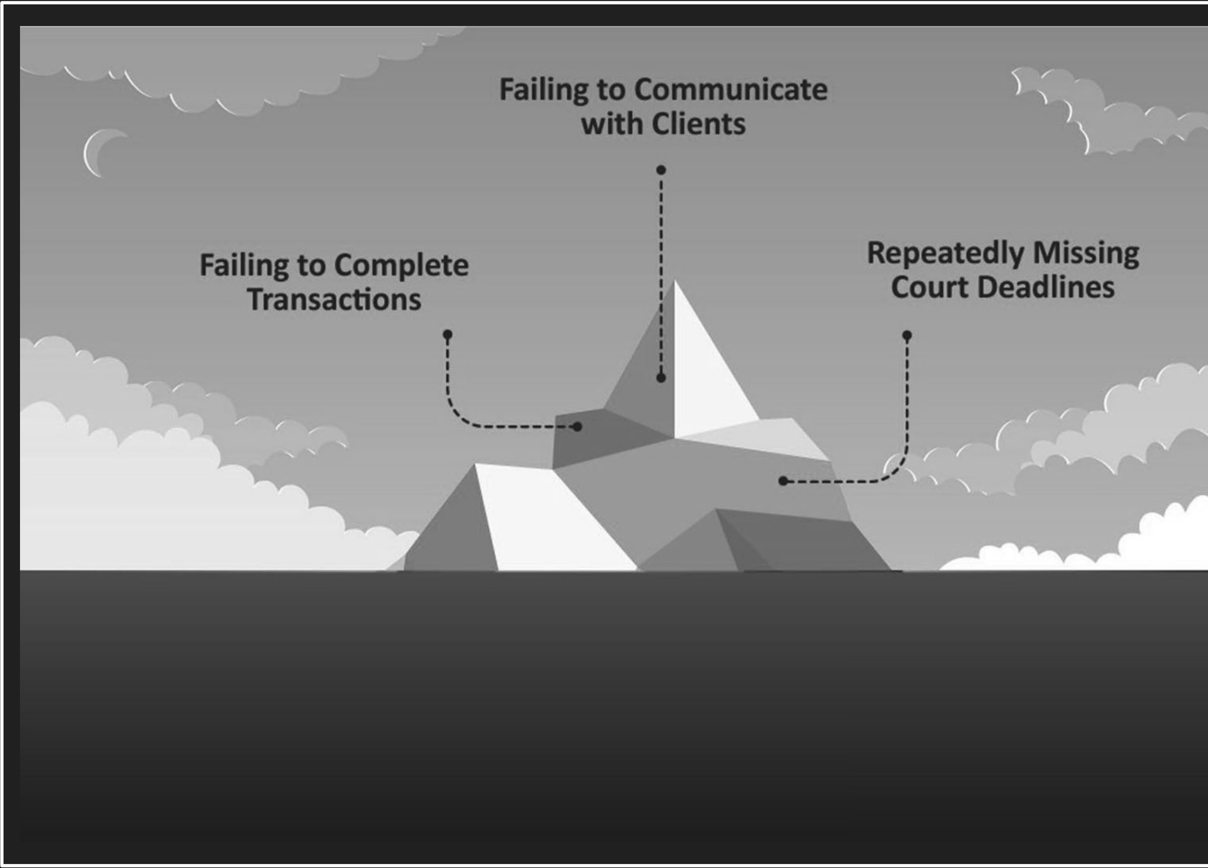
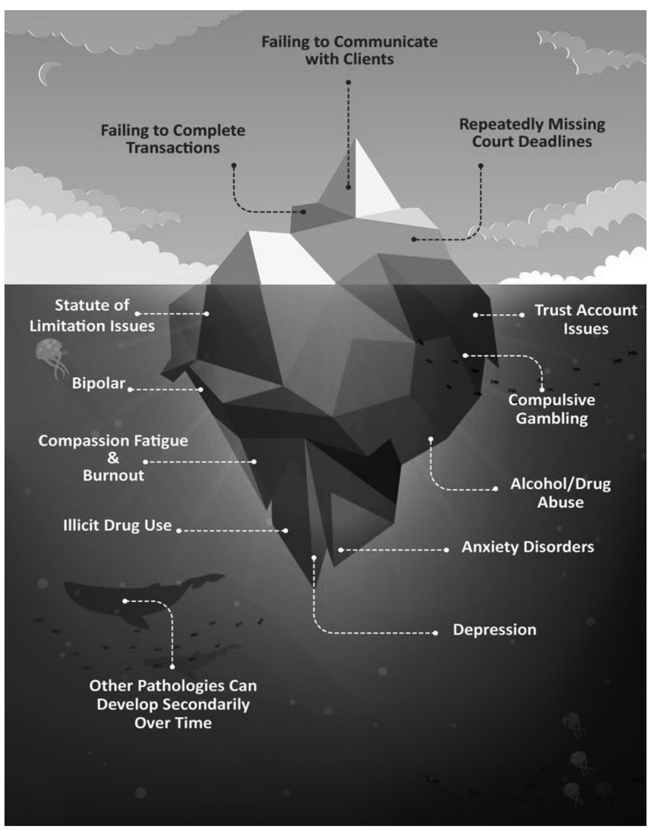
PROFESSIONALISM

PERCEPTION

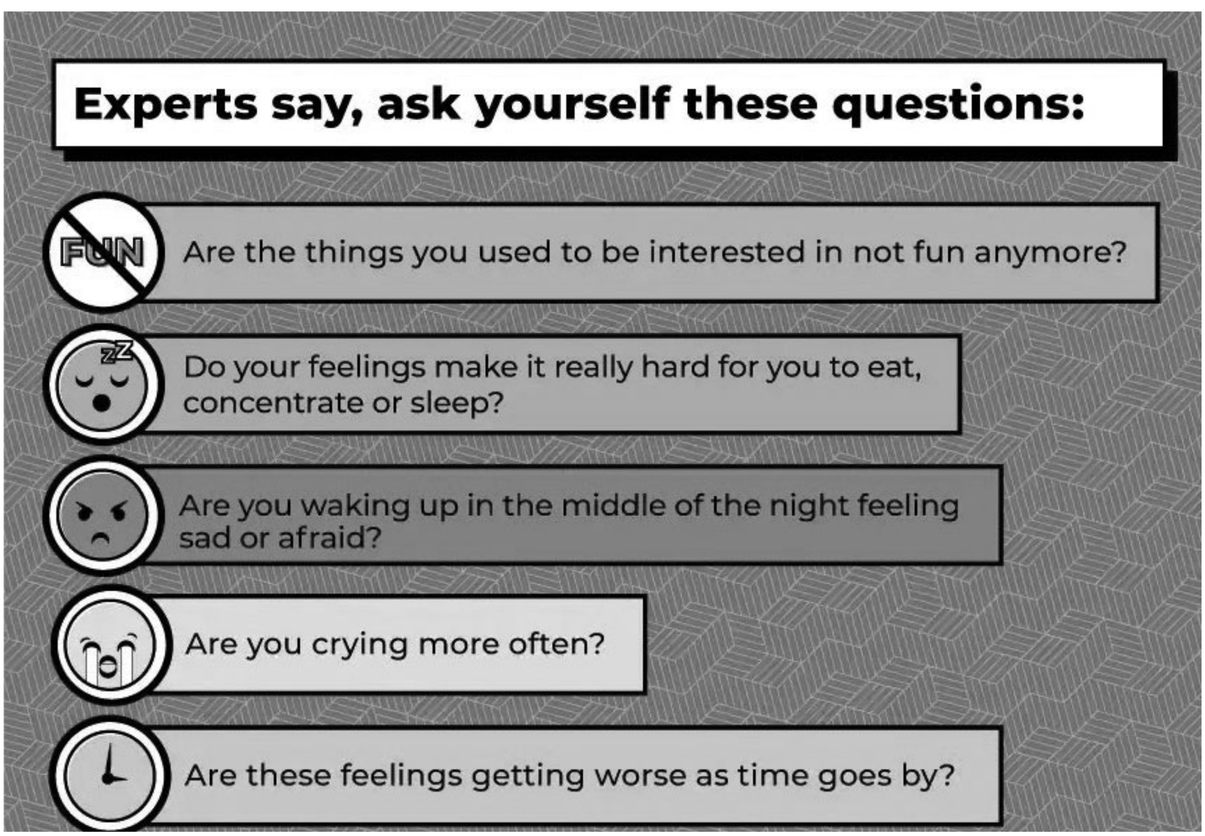
IN IMPAIRMENT CASES,
THE PROFESSION OFTEN SEES ONLY THE

"TIP OF THE ICEBURG"

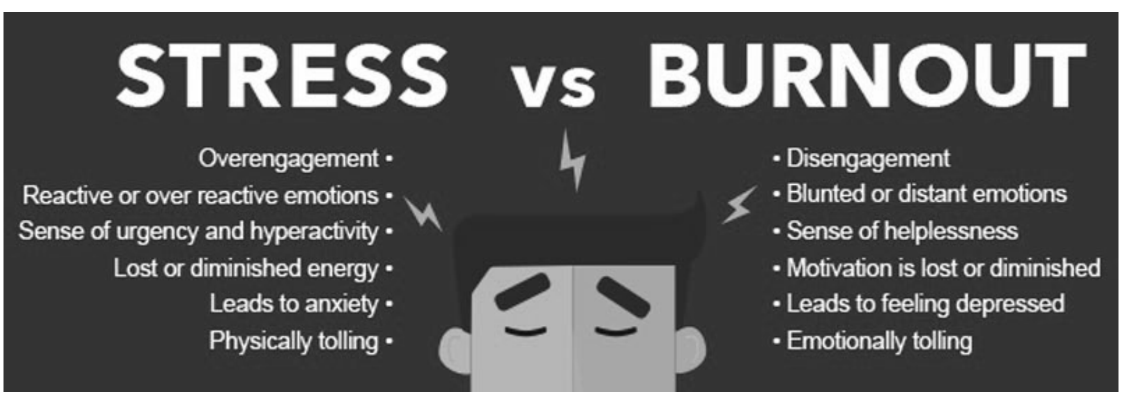

Failing to Communicate with Clients
Failing to Complete Transactions
Repeatedly Missing Court Deadlines


Failing to Communicate with Clients
Failing to Complete Transactions
Repeatedly Missing Court Deadlines
Statute of Limitation Issues
Trust Account Issues
Bipolar
Compulsive Gambling
Compassion Fatigue & Burnout
Alcohol/Drug Abuse
Illicit Drug Use
Anxiety Disorders
Depression
Other Pathologies Can Develop Secondarily Over Time

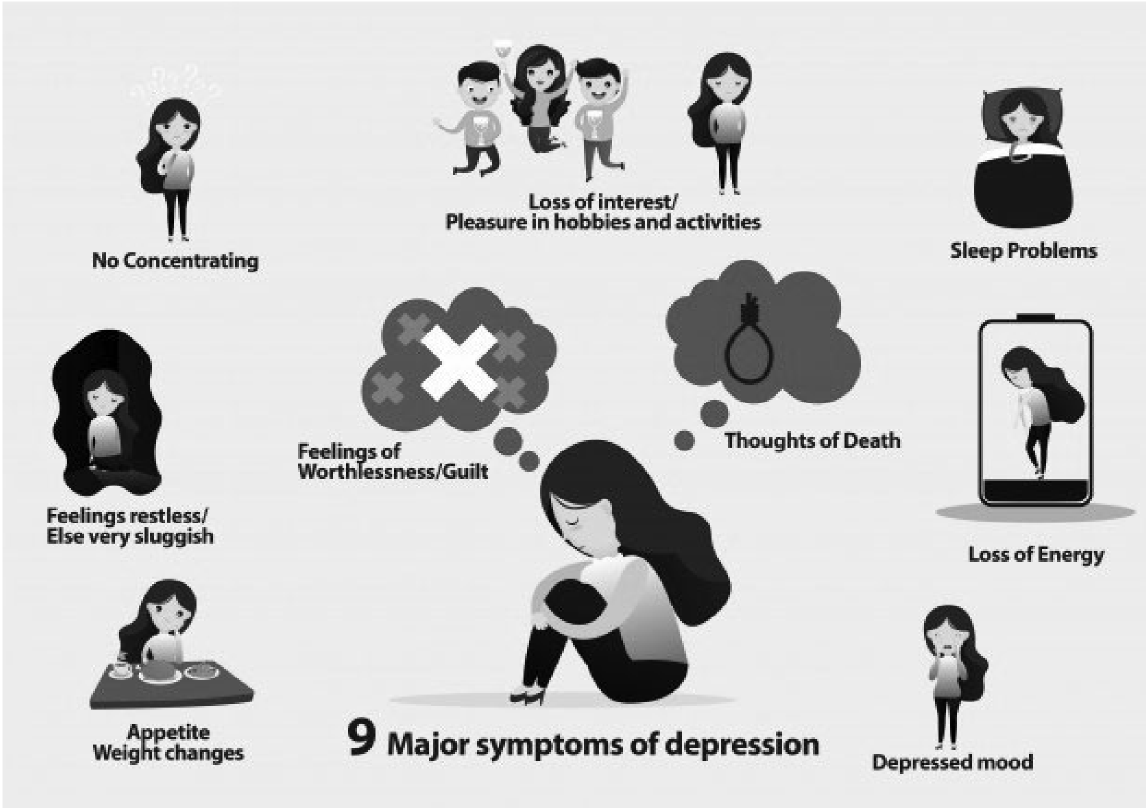
PROFESSIONALISM



PROFESSIONALISM



PROFESSIONALISM



PROFESSIONALISM

WHAT IS YOUR why?

PURPOSE

JLAP'S PRIMARY MISSION

CONFIDENTIAL HELP

- JLAP is first and foremost an absolutely confidential method of providing life-saving help to an impaired judge, lawyer, law student, or family member, while protecting the public.

PROTECTING THE PUBLIC

- Early intervention and help through JLAP reduce the damage that impaired legal professionals visit upon the profession and the public.

WHAT IS JLAP?

- JLAP is a 501(c)(3) non-profit corporation
- Formed on February 18, 1992 (as LAP), now JLAP as of 2014
- LSBA is the sole owner of JLAP
- Louisiana JLAP is based upon the principle of . . .

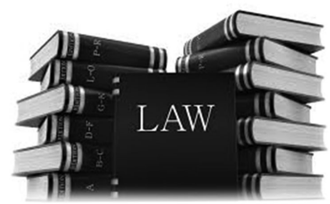
"Lawyers Helping Lawyers"

JLAP STATUTORY LAW

- La. R.S. § 37:221
- "It is hereby declared to be the public policy of the state of Louisiana to promote and encourage the use of counseling by peers and the intervention process in order to initiate successful treatment of mental health issues among members of the legal profession."
- "No person shall be required to disclose, by way of testimony or otherwise, privileged information or to produce, under subpoena, any records, documentary evidence, opinions, or decisions relating to such privileged information:

  (a) in connection with any civil or criminal case or proceeding

  (b) by way of any discovery procedure
- **(<u>Only the person involved can waive confidentiality!</u>)**



JLAP JURISPRUDENCE

LSBA VS. ARTHUR F. DUMAINE, 550 So.2d 1197 (La. 1989)

"Lawyer assistance programs in several other states that have proven successful in combatting alcohol and drug abuse have employed full-time professional program directors."

"Assistance usually consists of personal and individual assistance by attorneys ***recovering from the same type of impairment*** as the impaired lawyer."

"Considering the unique nature of this disease [alcoholism], we also think that the supervising person or agency should be assisted by another attorney who is himself a recovering alcoholic."

PROFESSIONALISM

JLAP'S REFERRAL SOURCES

- Persons in distress and seeking confidential help
- Law Firms seeking help for an impaired lawyer
- Family member or peer seeking help for someone else
- Bar Applicants seeking JLAP information
- Bar Applicants via the Committee on Bar Admissions
- Lawyers via the Office of Disciplinary Counsel
- Judges via the Judiciary Commission

THE ULTIMATE JLAP MISSION

CONFIDENTIAL HELP <u>WITHOUT ODC INVOLVEMENT</u>!

- JLAP encourages impaired individuals to REACH OUT to JLAP early with no pending unethical conduct issues and no past, present, or future threat of ODC investigation.
- JLAP continues to make every effort to improve the ratio of confidential self-help versus ODC referrals each year.

STATISTICS APPLIED TO LOUISIANA

- In Louisiana there are just over 23,000 members of the Bar (lawyers and judges).
- 20% = 4,600 suffering from alcoholism and addiction.
- 30% = 6,900 suffering from depression.
- The National Institute on Alcohol and Alcohol Abuse estimates that 10% of the U.S. population are alcoholic or otherwise chemically dependent.
- However, chemical dependency within the legal profession may be as high as 20% of the population.

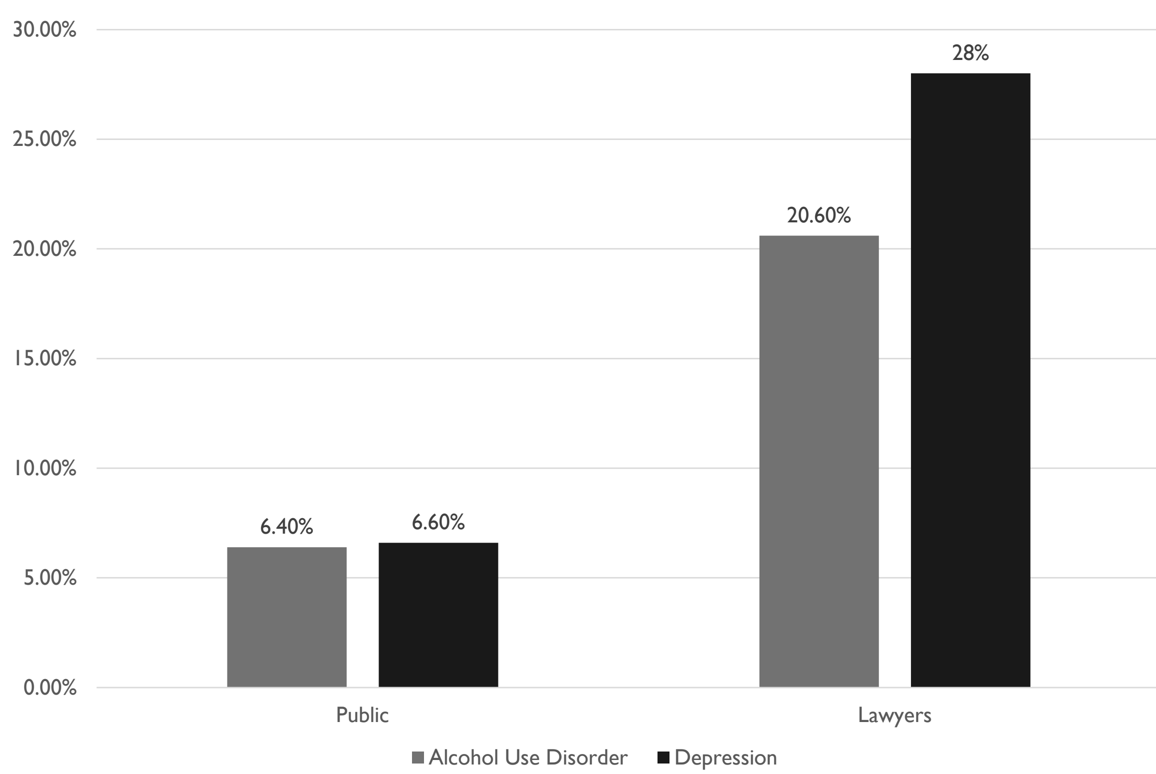
PROFESSIONALISM

LAWYERS
AND
MENTAL HEALTH STATISTICS

In Louisiana,
in the legal profession:

- 20% Alcoholism and Addiction Rate
- 30% Depression Rate
- 19% of lawyers had severe anxiety
- 11.4% of lawyers had suicidal thoughts in the previous year

PROFESSIONALISM



"IT'S NOT MY PROBLEM"

- The truth is that **<u>no one in the legal profession is immune</u>** to developing mental health issues over time, but for a personal support system, we are all at risk.
- The pressures of practicing law can result in unhealthy coping skills and/or the development of impairment.
- At least 50% of disciplinary complaints involve some type of mental health issue as the root cause of the conduct.
- Lawyer misconduct and headlines about damage to clients impacts the image of the whole profession.

PLEDGE

PROFESSIONALISM

JLAP IS COMMITTED TO:

Establish Trust

Enhance Wellness

Educate the Judiciary and Legal Community

Extend a Confidential Safe Haven of HEALING

While Protecting the Public!

"Step by Step to the Best YOU!"

PROGRESS

THE IMPORTANCE OF EARLY INTERVENTION

- JLAPs provide education on how to better identify subtle peer behaviors that may indicate a mental health impairment.
- JLAPs inform the profession about State LAPs' **CONFIDENTIAL** facilitation of intervention, evaluation, assessment, and treatment for legal professionals.
- JLAPs promote calling LAP long before Rule 8.3 is engaged.
- **<u>When there is early Intervention</u>** the impaired person, the family, the firm, the peers, the clients, the profession, and the public **ALL WIN**.

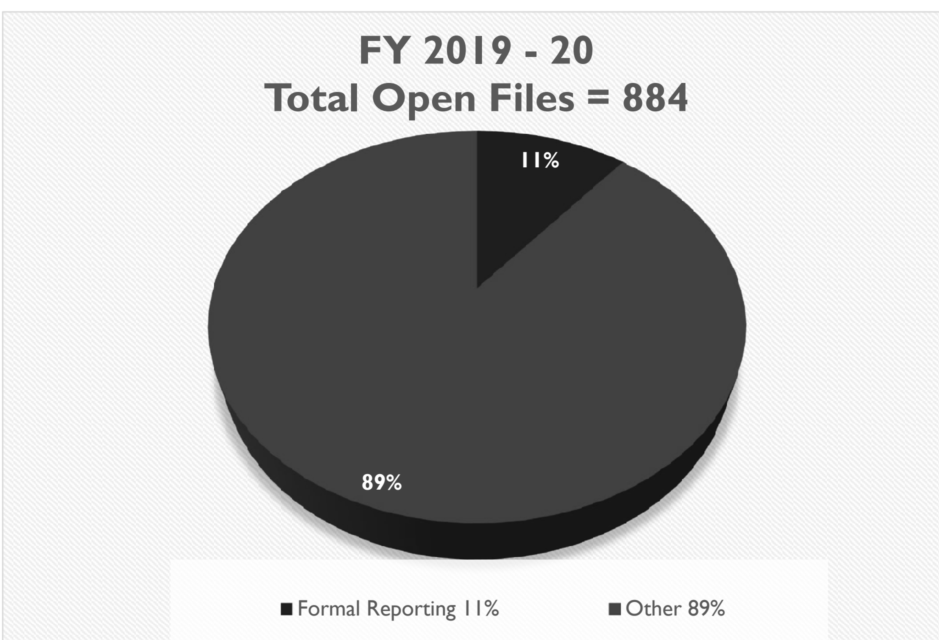
JLAP'S SUCCESS RATES IN SUBSTANCE USE CASES

JLAP's formal monitoring program has one of the highest success rates of any professionals' program in the nation:

Over 95% no-relapse rate in the last five years

PROFESSIONALISM

ONLY 11% OF JLAP'S CASES INVOLVE MONITORING FOR DISCIPLINE OR BAR ADMISSIONS



PROFESSIONALISM

- ***If you, a colleague, or another legal professional is at risk . . .***
- ***Don't wait for Discipline.***
- ***Assist with a "Step by Step to a Better Them"***

- ***MAKE THE CONFIDENTIAL CALL!***
- ***JUDGES and LAWYERS ASSISTANCE PROGRAM (JLAP)***
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THE GOAL OF STATE LAPS:

Healthy Judges, Lawyers and Law Students at Their Best!

Studies Available at: www.LouisianaJLAP.com

- 2015 ABA Study: "The Prevalence of Attorney Substance Abuse and Mental Health Issues" provides current statistics.
- 2017 ABA National Task Force: "The Path to Lawyer Well-Being" LAPs provide education on how to better identify subtle peer behaviors that may indicate a mental health impairment.
- 2015 JLAP Performance Audit: JLAP's clinical program is "Broad Brush" and addresses ALL mental health and substance abuse issues.

- **Also Available at: www.LouisianaJLAP.com**

- Specific wellness and mental health information for all stakeholders in the profession.

- Self-tests to aid professionals in discretely determining if they may be experiencing wellness, substance use, or other mental health difficulties.

- A plethora of referrals to mental health resources.

- Comprehensive information on how JLAP can help you or someone you may be concerned about.

- **Dr. Angela White-Bazile, Esq.**
- **Executive Director**
- **Judges and Lawyers Assistance Program, Inc.**
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SETTLING DIFFICULT SUCCESSIONS

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THE 51ST ANNUAL ESTATE PLANNING CONFERENCE
NOVEMBER 18-19, 2021

I. Facilitating Settlement before the Succession Begins: the No-Contest Clause (a.k.a. *In Terrorem Clause*)

A. What is a no-contest clause?

1. "An 'in terrorem clause,' also called a 'no-contest clause,' is a testamentary provision providing for the revocation of a bequest if a legatee contests the validity of the will." *Succession of Robinson*, 52,718 (La. App. 2 Cir. 6/26/19); 277 So. 3d 454, 458.
2. Thus, a no-contest clause can be viewed as a condition placed on a legacy in a will.

B. What can a no-contest clause do? Not Do?

1. A no-contest clause *can* disinherit a legatee that challenges a will, providing a powerful deterrent against a will contest.
2. A no-contest clause *cannot* prevent the underlying challenge from occurring if the challenger is unfazed by the penalty.
   a. Challengers with meager legacies may not care about losing them, being motivated by something other than their inheritance.
   b. Unnamed intestate heirs, who would not receive a legacy under the will anyway, may have no qualms attacking a will with a no-contest clause.

C. Are no-contest clauses enforceable in Louisiana?

1. Yes. "No-contest clauses are not expressly prohibited by Louisiana law," *Robinson*, 277 So. 3d at 458, and Louisiana courts will enforce the same as a matter of testamentary freedom,

Succession of Laborde, 2017-1334 (La. App. 1 Cir. 05/31/18); 251 So. 3d 461, 463–65.

2. Additionally, in enforcing no-contest provisions, Louisiana rejects the good-faith exception (seen in some other states) that allows unknowing legatees to withdraw will challenges, without consequence, once they become aware of a no-contest clause.

    a. For example, in *Succession of Laborde*, the decedent's will was probated, his daughter filed a motion to contest and nullify the will, and then a codicil containing a no-contest clause was filed. *Laborde*, 251 So. 3d at 463.

    b. The codicil provided that, if the daughter contested the will, she would forfeit all bequests to her. *Id.*

    c. The executrix then sought to enforce the no-contest clause, while the daughter objected to its enforcement by arguing that her actions prior to the codicil being probated had no legal effect, and furthermore, she withdrew her challenge in the months after the codicil was filed. *Id.*

    d. The First Circuit ruled that the no-contest clause was enforceable, because "the clause contains neither a knowledge requirement nor a good faith exception based on lack of knowledge [and the decedent] could have restricted the clause's application to legal actions filed after the codicil was probated, or after [his legatee] learned of its contents, but he did not. In the absence of ambiguity, the codicil's terms must be carried out as written." *Id.* at 465.

SETTLING DIFFICULT SUCCESSIONS

D. What limits does the law place on a no-contest clause?

1. Despite their general enforceability, no-contest clauses may not impose conditions or strictures that are "contrary to law or good morals." *Laborde*, 251 So. 3d 461, 464.

2. Thus, a no-contest clause may not impinge on forced heirship. *See id.*

3. A no-contest clause cannot penalize *all* legatees based on the challenge of a single legatee; the penalty should be challenger-specific.

   a. In *Succession of Kern*, the Fourth Circuit considered a no-contest clause mandating that, if any heir challenged the will in any way, all bequests would become null and void, and the whole estate would go to a charity. 252 So.2d 507, 510 (La. App. 4 Cir. 1971).

   b. The court found this provision to be "repugnant to law and good morals" because it left innocent legatees, that were expressly named in the will, "virtually helpless and at the mercy of any [challenging] heir not mentioned in the will." *Id.*

   c. The court explained that the provision could allow an heir not named in the will "to force a legatee to surrender a portion of his legacy to prevent the have-not heir from instituting legal proceedings" and nullifying the entire will. *Id.*

   d. As a result, the court did not enforce the no-contest provision; but the rest of the will stood. *Id.*

4. Being penal in nature, a no-contest clause will be strictly enforced in accordance with its "clear language" and without any "effort to ascertain the intent of the testator." *In re Succession of Scott*, 2005-2609 (La. App. 1 Cir. 11/3/06); 950 So. 2d 846, 849.

   a. In *Succession of Scott*, the testator's *in terrorem* clause provided that, "[i]f any of the named legatees should contest any provision in this will, then the naming of that person in my will shall be struck and they shall not be considered a legatee." *Scott*, 950 So. 2d at 847.

   b. One of the testator's children was not named as a legatee, but was the beneficiary of a trust named as a legatee. She filed a petition for declaratory judgment seeking a declaration that she was not subject to the no-contest clause. *Id.* at 848.

   c. The First Circuit first considered whether the term "named legatee" was ambiguous, and found that it was not. The court then addressed the issue of whether the daughter, as a beneficiary of the trust, was truly the “named legatee,” or whether, it was the trust. After considering prior jurisprudence citing the Trust Code provision that vests title to trust property in the trustee, the court ruled “[i]t follows then that it is the trustee, and not a beneficiary, who is a legatee under a will.” *Scott*, 950 So. 2d at 848–49.

d. As such, the court ruled that the daughter, as a beneficially only, was free to challenge to challenge the will without triggering the no-contest clause. *Id.* at 849.

E. How can a no-contest clause be used to settle a potentially difficult succession?

1. As a prophylactic measure, a no-contest clause can deter legatees from aggressive challenges that often make successions difficult to settle. An ounce of prevention, in this regard, is worth a pound of cure.

2. Even when litigation occurs in the presence of a no-contest clause, litigants often tread lightly in an effort to avoid any act that could be construed as triggering its provisions. These limitations can produce less acrimonious litigation that is easier to settle.

II. Bringing the Matter to a Head: Confronting the Succession Representative with Removal as a Means of Facilitating Settlement

A. What Are the Succession Representative’s Duties?

1. The succession representative’s duties are “collecting, preserving and managing the property of the succession in accordance with law.” *La. Code Civ. Proc. art. 3191.*

2. Louisiana Code of Civil Procedure Article 3191 requires the Succession Representative to "act at all times as a prudent administrator."

3. A succession representative is prohibited from self-dealing under Louisiana Code of Civil Procedure article 3194, subject to the exceptions under Article 3195.

4. Close the succession as soon as advisable. *La. Code Civ. Proc. art. 3197.*

5. The succession representative is required to file an annual accounting and a final account under Louisiana Code of Civil Procedure articles 3331-32; but an independent administrator/executor is not required to file interim accountings pursuant to Louisiana Code of Civil Procedure article 3396.18.

6. Additional specific duties are addressed throughout the Code of Civil Procedure articles on probate procedure.

SETTLING DIFFICULT SUCCESSIONS

B. Who is Disqualified from Serving?

1. Under Louisiana Code of Civil Procedure article 3097, a person is disqualified who is:

   a. Under age 18;
   b. Interdicted or proven to be mentally incompetent;
   c. A convicted felon, under US law or the laws of any state or territory;
   d. A non resident who has not appointed and filed a designation of agent for service of process;
   e. A corporation not authorized to perform the duties of the office in Louisiana;

f. A person proven to be unfit because of bad moral character.

2. Note that once a succession representative has been appointed / confirmed, even if he is later determined to be disqualified under Article 3097, there is no *per se* or mandatory removal provision.

C. What Do the Louisiana Cases on Removal Tell Us?

1. It's up to the judge.

2. Mismanagement/violation of duty alone is not necessarily enough to warrant removal: In *Succession of Krushevski,* 528 So. 2d 743 (La. App. 4 Cir. 1988), the succession representative continued the decedent's practice of speculating in the stock market, but the court concluded that even though that practice constituted mismanagement, because the executor was acting in good faith (managing the property the same way his father did and changing his ways when advised by his attorney against the practice), the trial court did not err in failing to remove him.

3. Likewise, in *Succession of McIntire*, 2000-1275 (La. App. 4 Cir. 4/25/01); 785 So.2d 1032, the executor violated numerous specific and general duties (failure to maintain separate accounts for personal and succession funds, failure to file annual accountings, failure to include numerous assets on the descriptive list), but the fourth circuit held that the trial court was within its discretion not to remove the executor.

4. Other rulings are stricter; in *Succession of Lawless*, 415 So. 2d 1008 (La. App. 4 Cir. 1982), the executor's failure to properly

manage and maintain an apartment complex held in the succession over five years was grounds for removal.

5. The difference between *McIntire* and *Lawless*? Perhaps was the fact that the executor in *McIntire* was the decedent's husband and the usufructuary of the residuary estate, while the residuary legatee in *Lawless* was Dillard University.

6. Self-dealing can be grounds for removal, if, as in *Succession of LaFleur*, 99-1100 (La. App. 3 Cir. 12/8/99); 752 So. 2d 237, there the succession representative sold succession property to a closely-held company he owned an interest in and refused to distribute property so that he could continue to control property he inherited an interest in.

7. Conflicts between the succession representative and the succession do not require removal of the succession representative. In *Succession of Favalora*, 169 So. 2d 197 (La. App. 4 Cir. 1964), claims existed between the succession representative and the succession regarding the determination of separate and community property but the court held that the existence of such claims alone would not require the removal of the executrix.

8. Incarceration of the succession representative alone may not be enough to require removal. In *Succession of Moses*, 361 So. 2d 253 (La. App. 1 Cir. 1978), the court, after careful consideration, determined that while incarceration alone was not *per se* grounds

for removal, the facts showed that the succession representative, who was in jail awaiting trial in connection with the murder of the decedent, had neglected her duties and failed to manage the succession properly during the time she was incarcerated.

9. If a person who is not qualified under Louisiana Code of Civil Procedure article 3097 is appointed as succession representative, the fact that he is disqualified is not alone sufficient to require removal, but at least one court has held that failure to remove a disqualified succession representative where other qualified persons are available to serve is reversible error. *See Succession of Revere*, 393 So. 2d 153 (La. App. 1 Cir. 1980).

D. What is the Standard of Proof?

1. The evidentiary burden of proof at trial for removal is clear and convincing evidence. *See Succession of Cucchero*, 2002-0368 (La. App. 1 Cir. 2/14/03); 845 So. 2d 450.

III. Tax Considerations in Estate Settlements

A. Respecting a Settlement for Tax Purposes; Deductibility of Expenses

1. Generally, the settlement will be respected provided

    a. The settlement is a bone fide agreement in response to a bone fide controversy

    b. The settlement is economically fair

    c. *See Bosch*, 387 U.S. 456 (1967); *Lyeth v. Hoey*, 305 US 188 (1938); *Getty v. Com'r*, 913 F.2d 1486 (9th Cir. 1990); PLR 8902045; Rev. Rul. 89-31; TAM 8945004; *Estate of Warren v. Com'r*, 981 F2d 776 (5th Cir. 1993).

2. Expenses of the estate are deductible IRC Sec. 2053(a)(2).

B. *Income Tax Attributes of Legacies*

1. Tax-deferred Retirement Accounts

   a. Where a spouse is the sole designated beneficiary of a tax-deferred retirement account such as a 401(k) or traditional IRA, the spouse can roll the account over into an IRA for a spouse and defer distributions until the spouse's required beginning date, generally now age 72.

   b. Minors and chronically ill beneficiaries can also have extended pay-out periods and defer recognition of income.

   c. Generally, other beneficiaries must pay out the account within ten years, which means that tax is accelerated.

   d. A retirement account is likely to be most advantage to a beneficiary who can defer the tax over the longest time and who has the lowest income tax rate.

2. What is the basis in the asset your client receives in a settlement?

   a. Assets that are included in the estate of the decedent generally have a new basis for income tax purpose, unless they are IRD ("income in respect of a decendent").

   b. Assets being distributed from a trust that was not included in the decedent's estate will not have a new basis—for example assets being distributed from an exemption spouse set up under the will of a predeceased spouse.

3. Other Income Tax Considerations to Investigate

   a. Income tax attributions related to depreciated assets and closely-held business interests, particularly where debt is involved.

   b. Determine whether a Section 754 election has been made with respect to assets that are held by an entity taxed as a partnership—will your client have a new "outside" basis or is the basis stepped up as to assets inside the partnership?

   c. Consider S-election issues. Is your client a qualified sub-chapter S shareholder? If your clients receives assets in trust, has the necessary election been made to qualify the trust as a QSST or EBST?

   d. What about income tax liens?

e. Is the asset your client receives income in respect of a decedent (IRD) such that it is taxable income to your client? Stock options, compensation distributions, declared but unpaid dividends for example.

4. Other Estate/GST Tax Considerations to Investigate

a. Are the assets your client is receiving subject to an estate tax lien? Can you get the lien released?

b. Have the estate taxes been paid and what risk is there that the tax will be adjusted under audit?

c. How is estate tax being allocated? Will the distribution your client receives bear estate tax?

d. Any GST exemption issues?

C. Tax Trip Wires for Funding Legacies

Special thanks to B. Trevor Wilson of Jones Walker LLP for his help with this section of the outline.

1. General Concepts.

a. Generally, no gain is recognized by a trust or estate on the distribution of property to a beneficiary. I.R.C. § 643(e)(3) and Treas. Reg. § 1.661(a)-2(f).

b. However, the trust or estate recognizes gain on the distribution of property to a beneficiary in the following situations:

i. The distribution is in satisfaction of a pecuniary bequest or other property is distributed in lieu of property specified in a bequest. Treas. Reg. § 1.661(a)-2(f).

ii. The estate or trust elects to recognize gain on the distribution. I.R.C. § 643(e)(3).

iii. The property is distributed in satisfaction of a requirement that all income be distributed currently. Treas. Reg. §§ 1.651(a)-2(d), 1.661(a)-2(f).

2. Funding of a fractional share legacy

a. If funded in a non-prorata manner, and the fiduciary does not have the authority to select assets will trigger gain.

b. Any loss realized on a distribution generally is disallowed under the related party rules because the trust or estate and beneficiary are treated as related persons. I.R.C. § 267(b)(6) and (13). However, these loss disallowance rules do not apply if an estate distributes the property in satisfaction of a pecuniary bequest. I.R.C. § 267(b)(13).

c. If the fiduciary has the authority to select assets, no gain or loss is triggered on a fractional share funding. PLR 8119040.

d. However, there is no corresponding rule for funding a pecuniary bequest.

e. To protect the marital deduction, the funding must be fairly representative of the appreciation and depreciation of the estate. Rev. Proc. 64-19. 1964-1 CB 682.

f. The beneficiary of a trust or estate who receives a distribution of property generally takes a basis in the distributed property equal to the distributing trust's or estate's adjusted basis adjusted for any gain or loss recognized by the trust or estate on the distribution. I.R.C. § 643(e)(1). However, this basis cannot exceed the fair market value of the distributed property at the time of distribution. I.R.C. § 643(e)(2).

3. Funding a Pecuniary Amount Formula

a. When you fund a pecuniary legacy with assets that have changed in value, that funding triggers a capital gain or loss to the extent that the asset used to fund has appreciated or depreciated. Treas. Reg. §§ 1.661(a)-2(f), 1.1014-4(a)(3); Kenan v. Comm'r, 114 F.2d 217 (2d Cir. 1940).

b. Losses are recognized per I.R.C. § 267(b)(13), notwithstanding the general rule disallowing losses per the related party rules under I.R.C. § 267(b)(6) and (13).

D. Tax Trip Wires in Modifying Interests in Trusts

1. Consider a trust in which spouse is sole income beneficiary for life and child from a prior marriage is sole principal beneficiary. Child and spouse agree to terminate the trust and divide the assets.

a. Spouse is treated as having sold spouse's interest in the trust and, because of the way the split interest rules work, spouse has no basis in spouse's income interest in the trust and has a capital gain. See Internal Revenue Codes §§ 1014, 1015, and 1041).

b. Child has basis in the remainder interest and will not recognize gain to the extent of basis.

c. Beware of Chapter 13 and the special valuation rules for split interests in trusts. These rule could capture an arm's length transaction and treat it as a gift of 100% of the value of the trust property.

2. Consider the risk of terminating a QTIP trust, which could disqualify the gift to the trust for the marital deduction or, if the deduction has been taken will trigger a gift from spouse to child of the full value of the trust assets. IRC Sec. 2519.

E. Renunciations (a/k/a Qualified or Unqualified Disclaimer)

1. Internal Revenue Code § 2518(a) provides that a disclaimed interest is, for gift tax purposes, treated as if the interest had never been transferred to the disclaimant—provided the disclaimer is done timely and properly. Essentially, § 2518(a) lets the intended recipient make a gift to the next-in-line recipient free of additional gift or estate tax.

2. To avoid federal transfer tax consequences as a result of the disclaimer, the disclaimer must meet the requirements for a "qualified" disclaimer under Internal Revenue Code § 2518. To have a qualified disclaimer under Internal Revenue Code § 2518(b), there must be an irrevocable and unqualified refusal by a person to accept an interest in property, and each of the following requirements must be met:

   a. The disclaimer must be in writing.

   b. The writing must be made in time, meaning it must be received by the transferor of the interest or the holder of legal title to the property **within nine months** after the later of:

i. the date on which the transfer creating the interest was made; or

ii. the date on which the disclaiming person attains age 21.

c. The disclaiming person must not have accepted the interest or any of its benefits.

d. As a result of such refusal, the interest must pass without any direction on the part of the disclaiming person and the interest must pass either:

i. To the spouse of the decedent, or

ii. To a person other than the disclaiming person.

3. QTIP Property. A remainder beneficiary of qualified terminable interest property must disclaim within nine months of the date of the transfer creating the interest—typically the date of death of first spouse to die, not the later death of the surviving spouse.

F. The Role of DSUE in Settlements

1. In order to transfer a decedent's unused exemption to the surviving spouse, the succession representative must file a US Estate (and Generation-Skipping) Tax Return and elect to transfer the unused exemption.

2. This could be used as a carrot or a stick to close a settlement because the DSUE election could give surviving spouse additional exemption to use to pass assets to his or her children.

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RECENT DEVELOPMENTS IN TAXATION OF INTEREST TO ESTATE PLANNERS

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RECENT DEVELOPMENTS IN TAXATION

REBECCA M. HINTON

Rebecca M. Hinton is an attorney with Taylor, Porter, Brooks & Phillips, L.L.P. Her practice focuses on federal and state taxation, estate planning, succession administration, business formations and business transactions.

Prior to attending law school, Ms. Hinton received her B.S. in Accounting from Louisiana Tech University, graduating summa cum laude. In 2006, Ms. Hinton received her J.D. from the Louisiana State University Paul M. Hebert Law Center where she was Production Editor for the Louisiana Law Review. Ms. Hinton graduated from Louisiana State University Paul M. Hebert Law Center with the honor of Order of the Coif.

Practicing law since September 2006, Ms. Hinton's practice areas focus on the following:

- Assisting clients with the preparation of their personal estate planning documents, ranging from traditional wills and powers of attorney to establishing large-scale trusts, family limited liability companies, and long-term gifting plans to lessen federal estate and gift tax exposure.
- Advising clients on formation and operation of entities for both tax planning and state law compliance issues, and drafting business documents to achieve client objectives.
- Structuring and advising clients concerning business and personal financial transactions and options to lessen tax exposure.
- Supporting clients in administering successions.
- Providing advice to non-profit entities on formation, corporate governance, tax exemption, and compliance with tax-exempt law.
- Handling federal, state and local tax controversies with the Internal Revenue Service, Louisiana Department of Revenue and local taxing authorities, including audits, administrative negotiations, trial preparation and litigation.
- Assisting individuals and businesses in obtaining federal, state, and local tax and business incentives.

RECENT DEVELOPMENTS IN TAXATION

In addition to these practice areas, Ms. Hinton is ranked by her peers among the *Best Lawyers in America* (2020 – 2022) in tax law and successions (2021 – 2022). She is a former adjunct professor at Louisiana State University Paul M. Hebert Law Center, and frequently presents at CLE and other seminars on the topics of federal estate and gift taxation, estate planning, and federal taxation.

RECENT DEVELOPMENTS IN TAXATION
OF INTEREST TO ESTATE PLANNERS

By Rebecca M. Hinton

I. Federal Legislative Developments

A. The Current State of Estate, Gift and Generation-Skipping Transfer ("GST") Taxes

1. The following chart sets forth the basic exclusion amount against federal estate taxes, the lifetime exclusion amount against federal gift taxes, the GST exemption amount, and the maximum tax rates applicable to these taxes, for 2017 through 2022. Effective January 1, 2011, these exclusion and exemption amounts were unified, such that taxpayers now have the option of gifting these amounts during their lifetime, at death, or some combination thereof.

	2017 Amount	2018 Amount[1]	2019 Amount[2]	2020 Amount[3]	2021 Amount[4]	2022 Amount*
Estate Tax Basic Exclusion Lifetime Gift Tax Exclusion GST Tax Exemption	$5,490,000	$11,180,000	$11,400,000	$11,580,000	$11,700,000	$12,060,000
Maximum Rate	40%	40%	40%	40%	40%	40%

* These 2022 amounts are estimated amounts from Thompson Reuters Checkpoint, released in September 2021, based on the average inflation index for the 12-month period ending on August 31, 2021, published in the Consumer Price Index for all urban consumers by the U.S. Department of Labor.

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[1] *Rev. Proc. 2018-18*.

[2] *Rev. Proc. 2018-57*.

[3] *Rev. Proc. 2019-44*.

[4] *Rev. Proc. 2020-45*.

2. The 2017 Tax Cuts and Jobs Act (the "2017 Tax Act"),[5] passed December 22, 2017, increased the federal estate, gift, and generation-skipping transfer tax unified credit basic exclusion amount to $10 million (with inflation adjustments) effective for decedents dying and gifts made after 2017 and prior to 2026.[6] Effective January 1, 2026 and thereafter, the basic exclusion amount will return to the amount set in 2012 - $5 million per individual taxpayer, adjusted for inflation.

B. Federal Legislative and Regulatory Developments

1. Finalized ABLE Account Regulations

a) On November 19, 2020, the Internal Revenue Service finalized regulations applicable to qualified ABLE programs authorized under *Int. Rev. Code Sec. 529A*.[7] The finalized regulations replace the proposed regulations previously issued in 2015 and 2019, adopting these prior regulations with some modifications.

b) The Stephen Beck, Jr., Achieving a Better Life Experience Act of 2014 (the "ABLE Act")[8] enacted *Int. Rev. Code Sec. 529A*, which allows states or state agencies to establish and maintain tax-advantaged savings accounts (an "ABLE Account") to fund the qualified disability expenses of an individual who is the "designated beneficiary" of such account.

(1) The "designated beneficiary" of an ABLE Account is the eligible individual who established the ABLE Account, and is also the owner of the ABLE Account.[9]

c) Residency Requirements

(1) When the ABLE Act was originally passed, ABLE Accounts were required to be established in the state where the designated beneficiary resided.

(2) The Protecting Americans from Tax Hikes Act of 2015[10] repealed this residency requirement.

[5] H.R. 1 – 115th Congress (2017 – 2018), Public Law No. 115-97.

[6] *Id.*, impacting *Internal Revenue Code Sections 1014, 2001 – 2210, 2502, 2505* and *2601 – 2664*.

[7] T.D. 9923, RIN 1545-BM68, RIN 1545-BP10, 85 Fed. Reg. __ (Nov. 19, 2020).

[8] Pub. Law 113-295.

[9] *Int. Rev. Code Sec. 529A(e)(3)*.

[10] The "PATH Act," Pub. Law 114-113.

(3) The Preamble to the final ABLE Account regulations confirm that a qualified state ABLE program has authority to set its own rules for individuals allowed to participate in its program.

d) Determination of Eligible Individuals

(1) *Internal Revenue Code Section 529A(e)(1)* and the 2015 proposed regulations issued thereunder provided that an individual is an eligible individual for a tax year if he or she is either (i) entitled during that year to benefits based on blindness or disability under title II or XVI of the Social Security Act, provided that such blindness or disability occurred prior to the date the individual attained age 26, or (ii) the subject of a disability certification filed with the Treasury Secretary or his delegate for that year.

(2) The final regulations, along with the 2015 regulations, confirm that determination of eligibility is made each tax year, and once determined, applies for the entire tax year.[11]

(3) The final regulations also require a qualified state ABLE program to specify the documentation an individual must provide, both at the time an ABLE Account is established and thereafter, to ensure that the designated beneficiary of the ABLE Account is, and continues to be, an eligible individual.[12]

e) Disability Standard

(1) To qualify as an eligible individual, such individual must be subject to a disability. The definition of disability in the ABLE Account regulations cross-references the definition of having "marked and severe functional limitations" as set forth in the Social Security regulations.

(2) The final regulations do provide, though, that the standard for disability for purposes of *Int. Rev. Code Sec. 529A* is applied regardless of the eligible individual's age, and whether or not the eligible individual is engaged in substantial gainful activity.[13]

(a) Language within the Social Security regulations would disqualify an individual who is engaged in substantial gainful activities from its coverage. The ABLE Account

[11] Treas. Regs. § 1.529A-2(d)(1)(i).

[12] *Id*.

[13] Treas. Regs. § 1.529A-2(e)(2).

regulations conclusively confirm that an eligible individual able to engage in substantial gainful activity will not disqualify such person from being able to establish an ABLE Account.

f) Establishment of and Signatory Authority Over an ABLE Account

(1) *Internal Revenue Code Section 529A(e)(3)* defines the "designated beneficiary" of an ABLE Account as the eligible individual who is the owner of the account. After considering that some eligible individuals may not have capacity or otherwise be able to establish an ABLE Account on their own account, the 2015 proposed regulations provided that an ABLE Account could be established by an agent under power of attorney, or a parent or legal guardian of an eligible individual.

(2) The 2020 final regulations provide an expanded ranking of individuals with authority to establish an ABLE Account for an individual or exercise signature authority over such individual's ABLE Account. This ranking, in order of priority, consists of the individual selected by the eligible individual or the eligible individual's agent under a power of attorney, conservator or legal guardian, spouse, parent, sibling, or grandparent. A representative payee (whether an individual or organization) appointed by the Social Security Administration may also establish an ABLE Account for the benefit of an eligible individual.[14]

g) Limitation on ABLE Accounts Per Eligible Individual

(1) *Internal Revenue Code Section 529A(b)(1)(B)* provides that an eligible individual may have only one ABLE Account. Special rules apply in the event funds within an ABLE Account are rolled over, but continue to provide that an eligible individual is ultimately limited to one ABLE Account at a time.

(2) The final regulations confirm that an eligible individual is not prohibited from establishing an ABLE Account if a prior ABLE Account established for such individual has been closed.[15]

[14] Treas. Regs. § 1.529A-2(c)(1).

[15] Treas. Regs. § 1.529A-2(c)(3).

h) Contributions to ABLE Accounts

(1) All contributions to ABLE Accounts are required to be made in cash, or cash equivalent formats.

(2) The 2015 proposed regulations included within the definition of cash, contributions in the form of check, money order, credit card payment, electronic transfer, or other similar methods of payments.

(3) The final regulations expand the 2015 definition of cash to also include contributions to an ABLE Account to be made as an after-tax payroll deduction.[16]

2. Final Regulations Impose Fee on Individuals Seeking Estate Tax Closing Letters

a) On December 31, 2020, the Treasury Department published proposed regulations which would impose a $67 user fee for individuals who request an estate tax closing letter, IRS Letter 627, from the IRS.[17] The person responsible for the fee would be the estate of the decedent, or any party authorized under *Int. Rev. Code Sec. 6103*.

(1) *Internal Revenue Code Section 6103* authorizes disclosure of estate information to "(i) the administrator, executor, or trustee of such estate, and (ii) any heir at law, next of kin, or beneficiary under the will, of the decedent, but only if the Secretary finds that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained therein . . ."

b) Currently, the IRS issues estate tax closing letters only upon the request of an authorized person after an estate tax return has been accepted by the IRS (1) as filed, (2) after an adjustment agreed upon by the estate, or (3) after an adjustment in the deceased spousal unused exclusion ("DSUE") amount.

c) The IRS is proposing this new $67 user fee due to the resource constraints currently imposed on the IRS, and as a convenience fee to the person requesting the closing letter. The fee imposed purportedly is an effort by the IRS to recover the costs incurred in providing these letters.

[16] Treas. Regs. § 1.529A-2(g)(1).

[17] REG-114615-16, RIN 1545-BP75, 85 Fed. Reg. ___ (Dec. 31, 2020), as clarified in REG-114615-16, RIN 1545-BP75, 86 Fed. Reg. ___ (Apr. 22, 2021). Note that in addition to the imposition of this fee, the IRS increased the fee for certain Private Letter Ruling ("PLR") requests from $30,000 to $38,000. Rev. Proc. 2021-1.

d) The proposed regulations did not provide guidance on the procedures to be used to request the estate tax closing letter and pay the fee, but the IRS has indicated that it will initiate a one-step, web-based procedure to make the request.

e) Comments on these proposed regulations were due March 1, 2021. The IRS received five comments.

(1) One of the commenters opposed the fee, and requested that the IRS return to its procedure in place prior to 2015, thus providing a closing letter for every estate tax return filed. This request was rejected.

f) On September 27, 2021, the IRS issued final regulations which conclusively provide for the $67 fee to obtain estate tax return closing letters.[18] The Treasury Department and the IRS adopted the proposed regulations without significant change.

(1) For those who oppose payment of the fee, the IRS has indicated executors may still request an account transcript, which will indicate whether the return has been reviewed, and this request can be made free of charge.

(2) This fee will be imposed starting October 28, 2021.[19]

3. Consolidated Appropriations Act of 2021 (the "Act")[20]

a) On December 21, 2020, Congress approved a 2,124-page, $2.3 trillion funding package consisting of a $900 billion end-of-the-year COVID-19 stimulus bill attached to a $1.4 trillion omnibus spending bill to fund the government through September 30, 2021. President Trump signed the bill on December 27, 2020. Some of the tax provisions in the Act important to estate planners include the following:

(1) Medical Expense Deduction Adjusted Gross Income Limitation Permanently Reduced to 7.5%

(a) With the passage of the Act, taxpayers who itemize their deductions are entitled to claim an itemized medical

[18] TD 9957, RIN 1545-BP75.

[19] IR 2021-194.

[20] This Act is sometimes referred to as the "COVID-19 Relief Bill." Consolidated Appropriations Act, 2021, H.R. 133, 117 Congress, Public Law 116-260.

expense deduction under *Int. Rev. Code Sec. 213* for medical expenses that exceed 7.5% of their adjusted gross income.[21]

(b) Under prior law, the 7.5% adjusted gross income limitation was set to increase to a 10% adjusted gross income threshold in 2021. The Act retained the 7.5% adjusted gross income limitation permanently.

(2) Exclusion from Income Available to Emergency Workers

(a) The Act permanently extended the income exclusion available to emergency workers who are members of a "qualified volunteer emergency response organization," which allows such workers to exclude from gross income specified state or local government payments or state and local tax relief received due to their volunteer services.[22] This exclusion was previously scheduled to expire on December 31, 2020.

(3) Exclusion from Income Related to Discharge of Qualified Mortgage Debt

(a) Pursuant to general tax principles, cancellation of debt by a lender should result in discharge of indebtedness income, includible in the income of the party discharged unless an exclusion from income otherwise applies.

(b) Prior to passage of the Act, *Internal Revenue Code Section 108(a)(1)(E)* allowed an exclusion from gross income of up to $2 million (or $1 million for married taxpayers filing separately) of discharge of debt income if such income arose from the discharge of qualified principal residence debt. This exclusion was set to expire on December 31, 2020.

(c) The Act extended the exclusion available under *Internal Revenue Code Section 108(a)(1)(E)*, but with modified terms.[23] Under this Code section as amended by the Act, taxpayers can now exclude up to $750,000 (or $375,000 for married taxpayers filing separately) of

[21] Act, at Sec. 101, amending *Int. Rev. Code Sec. 213(a)*.

[22] *Id*. at Sec. 103, amending *Int. Rev. Code Sec. 139B*.

[23] *Id*. at Sec. 114(a), amending *Int. Rev. Code Sec. 108(a)(1)(E)*.

discharge of debt income if such income arose from the discharge of qualified principal residence debt.

(d) This amended exclusion is currently set to expire on December 31, 2025.

(4) Exclusion from Income Available for Certain Employer Payments of Employee Student Loan Debt

(a) Employers are allowed to provide qualifying educational assistance to employees, up to a maximum annual threshold of $5,250, and have such amounts excluded from the employee's income.

(b) The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act")[24] expanded the definition of qualified educational assistance eligible for this exclusion to include eligible student loan repayments made by employers, as long as such repayments were made after March 27, 2020 and prior to January 1, 2021. Eligible student loan repayments were defined to include payments of principal or interest by an employer on qualified student loans of an employee, whether such payments were made directly to the lender or to the employee.

(c) The Act extended the availability of this income exclusion for employer-made student loan debt repayments through December 31, 2025.[25]

(5) Extension of New Markets Tax Credit

(a) The New Markets Tax Credit provides significant tax credit opportunities to individual or corporate taxpayers who invest in low-income communities. The ability to claim the New Markets Tax Credit was set to expire December 31, 2020.

(b) The Act extended the tenure of the New Markets Tax Credit through December 31, 2025.[26]

[24] CARES Act, Pub. Law 116-136 (March 27, 2020).

[25] Act at Sec. 120, amending *Int. Rev. Code Sec. 127(c)(1)(B)*.

[26] *Id*. at Sec. 112(a), amending *Int. Rev. Code Sec. 45D(f)(1)(H)*.

b) The Taxpayer Certainty and Disaster Tax Relief Act ("TCDTR")[27]

(1) The TCDTR, was passed as part of the Consolidated Appropriations Act, 2021.

(2) Charitable Contribution Deductions Available to Non-Itemizing Taxpayers

(a) Generally, taxpayers who do not itemize their deductions are unable to claim their charitable contributions as deductions on their Federal income tax returns.

(b) The TCDTR allows taxpayers who do not itemize their deductions to take up to a $300 above-the-line deduction for cash contributions to qualified charitable organizations. The TCDTR allows married taxpayers to claim up to a $600 above-the-line deduction for such charitable donations.[28] If taxpayers overstate these deductions, they can be subject to a 50% penalty on any tax underpayments arising from such overstatement of the deduction.[29]

(c) This provision is effective for tax years beginning after December 31, 2019.[30]

(d) Note that the CARES Act initially granted this above-the-line charitable contribution deduction. The TCDTR Act extended the term of this deduction, and also increased the penalties applicable to abuse of this deduction.

(3) Unlimited Charitable Deduction for Cash Gifts to Public Charities

(a) Under prior law, a taxpayer who contributed cash to public charities could claim deductions for such cash contributions, and the deductibility of these contributions was capped at 60% of the donor-taxpayer's adjusted gross income.

(b) Under the TCDTR, the 60% of adjusted gross income limitation does not apply for tax years 2020 and

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[27] H.R. 748, 116th Congress (2019-2020).

[28] TCDTR, Sec. 212(a), amending *Int. Rev. Code Sec. 170(p); see also* IR 2021-190 (Sept. 17, 2021).

[29] *Id*. at Sec. 212(b), amending *Int. Rev. Code Sec. 6662(l)*.

[30] *Id*. at Sec. 212(d).

2021,[31] meaning for these tax years, a taxpayer has the opportunity to eliminate 100% of his or her adjusted gross income, and corresponding income tax liability, if a taxpayer makes cash contributions to public charities of the full amount of his or her adjusted gross income.

(c) This amendment is effective for tax years beginning after December 31, 2019.[32]

(4) Qualified Disaster Distributions and Loans Allowed from Retirement Plans without Penalty

(a) Under general tax rules, if a taxpayer makes a withdrawal from his or her retirement plan prior to age 59 ½ (an "early withdrawal"), such withdrawal is subject to a 10% payment (commonly referred to as a penalty), unless some type of designated hardship applies to negate the application of the penalty.

(b) The TCDTR provides that the 10% payment will not apply to an early withdrawal from a retirement plan as long as it is a "qualified disaster distribution." Qualified disaster distributions are capped at $100,000 in total for a taxpayer.[33]

(c) A qualified disaster is a major disaster that the President declares during the period beginning on January 1, 2020, and ending on February 25, 2021, but which must have occurred between December 28, 2019, and on or before December 27, 2020, and during the period specified by the Federal Emergency Management Agency ("FEMA") as the period during which the disaster occurred (the "Incident Period"). The qualified disaster definition applies to qualified disaster distributions from qualified retirement plans, qualified disaster employee retention credits, and qualified disaster loans to participants from qualified retirement plans. A major disaster for this purpose does not include any area with respect to which a major declared disaster was declared only because of a COVID-19 incident.

(d) A qualified disaster distribution is a distribution from a qualified retirement plan that is made on or after the first day of the Incident Period (which must occur between

[31] *Id*. at Sec. 213, amending *Int. Rev. Code Sec. 170(b)(1)(G)(i)*. *See also* IR 2021-190 (Sept. 17, 2021).

[32] *Id*. at Sec. 213(c).

[33] *Id*. at Sec. 302(a).

December 28, 2019, and December 27, 2020) and after the date on which the area in which FEMA declares the principal place of residence of the participant requesting such distribution to be a federal disaster area, provided the distribution is made before June 25, 2021 (the date 180 days following enactment of the Act).

(e) To be a qualified disaster distribution, the distribution must occur on or after the date of the incident of a qualified disaster impacting the participant's principal place of residence and prior to June 25, 2021. The income the individual recognizes from the qualified disaster distribution is automatically spread over three years, beginning with the tax year of the distribution, unless the individual elects otherwise.

(f) A qualified disaster distribution can be available, if the plan so provides, for each qualified disaster occurring to the participant's principal place of residence, if the disaster occurred during the time frames above defining a Qualified Disaster and the Incident Period and as long as the disaster occurred for the individual during the period specified by FEMA.

(g) Employers have discretion as to whether to allow or disallow qualified disaster distributions from retirement plans.

(h) Employees who take a qualified disaster distribution may repay the distribution within the three-year period beginning on or after the date they received the funds. Such repayment may occur in more than one payment. The repayment can be made up to the amount of the distribution but may not include any earnings. If the qualified disaster distribution is transferred to the participant's individual retirement account, the individual may re-contribute funds to the plan from which the participant received the qualified disaster distribution directly from the individual retirement account holding the distribution.

(i) Alternatively, a taxpayer may consider taking a loan against his or her retirement plan, such loan amounts being capped at $50,000 under general tax rules. If a taxpayer attempts to take a loan in excess of $50,000, such excess amount is treated as a distribution from the retirement plan.

(j) For loans related to qualified disasters, though, the TCDTR increases the $50,000 cap on loans from retirement plans to $100,000.[34]

c) The COVID-Related Tax Relief Act of 2020 ("COVIDTRA")

(1) Like the TCDTR, The COVID-Related Tax Relief Act of 2020 was passed as part of the Consolidated Appropriations Act, 2021.

(2) Extension of Educator Expense Deduction to Apply to PPE

(a) *Internal Revenue Code Section 62(a)(2)(D)(ii)* provides a $250 above-the-line deduction to eligible K – 12 educators who spend their own funds to cover school-related items.

(b) COVIDTRA directs the Treasury Department to issue regulations or other guidance by February 28, 2021 to ensure that personal protective equipment ("PPE"), disinfectant, and other supplies related to the prevention of COVID-19 can be included in the amounts eligible for the $250 deduction.[35]

(c) The IRS issued this required guidance by means of Revenue Procedure 2021-15.

(3) Emergency Financial Aid Grants Excluded from Income in Calculations Related to the American Opportunity Tax and Lifetime Learning Credits

(a) *Internal Revenue Code Section 25A* allows eligible individual taxpayers to claim the American Opportunity Tax Credit and/or the Lifetime Learning Credit for higher education expenses incurred at post-secondary educational institutions paid on behalf of the taxpayer, his or her spouse, and his or her dependents. Taxpayers must fall under specified income thresholds to be eligible for these credits.

(b) In calculating a taxpayer's income to determine eligibility for these education-related credits, COVIDTRA allows a taxpayer to exclude certain CARES Act emergency financial aid grants that the taxpayer may have received. This exclusion is not available to the extent any portion of

[34] *Id*. at Sec. 302(c)(3).

[35] COVIDTRA, Sec. 275.

funds received by a taxpayer represent payments for teaching, research, or other services that were performed as a condition of the taxpayer receiving the emergency financial aid.[36]

(c) This exclusion opportunity applies to emergency financial aid grants made after March 26, 2020.

C. Proposed Federal Legislation

1. President Biden's Proposals

a) Individual Taxes

(1) Changes in Tax Rates

(a) President Biden has advocated for an increase in the top individual income tax rate from the current 37%[37] to 39.6% for taxpayers who earn more than $400,000 annually.[38] This proposal, if passed, would go into effect January 1, 2022.

(b) President Biden has advocated for an increase in the highest individual capital gains tax rate from 20% to 37% (or 40.8% including the net investment income tax) for taxpayers with adjusted gross income in excess of $1 million (or $500,000 for married taxpayers filing separately).[39] This $1 million threshold would be increased annually for inflation. Note that the numbers reflected in the Administration's Fiscal Year 2022 Revenue Proposals (the "Green Book"), issued by the Department of the Treasury in May 2021, would result in this income tax increase being effective April 28, 2021, the date that President Biden

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[36] *Id*. at Sec. 277(c).

[37] *See* American Families Plan (released April 28, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/ (last visited September 26, 2021) and General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals (the "Green Book"), issued by the Department of the Treasury in May 2021 available at https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf (last visited September 26, 2021). The top individual income tax rate was decreased to 37% in the 2017 Tax Act. The 2017 Tax Act individual income tax rates are currently set to remain in effect until January 1, 2026.

[38] *See* H.R. 946 (introduced February 8, 2021 by Rep. Pascrell (D-NJ)) which increases the top individual income tax rate to 39.6%; *but see* S. 126 (introduced by Sen. Cruz (R-TX) on January 28, 2021), which advocates for the 2017 Tax Act individual income tax rates to continue permanently.

[39] Note that an increase in the highest individual income tax rate would increase this tax rate accordingly.

introduced his tax proposals by means of the American Families Plan and the American Jobs Plan.[40]

(2) Limitations on Section 1031 Exchange Gain Deferral

(a) President Biden's proposals would limit the *Int. Rev. Code Sec. 1031* exchange benefits to allow the deferral of gain recognition on a maximum amount of $500,000 of gain for each taxpayer ($1 million for married taxpayers filing jointly).[41] Any excess gain realized from a Section 1031 exchange would be recognized by the taxpayer in the year of the exchange. This proposal, if passed, would go into effect January 1, 2022.

b) Taxation on Gratuitous Transfers of Appreciated Assets

(1) President Biden proposed legislation in the Spring of 2021 which would treat certain transfers of appreciated property through lifetime gift or at death as an income tax realization event for the donor or the decedent at the time of the transfer.

(a) Under this proposal, a donor would recognize income on the difference between the gifted asset's fair market value on the date of the donation minus the donor's basis in that asset.

(b) For a decedent, the amount of income recognized would be the excess of the asset's fair market value on the decedent's date of death less the decedent's basis in the asset. Such gain would be taxable income to the decedent on the Federal gift or estate tax return or on a separate capital gains return. The decedent's estate would be entitled to offset such gains with capital losses and carry-forwards, and up to $3,000 of ordinary income on the decedent's final income tax return, and the tax imposed on gains deemed realized at death would be deductible on the estate tax return of the decedent's estate (if any).[42]

(c) The proposals do allow for certain exclusions to the application of these provisions.

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[40] *See* Green Book at p. 68.

[41] *See* Green Book at p. 84.

[42] *Supra* n. 38.

(i) Transfers from a decedent to his or her spouse or a charity would allow for the decedent's basis in the asset to be carried over to such recipient. Gain would not be recognized until the surviving spouse later transfers the asset or dies. For appreciated assets transferred to charity, no capital gains would result for the charity.

(ii) The proposal also excludes gain recognition on transfers of tangible personal property, such as household furnishings and personal effects, but excluding collectibles.

(iii) The proposal also recognizes and adopts the $250,000 exclusion on transfer of a principal residence available under *Int. Rev. Code Sec. 121*, and makes this exclusion portable to a surviving spouse.

(iv) The proposal also allows a $1 million per transferor exclusion on the recognition of unrealized capital gains on gifts or transfers at death. This $1 million exclusion would be indexed annually for inflation, and would be portable to the surviving spouse, effectively resulting in this exclusion being $2 million for married taxpayers. For assets covered by this exclusion, the recipient's basis in inherited property would be the fair market value of the assets as of the decedent-transferor's date of death. Note though, for gifted property, if such property was covered by the $1 million exclusion, the donee's basis in the property would equal the donor's basis in the property at the time of the gift.

(v) The proposal also allows for an elective deferral on the taxation of the appreciation of specified family-owned businesses. Taxes on these assets would not be due until the business is sold or ceases to be family owned and operated.

(vi) The proposal provides for a 15-year payment plan to pay the taxes that arise from the appreciation of nonliquid assets transferred at death. Security may be required to implement this payment plan.

(d) This proposal would apply for gifts made or decedents dying January 1, 2022 and thereafter.

(e) Other proposals by President Biden would also tax gain on unrealized appreciation in property held by a trust, partnership, or other noncorporate entity that is the owner of property if that property has not been the subject of a recognition event within the prior 90 years, with such testing period beginning on January 1, 1940. The first possible recognition event for any taxpayer under this provision would thus be December 31, 2030.

(i) Effectively, this provision would apply deemed sale rules and require income recognition every 90 years to assets placed in a trust, partnership, or other noncorporate entity, to the extent that such assets had not been subject to an income realization event within 90 years.

2. Build Back Better Act Reconciliation Bill[43] - Take One

a) On September 13, 2021, the House Ways & Means Committee introduced the Build Back Better Act reconciliation bill.

(1) Reconciliation bills can be passed by means of a simple majority vote. Currently, Congress is very evenly divided. The House of Representatives is comprised of 220 Democrats to 211 Republicans, and the Senate has an even 50-50 split (but Vice President Harris casts a vote in the event of a tie).

b) Proposed Individual Tax Rate Changes and Changes to Income Exclusion Rules

(1) The Build Back Better Act proposes an increase in the highest individual income tax rate to 39.6% for married couples filing jointly with adjusted gross income ("AGI") in excess of $450,000, married taxpayers filing separately with AGI in excess of $225,000, and estates and trusts with income in excess of $12,500.[44] If passed, this proposal would apply January 1, 2022 and thereafter.

(2) The Build Back Better Act expands the coverage of the 3.8% net investment income tax to apply to net income derived in the ordinary course of a trade or business for taxpayers with income in excess of $500,000 for married taxpayers filing jointly, or $400,000

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[43] S. Con. Res. 14.

[44] *Id*. at Sec. 138201.

for single taxpayers.[45] This new net investment income tax would not apply to earnings already subject to FICA taxes.

(a) This proposed change would apply to distributions from S corporations, partnerships, and disregarded LLCs and, if passed, would apply to tax years after December 31, 2021.

(b) This change could unwind planning whereby many of our clients have chosen to operate their businesses as S corporations for federal income tax purposes. Under current laws, owners of an S corporation may establish a certain amount of their payments from the S corporation as salaries, subject to FICA taxes, and take the remainder of their distributions from the entity as operating distributions. If this proposed law passes, the operating distributions will be subject to a 3.8% net investment income tax. As such, having the entity taxed as an S corporation may be a structural and ownership hassle that might not provide the tax benefits previously provided by this tax status.

(3) The Build Back Better Act imposes an additional 3% income tax surcharge on married taxpayers who file jointly and have modified AGI in excess of $5 million (or $2.5 million if they file separately).[46]

(a) This surcharge would apply on AGI reduced by investment interest expenses.

(b) Note that charitable contribution deductions are not deductible by individuals for purposes of calculating this tax. Charitable contribution deductions do remain available to estates and trusts for purposes of determining the applicable surcharge, due to how AGI is calculated for trusts and estates. This surcharge as applicable to estates and trusts is discussed below.

(4) The Build Back Better Act advocates for an increase in the highest capital gains tax rate from the current 20% to 25%.[47]

(a) This increased tax rate would apply to capital gains or dividends realized after September 13, 2021; however, an

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[45] *Id*. at Sec. 138203.

[46] *Id*. at Sec. 138206.

[47] *Id*. at Sec. 138202.

exception is provided for such income realized from transactions which were subject to a written binding contract entered prior to September 14, 2021. This exception is unavailable, though, if the written binding contract is materially amended on September 14, 2021 or thereafter.

(5) The Build Back Better Act proposes an amendment to *Int. Rev. Code Sec. 1202* to provide that the currently applicable 75% and 100% exclusion rates will not be available for taxpayers with AGI equal to or exceeding $400,000.[48] All taxpayers would continue to be eligible for the base 50% exclusion provided in *Int. Rev. Code Sec. 1202(a)(1)*. If passed, this change in law would apply to sales of qualified small business stock sold or exchanged after September 13, 2021, unless the sale of such stock was subject to a binding contract prior to that date.

c) Proposed Changes to Carried Interest Rules

(1) The Build Back Better Act would extend the current three year holding period required to a five year holding period in order for gain attributable to dispositions of partnership interest to qualify for long-term capital gain treatment.[49] If passed, this change would apply to tax years beginning after December 31, 2021.

d) Proposed Limitation of Section 199A Deduction

(1) The Build Back Better Act would amend *Int. Rev. Code Sec. 199A* to limit the maximum allowable deduction under this provision to $500,000 for joint filers, $400,000 for individual filers, $250,000 for married taxpayers filing separately, and $10,000 for trusts and estates.[50] If passed, this limitation on the deduction would apply January 1, 2022 and thereafter.

(a) Note that the reduction in the availability of this deduction for trusts will effectively eliminate benefits that could have been available for trusts that owned real estate or interests in qualifying businesses. Due to the severe deduction limitation, from a pure tax perspective, it is better to have flow through entities owned directly by individuals who qualify for higher deduction limits.

[48] *Id*. at Sec. 138150.

[49] *Id*. at Sec. 138149.

[50] *Id*. at Sec. 138204.

e) Proposed Limitation on Deduction of Business Losses

(1) The Build Back Better Act would disallow the use of net business deductions in excess of business income for non-corporate taxpayers.[51] Disallowed losses could be carried forward to subsequent tax years, but losses can only be used against business income for the business that generated the loss (i.e., a taxpayer who owns multiple businesses cannot offset losses from one business against income from another business). If passed, this change would apply to tax years beginning after December 31, 2021.

(a) Under current law, taxpayers can utilize up to $250,000 of pass-through business losses (or $500,000 for married taxpayers filing jointly) to offset non-business income.

f) Proposed Reduction of the Estate and Gift Tax Exclusion

(1) The Build Back Better Act would lower the lifetime estate and gift tax exclusion from the current $11.7 million, down to $5 million, indexed for inflation. This change would apply for gifts made and decedents dying after December 31, 2021.[52]

g) Proposed Changes to Grantor Trust Taxation Rules

(1) The Build Back Better Act would include assets held within a grantor trust in a decedent's estate, if the decedent is the deemed owner of the trust.[53] This change in law would apply to grantor trust created on and after the date of enactment of this legislation, if passed, <u>and</u> also to contributions to an existing grantor trust made on or after the date of enactment.

(a) Current tax laws treat assets held within a grantor trust as owned by an individual for income tax purposes, but treat assets held within these trusts as gifted by the settlor (and thus excluded from the settlor's estate) for gift and estate tax purposes.

(b) If passed, this legislation would result in a new Code section, *Int. Rev. Code Sec. 2901*, being enacted which will provide that assets held by a grantor trust are included in a

[51] *Id*. at Sec. 138205.

[52] *Id*. at Sec. 138207.

[53] *Id*. at Sec. 138209.

deemed owner's estate for transfer tax purposes. This Code section would also provide that distributions from a grantor trust are treated as gifts by the deemed owner unless the distribution is made to the deemed owner's spouse, or the distribution discharges an obligation of the deemed owner. Additionally, if the grantor trust status of a trust is terminated during the deemed owner's lifetime, the assets held by the trust will be treated as gifted by the deemed owner at such time.

(2) The Build Back Better Act would also disallow the recognition of losses that arise from a sale or exchange between a grantor trust and the deemed owner of the grantor trust.[54]

(a) This proposal introduces a new Code section, *Int. Rev. Code Section 1062*. This provision provides that grantor trust rules are ignored whenever there is a transfer of property between a trust and the deemed owner of the trust as part of a sale or exchange transaction.

(b) The rule specifically will not apply to the deemed owners' revocable living trust.

(c) A further amendment is made to the related taxpayer rules in *Int. Rev. Code Sec. 267(b)* by adding a new subsection (14), which states that a grantor trust and its deemed owner are "related parties," thus resulting in the disallowance of losses.

(d) If passed, this change would apply to sales to grantor trusts created on or after the date of passage, or to any portion of the grantor trust created prior to such date that is attributable to a contribution made on or after the date of passage.

h) Proposed Disallowance of Valuation Discounts

(1) The Build Back Better Act would disallow valuation discounts on transfers of nonbusiness assets for both gift and estate tax purposes.[55] This change in law would amend *Int. Rev. Code Sec. 2031*, and apply to transfers of assets by gift or inheritance after the date of enactment of this legislation, if passed.

[54] *Id*.

[55] *Id*. at Sec. 138210.

(a) Nonbusiness assets are defined as any passive asset which is held for the production or collection of income and is not used in the conduct of an active trade or business. Specifically listed passive assets include cash or cash equivalents, stocks in a corporation or any other equity, profits, or capital interest in an entity, evidences of indebtedness, annuities, real properties, assets other than a patent, trademark or copyright which produces royalty income, commodities, collectibles or personal property.

(b) Passive assets which are held as part of the reasonably required working capital of a trade or business are excluded from application of this rule. Real property is another example of a passive asset that might be excluded from this rule, but only if the real property assets are used in the active conduct of a real property trade or businesses in which the transferor materially participates. A "real property trade or business" is one that involves development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or a brokerage trade or business. The transferor must perform at least 750 hours of services during the taxable year in the real property trade or business in addition to "materially participating" (i.e., be involved in the operations on a regular, continuous and substantial basis) in that business. No interest in a limited partnership held as a limited partner is to be treated as one in which the taxpayer materially participates.

(c) There is a "look-through" rule which says that the assets of an entity owned by a subsidiary entity that the parent holds 10% of (i.e., 10% of the vote or value of the entity) are treated as being directly owned by the parent entity. This "look-through" rule seems to be included to allow holding company interests to receive discounts when transferred so long as the subsidiary assets are used in an active business.

(d) This provision, if passed, would apply to transfers after the passage date.

i) Reduction in Value of Farmland

(1) For one taxpayer-friendly proposed change, the Build Back Better Act would allow for a reduction in the value of farmland by up to $11.7 million, by amending the provisions of *Int. Rev. Code*

Sec. 2032A.[56] This proposed change would apply for decedents dying after December 31, 2021.

(a) For estate tax purposes, assets are required to be valued based on their highest and best use. For farmland, typically farming usage is not viewed as the highest and best use of real estate. Accordingly, this valuation requirement often results in estates owning farmland having to pay estate taxes on fair market values that may be drastically inflated, considering the actual use of the property.

(b) To account for this discrepancy between actual use of real estate and estate tax valuation requirements, *Int. Rev. Code Sec. 2032A* currently allows for a downward adjustment of up to $750,000. The Build Back Better Act would change this Code provision, with respect to solely farmland, by allowing a downward adjustment in value of up to $11.7 million.

j) Surcharge on Trust and Estate Income

(1) The Build Back Better Act proposes application of a 3% surcharge on the modified AGI of estates and trusts in excess of $100,000. This surcharge would not apply to charitable trusts. This proposed change, if passed, would be effective for tax years beginning January 1, 2022.

k) Limitation on Section 1202 Exclusion Available to Trusts and Estates

(1) The Build Back Better Act proposes a limitation of the benefits available under *Int. Rev. Code Sec. 1202*, related to sale of qualified small business stock.

(a) Currently, *Int. Rev. Code Sec. 1202* allows taxpayers to exclude up to $10 million of gain realized from the sale of qualified small business stock.

(b) The Build Back Better Act would cap the exclusion available under *Int. Rev. Code Sec. 1202* to 50% of the gain, when such stock is sold by a trust or estate.

[56] *Id*. at 318208.

(c) This proposal, if passed, would apply to sales after September 13, 2021, unless the estate or trust was a party to a binding contract for sale as of September 12, 2021.

l) Proposed Changes to Retirement Benefits

(1) The Build Back Better Act would disallow individuals with income in excess of $400,000 from converting traditional IRAs or employer plan accounts to Roth IRAs.[57] The proposals would also disallow an individual with income in excess of $140,000 from contributing to a traditional IRA, then converting the traditional IRA to a Roth IRA. A separate provision in the bill would also prohibit the conversion of traditional IRAs or employer plan accounts to Roth IRAs for all taxpayers, regardless of income level.

(2) The Build Back Better Act would prohibit an IRA from owning securities if the issuer of such securities requires the IRA owner to have a minimum level of assets or income, completion of a specified minimum level of education, or to have specified licenses or credentials, for securities that are not registered under federal securities laws.[58] If an IRA holds such investments, the IRA would lose its tax-favored status.

(3) The Build Back Better Act would prohibit the investment of IRA assets in an asset in which the IRA owner holds a 10% ownership interest if the asset is not tradeable on an established securities market.[59] For this provision, it does not matter whether the IRA owner has direct or indirect ownership in the asset, and it likewise applies to an entity in which the IRA owner is an officer. If an IRA does not divest of such investments within two years of passage of this legislation, if passed, the IRA would lose its tax-favored status.

(4) The Build Back Better Act restricts taxpayers on making contributions to IRAs, Roth IRAs and defined benefit plans when a taxpayer's income exceeds $450,000, for married taxpayers filing jointly, and such taxpayer has retirement plans with balances in excess of $10 million.[60]

[57] *Id*. at Sec. 138311. This change would be effective January 1, 2032.

[58] *Id*. at Sec. 138312.

[59] *Id*. at Sec. 138314.

[60] *Id*. at Sec. 138301.

(a) Additionally, taxpayers who have retirement plans with balances in excess of $10 million will be required to take distributions from such plans under new proposed required minimum distribution rules.

(b) If passed, these changes would go into effect January 1, 2022, with the exception of the prohibition on conversions of traditional IRAs to Roth IRAs, which would go into effect January 1, 2032.

m) Proposed Changes Related to Conservation Easement Charitable Deductions

(1) The Build Back Better Act would limit the charitable deduction available for contributions of conservation easements, if made by pass-through entities, if the amount of the deduction exceeds 2.5 times the sum of each owner's adjustment basis in the entity that relates to the contributed property.[61]

(a) Essentially, this provision is attempting to codify the guidance in *IRS Notice 2017-10* which designates certain transactions as syndicated conservation easement transactions.

(2) This proposed change would not apply to family partnerships.

(3) In a taxpayer-friendly measure, this proposal would allow taxpayers to cure defects in conservation easement deeds. If a taxpayer was notified by the Commissioner of the IRS of a defect in a conservation easement deed, the taxpayer would have 90 days from the date of such notice to correct the easement deed.

(4) If passed, this proposed change would apply for subject charitable contributions made after December 23, 2016, and for certain specified historic preservations, this would apply for contributions made after December 31, 2018.

n) Permitted S Corporation Conversions

(1) The Build Back Better Act allows S corporations which were classified as S corporations on May 13, 1996 to reorganize as partnerships in a tax-free manner.[62] To take advantage of this

[61] *Id*. at Sec. 138403.

[62] *Id*. at Sec. 138509.

provision, the S corporation must liquidate completely and transfer substantially all of its assets and liabilities to a domestic partnership between December 31, 2021 and December 30, 2023.

3. Build Back Better Act Reconciliation Bill – Take Two

a) Following weeks of failed negotiations between the current administration and members of Congress, on October 28, 2021President Biden introduced a new framework of goals and initiatives to be encapsulated into the Build Back Better Act reconciliation bill.[63]

(1) The new framework cut the proposed spending amount of $3.5 trillion in the initial bill down to approximately $1.850 trillion.

(2) To fund this spending proposal, the new Build Back Better Act included the following tax provisions:

(a) The new framework imposes a 15% minimum tax on earnings of large corporations. Corporations with profits in excess of $1 billion would be subject to this proposal. The proposal also includes a 1% surcharge to corporations for corporate stock repurchases.

(b) The revised reconciliation bill proposes a new surtax on the income earned by millionaires. The new surtax would charge a 5% additional tax rate on income above $10 million, and an additional 3% surtax on income in excess of $25 million.

(i) Additional commentary indicates that loopholes to avoid the 3.8% Medicare will be closed.

(c) The new framework would provide higher investment in the IRS to allow for the increase in audits of higher net worth taxpayers. The additional investment would also work to modernize IRS technology and provide for enhanced taxpayer services.

(i) Guidance from the White House indicates that taxpayers with income of less than $400,000 would not be targeted by increased audits.

[63] *See* https://www.whitehouse.gov/briefing-room/statements-releases/2021/10/28/president-biden-announces-the-build-back-better-framework/ (last visited November 7, 2021) and H.R. 5376 (revised 10/28/2021).

(d) The new framework retains the limitation on business losses included in the initial Build Back Better Act.

b) Items <u>Omitted</u> from the Initial House Ways and Means Build Back Better Act Proposal

(1) All estate and gift tax proposals, including the reduction in the estate and gift tax exclusion, elimination of valuation discounts for transfers of closely-held entity interests, and the proposed grantor trust changes;

(2) Tax rate increases to individual, corporate, and capital gains rates;

(3) The increased five-year holding period proposal applicable to carried interests in partnerships;

(4) Limitations on the *Int. Rev. Code Sec. 199A* pass-through deduction applicable to pass-through entities; and

(5) Most of the changes related to IRAs and Roth IRAs.

II. Credits and Indexing

Under the Taxpayer Relief Act of 1997, certain estate and gift tax provisions are indexed for inflation beginning after 1998. The current amounts applicable to these provisions are set forth below:

Provision	Code Section	2020 Amount[64]	2021 Amount[65]	2022 Amount*
Annual Gift Tax Exclusion	§2503(b)	$15,000	$15,000	$16,000
Limitation on Special 2% Interest Rate for Installment Payments	§6601(j)	$1,570,000	$1,590,000	$1,640,000
Exclusion for Gifts to Foreign Spouse	§2523(i)(2)	$157,000	$159,000	$164,000
Reportable Gifts from Certain Foreign Persons	§6039F	$16,649	$16,815	$17,339

* These 2022 amounts are estimated amounts from Thompson Reuters Checkpoint, released in September, 2021 based on the average inflation index for the 12-month period ending on August 31, 2021, published in the Consumer Price Index for all urban consumers by the U.S. Department of Labor.

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[64] *Rev. Proc. 2019-44*.

[65] *Rev. Proc. 2020-45*.

III. Louisiana Legislative Developments

A. Potential Overhaul of Louisiana's Taxation Regime

1. The 2021 Regular Session of the Louisiana Legislature saw many bills and much debate addressing potential changes to Louisiana's system of taxation. Because so many of Louisiana's taxing principles are embedded in the Louisiana Constitution, the bills that survived legislative debate will be presented to Louisiana taxpayers to either approve or reject the proposed tax amendments to the Louisiana Constitution. The vote on these amendments was originally scheduled to be held on October 9, 2021. In the aftermath of Hurricane Ida, though, Louisiana Secretary of State Kyle Ardoin rescheduled this election to now be held on November 13, 2021.[66]

2. Prior to the start of the 2021 Regular Session of the Louisiana Legislature, a group of state legislators identified four goals they hoped to achieve to reform Louisiana's system of taxation. These four goals included:

   a) Centralization of the collection and administration of state and local sales and use taxes;

   b) Elimination of the federal income tax deduction for individuals and corporations, and modification of the income tax rates for individuals and corporations (including the establishment of a flat corporate tax rate of 6%);

   c) Reduction, repeal, or simplification of the Louisiana corporate franchise tax system; and

   d) Elimination of inventory from the local property tax base.

3. Ultimately, Louisiana lawmakers passed bills to accomplish two of the identified goals. The lawmakers were unable to reach a consensus on bills to repeal the Louisiana corporate franchise tax system, or eliminate inventory from the property tax base.

   a) Note that Louisiana is currently one of 16 states which levy a corporate franchise tax.[67]

4. Centralized Collection of Sales and Use Taxes

   a) The Louisiana Legislature passed House Bill 199, which establishes the State and Local Streamlined Sales and Use Tax Commission ("Commission"), intended to streamline the collection and administration

[66] Election Delay Announcement Release 9.8.21.pdf (last visited September 19, 2021).

[67] https://taxfoundation.org/louisiana-tax-reform-proposals (article dated April 28, 2021) (last visited September 30, 2021).

of state and local sales and use taxes. This proposal will be included on the November 13, 2021 ballot, in hopes of gaining majority approval from Louisiana citizens.

(1) The Commission, if approved, will have eight Senate-approved members. The Commission will oversee streamlined electronic filing of state and local sales and use taxes, provide for electronic remittance of these taxes, and generally administer the collection of all Louisiana state and local sales and use taxes for sales made in or items introduced into Louisiana.

(2) A constitutional amendment is necessary for the full passage of House Bill 199, as this bill impacts the autonomy of local tax collectors.

5. Proposed Modifications to Louisiana Corporate Franchise Taxes

a) Senate Bill 161, while not resulting in a repeal of the Louisiana corporate franchise tax system, does propose some modifications to the current system. This bill, if approved by Louisiana citizens, will:

(1) Reduce the corporate franchise tax rate from $3.00 to $2.75 per $1,000 of taxable capital in excess of $300,000,

(2) Incorporate additional rate reductions based on future collections of corporate income and franchise taxes, and

(3) Continue the suspension of corporate franchise tax on the first $300,000 of taxable capital as applies for small business corporations until July 1, 2023.

b) If approved by a majority of Louisiana citizens, final application of this bill is contingent on the passage of House Bills 278 and 292.

6. Elimination of the Federal Income Tax Deduction and Simplification of Corporate Tax Rates

a) House Bill 292 repeals the federal income tax deduction currently authorized under *La. R.S. 47:287.85* and affiliated statutes.

(1) Because the federal income tax deduction is included in the Louisiana Constitution, Louisiana voters must approve of this bill to amend and remove this deduction from the Louisiana Constitution.

(2) Louisiana is one of a few states that allows for the deduction of federal income taxes in determining a Louisiana resident's state income tax liability. Due to allowing for this deduction, Louisiana has historically had higher income tax rates. If this deduction is in

fact repealed, this repeal will allow for lower income tax rates. While these tandem changes may not, in effect, greatly change the tax revenues generated for Louisiana, the lowering of Louisiana's income tax rates will make Louisiana appear more competitive in state-by-state comparisons.

(3) Additionally, under the current system of allowing for the federal income tax deduction, Louisiana ties itself to federal legislator whims and changes outside of Louisiana's control. This causes Louisiana's tax system to act as a mirror to the federal income tax system, such that increases in federal income taxes result in lower Louisiana tax revenue, and vice versa.

b) House Bill 292 also reduces the Louisiana corporate income tax brackets from five brackets to three brackets, and provides for corporate income tax rates of 3.5%, 5.5%, and 7.5% for the respective brackets.

c) To be fully passed, House Bill 292 must be approved by a majority of Louisiana citizens at the upcoming election, and a couple other proposed bills must also receive citizen approval.

(1) First, Senate Bill 159 must be passed to amend Article VII, Section 4 of the Louisiana Constitution. This bill proposes to eliminate the federal income tax deduction for Louisiana income and corporate tax reporting purposes. This bill would also set a cap on Louisiana income tax rates at 5%.

(2) Second, House Bill 278 and Senate Bill 161 (impacting the Louisiana corporate franchise tax system, discussed above), must be passed in order to allow House Bill 292 to become law.

(a) House Bill 278 reduces Louisiana individual income tax rates as follows: The 2% rate is reduced to 1.85%, the 4% rate is reduced to 3.5%, and the 6% rate is reduced to 4.25%. If enacted, these changes would apply in 2023.

B. Louisiana Income Tax Incentives Available to Taxpayers for Foster Care and Adoption

1. Act 378[68] of the 2021 Regular Session of the Louisiana Legislature ("Act 378"), effective January 1, 2022 provides income tax incentives to taxpayers related to foster care and adoption of certain infants and children.

a) The legislation grants a $5,000 Louisiana income tax deduction for a taxpayer who adopts a child who is in foster care, a youth receiving

[68] L. 2021, H424.

extended foster care services pursuant to the Extended Foster Care Program Act, and an infant unrelated to the taxpayer who is less than one year old and is adopted through a private agency or attorney. The age of the infant is evaluated at the time of the adoption placement.

b) The Louisiana income tax deduction is available in the year the adoption becomes final, and the deduction cannot exceed the total taxable income of the claiming taxpayer. If claimed, this deduction is in lieu of the dependence deduction authorized under *La. R.S. 47:294*.

2. Act 378 also allows a non-refundable Louisiana income tax credit for donations made by a Louisiana taxpayer to a qualifying foster care charitable organization. This credit will equal the lesser of the actual amount of the donation used by the foster care organization to provide services to qualified individuals or $50,000. The availability of the credits that can be granted under this provision is capped at $500,000, and these credits will be granted on a first-come, first-served basis. While non-refundable, the unused portion of these credits can be carried forward for up to five years.

a) To be classified as a qualifying foster care organization, an organization must apply to the Louisiana Department of Revenue ("LDR") and provide requested information. Thereafter, qualifying foster care organizations must file annual reports with the LDR.

C. Refundable Income Tax Credit for Funeral and Burial Expenses Arising from Pregnancy-Related Deaths

1. Act 470 of the 2021 Regular Session of the Louisiana Legislature,[69] effective January 1, 2022, enacts an income tax credit for the reasonable funeral and burial expenses associated with the pregnancy-related death of a person. The estate of the deceased person may claim the credit. If the estate does not claim the credit, the individual who actually paid the funeral and burial expenses may claim the credit.

2. To qualify for the credit, the individual or estate claiming the credit must be a Louisiana taxpayer. The amount of the credit will be equal to the lesser of the actual reasonable funeral and burial expenses paid or $5,000. The credit must be claimed in the year in which the death occurred.

3. A "pregnancy-related death" means the death of a Louisiana resident while pregnant, during labor and delivery, or within one year after childbirth from a pregnancy complication, a chain of events initiated by the pregnancy, or the aggravation of an unrelated condition by the normal effects of the pregnancy.

[69] L. 2021, H301.

4. “Reasonable funeral and burial expenses” include costs and fees associated with transportation of the remains, embalming or cremation services, caskets, plots, grave markers, or headstones, funeral home facility and staff services, and other related professional services. These expenses do not include costs and fees associated with flowers, vaults, or urns.

5. If the amount of the credit exceeds the amount of the taxpayer’s tax liability for the taxable year, the excess tax credit amount will constitute an overpayment, and the secretary of the LDR will make a refund of the overpayment to the claiming taxpayer.

D. Refundable Income Tax Credit Available to Taxpayer Who Delivers Stillborn Child

1. Act 467 of the 2021 Regular Session of the Louisiana Legislature,[70] effective January 1, 2022, establishes a $2,000 income tax credit for a Louisiana taxpayer who delivers a stillborn child.

2. This credit must be claimed in the year in which the stillbirth occurred.

3. If the amount of the credit authorized exceeds the amount of the taxpayer’s tax liability for the taxable year, the excess tax credit amount will constitute an overpayment, and the LDR will make a refund of the overpayment to the claiming taxpayer.

E. Louisiana Youth Jobs Tax Credit Program

1. Act 454 of the 2021 Regular Session of the Louisiana Legislature (“Act 454”),[71] effective June 23, 2021 provides a non-refundable Louisiana income tax credit against Louisiana income and corporate franchise taxes to a business which hires one or more eligible youth on or after July 1, 2021. The eligible youth must work at least three consecutive months in a full-time or part-time position at the business in order for this credit to be available.

2. The credit available is equal to $1,250 for hiring an eligible youth in a full-time position or $750 for hiring an eligible youth in a part-time position.

3. The LDR is authorized to grant up to $5 million of these credits in any calendar year. The LDR will issue administrative rules which establish the method of allocating available tax credits to investors, including but not limited to a first-come, first-served system; reservation of tax credits for a specific time; or other method that the LDR, in its discretion, may find beneficial to the program.

[70] L. 2021, H301.

[71] L. 2021, H680.

4. Taxpayers may carryforward unused credits for a period not to exceed five tax years.

5. These credits are scheduled to remain in effect until December 31, 2025.

F. Apprenticeship Tax Credit

1. Act 454 also establishes a non-refundable tax credit, which can be used to offset Louisiana income and corporate franchise taxes, to a business which employs eligible apprentices.

   a) An eligible apprentice is defined as a person who has entered into a written apprentice agreement with an employer or an association of employers pursuant to a registered apprenticeship program or a person who is enrolled in a training program accredited by the National Center for Construction Education and Research which has no less than four levels of training and no less than 500 hours of instruction.

2. A business can claim a credit equal to $1.25 per hour of employment for a maximum credit of $1,250 per eligible apprentice for each eligible apprentice employed for a minimum of 250 hours during the taxable period.

3. The LDR is authorized to issue up to $2.5 million of these credits in any calendar year. As with the Louisiana Youth Jobs Tax Credit Program, the LDR has authority to issue administrative rules which establish the method of allocating available tax credits to investors, including but not limited to a first-come, first-served system; reservation of tax credits for a specific time; or other method that the LDR, in its discretion, may find beneficial to the program.

4. Taxpayers may carryforward unused credits for a period not to exceed five tax years.

5. Credits are available under this program for the employment of eligible apprentices from January 1, 2022 through December 31, 2028.

G. Hurricane Ida Extensions

1. The LDR has granted an automatic filing and payment extension to certain taxpayers located in specified portions of Louisiana.[72]

2. To qualify for this automatic extension, eligible taxpayers include individuals and businesses whose homes, principal places of business, critical tax records, or paid tax preparers are located in one of the following parishes:

[72] Louisiana Revenue Information Bulletin No. 21-024 (Sept. 7, 2021). Note that the federal extensions are discussed in Miscellaneous Cases and Administrative Developments at Section F, herein.

Ascension, Assumption, East Baton Rouge, East Feliciana, Iberia, Iberville, Jefferson, Lafourche, Livingston, Orleans, Plaquemines, Pointe Coupee, St. Bernard, St. Charles, St. Helena, St. James, St. John the Baptist, St. Martin, St. Mary, St. Tammany, Tangipahoa, Terrebonne, Washington, West Baton Rouge, and West Feliciana.

3. Automatic extensions will be based upon the taxpayer's location address on file with the LDR. If a taxpayer's location address is not within one of the listed parishes, a taxpayer may still be eligible for the relief from penalties and interest even if the automatic extension does not apply to the taxpayer.

a) For example, if a taxpayer business is located in Caddo Parish, but has a paid tax preparer located in East Baton Rouge Parish, the automatic extension will not apply to the taxpayer, but the taxpayer is eligible to request interest and penalty relief on forms provided by the LDR.

4. For individual income, corporate income, franchise, fiduciary income, partnership, and partnership composite tax returns with original or extended due dates on or after August 26, 2021, and before January 3, 2022, the automatic extended due date to file the return is January 3, 2022.

a) Note that the original due date of income and franchise tax for all Louisiana taxpayers was extended to June 15, 2021 due to the February winter storms.[73] Interest and penalties are imposed by statute on delinquent income and franchise taxes for the 2020 tax year beginning June 16, 2021 and will continue to accrue until paid. Eligible taxpayers are granted an extension to file only for Hurricane Ida.

b) For Ascension, Calcasieu, East Baton Rouge, Iberville, and Lafayette parishes, taxpayers who were granted automatic filing and payment extensions under Louisiana Revenue Information Bulletin No. 21-015 due to flooding in the latter portion of May 2021 and who filed an extension with the LDR on or before August 16, 2021, received an extension to file their return by November 15, 2021. However, income and franchise taxes for the 2020 tax year was due on or before August 16, 2021, for taxpayers in these five impacted parishes. Since penalty and interest began accruing on taxes due before August 26, 2021, Louisiana Revenue Information Bulletin No. 21-024 provides no relief from penalties and interest accruing on these tax payments previously due.

5. The extension related to Hurricane Ida includes estimated income tax payments with original due dates between August 26, 2021 and January 3, 2022.

[73] *See* Louisiana Revenue Information Bulletin No. 21-015 (June 10, 2021).

As such, this extension applies to the third calendar quarter estimated tax payment previously due for many taxpayers on September 15, 2021.

IV. Cases and Additional Administrative Developments

A. Estate Valuation and Inclusion of Assets in a Taxable Estate

1. Determination of Estate Value Considering Split Gifts to Charities

a) In *Estate of Miriam M. Warne, et vir. v. Commissioner*,[74] a husband ("H") and wife ("W") had accumulated a large amount of real estate which they owned in five separate limited liability companies (the "LLCs"). H died in 1999. W made gifts of minority interests in the various LLCs to her two sons in 2012. W died in 2014. In May 2015, W's estate filed her estate tax return, and also late-filed a 2012 gift tax return for W reporting the gifts W made to her sons in 2012.

b) At the time of W's death, she had a revocable trust (the "Family Trust") which owned all of her assets. The Family Trust held majority interests in the LLCs, in the following percentages – 78%, 72.5%, 86.3%, 87.432%, and 100%. At that time, the minority interests in the LLCs were owned in part, in varying amounts, by W's sons, three granddaughters, and a subtrust of the Family Trust. The agreements governing all of the LLCs granted "significant power to the majority interest holder," including the right to unilaterally dissolve the respective LLCs, and also the exclusive power to remove and appoint managers.

c) Royal Gardens, LLC ("Royal Gardens") was the LLC which was owned 100% by the Family Trust. The agreement governing the Family Trust provided that upon W's death, the interests in Royal Gardens were left 75% to the Warne Family Charitable Foundation (the "Foundation"), and 25% to a church.

d) W's estate tax return listed the value of 100% of Royal Gardens at $25.6 million. The return listed the value of the Family Trust's ownership in the other LLCs at $18,006,000, $8,720,000, $11,325,000, and $10,053,000, resulting in the five LLCs being cumulatively valued in W's estate at $73,704,000. To reach these values, the underlying real estate owned by each LLC was valued, and lack of control and lack of marketability discounts were thereafter applied to the LLC interests.

e) Following its review of the 2012 gift tax return and the estate tax return, the IRS assessed a gift tax deficiency of $368,462, and assessed an estate tax deficiency of $8,351,970 against W's estate. At trial, the issues remaining in dispute included: (1) the value of certain fee interests owned by the LLCs, (2) the correct lack of control and lack of marketability discount applicable for the majority interests in the LLCs owned by the

[74] T.C. Memo. 2021-17 (Feb. 18, 2021).

Family Trust, (3) whether valuation discounts applied to the 75% and 25% Royal Gardens interests left to the Foundation and the church, respectively, and (4) whether a failure to file penalty applied to the late-filed 2012 gift tax return.

f) The court considered various approaches advanced by the parties' appraisers in determining the value of the subject fee interests.

g) On the issue of the appropriate lack of control discount, the IRS asserted that a 2% discount should apply to the majority interests, whereas W's estate argued that a lack of control discount in the range of 5% - 8% should apply. The court determined that the purportedly comparable databases used by the IRS to reach the 2% discount were in fact too dissimilar to the LLCs, and rejected the 2% discount. For its 5% - 8% discount, W's estate advanced that potential litigation with minority interest holders should support a higher discount. The court, however, did not find any evidence of potential litigation, and ultimately determined that a 4% discount was appropriate.

h) In determining the appropriate lack of marketability discount, W's estate and the IRS both looked to restricted stock equivalent discounts, but the IRS advocated for a 2% discount, whereas W's estate utilized a 5% - 10% discount. The court found the expert from W's estate to be more thorough, and found that the lower range of the estate's numbers was appropriate, allowing a 5% discount for lack of marketability.

i) The most notable issue in this case related to the value of the charitable contribution deduction allowable to the estate through the donation of the 75% and 25% interests in Royal Gardens to the Foundation and the church. W's estate argued that the value of the charitable contribution deduction should not be discounted, as ultimately 100% of the Royal Gardens interest went to charity. The court, however, disagreed with W's estate, and allowed discounts to apply to the charitable deductions for the gifts to the Foundation and the church.

(1) In reaching its decision on this issue, the Tax Court applied a two-step analysis.

(2) The court first reasoned that to value the gross estate, the court must value all of the assets of the estate without considering how the assets are disposed of.

(3) Second, the court reasoned that a charitable contribution deduction is allowed for only what a charity receives (and not what the estate contributes).

(a) In its analysis, the court cited *Ahmanson Foundation v. United States*[75] to support its application of the two-step analysis.

(b) In *Ahmanson*, a decedent ("D") owned 100% of a corporation through his ownership of the one voting share and 99 nonvoting shares of the corporation. D left his voting share to his sons, and the 99 nonvoting shares to a charitable foundation. D's estate was valued considering all of D's ownership of the corporation, but the value of the charitable contribution deduction for the 99 nonvoting shares left to the foundation was subject to a 3% discount due to the foundation receiving nonvoting rights.

(4) Applying *Ahmanson*, the Tax Court did not find it distinguishable based on the fact that *Ahmanson* involved a division of a corporation between an individual and a charity, whereas W's estate left Royal Gardens wholly to charitable recipients. The court stated that "it is the value of the property received by the donee that determines the amount of the deduction available to the donor."

(5) Prior to trial, the parties had stipulated as to applicable discounts in the event the Tax Court determined that discounts were appropriate in determining the charitable contribution deduction.

(a) The parties stipulated a 27.385% discount for the 25% interest in Royal Gardens that passed to the church, and a 4% discount for the 75% interest in Royal Gardens that was transferred to the Foundation.

(b) Ultimately, these discounts resulted in a $2.5 million reduction in the charitable contribution deduction available to the estate.

j) Lastly, the Tax Court held that the failure to timely file penalty under *Int. Rev. Code Sec. 6651(a)(1)* was applicable with respect to the 2012 gift tax return, as W's estate failed to establish reasonable cause for the late filing.

[75] 674 F.2d 761 (9th Cir. 1981). Note that the *Warne* case is appealable to the Ninth Circuit Court of Appeals.

2. Valuation of Image, Likeness, and Music Catalogs for Estate Tax Purposes

a) In *Estate of Michael Jackson v. Commissioner*,[76] the Tax Court issued its opinion on the value of hard-to-value assets held in Michael Jackson's estate at the time of his death.

b) Michael Jackson ("Jackson") passed away in 2009. Following his death, his estate ("Estate") filed an IRS Form 706, estate tax return, reporting the value of Jackson's image and likeness at $2,105, the value of the New Horizon Trust II (Sony/ATV) ("Trust II") at $0, and the value of the New Horizon Trust III (Mijac Music) ("Trust III") at $2,207,351. The two music trusts held rights to publish Jackson's music, the Beatles catalog, and songs by other stars including Bob Dylan and Taylor Swift.

c) After reviewing the Estate's IRS Form 706, the IRS issued a notice of deficiency, valuing Jackson's image and likeness at $161 million, the Trust II at $206 million, and Trust III at $114 million. In addition to these valuation increases, the notice of deficiency ultimately increased the value of the Estate by over $1.1 billion, and asserted that the Estate had underpaid its estate tax obligation by $700 million (including $500 million of additional estate taxes and $200 million in undervaluation penalties).

d) The Estate filed a petition in Tax Court to challenge the values asserted by the IRS. At trial, the Estate conceded a bit on some of the values presented, arguing that the value of Jackson's image and likeness was actually $3 million, the value of Trust II was $0, and the value of Trust III was $2.3 million, all still significantly lower than the values asserted by the IRS.

e) At trial, the Tax Court evaluated the value of the disputed assets utilizing an income approach, examining how much revenue the assets would produce in the future.

f) The IRS projected the value of these assets by considering future revenue streams, including values determined for themed attractions and products, branded merchandise, and a Circque de Soleil show as "foreseeable opportunities" for use of Jackson's assets, such opportunities purportedly in existence as of Jackson's death.

g) The Tax Court noted though that none of the opportunities advanced by the IRS were actually foreseeable at the time of Jackson's death. The court further noted that the IRS valuation expert "simply glosses over Jackson's having been accused multiple times of the most heinous acts in his analysis of each supposedly foreseeable revenue stream."

[76] T.C. Memo. 2021-48 (May 3, 2021).

h) The Tax Court determined that it needed to value each asset as if "in the decedent's hands at the time of its transfer by death." Examining values from this perspective, the court noted that Jackson was deep in debt at the time of his death, and bankruptcy could have been in his foreseeable future. The court also noted that Jackson was extremely unpopular in the last couple years of his life, significantly lowering the value of his image and likeness. The court ultimately valued each of the assets at issue using an income approach, by more realistically calculating the future revenue that each asset could produce.

i) For Jackson's image and likeness, the court projected a net revenue stream from licensing Jackson's image and likeness out over a 10 year period. After determining these values, the court discounted the projected revenue stream to a date of death value using a discount rate of 15.4% and reached a value of $4.1 million.

j) For Trust II, the court valued Jackson's share of this trust at $212 million, but noted that Jackson had a $300 million loan secured by the assets held in Trust II. Because this loan was still outstanding at Jackson's death, the court valued Trust II at $0, consistent with the values presented by the Estate.

k) The court found Trust III the most difficult to value as the experts disagreed on three major points: (i) the number of unreleased songs as of Jackson's date of death, (ii) the correct starting point for the cash flow projections, and (iii) the spike and growth rate for each group of songs. One expert stated that there were about 10,000 pieces of musical tape in Jackson's vault, but after listening to everything, determined that there were maybe two potential songs that could be released. Another expert determined that there were at least 83 unreleased songs in the vault, 21 released by the Estate after Jackson's death and another 62 unreleased songs as confirmed by the Estate. After examining the value of Jackson's prior released songs, the court calculated a value for approximately 85 songs at $179 million, but noted that this value would be subject to liabilities of approximately $72 million, resulting in Trust III being valued at $107 million.

l) The Tax Court's values were $105.8 million more than the values presented by the Estate, but significantly lower than the $481 million values advanced by the IRS. The Tax Court determined that the values presented by the Estate were not unreasonable, and did not apply valuation penalties to the Estate.

3. Determination of Value of Life Insurance Policy Includible in Decedent's Estate

a) In *Estate of Morrissette v. Comr.*,[77] a decedent ("D") owned a moving and logistics company that was initially formed in 1943. D had three sons ("Sons") who were involved in the family business. Over the years, the family encountered significant disharmony, which caused concern to D that the family business might not remain in the family. To facilitate D's goal of keeping the business in the family, D established a revocable trust ("RT"), and named Sons as co-trustees of RT. D also established three perpetual Dynasty trusts. In 2006, RT entered into two split-dollar life insurance arrangements with the three Dynasty trusts. RT then contributed a total of $29.9 million to the Dynasty trusts to fund the Dynasty trusts' purchase of life insurance policies on each of D's Sons' lives. The split-dollar life insurance arrangements provided that RT would receive the greater of the cash surrender value of the respective policy or the aggregate premium payments on that policy upon termination of the split-dollar life insurance arrangement or the death of the insured Son. If proceeds resulted from a Son's death, the payout to RT would be made from proceeds of the death benefit of the policy insuring Son, and any remaining balance payable under such policy would be paid to the Dynasty trusts. The purpose of this life insurance arrangement was to provide funding for the buyout of interests in the family business in the future.

b) From 2006 through 2009, D reported gifts to the Dynasty trusts by applying the economic benefit regime set forth under *Treas. Reg. Sec. 1.61-22*. The amount of each gift reported was the cost of the current life insurance protection as determined using Table 2001, an IRS-issued table, less the amount of each premium paid by the respective Dynasty trust.

c) The IRS determined that D's $29.9 million contribution was a gift for tax year 2006, and asserted a gift tax deficiency against D's estate. D's estate moved for partial summary judgment on the issue of whether the split-dollar life insurance arrangements were governed by the economic benefit regime under *Treas. Reg. Sec. 1.61-22*.

d) In this 2016 gift tax case, the Tax Court held in favor of D's estate, ruling that the three Dynasty trusts received only the economic benefit of current life insurance protection from the split-dollar life insurance arrangements with RT, making RT the deemed owner of the insurance contracts. The court found inapplicable the general rule that would have made the Dynasty trusts the owners of the policies and characterized D's premium payments of the $29.9 million through RT as gifts.

[77] 146 T.C. No. 11 (Apr. 13, 2016).

e) The Tax Court added that the general rule under *Treas. Reg. Sec. 1.61-22(c)(1)* is that the person named as the owner of the insurance contract—the Dynasty trusts—is treated as the owner of the policies. However, the court continued, finding that the exception to that rule applied, because RT was to receive the greater of the aggregate premiums paid or the cash surrender value of the contract, foreclosing the possibility that one of the Dynasty trusts would receive an additional economic benefit. The court found that under the split-dollar life insurance arrangements, the Dynasty trusts "had no current or future right to any portion of the policy cash value, and thus, no current access under the regulations."

f) The court noted that D structured her transaction identically to the split-dollar arrangement in the example provided in the applicable treasury regulations. The court stated that it was "aware that the Court has previously been unpersuaded by a preamble to regulations," but the preamble was consistent with D's estate's interpretation and contrary to the IRS's interpretation.[78] The court ruled consistently with the preamble to the regulations, finding RT the deemed owner of the life insurance policies, resulting in no additional gift taxes owed by D's estate.

g) This 2016 decision was the first ruling by the Tax Court on an inter-generational split-dollar life insurance arrangement.

h) The Estate of Morrissette again made an appearance before the Tax Court in 2021 when the court had to evaluate whether the value of the transferred premiums or the cash surrender value of the life insurance policies were included in D's estate under *Int. Rev. Code Secs. 2036* or *2038*.[79]

i) In 2009, D passed away. After D's death, one of D's Son's asked whether they should consider cancelling the life insurance policies. D's estate attorney advised against cancelling the policies prior to the filing and audit period for D's estate tax return, stating that the policies should be kept in place without change at least for the next three years. D's estate included its repayment right under the split dollar arrangement at a value of $7.5 million on D's estate tax return, taking into consideration the time delay for when such repayment would be made – estimating such repayment delay to be approximately 15 years. The IRS, however, valued the repayment right owed to D's estate at $32.6 million, or the cash surrender value of the life insurance policies at the time of D's death.

[78] The IRS also argued that the transaction was an abusive transaction under the provisions of *IRS Notice 2002-59*, but the Tax Court rejected this argument finding that the facts bore "no resemblance to the transactions" prohibited by this notice.

[79] *Estate of Morrissette v. Commissioner*, T.C. Memo 2021-60 (May 13, 2021).

(1) *Internal Revenue Code Section 2036* provides that property is includible in a taxpayer's estate when the taxpayer made an inter vivos transfer of property that is not part of a <u>bona fide sale</u> for <u>adequate consideration</u>, and the taxpayer retained at death an interest in the property, retained the right to receive income from the property, or held the right either alone or with another person to designate the persons who will possess or enjoy the property or the income therefrom.

(2) *Internal Revenue Code Section 2038* provides that property is includible in a taxpayer's estate when the taxpayer made an inter vivos transfer of property that is not part of a <u>bona fide sale</u> for <u>adequate consideration</u>, and the taxpayer retained the power, exercisable by the taxpayer alone or with another person, to alter, amend, revoke, or terminate the transferee's enjoyment of the transferred property, and the taxpayer possessed this right at death or released this right within three years of the taxpayer's death.

j) At trial, the IRS argued that either the value of the advanced life insurance premiums, $29.9 million, or the cash surrender values, $32.6 million, were includible in D's estate, as the primary purpose of the split dollar life insurance arrangement was to lower D's estate tax exposure.

k) One of D's sons argued, however, that the purpose of the arrangement was to provide for funds for the Sons to buyout his brother(s) from their family business, in the event of a death, and repay their mother for her financing of this buyout transaction. The Son further stated that the family would have entered this transaction regardless of any estate tax benefits provided by the arrangement.

l) Based on the testimony at trial, the Tax Court determined that *Int. Rev. Code Secs. 2036* and *2038* did not apply to pull the transferred premiums or the cash surrender value of the life insurance policies back into D's estate. The court ruled that the family had legitimate, non-tax reasons for entering the split-dollar arrangements, causing these Code sections to be inapplicable.

(1) For the bona fide sale exception to apply, the court must find:

(a) A legitimate and significant non-tax reason for the transaction and

(b) Adequate and full consideration in money or money's worth.

(2) In this case, the court found the desire to keep the family business in the family, prevent against issues arising from family disharmony, and avoid the risk of potentially having to sell the

business to non-family members all qualified as legitimate, significant non-tax reasons for entering the split dollar arrangement.

(3) The court also determined that adequate and full consideration were provided to RT (and in turn, D) even if the right to collect on the reimbursement rights resulted in lower proceeds than the $29.9 million advanced to the Dynasty trusts, because other economic value was provided to D in providing for the succession of management of the family business.

m) The IRS also argued that the reimbursement obligation owed to D's estate should be valued at the full cash surrender value of the life insurance policies because RT would receive this value on termination of the split dollar arrangement, and the restriction that the arrangement could only be terminated with the mutual agreement of the parties was a "restriction on the right to sell or use" property that must be ignored under *Int. Rev. Code Sec. 2703(a)*.

(1) *Internal Revenue Code Section 2703(a)* generally provides that restrictions in agreements or governing documents can be disregarded if application of such restrictions could result in lower fair market value determinations.

(2) *Internal Revenue Code Section 2703(b)* provides exceptions to the application of *Int. Rev. Code Sec. 2703(a)* when the agreement or restrictions are entered as part of a bona fide arrangement which is not a device to transfer property for less than adequate consideration.

n) The Tax Court determined that the exception under *Int. Rev. Code Sec. 2703(b)* applied, finding the transactions between D, RT, and the Dynasty trusts to be for bona fide, business purposes.

o) The Tax Court did, however, determine that D's estate should include in D's estate the value of the rights held by it under the split dollar arrangement. The notice of deficiency issued by the IRS valued the reimbursement rights at the cash surrender value of $32 million, but at trial, the IRS's expert testified that the value of these rights would be approximately $17.5 million if the policies remained in effect until the Sons' deaths, and at $27.9 million if the policies were terminated three years after D's estate filed its estate tax return.

p) Both D's estate and the IRS applied discounts to the value of the reimbursement rights, using a discounted cash flow analysis – but both parties used different discount rates. The IRS used rates related to the return on corporate bonds and company specific debt (applying discount rates in the range of 6.4% and 8.85%). D's estate used life settlement data which utilized discount rates of 15% and 18%.

q) Ultimately, the court found that the discount rates utilized by D's estate to value these rights was excessive, and agreed with the discount rates used by the IRS. The Tax Court ruled that the parties needed to calculate the fair market value of the split dollar arrangement rights consistent with the methodology advanced by the IRS.

r) The most important factor in the determination of the reimbursement rights value was the agreement by the Tax Court with the IRS that the life insurance policies would be terminated shortly after D's death, rather than at the Sons' deaths. Even though the Sons argued that there was no plan to terminate the policies, the court focused on the testimony that one of the Sons asked about terminating the policies after D's death, but retained the policies in place due to the advice of the estate's counsel to keep the policies in place at least through the audit period for the estate tax return – three years. The court determined that this assumed termination date was persuasive enough to rely on when determining the value of the reimbursement rights held by D's estate.

s) On the issue of whether penalties applied to the undervaluation, D's estate argued that the IRS failed to obtain prior written supervisory approval to impose penalties, as required under *Int. Rev. Code Sec. 6751(b)*. Nonetheless, this argument failed as the IRS provided emails between the assigned revenue agent and his supervisor, and also corroborating testimony to support its argument that the necessary approval was obtained. As such, the 40% accuracy related gross valuation misstatement penalty allowed under *Int. Rev. Code Sec. 6662(h)* was charged against D's estate.

4. Life Insurance Death Benefit Includible in Value of Closely-Held Corporation When Stock Purchase Agreement Procedures Abandoned

a) In *Estate of Connelly v. United States*,[80] two brothers owned a closely-held corporation ("Corporation") at the time that one of the brothers ("Decedent") passed away. Decedent was the President, CEO, and majority shareholder in Corporation at the time of his death.

b) In 2001, the two brothers executed a Stock Purchase Agreement in an effort to maintain family ownership in the Corporation and incorporate some of their estate planning goals. The Stock Purchase Agreement provided that upon the death of one of the brothers, the surviving brother ("Surviving Brother") had the option to purchase the deceased brother's stock in the Corporation, and if the surviving brother did not exercise this

[80] (DC E.D. MO 9/21/2021) 128 AFTR 2d ¶2021-5231, Case No. 4:19-c-01410.

option, the Corporation was required to purchase the stock owned by the deceased brother. The Stock Purchase Agreement provided that the brothers could mutually agree to the value of their stock in Corporation each year, on a per share basis, through execution of a "Certificate of Agreed Value." If they failed to execute such a certificate, the value of the stock would be determined through obtaining two or more appraisals. The Corporation owned a life insurance policy on each of the brothers with a death benefit of $3.5 million. Following the execution of the Stock Purchase Agreement, the brothers never executed a "Certificate of Agreed Value."

c) Upon Decedent's death in 2013, the Corporation received the $3.5 million payable from the life insurance policy on Decedent. Surviving Brother chose not to exercise his option to acquire Decedent's stock in Corporation. Without obtaining an appraisal, the Corporation redeemed Decedent's stock for $3 million, evidenced by a purchase agreement executed between Corporation and Decedent's estate. Surviving Brother served as executor of Decedent's estate. The purchase agreement executed between the Corporation and Decedent's estate provided the following:

(1) Decedent's estate would receive $3 million from Corporation for the purchase of Decedent's stock in the Corporation;

(2) Decedent's son was granted a three-year option to purchase Decedent's stock in Corporation from Surviving Brother for a price of $4,166,666; and

(3) If Surviving Brother sold Corporation within ten years of the date of this agreement, Surviving Brother and Decedent's son would evenly divide any gains realized from such future sale.

d) Surviving brother, as executor of Decedent's estate, reported the value of Decedent's stock in Corporation at $3 million on Decedent's estate tax return.

e) The IRS audited the estate tax return filed by Decedent's estate, and increased the value of the Corporation stock reported by the estate. The IRS asserted that the value of the Corporation stock should have included the value of the $3 million life insurance proceeds that were used to redeem the Corporation stock from Decedent's estate.

f) At trial, the district court had to evaluate whether the Stock Purchase Agreement controlled the value of Decedent's Corporation stock for estate tax purposes.

(1) *Internal Revenue Code Section 2703(a)* generally provides that the fair market value of ownership interest in an entity is to be determined irrespective of the terms of a buy-sell agreement.

(2) *Internal Revenue Code Section 2703(b)*, however, allows a buy-sell agreement to control the value of ownership interest in an entity if three requirements are satisfied:

(a) The arrangement is a bona fide business arrangement;

(b) The arrangement is not a device to transfer ownership to members of a decedent's family for less than adequate consideration; and

(c) The terms of the agreement are comparable to agreements reached in arms' length transactions.

(3) Additionally, case law and guidance under *Treas. Regs. § 20.2031-2(h)* further provide that a buy-sell agreement must satisfy the following additional factors in order for its terms to be controlling for estate tax purposes:

(a) The offering price under the agreement must be fixed and determinable;

(b) The agreement must be legally binding upon the parties during their lives and after their deaths; and

(c) The restrictions within the buy-sell agreement must have been entered for bona fide business reasons, and such restrictions cannot be a substitute for a testamentary disposition for less than adequate consideration.

(4) Decedent's estate asserted that the terms of the Stock Purchase Agreement determined the value of Decedent's Corporation stock, and alternatively, the value of the Corporation should not include the $3 million life insurance proceeds on Decedent as the Corporation held a corresponding $3 million obligation to utilize these life insurance proceeds to redeem Decedent's Corporation stock from his estate.

(a) Decedent's estate essentially argued that even though it did not follow the terms of the Stock Purchase Agreement, the existence of the agreement provided sufficient basis to accept the value agreed to between Decedent's estate and Corporation for the purchase of Decedent's stock.

(5) The IRS asserted that the terms of the Stock Purchase Agreement did not satisfy the requirements of *Int. Rev. Code Sec. 2703(b)*, and thus should be disregarded under the general principles of *Int. Rev. Code Sec. 2703(a)*. The IRS further argued that the life insurance proceeds received by the Corporation increased its fair market value dollar-for-dollar.

(6) In evaluating the provisions of *Int. Rev. Code Sec. 2703(b)*, the district court held that the Stock Purchase Agreement was a bona fide agreement, despite the arguments of the IRS to the contrary.

(7) While finding the Stock Purchase Agreement to be a bona fide agreement, the district court held that Decedent's estate failed to show that the agreement was not a device to transfer property to Decedent's family members for less than full consideration. The district court determined that the process used by the Corporation and Decedent's estate to set the value of Decedent's Corporation stock was a testamentary device – essentially the value of the life insurance proceeds was excluded from the valuation and the failure to obtain an appraisal per the terms of the Stock Purchase Agreement were detrimental to providing this element to avoid the application of *Int. Rev. Code Sec. 2703(a)*.

(8) In looking at the additional requirements under *Treas. Regs. § 20.2031-2(h)*, the district court also found that the purchase price for Decedent's Corporation stock was not fixed and determinable. The court reached this decision on the basis that the brothers had never executed a Certificate of Agreed Value, and Surviving Brother and the Corporation did not obtain the appraisals required under the terms of the Stock Purchase Agreement. The court likewise found these failures to demonstrate that the Stock Purchase Agreement was not binding during the parties' lives and after their deaths.

g) Once the district court determined that the Stock Purchase Agreement did not establish the value of Decedent's Corporation stock, the court then had to determine the fair market value of such stock, and whether the death benefit received by the Corporation should have been considered in determining such value.

(1) The primary issue before the court was whether the redemption obligation was an offsetting corporate liability that would offset the value of such life insurance proceeds held by the Corporation.

(2) Ultimately, the district court determined that the value of the life insurance proceeds should be considered when valuing the Corporation, and the redemption obligation should not be factored

into the value of the Corporation. The court reasoned that the buyer of 100% of the Corporation, under a willing buyer/willing seller analysis, would not demand a reduced purchase price based on the redemption obligation, and the value of the Corporation, or what the buyer would receive in its purchase remained the same. The court reasoned that the willing buyer would receive partial ownership in Corporation that held the life insurance proceeds, or if the redemption occurred, the buyer's ownership in Corporation would increase to 100% following the redemption by an offsetting amount, and the increased stock ownership likewise justified the increased value of Corporation. Accordingly, the court did not consider the redemption obligation to reduce the value of Corporation.

h) In this case, the failure to follow the terms of the Stock Purchase Agreement resulted in the value of life insurance proceeds being included in the value of Corporation. Typically this outcome can be avoided through drafting of a buy-sell agreement in a manner that satisfied *Int. Rev. Code Sec. 2703(b)*. This case illustrates, though, that while drafting is important, clients must also follow the terms of this agreements to achieve the desired tax outcomes.

B. Estate Tax Procedural Issues

1. Executor Liable for Unpaid Estate Taxes Due to Transferee Liability Provisions

a) In *United States v. The Estate of Kelley, et al.*,[81] a taxpayer ("Kelley") died on December 30, 2003. After his death, Kelley's co-executors filed Kelley's estate tax return on September 23, 2004. The IRS examined the estate tax return, and assessed additional estate taxes based on an adjusted value of Kelley's gross estate. One of Kelley's co-executors, his brother Richard Saloom ("Saloom"), consented to the additional assessments presented by the IRS. Saloom was also the sole heir of Kelley's estate.

b) Between 2003 and 2007, Saloom ultimately distributed and received all of Kelley's property, without fully satisfying the additional assessment charged by the IRS against Kelley's estate.

c) By January 2008, Kelley's estate did not hold any assets, but continued to owe $400,000 in estate taxes to the IRS. Saloom made some installment payments on the estate taxes owed by Kelley's estate.

[81] (DC NJ 10/22/2020) 126 AFTR 2d ¶2020-5398.

d) Saloom passed away on March 21, 2008. Prior to Saloom's death, Saloom instructed his daughter ("Daughter") to continue making installment payments to the IRS to satisfy the estate taxes owed by Kelley's estate.

e) Daughter was appointed as the sole executrix of Saloom's estate, and she was also Saloom's sole legatee. Daughter filed a state inheritance tax return on behalf of Saloom's estate which reported a liability owed by Saloom of $456,406 in "federal tax" indebtedness. Daughter distributed Saloom's estate to herself without first satisfying the "federal tax" indebtedness owed by Saloom.

f) The IRS sued Saloom's estate to collect the estate taxes owed by Kelley's estate under the theories of transferee and fiduciary liability owed by Saloom's estate. The IRS asserted that pursuant to *Int. Rev. Code Sec. 6324*, Saloom's estate was liable for Kelley's estate taxes as a transferee of Kelley's property.

(1) *Internal Revenue Code Section 6324(a)(2)* provides that a transferee of an estate is personally liable for unpaid estate taxes up to the value of assets received from the estate when the estate fails to pay its estate taxes.

(2) An executor of an estate who pays estate debts or makes distributions of assets to himself prior to paying taxes owed by such estate can be held personally liable for the estate tax claim to the extent of such payments or distributions made.[82]

g) The district court held Saloom's estate to be liable for Kelley's estate taxes under theories of both transferee liability and fiduciary liability, as Saloom knew of the liability owed by Kelley's estate yet distributed Kelley's assets to himself without paying such taxes. The court found Saloom's estate liable for all of the estate taxes owed by Kelley's estate, as Saloom received assets from Kelley's estate valued in excess of its estate tax liability. The court reasoned that Saloom's estate was liable under fiduciary theories on the basis that Saloom distributed Kelley's assets to himself, such distributions rendered Kelley's estate insolvent and unable to pay the IRS, and Saloom knew that Kelley's estate owed the estate taxes at the time of these distributions.

h) The court also held that, pursuant to solely fiduciary liability theories, Daughter was personally liable for the taxes owed by Saloom's estate, as she had knowledge of Kelley's estate tax liability as reflected on

[82] 31 U.S.C. §3713(b).

the state inheritance tax return she filed for Saloom's estate, and distributed Saloom's assets to herself despite this liability remaining outstanding.

2. Estate Not Entitled to Refund Arising from Attorney's Failure to File Estate Tax Return

a) In *Andrews v. United States*,[83] a taxpayer, in his capacity as executor and trustee of an estate ("Estate"), sought a refund for late filing and late payment penalties plus interest paid by the Estate to the IRS. The attorney for the Estate advised the taxpayer to file an extension request for the deadline to file the Estate's estate tax return. The Estate paid the late filing and late payment penalties plus interest owed by the Estate prior to the purportedly extended due date for the Estate's estate tax return, but the estate tax return was not actually filed by the extended deadline. The taxpayer asserted that he delegated the duty to file the estate tax return to the Estate's attorney, and the attorney failed to file the return by its due date. The taxpayer argued that his reliance on the attorney was reasonable, justifying a return of the late filing and late payment penalties plus interest paid by the Estate.

b) The Court of Federal Claims denied the refund request filed by the taxpayer, finding that the taxpayer's reliance on the Estate's attorney was not sufficient to show reasonable cause. The court found that the filing of the estate tax return was a nondelegable duty owed by the taxpayer.

3. Executor Personally Liable for Estate Taxes Due to Distribution of Estate Assets Prior to Satisfaction of Estate Tax Liability

a) In *Estate of Lee*,[84] a decedent died testate on September 30, 2001. Mr. Frese, a licensed attorney and municipal court judge, was appointed as executor ("Executor") of decedent's estate ("Estate"). Executor filed an IRS Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return on behalf of the Estate around May 21, 2003, i.e., on a non-timely basis. In April 2006, the IRS issued a notice of deficiency to Executor asserting that the Estate owed over $1 million in estate taxes. Executor immediately thereafter filed a petition in Tax Court to dispute the additional estate taxes asserted by the IRS. Meanwhile, from July 2003 through February 2007, Executor made $1,045,000 of distributions from the Estate, $640,000 of which was distributed after the filing of the Tax Court petition by Executor. Following this last distribution, the Estate held only $183,000 worth of assets, significantly below the additional estate taxes claimed by the IRS.

[83] No. 20-641T (Fed. Cl. May 12, 2021).

[84] TC Memo 2021-92 (July 20, 2021).

b) In March 2010, the Tax Court ruled that the Estate owed $536,151 to the IRS.

c) In 2013, the IRS issued a Notice of Federal Tax Lien to the Executor, to which Executor submitted an Offer in Compromise in an attempt to settle the IRS's claim against the Estate. The Executor asserted doubt as to collectability as the basis for submitting the Offer in Compromise. The IRS declined the Offer in Compromise, finding that the offer made was too low. The IRS took the position that the reasonable collection potential from the Estate should include amounts that it could collect <u>from the Executor</u> pursuant to *31 U.S.C. §3713(b)*, the "Federal Priority Statute."

> (1) The Federal Priority Statute provides that an executor can be liable for unpaid estate taxes owed by an estate to the extent the executor distributes assets from an estate when either (1) the estate is insolvent at the time of the distribution, or (2) the distribution itself rendered the estate insolvent and the executor had knowledge or notice of a claim by the United States at the time of such distribution.

d) The Executor asserted that the Estate did not have knowledge or notice of the estate taxes claimed due by the IRS at the time of the Executor's distributions from the Estate, and *31 U.S.C. §3713(b)* was inapplicable to hold Executor personally responsible for such taxes.

e) Despite his arguments, the Tax Court held that Executor had both knowledge <u>and</u> notice of the estate tax claim against the Estate at the time of the Executor's February 2007, $640,000 distribution from the Estate. The court noted that the Executor had notice of the estate tax claim in April 2006, when the Executor received the notice of deficiency issued against the Estate. The court determined that the receipt of a notice of deficiency prior to a distribution of assets from an estate satisfied the notice requirement imposed by the Federal Priority Statute. The Tax Court also determined that the Executor had acknowledge of the asserted estate tax claim prior to the February 2007 distribution, as the Executor had filed a claim in the Tax Court to dispute the notice of deficiency prior to such time.

f) The Tax Court held that Executor, a licensed attorney, "made the February 2007 distribution at his own peril" and his arguments could not absolve him from personal liability for the estate taxes owed by the Estate. The court determined that the amount of the February 2007 distribution should be considered in determining the ability of the Estate to pay in its Offer in Compromise evaluation.

4. Israeli Marriage Respected for Purposes of Applying Estate Tax Marital Deduction

a) In *Estate of Semone Grossman*,[85] a decedent ("Decedent") married his first wife ("Wife 1") in New York in 1955. Decedent and Wife 1, both Jewish, separated in 1965, and Decedent attempted to terminate their marriage by a unilateral divorce in Mexico. In 1967, Decedent married his second wife ("Wife 2") in New Jersey in a civil marriage ceremony. Wife 2 was not Jewish. After Decedent's relationship with Wife 2 ended, Wife 1 sued Decedent and Wife 2 in New York, seeking a declaratory judgment that Decedent's divorce from Wife 1 was invalid, and that Wife 1 remained Decedent's wife. Wife 1 prevailed in this lawsuit, but she neither lived nor reconciled with Decedent following this suit.

b) In 1986, Decedent became engaged to a third woman, also Jewish, who eventually became Decedent's third wife ("Wife 3"). Decedent and Wife 3 intended to marry in Israel. To allow for this marriage, Decedent and Wife 1 obtained a religious divorce under Jewish rabbinical law, and Decedent and Wife 3 married in Israel in 1987.

c) Following their marriage, Decedent and Wife 3 lived in New York as husband and wife until Decedent's death in 2014. Upon his death, Decedent left most of his estate to Wife 3. Decedent's estate filed an IRS Form 706, and claimed a marital deduction under *Int. Rev. Code Sec. 2056(a)* for the assets left to Wife 3.

(1) *Internal Revenue Code Section 2056(a)* provides that the value of an estate is determined by deducting the value of any interest in property that passes to the decedent's surviving spouse from a decedent's gross estate.

d) The IRS disallowed the marital deduction claimed by Decedent's estate, alleging that Decedent's religious divorce from Wife 1 was invalid under New York law, and Wife 1 was Decedent's surviving spouse at the time of his death. The notice of deficiency asserted that additional estate taxes of $35.5 million, and accuracy-related penalties of $7.1 million were owed by Decedent's estate.

e) Decedent's estate challenged the deficiency issued by the IRS in Tax Court, asserting that New York law was irrelevant, as only Israeli law determined whether Decedent's marriage to Wife 3 was valid, and even if New York law was applicable, New York courts would respect Decedent's marriage to Wife 3 under the well-respected "place of celebration" test. The

[85] T.C. Memo. 2021-65 (May 27, 2021).

"place of celebration" test recognizes a marriage as valid if it is valid in the place where the marriage was celebrated.

f) The Tax Court agreed with the analysis presented by Decedent's estate, that the focus should be on the validity of Decedent's marriage to Wife 3, and not the locale and validity of Decedent's divorce from Wife 1. The Tax Court examined the validity of Decedent's marriage to Wife 3 under New York law, and determined that New York law would look to the place of the celebration of the marriage to determine if the marriage was valid at such place. Because Decedent's marriage to Wife 3 was valid under Israeli law, the court found their marriage to be valid under New York law and allowed the marital deduction authorized by *Int. Rev. Code Sec. 2056(a)* to apply to the assets left by Decedent to Wife 3.

5. Issuance of Estate Tax Closing Letter Does Not Prevent IRS Examination of Return

a) In *Chief Counsel Advice 202142010*, the Chief Counsel's Office stated that the issuance of an IRS Letter 627, *Estate Tax Closing Letter* did not preclude the IRS from examining the subject estate tax return.

b) In the facts at issue, the pronouncement indicated that an estate tax return was filed by an estate and accepted by the IRS. Thereafter, the IRS issued a refund and the IRS Letter 627 to the estate. Following the issuance of the letter, the IRS examined the estate tax return. The examination prompted the estate's attorney to assert that the IRS was improperly reopening the examination of the estate tax return. The Chief Counsel's Office stated, though, that because the IRS never examined the subject estate tax return in the first place, the letter from the IRS stated its examination of the estate tax return was not the reopening of a closed examination, and such review was not precluded.

C. Gift Tax Procedural and Valuation Issues

1. Completed Gift Resulted from Transfer from Trust to Third Party's Bank Account

a) In *Chief Counsel Advice 202045011*, a taxpayer ("Taxpayer") was the sole beneficiary of a trust. Upon dissolution of the trust, Taxpayer directed the trustee of the trust to transfer the trust's funds to a bank account over which Taxpayer had no ownership nor control.

b) The Chief Counsel's office determined that, in effect, the trust distributed the assets to or for the benefit of the Taxpayer. Further, the transfer of the trust's funds to the bank account was completed at the request of the Taxpayer, and as the Taxpayer did not have ownership in or signatory authority over the bank account, the Taxpayer released his dominion and control over the trust's assets resulting in a completed gift by the Taxpayer for gift tax purposes.

c) The Chief Counsel's office also determined that the transfer of the trust's funds to the bank account was not a qualified disclaimer under *Int. Rev. Code Sec. 2518*, because the Taxpayer directed the transfer of the funds to the bank account. Based on the Taxpayer's direction, the transaction was treated as if the trust's assets were distributed to the Taxpayer, then the Taxpayer made a gift to the bank account owner of the trust funds.

D. Conservation and Façade Easement Issues

1. IRS Pursues "Abusive" Syndicated Conservation Easements

a) *Notice 2017-10*[86]

(1) In December 2017, the IRS issued *Notice 2017-10* which classified certain syndicated conservation easement transactions as "listed transactions" requiring special reporting to the IRS. Pursuant to this Notice, if a taxpayer invested in a pass-through entity that promoted the possibility of obtaining a charitable contribution deduction for a conservation easement equal to or greater than 2.5 times the amount of the investment, such transactions fell within the "listed transaction" reporting requirements of *Notice 2017-10*.

(2) Subsequent reporting following this notice indicated that investors were claiming deductions significantly in excess of the 2.5 times measure presented in the notice, thus confirming the suspicions of the IRS that, arguably, tax abuse is occurring with the conservation easement deduction.

b) *IRS Information Letter 2019-0018*

(1) Recently, the IRS indicated in *Information Letter 2019-0018* that it will significantly increase its enforcement actions related to syndicated conservation easement transactions as defined in *Notice 2017-10*.

(2) The IRS has stated that it will audit and pursue both the individual investing taxpayers in these entities, and the pass-through entities promoting these types of investments. The IRS will look into taxpayers who properly disclose such investments, and also taxpayers who fail to satisfy the disclosure requirements under *Notice 2017-10*.

(3) The IRS is coordinating its efforts in this area by evaluating examinations conducted by the Small Business and Self-Employed Division, Large Business and International Division, and the Tax Exempt and Government Entities Divisions. Additionally, the IRS has also initiated investigations through its Criminal Investigations Division.

(4) In addition to auditing investor taxpayers, the IRS is also pursuing investigations of promoters, appraisers, and tax return

[86] 2017-4 IRB.

preparers who have facilitated or been involved with this deduction in an abusive manner. The IRS has also received referrals of complicit practitioners through the IRS Office of Professional Responsibility.

(5) The IRS has indicated that it will assert all appropriate penalties that apply to these deemed abusive transactions, including penalties for participants (40% accuracy-related penalty), appraisers (penalty for substantial and gross valuation misstatements attributable to incorrect appraisals), promoters, material advisors, and accommodating entities (penalty for promoting abusive tax shelters and penalty for aiding and abetting understatement of tax liability), as well as return preparers (penalty for understatement of taxpayer's liability by a tax return preparer). The Department of Justice has filed complaints to attempt to stop individuals and entities from organizing, promoting, or selling allegedly abusive syndicated conservation easement investments.

(6) As of the date of the information letter, the IRS had more than 80 cases docketed with the Tax Court that address this particular issue.

(7) If taxpayers engaged in a syndicated conservation easement transaction that could be questionable, the IRS recommends that such taxpayers consult an independent tax advisor. The IRS has further indicated that such taxpayers may be able to avoid the imposition of penalties if they amend previously filed tax returns to remove improper deductions and related tax benefits in a timely manner, or timely make an administrative adjustment request.

c) Syndicated Conservation Easement Settlement Initiative

(1) In a press release issued on June 25, 2020,[87] the IRS announced a limited time offer to settle certain syndicated conservation easement cases pending before the Tax Court. The IRS indicated it would be sending letters with applicable terms to the eligible taxpayers.

(2) The settlement offer key terms were to include:

(a) Full disallowance of the charitable contribution deduction for the donation of the conservation easement.

[87] IR 2020-130 (6/25/2020).

(b) All partners in the syndicated entity must agree to settle, and the partnership must agree to pay the taxes due as a result of the denial of the charitable contribution deduction in full, including interest and penalties, prior to settlement.

(c) "Investor" partners can deduct their cost of acquiring their ownership interest in the syndicated entity and pay a reduced penalty of 10 – 20%, depending on the ratio of the charitable contribution deduction claimed to the cost of acquiring the ownership interest in the syndicated entity.

(d) "Promoter" partners (those who provided services in connection with any syndicated conservation easement transaction) must pay the maximum penalty asserted by the IRS, typically 40% if the gross valuation misstatement penalty applies, with no deduction for costs.

(3) The IRS recommends parties involved in these transactions consult with independent tax counsel, that is, a qualified advisor who was not involved in the promotion of the syndicated conservation easement or selected by the promoter to defend the transaction.

(4) On August 31, 2020, the IRS announced the completion of its first settlement entered under the syndicated conservation easement settlement initiative.[88] The settlement was reached with Coal Property Holdings.

(a) The settlement will be documented in a stipulated decision document entered in the Tax Court, and also in a separately signed closing agreement.

(b) Both the IRS and the taxpayer agreed to the public statement acknowledging the settlement.

(5) On October 1, 2020, the Chief Counsel's office published *Chief Counsel Notice 2021-001*,[89] which provides additional information on this settlement program.

(a) This guidance indicates that if all the partners of a partnership do <u>not</u> participate in the settlement, the settlement option is generally unavailable unless

[88] IR 2020-196 (8/31/2020).

[89] IR-2020-228 (10/1/2020).

extraordinary circumstances exist as to why all partners cannot participate.

(b) The guidance reiterates that only partnerships with cases docketed before the Tax Court are eligible to participate. Additionally, such partnerships must have received a settlement offer from the IRS in order to be eligible to participate. Docketed cases in the Appeals jurisdiction may participate if they receive a settlement offer from the IRS.

(c) The additional guidance provides that the settlement terms may be extended to newly filed conservation easement cases beyond those existing as of June 25, 2020, the date the initiative began.

(d) The guidance provides that if a partner participated in multiple syndicated conservation easement transactions, all of which are docketed before the Tax Court, a partner has the right to choose which cases to settle under the initiative.

(e) With respect to the financial aspect of the settlement, the new guidance indicates that the settlement amount required under the initiative must be paid in a lump sum payment that includes the aggregate tax, penalties, and interest due from the partnership, or if less than all the partners, the partners reaching the settlement. Such payment must be remitted at the time the partnership signs the Closing Agreement resolving the settlement.

(f) This additional guidance provides more details on the penalties that will apply under the settlement initiative.

2. First Criminal Charges in Syndicated Conservation Easement Promoter Case

a) On December 21, 2020, two Atlanta-based tax professionals pled guilty to conspiracy to defraud the United States by promoting syndicated conservation easement transactions.[90]

b) The two individuals participated in conservation easement transactions that garnered $1.2 billion in purportedly fraudulent charitable contribution deductions for their clients. As payment for these transactions,

[90] IRS Press Release No. 20-1381.

each of the individuals received approximately $1.7 million in commissions over the course of 2013 through 2019.

3. IRS Provides Sample Amendment Language Satisfying Perpetuity Requirement

a) In *IRS AM 2020-001*, the Internal Revenue Service stated that the inclusion of an amendment clause in an easement deed will not automatically cause the easement to violate the perpetuity requirement under *Int. Rev. Code Sec. 170(h)*. The IRS indicated that it would examine any amendment clause in relation to the easement deed as a whole, and also evaluate the facts and circumstances surrounding the granting of the easement to determine whether the perpetuity requirement is satisfied.

b) The IRS thereafter provided the following sample amendment language that it stated satisfies the perpetuity requirement under *Int. Rev. Code Sec. 170(h)*. The sample language is provided verbatim below:

Grantee and Grantor may amend this Easement to enhance the Property's conservation values or add real property subject to the restrictions set forth in this deed to the restricted property by an amended deed of easement, provided that no amendment shall (i) affect this Easement's perpetual duration, (ii) permit development, improvements, or uses prohibited by this Easement on its effective date, (iii) conflict with or be contrary to or inconsistent with the conservation purposes of this Easement, (iv) reduce the protection of the conservation values, (v) affect the qualification of this Easement as a "qualified conservation contribution" or "interest in land", (vi) affect the status of Grantee as a "qualified organization" or "eligible donee," or (vii) create an impermissible private benefit or private inurement in violation of federal tax law. No amendment shall be effective unless documented in a notarized writing executed by Grantee and Grantor and recorded in the Clerk's Office of the Circuit Court of [County, State].

4. IRS Provides Sample Conservation Easement Language Compliant with Perpetuity Requirement

a) In *Chief Counsel Advice 202130014*, the IRS provided sample language for a conservation easement deed that generally will not result in the deed violating the enforceability in perpetuity requirement under *Int. Rev. Code Secs. 170(h)(2)(C)* and *170(h)(5)(A)*.

b) Taxpayers may only claim charitable contribution deductions for conservation easements that satisfy the requirements under *Int. Rev. Code Sec. 170(h)*, as long as they are granted in perpetuity. Language in easements that limits a donee's ability to receive extinguishment proceeds related to post-easement improvements by a contributing taxpayer have routinely been held to violate the perpetuity requirements.

c) *Chief Counsel Advice 202130014* provides sample language that, if closely adhered to by taxpayers, should not violate the perpetuity requirements. The sample language is provided verbatim below:

> Donor agrees that the donation of the perpetual conservation restriction described in this deed gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction, at the time of the gift, bears to the fair market value of the property as a whole at that time. For purposes of this paragraph, the proportionate value of the donee organization's property rights shall remain constant.
>
> On a subsequent sale, exchange, or involuntary conversion of the subject property, the donee organization will be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction.
>
> All of the donee organization's proceeds from a subsequent sale or exchange of the property must be used by the donee organization in a manner consistent with the conservation purposes of the original contribution.

5. Charitable Contribution Deduction Denied for Failure to Include Use Restriction in Easement

a) In *Pine Mountain Preserve, LLLP v. Commissioner*,[91] a father and son claimed $33.4 million in charitable contribution deductions for conservation easements established by their limited partnership (the "LP") in 2005, 2006 and 2007. The LP established three separate easements on a tract of land located near Birmingham, Alabama, that provided for conservation purposes of habitat protection and open space preservation within a defined conservation area. The easements further established that the property subject to the easements was restricted from commercial and residential development in perpetuity; however, two of the easements included a carve-out to allow a number of "building areas" to allow the LP to construct single-family residences and other structures.

b) The Tax Court determined that the two easements which allowed for "building areas" failed to include a <u>permanent</u> restriction on the use of the land as required under *Int. Rev. Code Sec. 170(h)(2)(C)*, since portions of the land could be taken back by the LP and used for residential development. As such, these two easements did not include donation of a

[91] 151 T.C. No. 14 (Dec. 27, 2018).

"qualified real property interest" that would justify allowance of a charitable contribution deduction under *Int. Rev. Code Sec. 170*.

c) The Tax Court did find that the third easement, which did not include the "building area" carve-out nor allow for residential development on the land in any manner, did constitute a donation of a "qualified real property interest," and a charitable contribution deduction under *Int. Rev. Code Sec. 170* was allowed for this particular easement, though less than the value claimed by the LP for this easement deduction.

d) The LP appealed the Tax Court's decision to the appellate court, arguing the legitimacy of the two denied easements, and challenging the value utilized by the Tax Court for the charitable contribution deduction for the lone approved easement. The appellate court issued its opinion in November 2020.[92]

e) On appeal, the appellate court examined whether the two easements that were denied were in fact "qualified real property interests," that is, whether they were "granted in perpetuity" as required under *Int. Rev. Code Sec. 170(h)(2)(C)*. The appellate court interpreted the IRS's view of this restriction as essentially disallowing the retention of any form of development right. The appellate court expressed its view that the IRS misunderstood the plain language of *Int. Rev. Code Sec. 170(h)(2)(C)* and the common law meaning of the word "perpetuity." The appellate court stated that *Int. Rev. Code Sec. 170(h)(2)(C)* refers to "a" singular restriction on the potential use of the subject property. The court interpreted the meaning of "perpetuity" as meaning the LP, its heirs, successors, and assigns, would remain subject to the restriction indefinitely. The court found these requirements satisfied in all three deeds, regardless of the "building area" language in two of the deeds, because there was no language in any of the easement deeds which caused the restrictions, either automatically or upon the occurrence of certain events, to revert back to the LP or its successors.

f) The appellate court inferred that the challenges raised by the IRS did not call into question whether the easements were "granted in perpetuity" as required under *Int. Rev. Code Sec. 170(h)(2)(C)*, the basis for which two of the LP's easement deductions were denied, but did note that the challenges could raise the issue of whether the easements were "protected in perpetuity" as required under *Int. Rev. Code Sec. 170(h)(5)(A)*. But on the issue of whether all three easements were "granted in perpetuity" as required under *Int. Rev. Code Sec. 170(h)(2)(C)*, the appellate court ruled that all three easements satisfied its requirements.

[92] *Pine Mountain Preserve, LLLP*, 126 AFTR2d 2020-___ (CA-11, 2020).

g) The appellate court remanded the case back to the Tax Court to determine whether the two denied conservation easements were both "granted in perpetuity" under "granted in perpetuity" as required under *Int. Rev. Code Sec. 170(h)(2)(C)*, and "protected in perpetuity" as required under *Int. Rev. Code Sec. 170(h)(5)(A)*. The Tax Court must also reexamine the allowable deduction for the one previously approved easement charitable contribution deduction, and value this deduction using the Easement-Valuation-Methods Regulation when making such calculation.[93]

6. Charitable Contribution Deduction Denied for Failure to Protect Conservation Purpose in Perpetuity

a) In *Glade Creek Partners, LLC v. Commissioner*,[94] a taxpayer donated a conservation easement over 1,313 acres of undeveloped real estate to a charitable organization ("Organization"). The taxpayer held this land after its efforts to establish a residential development failed. The taxpayer claimed a charitable contribution deduction of $17.5 million for the donation of the conservation easement to the Organization. The easement deed stated that the land was intended to be used to provide and preserve an open space for wildlife, and granted the Organization the right to protect the property in perpetuity and prevent use of the property for purposes inconsistent with the easement deed. The taxpayer did, however, retain the right to use the donated real estate for agricultural activities, and also retained the right to construct single family dwellings, related buildings, and access roads on the donated real estate. Additionally, the easement deed provided that upon extinguishment of the easement, the taxpayer could subtract from any extinguishment proceeds any increase in the fair market value of the donated real estate attributable to the taxpayer's post-easement improvements on the real estate to determine the extinguishment proceeds deliverable to the Organization.

b) The Tax Court denied the taxpayer's charitable contribution deduction under the provisions of *Int. Rev. Code Sec. 170(f)(3)(A)*, finding that the donation of the easement was not made exclusively for conservation purposes. The Tax Court determined that the provision in the easement deed allowing the taxpayer to subtract the value attributable to the taxpayer's post-easement improvements on the real estate in order to determine the Organization's extinguishment proceeds violated the

[93] The Easement-Valuation-Methods Regulation requires the valuation expert to consider the before and after value of the property subject to the easement, and also consider the value of a property's highest and best use in reaching a value for an easement donation. *See* IRS, Conservation Easement Audit Techniques Guide (rev. Nov. 4, 2016) at p. 23; *see also* Treas. Regs. § 1.170A-14(e)(2) and (3).

[94] T.C. Memo 2020-148 (Nov. 2, 2020).

provisions of *Treas. Regs. Sec. 1.170A-14(g)(6)(ii)*, which does not allow such subtractions.

c) *See also TOT Property Holdings, LLC v. Commissioner*,[95] holding similarly.

7. Conservation Easement and Timber Donation Deductions Denied

a) In *Sells v. Commissioner*,[96] a limited liability company ("LLC") owned a large piece of mountainous land in Alabama (the "Land"). The LLC members were interested in placing a conservation easement on the Land. In 2003, the LLC deeded a conservation easement on the Land to a charitable real estate trust ("Trust"), and claimed a charitable contribution deduction for the donation of the deed of $5.4 million based upon the LLC's appraisal of the Land. The LLC also reported a second noncash charitable contribution valued at $275,340 for a donation of the timber on the Land to the Trust; the value of the timber was appraised separately from the Land.

b) The deed granting the conservation easement included an extinguishment proceeds clause which stated that the fair market value of the Land would not include an increase in value of the Land after the date of the easement deed arising from improvements to the Land.

c) The LLC claimed charitable contribution deductions for the donation of the easement deed and the timber to the Trust, and issued K-1s to its members including these deductions. The IRS reviewed the LLC's income tax return and denied these deductions.

d) The issue before the Tax Court was whether the claimed charitable contribution deductions should be allowed.

e) In evaluating whether a deduction should be allowed related to the easement deed, the court found the extinguishment proceeds clause which essentially subtracted the value of post-easement improvements from extinguishment proceeds available to the Trust violated the provisions of *Treas. Regs. Sec. 1.170A-14(g)(6)(ii)*, and disallowed this deduction.

f) In evaluating the deduction related to the LLC's timber, the court determined that the easement deed prohibited the cutting of timber and conversion thereof into lumber, as such actions were inconsistent with the conservation purpose provided in the deed. Accordingly, the LLC's donation of the timber was held to be either (1) a gift of a partial interest in real estate that did not qualify as a conservation easement, or (2) a future

[95] No. 20-11050 (11th Cir. June 23, 2021).

[96] T.C. Memo. 2021-12.

interest in tangible personal property. If a gift of a partial interest in real estate, the deduction was disallowed under *Int. Rev. Code Sec. 170(f)(3)(A)*. If a future interest in tangible personal property, the LLC could not claim the charitable contribution deduction until the timber was actually severed from the Land, in accordance with *Int. Rev. Code Sec. 170(a)(3)*. In either event, the charitable contribution for the timber was also denied.

8. Installation of ADA-Required Ramp Does Not Violate Façade Easement Rules

a) In Legal Advice Issued by Associate Chief Counsel AM 2021-001, the IRS indicated that a donor of a façade easement on a building in a registered historic district could install an accessibility ramp in order to comply with the Americans With Disabilities Act ("ADA") without running afoul of the rules applicable to façade easements on historic buildings. The IRS determined that the construction of the accessibility ramp was similar to "upkeep," and does not violate the rules under *Int. Rev. Code Sec. 170(h)*.

(1) Note that "upkeep" is allowed under *Int. Rev. Code Sec. 170(h)*, but not defined thereunder. The Legal Advice noted that upkeep is allowed as essential for the preservation of a certified historic structure.

b) *Internal Revenue Code Section 170(h)(4)(A)(iv)* allows a charitable contribution deduction to a taxpayer who contributes an easement that conserves all or a portion of a certified historic structure (a "façade easement") to a qualified non-profit organization.

c) A certified historic structure includes: (i) any building, structure, or land area listed in the National Register, or (ii) any building located in a registered historic district and certified by the Secretary of the Interior as being of historic significance to the district.[97]

d) To qualify for a charitable contribution deduction for the donation of a façade easement, the donated easement must:[98]

(1) Constitute a qualified real property interest;

(2) Be donated to a qualified non-profit organization organized exclusively for conservation purposes;

(3) Preserve the conservation purpose of the easement in perpetuity; and

[97] *Int. Rev. Code Secs. 170(h)(4)(C)(i)* and *170(h)(4)(C)(ii)*.

[98] *Int. Rev. Code Sec. 170(h)*.

(4) Contain perpetual restrictions in the easement deed.

e) Additionally, the easement deed granting the façade easement which encumbers the exterior of a building located within a historic district, certified by the Interior Secretary as being of historic significance to the district, must preserve the entire exterior of the building, including its front, rear, sides, and height, and must prohibit any change to the exterior that is inconsistent with the historical character of the exterior.[99]

E. Other Charitable Deduction Issues

1. IRS Form 8283 Revised as of December 2020

a) The IRS issued a new draft IRS Form 8283 and instructions thereto, as revised in December 2020.

b) IRS Form 8283, Noncash Charitable Contributions, is used by taxpayers to report information concerning noncash charitable contributions valued in excess of $500 for individuals, partnerships, and S corporations, and is filed jointly with the taxpayer's income tax return reporting the charitable contribution deduction.

c) The changes to the IRS Form 8283 are as follows:

(1) IRS Form 8283, Section B, Part I, Information for Donated Property, includes a new checkbox to designate donations of clothing and household items.

(2) The location of reporting donations of partial interests and restricted property was changed from Section A to Section B (excluding qualified conservation easement contributions).

(3) Section B, Part IV, Declaration of Appraiser now requires the appraiser's name, appraiser's signature, title, and the date the appraiser signed the form.

2. Charitable Contribution Deduction Denied to Marijuana Dispensary Business

a) In *San Jose Wellness v. Commissioner*,[100] the taxpayer operated a medical cannabis dispensary, a legal business operation ("Business") under California law. The Business claimed a deduction for charitable

[99] *Int. Rev. Code Sec. 170(h)(4)(B)(i)*.

[100] 156 T.C. No. 4 (Feb. 17, 2021).

contributions under *Int. Rev. Code Sec. 170(a)*, but the IRS disallowed the deduction pursuant to *Int. Rev. Code Sec. 280E*.

(1) *Internal Revenue Code Section 280E* is a broad deduction prohibition which disallows deductions by a taxpayer who carries on a trade or business of trafficking in controlled substances.

b) The Business argued that it also sold non-cannabis items and services, so its trade or business did not consist of trafficking in controlled substances. The Business also argued that its charitable contributions were not paid or incurred in carrying on a trade or business within the meaning of *Int. Rev. Code Sec. 280E*, i.e., these were not business expenses the deduction of which was prohibited under *Int. Rev. Code Sec. 280E*.

c) The Tax Court held in favor of the IRS, disallowing the deductions claimed by the Business, including the charitable contribution deduction. The Tax Court held that *Int. Rev. Code Sec. 280E* is not limited to business expenses, but actually applies to any amounts or expenses paid or incurred by a trade or business involved in trafficking in controlled substances. The court did not find the charitable contributions as outside the scope of the medical cannabis dispensary activities of the Business, so the deductions for these contributions were disallowed pursuant to the provisions of *Int. Rev. Code Sec. 280E*.

3. Charitable Contribution Deduction Denied for Failure to Provide Appraisals

a) In *Duane Pankratz v. Commissioner*,[101] a taxpayer ("Taxpayer") who was a veterinarian, innovator, and entrepreneur resided in South Dakota and accumulated a large amount of land and interests in business ventures. In 2008, Taxpayer donated his interests in four oil and gas projects to a local church, and valued this contribution at $2 million based on his purchase price for these interests and the amount by which he expected the interests to increase in value. Taxpayer did not obtain an appraisal to value the contributed interests.

b) In 2009, Taxpayer donated a conference center to another religious charity. Taxpayer hired a certified general appraiser to value the conference center, but after visiting the conference center the appraiser indicated that he did not feel comfortable providing an appraised value. Accordingly, the Taxpayer did not obtain a professional appraisal for the 2009 contribution.

(1) For charitable contributions valued in excess of $5,000, a taxpayer is required to both obtain a qualified appraisal and attach a

[101] TC Memo 2021-26 (March 3, 2021).

summary of the appraisal to the taxpayer's income tax return.[102] If the value of contributed property exceeds $500,000, the taxpayer is required to attach the full appraisal to the taxpayer's income tax return.[103]

c) Taxpayer reported and deducted his 2008 and 2009 charitable contributions on his individual income tax return, prepared by his unlicensed return preparer. Taxpayer's return preparer did not inform Taxpayer that appraisals were required to substantiate these charitable contribution deductions. Taxpayer signed his individual income tax returns without reviewing them.

d) The IRS denied the 2008 and 2009 charitable contribution deductions claimed by Taxpayer due to his failure to provide appraisals with his individual income tax return.

e) The Tax Court ruled in favor of the IRS, denying the charitable contribution deductions claimed by Taxpayer due to his failure to obtain and provide qualified appraisals. Taxpayer argued that he reasonably relied on his return preparer in reporting the charitable contribution deductions, but the Tax Court found the reliance as unreasonable and not in good faith as the return preparer did not have a professional license nor experience to qualify him as a competent adviser. The Tax Court determined that, based on the Taxpayer's education, sophistication, and business experience, he should have realized that appraisals would be required to substantiate his deductions.

4. Noncash Charitable Contribution Deductions Denied for Failure to Properly Substantiate

a) In *Chiarelli v. Commissioner*,[104] a taxpayer ("Taxpayer") was advised to donate a large portion of inherited personal property to charitable organizations. In 2012, 2013 and 2015, Taxpayer made donations of the personal property, and claimed charitable contribution deductions on his IRS Form 1040, U.S. Individual Income Tax Return for such tax years. Taxpayer reported noncash charitable contribution deductions of $89,110, $93,087, and $77,300, respectively, for the tax years at issue, on Schedule A, Itemized Deductions. He also attached a Form 8283, Noncash Charitable Contributions, to each of these income tax returns, but he did not complete Section A of Form 8283, which requested detailed information about donated property valued at less than $5,000. Taxpayer did complete Section B of Form 8283, which requests detailed information about donated

[102] *Int. Rev. Code Sec. 170(f)(11)(C)*.

[103] *Int. Rev. Code Sec. 170(f)(11)(D)*.

[104] T.C. Memo. 2021-27 (March 3, 2021).

property valued in excess of $5,000, including a description of the donated property, a summary of the property's physical condition at the time of donation, its appraised fair market value, the date the property was acquired, its manner of acquisition, and the Taxpayer's cost or adjusted basis in the contributed property. The Forms 8283 were not signed by donor, the donee charitable organizations, nor the appraisers hired by Taxpayer. The Taxpayer did submit letters from appraisers concerning some of the property he donated.

b) The IRS disallowed the charitable contribution deductions claimed by the Taxpayer, and the Taxpayer filed suit in Tax Court to challenge such disallowance.

c) The Tax Court held in favor of the IRS, disallowing the charitable contribution deductions claimed by Taxpayer. The Tax Court noted that the Forms 8283 provided by Taxpayer were incomplete, and did not include necessary signatures from Taxpayer or third parties. As such, the Taxpayer did not strictly comply with the substantiation requirements to justify the claiming of a charitable contribution deduction.

d) For smaller contributions made by Taxpayer, valued at less than $250, the Tax Court denied the deductions as the Taxpayer did not obtain contemporaneous written acknowledgments from the donee charitable organizations to support these deductions. The Tax Court determined that for noncash contributions valued at less than $5,000, Taxpayer did not retain receipts or sufficiently describe the property on his Forms 8283, as required by *Treas. Regs. §1.170A-13(b)(1)*. The Tax Court also determined that for the noncash contributions valued in excess of $5,000, the Taxpayer did not obtain qualified appraisals nor attach summaries of such appraisals to his tax return. The Tax Court found the Taxpayer's appraisals were not qualified appraisals because the appraisals did not describe the physical condition or age of the donated properties, the qualifications of the appraiser, a statement that the appraisal was prepared for income tax purposes, and the appraised fair market value of the individual properties donated, as required by *Int. Rev. Code Sec. 170(f)(11)(C)* and *Treas. Regs. §1.170A-13(c)(2).*

(1) *Treasury Regulation Section 1.170A-13(b)(1)* requires that for noncash charitable contributions valued at $5,000 or less, a taxpayer must maintain a receipt from the donee charitable organization, unless doing so is impractical. The donee receipt must show: (1) the name of the donee, (2) the date and location of the contribution, and (3) a description of the property in detail reasonably sufficient under the circumstances. A taxpayer who lacks a donee receipt is required to keep reliable written records including, among other things: (1) the name and address of the donee organization to which the contribution was made, (2) the date and

location of the contribution, (3) a description of the property in detail reasonable under the circumstances (including the value of the property), and (4) the fair market value of the property at the time the contribution was made, the method used to determine the fair market value, and if the fair market value was determined by appraisal, a copy of the signed report of the appraiser.

(2) *Internal Revenue Code Section 170(f)(8)(A)* provides that contributions in excess of $250 must be substantiated with a "contemporaneous written acknowledgment" from the donee charitable organization. If a taxpayer does not have a "contemporaneous written acknowledgment," the charitable contribution deduction will be disallowed.

(3) For charitable contribution deductions valued over $500, a taxpayer must: (1) meet the information requirements for noncash contributions of $250 or more; (2) maintain written records with a more detailed description of the property, including the manner and approximate date of acquisition and the cost or other basis in the property; and (3) state such information in an income tax return if required by the return form or its instructions.[105]

(4) For charitable contributions of property valued in excess of $5,000, in addition to complying with the substantiation requirements for property in excess of $250 and $500, a taxpayer must obtain a "qualified appraisal" of each donated item, and attach to each tax return a fully completed appraisal summary on Form 8283.[106]

5. Charitable Contribution Deduction Denied for Partial Interest Donation of House and Contents

a) In *Mann v. United States*,[107] married taxpayers (the "Taxpayers") determined that a house they recently purchased was unsuitable. Taxpayers contracted for a builder to demolish the house and build a new one. Prior to demolishing the house, Taxpayers contacted an organization named Second Chance, which qualified as a non-profit organization under *Int. Rev. Code Sec. 501(c)(3)* to inquire about donating the house prior to its destruction.

(1) Second Chance works to salvage building materials, fixtures, and furniture from properties prior to their destruction, sells

RECENT DEVELOPMENTS IN TAXATION

[105] *Int. Rev. Code § 170(f)(11)(B); Treas. Regs. § 1.170A-13(b)(3)(i)*.

[106] *Int. Rev. Code § 170(f)(11)(C); Treas. Regs. § 1.170A-13(c)(2)*.

[107] 123 AFTR 2d ¶ 2019-396, No. TDC-17-0200 (D. Md. Jan. 31, 2019).

such salvaged items at its retail stores, and recycles items that cannot be resold. Second Chance also hires disadvantaged individuals to perform "deconstruction" work, to help them gain life skills training through performing such work.

b) On December 1, 2011, Taxpayers signed an agreement with Second Chance to donate the house, and also various pieces of furniture and personal property to Second Chance. Taxpayers did not record this agreement in the public records.

c) In their negotiations, Second Chance told Taxpayers that generally donors to the organization claim charitable contribution deductions for items that make it into Second Chance's warehouse, and Second Chance promised to make a list of such items for Taxpayer's records. Second Chance told Taxpayers that they could receive a fair market value charitable contribution deduction for these items as determined by a qualified appraiser.

d) To assist with the cost of paying Second Chance's employees, Second Chance requests donors to made cash donations in addition to their in-kind donations. It was purportedly well known that Second Chance would not agree to participate in a deconstruction project unless a potential donor also made a substantial cash donation to Second Chance.

e) To move forward with their agreement, Taxpayers made a $10,000 donation to Second Chance in 2011, and a second $1,500 donation to Second Chance in 2012. Second Chance provided Taxpayers with a written acknowledgement which stated that Taxpayers "did not receive anything of value in exchange" for their donations to Second Chance, and further stated that "the entire value of their donation was deductible."

f) After the agreement was entered, Taxpayers obtained two appraisals for the house and its contents. One appraisal reflected the house value at $675,000, after applying a sales comparison methodology and determining that the highest and best use for the house was to move it intact to a different location. The second appraisal valued the house at $313,353, based on the assumption that the house would be donated to Second Chance for training purposes. The appraisal for the house contents reflected a value of $24,206, determining the values based on replacement costs for the contents less applicable depreciation.

g) After the house was demolished, Second Chance failed to provide Taxpayers with a list of items salvaged from the house. Ultimately, the deconstruction efforts provided by Second Chance did not reduce the expected costs to Taxpayers for demolition of the house.

h) On their 2011 individual income tax return, Taxpayers claimed a charitable contribution deduction of $675,000 for the house, a deduction of $24,206 for the value of their house contents, and a $10,000 deduction for the cash contribution made to Second Chance. Taxpayers' 2012 individual income tax return claimed a charitable contribution deduction of $1,500 for the second cash contribution made to Second Chance.

i) The IRS disallowed all of Taxpayers' charitable contribution deductions for both tax years. Taxpayers paid the taxes asserted due and filed a refund claim in federal district court. To avoid portions of the litigation related to the 2011 deductions, Taxpayers filed an amended 2011 individual income tax return wherein they lowered the value of the deduction attributable to the house from $675,000 to $313,353. The IRS rejected this deduction yet again.

j) The district court ruled in favor of the IRS, holding that Taxpayers were not entitled to a charitable contribution deduction for the value of the house and household contents donated to Second Chance. The district court did, however, allow Taxpayers' charitable contribution deductions for the cash donations to Second Chance.

k) With respect to the donation of the house, the district court agreed with the IRS's assertions that in donating the house to Second Chance, Taxpayers donated only a partial interest in the house to Second Chance, and partial interest donations are generally disallowed under *Int. Rev. Code Sec. 170*. Under state law, individuals can sever a house from the underlying land and transfer the entire interest in a separated house, but for tax purposes, such a donation is only valid if the transaction is recorded separately in the state land records. Since the agreement between Taxpayers and Second Chance was not recorded, under state law Taxpayers did not properly sever the house from the underlying land sufficient to transfer ownership of the house to Second Chance. The district court likened Taxpayers' actions to granting a license to Second Chance to access and use the house for training purposes, and this usage right was not sufficient to allow a charitable contribution deduction under *Int. Rev. Code Sec. 170*.

l) The district court further noted that even if Taxpayers had properly recorded their agreement with Second Chance in a manner to support their charitable donation, the value of the donation was not supported by either of Taxpayers' appraisals as both failed to value the house in a manner and using a methodology sufficient to support a charitable contribution deduction under *Int. Rev. Code Sec. 170*. These deficient appraisals were likewise the reason the district court disallowed the charitable contribution deduction for the donation of the household contents.

m) In upholding the charitable contribution deductions for Taxpayers' cash contributions to Second Chance, the district court disagreed with assertions by the IRS that these deductions should be disallowed on the premise that the payments were a quid pro quo for the deconstruction services received by Taxpayers from Second Chance. While the court acknowledged that the cash donations were presumptively required by Second Chance in order to accept the house, the court still determined that Taxpayers did not receive a "specific benefit in return" from Second Chance related to these payments.

n) On this issue, the court likened the facts to a 2012 façade conservation easement case, *Scheidelman*,[108] in which the taxpayers donated a façade conservation easement along with a cash contribution equal to 10% of the value of the easement, such cash contribution being applied toward the administrative and maintenance costs associated with the easement. In *Scheidelman*, the Second Circuit Court of Appeals upheld the charitable contribution deduction for the cash contribution even though the cash contribution was required, finding that the donation was not a quid pro quo because the donor did not receive a specific benefit from the charity in return for the donation, other than the charity's acceptance of the conservation easement – while the donor received a benefit in the allowance of a charitable contribution deduction, that benefit was from the IRS, and not from the charity itself.

o) In the *Mann* case, the district court reasoned that Taxpayers made the cash contribution to Second Chance so that Second Chance would accept the house, but not in order to secure tangible goods or services in return from Second Chance. Instead, Taxpayers made the contribution in order to obtain a charitable contribution deduction, and this was not a specific benefit provided by Second Chance. The district court also noted that the deconstruction of the house did not provide a collateral benefit to Taxpayers in that it did not actually reduce the cost of having the house demolished; instead, it was more than likely a hindrance and additional cost for the project.

p) The Taxpayers appealed the district court decision to the Fourth Circuit Court of Appeals, which upheld the ruling of the district court.[109] Because the Taxpayers failed to record a transfer of ownership in the house in the public records, the Taxpayers still remained owners of the house and the charitable contribution deductions claimed by Taxpayers related to the house were improper.

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[108] *Scheidelman, Huda v. Comr.*, 109 AFTR 2d 2012-2536 (2012, CA2).

[109] *Mann v. United States*, No. 19-1793 (4th Cir. Jan. 6, 2021).

6. Sham Donation of Property Resulted in $0 Value of Property for Purposes of Calculating Accuracy-Related Penalty

a) In *Fakiris v. Comr.*,[110] a taxpayer ("Taxpayer") was a commercial real estate owner and developer. Taxpayer was the managing member and 60% owner of a limited liability company (the "LLC") that was engaged in the business of developing real estate. In 2001, the LLC bought a theater for $700,000, subject to a $500,000 mortgage.

b) In December 2003, a corporation ("Corp") was organized as a nonprofit organization, but Corp had not yet received its IRS determination letter recognizing its charitable status. Corp began discussions with LLC to purchase the theater, and sometime prior to June 29, 2004, the LLC agreed to donate the theater to Corp. LLC had concerns though that Corp was not yet recognized as tax-exempt, so Corp brought a Section 501(c)(3) organization ("Organization") into its discussions with LLC. LLC, Corp and Organization agreed that LLC would transfer the theater to Organization, and Organization would later transfer the theater to Corp.

c) On June 29, 2004, LLC sold the theater to Organization for a purchase price of $470,000, the amount outstanding on LLC's mortgage for the theater, and Corp's founder provided this purchase price. The sale contract included provisions that restricted the ability of Organization to sell the theater for five years after the sale, and permitted LLC to direct the transfer of the theater to Corp once it obtained its 501(c)(3) exempt status. These transfer restrictions were not reflected in the deed recorded for the transfer of the theater.

d) On the same day of the sale, June 29, 2004, Organization transferred the theater to Corp in violation of the restrictions in the sale contract between Organization and LLC. Corp did not receive notice of its 501(c)(3) exempt status until September 30, 2004, but its exempt status was retroactively effective on May 11, 2004.

e) Taxpayer reported a $3 million charitable contribution deduction (calculated as 60% of the $5 million appraised value of the theater on the date of sale, based on Taxpayer's 60% ownership of LLC) on his 2004 federal income tax return due to the LLC's transfer of the theater to Organization. Taxpayer carried forward the majority of this charitable contribution deduction to tax years 2005 through 2008. The IRS timely issued notices of deficiency to Taxpayer for tax years 2006 through 2008, disallowing the $3 million charitable contribution deduction claimed by

[110] T.C. Memo 2017-126 (June 28, 2017).

Taxpayer for his 2004 tax year, finding that the requirements under *Int. Rev. Code Sec. 170* were not satisfied.

f) The Tax Court held that the LLC's transfer of the theater to Organization was not a completed gift, so Taxpayer was not entitled to claim the charitable contribution deductions. Applying state law and considering the sales contract in globo, the Tax Court determined that the LLC's retention of the right to direct the transfer of the theater for the five year period following the sale resulted in the LLC retaining dominion and control over the theater. For this reason, the court viewed the LLC's transfer of the theater as a conditional gift because the possibility that the condition would be satisfied was not so remote as to be negligible, and the gift was not complete pursuant to *Int. Rev. Code Sec. 170(a)(1)* and *Treas. Reg. Sec. 1.170A-1(e)*. The court was not concerned with the fact that these restrictions were not included in the deed that was filed in the public records.

g) Taxpayer was also held liable for the 40% gross valuation misstatement accuracy-related penalty under *Int. Rev. Code Sec. 6662(h)* for his underpayments of tax in 2006 through 2008.

h) On supplemental review, the Tax Court later had to determine the amount of the 40% gross valuation misstatement accuracy-related penalty to be charged to Taxpayer.[111] The issue before the Tax Court was whether the value of the property should be $0, since the transfer of the theater was not a completed gift, or whether the actual value of the theater should be used in calculating the penalty. The Tax Court determined that the value of the theater should be $0, since the transaction was viewed as a sham and no value was in fact transferred to the Organization.

(1) Ironically, in this supplemental review, the IRS was asking the Tax Court to include a value of the theater in its calculation of the accuracy-related penalty. By requesting that the theater have a value, the IRS was actually arguing for a lower penalty to apply to Taxpayer.

F. Miscellaneous Cases and Administrative Developments

1. Treasury Department 2020 – 2021 Priority Guidance Plan

a) Each year, the IRS and the Treasury Department issue their priority guidance plan, which describes projects they plan to work on in the upcoming fiscal year, running from July 1 through June 30. Previously, the plan listed several projects that related to estate, gift, and generation-

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[111] T.C. Memo. 2020-157.

skipping transfer taxes, many of which carried over on the plan year-to-year. Now, the priority guidance plan includes only projects that the IRS and Treasury Department realistically expect to complete in the fiscal plan year, so the number of transfer tax-related items covered in these plans has declined in recent years.

b) The 2020 – 2021 IRS Priority Guidance Plan issued November 2020 included the following projects applicable to estates, gifts, and trusts:

(1) Guidance on the basis of grantor trust assets at death under *Int. Rev. Code Sec. 1014*.

(2) Guidance on the user fee imposed for estate tax closing letters under *Int. Rev. Code Sec. 2001*.

(3) Regulations under *Int. Rev. Code Sec. 2032(a)* concerning the imposition of restrictions on estate assets during the six-month alternate valuation period. Note that proposed regulations were issued on this topic in November 2011.

(4) Regulations under *Int. Rev. Code Sec. 2053* applicable to personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against an estate.

(5) Regulations under *Int. Rev. Code Sec. 7520* regarding the use of actuarial tables in valuing annuities, interests for life or a term of years, and remainder or reversionary interests.

2. Treasury Department 2021 – 2022 Priority Guidance Plan

a) The 2021 – 2022 IRS Priority Guidance Plan was released by the IRS on September 9, 2021, updated as of August 31, 2021. The updated plan identifies guidance projects that the IRS and Treasury Department intend to work on as priorities during the 12-month period from July 1, 2021, through June 30, 2022.

b) The 2021 – 2022 IRS Priority Guidance Plan issued in September 2021 included the following projects applicable to estates, gifts, and trusts:

(1) Final regulations on the user fee imposed for estate tax closing letters under *Int. Rev. Code Sec. 2001*.[112]

[112] This was accomplished; see above in materials.

(2) Final regulations addressing *Int. Rev. Code Secs. 1014(f)* and *6035* addressing basis consistency reporting between an estate and a person acquiring property from a decedent.[113]

(3) Regulations under *Int. Rev. Code Sec. 2032(a)* concerning the imposition of restrictions on estate assets during the six-month alternate valuation period.

(4) Regulations under *Int. Rev. Code Sec. 2053* applicable to personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against an estate.

(5) Regulations under *Int. Rev. Code Sec. 7520* regarding the use of actuarial tables in valuing annuities, interests for life or a term of years, and remainder or reversionary interests.

3. Federal Filing Deadlines Delayed Due to Hurricane Ida

a) The Internal Revenue Service announced filing relief for all Louisiana residents and businesses impacted by Hurricane Ida. Tax filings and payments due between August 26, 2021 and January 3, 2022 now have an automatic extended filing and payment deadline of January 3, 2022.[114]

b) Some examples of filings impacted by this extension are included below:

(1) Individuals who had filed an extension for their 2020 income tax return, which was otherwise due on October 15, 2021, now have until January 3, 2022 to file this return. Note that this extension does not apply to tax payments related to the 2020 returns, as such payments were otherwise due on May 17, 2021.

(2) Individuals with 2021 estimated income tax payments due after August 26, 2021 will now have until January 3, 2022 to make such estimated payments.

(3) Calendar year tax-exempt organizations with returns on valid extension (otherwise due on November 15, 2021) now have until January 3, 2022 to file such returns.

[113] *See* proposed and temporary regulations published on March 4, 2016 at _______.

[114] IR 2021-175 (Aug. 31, 2021).

(4) Impacted business, employment tax, and excise tax filings are also eligible for some extensions applicable to such filings, but different payment and penalty deadlines may apply to these filings.

c) The IRS is basing this automatic filing relief on taxpayers who have an IRS address of record located in the disaster area. Taxpayers who satisfy this requirement do not need to contact the IRS to obtain this relief; this relief is automatic. That said, the IRS indicates that if a Louisiana taxpayer receives a late filing or late payment notice from the IRS related to a return or payment due on the postponement period of August 26, 2021 through January 3, 2022, such taxpayer should contact the number included in such notice to have any penalties reflected in the notice abated.

d) The IRS will also work with taxpayers who live outside of the areas impacted by Hurricane Ida, but either have tax records located in areas impacted by Hurricane Ida or are assisting relief efforts as part of a recognized governmental or philanthropic effort in areas impacted by Hurricane Ida, who may qualify for relief due to the location of such records or the efforts of such individuals in assisting those impacted by Hurricane Ida to provide some form of tax relief. Such individuals can contact the IRS at (866) 562-5227 to discuss these matters with the IRS.

e) The IRS is also granting some early filing relief for individuals who endured uninsured or unreimbursed disaster losses related to Hurricane Ida. Impacted individuals are able to claim these casualty losses, as otherwise allowed under federal tax laws, on either the return of the year the loss was incurred (i.e., their 2021 federal income tax return), or an original or amended return for the prior year (i.e., an original or amended 2020 federal income tax return). To take advantage of this potential early claiming of such casualty losses, taxpayers should be sure to include the FEMA declaration number (4611) related to Hurricane Ida in Louisiana on any return claiming such losses.

4. Acceptance of E-Signatures

a) During the initial stages of the COVID-19 pandemic, the IRS issued announcements indicating its acceptance of electronic signatures on certain tax filings that cannot be electronically filed with the IRS. As the pandemic continued on, the IRS expanded the listing of forms that could be signed with electronic signatures, and also continued to extend the time periods when electronic signatures would be allowed. [115]

[115] *See* Tax Alert 2020-2148 (issued Sept. 10, 2020, extending the acceptance of electronic signatures on specified forms through December 31, 2020); *see also IRS Memo: Temporary Deviation from Handwritten Signature Requirement for Limited List of Tax Forms, Control Number NHQ-10-0421-0002* (allowing the acceptance of electronic signatures <u>and</u> emailed documents); *IRS Webpage – IRS Operations During COVID-19: Mission-*

b) In early September 2021, the IRS updated provided guidance[116] and updated its webpage[117] to extend the allowance of electronic signatures on specified forms and returns that cannot be filed electronically. This guidance does not prescribe a certain method for electronic signing, so taxpayers are able to utilize their preferred e-signature method. As relevant to estate planners, forms impacted by this change include the following:

(1) IRS Form 706, *U.S. Estate (and Generation-Skipping Transfer) Tax Return*

(2) IRS Form 706-A, *U.S. Additional Estate Tax Return*

(3) IRS Form 706-NA, *U.S. Estate (and Generation-Skipping Transfer) Tax Return*

(4) IRS Form 706-GS(D), *Generation-Skipping Transfer Tax Return for Distributions*

(5) IRS Form 706-GS (D-1), *Notification of Distribution from a Generation-Skipping Trust*

(6) IRS Form 706-GS(T), *Generation-Skipping Transfer Tax Return for Terminations*

(7) IRS Form 706-QDT, *U.S. Estate Tax Return for Qualified Domestic Trusts*

(8) IRS Form 706 Schedule R-1, *Generation-Skipping Transfer Tax*

(9) IRS Form 709, *U.S. Gift (and Generation-Skipping Transfer) Tax Return*

(10) IRS Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*

(11) IRS Form 3520-A, *Annual Information Return of Foreign Trust with a U.S. Owner*

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critical functions continue, 4/29/21 (extending the acceptance of electronic signatures on specified forms through December 31, 2021).

116 FS 2021-21 (September 2021).

117 Details on using e-signatures for certain forms | Internal Revenue Service (irs.gov) (last visited September 19, 2021).

(12) IRS Form 4421, *Declaration – Executor's Commissions and Attorney's Fees*

(13) IRS Form 4768, *Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes*

(14) IRS Form 8283, *Noncash Charitable Contributions*

(15) IRS Form 8832, *Entity Classification Election*

(16) IRS Form 8971, *Information Regarding Beneficiaries Acquiring Property for a Decedent*

c) The September 2021 guidance issued by the IRS appeared to indefinitely extend the time period during which the IRS would accept electronic signatures. The IRS clarified this guidance, though, to provide that the extended time period allowing for e-signature relief lasts through December 31, 2021.[118] Despite this specified expiration date, the IRS has noted that it is "studying possible further extensions of this option."

d) Note that the list of forms accepted with electronic signatures should always be monitored and confirmed prior to filing a return with an electronic signature. If a taxpayer files a form with an electronic signature that otherwise requires an actual, handwritten signature, the improperly signed form could result in the form being treated as invalid, which in turn could result in missed or untimely elections and potentially penalties.

5. Tax Pro Accounts and Online Power of Attorney Authorization

a) On July 19, 2021, the Internal Revenue Service launched its Tax Pro Account website.[119] The purpose of the Tax Pro Account is to allow taxpayers to electronically control who may represent them or review their tax records.

b) By use of a Tax Pro Account, tax professionals can digitally initiate IRS Powers of Attorney and Tax Information Authorization forms which are in a simpler format than the physical versions of these forms. After preparation by a tax professional, the tax professional can submit these forms to taxpayers' online accounts for them to review, approve, or reject the forms, and provide an electronic signature by checking a box in order to submit these completed forms to the IRS electronically. Once completed,

[118] Tax Alert 2021-1606.

[119] Use Tax Pro Account | Internal Revenue Service (irs.gov) (last visited September 19, 2021); *see also* IR 2021-154 (July 19, 2021).

this new digital authorization will go directly to the IRS's Centralized Authorization File (CAF) database, and these forms will no longer require manual processing for taxpayers who choose to utilize this option. The IRS indicates that most submitted requests will immediately appear on a list of approved authorizations in the taxpayer's Tax Pro Account and the tax professional's Tax Pro Account, though some requests may take up to 48 hours for approval. Once approval is obtained, tax professionals will be able to access linked taxpayer's records through an e-Services Transcript Deliver Service.

(1) Prior to establishment of the Tax Pro Account, or for tax professionals who do not establish a Tax Pro Account, tax professionals were required to have their clients complete an IRS Form 2848, *Power of Attorney*, or an IRS Form 8821, *Tax Information Authorization*, physically signed by the clients and the tax professional, in order to authorize a tax professional to interact with the IRS on the client's behalf, or to allow the tax professional to receive the client's confidential tax information.

c) This new digital authorization process is only available to individual taxpayers currently. To be eligible, an individual taxpayer must have an address located in the United States or the District of Columbia.

d) For a tax professional to be eligible to set up a Tax Pro Account, the tax professional must have:

(1) For Tax Information Authorization, (i) a CAF number in good standing to the tax professional as an individual, and (ii) a CAF address located in the United States or the District of Columbia.

(2) For Power of Attorney, (i) a CAF number in good standing to the tax professional as an individual, (ii) a CAF address located in the United States or the District of Columbia, (iii) authority to practice before the IRS as an attorney, CPA, enrolled agent, enrolled actuary or enrolled retirement plan agent, and (iv) license to practice in the United States or the District of Columbia as an attorney or accountant.[120]

e) Once a Tax Pro Account is established, tax matters can be authorized from 2000 and forward, plus three future calendar years, concerning the following items:

(1) IRS Form 1040 (income taxes)

[120] Presumably, the last requirement does not apply to enrolled agents, enrolled actuaries or enrolled retirement plan agents.

(2) Split Spousal Assessment or IRS Form 8857, Innocent Spouse Relief

(3) Shared Responsibility Payment

(4) Shared Responsibility Payment – Split Spousal Assessment

(5) Civil Penalty (limited to certain time periods)

f) If a taxpayer establishes a Tax Pro Account, such establishment will revoke any prior authorizations on file with the IRS for the same tax matters, tax periods and authorizations established by the taxpayer. If a taxpayer wishes to keep authorizations intact after establishment of a Tax Pro Account, the taxpayer should submit a new IRS Form 2848 or 8821 through the Tax Pro Account, by fax, or mail.

g) The Tax Pro Account instructions provide guidance on other topics, including physical address rules, multiple representatives, authorizations for overlapping periods, and obtaining copies of authorization requests. Guidance does indicate that when a taxpayer has multiple representatives, each tax professional must submit his or her own authorization request and submit it to the taxpayer's Tax Pro Account. Additionally, the IRS has indicated that it will respect only two representatives as receiving copies of IRS notices and communications; if more than two representatives are identified to receive copies, the IRS will only respect the first two requests.[121]

h) Following the launch of the Tax Pro Account, the IRS released draft instructions for IRS Form 2848, *Power of Attorney*, and IRS Form 8821, *Tax Information Authorization*.

(1) The draft instructions for both forms recommend use of the new Tax Pro Account.

(2) The draft instructions for both also authorize use of electronic signatures.

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6. Estate Liable for Decedent's Report of Foreign Bank and Financial Accounts ("FBAR") Penalties

a) In *Estate of Danielson*,[122] a taxpayer ("Taxpayer") started selling Swiss annuities in 1993. In tax years 1994 and 1995, Taxpayer filed FBARs to report foreign accounts which he held in such years. Thereafter,

[121] *See* IRM Procedural Update Number: wi-21-0721-0914: Tax Pro Account – New Online System Interface (July 6, 2021).

[122] DC FL 10/6/2020, 126 AFTR 2d ¶2020-5343.

Taxpayer formed a wholly-owned corporation ("Corporation"), and opened two foreign accounts (the "Accounts") titled in the name of the Corporation, in which Taxpayer possessed a beneficial interest as the sole shareholder of the Corporation. From 2006 through 2009, the Accounts' monthly balances exceeded $10,000, but Taxpayer did not file FBARs for these tax years. Also for the tax years at issue, Taxpayer indicated on his Federal income tax return that he did not have a financial interest in nor signatory authority over any financial accounts held outside of the United States. Prior to his death, the IRS assessed FBAR penalties against Taxpayer for tax years 2006 through 2009, which remained unpaid at the time of his death. The IRS later asserted these penalties against Taxpayer's estate ("Estate").

(1) If a United States citizen possesses a foreign financial account which has a balance of more than $10,000 in the preceding year, the citizen is required to complete IRS Form 1040, Schedule B, Part III (Foreign Accounts and Trusts), and also to complete an FBAR for such accounts.

(2) If a citizen fails to comply with this reporting obligation, the IRS can collect civil penalties against a citizen for failure to file FBARs.[123] If the IRS determines a failure to file FBARs to be willful, the IRS can assess FBAR penalties equal to the greater of $100,000 or 50% of the balance in the foreign account at the time the violation occurs.[124] A showing of willfulness requires the IRS to establish that a citizen recklessly or carelessly disregarded the duty to file FBARs; actual knowledge of the FBAR filing requirement is not necessary for a determination of willfulness. A taxpayer's false response to foreign account questions on an IRS Form 1040 has been held to support a finding of willful failure to file an FBAR.[125]

b) The district court determined that the Estate was liable for the FBAR penalties owed by the Taxpayer. The district court reasoned that Taxpayer was aware of his FBAR reporting obligation, as he did file FBARs for some tax years. The court further found that, under penalty of perjury, Taxpayer indicated that he did not possess foreign accounts on his individual income tax return in the tax years at issue. Based on these factors, the district court determined that the Taxpayer recklessly disregarded his obligation to report the Accounts, and his failure to file FBARs was willful.

[123] 31 CFR §1010.810(g).

[124] 31 U.S.C. § 5321(a)(5).

[125] *See Rum*, (DC FL 2019), 124 AFTR 2d ¶2019-5389.

7. FBAR Suit Against Decedent's Heirs Allowed

a) In *United States v. Wolin*,[126] a taxpayer ("Taxpayer") set up a Swiss foundation in 1983. The foundation's trustee opened a bank account with UBS (the "Swiss account"), on which the Taxpayer possessed the signature card for the account. In 2008, the Taxpayer made cash withdrawals from and wrote checks on the Swiss account, received sales proceeds related to investment assets held within the Swiss account, and deposited interest and dividend income into the Swiss account. The Taxpayer did not disclose the Swiss account to the IRS at any time, and likewise did not file FBARs related to the Swiss account.

b) Taxpayer died in 2014, and in 2015, the IRS assessed FBAR failure to file penalties against Taxpayer's estate. Taxpayer's estate did not pay the FBAR penalties, so the IRS initiated steps to recover the FBAR penalties from Taxpayer's estate, asserting that the FBAR penalties survived Taxpayer's death, and resulted in a liability owed by his estate.

c) Taxpayer's daughter filed a motion to dismiss the claim by the IRS for the FBAR penalties, but a New York district court denied the motion filed by the taxpayer's daughter.

d) One of the decedent's daughters argued that the asserted FBAR penalties could not be asserted after the death of decedent. The district court held, however, that the FBAR penalty was remedial, and survived the decedent's death.

(1) Under common law, a claim survives a party's death if the claim is "remedial" and not "punitive."[127]

(2) Tax cases have generally held that actions to recover tax penalties are remedial, as the purpose of such penalties is to reimburse the IRS for the costs of investigating violations of tax laws.[128]

e) *See also United States v. Gill*,[129] in which a Texas district court held that FBAR penalties arising from a taxpayer's non-willful failure to file FBARs also survive death as remedial in nature.

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[126] DC NY, 126 AFTR 2d ¶2020-5337.

[127] *See Sharp v. Ally Fin., Inc.*, 328 F.Supp 3d 81 (DC NY 2018).

[128] *See Estate of Kahr*, (1969, CA2) 24 AFTR 2d ¶ 69-5332.

[129] No. H-18-4020 (S.D. Tex. June 30, 2021).

8. Foreign Trust Owner and Beneficiary Liable for 35% Penalty Arising from Failure to Report Trust Distribution

a) In *Wilson v. United States*,[130] a United States taxpayer ("Taxpayer") was the owner and beneficiary of a foreign trust ("Trust"). Taxpayer established the Trust in 2003, funding it with $9 million in assets. Taxpayer liquidated the Trust in 2007, distributing all of the Trust assets, then valued at approximately $9.2 million, to himself. Taxpayer filed the necessary distribution reports and annual return for the Trust in 2007, though filed late. Despite these filings, the IRS assessed a 35% penalty against Taxpayer for failure to report distributions he received as a beneficiary of the Trust.

b) Taxpayer paid the penalty and filed suit for a refund, asserting that he should have been responsible for only a 5% penalty as an owner of the Trust.

c) The district court ruled in favor of Taxpayer, holding that the 5% penalty applies when a person is both the owner and beneficiary of a foreign trust.[131]

(1) *Internal Revenue Code Section 6048(b)* requires a United States owner of a foreign trust to ensure that such trust filed its annual returns. *Internal Revenue Code Section 6048(c)* requires a United States beneficiary of a foreign trust to file returns to report the distributions received by such beneficiaries.

(2) *Internal Revenue Code Section 6677* imposes penalties for the late filing of the returns described above. A 35% penalty is charged against beneficiaries who fail to make their required reports, and a 5% penalty applies to owners who fail to timely file a trust's annual return.

d) The Second Circuit Court of Appeals overturned the district court's decision, holding that "the plain language of Code Sec. 6048 and Code Sec. 6677 requires that when an individual fails to timely report the distributions he received from a foreign trust, the 35% penalty applies; his concurrent status as owner of the trust does not alter this rule."

(1) Note that the court did not address whether Taxpayer could be liable for both the 5% and 35% penalties.

e) United States owners and beneficiaries of foreign trusts are required to file Form 3520-A, *Annual Information Return of Foreign Trust With a*

[130] No. 20-603 (2nd Cir. 2021).

[131] (2019, DC NY), 124 AFTR 2d ¶ 2019-6693.

U.S. Owner and/or Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts* to report:

(1) Ownership of a foreign trust;

(2) Transfers of property to a foreign trust; or

(3) Distributions from a foreign trust.

(a) Failure to comply with the aforementioned reporting obligations can result in penalties based upon a foreign trust's value, with a minimum penalty of $10,000, or based upon the value of transfers made to or distributions made from a foreign trust.

9. Fifth Amendment Could Not Be Invoked by Trustee

a) In *United States v. Fridman*,[132] the IRS issued a summons to the trustee ("Trustee") of a New York trust ("Trust"), requesting bank account information related to the Trust. Trustee filed a suit in district court asserting that he did not have to comply with the summons, alleging that the act of production privilege applied. The IRS countered Trustee's suit, arguing that the collective entity doctrine prevented assertion of the act of production privilege.

(1) The Fifth Amendment of the United States Constitution provides that a person cannot be compelled to be a witness against himself in a criminal case. A person can assert the Fifth Amendment privilege against producing subpoenaed documents, and this assertion is sometimes referred to as the "act of production privilege."

(2) Despite the act of production privilege, case law has limited this privilege, sometimes providing that an individual custodian who possesses a collective entity's records in a representative capacity generally cannot refuse to produce documents under the act of production privilege – this theory is sometimes referred to as the collective entity doctrine.[133]

[132] No. 18-3530 (2nd Cir. 2020).

[133] *See Braswell*, (1988, S.Ct.) 62 AFTR 2d 88-5724.

(3) A collective entity has been defined as "an organization which is recognized as an independent entity apart from its individual members."[134]

b) The issue before the Second Circuit Court of Appeals was whether a trust qualified as a collective entity, obviating the availability of the act of production privilege claimed by Trustee.

c) The district court ruled in favor of the IRS, finding that the trust was a collective entity, and Trustee was required to produce the requested bank information.

d) The Second Circuit affirmed the ruling of the district court, agreeing that a trust was a collective entity. The court reasoned that the trust had a separate legal existence from the Trustee, which is typically required for classification as a collective entity. The court noted that the Trust would continue under state law if the Trustee resigned or was removed, so the Trust and the Trustee could not be considered the same taxpayer.

e) The Second Circuit also reasoned that the Trust represented a formal institutional arrangement, with its own organization and governing structure. The court also noted that the records of the Trustee were distinct from the records of the Trust. Finding the Trust to be a collective entity, the court held that the act of production privilege was unavailable to Trustee, and he was required to produce the summoned Trust documents.

10. Compensatory Damage Claims Survive Decedent's Death

a) In *Johnson v. Wall*,[135] a district court held that a compensatory damage claim against IRS agents survived the death of the taxpayer-decedent.

b) In this case, a taxpayer's estate asserted claims against the IRS that its agents violated *31 U.S.C. Section 3109* by failing to announce their identities prior to serving a search warrant on the taxpayer-decedent. The taxpayer-decedent died following the incident from unrelated causes.

c) The IRS asserted that the taxpayer's estate's claim did not survive the death of the taxpayer-decedent.

d) The district court held in favor of the taxpayer's estate, finding the estate's claim for compensatory damages to be economic damages for property loss, which are remedial in nature and survive a taxpayer's death.

[134] *Bellis*, (1974, S.Ct.) 39 AFTR 2d 77-815.

[135] No. C14-5579 BHS (W.D. Wash. Feb. 17, 2021).

The court noted that while punitive damages cannot survive a claimant's death, the remedial compensatory damages asserted by taxpayer's estate survived.

11. IRS Required to Provide IRS Form 706 as Part of Freedom of Information Act ("FOIA") Request for IRS Form 709

a) In *Mertes v. IRS*,[136] a taxpayer ("Taxpayer"), pursuant to FOIA, requested an IRS Form 709 (gift tax return) that referenced an IRS Form 706 (estate tax return). The IRS provided the IRS Form 709 in a non-redacted format to Taxpayer, but did not provide the IRS Form 706 that was referenced in the IRS Form 709. The IRS asserted that it did not have to provide the IRS Form 706 as part of the Taxpayer's request, pursuant to Department of Justice guidelines which would view the IRS Form 706 as a separate document, and not a part of the IRS Form 709.

b) The district court ruled in favor of Taxpayer, requiring the IRS to disclose the IRS Form 706. The court determined that Taxpayer's FOIA request was intended to include both the IRS Form 709 and the attached IRS Form 706. The court noted that the IRS Form 706 was referenced in the IRS Form 709, and was a critical and integrated component of the IRS Form 709. The court stated that treating the IRS Form 706 as a "separate record" did not maintain the integrity of the IRS Form 709, so disclosure of the IRS Form 706 was appropriate.

12. Ten Percent Early Distribution Payment is a Tax, and Not a Penalty

a) In *Grajeles v. Commissioner*,[137] a taxpayer ("Taxpayer") took an early distribution from her IRA. No exceptions existed to allow the requested distribution to Taxpayer, so the IRS determined that the 10% payment authorized under *Int. Rev. Code Sec. 72(t)(1)* applied to the distribution. Taxpayer asserted that the 10% payment was a penalty, the IRS failed to abide by the provisions of *Int. Rev. Code Sec. 6751(b)* governing assessment of penalties, and thus the 10% amount was invalidly charged by the IRS.

(1) *Internal Revenue Code Section 72(t)(1)* imposes a "10-percent additional <u>tax</u> on early distributions from qualified retirement plans."[138]

(2) *Internal Revenue Code Section 6751(b)* states that the IRS cannot assess a penalty under the Internal Revenue Code unless the

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[136] No. 1:19-CV-1218 AWI SKO (E.D. Cal. Jan. 25, 2021).

[137] 156 T.C. No. 3 (2021).

[138] Emphasis supplied.

initial determination of such assessment is personally approved in writing by the immediate supervisor of the individual making such determination, or a higher level official designated by the Secretary.

(3) *Internal Revenue Code Section 6751(c)* states that the term "penalty" includes an addition to tax or other additional amounts.

b) The Tax Court held that the 10% amount charged pursuant to *Int. Rev. Code Sec. 72(t)(1)* was a tax, and not a penalty, addition to tax, or an additional amount. Accordingly, the court determined that imposition of the 10% amount did not require written supervisory approval under *Int. Rev. Code Sec. 6751(b)* prior to assessment thereof.

c) The Tax Court reached its decision based on the following reasoning

(1) *Internal Revenue Code Section 72(t)(1)* expressly labels the 10% payment as a tax.

(2) Other courts have reached a similar determination.[139]

(3) The bankruptcy case[140] raised by Taxpayer, which referred to the 10% amount as a "penalty" for bankruptcy purposes, was not controlling as it was based on and limited to the application of bankruptcy policies and proceedings.

13. Donors to Donor Advised Fund ("DAF") Lacked Standing to Sue DAF Managers

a) In *Pinkert v. Schwab Charitable Fund, et al.*,[141] a donor ("Donor") to a DAF filed suit against a public charity and DAF sponsor, and also the brokerage firm that worked with the charity. Donor alleged claims of breach of charitable trust, asserting that defendant did not use cost efficient funds for investment purposes, thus lowering the amount of funds available for distribution to charitable organizations and causing his reputation to suffer due to reduced funds being available for distribution from his DAF.

b) The California District Court dismissed Donor's claims, finding that Donor did not have standing to sue the defendant for breach of fiduciary duty. The district court reasoned that Donor made completed gifts to his DAF, and thus gave up legal control over amounts contributed to his DAF at the time of contribution. Donor argued that he had standing due to his ability to advise on the investments in and distributions from the DAF, but

[139] *See Williams*, 151 T.C. 1 (2018) and *Thompson*, T.C. Memo. 1996-266.

[140] *See In re Cassidy*, 71 AFTR 2d ¶93-380.

[141] NO. 20-cv-07657-LB (N.D. Cal. June 17, 2021).

the court determined that the right to designate investments and advise on distributions was insufficient to assert standing.

c) In reaching its conclusion, the California district court focused on *Int. Rev. Code Sec. 170(f)(18)*, which provides that a donor to a DAF can claim a charitable income tax deduction only when the donor makes a "completed gift" and "relinquishes control over the donated property." The court also considered the language in the DAF agreement between the Donor and the defendant which provided that donations to the DAF were irrevocable and unconditional, once contributed donations came under the exclusive legal authority and control of the DAF as to the use and distribution of the contributed funds, Donor was prohibited from imposing any material restriction or condition on the contributed funds, and the defendant maintained exclusive authority over distributions from the DAF and could decline or modify any requests made by Donor as to such distributions.

d) *See also Fairbairn v. Fidelity Investments Charitable Gift Fund*,[142] where plaintiff's claims were dismissed based on inability of plaintiff to establish a "special relationship" with a DAF sponsor in order to bring his claim of breach of fiduciary duty against the sponsor.

14. Case Dismissed Due to Lack of Prosecution After Taxpayer's Death

a) In *Irvin H. Catlett, Jr. v. Commissioner*,[143] a taxpayer ("Taxpayer") was in jail due to filing fraudulent tax returns on behalf of his clients. While in jail, the IRS commenced a civil investigation into Taxpayer's personal tax returns. The IRS determined that Taxpayer undertook fraudulent reporting on personal tax returns, and issued a notice of deficiency to Taxpayer. Taxpayer filed a petition in Tax Court to dispute the findings in the notice of deficiency, but he passed away prior to his case being calendared.

b) Following Taxpayer's death, the IRS attempted to locate members of Taxpayer's family, and filed status reports with the Tax Court to update it on its findings. The IRS informed the Tax Court that Taxpayer died intestate and no probate proceedings were commenced in state court, but the IRS located the Taxpayer's brother and children, all of whom declined to participate in the Tax Court proceeding. The Taxpayer's brother and children were notified of the Tax Court trial session, but they chose not to appear nor communicate with the Tax Court. Thereafter, the IRS moved to dismiss the case for lack of prosecution.

[142] No. 3:2018cv04881-Document 257 (N.D. Cal. 2021).

[143] T.C. Memo. 2021-102 (2021).

c) Based on the facts, the Tax Court determined that the Taxpayer's case should be dismissed due to lack of prosecution, as no party had been substituted for Taxpayer following his death. The resulting dismissal sustained the adjustments and penalties imposed by the IRS in its notice of deficiency against Taxpayer.

15. Transfer of Inherited IRA Assets to Non-IRA Account Cannot Be Reversed

a) In *Private Letter Ruling 202125007*, the surviving spouse ("Spouse") of a decedent ("Decedent") assumed ownership of an IRA owned by Decedent. Spouse named a valid irrevocable trust ("Trust") as the beneficiary of the IRA, and named his children as trustees and beneficiaries of Trust. Upon Spouse's death, the IRA became an inherited IRA maintained for the benefit of Trust.

b) Following Spouse's death, the custodian of the inherited IRA advised the Trust to transfer the inherited IRA's assets to a non-IRA account so that the Trust could trade stocks. Following this advice, in Year 1 Trust transferred substantially all of the assets of the inherited IRA into a non-IRA account held for the benefit of Trust.

c) Several months after the transfer of the inherited IRA assets to the non-IRA account, Trust wanted to transfer the assets of the non-IRA account back to an inherited IRA account without including such distributions in the Trust's taxable income.

d) The IRS ruled that the Trust could not transfer the assets of the non-IRA account back to an inherited IRA account. The IRS reasoned that the sole way to transfer assets from one inherited IRA to another inherited IRA is by means of a trustee-to-trustee transfer, which necessitated a direct transfer of one IRA to another IRA. Under these facts, the inherited IRA assets were transferred to a non-IRA account, so the Trust could no longer make a trustee-to-trustee transfer from one IRA to another IRA.

16. Estate Can Become Substitute Plaintiff in Whistleblower Suit

a) In *Insinga v. Commissioner*,[144] a taxpayer had filed a whistleblower claim under *Int. Rev. Code Sec. 7623*. After filing the claim, the IRS denied the taxpayer's claim, which taxpayer appealed to the Tax Court under the authority of *Int. Rev. Code Sec. 7623(b)(4)*.

b) The taxpayer's claim was pending at the time of taxpayer's death in 2021. The taxpayer's counsel filed a motion the substitute the taxpayer's

[144] 157 T.C. No. 8 (Oct. 27, 2021).

estate as plaintiff so that the claims could be pursued following the taxpayer's death.

c) The Tax Court granted the motion filed by taxpayer's estate, finding that a whistleblower claim survives the death of a whistleblower.

(1) The Tax Court noted that the Internal Revenue Code is silent on the issue of whether a whistleblower claim survives a taxpayer's death.

(2) The Tax Court then looked to federal common law which gives the general rule rights of action granted under Federal laws survive a plaintiff's death if the Federal law is remedial and not penal.

(3) Applying this general rule, the Tax Court examined *Int. Rev. Code Sec. 7623* and determined that this statute was remedial, and not penal, allowing the survival of the whistleblower claim.

(4) The Tax Court also noted *Treas. Regs. § 301.7623-4(d)(4)* which provides rules applicable to claims pending before the IRS Whistleblower Office at the time of the whistleblower's death. This regulation states that "if a whistleblower dies before or during the whistleblower administrative proceeding, the Whistleblower Office may substitute an executor, administrator, or other legal representative on behalf of the deceased whistleblower for purposes of conducting the whistleblower administrative proceeding."

MANAGING THE TRANSITION OF CLOSELY HELD COMPANIES

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TRANSITION OF CLOSELY-HELD COMPANIES

I. Transitions upon Death of a Member / Partner in a Closely-Held Entity

A. What Happens to the Entity when a Member / Partner Dies?

1. Except as provided in the articles of organization or a written operating agreement, a limited liability company is dissolved and its affairs shall be wound up upon the first to occur of the following: (1) The occurrence of events specified in writing in the articles of organization or operating agreement; or (2) The consent of its members. *La. R.S. 12:1334*.

   a. An LLC should not terminate simply by virtue of the death of a member under default law.

   b. Ensure that the governing documents do not provide for termination in the event of the death of a member (unless that is specifically desired by all parties, present and future).

2. A partner ceases to be a member of a partnership upon: his death… A partner also ceases to be a member of a partnership in accordance with the provisions of the contract of partnership. *La. C.C. Art. 2818.*

3. Unless continued as provided by law, a partnership is terminated by . . . the reduction of its membership to one person. A partnership also terminates in accordance with provisions of the contract of partnership.[1] *La. C.C. Art. 2826.*

[1] A partnership in commendam, however, terminates by the retirement from the partnership, or the death, interdiction, or dissolution, of the sole or any general partner unless the partnership is continued with the consent of the remaining general partners under a right to do so stated in the contract of partnership or if, within ninety days after such event, all the remaining partners agree in writing to continue the partnership and to the appointment of one or more general partners if necessary or desired. La. C.C. Art. 2826.

a. Unless specifically provided otherwise in the partnership agreement, if there is a partnership with two partners and one dies, the surviving partner may be surprised to find that the entity automatically ceases to exist.

4. Trustees and succession representatives, in their capacities as such may be partners. *See La. C.C. Art. 2801.*

   a. Consider providing in the partnership agreement that the partnership will not automatically terminate upon death of a partner / member. The agreement could also provide that the deceased partner's succession representative is automatically admitted as a partner as to the deceased partner's interest upon the deceased partner's death to ensure continuation.

B. What Rights to Information Exist after the Death of a Member / Partner?

1. A partner may inform himself of the business activities of the partnership and may consult its books and records, even if he has been excluded from management. A contrary agreement is null. He may not exercise his right in a manner that unduly interferes with the operations of the partnership or prevents other partners from exercising their rights in this regard. *See La. C.C. Art. 2813.*

   a. If a partner dies, the Civil Code does not afford the same rights to information to the partner's heirs / legatees.

   b. Consider including what rights the decedent's succession should have and include that in the partnership agreement.

2. Unless otherwise agreed, unanimity is required to admit new partners into a partnership. Decisions affecting the management or operation of a partnership must be made by a majority of the partners, but the parties may stipulate otherwise. *La. C.C. Art. 2807*.

   a. To avoid a situation in which a legatee is bequeathed a decedent's partnership interest being frozen out of the partnership (e.g., if one of the remaining partners did not wish to admit the legatee of the interest), the agreement could provide that the legatee of the deceased partner's interest will automatically be admitted as a partner. There may be some limitations surrounding this, such as providing that the automatic admission provision only applies to a certain class of legatees (*e.g.*, the partner's descendants).

3. Each limited liability company shall keep at its registered office, among other documents: copies of the limited liability company's federal and state income tax returns and reports, if any, for the three most recent years, a copy of any operating agreement which is in writing, copies of any financial statements of the limited liability company for the three most recent years. *See La. R.S. 12:1319*.

   a. This information is vital to valuing the decedent's interest in the company.

4. Unless otherwise provided in the articles of organization or an operating agreement, a member may (1) inspect and copy any limited liability company record upon reasonable request during ordinary business hours, (2) obtain from time to time upon reasonable demand the following: (a) True and complete information regarding the state of the business and financial condition of the limited liability company, (b) Promptly after becoming available, a copy of the limited liability company's federal and state income tax returns for each year, and (c) Other information regarding the affairs of the limited liability company as is just and reasonable, and (3) Demand a formal accounting of the

limited liability company's affairs whenever circumstances render it just and reasonable. *See La. R.S. 12:1319*.

5. Except as otherwise provided in the articles of organization or a written operating agreement, if a member who is an individual dies . . . the member's membership ceases and the member's executor, administrator, guardian, conservator, or other legal representative shall be treated as an assignee of such member's interest in the limited liability company. *La. R.S. 12:1333(A)*.

6. Except as otherwise provided in the articles of organization or a written operating agreement: (1) An assignee of an interest in a limited liability company shall not become a member or participate in the management of the limited liability company unless the other members unanimously consent in writing, and (2) Until the assignee of an interest in a limited liability company becomes a member, the assignor shall continue to be a member. *La. R.S. 12:1332*.

   a. The rights afforded to LLC members under La. R.S. 12:1319 are not automatically extended to the assignee of the interest after the member's death. Consider extending these rights (or perhaps a pared down version of the rights) to assignees, so that the member's succession representative is able to value the decedent's LLC interest. This could include a limitation on the class of the assignees who would be entitled to the rights (succession representative, descendants, etc.).

   b. Consider including what rights the decedent's succession should have and include that in the partnership agreement.

C. What Obligations are Triggered by the Death of a Member / Partner?

1. The former partner or his successors is entitled to an amount equal to the value that the share of the former partner had at the time membership ceased. *See La. C.C. Art. 2823.*

2. If a partnership continues to exist after the membership of a partner ceases, unless otherwise agreed, the partnership must pay in money the amount referred to in Article 2823 as soon as that amount is determined together with interest at the legal rate from the time membership ceases. *See La. C.C. Art. 2824.*

   a. A compelled buyout may be devastating if the deceased partner's interest is large. Consider imposing restrictions around this requirement (*e.g.*, lengthen the amount of time the partnership has to pay the former partner his share).

3. Does the operating agreement of the entity require that the interest first be made available for sale to the surviving members/partners in a right of first refusal, or is a buy/sell provision triggered by the death of a member/partner?

   a. Consider including a class of permitted transferees who, upon acquiring an interest in the entity, are exempted from these types of requirements.

      i. See Sample Provisions for draft language regarding permitted transferees.

D. Who has Management Authority after the Death of a Member / Partner?

1. Except as otherwise provided in the articles of organization, the business of the limited liability company shall be managed by the members, subject to any provision in a written operating agreement restricting or enlarging the management rights and

duties of any member or group or class of members. *La. R.S. 12:1311*.

2. Unless otherwise provided in the articles of organization or a written operating agreement, each member of a limited liability company shall be entitled to cast a single vote on all matters properly brought before the members, and all decisions of the members shall be made by majority vote of the members. *See La. R.S. 12:1318*.

   a. If a decedent was the sole member of an LLC and served as manager (or if the LLC was member-managed), then, upon his death, there would be no one to take over management.

3. The articles of organization may provide that the business of the limited liability company shall be managed by or under the authority of one or more managers who may, but need not, be members. The articles of organization or an operating agreement may prescribe qualifications for managers. *La. R.S. 12:1312*.

   a. In a manager managed LLC, consider naming multiple individuals / entities to serve as successor manager to avoid a vacancy in the role.

   b. In the event no one named in the operating agreement is willing and able to serve, provide a procedure for the appointment of a successor manager.

4. If management is vested in one or more managers, then, unless otherwise provided in the articles of organization or an operating agreement: (1) Election of managers to fill initial positions or vacancies shall be by plurality vote of the members, and (2) Any or all managers may be removed by a vote of a majority of the

members, with or without cause, at a meeting called expressly for that purpose. *La. R.S. 12:1313*.

a. Under La. R.S. 12:1334, an LLC should not terminate simply by virtue of the death of a member under default law. However, if the LLC is a single-member LLC and the sole member was also the manager, who will serve as manager?

b. If the LLC's operating agreement does not name a successor manager or otherwise provide a procedure by which a manager can be selected, then, following the death of the sole member, there is no way to appoint a manager to continue the company's operations (or wrap up operations, as the case may be).

c. Consider including a provision in the operating agreement to automatically admit the decedent's succession representative as the member of the LLC, which will allow the representative to select the successor manager.

E. Continuation of the Business

1. When it appears to the best interest of the succession, and after compliance with Article 3229,[2] the court may authorize a succession representative to continue any business of the deceased for the benefit of the succession; but if the deceased died testate and his succession is solvent, the order of court shall be subject to the provisions of the testament. This order may contain such conditions, restrictions, regulations, and requirements as the court may direct. *La. C.C.P. Art. 3224.*

a. This Article gives the courts the authority to authorize a succession representative to continue the business of a decedent for the benefit of the succession.

[2] Louisiana Code of Civil Procedure article 3229 provides, in part, that when an application is made for an order under Article 3224, notice of the application shall be published once in the parish where the succession proceeding is pending in the manner provided by law.

b. The article specifically provides that the provisions of a testator's last will and testament will control the continuation of a business. In drafting the last will and testament of a client with managerial authority in a closely-held entity, consider providing that, in the event the decedent ceases to serve in a managerial capacity, the executor will have the authority to name the manager.

i. The entity's governing documents need to allow for this type of appointment.

F. *Cautionary Tales: Recent Cases Illustrate the need to Plan for the Transfer of Business Interests*

1. In *Dorignac v. Dorignac*, Docket No. 763-318 before the 24th Judicial District Court for the Parish of Jefferson, ownership of Dorignac's Food Center was (following a series of allegedly questionable estate plan changes) bequeathed in part to trusts of which the owners' grandsons were the ultimate principal beneficiaries. The owners' son also received an ownership interest in Dorignac's following a late change to the surviving spouse-owner's estate plan.

a. The trustees of the trusts, together with the son, executed an amended and restated operating agreement for the LLC that owned Dorignac's. The amendment conferred managerial authority over the LLC owning Dorignac's upon the trustees following the son's death.

b. The grandsons sued the trustees/managers on the grounds (among others) that:

i. the trust accountings lacked the information required by the Trust Code;

ii. the trustees refused to provide any financial information related to Dorignac's, which is the primary asset of the trusts;

iii. they were entirely cut out of participating in working at Dorignac's and the trustees attempted to prevent the grandsons from ever becoming members of the LLC that owned Dorignac's; and

iv. The trustees were dealing on their own accounts by hiring themselves as managers of the LLC owning Dorignac's and paying themselves compensation as such. One of the trustees allegedly served as President of Dorignac's and managed the day-to-day operations of the store.

c. According to the grandsons, the ownership of the grocery store which was set to pass to them in trust under their grandparents' estate plan was ultimately entirely taken from their control and they were left with the mere monetary trust distributions from the family-owned company.

d. The grandsons ultimately dismissed their case against the trustees following a settlement in the case, but the proceedings up until a settlement was reached demonstrate the need for clarity and precision in preparing both governing documents for entities as well as estate planning documents transferring the interests in those entities to ensure the owner's wishes are carried out following their death.

2. *The Succession of George Tommy Daison, Sr.* is currently pending before the 24th Judicial District Court for the Parish of Jefferson at Docket No. 812040.

a. The decedent was the CEO and President of a corporation. At the time of the decedent's death, he was the majority owner of the entity, and his interest in the company comprised the bulk of the decedent's estate. The administrator of the decedent's succession petitioned the court for authority to continue the business of the decedent. Two individuals who co-owned the entity with the decedent opposed the Administrator's petition.

b. The Administrator's petition argued that the remaining co-owners were potentially engaged in illegal activities related to the company. Given the decedent's majority stake in the company and the fact that it was the primary asset in the decedent's estate, the Administrator requested that he be given permission to continue the business. The Administrator also indicated to the court that he had been unable to obtain information and documents from the remaining owners.

c. Pointing to Louisiana Code of Civil Procedure Article 2334, in its ruling on May 28, 2021, the court found that it would benefit the succession to allow the Administrator to continue the decedent's business. In so ruling, the court stated that, without a court order permitting the Administrator to continue the decedent's business, the Administrator and heirs would be "in the dark." The court noted that the Administrator was (unsuccessfully) seeking from the company information related to the valuation of the company, which information is "crucial to the disposition of the succession."

d. This case illustrates the importance of proactively including provisions in governing documents as to management of an entity following an owner's death.

II. Lifetime Transfers Interests in Closely-Held Entities

A. Rights of Transferees

1. Unless otherwise provided in the articles of organization or an operating agreement, a membership interest shall be assignable in whole or in part. An assignment of a membership interest shall not entitle the assignee to become or to exercise any rights or powers of a member until such time as he is admitted in accordance with the provisions of this Chapter. An assignment shall entitle the assignee only to receive such distribution or distributions, to share in such profits and losses, and to receive such allocation of income, gain, loss, deduction, credit, or similar item to which the assignor was entitled to the extent assigned. *La. R.S. 12:1330*.

B. **Management Considerations**

1. Consider including a provision that the manager is not required to be a member of the entity.

   a. If a client forms and funds an investment LLC and later desires to donate a 100% interest in that LLC to a trust established for the benefit of his descendants, the client may still wish to serve as manager of the LLC.

III. Tax Planning Considerations

A. Death of a Shareholder of an S Corporation

1. An estate and certain trusts may own stock issued by a subchapter S corporation. The trusts that may own S corporation stock include (but are not limited to):

   a. A grantor trust treated as owned by the decedent, both during the grantor's lifetime and for the two years following the grantor's death;

   b. a trust to which stock is transferred pursuant to the terms of a will, but only for two years after the transfer;

   c. an electing small business trust (ESBT); and

   d. a qualified subchapter S trust (QSST).

   See Internal Revenue Code Sections 1361(c)(2) and (d).

2. The fiduciaries (succession representative(s) and trustee(s)) of a decedent with S corporation stock must ensure that the stock is held by a permitted S corporation shareholder.

3. Estates are permissible S corporation shareholders. Therefore, the decedent's succession representative may keep the stock in the estate for as long as the estate properly remains open.

a. An estate may remain open for the period needed to perform the ordinary duties of administration, such as the collection of assets and the payment of debts, taxes, and bequests. *Treas. Reg. §1.641(b)-3(a).*

b. This may be particularly important if the stock will be distributed to someone who is not a permitted S corporation shareholder.

4. If the decedent's S corporation stock (i) was owned by a grantor trust at the time of the decedent's death, or (ii) passes to a trust pursuant to the decedent's will, then the trustee's ability to deal with the stock will depend on the terms of the trust.

   a. If the trust terms do not allow the trust to own S-corporation stock, the trustee may consider exercising discretionary powers (to the extent such powers exist) to distribute principal in order to distribute such stock to an individual beneficiary.

   b. A marital deduction trust under which the surviving spouse has a right to withdraw all of the trust principal will qualify as a permitted shareholder because such trust is a grantor trust as to the surviving spouse.

      i. The trust would not need to make any QSST election.

   c. A QTIP trust must make a timely QSST election.

   d. If a trust has two or more beneficiaries, consider splitting the trust into separate trusts if allowed under the trust instrument.

5. If the trust satisfies all the requirements of a QSST (see IRC §1361(d)(2) and (3)(A) and (B)) or ESBT (see IRC §1361(e)(1)(A)), the trustee should inform the current income beneficiary of the availability of the QSST or ESBT election.

   a. The trustee is responsible for making any ESBT election, which must comply with the requirements of Treas. Reg. §1.1361-1(m)(2). Consent by the beneficiaries is not necessary for the trustee to make the election.

b. The beneficiary is personally responsible for making any QSST election. It must comply with the requirements of Treas. Reg. §1.1361-1(j)(6). Although the trustee is not the responsibly party for making the QSST election, the trustee should confirm that an appropriate and timely election has been made by the beneficiary so that the trust remains a permitted shareholder.

c. Both a grantor trust treated as owned by the decedent during his or her lifetime that continues in existence after the grantor's death *and* a testamentary trust that inherits S corporation stock from the decedent are limited to a two-year time period during which they may hold S corporation stock following the decedent's death. *IRC §1361(c)(2)(A).*

d. After the two-year window, the only way for the trusts to continue as permitted S corporation shareholders is by timely making the QSST or ESBT election. *Treas. Reg. §1.1361-1(h)(3)(i)(B) and (D).*

e. The QSST or ESBT election must be made within two months and fifteen days from the date on which the trust otherwise ceases to be an eligible S corporation shareholder (*i.e.,* the election must be made within two years, two months and fifteen days following the decedent's death). *IRC §1361(d)(2)(C), §1361(d)(2)(D).*

f. Absent a timely QSST or ESBT election, the trusts would become ineligible shareholders and the S corporation whose stock is held by these trusts could face termination of its S election.

g. A separate QSST election is needed for each S corporation whose stock is owned by a trust. Once a QSST election is made, it is treated as being made for successive beneficiaries unless such a beneficiary affirmatively refuses to consent to the election within two months and 15 days of becoming the current income beneficiary. *IRC §1361(d)(2)(B)(ii); Reg. §1.1361-1(j)(9), §1.1361-1(j)(10).*

h. Once an ESBT election is made, it applies for the year it is made and all future years, unless revoked with IRS consent. *IRC* §1361(e)(3).

6. If any S corporation shareholder's entire interest in the entity terminates, the S corporation (with shareholder consent) may

elect to close the corporation's taxable year and treat the year as if it consisted of two taxable years: one ending on the date of termination and the second of ending at the end of the year.

a. A shareholder's entire interest is terminated on the occurrence of any event through which the shareholder's entire stock ownership in the S corporation ceases, including (but not limited to) a sale or other disposition of the stock and the death of the shareholder.

b. If the decedent's fiduciary sells all of its interest in the S corporation, it may be prudent to require in the sales contract that the S corporation will make the election to close the taxable year. *IRC §1377(a)(2), Treas. Reg. §1.1377-1(b)(4).*

B. §754 Election for Partnerships

1. When a partner dies, his interest in the partnership is valued at its fair market value as of the decedent's date of death. This valuation establishes the basis of the partnership interest in the hands of the heir/legatee acquiring the interest from the decedent. *IRC Sections 742, 1014(a).*

2. The value of the decedent's partnership interest used for estate valuation purposes is generally *not* the same as the basis that the partnership has in its property, which basis is unaffected by the death of a partner.

a. The heir/legatee's basis is the fair market value of the partnership interest, but the heir/legatee inherits the decedent's capital accounts and his share of inside basis. So, there is almost always a disparity between the outside basis and share of inside basis. The §754 election allows the disparity to be eliminated.

3. Without the election, the tax consequences to the estate / heir / legatee of the decedent's interest resulting from transactions and operations of the partnership will not take into account the adjusted basis.

4. The §754 election is automatically effective if it was made before the partner's death and was not revoked. *IRC Section 754; Treas. Reg. §1.754-1(b).*

5. If the §754 election was not made before the death of a partner, then the partnership may make the election by filing a statement with its return for the taxable year of the partner's death. *Treas. Reg. §1.754-1(b)(1).*

6. If the partnership does not file a timely §754 election for the taxable year of the partner's death, the transfer of the partnership interest from the estate to the legatee may be a subsequent transfer allowing a timely §754 election to be made if the estate distributes the partnership interest in kind and elects to treat the distribution as a sale or exchange from the estate to the legatee, then, arguably, the partnership has a second chance to make the §754 election.

7. If the effect of the §754 election is to increase the estate/heir/legatee's basis in the partnership property, the election is advantageous from the estate's viewpoint. The partnership may be reluctant to make the election because of increased administration and accounting recordkeeping requirements and

because the partnership cannot be sure of the election's impact upon subsequent transfers at death.

8. If the partnership refuses or fails to make a §754 election, that may be a factor that decreases the otherwise fair market value of the partnership interest.

9. If the §754 election is not in effect and is not to be made, the estate may make a §732(d) election on its own behalf without affecting the other partners.

   a. By making this election, any partnership property distributed to the estate within two years after the decedent's death will receive the basis that the property would have received if the adjustment under a §754 election had been made with respect to the estate's partnership interest. *Treas. Reg. §1.732-1(d)(1)(iii).*

IV. Sample Provisions

A. Admission of Succession Representative as Member of the Company

1. In the case in which a Member's membership ceases, the former Member or such Member's executor, administrator, guardian, curator, agent under power of attorney, conservator, or other legal representative shall be treated as an Assignee of such Member's Interest unless such person’s legal representative is a Permitted Transferee, and shall have no right to immediate valuation or payment of the affected Interest, except that, in the event a Member dies or is adjudged to be incompetent by a court of competent jurisdiction, or his or her property is being managed pursuant to a power of attorney granted by him or her, his or her

executor, administrator, curator, mandatary, agent, guardian, or conservator shall be automatically admitted as a Member. In no event shall a creditor of a Member be admitted under this Section.

a. It may that the fiduciaries of only certain enumerated members should automatically be admitted into the company, as opposed to all members.

B. Successor Manager Appointment

1. In the event [NAME] ceases to serve as Manager and the Members have not otherwise appointed a successor, then [NAME] and [NAME] (or the one between them who is willing and able) shall serve as successor Managers.

2. The Members may appoint as many additional Managers as the Members deem necessary. A Manager need not be a Member.

C. Creation of a Class of Permitted Transferees

1. With the written consent of [the holders of a Supermajority of Interests], a Member may sell, donate exchange, mortgage, pledge, grant a security interest in or otherwise transfer ("Transfer") any portion of such Member's Interest in the Company, subject to the provisions of this Article. A Transfer shall also include a Transfer of an Interest to a fiduciary or a change in the person(s) acting on behalf of a Member in a fiduciary capacity, including, but not limited to, a person serving as trustee, curator, tutor, succession representative, custodian, agent under a power of attorney or any other event that causes a Member's status as a Member to terminate.

2. A Member may transfer its Interest in the Company during the Member's lifetime, or such Member's Interest in the Company may Transfer upon such Member's death, without the written consent of any other Members: (i) to or in trust for the exclusive benefit of any descendant(s) of [Member(s)' Name(s)] (a "Descendant"); (ii) to a trust for the exclusive benefit of the spouse of any Member as income beneficiary and any one or more Descendants as principal beneficiary(ies); or (iii) to an Entity (including a trust) wholly owned or held for the benefit of one or more persons or Entities described in this Section and wholly controlled by one or more Descendants or any other person approved by the Manager and holders of a Supermajority of Interests (collectively, the "Permitted Transferees"). Upon any Transfer to a Permitted Transferee, the Permitted Transferee shall automatically be admitted as a Member of the Company upon compliance with Section [____]. Any such Transfer to a Permitted Transferee pursuant to this Section shall not be subject to the provisions of Section [containing mandatory Right of First Refusal].

3. Any Transfer of a Member's Interest in the Company in compliance with the foregoing Sections shall be deemed a "Permitted Transfer".

4. Any attempted Transfer that is not approved pursuant to this Article (a "Non-Permitted Transfer") shall be, at the election of the Company, (i) null and void, ab initio, as if such transfer never

occurred, or (ii) allowed, but the only rights granted to such transferee as a result of such Non-Permitted Transfer shall be those granted to an Assignee of such Member's Interest, which shall carry with it the obligations of a Member to make Capital Contributions set forth hereunder.

5. Any Member who transfers an Interest shall cease to be a Member with respect to any such transferred Interest.

D. §754 Election

1. The Managers shall have the power, in their sole discretion, to (a) cause an election under §754 of the Code to be made with respect to the Company, (b) determine the method (or methods) adopted by the Company for making any income tax allocations required by section 704(c) of the Code or the Treasury Regulations issued thereunder, (c) make such allocations for Federal, state and local income tax purposes as may be necessary to maintain substantial economic effect, or to ensure that such allocations are in accordance with the Interests of the Members in the Company, within the meaning of the Code and the Treasury Regulations, and (d) determine all other tax matters relating to the Company, including accounting procedures, not expressly provided for by the terms of this Agreement.

Estate Planning Strategies for Individuals with Moderate Wealth including Tax Considerations

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Estate Planning Strategies for Individuals with Moderate Wealth including Tax Considerations

By: Jacob C. White

Part 1: Relevant Issues to Be Considered

I. What Constitutes Moderate Wealth?

a. The focus of this presentation is on estates ranging from around $1 Million to around $10 Million, however topics discussed herein will sometimes touch on even larger estates.

b. Similar to larger estates, estates of this size have both tax and non-tax considerations.

   i. Estate and Gift Tax

      1. While these estates are currently below the gift and estate tax credit levels, and thus not presently subject to estate tax, the estate tax should nonetheless be considered in the estate planning process as current credit limits may be reduced.

         a. Regardless of any changes being considered in the present Congress, the current estate tax credit of $10 Million, indexed for inflation, is set to sunset at the end of 2025 and therefore will return to $5 Million, indexed for inflation.

      2. It is important to take account of non-probate assets, like life insurance and qualified retirement accounts, which may be included in a decedent's estate, resulting in an increased estate value that could push an estate into taxable territory.

   ii. Generation-Skipping Transfer Tax

      1. These estates are likewise currently below the generation-skipping transfer tax level but may be subject to it once again beginning in 2026.

      2. Although the basic exclusion amount is the same, the analysis and available annual exclusion for generation-skipping transfer tax is not the same as for the estate and gift tax, so an estate could find itself with inconsistent results for estate and generation-skipping transfer tax purposes if the differences are not considered during lifetime planning.

iii. Income Tax

1. A more likely tax concern is in reducing present and future income taxes.

2. In the present, proper planning can shift income to younger generations who likely have lower effective income tax rates and may not be subject to the Net Investment Income Tax.

3. In the future, proper planning can take full advantage of the basis step-up provided by IRC §1014.

    a. The basis step-up is a huge benefit to the heirs of a decedent who owns appreciated property by allowing them to sell that property without taxable gain or with reduced taxable gain.

    b. Properties which the decedent has effectively disposed of before death will not get this step-up. So disposal of properties before death is a trade-off, pitting estate and generation-skipping transfer tax concerns as well as lifetime income tax concerns against future income tax concerns tied to basis.

iv. Management of Assets

1. Aside from estate and income tax considerations, which are present to varying degrees, an estate plan for a moderately wealthy individual will take into account how assets will be managed both during life and once the client has passed away.

2. Consider whether the estate plan will allow the client's property to be partitioned in the future or whether mechanisms are in place to preserve it in the family for future generations.

v. Probate Process

1. Consider the probate process in the state or states where the decedent has assets to help determine how to structure the plan.

vi. Practical Lifetime Considerations

1. Ensuring your client has maintained enough property and/or control to live their life.

a. Often this is a more delicate balance with moderately wealthy individuals than it would be with very high wealth individuals.

II. Estate and Gift Tax Considerations

a. IRC § 2001 imposes a tax on the amount of a taxable estate (including adjusted taxable gifts) with a current top marginal rate of 40%.

  i. The top rate was 45% prior to the 2017 Tax Cuts and Jobs Act and is set to return to 45% in 2026 absent additional legislation.

b. IRC § 2010(c)(3)(A) provides a $5,000,000 basic exclusion amount from the estate tax (and taxable gifts), which is indexed for inflation pursuant to IRC § 2010(c)(3)(B).

c. Currently IRC § 2010(c)(3)(C) doubles the basic exclusion amount from $5,000,000 to $10,000,000 per person for decedents dying or gifts made after December 31, 2017 and before January 1, 2026.

d. As a result, in 2021 an individual has up to $11.7 Million in unified credit and a married couple has up to $23.4 Million.

  i. Assuming no tax law changes, in 2022 it is projected that an individual will have $12,060,000 and a married couple will have $24,120,000.

e. Treas. Reg. § 20.2010-1(c) clarifies that credit utilized based on the present amounts will not be clawed back, so a plan will want to position a client to take advantage of the $10,000,000 basic exclusion amount before it expires if a client's estate would be taxable under the amount applying beginning in 2026.

  i. For example, if a client effectively gifted $10,000,000 in assets this year, while the current $11.7 Million indexed credit amount is in place, those gifts would be sheltered from gift tax (and later estate tax) regardless of a subsequent reduction in the basic exclusion amount. So if the client died in 2026, after the basic exclusion amount has reverted back to $5,000,000, they will still have sheltered $10,000,000 based upon the 2021 gift.

f. IRC § 2503(b) provides an annual exclusion for gifts (other than gifts of future interests) at a base amount of $10,000 adjusted for inflation. As a result, in 2021 there is a $15,000 annual exclusion for gifts.

  i. Assuming no tax law changes, in 2022 it is projected to increase to a $16,000 annual exclusion for gifts.

ii. Gifts in trust are generally considered to be gifts of future interests. However, a properly drafted trust can cause gifts to in trust to qualify for the annual exclusion.

1. Crummey Powers, also known as withdrawal rights, allow beneficiaries of the trust to withdraw donations made to the trust during a limited time period (usually something like 30 days).

    a. Typically the right is limited to the amount of annual exclusion available per person holding such right.

    b. This right is considered a general power of appointment under IRC § 2041(b), which causes the gift to the trustee to be a gift of a present interest, rather than a future interest.

    c. The beneficiaries holding withdrawal rights must be informed of their withdrawal rights as gifts are made, so notices often referred to as Crummey Letters should be sent out each time an annual exclusion gift is made to the trust.

    d. The strategy is named for the case *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968), which approved the annual exclusions claimed for gifts in trust under this framework.

2. 5 and 5 powers should also be included in the trust document to ensure that a beneficiary does not inadvertently make a gift to the trust by allowing their withdrawal right to lapse.

    a. IRC § 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942 shall be deemed a transfer or property by the individual possessing the power of appointment.

    b. IRC § 2514(e) provides that a lapse of a withdrawal right shall be considered a release of the power, but only to the extent that the property which could have been appointed exceeds the greater of:

        i. $5,000, or

        ii. 5% of the aggregate value of the assets or proceeds out of which the lapsed withdrawal right could have been satisfied.

c. Therefore, provisions referencing this limitation may allow annual exclusion rights to lapse over time (known as hanging withdrawal rights), without causing a beneficiary to exercise their power of appointment.

g. IRC § 2056 provides the marital deduction for bequests to a surviving spouse.

   i. This deduction applies to standard bequests as well as qualified terminable interest property for which an election is made (which can apply to usufruct property and property placed in qualifying trusts for the surviving spouse).

      1. Treas. Reg. § 20.2056(b)-7(b)(2)(i) also provides for partial QTIP elections.

   ii. Whether property is bequeathed directly to a surviving spouse or is qualified terminable interest property as elected, it will be included in the surviving spouse's estate.

      1. The deduction only defers estate tax liability, if there is any.

      2. However, the potential benefit of maintaining property in the surviving spouse's estate is to allow for an additional step-up at that spouse's death.

h. IRC § 2518 provides for qualified disclaimers, which generally must be made within nine months.

   i. These allow bequests to pass to an alternate legatee without passing to the original legatee's estate.

   ii. In conjunction with marital deduction planning, this can provide needed flexibility depending on the relative size of the estate and other considerations.

   iii. La. C.C. art. 963 provides requirements for the renunciation of Louisiana succession rights.

i. IRC § 2010(c)(5) provides for a portability election, allowing a surviving spouse to obtain the use of the last deceased spouse's unused estate tax credit.

j. IRC § 2055(a)(2) provides for an estate tax charitable deduction for bequests to charitable organizations.

III. Generation-Skipping Transfer Tax Considerations

a. IRC § 2601 imposes tax on generation-skipping transfers

   i. Per IRC § 2611, these include taxable distributions, taxable terminations, and direct skips, as further defined in IRC § 2612.

   ii. IRC § 2613, a skip person is a natural person assigned to a generation two or more generations below the generation assignment of the transferor or certain trusts in which interests are only held by skip persons.

   iii. So, generally, we are talking about gifts made directly to grandchildren or others of a lower generation or certain trusts with grandchildren or others of a lower generation as beneficiaries.

b. IRC § 2641 ties the generation-skipping transfer tax rate to the maximum Federal estate tax rate provided by IRC § 2001.

   i. As with the top marginal rate on the estate tax, the current rate for the generation-skipping transfer tax is 40% and will increase to 45% in 2026, absent further legislation.

c. IRC § 2631 ties the generation-skipping transfer exclusion to the basic exclusion amount provided by IRC § 2010(c).

   i. As with estate and gift tax, in 2021 an individual has up to an $11.7 Million exclusion and a married couple has up to a $23.4 Million exclusion.

d. Per IRC § 2642(a), the generation-skipping transfer tax is calculated by reference to an inclusion ratio, based upon a fraction, the numerator of which is the amount of exemption allocated and the denominator of which is the value of the property transferred, as reduced by Federal estate tax or State death tax and any charitable deduction allowed.

e. IRC § 2642(c) provides an annual exclusion amount tied to the gift tax annual exclusion amount provided by IRC § 2503(b) to direct skips.

   i. This provides a 15,000 annual exclusion amount in 2021, which is projected to be $16,000 in 2022.

      1. For example, a gift of $15,000 directly to a grandchild would be eligible for both the gift tax annual exclusion and the generation-skipping transfer tax annual exclusion.

   ii. Note, IRC § 2642(c)(2) creates an exception for transfer in trust for an individual unless:

(A) during the life of such individual, no portion of the corpus or income of the trust may be distributed to (or for the benefit of) any person other than such individual, and

(B) if the trust does not terminate before the individual dies, the assets of such trust will be includible in the gross estate of such individual.

iii. This means that in gifting to trusts, gifts that qualify for the annual exclusion from gift tax based upon Crummey Powers will not necessarily qualify for a generation-skipping transfer exclusion. Therefore, if those amounts are not reported, the property will have a full inclusion ratio.

f. The main point is that there is potential for a mismatch between an individual's estate and gift tax credit and their generation-skipping transfer tax credit, which could lead to unexpected generation-skipping transfer tax if not considered and accounted for.

i. Even if a client has more than sufficient generation-skipping transfer tax credit, they may end up with a full inclusion for an applicable gift that is not reported, as the credit will not be applied.

1. Per IRC § 2642(b)(3), a late allocation may be made for an inter vivos transfer, but the value of the property allocated will be based upon its value at the time of filing the return, rather than at the time the gift is made.

a. Therefore, if the property has increased in value between the time of the gift and the time the gift tax return is filed, the higher value will be used to determine the amount of exemption used.

IV. <u>Income Tax Considerations</u>

a. IRC § 1(j)(2) imposes a tax on taxable income with current rate brackets on individuals at 10%, 12%, 22%, 24%, 32%, 35%, and 37%.

i. These only apply to taxable years beginning after December 31, 2017 and before January 1, 2026.

b. IRC § 1(j)(2)(E) provides compressed rate brackets for trusts, with rates of 10%, 24%, 35%, and 37%. Notably, trusts hit the top 37% tax bracket as only $12,500 of taxable income.

i. Trust income that is not distributed hits the top tax bracket very quickly, leading to a potentially significant increase in income tax liability over what an individual would incur.

ii. The current reduced trust rates will also sunset after 2025.

c. IRC § 1411 provides a Net Investment Income Tax (NIIT) of 3.8% on net investment income, which generally covers passive income. This only applies above certain income levels.

i. For a married couple filing jointly, this kicks in for modified adjusted gross income over $250,000, while applying at $125,000 for a married person filing separately, and $200,000 for anyone else.

1. This may provide extra incentive to shift income producing passive assets to younger family members who are more likely to be below the NIIT thresholds.

ii. For trusts, this kicks in at $13,050 of undistributed income.

d. IRC § 1014 provides generally that the basis of property acquired from a decedent will be the fair market value of the property at the date of the decedent's death (i.e. stepped-up basis).

i. In contrast, IRC § 1015 provides that the basis of property acquired by gift will be the same as it would be in the hands of the donor (i.e. carryover basis).

ii. The ability to receive a stepped-up basis is a huge benefit to legatees, as it allows them to potentially avoid or at least significantly reduce taxable gain on the subsequent sale of inherited property.

iii. In the case of a moderately wealthy individual this provides a strong incentive to maintain as much appreciated property in the individual's estate as possible until death so as to obtain the maximum income tax benefit.

1. Therefore, the estate plan should generally only remove as much property from the estate prior to death as is necessary to keep the estate below the taxable threshold and should carefully consider basis of the properties removed.

V. <u>Management Considerations</u>

a. Separate from the tax issues presented above, an estate plan for an individual of moderate wealth should provide clear direction as to who will manage property during life and after the individual is deceased.

i. As discussed herein, this can take the form of establishing a management transition through family company governing documents as well as through the selection of trustees if a trust is used.

b. This avoids the potential for a delay in management transition that could harm the heirs and also prevents a possible management deadlock.

i. For example, if a company is simply left in equal shares to the client's children, this could create such a deadlock.

c. This could also avoid the possibility of a partition down the road by putting safeguards in place to keep property in the family.

VI. Probate Considerations

a. While "avoiding probate" is not necessarily as significant of a consideration in Louisiana as it may be promoted to be, a plan should take account of immediate needs when the client passes away.

i. For example, having structures in place that allow some properties to be immediately distributed.

ii. Additionally, incorporating insurance to ensure liquidity.

b. Often, estates at this level of wealth have property in multiple states. So a well-crafted plan can potentially avoid the necessity of multiple probate proceedings as well.

VII. Practical Lifetime Considerations

a. In any type of planning, a client will of course want to maintain enough assets for their own support.

b. Often the decision regarding planning options is more difficult with clients of moderate wealth.

i. For example, a client may have enough assets to be near or over the taxable threshold, but will need to keep enough property on their balance sheet to meet their own business obligations.

VIII. To Recap

a. While estates of moderately wealthy individuals will take into account estate tax and generation-skipping transfer tax issues as larger estates would, planning will not necessarily be driven as heavily by those considerations and may in fact be driven much more by income tax concerns like the basis step-up, and practical management concerns, probate concerns, and concerns regarding the client's lifetime needs.

b. Given a fluid tax environment, including the currently scheduled reduction of the unified credit in 2026, if not sooner, a plan needs to build in flexibility to allow it to address future changes.

Part 2: Planning Strategies

I. What Strategies Are Available?

a. There are multiple testamentary/post-mortem and lifetime options available that can serve the tax and non-tax needs of a moderate wealth client.

b. The testamentary strategies covered herein include:

   i. Establishing a testament that will allow for use of the QTIP election and the use of disclaimers in a way that will provide flexibility to address estate, generation-skipping, and income tax concerns present at the time of the client's death. More specifically:

      1. Utilizing the marital deduction to defer estate tax until the death of the surviving spouse.

         a. Including direct bequests to a spouse and qualified terminable interest property bequests.

      2. Utilizing qualified disclaimers to provide an alternate bequest structure based on tax and other considerations.

      3. Electing portability to pass any remaining credit to a surviving spouse.

   ii. Providing for charitable bequests as necessary to obtain an estate tax deduction.

c. The lifetime strategies covered herein include:

   i. The use of family investment entities to aggregate assets and allow for easy lifetime gifting, such as family limited partnerships.

   ii. The structuring of existing family operating entities to allow for lifetime gifting.

   iii. The use of inter vivos trusts, which may be used to allow for lifetime gifting, whether or not in conjunction with family entities.

iv. Life insurance planning, including the use of irrevocable life insurance trusts.

v. Establishing vehicles for lifetime charitable giving, including private foundations and charitable remainder trusts.

vi. Beneficiary planning for retirement plans.

II. Testamentary Planning

a. A tried and true method to allow larger estates to make use of all available estate tax credit and obtain deferral on estate tax liability has been to utilize a formula that uses all available estate tax credit at the decedent's death in conjunction with utilizing the marital deduction for any excess, ensuring that any estate tax that would be due will instead be due on the death of the surviving spouse.

i. For example, a testament may direct the decedent's property up to the value of the decedent' available estate tax credit to a credit shelter trust, with any amount in excess passing to the surviving spouse, whether directly or in the form of qualified terminable interest property.

b. In a moderate wealth estate, where there is uncertainty if estate tax will ever be due, this type of structure may instead be counter-productive in light of income tax concerns.

i. For example, if the estate is nowhere near the estate tax threshold, this structure may succeed in using up the decedent's estate tax credit and sheltering the assets from future estate tax when the surviving spouse passes away.

ii. However, such property may be taxable at trust income tax rates and will not be eligible for an additional basis-step up when the second spouse passes away.

c. An alternate strategy to provide flexibility would be for all assets to pass in a way that is subject to the marital deduction, while providing that a disclaimer will cause the assets to pass in a way that utilizes available estate tax (and if applicable generation-skipping transfer tax) credit.

i. In conjunction with this, the executor will also have the option to elect portability so that the surviving spouse will have the benefit of the first spouse's unused credit amount.

ii. Please note, pursuant to Rev. Proc. 2016-49, a QTIP election which would ordinarily be void as a result of not being necessary to reduce estate tax liability, will be effective is made in conjunction with a portability election, subject to the terms of the revenue procedure.

d. Example of Disclaimer Strategy: Husband's testament, after bequeathing home, vehicles, and personal property to Wife, bequeaths remaining property to a QTIP Trust for Wife, with a provision that any disclaimed/renounced property will pass to a credit shelter trust for Wife's benefit, with children as principal beneficiaries.

   i. On the estate tax and generation-skipping transfer tax side, this guarantees deferral on the entire estate if that is preferred, while alternatively allowing disclaimed properties to use up estate tax credit.

      1. Wife may elect to disclaim certain properties to the credit shelter trust so as to lock in the estate tax credit used on those items.

      2. The items not disclaimed will instead stay with the QTIP trust and, assuming a QTIP election is made, will be considered part of Wife's estate when she dies.

   ii. On the income tax side, this also provides some options.

      1. A QTIP trust will necessarily require income to be distributed annually. So that income will be taxed at Wife's individual tax rate.

         a. Conversely, any property disclaimed to the credit shelter trust may end up having income taxed at compressed trust rates to the extent it is not distributed.

      2. Assuming a QTIP election is made for the property passing to the QTIP trust, that property will be part of Wife's taxable estate at her death and will receive another basis step-up when she dies.

         a. Conversely, the property passing to the credit shelter trust will be outside of Wife's estate and so will not receive another basis step-up when Wife dies.

         b. Additionally, even if the property passes to the QTIP trust, if no QTIP election is made, that property will also be outside of Wife's estate.

   iii. As to management, the properties will be managed by a trustee selected by Husband or pursuant to a mechanism established in the will.

      1. Of course, you also have the benefit of asset protection for the assets held in either trust.

a. For Louisiana trusts, La. R.S. 9:2004 provides general creditor protection for the interests of the beneficiaries in spendthrift trusts, not including, however, property donated to the trust by the beneficiary.

iv. As to probate considerations, the property will pass pursuant to the terms of the QTIP trust and the credit shelter trust respectively. So there will be no further probate of these properties when Wife dies.

1. More importantly, this allows the first deceased spouse to control where the property goes when the second spouse dies.

   a. This is particularly important in the event the second spouse remarries, as it will ensure preservation of property for the principal beneficiaries of the QTIP trust as selected by the first spouse to die.

   b. La. C.C. art. 2340 provides the presumption of community. Having assets placed in trust makes it easier to segregate the separate inherited assets and prevent them from being commingled with a subsequent spouse's assets.

   c. Typically, an individual will want their spouse to have lifetime use of the property, while insuring the property will eventually pass to their descendants.

v. In terms of present considerations, Wife will have the benefit of the income from the property passing to the QTIP trust (and often will have the benefit of property passing to a credit shelter trust, depending on its terms).

vi. This setup provides multiple options based upon the estate and income tax considerations present at the time of death.

1. Consider if Husband's estate is nowhere near the estate tax exclusion amount.

   a. In such a case, Wife may elect not to disclaim any of the property so that it all passes to the QTIP trust and the Executor may elect portability so that Wife now has the use of all of Husband's estate tax credit in case it is needed in the future.

      i. All of the property would pass through Wife's estate for estate tax purposes and would all get a second step-up in basis.

ii. Even if the estate tax credit amount were to drop significantly, by utilizing portability, Wife would have the benefit of Husband's unused estate tax credit.

b. If the estate is small enough and obtaining a second step-up on the value of estate property is not such a concern (i.e. the assets are not likely to appreciate significantly), the executor may determine it is not worth the administrative burden to file an estate tax return and elect QTIP treatment and portability.

i. However, the non-tax benefits of having the property in trust will remain, including management, asset protection, and preservation of separate property.

2. If Husband's estate is closer to the estate tax credit limit, the executor can still choose how to make use of his estate tax credit.

e. Of course, there are other variations of this plan that may have some tax flexibility and practical benefits.

i. For example, Husband's testament could leave a usufructuary interest to wife for life, with naked ownership, as well as disclaimed amounts, passing to a trust or other individuals.

1. Similar to a properly drafted trust, the property not disclaimed will be eligible to be treated as QTIP property subject to the marital deduction but will only be treated as such with a QTIP election.

2. Unlike using a QTIP trust, the property will not have asset protection and will be complicated by split ownership between Wife and others.

ii. As another example, Husband's testament could leave the property to Wife directly, with disclaimed property going to a trust or to other individuals.

1. Administratively, this removes the burden of having to file a QTIP election, as the property will be subject to the marital deduction and will be included in Wife's estate.

2. However, it also removes the flexibility to decide whether the property will be included in Wife's estate or not via the decision whether or not to make a QTIP election.

a. Of course, if the disclaimed property passes to a trust for Wife's immediate benefit, this essentially allows the same decision to be made post-mortem without the burden of an estate tax filing (assuming none is required by the estate value).

i. That is, the property remaining with Wife will be entitled to the martial deduction and part of her estate while the property passing to the trust will be outside of Wife's estate.

(1) Note that a timely estate tax return will still be needed to elect portability for Husband's unused exemption amount.

3. This may also allow Wife more flexibility in deciding how to plan with the assets later, but also removes the benefits of asset protection and no longer allows Husband's testament to control the ultimate disposition of the property.

f. As an alternative to the marital deduction strategies discussed above, a client who is near the estate tax threshold could bequeath an amount to a charitable organization necessary to reduce estate tax liability.

i. This may be especially attractive to someone who is not married and therefore cannot take advantage of the marital deduction.

ii. The client's testament can include a provision directing property to a charitable organization if their estate reaches a certain value by the time of their death.

iii. In addition to making use of existing charities, this strategy could make use of a foundation established by the client during their life.

III. Family Investment Entities

a. Often a client of moderate wealth will have significant investments, including immovable property, securities, etc., and will use the earnings from these investments during their lifetime.

i. Thus, they may not want to get rid of these properties completely, but may decide to gift portions of such properties to others, which can have estate tax, generation-skipping transfer tax, and income tax benefits.

b. The contribution of these properties to a family investment entity can provide several non-tax benefits, including asset protection, simplification of management, and an increased possibility that such assets will be kept together in the family, as well as facilitating lifetime gifting in a way that takes advantage of minority and lack of marketability discounts.

c. Sometimes a client will use a limited liability company and sometimes a limited partnership (partnership in commendam in Louisiana) will be used.

    i. While a limited liability company can be structured in many different ways, including reserving voting rights to only certain membership interests, a limited partnership structure is built for estate planning of this nature.

    ii. More specifically, a limited partnership structure will include limited partners, who have limited liability and no management rights, and general partners, who manage the partnership and are subject to liabilities.

    iii. A typical way to utilize this structure from the outset is for client(s) to form the limited partnership with client(s) owning the limited partnership units directly and the general partnership units being owned by a limited liability company which is owned by the client(s). Client(s) will remain in control of the limited liability company, and thus control the limited partnership. Any lifetime gifting will be done using limited partnership units only.

d. <u>Example of Limited Partnership Formation</u>: Husband and Wife contribute community immovable property and securities to a limited partnership in exchange for equal amounts of general partnership units and limited partnership units. As an extra liability shield, they use the general partnership units to capitalize a disregarded limited liability company tasked with management.

    i. On the estate tax and generation-skipping transfer tax side they have not immediately received any benefit from the creation of this entity.

        1. However, with the right provisions in place, they may be able to obtain valuation discounts on gifts of these limited partnership units during their lives and on units that pass upon their deaths if still owned.

            a. These include lack of control and lack of marketability.

    ii. On the income tax side, per IRC §722, Husband and Wife will take an outside basis in their partnership interests equal to the basis in the property contributed to the limited partnership. Additionally, the income of the partnership will continue to pass through to Husband and Wife while they own partnership units.

iii. In terms of present management, Husband and Wife retain control of the limited partnership through their ownership of the controlling general partner, even if they subsequently gift away limited partnership units.

iv. In terms of future management, Husband and Wife can lock in a management structure through the general partner limited liability company's operating agreement or can leave the interests in the general partner to the heir(s) or trustee who will be entrusted with management.

v. In terms of probate considerations, Husband and Wife have potentially reduced the complexity of administering their estates, as the property to be transferred will consist of interests in the general partner limited liability company and limited partnership units.

1. As opposed to having to transfer securities and immovable property interests, they will instead be transferring units in the closely held limited partnership, which do not have to be recorded.

    a. If they die owning partnership units, those units, as movables, will pass pursuant to the law of their domicile, whereas immovable property would typically pass pursuant to the law of the state where located, and could require a probate proceeding.

        i. Per La. C.C. art. 3532, succession to movables is governed by the state of domicile.

        ii. Per La. C.C. art. 3534, succession to immovables situated in another state is governed by the law of that state.

2. The same benefit holds up for units that they transfer during their lifetimes.

vi. In terms of present considerations, the Husband and Wife still own the property though the partnership units they own.

1. So, while they have put themselves in an enhanced position for estate planning purposes, they have not divested themselves of anything they may need to live on.

e. <u>Example of Direct Limited Partnership Unit Gifts:</u> After forming the limited partnership, Husband and Wife gift limited partnership units to their two children.

i. Husband and Wife should achieve some valuation discount on the units transferred, meaning that they will use up less gift tax credit than the actual value the underlying property the units represent.

1. So this will effectively reduce the clients' taxable estates at an enhanced value.

2. For someone who is only moderately wealthy, this may be as simple as making annual exclusion gifts of limited partnership units using a formula to ensure that only up to the annual exclusion amount is transferred.

   a. Using this strategy, Husband and Wife could each shift $15,000 worth of discounted limited partnership units, per donee, per year. In a larger family, this could really add up if done consistently, without ever using up gift tax credit or generation-skipping transfer tax credit.

   b. Unlike trust gifting, discussed later, if units are gifted directly, they will be eligible for both the gift tax annual exclusion and the generation-skipping annual exclusion.

3. If no legislative changes are made, so that the estate tax exclusion is set to drop back to its prior level in 2026, Husband and Wife will be in position to make significant lifetime gifts of limited partnership units so as to take maximum advantage of their gift tax credit.

4. Clients will want to file gift tax returns to establish the value of the gifted interests and to start the statute of limitations on the gifts made.

   a. Sometimes spouses will elect to split their gifts on such returns so that each effectively gifts half of the amount transferred.

   b. An alternative is to partition the property before any transfers, so that each spouse gifts their separate property and reports it separately.

ii. On the income tax side, this may create value by shifting value to family members who are in lower income tax brackets.

1. For example, if Husband and Wife are already at the top tax bracket, the ownership of units by children or grandchildren, who are likely taxed at lower brackets, will create less ultimate income tax liability.

2. Additionally, if Husband and Wife are subject to NIIT based upon their modified adjusted gross income and their children are not, they can remove application of NIIT, thereby further reducing taxes.

iii. The downside of course is that the units gifted during the lifetimes of Husband and Wife will not receive a step-up in basis at the deaths of either Husband or Wife.

1. The units held at death will obtain a step-up in basis, which will increase the outside basis in the actual partnership units owned at death, but not the inside basis of the properties owned by the partnerships.

a. In such a case, an IRC § 754 election must be made by the partnership in order to obtain a step-up in the partnership's actual assets attributable to the stepped-up units.

iv. In terms of management, Husband and Wife will still be in control of the limited partnership itself, and none of the limited partner unit owners will be in a position to partition the property or otherwise interfere with management.

1. Typically, a limited partnership used for this purpose should include very restrictive transfer provisions may not be sold to third parties.

a. Practically speaking, there should be limited appeal for a third party to purchase limited partnership unit in any event.

v. In terms of probate, most of the benefit will have occurred at formation. However, these units will now be out of Husband's and Wife's estates.

vi. As a practical lifetime consideration, Husband and Wife will no longer have the benefit of the income from the units gifted.

f. <u>Example of Limited Partnership Units Held at Death</u>: Husband dies, leaving his remaining limited partnership units to his two children, and leaving ownership of general partner limited liability company to Wife.

i. The limited partnership units that pass to children will be eligible for valuation discounts at Husband's death, so if Husband's estate is near the taxable threshold (assuming no other mitigation measures are taken), this can help bring the value down.

ii. As to income tax, the upside of Husband holding those units at death is that they will receive a step-up in their outside basis.

1. The inside basis of partnership property will not be increased unless an IRC § 754 election is made, which will equalize the inside basis of the portion of partnership property allocated to the partnership units stepped-up at death.

2. Another consideration is that all community partnership units will be stepped-up, not just those owned as Husband's half of the community.

    a. So this is a reason not to unnecessarily partition community property unless it is necessary in conjunction with lifetime transfers to be made.

    b. Per Rev. Rul. 79-124, if an IRC §754 election is made, the community units of the surviving spouse will also have their portion of inside basis stepped up to match with the stepped-up outside basis.

IV. <u>Existing Operating Entities</u>

a. Existing entities can likewise be tailored to take account of a client's estate planning needs.

b. For example, an existing LLC may simply have the operating agreement amended to create non-voting interests which may be gifted during the client's lifetime or bequeathed in way that puts control in the hands of the intended heir.

c. For an existing S-Corporation, the stock may be recapitalized so as to create voting and non-voting shares, serving the same purpose of allowing value, without control, to be gifted or bequeathed at death.

    i. S-Corporations come with their own issues in relation to trust planning, as further discussed below.

    ii. Moreover, it is important to note that an S-Corporation can only have one class of stock as it relates to distribution rights (not voting rights). So any recapitalization needs to ensure it satisfies the one-class of stock rule.

    iii. Finally, the basis-step-up will not be treated the same way when it comes to S-Corporation stock. Unlike with partnerships, there is no election like an IRC § 754 election for partnerships that provides a stepped-up basis in the properties owned by the S-Corporation.

d. <u>Example of S-Corporation Recapitalization</u>: Husband and Wife own 500 shares of voting S-Corporation stock in an S-Corporation that they own and operate. They recapitalize so that they own 50 voting shares and 450 non-voting shares, keeping the same distribution rights.

i. By recapitalizing, Husband and Wife have opened up the possibility of transferring ownership during their lifetime like they could do with family limited partnership units.

ii. This also leaves the possibility of leaving these shares to different people at death so as to preserve control.

iii. Note also that IRC § 2036(b) creates estate inclusion when a decedent retains the right to vote transferred shares.

1. In a trust context, if the donor is the trustee of the trust, a transfer of voting shares to the trust can lead to estate inclusion.

2. Therefore, use of non-voting shares avoids this possibility.

V. <u>Inter Vivos Trust Planning</u>

a. Inter Vivos (Lifetime) Trusts provide an array of estate planning options based upon relevant estate tax, generation-skipping transfer tax, and income tax considerations.

b. While many possible trust variations are beyond the scope of this presentation, there are multiple options to meet the needs of a moderate wealth client. Some specific features are detailed herein.

c. <u>Gift and Estate Tax Features</u>:

i. A completed gift to a trustee, like a completed gift to an individual, will cause the property to be outside of the grantor's (settlor's) estate at death.

1. There are many potential pitfalls in making trust transfers that will cause the property to be included in the client's estate.

2. These include things like the trust being revocable by the grantor, the grantor having an interest during life, or the grantor being the trustee without having sufficient distribution standards in place.

a. *See* IRC §§ 2036 and 2038

ii. The annual gift tax exclusion (currently set at $15,000) only applies to gifts of present interests. A gift to a trust generally does not constitute a gift of a present interest.

1. Typically, a property drafted withdrawal right (Crummey Power) will provide certain beneficiaries the right to withdraw contributions to the trust as they are made, subject to certain limitations.

2. So a trust can be drafted so as to allow gifts to be made that take advantage of the annual exclusion amounts available.

d. Generation-Skipping Transfer Tax Features:

i. Gifts in trust that are eventually left to skip persons due to taxable terminations or taxable distributions are subject to the generation-skipping transfer tax at the time of such terminations or distributions unless available generation-skipping transfer tax exemption is allocated to the gifts when made.

ii. An annual exclusion will not be available to a transfer in trust unless the trust is solely for a skip person and will be included in that skip person's estate.

iii. The available generation-skipping transfer tax exemption will not be applied to the gifted amount automatically, so it will need to be reported on gift tax return.

iv. While available generation-skipping transfer tax exemption can be allocated to transfers in trust, a potential pitfall is to make a transfer in trust that qualifies for the estate tax annual exclusion, but which does not qualify for the annual generation-skipping transfer tax exclusion.

1. In such a case, the property, once distributed, is subject to generation-skipping transfer tax, even if the client had a sufficient exemption available.

2. While a late allocation can be made, it will use the exemption amount at the value of the property gifted when the late allocation is made, which may cause an increased use of the exemption amount.

a. *See* IRC § 2642(b)(3)

e. Income Tax Features:

i. Trusts generally have compressed tax brackets, meaning trust earnings will be taxed at higher income tax levels than they would in the case of individual beneficiaries.

1. However, if the necessary provisions are in place to cause a trust be a "grantor trust" for income tax purposes, the trust income will instead be taxed to the grantor, even if the trust is out of the grantor's estate for estate tax purposes.

    a. IRC §§ 671-677 provide specific powers that will cause a grantor to be treated as the owner of the trust for income tax purposes.

    b. One specific power to obtain grantor trust treatment that may also be specifically helpful for a moderate wealth estate is provided by IRC § 675(4) is "a power to reacquire the trust corpus by substituting other property of an equivalent value."

2. Likewise, this can be used to tax trust earnings to a beneficiary in some circumstances.

    a. IRC § 678 provides for a non-grantor to be treated as the owner of the trust for income tax purposes.

    b. This section requires the non-grantor to have powers that would cause inclusion to a grantor under IRC §§ 671-677 along with a withdrawal right.

3. Additionally, in certain circumstances, you will end up with a trust structure that is required to distribute all income to the beneficiaries regularly.

    a. For example, a QTIP trust will, by its terms, have to distribute income at least annually to a spouse.

        i. These are more often present in testamentary trust planning.

    b. As another example, if Subchapter S Corporation stock is transferred to a trust, the trust will have to either be a grantor trust, so that income is taxed to an individual, or will have to qualify as a Qualified Subchapter S Trust or an Electing Small Business Trust, where income is taxed to the individual beneficiaries.

        i. *See* IRC § 1361(c)(2)

ii. Completed transfers in trust will not be included in the grantor's estate and thus will not receive a step-up in basis at the grantor's death.

1. Therefore, as with other gifts made during the client's lifetime, the trade-off of for potential estate tax savings is that the client will forego a basis step-up which could be valuable to their heirs in the future.

f. Management Features:

i. The client can designate who will serve as the trustee of the trust (or the successor trustee if the client is the initial trustee) or can use alternative measures, such as putting in place a committee to select trustees, so as to provide for a management transition.

g. Probate Features:

i. Properties placed in trust will devolve pursuant to the terms of the trust and will not require probate.

h. Practical Lifetime Use Features:

i. IRC § 2036 requires property to be included in a decedent's estate when the decedent has retained a lifetime income interest.

1. Therefore, if a client gifts property to a trust in which they have an income interest, the property will continue to be included in their estate, thereby defeating any estate tax benefit.

ii. However, another option to make a completed gift to a trust, while preserving possible use of the property donated, is through the use of a spousal lifetime access trust (also known as a SLAT).

1. The spouses will partition property so that the donor spouse is donating separately owned property to a trust that is set up for the benefit of the other spouse.

2. The donating spouse should not be the trustee. The beneficiary spouse may be the trustee, but it will be necessary to include ascertainable standards in place to avoid inclusion in their estate (health, education, maintenance, support).

3. Unlike a QTIP trust, the object of this trust is to use the donating spouse's gift tax credit by placing the property in a trust that remains available for the other spouse's use.

a. Therefore, if used correctly, the property will be removed from the donor spouse's estate but may still be indirectly used for the donor's benefit.

4. Under IRC § 677(a) the trust will be treated as owned by the donor spouse for income tax purposes (i.e. as a grantor trust).

5. There are limitations and pitfalls with this strategy, including:

    a. Under a step-transaction theory, the IRS could claim the partitioned property is actually owned by the donee spouse, potentially causing the trust to be included in the donee spouse's estate.

    b. Under the reciprocal trust doctrine, if each spouse creates a trust for the other with similar terms, this could result in each spouse being treated as having donated to the trust for their benefit, meaning there would be no estate tax benefit to the trust as it would be included in their estate pursuant to IRC § 2036.

    c. There are also practical considerations, such as what happens if the spouses split up.

i. Example of Annual Exclusion Gift to Trust: Husband and Wife each transfer $60,000 to a trust established for the benefit of their descendants, with an independent trustee, which includes 2 children and 2 grandchildren, and in which each child and grandchild has a withdrawal right and is properly notified of such right.

  i. On the gift and estate tax side, Husband and Wife will each be entitled to apply their annual exclusion to the transfers, $15,000 for each beneficiary with a withdrawal right for each of Husband and Wife.

    1. As a result, they have removed $120,000 from their collective estates without incurring any gift or estate tax liability.

        a. Over time, they could remove significant value from their estates without utilizing any gift and estate tax credit using this strategy.

  ii. While a gift tax return will not be required for these annual exclusion transfers, they will want to file returns so as to apply generation-skipping transfer tax exemption to the transfer.

    1. So annual exclusion gifting of this nature will cause a mismatch between Husband's and Wife's eventual estate tax credit available and their eventual generation-skipping transfer tax exemption available.

iii. On the income tax side, assuming no provisions are included causing this trust to be a grantor trust, income on the earnings from the cash will be taxed at compressed trust rates.

iv. Unlike inter vivos gifts of property, a gift of cash does not cause the same basis trade-off.

1. That is, this is not the same as donating stock that could increase in value and thereby foregoing a potential step-up on the stock at the decedent's death.

v. The management of the property is now in the hands of the trustee and will remain that way after death, subject to the terms of the trust.

vi. The property will not be subject to probate and will pass according to the terms of the trust.

vii. In terms of lifetime use, the property may be used for the benefit of Husband's and Wife's children and grandchildren, pursuant to the standards they have established in the trust instrument. However, it will not be available to Husband and Wife.

j. Example of Swapping Property for Basis Concerns: Husband has donated separate stock to a trust naming his children as beneficiaries in which he has the power to reacquire trust property by substituting other property of an equivalent value pursuant to IRC § 675(4). At the time of the donation, Husband was trying to minimize his estate based upon existing credit amounts. These are now less of a concern. The stock is worth $200,000, with a $100,000 basis. Husband has stock in his personal name that is worth $200,000, with a $200,000 basis.

i. By completing the gift of stock, Husband has removed the stock from his estate.

ii. If Husband's concern is now centered more around obtaining a step-up in basis, Husband can exercise his IRC §675(4) substitution power to pull the low basis stock back into his estate, so that it will continue obtain the step-up when he dies.

iii. Since he has a provision in the trust that causes it to be a grantor trust, both sets of stock will be taxable as his income, so he has not created any additional lifetime income tax liability but has potentially provided for a basis step-up benefit upon his death.

k. Example of Contribution of FLP Interests to Trust: Husband and Wife have established a family limited partnership, wherein they hold the limited partnership units and own a limited liability company that holds the general partnership units. They donate interests to an irrevocable trust using a formula based on the amount of the applicable annual exclusion per the number of individuals holding withdrawal rights in the trust.

i. Similar to the direct gifting of interests to their children, this structure allows Husband and Wife to take advantage of the annual gift tax exclusion to donate small portions of their limited partnership units, while maintaining control of the limited partnership.

ii. Even if a third party is the trustee, Husband and Wife maintain control of the limited partnership through their control of the general partnership units.

iii. The downside of course is that they forego the basis step-up on those units by gifting them during their lifetimes.

iv. Even though they have only gifted annual exclusion amounts, Husband and Wife will want to file gift tax returns to report the annual exclusion gifts made so as to start the statute of limitations on assessment.

VI. Life Insurance

a. Moderately wealthy individuals, like other individuals, will often have life insurance in place before ever engaging an attorney for their estate planning needs.

i. In addition to providing immediate liquidity to a surviving spouse for their needs, the insurance may be in place to ensure a means for the payment of outstanding business debts.

ii. That is to say, depending on their needs, a client may have a relatively small amount of insurance coverage, or may in fact have a significant policy in place relative to the other assets comprising their estate for tax purposes.

b. Unfortunately, clients often do not recognize the estate tax implications of their insurance policy ownership or that such policies could cause their estate to be above the taxable threshold.

i. IRC § 2042(2) provides that life insurance will be included in a decedent's estate if the decedent has "incidents of ownership, exercisable either alone or in conjunction with any other person"

1. While this is less likely to come up, IRC § 2042(1) includes life insurance proceeds on the life of a decedent in the decedent's estate when they are payable to his executor.

c. An often-used strategy to avoid the inclusion of life insurance proceeds in the Decedent's estate is to establish an irrevocable life insurance trust (known as an ILIT) and transfer the policy to the trustee of the trust, who will not be the insured. The trustee, as the owner of the trust, will then designate the trust as the beneficiary of the policy.

d. Example of Life Insurance Trust: Husband establishes irrevocable life insurance trust with Wife as Trustee and donates his separately owned term life insurance policy to the trust. Wife is the income beneficiary for life and the principal beneficiaries are a class consisting of Husband and Wife's children, which are their two children at the time the trust is established. All of the income and principal beneficiaries have withdrawal rights up to the amount of the annual gift tax exclusion available.

    i. Gift and Estate Tax Considerations

        1. The donation of a term life policy will not necessarily create a taxable gift. However, if premiums have already been paid in the year of the donation, the amount of premiums may be taxable.

            a. Of course, if the policy is paid up or has cash value, there will be additional value included in the gift that must be taken into account.

            b. The annual exclusion will be available up to $15,000 for each beneficiary with a withdrawal right. So in this case, Husband could exclude up to $45,000 of potential gift tax on the transfer.

        2. In future years, Husband will be able to donate cash to the trust which will allow the trustee to pay the premiums on the policy.

            a. These cash gifts will likewise be eligible for the annual exclusion, so potentially there is no use of gift tax credit in funding the annual insurance premiums.

                i. Note however, that the annual exclusion is per person, so annual exclusion gifts to the life insurance trust will limit Husband's ability to otherwise make annual exclusion gifts to the individuals holding withdrawal powers.

                    (1) For example, if Husband wants to gift limited partnership units to his children in a given year, as described in prior strategies,

he will have less annual exclusion to utilize on those gifts.

ii. Husband should not directly pay the premiums on any policies owned by the trusts. Instead, the annual exclusion amounts should simply be gifted to the trustee.

3. By removing his incidents of ownership in the policy, Husband has ensured that the insurance proceeds will not be part of his taxable estate at his death.

ii. Generation-Skipping Transfer Tax Considerations

1. By drafting this trust so that it is payable to the children of Husband and Wife, the potential for an indirect skip has been removed (assuming no provision provides for payment to the children of a descendant if a child dies during the term).

a. In the event this is the case, no generation-skipping transfer tax exemption will need to be allocated to the annual exclusion amounts.

b. However, if there is potential for an indirect skip from this trust in the future, then annual exclusion gifts should be reported on a gift tax return so as to allocate generation-skipping transfer tax exemption to such gifts.

iii. Income Tax Considerations

1. Per IRC § 677(a)(3), if an ILIT can use its income to pay for premiums on insurance on the grantor's life, it will be a grantor trust.

a. Typically an ILIT will have such a provision, which may also be beneficial for purposes of avoiding potential application of the transfer for value rule (*See* IRC § 101(a)(2)).

i. This should only come up if grantor sells a policy to the trust for some reason, such as to avoid application of IRC § 2035(a) if the sale is within three years of an expected death.

b. Generally, there will not be income from the ownership of a policy, so the grantor trust treatment may not matter otherwise.

2. There will be no basis considerations since the death benefit will pay out cash to the trustee on Husband's death.

iv. Management Considerations

1. Husband will have transferred the policy to the trustee so he will no longer have any control.

   a. Note: It is very important to ensure that the policy is actually transferred to the trustee and that the trustee actually names the trust as the beneficiary. If neither of these occurs, the trust will not operate as planned.

      i. If Husband still owns the policy, it will be included in his estate at death, even if the trust is named as the beneficiary.

      ii. If Husband transfers the policy but it is payable to someone else, like Wife, rather than the trust, then the proceeds will be part of her estate.

2. Trustee will have the ability to use the policy funds to purchase assets from Husband's estate in case the estate needs liquidity.

   a. This will be especially helpful if he does in fact have an estate tax liability or any other debts.

   b. Rather than having to sell assets to a third party to pay estate debts, they can be sold to a trust which likely includes the same beneficiaries, so those properties are not lost to the family.

v. Probate Process

1. The policy proceeds will be paid out directly to the trustee, so it will be available immediately without any delay for probate.

   a. Of course, this would also be the case if someone else was named as beneficiary.

vi. Practical Lifetime Considerations

1. Husband will not have given up significant property by transferring a term policy to the trust, so unlike other planning options, this does not create the risk of overly reducing the client's estate.

2. Even if the policy includes cash value, it is not likely that Husband would have relied upon that value during his lifetime as he would with other assets that can be gifted.

e. As an alternative, a properly drafted trust could purchase insurance on the person's life rather than having a policy gifted to it.

   i. There would not be a potential gift on a policy transfer. However, the trust would otherwise operate the same way, with cash being donated annually in sufficient amounts to allow the trustee to pay premiums on any insurance purchased.

f. As another alternative, a married client could continue to own the policy and leave it to their spouse.

   i. For estate tax purposes, although the policy is included in the insured spouse's estate, they will be entitled to a marital deduction for the amount paid to the beneficiary spouse.

      1. While the death benefit will not be taxable at the first spouse's death, it will be included in the second spouse's estate when they die. In contrast, an amount left in trust for the surviving spouse could avoid being taxed in either spouse's estate.

   ii. This mechanism is much simpler, so it may make more sense for someone whose estate is not as close to the estate tax threshold.

   iii. Additionally, per La. R.S. 22:912, the proceeds are exempt from existing creditors when paid to surviving spouse. However, the proceeds will not get the enhanced protection from future creditors of surviving spouse that they would receive if placed directly in trust.

g. In another alternative, if they insured is unmarried, they can donate ownership of the policy to the intended beneficiary.

   i. This will remove the policy from the insured's estate as well.

   ii. Again, they will lose the creditor protection benefits available with a trust.

   iii. Finally, client will lose control of the policy under this strategy and will have to depend on their children to keep the policy in force.

VII. Charitable Planning

a. A client who is near the taxable threshold may make use of a charitable deduction to keep their estate from being taxable at death.

i. While a testament may make bequests to an existing charitable organization, an alternative is for the client to establish a foundation during their lifetime and fund it from their testament.

ii. Among the benefits, if a client wants to keep their heirs involved in the charitable process going forward, a private foundation is an effective way to facilitate this.

b. Additionally, a client can donate a foundation formed during their life and obtain income tax deductions, as an alternative to obtaining an estate tax deduction.

i. *See* IRC § 170.

c. Example of Private Foundation: Client establishes a private foundation during life using a non-profit trust and obtains tax exempt status. Client is named as the initial trustee and names his children as successor trustees.

i. By having the trust in place during his life, client can make donations to it, thereby potentially obtaining income tax deductions, and direct funds to other charitable organizations of his choosing.

1. This may be especially helpful if client needs to make a substantial gift in a given year to obtain an income tax benefit, but would like to ensure continuing funding of charitable causes through the foundation.

2. A private foundation can also be used in conjunction with a charitable remainder trust if client desires to establish one during their lifetime.

ii. At death, Client has the option to bequeath funds to the charitable foundation so that his children can continue to manage the family's charitable endeavor, with the benefit of an estate tax deduction.

VIII. Retirement Plans

a. Retirement plans are generally included in a decedent's taxable estate. Moreover, pre-tax retirement assets will be income taxed when they are distributed.

i. Therefore, it is often said that retirement plans are taxed twice, first by the estate tax and then by income tax.

b. Unlike other assets, there is not a mechanism to donate a retirement plan during your lifetime, short of taking taxable distributions and donating those, which is likely counterproductive.

c. Moreover, unlike other properties, the assets in a retirement plan do not receive a basis step-up.

d. So unlike other assets described herein, the usual estate tax limitation versus basis step-up trade-off is not present with retirement plans.

e. Instead, the driver is in stretching out required minimum distributions so that the plan can grow for as long as possible and beneficiaries can minimize their annual income tax liability on distributions.

f. Under the Setting Every Community Up for Retirement Enhancement (SECURE) Act, retirement planning considerations have changed significantly.

   i. IRC § 401(a)(9)(H)(i) now provides that all plan assets must be distributed within 10 years when the plan has been left designated beneficiaries who do not qualify as "eligible designated beneficiaries".

   ii. Unlike the general 10-year rule, IRC § 401(a)(9)(H)(ii) allows an account to be paid out to an eligible designated beneficiary over their life expectancy.

   iii. IRC § 401(a)(9)(E) defines the following as eligible designated beneficiaries:

      1. Surviving spouse of the employee

      2. Minor child of the employee

      3. Individual who is Disabled, as statutorily defined

      4. Individual who is Chronically ill, as statutorily defined

      5. Individual not more than 10 years younger than the employee

g. While the detailed distribution rules and strategies are being addressed in more depth in another presentation, a client will want to consider the effect of their beneficiary designation in the context of their estate planning in general.

   i. Certainly, if a client is married, the most beneficial path will likely still be to designate the client's spouse as their beneficiary, so as to allow the beneficiary spouse a full roll-over.

   ii. Additionally, if the plan will not be left to a spouse, and there are any other persons who would qualify as eligible designated beneficiaries to whom client already planned to leave bequests, it may be worth naming those persons as beneficiaries in lieu of leaving probate assets.

BESSEMER TRUST

Bessemer Trust Overview

At a Glance

- Multifamily office founded in 1907
- Industry-leading 3-to-1 client-to-employee ratio
- 19 offices globally, serving more than 2,500 clients
- Over $100 billion in assets under supervision
- 10-year client asset retention rate of 98%
- Financially stable with a strong balance sheet
- Trustee or co-trustee for more than 11,000 trusts, 60% of client relationships

Privately owned and independent, Bessemer Trust is a multifamily office that has served individuals and families of substantial wealth for more than 110 years. We offer comprehensive investment management, wealth planning, and family office services to help you and your family achieve peace of mind for generations.

Consistently recognized as a leading multifamily office, we provide highly personalized advice and service our clients know they can depend on. We take the time to understand each of your objectives in order to deliver long-term, fully integrated solutions to help you:

- Protect your lifestyle through economic cycles
- Increase your wealth beyond taxes, inflation, and fees
- Manage day-to-day financial complexities
- Transfer your wealth across generations and fulfill philanthropic goals

Dedicated Advisor Teams Delivering Fully Integrated Capabilities

Bessemer Trust clients experience a level of personal attention and service difficult to find elsewhere. Your Bessemer team works closely with you to provide customized, integrated solutions that reflect your unique circumstances and aspirations. Our senior team members average 28 years of industry experience and more than a decade with the firm. Our clients place their trust in us knowing they will have ongoing dialogue with a proactive, experienced, and loyal team.

A commitment to excellence in investment management, wealth planning, and client service has been our focus for more than 110 years and reflects our overarching mission: to provide peace of mind for generations.

The Bessemer Difference

Private ownership and independence
Results in continuity of purpose, stability, and objectivity

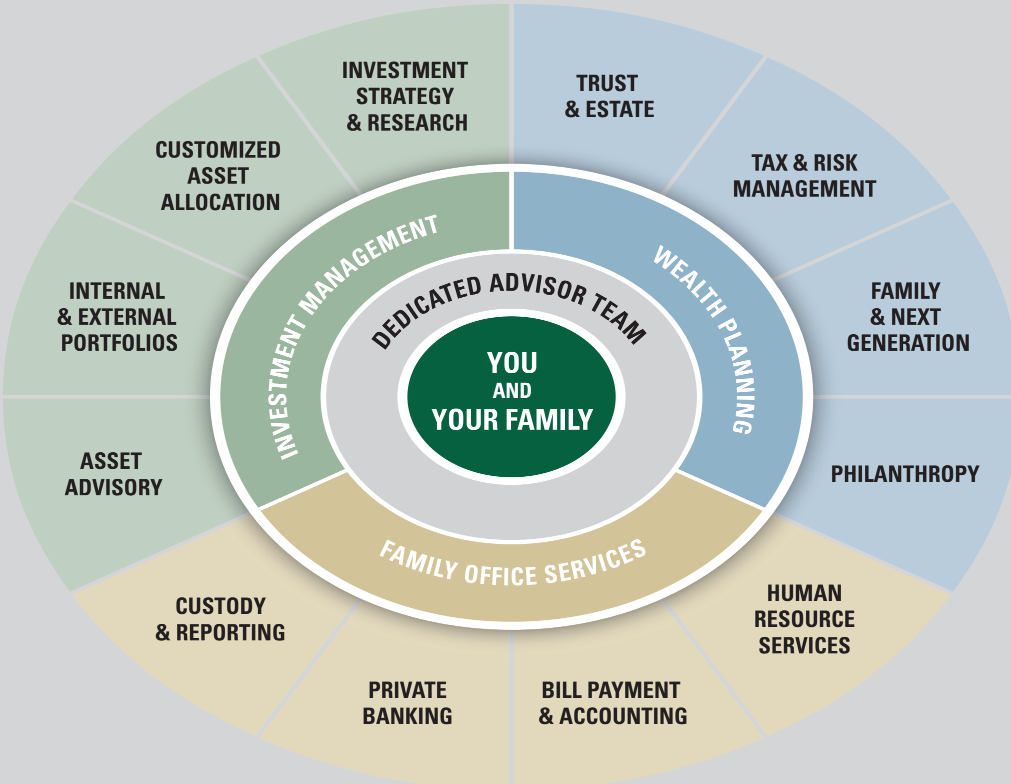
Singular focus on private wealth management
Allows us to deliver deep expertise

Alignment of interests among clients, owners, and employees
Encourages long-term success as we invest side by side

Culture of service, not sales
Strengthens our ability to provide appropriate and unbiased advice

Expert Advice and Personal Service

We deliver best-in-class expertise across investment management, wealth planning, and family office services. A thoughtful approach to planning enables us to integrate and align our broad capabilities with your unique objectives.



Investment Management

We customize your asset allocation to reflect your specific goals. Our investment approach is flexible and highly disciplined, taking advantage of our research insights to pursue attractive long-term returns. Using a mix of internal and external managers, we build multi-asset class, diversified portfolios designed to participate in strong markets while offering protection in down markets.

Wealth Planning

Wealth impacts all aspects of life – and your needs will evolve over time. We stand ready to assist with trust administration and estate planning, to develop strategies aimed at minimizing taxes and managing risks, to help communicate wealth plans to the next generation, and to give guidance on a strategic approach to philanthropy. Our wealth planning teams have one focus: providing advice to help you preserve and transfer wealth.

Family Office Services

We have helped clients manage the day-to-day complexities of wealth since 1907, when our owners, the Phipps family, founded the firm. This long history gives us unparalleled experience providing clients with a broad range of family office services, including custody and consolidated reporting, private banking, bill payment, and payroll.

For more than a century, individuals and families of substantial wealth have depended on Bessemer Trust for sophisticated advice on their complex financial needs. For more information on how our capabilities could offer you similar peace of mind, please contact your advisor.

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The Old Farm Back Home:

Advising Out-of-State Clients on Ancillary Successions

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ANCILLARY SUCCESSIONS

LSU Estate Planning Conference

Ancillary Successions – What Are They?

- Simply refers to the various legal processes used when a non-Louisiana domiciliary dies owning property in Louisiana.
- Many of the same rules that govern Louisiana domiciliary successions apply
  - Ownership still transfers on death (Seizin)
  - Succession proceeding is simply method of proving ownership / authority of succession representative
- Preventing / resolving title issues often predominates
  - Even more so than in domiciliary successions

Ancillary Succession Fundamentals

ANCILLARY SUCCESSIONS

- Who typically institutes an ancillary succession?
  - Out-of-State Domiciliary Owning:
    - Immovable Property in Louisiana (by far the most common)
    - Movable property in Louisiana (particularly registered movables – cars, boats)
    - A cause of action to be filed or maintained in a LA Court
      - Succession Rep. must qualify in LA to have capacity to appear in Ct.

Ancillary Succession Fundamentals

- What procedural avenues are available?
  - Again, a lot like LA domiciliary successions:
    1. Judicial Succession ("Opening" as Succession)
       - With Administration
       - Without Administration (Simple Putting in Possession)
       - Small Succession (w/ or w/o Administration)
       - **Jurisdiction for ALL Ancillary Successions = Any parish where immovable property located, and if none, where any movable property is located (La. CCP 2811)**
    2. Non-Judicial Succession
       - Certain Small Successions ("Succession by Affidavit")
       - Other Abbreviated Title Transfers (e.g., OMV Title Affidavit)

Ancillary Succession Fundamentals

- Developing a Plan for the Client
  - Intake Interview is Critical:
    - What sort of property in Louisiana?
      - Immovable?
        - Land/House/Surface Interest; or Mineral Interests?
      - What is the Value?
        - Are mineral interests prescribed and/or no longer paying out?
      - Unknown interests? Title search / abstracting warranted?
    - Testate / Intestate? Disputed / Undisputed?
    - Any other Co-Owners?
    - What are the plans for the property (e.g., sell, hold, contribute)?
      - Title insurance being issued / title review being conducted?
- ***PRACTICALITY / EFFICIENCY LEAD THE CHARGE!!!***

Ancillary Succession Procedure

Ancillary Successions With Administration

- Executor or administrator needs access to information, to collect estate assets an/ord pay debts
- The procedure in an ancillary succession is the same as a LA domiciliary succession, except as provided Book VI, Title IV of Code of Civil Procedure
  - Petition to Appoint Administrator / Executor
  - Detailed Descr. List, Petition for Possession, etc.
- Primary procedural differences occur when Non-LA Succession Proceeding has already been opened AND:

  (i) Succession Representative Already Appointed, and/or

  (ii) Will Already Been Probated
- *(Remember: Non-La Succession Proceeding Not Required)*

Ancillary Succession Procedure

ANCILLARY SUCCESSIONS

Ancillary Successions With Administration

- When a domiciliary proceeding already exists, AND:

1) Succession Representative already appointed:
   - Succession Rep from domiciliary proceeding still must qualify in LA Proceeding,
   - However, priority is given to previously appointed Succession Rep if not disqualified under CCP art. 3097 (minor, interdict, felon, etc.)

2) Will already probated:
   - **"Duly authenticated"** (or "Exemplified") copy of will and probate order from domiciliary proceeding are submitted to LA Ct., will must be admitted to probate in LA proceeding.
     - Under Uniform Probate Law (La. R.S. 9:2421 et seq.) LA Ct. essentially gives rubberstamp approval to foreign probate order

STAN STANART
COUNTY CLERK, HARRIS COUNTY, TEXAS
PROBATE COURTS DEPARTMENT

EXEMPLIFICATION CERTIFICATE

THE STATE OF TEXAS §
COUNTY OF HARRIS §

I, **Mike Wood**, a presiding Judge of one of the Probate Courts of Harris County, Texas do hereby certify that the following attestation and certificate of **Stan Stanart**, is in due form of law, and that the said Stan Stanart, is now, and was, at the time of making said certificate and attestation, the Clerk of the Probate Courts in and for Harris County, Texas; that he is the proper officer to make such certificate and attestation; that his signature, whether manual or electronic, thereto is genuine, and that as such Clerk of the Probate Courts, he is the sole custodian of papers, documents, records and seal pertaining to said Court.

IN TESTIMONY WHEREOF, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE SEAL OF SAID COURT, at my office in the Harris County Courthouse, Houston, Texas, on Sept 25, 2017.

Mike Wood
Judge Mike Wood, Probate Court, Harris County, Texas

THE STATE OF TEXAS §
COUNTY OF HARRIS §

I, **Stan Stanart,** Clerk of the Probate Courts in and for Harris County Texas do hereby certify that the **Honorable Mike Wood,** whose genuine signature, whether manual or electronic, appears on the foregoing certificate is now, and was, at the time of signing said certificate, a presiding Judge of one of the Probate Courts of Harris County, Texas, duly commissioned and qualified in accordance with the laws of the State of Texas, and that said attestation is in due form of law. I further certify that the attached is a true and correct copy of the **Last Will and Testament, Order Admitting Will to Probate and Granting Letters Testamentary, Letters Testamentary**.

In Cause No. the **Estate of:** , **Deceased** as the same appears on file and of record in my office.

IN TESTIMONY WHEREOF, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE SEAL OF SAID COURT, at my office in the Harris County Courthouse, Houston, Texas, on Sept 21, 2017.

Stan Stanart
Stan Stanart, Clerk, Probate Courts, Harris County, Texas

P.O. Box 1525 • Houston, TX 77251-1525 • (713) 274-8585

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Ancillary Succession Procedure

Ancillary Successions WITHOUT Administration

- Essentially identical procedure to LA succession proceeding, with one big exception → Small Successions by Affidavit
  - Non-LA Domiciliary (i) who died testate AND (ii) whose will has been probated by foreign court gets to take advantage of the Code of Civil Procedures more liberal (and practical) small succession by affidavit procedure

ANCILLARY SUCCESSIONS

Ancillary Succession Procedure

Small Successions Generally

- LA CCP art. 3421: Small successions include any succession (LA or Ancillary):

(i) Having a gross value of $125,000 or less, valued as of the date of death; or

(ii) Of any value, if the date of death occurred at least 20 years before the date of filing of a small succession affidavit (discussed later).

AND since 2020, LA CCP art. 3421 now includes Paragraph (B), which provides that small successions also include a succession of a person who:

(i) Died testate,

(ii) Leaving no immovable property, and

(iii) Probate of the testament would have the same effect as intestacy.

(Acts 2020, No. 173, § 1)

Ancillary Succession Procedure

ANCILLARY SUCCESSIONS

Small Successions Generally

- Other than lower court costs and succession representative compensation, small successions are otherwise handled in the same manner as any other succession (domestic or ancillary), **unless eligible for a non-judicial small succession proceeding**

- Non-Judicial ("Affidavit") Small Succession only available to:
  1) A Louisiana **or** Non-Louisiana domiciliary who died intestate;
  2) A Louisiana domiciliary (only) who died testate (but only if no imm. prop and same effect as intestacy); or
  3) A **Non-Louisiana domiciliary** (only) who died testate and whose will has already been probated outside of Louisiana, and whose sole heirs include the following:

     (i) Descendants, (ii) Ascendants, (iii) Brothers/Sisters/Their Descendants,

     (iv) Surviving Spouse, or **(v) "*His legatees under a testament*"**

Ancillary Succession Procedure

Contents of Small Succession Affidavit

Intestate Affidavit (CCP Art. 3432):

(1) The date of death of the deceased, and his domicile at the time thereof;

(2) The fact that the deceased died intestate;

(3) The marital status of the deceased, the location of the last residence of the deceased, and the name of the surviving spouse, if any;

(4) The names and last known addresses of the heirs of the deceased, their relationship to the deceased;

(5) A description of the property left by the deceased, including whether the property is community or separate, and which in the case of immovable property must be sufficient to identify the property for purposes of transfer;

(6) The value of each item of property, and the aggregate value of all property, at the time of the death of the deceased;

(7) An affirmation that the affiant, if an heir, has accepted the succession of the deceased.

Ancillary Succession Procedure

Contents of Small Succession Affidavit

Testate Affidavit (CCP Art. 3432.1):

(1) The date of death of the deceased, and his domicile at the time thereof;

(2) The fact that the deceased died testate;

(3) The marital status of the deceased, the location of the last residence of the deceased, and the name of the surviving spouse, if any, and the names of the legal heirs of the deceased, and identifying any legal heirs who are also forced heirs of the deceased;

(4) The names and last known addresses of the legatees of the deceased;

(5) A description of the property left by the deceased, including whether the property is community or separate, ***and which in the case of immovable property must be sufficient to identify the property for purposes of transfer***;

(6) The value of each item of property, and the aggregate value of all property, at the time of the death of the deceased;

(7) An affirmation that the affiant, if an heir, has accepted the succession of the deceased;

(8) ***An attachment consisting of certified copies of the testament and, if the testament has been probated by court order of another state, the probate order of the other state***.

Ancillary Succession Issues

Issues with Ancillary Successions

- Foreign Trust Issues
- Procedural Traps
- Improper Use of Small Succession Affidavit
- Property Description Issues

Ancillary Succession Issues

ANCILLARY SUCCESSIONS

Foreign Trust Issues

- Wills of out-of-staters often include bequests to existing trusts (e.g., “pour-over wills”) or create testamentary trusts that contain provisions that violate the Louisiana Trust Code, such as prohibited substitutions (e.g., “I give to my brother Jim (who has children), and upon his death I give to my friend Alex.”).
- Depending on the severity of the defect in the trust, Louisiana courts have deemed such foreign trusts completely invalid (*See*, *e.g.*, *Succession of Guillory*, 94 So.2d 38 (1957); *Succession of Meadors*, 135 So.2d 679 (1961)).
- Transferring title to the trust into question (i) whether the transfer to such trust is itself valid, and/or (ii) the identity of the rightful owners at any given point in time following the transfer to the trust.
- Clouds title to immovable property and possibly impairs insurability of title.

Ancillary Succession Issues

Foreign Trust Issues

- Statutes that affect foreign wills and trusts only appear to:

  (i) validate the form and/or execution of a foreign trust or will when the law of the state of making differs from Louisiana law. *See* La. R.S. 9:2262.4 (Foreign Trust Laws); La. R.S. 9:2401 (Uniform Wills Law – Repealed 2020)); or

  (ii) provide prescriptive relief for failure to evidence in the public record the trustee of the foreign (defective trust) to convey immovable property out of the trust (La. R.S. 9:5646 – sales out of trust can’t be attacked after 5 years)

- Substantive defects in the foreign trust or will nonetheless remain unaffected, and cause problems particularly for immovable property

Ancillary Succession Issues

Foreign Trust Issues (The Workaround)

- To "cure" problems with foreign trusts, the immovable property is sometimes sold by the succession representative to an LLC or other entity formed by or for the beneficiaries of the defective trust in exchange for cash or a note, which is then distributed to the trust in the judgment of possession
  - Basically removing the Trust from the Chain of Title
- Cashflow issues or income tax issues related to the note and possible forgiveness sometimes warrant a contribution of the immovable property directly to the LLC in exchange for membership interests

Ancillary Succession Issues

Procedural Traps (Hypothetical)

- CleanAir Corp. is purchasing industrial property in Ascension Parish to build a $500MM refining facility. As part of curing title to the property, a series of successions are opened to convey the various interests currently titled in deceased members of the Oldblood Family into the family LLC prior to the sale to CleanAir. In total, four successions are opened in Ascension Parish for all for outstanding decedents' interests: (i) Jimmy (Greenwich, CT), (ii) Ricky (La Jolla, CA), (iii) Bobby (New Orleans, LA), and (iv) Mike (W. Palm B., FL). JOPs are issued; the heirs of the decedents transfer their interests into the family LLC; the property is sold by the Family LLC to CleanAir for $70MM; CleanAir builds and begins to operate its $500MM refining facility.
- 9 years later, Maureen, the daughter of Jimmy Oldblood, and Adele, the daughter of Bobby Oldblood – both of whom were cut out of their respective fathers' wills – file suit alleging that the wills probated in their fathers' successions (i) were invalid as to form, and (ii) violated their forced heirship rights. These suits seek to invalidate the sale of the property to CleanAir. CleanAir and the other parties in interest file exceptions alleging that Maureen and Adele's claims are outside of 5ys and are prescribed. Who wins?

Ancillary Succession Issues

Procedural Traps (Jurisdiction/Venue)

- Not Maureen (Jimmy's daughter). But Adele's (Bobby's daughter's) claim has legs. Venue is jurisdictional for a succession proceeding (La. CCP 2811). A proceeding to open a succession must be brought in the district court of the parish where the deceased was domiciled at the time of his death. This venue cannot be waived. (See La. CCP 44). Only the succession of a **non-Louisiana domiciliary** may be opened in the district court of any parish where immovable property of the deceased is located under Article 2811.
- Despite this, out of convenience succession proceedings of Louisiana domiciliaries are often brought in the parish where the decedent owned immovable property – and not where he was domiciled – as is revealed by allegations in the petitions as well as recitations contained in the affidavits of death and heirship.

Ancillary Succession Issues

Procedural Traps (Jurisdiction/Venue)

- All succession proceedings violative of CCP 2811 are absolutely null and void. *Succession of Bibbins*, 152 So. 592 (Orleans App. 1934)
- The impact of this nullity is far – reaching:
  - A judgment of possession in such a proceeding is null. *Howell v. Kretz*, 131 So. 204 (La. App. 1 Cir. 1930).
  - A decree appointing an administrator is null. *Taylor v. Williams*, 110 So. 100 (La. 1926); *Succession of Franklin*, 114 So. 583 (La. 1927).
  - An attempted sale by an administrator is null. *Succession of Franklin*, *supra.*
  - A purported probate of a testament is null. Civil Code Article 1605, *In re Succession of Hilburn*, 2011 La. App. LEXIS 756 (La. App. 1 Cir. 2011).

Ancillary Succession Issues

Procedural Traps (Jurisdiction/Venue)

- When a judgment is absolutely null based on a jurisdictional ground, it has no legal existence and its nullity may be shown in collateral proceedings at any time, by any party, and before any court. CCP 2002; *Walworth v. Stevenson*, 24 La. Ann. 251 (La. 1872); *Miles v. Our Lady of the Lake Regional Medical Center*, 836 So. 2d 136 (La. App. 1 Cir. 2002).
- Liberative prescriptions otherwise available to cure defects as a result of inaction are unavailable in the face of an absolutely null proceeding, including:
  - 2-year prescription against unrecognized successors in La. R.S. 9:5630;
  - 2-year prescription for defects in legal procedure relating to succession sales as provided in La. R.S. 9:5632;
  - 5-year prescription running against the probate of a testament, commencing with the judicial opening of a succession provided in La. R.S. 9:5643;
  - 5-year prescription running against annulment of a testament and the reduction of an excessive donation provided in Civil Code 3497.

Ancillary Succession Issues

Improper Use of Small Succession Affidavit

- Always consider if a Small Succession Affidavit is the “prudent” choice – even if it’s legally valid
  - It’s a beautiful thing, but often misunderstood and misused to the point of reputational damage
  - For larger estates (ancillary or domestic) consider instituting a succession proceeding (w/ or w/o administration) and obtaining a JOP – even if SSA is available and proper
- **BUT WHATEVER YOU DO, DON’T ACTUALLY MISUSE A SMALL SUCCESSION AFFIDAVIT!!!**
  - It happens **MUCH** more than you’d think…

Ancillary Succession Issues

ANCILLARY SUCCESSIONS

Improper Use of Small Succession Affidavit

- If the Decedent died testate, the SSA procedure is only available to transmit title to **immovable** property when the decedent is a non-Louisiana domiciliary AND when the will has already been probated in a foreign court
  - All-too-often, the SSA procedure is utilized to try to transmit title to immovables for (i) Louisiana domiciliaries (attaching an unprobated will to the SSA as is otherwise req'd under CCP 3432.1), or (ii) non-Louisiana domiciliaries, but while attaching an **unprobated** will.
- The confusion is somewhat understandable:
  - (i) Why isn't a similar process available for Louisiana domiciliaries?
  - (ii) CCP 3432.1 (which applies to BOTH domestic and ancillary successions) requires that the SSA contain: "(5) A description of the property left by the deceased . . . ***and which in the case of immovable property must be sufficient to identify the property for purposes of transfer***."

Ancillary Succession Issues

Property Description Issues

- Be cognizant of how much time and effort goes in to Property Description Development.

Example of Mineral Interest Description (Long-Form):

All of Decedent's right, title and interest to the property acquired by Walter Smith pursuant to (i) that certain Mineral Deed by Charles Jones in favor of Walter Smith, dated June 12, 1922, recorded June 28, 1922, in Book LB12, Page 9, Instrument No. 153, records of St. Landry Parish, Louisiana, and (ii) that certain Mineral Deed by Greg Smith in favor of Walter Smith, dated June 21, 1926, recorded June 28, 1926, in Book LB12, Page 28, Instrument No. 14332, records of St. Landry Parish, Louisiana, including but not limited to any interests in and to the following described lands: S2SW; Section 26, T8S, R3E, St. Landry Parish, LA; and W2NWNW; Section 35, T8S, R3E, St. Landry Parish, LA.

Example of Mineral Interest Description ("Quick and Dirty"):

One-Fourth interest in that certain Mineral Interest #7977714 — Great Southern Oil & Gas Co. (formerly owned by Texaco, Inc.) — Div. Order 677000-013 — Laterre Co., Inc. #2672 Golden Meadow Field — Lafourche Parish #98566.

Ancillary Succession Advice

Advising Client's After the Ancillary Succession is Complete

- Should we avoid these things?
  - Although an ancillary proceeding in Louisiana is far simpler than in many other states, I would still recommend that the client transfer interests in Louisiana immovable property to an LLC or other legal entity, so that no Louisiana probate proceeding would be required.
    - I'd advise against using trusts.
      - Compliance with the Louisiana Trust Code can be too-limiting a proposition for out-of-staters , which includes some restrictions that are not found in many other states.
      - Still possible that ancillary probate will be required if principal beneficiary dies and trust holds immovable property in Louisiana
  - But must still weigh costs of LLC against the value of the LA immovable property interest (e.g., annual filing fees; needs to be registered in LA if foreign LLC?)

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Thank you (And Questions)

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The Rules of Technological Conduct

Did You Transition Ethically into the Land of Zoom?

Betty A. Raglin

Legacy Estate & Elder Law of Louisiana, LLC

When January 1, 2020, came around, I was certain that "zoom" was the sound made while playing with Hot Wheels cars, having no knowledge of a videoconference platform of the same name. Today, though, I've learned a whole different type of Zoom, and have mastered the service's more basic functions. Despite any wishes to the contrary, videoconferencing will likely have an ongoing role in the practice of law, joining many other technologies that have added convenience and complications to the practice of law.

Are there any differences between a lawyer's ethical obligations to clients in the bricks and mortars "real world" compared to clients who chiefly or only interact with the firm through a technological middle-man? The same rules apply whether in meatspace or cyberspace, although in the realm of technology, the type and number of threats exponentially expand, and a lawyer's need to seek guidance from technology professionals increases.

Guidance from ABA/LSBA

The American Bar Association's Standing Committee on Ethics and Professional Responsibility recently published two Formal Opinions dealing with virtual law practice (Opinion 498) and remote law practice (Opinion 495).

The Louisiana State Bar Association weighed in on "Lawyer's Use of Technology" in a published public opinion in 2019.

A review of these Opinions points to several areas of significant concern, including confidentiality, diligence, competency and supervision.

The Rules

While guidance is welcomed and appreciated, guidance is not mandatory. The Rules of Professional Conduct are, however. Below are rules dealing with competency, diligence, communication, confidentiality, safekeeping property and supervision of non-lawyers in a legal matter. Although only a portion of Rule 1.15 is applicable to this presentation, the entirety of the rule is reproduced below, showing revisions made in August of this year.

Louisiana's most relevant Rules of Professional Conduct provide that:

Rule 1.1 Competence

(a) A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.
(b) A lawyer is required to comply with the minimum requirements of continuing legal education as prescribed by Louisiana Supreme Court rule.
(c) A lawyer is required to comply with all of the requirements of the Supreme Court's rules regarding annual registration, including payment of Bar dues, payment of the disciplinary assessment, timely notification of changes of address, and proper disclosure of trust account information or any changes therein.

Rule 1.3. Diligence

A lawyer shall act with reasonable diligence and promptness in representing a client.

Rule 1.4. Communication

(a) A lawyer shall:
(1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;
(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;
(3) keep the client reasonably informed about the status of the matter;
(4) promptly comply with reasonable requests for information; and

(5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.
(b) The lawyer shall give the client sufficient information to participate intelligently in decisions concerning the objectives of the representation and the means by which they are to be pursued.
(c) A lawyer who provides any form of financial assistance to a client during the course of a representation shall, prior to providing such financial assistance, inform the client in writing of the terms and conditions under which such financial assistance is made, including but not limited to, repayment obligations, the imposition and rate of interest or other charges, and the scope and limitations imposed upon lawyers providing financial assistance as set forth in Rule 1.8(e).

Rule 1.6. Confidentiality of Information

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent reasonably certain death or substantial bodily harm;

(2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;

(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services.

(4) to secure legal advice about the lawyer's compliance with these Rules;

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client;

(6) to comply with other law or a court order; or

(7) to detect and resolve conflicts of interests between lawyers in different firms, but only if the revealed information would not compromise the attorney-client privilege or otherwise prejudice the client.

(c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

Rule 1.15. Safekeeping Property

(a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property. Except as provided in (g) and the IOLTA Rules below, funds shall be kept in one or more separate interest-bearing client trust accounts maintained in a bank, credit union or savings association: 1) authorized by federal or state law to do business in Louisiana, the deposits of which are insured by an agency of the federal government; 2) in the state where the lawyer's primary office is situated, if not within Louisiana; or 3) elsewhere with the consent of the client or third person. No earnings on a client trust account may be made available to or utilized by a lawyer or law firm. Other property shall be identified as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of five years after termination of the representation.

(b) A lawyer may deposit the lawyer's own funds in a client trust account for the sole purpose of paying bank service charges on that account or obtaining a waiver of those charges, but only in an amount necessary for that purpose.

(c) A lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred. The lawyer shall deposit legal fees and expenses into the client trust account consistent with Rule 1.5(f).

(d) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. For purposes of this rule, the third person's interest shall be one of which the lawyer has actual knowledge, and shall be limited to a statutory lien or privilege, a final judgment addressing disposition of those funds or property, or a written agreement by the client or the lawyer on behalf of the client guaranteeing payment out of those funds or property. Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.

(e) When in the course of representation a lawyer is in possession of property in which two or more persons (one of whom may be the lawyer) claim interests, the property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the property as to which the interests are not in dispute.

(f) Every check, draft, electronic transfer, or other withdrawal instrument or authorization from a client trust account shall be personally signed by a lawyer or, in the case of electronic, telephone, or wire transfer, from a client trust account, directed by a lawyer or, in the case of a law firm, one or more lawyers authorized by the law firm. A lawyer shall not use any debit card or automated teller machine card to withdraw funds from a client trust account. On client trust accounts, cash withdrawals and checks made payable to “Cash” are prohibited. A lawyer shall subject all client trust accounts to a reconciliation process at least quarterly, and shall maintain records of the reconciliation as mandated by this rule.

(g) A lawyer shall create and maintain an “IOLTA Account,” which is a pooled interest-bearing client trust account for funds of clients or third persons which are nominal in amount or to be held for such a short period of time that the funds would not be expected to earn income for the client or third person in excess of the costs incurred to secure such income.

(1) IOLTA Accounts shall be of a type approved and authorized by the Louisiana Bar Foundation and maintained only in "eligible" financial institutions, as approved and certified by the Louisiana Bar Foundation. The Louisiana Bar Foundation shall establish regulations, subject to approval by the Supreme Court of Louisiana, governing the determination that a financial institution is eligible to hold IOLTA Accounts and shall at least annually publish a list of LBF-approved/certified eligible financial institutions. Participation in the IOLTA program is voluntary for financial institutions. IOLTA Accounts shall be established at a bank, credit union, or savings association authorized by federal or state law to do business in Louisiana, the deposits of which are insured by an agency of the federal government or at an open-end investment company registered with the Securities and Exchange Commission authorized by federal or state law to do business in Louisiana which shall be invested solely in or fully collateralized by U. S. Government Securities with total assets of at least $250,000,000 and in order for a financial institution to be approved and certified by the Louisiana Bar Foundation as eligible, shall comply with the following provisions::

(A) No earnings from such an account shall be made available to a lawyer or law firm.

(B) Such account shall include all funds of clients or third persons which are nominal in amount or to be held for such a short period of time the funds would not be expected to earn income for the client or third person in excess of the costs incurred to secure such income.

(C) Funds in each interest-bearing client trust account shall be subject to withdrawal upon request and without delay, except as permitted by law.

(2) To be approved and certified by the Louisiana Bar Foundation as eligible, financial institutions shall maintain IOLTA Accounts which pay an interest rate comparable to the highest interest rate or dividend generally available from the institution to its non-IOLTA customers when IOLTA Accounts meet or exceed the same minimum balance or other eligibility qualifications, if any. In determining the highest interest rate or dividend generally available from the institution to its non-IOLTA accounts, eligible institutions may consider factors, in addition to the IOLTA Account balance, customarily considered by the institution when setting interest rates or dividends for its customers, provided that such factors do not discriminate between IOLTA Accounts and accounts of non-IOLTA customers, and that these factors do not include that the account is an IOLTA Account. The eligible institution shall calculate interest and dividends in accordance with its standard practice for non-IOLTA customers, but the eligible institution may elect to pay a higher interest or dividend rate on IOLTA Accounts.

(3) To be approved and certified by the Louisiana Bar Foundation as eligible, a financial institution may achieve rate comparability required in (g)(2) by:

(A) Establishing the IOLTA Account as:

(1) an interest-bearing checking account; (2) a money market deposit account with or tied to checking; (3) a sweep account which is a money market fund or daily (overnight) financial institution repurchase agreement invested solely in or fully collateralized by U.S. Government Securities; or (4) an open-end money market fund solely invested in or fully collateralized by U.S. Government Securities. A daily financial institution repurchase agreement may be established only with an eligible institution that is "well-capitalized" or "adequately capitalized" as those terms are defined by applicable federal statutes and regulations. An open-end money market fund must be invested solely in U.S. Government Securities or repurchase agreements fully collateralized by U.S. Government Securities, must hold itself out as a "money-market fund" as that term is defined by federal statutes and regulations under the Investment Company Act of 1940, and, at the time of the investment, must have total assets of at least $250,000,000.

"U.S. Government Securities" refers to U.S. Treasury obligations and obligations issued or guaranteed as to principal and interest by the United States or any agency or instrumentality thereof.

(B) Paying the required rate in (g)(2) above on the IOLTA checking account in lieu of establishing the IOLTA Account as the higher rate product; or

(C) Paying a "benchmark" amount of qualifying funds equal to the higher of 60% of the Federal Fund Target Rate as of the first business day of the quarter or other IOLTA remitting period, or 0.60%; no fees may be deducted from this amount which is deemed already to be net of "allowable reasonable fees." When applicable, the Louisiana Bar Foundation will express its benchmark in relation to the Federal Funds Target Rate.

(4) Lawyers or law firms depositing the funds of clients or third persons in an IOLTA Account shall direct the depository institution:

(A) To remit interest or dividends, net of any allowable reasonable fees on the average monthly balance in the account, or as otherwise computed in accordance with an eligible institution's standard accounting practice, at least quarterly, to the Louisiana Bar Foundation, Inc.;

(B) To transmit with each remittance to the Foundation, a statement, on a form approved by the LBF, showing the name of the lawyer or law firm for whom the remittance is sent and for each account: the rate of interest or dividend applied; the amount of interest or dividends earned; the types of fees deducted, if any; and the average account balance for each account for each month of the period in which the report is made; and

(C) To transmit to the depositing lawyer or law firm a report in accordance with normal procedures for reporting to its depositors.

(5) "Allowable reasonable fees" for IOLTA Accounts are: per check charges; per deposit charges; a fee in lieu of minimum balance; sweep fees and a reasonable IOLTA Account administrative fee. All other fees are the responsibility of, and may be charged to, the lawyer or law firm maintaining the IOLTA Account. Fees or service charges that are not "allowable reasonable fees" include, but are not limited to: the cost of check printing; deposit stamps; NSF charges; collection charges; wire transfers; and fees for cash management. Fees or charges in excess of the earnings accrued on the account for any month or quarter shall not be taken from earnings accrued on other IOLTA Accounts or from the principal of the account. Eligible financial institutions may elect to waive any or all fees on IOLTA Accounts.

(6) A lawyer is not required independently to determine whether an interest rate is comparable to the highest rate or dividend generally available and shall be in presumptive compliance with Rule 1.15(g) by maintaining a client trust account of the type approved and authorized by the Louisiana Bar Foundation at an "eligible" financial institution.

(7) "Unidentified Funds" are funds on deposit in an IOLTA account for at least one year that after reasonable due diligence cannot be documented as belonging to a client, a third person, or the lawyer or law firm.

(8) "Unclaimed Funds" are client or third person funds on deposit in an IOLTA account for at least two years that after reasonable due diligence the owner cannot be located or the owner refused to accept the funds.

(h) A lawyer who learns of Unidentified or Unclaimed Funds in an IOLTA account must remit the funds to the Louisiana Bar Foundation. No charge of misconduct shall attend to a lawyer's exercise of reasonable judgment under this paragraph (h).

A lawyer who either remits funds in error or later ascertains the ownership of remitted funds, or the owner thereof, may make a claim to the Louisiana Bar Foundation, which after verification of the claim will return the funds to the lawyer or owner, as appropriate.

IOLTA RULES

(1) The IOLTA program shall be a mandatory program requiring participation by lawyers and law firms, whether proprietorships, partnerships, limited liability companies or professional corporations.

(2) The following principles shall apply to funds of clients or third persons which are held by lawyers and law firms:

(a) No earnings on the IOLTA Accounts may be made available to or utilized by a lawyer or law firm.

(b) Upon the request of, or with the informed consent of a client or third person, a lawyer may deposit funds of the client or third person into a non-IOLTA, interest-bearing client trust account and earnings may be made available to the client or third person, respectively, whenever possible upon deposited funds which are not nominal in amount or are to be held for a period of time long enough that the funds would be expected to earn income for the client or third person in excess of the costs incurred to secure such income; however, traditional lawyer-client relationships do not compel lawyers either to invest such funds or to advise clients or third persons to make their funds productive.

(c) Funds of clients or third-persons which are nominal in amount or to be held for such a short period of time that the funds would not be expected to earn income for the client or third person in excess of the costs incurred to secure such income shall be retained in an IOLTA Account at an eligible financial institution as outlined above in section (g), with the interest or dividend (net of allowable reasonable fees) made payable to the Louisiana Bar Foundation, Inc., said payments to be made at least quarterly.

(d) In determining whether the funds of a client or third person can earn income in excess of costs, a lawyer or law firm shall consider the following factors:

(1) The amount of the funds to be deposited;

(2) The expected duration of the deposit, including the likelihood of delay in the matter for which the funds are held;

(3) The rates of interest or yield at financial institutions where the funds are to be deposited;

(4) The cost of establishing and administering non-IOLTA accounts for the benefit of the client or third person including service charges, the costs of the lawyer's services, and the costs of preparing any tax reports required for income accruing to the benefit of the client or third person;

(5) The capability of financial institutions, lawyers or law firms to calculate and pay income to individual clients or third persons;

(6) Any other circumstances that affect the ability of the funds of the client or third person to earn a positive return for the client or third person. The determination of whether funds to be invested could be utilized to provide a positive net return to the client or third person rests in the sound judgment of each lawyer or law firm. The lawyer or law firm shall review its IOLTA Account at reasonable intervals to determine whether changed circumstances require further action with respect to the funds of any client or third person.

(e) Although notification of a lawyer's participation in the IOLTA Program is not required to be given to clients or third persons whose funds are held in IOLTA Accounts, many lawyers may want to notify their clients or third persons of their participation in the program in some fashion. The Rules do not prohibit a lawyer from advising all clients or third persons of the lawyer's advancing the administration of justice in Louisiana beyond the lawyer's individual abilities in conjunction with other public-spirited members of the profession. The placement of funds of clients or third persons in an IOLTA Account is within the sole discretion of the lawyer in the exercise of the lawyer's independent professional judgment; notice to the client or third person is for informational purposes only.

(3) The Louisiana Bar Foundation shall hold the entire beneficial interest in the interest or dividend income derived from client trust accounts in the IOLTA program. Interest or dividend earned by the program will be paid to the Louisiana Bar Foundation, Inc. to be used solely for the following purposes:

(a) to provide legal services to the indigent and to the mentally disabled;

(b) to provide law-related educational programs for the public;

(c) to study and support improvements to the administration of justice; and

(d) for such other programs for the benefit of the public and the legal system of the state as are specifically approved from time to time by the Supreme Court of Louisiana.

(4) The Louisiana Bar Foundation shall prepare an annual report to the Supreme Court of Louisiana that summarizes IOLTA income, grants, operating expenses and any other problems arising out of administration of the IOLTA program. In addition, the Louisiana Bar Foundation shall also prepare an annual report to the Supreme Court of Louisiana that summarizes all other Foundation income, grants, operating expenses and activities, as well as any other problems which arise out of the Foundation's implementation of its corporate purposes. The Supreme Court of Louisiana shall review, study and analyze such reports and shall make recommendations to the Foundation with respect thereto.

Rule 5.3. Responsibilities Regarding Nonlawyer Assistance

With respect to a nonlawyer employed or retained by or associated with a lawyer:

(a) a partner, and a lawyer who individually or together with other lawyers possesses comparable managerial authority in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the person's conduct is compatible with the professional obligations of the lawyer;

(b) a lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer; and

(c) a lawyer shall be responsible for conduct of such a person that would be a violation of the Rules of Professional Conduct if engaged in by a lawyer if:

(1) the lawyer orders or, with the knowledge of the specific conduct, ratifies the conduct involved; or

(2) the lawyer is a partner or has comparable managerial authority in the law firm in which the person is employed, or has direct supervisory authority over the person, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

Louisiana State Bar Association
PUBLIC Opinion 19-RPCC-021[1] February 6th, 2019
Lawyer's Use of Technology

A lawyer must consider the benefits and risks associated with using technology in representing a client. When a lawyer uses technology in representing a client, the lawyer must use reasonable care to protect client information and to assure that client data is reasonably secure and accessible by the lawyer.[2]

Technology is constantly evolving and changing the practice of law. Lawyers' practices and the tools they use have changed. Consider typewriters versus computers, or regular mail and fax machines as compared to email. Some reasons for a lawyer to consider the benefits of accepting technological changes and adopting different methods to practice law include "saving money, saving time, or improving quality".[3] Technology and the internet can modify the way a lawyer practices, affecting communication, practice management, handling evidence and data storage. How a lawyer should handle various aspects of technology, including but not limited to, email communication with clients or others, and the handling of digital or electronic client files or information has been discussed in ethics opinions and articles around the country.[4]

The consensus is that if a lawyer is going to use technology, that lawyer has a duty to comply

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1 The comments and opinions of the Committee—public or private—are not binding on any person or tribunal, including—but not limited to—the Office of Disciplinary Counsel and the Louisiana Attorney Disciplinary Board. Public opinions are those which the Committee has published—specifically designated thereon as "PUBLIC"—and may be cited. Private opinions are those that have not been published by the Committee—specifically designated thereon as "NOT FOR PUBLICATION"—and are intended to be advice for the originally-inquiring lawyer only and are not intended to be made available for public use or for citation. Neither the LSBA, the members of the Committee or its Ethics Counsel assume any legal liability or responsibility for the advice and opinions expressed in this process.

2 In addition to confidentiality issues, a lawyer should consider what happens if a dispute arises with a service provider, what format the data is in and who owns or retains the rights to the digital data.

3 *Cloud Computing for Criminal Lawyers: It's Not the Future Anymore (2016),* Dane S. Ciolino, Alvin R. Christovich Distinguished Professor of Law, Loyola University New Orleans College of Law.

4 Law Sites, *25 States Have Adopted Ethical Duty of Technology Competence* (March 16, 2015), ABA Formal Opinion 06-442, *Review and Use of Meta Data*; Ethics Opinion 2011-200 from Pennsylvania; Ethics Opinion 2012-13/4 from New Hampshire; and Informal Advisory Opinion 2013-03 from Ohio.

with Rules 1.1, 1.3, 1.4, 1.6 and 1.15 of the ABA Model Rules of Professional Conduct. Lawyers must use technology competently and diligently. Lawyers also have an obligation to protect client information and confidentiality. Lawyers also have an obligation to diligently weigh the use of potential technology considering variables such as risk and a client's individual capacity or availability to use that technology.

This Committee has considered the ethical ramifications stemming from a lawyer's use of technology when practicing law. In its consideration, the Committee believes that the Louisiana Rules of Professional Conduct most likely[5] implicated by a lawyer using technology are Rules 1.1(a)[6], 1.3[7], 1.4[8], 1.6[9], 1.15(a)[10] and 5.3.[11]

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[5] A myriad of Louisiana Rules of Professional Conduct could be implicated depending on the facts and situation, such as Rule 7.2, *et. seq*., involving lawyer advertising or solicitation.

[6] Rule 1.1(a) of the Louisiana Rules of Professional Conduct, in pertinent part, provides: "*A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation*."

[7] Rule 1.3 of the Louisiana Rules of Professional Conduct, in pertinent part, provides: "*A lawyer shall act with reasonable diligence and promptness in representing a client.*"

[8] Rule 1.4 of the Louisiana Rules of Professional Conduct, in pertinent part, provides: "*Communication. (a) A lawyer shall:…(3) keep the client reasonably informed about the status of the matter;…(b) The lawyer shall give the client sufficient information to participate intelligently in decisions concerning the objectives of the representation and the means by which they are to be pursued*…"

[9] Rule 1.6(a) and (c) of the Louisiana Rules of Professional Conduct, in pertinent part, provides: "*…(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b)…(c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.*"

[10] Rule 1.15 of the Louisiana Rules of Professional Conduct, in pertinent part, provides: "*…(a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property…Other property shall be identified as such and appropriately safeguarded…"*

Competence and Diligence

When a lawyer contemplates the use of technology, that lawyer should remember Rules 1.1 and 1.3 of the Louisiana Rules of Professional Conduct requiring competence and diligence. The lawyer should carefully evaluate whatever technology is being considered and whether client information will be reasonably secure and retrievable by the lawyer. Whether it might be a disaster like a flood or fire or even a breach by a hacker, a lawyer using technology should evaluate risks to a client's files and information, as well as the lawyer's ability to practice without an incapacitating interruption. For instance, does the lawyer have "back-up" systems to retain/recover digital information in the event of a service interruption?

An article in *GPSOLO Magazine* quotes the Director of the FBI in 2012 when he stated at a conference that "I am convinced there are only two types of companies; those that have been hacked and those that will be."[12] As an example, in 2016, a District Attorney's office in Pennsylvania paid ransom to regain access to its computers. The criminals used malware to hold the DA's office computer network hostage and were later arrested.[13] In 2012, the American Bar Association amended Comment 8 to Rule 1.1 of the ABA Model Rules of Professional Conduct to add language requiring that competence included an expectation that a lawyer should be

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[11] Rule 5.3 of the Louisiana Rules of Professional Conduct provides: *"…With respect to a nonlawyer employed or retained by or associated with a lawyer: (a) a partner, and a lawyer who individually or together with other lawyers possesses comparable managerial authority in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the person's conduct is compatible with the professional obligations of the lawyer; (b) a lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer; and (c) a lawyer shall be responsible for conduct of such a person that would be a violation of the Rules of Professional Conduct if engaged in by a lawyer if: (1) the lawyer orders or, with the knowledge of the specific conduct, ratifies the conduct involved; or (2) the lawyer is a partner or has comparable managerial authority in the law firm in which the person is employed, or has direct supervisory authority over the person, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action."*

[12] *What to Do When Your Data is Breeched, GPSOLO,* Jan./Feb. 2016, Nelson, Ries and Simek.

[13] *Prosecutor's Office Paid Ransom to Regain Access to Computers; International Network Busted*, ABA Journal, 12/6/2016.

knowledgeable of both the benefits and risks of the use of technology.[14] While Louisiana does not have comments to its Rules, Rules 1.1(a) and 1.3 are straight-forward even without a specific technological competence/diligence requirement. If a lawyer is not comfortable working with technology, the lawyer should consider the benefits of obtaining advice from another lawyer or consultant knowledgeable about both technology and a lawyer's ethical and professional responsibilities. If relying on a non-lawyer, Rule 5.3 provides *"With respect to a non-lawyer employed or retained by or associated with a lawyer: …(b) a lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer;…"* Accordingly, when a lawyer decides to use a non-lawyer technology service provider or computer consultant, that lawyer should take reasonable steps to ensure that ethical standards and responsibilities of the lawyer are met by the conduct of the service provider or consultant. Failure to use technology competently could put a law firm at risk both ethically and financially if the conduct falls below the applicable standard of care.

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Communication

Lawyers have a duty to communicate with clients. Rules 1.4(a)(2) and (3) of the Louisiana Rules of Professional Conduct state the communication obligations of a lawyer: "…*a lawyer shall…(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished…*"; and "*…(3) keep the client reasonably informed about the status of the matter;…."* How lawyers choose to communicate with clients is changing, with emails and text messages sometimes replacing phone calls and letters. Lawyers first should be cognizant regarding a potential client's capacity or ability to use technology. In some cases, use of advanced technology with an elderly, underprivileged, unknowledgeable or rural client with limited internet access might not be reasonable. A lawyer may want to consider the benefit of

[14] [8] *To maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology, engage in continuing study and education and comply with all continuing legal education requirements to which a lawyer is subject.*

advising clients regarding potential risks associated with using technology, such as having an inadequate password, or other people being aware of their password as compared to in-person consultations or traditional communication options. When very sensitive information is being communicated, it may be appropriate to consider encryption, as well as to provide the option of communicating by means of more traditional methods. If a lawyer elects to use technology, a lawyer has an obligation to use that technology in a manner that meets all reasonable ethical and professional standards, as well as to advise a client regarding potential risks. Many lawyers use computers to transmit email or pleadings or other documents. Whether using computers at the office or using a mobile device, a lawyer should always consider whether client information is reasonably secure and retrievable by the lawyer. Failure of a lawyer to use basic minimum standards for security, such as secure passwords, firewalls and encryption, may put a lawyer at risk of a potential violation of the Louisiana Rules of Professional Conduct. Strong passwords should be used on all computers and mobile devices, such as smart phones and tablets. When using mobile devices a lawyer should consider how secure a network might be and whether the option to secure or delete data remotely will be available if the mobile device is misplaced or stolen. If a data breach of material client information were to occur, a lawyer would not only need to take reasonable steps to address the problem, but also to disclose the fact of the breach to the client.[15]

Confidentiality

The modern practice of law is evolving with the use of technology, such as "cloud computing", allowing a lawyer to be more mobile and potentially reducing overhead costs. With internet access, lawyers can access client data and/or store data practically anywhere. Cloud computing could be defined as using the internet for the electronic transfer of data and/or storage on a computer or server that is not located in a lawyer's office but in an offsite location. As cited in Pennsylvania's ethics opinion, a *Maximum PC* magazine article described "cloud computing" as "a fancy way of saying stuff is not on your computer."[16] As client information is sent offsite

[15] ABA Formal Opinion 18-483, *Lawyers' Obligations After an Electronic Data Breach or Cyberattack*
[16] Quinn Norton, "Byte Rights," *Maximum PC*, September 2010, at 12.

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using the "cloud", a lawyer has delegated to others some level of control and security of that data. As a result, the American Bar Association modified its rules in recent years to address technological changes affecting the way lawyers practice. Louisiana, following the ABA's lead on this issue, amended Rule 1.6 of the Louisiana Rules of Professional Conduct in January 2015 specifically to add Part "c": "*A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client".*[17] Rules 1.6 and 1.15 of the Louisiana Rules of Professional Conduct require a lawyer to protect client confidentiality and client property, stating: "*A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b)…",* and "*…(a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property…Other property shall be identified as such and appropriately safeguarded…"*

While there are always risks with the use of technology, a lawyer needs to weigh the benefits of using technology versus any risks that are associated with its use. For example, sending digital files in a non-secure format could allow the inadvertent release of information a lawyer or client would not want shared by the unintentional disclosure of "metadata," which is information embedded in electronic documents. The ABA issued an ethics opinion regarding those risks in 2006.[18] Additionally, email "web bugs" could also track lawyer-client communications. An Alaska ethics opinion has suggested that a lawyer's surreptitious use of email "bugs" or tracking of opposing counsel's email communications with his or her client would be an ethical violation.[19] Irrespective of the wisdom of this conclusion, lawyers must be aware that email

[17] This provision was first adopted by the ABA after an Ethics 2020 report which considered changes in the practice due to technology.

[18] ABA Formal Opinion 06-442, *Review and Use of Metadata*.

[19] Alaska Bar Association Ethics Opinion No. 2016-1

"opens" and "forwards" may be tracked and act accordingly. There is always a risk that a lawyer's computer system could be breached. Law firms face the same issues as other companies when it comes to defending against cyber-attacks or hacking and protecting confidential data. Additionally, lawyers have ethical rules that require confidentiality of client information. Thus, if a lawyer chooses to use technology in the lawyer's practice, basic issues must be addressed. The onus is on the lawyer to have technological competence or competent assistance to make sure clients' confidential information or files are reasonably secure and readily accessible, asking questions such as: Are fundamental security measures being met? Are there redundant back-up methods for the storage and retrieval of digital data? Has due diligence research been conducted on prospective service providers?

Supervision, Delegation or Outsourcing

Some lawyers are more comfortable working with and understanding technology than others. While a lawyer cannot relinquish the ultimate responsibility over a client's case, nothing prohibits a lawyer from receiving assistance with technology and related issues from a lawyer's staff or consultants. For example, a lawyer may need assistance regarding eDiscovery or prevention of the spoliation of evidence involving technology. However, if relying on a non-lawyer, Rule 5.3 provides *"With respect to a non-lawyer employed or retained by or associated with a lawyer:…(b) a lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer;…"* Accordingly, when a lawyer decides to use a non-lawyer technology service provider or computer consultant, that lawyer should take reasonable steps to ensure that ethical standards and responsibilities of the lawyer are also met by the conduct of the service provider or consultant.

Some Issues to Consider When Using a Vendor

Technology continues to evolve, and a lawyer must use due diligence when considering various technological options or providers. For example, when using various technology vendors for things such as a cloud-based practice management system or for data storage, a lawyer must review and consider the service agreement. Some issues and questions a lawyer may want to consider were outlined in an ethics opinion from the Ohio State Bar:[20]

- What safeguards does the vendor have in place to prevent confidentiality breaches?
- Does the agreement create an enforceable obligation on the vendor's part to safeguard the confidentiality of data?
- Do the terms of the agreement purport to give "ownership" of the data to the vendor, or is the data merely subject to the vendor's license?
- How may the vendor respond to governmental or judicial attempts to obtain disclosure of your client data?
- What is the vendor's policy regarding returning your client data at the termination of its relationship with your firm?
- What plans and procedures does the vendor have in case of natural disaster, electronic power interruption or other catastrophic events?
- Where is the server located (particularly if the vendor itself does not actually host the data, and uses a data center located elsewhere)? Is the relationship subject to international law?

The questions listed above are examples for a lawyer to consider when deciding whether or not to use a particular type of technology or software or service provider. Updated information about various types of technology and a lawyer's practice can be found at the ABA's Legal Technology Resource Center[21]. Additional resources and information about technology can be found at the Louisiana State Bar Associations' website[22].

[20] Ohio State Bar Opinion 2013-03, p.4
[21] http://www.americanbar.org/groups/departments_offices/legal_technology_resources.html
[22] https://www.lsba.org/PracticeManagement/TechCenter.aspx

Conclusion

A lawyer must consider the benefits and risks associated with using technology in representing a client. When a lawyer uses technology in representing a client, the lawyer must use reasonable care to protect client information and to assure that client data is reasonably secure and accessible by the lawyer.

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AMERICAN BAR ASSOCIATION

STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY

Formal Opinion 495 **December 16, 2020**

ETHICS

Lawyers Working Remotely

Lawyers may remotely practice the law of the jurisdictions in which they are licensed while physically present in a jurisdiction in which they are not admitted if the local jurisdiction has not determined that the conduct is the unlicensed or unauthorized practice of law and if they do not hold themselves out as being licensed to practice in the local jurisdiction, do not advertise or otherwise hold out as having an office in the local jurisdiction, and do not provide or offer to provide legal services in the local jurisdiction. This practice may include the law of their licensing jurisdiction or other law as permitted by ABA Model Rule 5.5(c) or (d), including, for instance, temporary practice involving other states' or federal laws. Having local contact information on websites, letterhead, business cards, advertising, or the like would improperly establish a local office or local presence under the ABA Model Rules.[1]

Introduction

Lawyers, like others, have more frequently been working remotely: practicing law mainly through electronic means. Technology has made it possible for a lawyer to practice virtually in a jurisdiction where the lawyer is licensed, providing legal services to residents of that jurisdiction, even though the lawyer may be physically located in a different jurisdiction where the lawyer is not licensed. A lawyer's residence may not be the same jurisdiction where a lawyer is licensed. Thus, some lawyers have either chosen or been forced to remotely carry on their practice of the law of the jurisdiction or jurisdictions in which they are licensed while being physically present in a jurisdiction in which they are not licensed to practice. Lawyers may ethically engage in practicing law as authorized by their licensing jurisdiction(s) while being physically present in a jurisdiction in which they are not admitted under specific circumstances enumerated in this opinion.

Analysis

ABA Model Rule 5.5(a) prohibits lawyers from engaging in the unauthorized practice of law: "[a] lawyer shall not practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction, or assist another in doing so" unless authorized by the rules or law to do so. It is not this Committee's purview to determine matters of law; thus, this Committee will not opine whether working remotely by practicing the law of one's licensing jurisdiction in a particular jurisdiction where one is not licensed constitutes the unauthorized practice of law under the law of that jurisdiction. If a particular jurisdiction has made the determination, by statute, rule, case law, or opinion, that a lawyer working remotely while physically located in that jurisdiction constitutes

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[1] This opinion is based on the ABA Model Rules of Professional Conduct as amended by the ABA House of Delegates through August 2020. The laws, court rules, regulations, rules of professional conduct, and opinions promulgated in individual jurisdictions are controlling.

the unauthorized or unlicensed practice of law, then Model Rule 5.5(a) also would prohibit the lawyer from doing so.

Absent such a determination, this Committee's opinion is that a lawyer may practice law pursuant to the jurisdiction(s) in which the lawyer is licensed (the "licensing jurisdiction") even from a physical location where the lawyer is not licensed (the "local jurisdiction") under specific parameters. Authorization in the licensing jurisdiction can be by licensure of the highest court of a state or a federal court. For purposes of this opinion, practice of the licensing jurisdiction law may include the law of the licensing jurisdiction and other law as permitted by ABA Model Rule 5.5(c) or (d), including, for instance, temporary practice involving other states' or federal laws. In other words, the lawyer may practice from home (or other remote location) whatever law(s) the lawyer is authorized to practice by the lawyer's licensing jurisdiction, as they would from their office in the licensing jurisdiction. As recognized by Rule 5.5(d)(2), a federal agency may also authorize lawyers to appear before it in any U.S. jurisdiction. The rules are considered rules of reason and their purpose must be examined to determine their meaning. Comment [2] indicates the purpose of the rule: "limiting the practice of law to members of the bar protects the public against rendition of legal services by unqualified persons." A local jurisdiction has no real interest in prohibiting a lawyer from practicing the law of a jurisdiction in which that lawyer is licensed and therefore qualified to represent clients in that jurisdiction. A local jurisdiction, however, does have an interest in ensuring lawyers practicing in its jurisdiction are competent to do so.

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Model Rule 5.5(b)(1) prohibits a lawyer from "establish[ing] an office or other systematic and continuous presence in [the] jurisdiction [in which the lawyer is not licensed] for the practice of law." Words in the rules, unless otherwise defined, are given their ordinary meaning. "Establish" means "to found, institute, build, or bring into being on a firm or stable basis."[2] A local office is not "established" within the meaning of the rule by the lawyer working in the local jurisdiction if the lawyer does not hold out to the public an address in the local jurisdiction as an office and a local jurisdiction address does not appear on letterhead, business cards, websites, or other indicia of a lawyer's presence.[3] Likewise it does not "establish" a systematic and continuous presence in the jurisdiction for the practice of law since the lawyer is neither practicing the law of the local jurisdiction nor holding out the availability to do so. The lawyer's physical presence in the local jurisdiction is incidental; it is not for the practice of law. Conversely, a lawyer who includes a local jurisdiction address on websites, letterhead, business cards, or advertising may be said to have established an office or a systematic and continuous presence in the local jurisdiction for the practice of law.

Subparagraph (b)(2) prohibits a lawyer from "hold[ing] out to the public or otherwise represent[ing] that the lawyer is admitted to practice law in [the] jurisdiction" in which the lawyer is not admitted to practice. A lawyer practicing remotely from a local jurisdiction may not state or imply that the lawyer is licensed to practice law in the local jurisdiction. Again, information provided on websites, letterhead, business cards, or advertising would be indicia of whether a lawyer is "holding out" as practicing law in the local jurisdiction. If the lawyer's website,

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[2] DICTIONARY.COM, https://www.dictionary.com/browse/establish?s=t (last visited Dec. 14, 2020).

[3] To avoid confusion of clients and others who might presume the lawyer is regularly present at a physical address in the licensing jurisdiction, the lawyer might include a notation in each publication of the address such as "by appointment only" or "for mail delivery."

letterhead, business cards, advertising, and the like clearly indicate the lawyer's jurisdictional limitations, do not provide an address in the local jurisdiction, and do not offer to provide legal services in the local jurisdiction, the lawyer has not "held out" as prohibited by the rule.

A handful of state opinions that have addressed the issue agree. Maine Ethics Opinion 189 (2005) finds:

> Where the lawyer's practice is located in another state and where the lawyer is working on office matters from afar, we would conclude that the lawyer is not engaged in the unauthorized practice of law. We would reach the same conclusion with respect to a lawyer who lived in Maine and worked out of his or her home for the benefit of a law firm and clients located in some other jurisdiction. In neither case has the lawyer established a professional office in Maine, established some other systematic and continuous presence in Maine, held himself or herself out to the public as admitted in Maine, or even provided legal services in Maine where the lawyer is working for the benefit of a non-Maine client on a matter focused in a jurisdiction other than Maine.

Similarly, Utah Ethics Opinion 19-03 (2019) states: "what interest does the Utah State Bar have in regulating an out-of-state lawyer's practice for out-of-state clients simply because he has a private home in Utah? And the answer is the same—none."

In addition to the above, Model Rule 5.5(c)(4) provides that lawyers admitted to practice in another United States jurisdiction and not disbarred or suspended from practice in any jurisdiction may provide legal services on a temporary basis in the local jurisdiction that arise out of or reasonably relate to the lawyer's practice in a jurisdiction where the lawyer is admitted to practice. Comment [6] notes that there is no single definition for what is temporary and that it may include services that are provided on a recurring basis or for an extended period of time. For example, in a pandemic that results in safety measures—regardless of whether the safety measures are governmentally mandated—that include physical closure or limited use of law offices, lawyers may temporarily be working remotely. How long that temporary period lasts could vary significantly based on the need to address the pandemic. And Model Rule 5.5(d)(2) permits a lawyer admitted in another jurisdiction to provide legal services in the local jurisdiction that they are authorized to provide by federal or other law or rule to provide. A lawyer may be subject to discipline in the local jurisdiction, as well as the licensing jurisdiction, by providing services in the local jurisdiction under Model Rule 8.5(a).

Conclusion

The purpose of Model Rule 5.5 is to protect the public from unlicensed and unqualified practitioners of law. That purpose is not served by prohibiting a lawyer from practicing the law of a jurisdiction in which the lawyer is licensed, for clients with matters in that jurisdiction, if the lawyer is for all intents and purposes invisible *as a lawyer* to a local jurisdiction where the lawyer is physically located, but not licensed. The Committee's opinion is that, in the absence of a local jurisdiction's finding that the activity constitutes the unauthorized practice of law, a lawyer may practice the law authorized by the lawyer's licensing jurisdiction for clients of that jurisdiction, while physically located in a jurisdiction where the lawyer is not licensed if the lawyer does not hold out the lawyer's presence or availability to perform legal services in the local jurisdiction or actually provide legal services for matters subject to the local jurisdiction, unless otherwise authorized.

AMERICAN BAR ASSOCIATION STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY

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AMERICAN BAR ASSOCIATION

STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY

Formal Opinion 498 **March 10, 2021**

Virtual Practice

The ABA Model Rules of Professional Conduct permit virtual practice, which is technologically enabled law practice beyond the traditional brick-and-mortar law firm.[1] *When practicing virtually, lawyers must particularly consider ethical duties regarding competence, diligence, and communication, especially when using technology. In compliance with the duty of confidentiality, lawyers must make reasonable efforts to prevent inadvertent or unauthorized disclosures of information relating to the representation and take reasonable precautions when transmitting such information. Additionally, the duty of supervision requires that lawyers make reasonable efforts to ensure compliance by subordinate lawyers and nonlawyer assistants with the Rules of Professional Conduct, specifically regarding virtual practice policies.*

I. Introduction

As lawyers increasingly use technology to practice virtually, they must remain cognizant of their ethical responsibilities. While the ABA Model Rules of Professional Conduct permit virtual practice, the Rules provide some minimum requirements and some of the Comments suggest best practices for virtual practice, particularly in the areas of competence, confidentiality, and supervision. These requirements and best practices are discussed in this opinion, although this opinion does not address every ethical issue arising in the virtual practice context.[2]

II. Virtual Practice: Commonly Implicated Model Rules

This opinion defines and addresses virtual practice broadly, as technologically enabled law practice beyond the traditional brick-and-mortar law firm.[3] A lawyer's virtual practice often occurs when a lawyer at home or on-the-go is working from a location outside the office, but a lawyer's practice may be entirely virtual because there is no requirement in the Model Rules that a lawyer

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[1] This opinion is based on the ABA Model Rules of Professional Conduct as amended by the ABA House of Delegates through August 2020. The laws, court rules, regulations, rules of professional conduct, and opinions promulgated in individual jurisdictions are controlling.

[2] Interstate virtual practice, for instance, also implicates Model Rule of Professional Conduct 5.5: Unauthorized Practice of Law; Multijurisdictional Practice of Law, which is not addressed by this opinion. *See* ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 495 (2020), stating that "[l]awyers may remotely practice the law of the jurisdictions in which they are licensed while physically present in a jurisdiction in which they are not admitted if the local jurisdiction has not determined that the conduct is the unlicensed or unauthorized practice of law and if they do not hold themselves out as being licensed to practice in the local jurisdiction, do not advertise or otherwise hold out as having an office in the local jurisdiction, and do not provide or offer to provide legal services in the local jurisdiction."

[3] *See generally* MODEL RULES OF PROFESSIONAL CONDUCT R. 1.0(c), defining a "firm" or "law firm" to be "a lawyer or lawyers in a partnership, professional corporation, sole proprietorship or other association authorized to practice law; or lawyers employed in a legal services organization on the legal department of a corporation or other organization." Further guidance on what constitutes a firm is provided in Comments [2], [3], and [4] to Rule 1.0.

have a brick-and-mortar office. Virtual practice began years ago but has accelerated recently, both because of enhanced technology (and enhanced technology usage by both clients and lawyers) and increased need. Although the ethics rules apply to both traditional and virtual law practice,[4] virtual practice commonly implicates the key ethics rules discussed below.

A. Commonly Implicated Model Rules of Professional Conduct

1. Competence, Diligence, and Communication

Model Rules 1.1, 1.3, and 1.4 address lawyers' core ethical duties of competence, diligence, and communication with their clients. Comment [8] to Model Rule 1.1 explains, "To maintain the requisite knowledge and skill [to be competent], a lawyer should keep abreast of changes in the law and its practice, *including the benefits and risks associated with relevant technology*, engage in continuing study and education and comply with all continuing legal education requirements to which the lawyer is subject." (*Emphasis added*). Comment [1] to Rule 1.3 makes clear that lawyers must also "pursue a matter on behalf of a client despite opposition, obstruction or personal inconvenience to the lawyer, and take whatever lawful and ethical measures are required to vindicate a client's cause or endeavor." Whether interacting face-to-face or through technology, lawyers must "reasonably consult with the client about the means by which the client's objectives are to be accomplished; . . . keep the client reasonably informed about the status of the matter; [and] promptly comply with reasonable requests for information. . . ."[5] Thus, lawyers should have plans in place to ensure responsibilities regarding competence, diligence, and communication are being fulfilled when practicing virtually.[6]

2. Confidentiality

Under Rule 1.6 lawyers also have a duty of confidentiality to all clients and therefore "shall not reveal information relating to the representation of a client" (absent a specific exception, informed consent, or implied authorization). A necessary corollary of this duty is that lawyers must at least "make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client."[7] The following non-

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[4] For example, if a jurisdiction prohibits substantive communications with certain witnesses during court-related proceedings, a lawyer may not engage in such communications either face-to-face or virtually (e.g., during a trial or deposition conducted via videoconferencing). *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 3.4(c) (prohibiting lawyers from violating court rules and making no exception to the rule for virtual proceedings). Likewise, lying or stealing is no more appropriate online than it is face-to-face. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.15; MODEL RULES OF PROF'L CONDUCT R. 8.4(b)-(c).

[5] MODEL RULES OF PROF'L CONDUCT R. 1.4(a)(2) – (4).

[6] Lawyers unexpectedly thrust into practicing virtually must have a business continuation plan to keep clients apprised of their matters and to keep moving those matters forward competently and diligently. ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 482 (2018) (discussing ethical obligations related to disasters). Though virtual practice is common, if for any reason a lawyer cannot fulfill the lawyer's duties of competence, diligence, and other ethical duties to a client, the lawyer must withdraw from the matter. MODEL RULES OF PROF'L CONDUCT R. 1.16. During and following the termination or withdrawal process, the "lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred." MODEL RULES OF PROF'L CONDUCT R. 1.16(d).

[7] MODEL RULES OF PROF'L CONDUCT R. 1.6(c).

exhaustive list of factors may guide the lawyer's determination of reasonable efforts to safeguard confidential information: "the sensitivity of the information, the likelihood of disclosure if additional safeguards are not employed, the cost of employing additional safeguards, the difficulty of implementing the safeguards, and the extent to which the safeguards adversely affect the lawyer's ability to represent clients (e.g., by making a device or important piece of software excessively difficult to use)."[8] As ABA Formal Op. 477R notes, lawyers must employ a "fact-based analysis" to these "nonexclusive factors to guide lawyers in making a 'reasonable efforts' determination."

Similarly, lawyers must take reasonable precautions when transmitting communications that contain information related to a client's representation.[9] At all times, but especially when practicing virtually, lawyers must fully consider and implement reasonable measures to safeguard confidential information and take reasonable precautions when transmitting such information. This responsibility "does not require that the lawyer use special security measures if the method of communication affords a reasonable expectation of privacy."[10] However, depending on the circumstances, lawyers may need to take special precautions.[11] Factors to consider to assist the lawyer in determining the reasonableness of the "expectation of confidentiality include the sensitivity of the information and the extent to which the privacy of the communication is protected by law or by a confidentiality agreement."[12] As ABA Formal Op. 477R summarizes, "[a] lawyer generally may transmit information relating to the representation of a client over the Internet without violating the Model Rules of Professional Conduct where the lawyer has undertaken reasonable efforts to prevent inadvertent or unauthorized access."

3. Supervision

Lawyers with managerial authority have ethical obligations to establish policies and procedures to ensure compliance with the ethics rules, and supervisory lawyers have a duty to make reasonable efforts to ensure that subordinate lawyers and nonlawyer assistants comply with the applicable Rules of Professional Conduct.[13] Practicing virtually does not change or diminish this obligation. "A lawyer must give such assistants appropriate instruction and supervision concerning the ethical aspects of their employment, particularly regarding the obligation not to disclose information relating to representation of the client, and should be responsible for their work product."[14] Moreover, a lawyer must "act competently to safeguard information relating to the representation of a client against unauthorized access by third parties and against inadvertent

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[8] MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt. [18].
[9] MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt. [19].
[10] *Id.*
[11] The opinion cautions, however, that "a lawyer may be required to take special security precautions to protect against the inadvertent or unauthorized disclosure of client information when required by an agreement with the client or by law, or when the nature of the information requires a higher degree of security." ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 477R (2017).
[12] MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt. [19].
[13] MODEL RULES OF PROF'L CONDUCT R. 5.1 & 5.3. *See, e.g.*, ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 467 (2014) (discussing managerial and supervisory obligations in the context of prosecutorial offices). *See also* ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 483 n.6 (2018) (describing the organizational structures of firms as pertaining to supervision).
[14] MODEL RULES OF PROF'L CONDUCT R. 5.3 cmt. [2].

or unauthorized disclosure by the lawyer *or other persons who are participating in the representation of the client or who are subject to the lawyer's supervision*."[15] The duty to supervise nonlawyers extends to those both within and outside of the law firm.[16]

B. Particular Virtual Practice Technologies and Considerations

Guided by the rules highlighted above, lawyers practicing virtually need to assess whether their technology, other assistance, and work environment are consistent with their ethical obligations. In light of current technological options, certain available protections and considerations apply to a wide array of devices and services. As ABA Formal Op. 477R noted, a "lawyer has a variety of options to safeguard communications including, for example, using secure internet access methods to communicate, access and store client information (such as through secure Wi-Fi, the use of a Virtual Private Network, or another secure internet portal), using unique complex passwords, changed periodically, implementing firewalls and anti-Malware/Anti-Spyware/Antivirus software on all devices upon which client confidential information is transmitted or stored, and applying all necessary security patches and updates to operational and communications software." Furthermore, "[o]ther available tools include encryption of data that is physically stored on a device and multi-factor authentication to access firm systems." To apply and expand on these protections and considerations, we address some common virtual practice issues below.

1. Hard/Software Systems

Lawyers should ensure that they have carefully reviewed the terms of service applicable to their hardware devices and software systems to assess whether confidentiality is protected.[17] To protect confidential information from unauthorized access, lawyers should be diligent in installing any security-related updates and using strong passwords, antivirus software, and encryption. When connecting over Wi-Fi, lawyers should ensure that the routers are secure and should consider using virtual private networks (VPNs). Finally, as technology inevitably evolves, lawyers should periodically assess whether their existing systems are adequate to protect confidential information.

[15] MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt. [18] (emphasis added).

[16] As noted in Comment [3] to Model Rule 5.3:

> When using such services outside the firm, a lawyer must make reasonable efforts to ensure that the services are provided in a manner that is compatible with the lawyer's professional obligations. The extent of this obligation will depend upon the circumstances, including the education, experience and reputation of the nonlawyer; the nature of the services involved; the terms of any arrangements concerning the protection of client information; and the legal and ethical environments of the jurisdictions in which the services will be performed, particularly with regard to confidentiality. See also Rules 1.1 (competence), 1.2 (allocation of authority), 1.4 (communication with client), 1.6 (confidentiality), 5.4(a) (professional independence of the lawyer), and 5.5(a) (unauthorized practice of law).

[17] For example, terms and conditions of service may include provisions for data-soaking software systems that collect, track, and use information. Such systems might purport to own the information, reserve the right to sell or transfer the information to third parties, or otherwise use the information contrary to lawyers' duty of confidentiality.

2. Accessing Client Files and Data

Lawyers practicing virtually (even on short notice) must have reliable access to client contact information and client records. If the access to such "files is provided through a cloud service, the lawyer should (i) choose a reputable company, and (ii) take reasonable steps to ensure that the confidentiality of client information is preserved, and that the information is readily accessible to the lawyer."[18] Lawyers must ensure that data is regularly backed up and that secure access to the backup data is readily available in the event of a data loss. In anticipation of data being lost or hacked, lawyers should have a data breach policy and a plan to communicate losses or breaches to the impacted clients.[19]

3. Virtual meeting platforms and videoconferencing

Lawyers should review the terms of service (and any updates to those terms) to ensure that using the virtual meeting or videoconferencing platform is consistent with the lawyer's ethical obligations. Access to accounts and meetings should be only through strong passwords, and the lawyer should explore whether the platform offers higher tiers of security for businesses/enterprises (over the free or consumer platform variants). Likewise, any recordings or transcripts should be secured. If the platform will be recording conversations with the client, it is inadvisable to do so without client consent, but lawyers should consult the professional conduct rules, ethics opinions, and laws of the applicable jurisdiction.[20] Lastly, any client-related meetings or information should not be overheard or seen by others in the household, office, or other remote location, or by other third parties who are not assisting with the representation,[21] to avoid jeopardizing the attorney-client privilege and violating the ethical duty of confidentiality.

4. Virtual Document and Data Exchange Platforms

In addition to the protocols noted above (e.g., reviewing the terms of service and any updates to those terms), lawyers' virtual document and data exchange platforms should ensure that

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[18] ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 482 (2018).

[19] *See, e.g.*, ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 483 (2018) ("Even lawyers who, (i) under Model Rule 1.6(c), make 'reasonable efforts to prevent the . . . unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client,' (ii) under Model Rule 1.1, stay abreast of changes in technology, and (iii) under Model Rules 5.1 and 5.3, properly supervise other lawyers and third-party electronic-information storage vendors, may suffer a data breach. When they do, they have a duty to notify clients of the data breach under Model Rule 1.4 in sufficient detail to keep clients 'reasonably informed' and with an explanation 'to the extent necessary to permit the client to make informed decisions regarding the representation.'").

[20] *See, e.g.*, ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 01-422 (2001).

[21] Pennsylvania recently highlighted the following best practices for videoconferencing security:

- Do not make meetings public;
- Require a meeting password or use other features that control the admittance of guests;
- Do not share a link to a teleconference on an unrestricted publicly available social media post;
- Provide the meeting link directly to specific people;
- Manage screensharing options. For example, many of these services allow the host to change screensharing to "Host Only;"
- Ensure users are using the updated version of remote access/meeting applications.

Pennsylvania Bar Ass'n Comm. on Legal Ethics & Prof'l Responsibility, Formal Op. 2020-300 (2020) (citing an FBI press release warning of teleconference and online classroom hacking).

documents and data are being appropriately archived for later retrieval and that the service or platform is and remains secure. For example, if the lawyer is transmitting information over email, the lawyer should consider whether the information is and needs to be encrypted (both in transit and in storage).[22]

5. Smart Speakers, Virtual Assistants, and Other Listening-Enabled Devices

Unless the technology is assisting the lawyer's law practice, the lawyer should disable the listening capability of devices or services such as smart speakers, virtual assistants, and other listening-enabled devices while communicating about client matters. Otherwise, the lawyer is exposing the client's and other sensitive information to unnecessary and unauthorized third parties and increasing the risk of hacking.

6. Supervision

The virtually practicing managerial lawyer must adopt and tailor policies and practices to ensure that all members of the firm and any internal or external assistants operate in accordance with the lawyer's ethical obligations of supervision.[23] Comment [2] to Model Rule 5.1 notes that "[s]uch policies and procedures include those designed to detect and resolve conflicts of interest, identify dates by which actions must be taken in pending matters, account for client funds and property and ensure that inexperienced lawyers are properly supervised."

a. Subordinates/Assistants

The lawyer must ensure that law firm tasks are being completed in a timely, competent, and secure manner.[24] This duty requires regular interaction and communication with, for example,

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[22] *See, e.g.*, ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 477R (2017) (noting that "it is not always reasonable to rely on the use of unencrypted email").

[23] As ABA Formal Op. 477R noted:

> In the context of electronic communications, lawyers must establish policies and procedures, and periodically train employees, subordinates and others assisting in the delivery of legal services, in the use of reasonably secure methods of electronic communications with clients. Lawyers also must instruct and supervise on reasonable measures for access to and storage of those communications. Once processes are established, supervising lawyers must follow up to ensure these policies are being implemented and partners and lawyers with comparable managerial authority must periodically reassess and update these policies. This is no different than the other obligations for supervision of office practices and procedures to protect client information.

[24] The New York County Lawyers Association Ethics Committee recently described some aspects to include in the firm's practices and policies:

- Monitoring appropriate use of firm networks for work purposes.
- Tightening off-site work procedures to ensure that the increase in worksites does not similarly increase the entry points for a data breach.
- Monitoring adherence to firm cybersecurity procedures (e.g., not processing or transmitting work across insecure networks, and appropriate storage of client data and work product).
- Ensuring that working at home has not significantly increased the likelihood of an inadvertent disclosure through misdirection of a transmission, possibly because the lawyer or nonlawyer was distracted by a child, spouse, parent or someone working on repair or maintenance of the home.

associates, legal assistants, and paralegals. Routine communication and other interaction are also advisable to discern the health and wellness of the lawyer's team members.[25]

One particularly important subject to supervise is the firm's bring-your-own-device (BYOD) policy. If lawyers or nonlawyer assistants will be using their own devices to access, transmit, or store client-related information, the policy must ensure that security is tight (e.g., strong passwords to the device and to any routers, access through VPN, updates installed, training on phishing attempts), that any lost or stolen device may be remotely wiped, that client-related information cannot be accessed by, for example, staff members' family or others, and that client-related information will be adequately and safely archived and available for later retrieval.[26]

Similarly, all client-related information, such as files or documents, must not be visible to others by, for example, implementing a "clean desk" (and "clean screen") policy to secure documents and data when not in use. As noted above in the discussion of videoconferencing, client-related information also should not be visible or audible to others when the lawyer or nonlawyer is on a videoconference or call. In sum, all law firm employees and lawyers who have access to client information must receive appropriate oversight and training on the ethical obligations to maintain the confidentiality of such information, including when working virtually.

b. Vendors and Other Assistance

Lawyers will understandably want and may need to rely on information technology professionals, outside support staff (e.g., administrative assistants, paralegals, investigators), and vendors. The lawyer must ensure that all of these individuals or services comply with the lawyer's obligation of confidentiality and other ethical duties. When appropriate, lawyers should consider use of a confidentiality agreement,[27] and should ensure that all client-related information is secure, indexed, and readily retrievable.

7. Possible Limitations of Virtual Practice

Virtual practice and technology have limits. For example, lawyers practicing virtually must make sure that trust accounting rules, which vary significantly across states, are followed.[28] The

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- Ensuring that sufficiently frequent "live" remote sessions occur between supervising attorneys and supervised attorneys to achieve effective supervision as described in [New York Rule of Professional Conduct] 5.1(c).

N.Y. County Lawyers Ass'n Comm. on Prof'l Ethics, Formal Op. 754-2020 (2020).

[25] *See* ABA MODEL REGULATORY OBJECTIVES FOR THE PROVISION OF LEGAL SERVICES para. I (2016).

[26] For example, a lawyer has an obligation to return the client's file when the client requests or when the representation ends. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.16(d). This important obligation cannot be fully discharged if important documents and data are located in staff members' personal computers or houses and are not indexed or readily retrievable by the lawyer.

[27] *See, e.g.*, Mo. Bar Informal Advisory Op. 20070008 & 20050068.

[28] *See* MODEL RULES OF PROF'L CONDUCT R. 1.15; *See, e.g.*, ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 482 (2018) ("Lawyers also must take reasonable steps in the event of a disaster to ensure access to funds the lawyer is holding in trust. A lawyer's obligations with respect to these funds will vary depending on the circumstances. Even before a disaster, all lawyers should consider (i) providing for another trusted signatory on trust

lawyer must still be able, to the extent the circumstances require, to write and deposit checks, make electronic transfers, and maintain full trust-accounting records while practicing virtually. Likewise, even in otherwise virtual practices, lawyers still need to make and maintain a plan to process the paper mail, to docket correspondence and communications, and to direct or redirect clients, prospective clients, or other important individuals who might attempt to contact the lawyer at the lawyer's current or previous brick-and-mortar office. If a lawyer will not be available at a physical office address, there should be signage (and/or online instructions) that the lawyer is available by appointment only and/or that the posted address is for mail deliveries only. Finally, although e-filing systems have lessened this concern, litigators must still be able to file and receive pleadings and other court documents.

III. Conclusion

The ABA Model Rules of Professional Conduct permit lawyers to conduct practice virtually, but those doing so must fully consider and comply with their applicable ethical responsibilities, including technological competence, diligence, communication, confidentiality, and supervision.

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accounts in the event of the lawyer's unexpected death, incapacity, or prolonged unavailability and (ii) depending on the circumstances and jurisdiction, designating a successor lawyer to wind up the lawyer's practice.").

ETHICS

RECENT DEVELOPMENTS IN LOUISIANA SUCCESSIONS, DONATIONS, AND TRUSTS

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2021

REC. DEVELOPMENTS IN SUCCESSION & DONATIONS

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At LSU, Professor Carter coaches LSU's Stutes-Kalinka Tax Moot Court Team, She also serves as the faculty advisor to the LSU Tax Club and the LSU Women Law Students Association.

Professor Carter earned a B.S. in Biology and a B.A. in Spanish from the University of Memphis, magna cum laude. She earned her J.D. from Tulane University Law School, magna cum laude. She was elected Order of the Coif, and was awarded a Civil Law Certificate. While at Tulane, Professor Carter served as an articles editor of the Tulane Law Review, Volume 81, worked as a research assistant to Professor A.N. Yiannopoulos, and was a founding member of the Tulane Civil Law Society. Professor Carter was awarded the 2006 Dean Rufus C. Harris Award for the Best Writing on a Civil Law Subject by the Tulane Law Review. Upon graduation, Professor Carter was awarded the 2007 Louisiana Bar Association Civil Law Award for attaining the highest grade in civil law studies. Professor Carter earned her LL.M. in Tax from the University of Alabama in 2010.

Before joining the LSU faculty, Professor Carter worked at the New Orleans law firm of Lugenbuhl, Wheaton, Peck, Rankin & Hubbard where she practiced in the areas of trusts, estates, successions, probate, business and commercial law, secured transactions, bankruptcy, and marine finance. Professor Carter is active in law reform in Louisiana and serves on several committees for the Louisiana State Law Institute, including the committees on Security Devices and Successions/Donations.

These and other CLE materials and scholarly works are available at: http://ssrn.com/author=1773379.

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I. <u>SUCCESSIONS & DONATIONS LEGISLATION</u>

A. <u>SMALL SUCCESSIONS</u>

ACT No. 44 (2021 Regular Session)

AN ACT

To amend and reenact R.S. 6:767(F) and 768(D) and (E) and Code of Civil Procedure Art. 3434, and to enact R.S. 6:325(E), 767(G), and 768(F), relative to banks, mutual associations, and savings banks; to provide relative to an affidavit for small successions; to provide for access and transfer of the contents of a safety deposit box by a bank, mutual association, or savings bank to a succession representative, heir, or legatee; to provide for access and transfer of money and property by a bank, mutual association, or savings bank to a succession representative, heir, or legatee; to provide liability protection for certain entities; to provide certain terms, conditions, and procedures; and to provide for related matters.

Be it enacted by the Legislature of Louisiana:

Section 1. R.S. 6:767(F) and 768(D) and (E) are hereby amended and reenacted, and R.S. 6:325(E), 767(G), and 768(F) are hereby enacted to read as follows:

§325. Death of a customer and access and transfer of contents of safety deposit boxes, money, and other property by bank to succession representatives, legatees, or heirs; authority.

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<u>**E. A small succession affidavit authorized by Title V of Book IV of the Louisiana Code of Civil Procedure shall constitute full and sufficient authority for the payment or delivery of any money or property, including property held in a safety deposit box, of the deceased customer described in the affidavit to the heirs or legatees of the deceased customer and the surviving spouse in community, if any, in the percentages listed therein, by the bank having such money or property in its possession or under its control. The transfer of the money or delivery of property identified in the affidavit to the persons named in the affidavit constitutes a full release and discharge for the payment of money or delivery of property and any creditor, heir, legatee, succession representative, or other person whatsoever shall have no right or cause of action against the bank paying the money or delivering the property pursuant to the provisions of this Subsection on account of the payment, delivery, or transfer.**</u>

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§767. Death of member or depositor and access and transfer of money and property by association to succession representatives, legatees, or heirs; authority

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F. **A small succession affidavit authorized by Title V of Book IV of the Louisiana Code of Civil Procedure shall constitute full and sufficient authority for the payment or delivery of any money or property, including property held in a safety deposit box, of the deceased customer described in the affidavit to the heirs or legatees of the deceased customer and the surviving spouse in community, if any, in the percentages listed therein, by the association having such money or property in its possession or under its control. The transfer of the money or delivery of property identified in the affidavit to the persons named in the affidavit constitutes a full release and discharge for the payment of money or delivery of property and any creditor, heir, legatee, succession representative, or other person whatsoever shall have no right or cause of action against the association paying the money or delivering the property pursuant to the provisions of this Subsection on account of the payment, delivery, or transfer.**

G. Any association may pay to the surviving spouse the value of any savings or demand account or shares standing in the name of the decedent in such association without authorization by any court proceeding, order, or judgment, whether the savings account or shares belong to the separate estate of the decedent or to the community property regime which existed between the decedent and the surviving spouse, subject to the provisions of R.S. 9:1513.

§768. Transfer of contents of safety deposit boxes by an association to succession representatives, legatees, heirs, minors, or interdicts; authority

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D. **A small succession affidavit authorized by Title V of Book IV of the Louisiana Code of Civil Procedure shall constitute full and sufficient authority for the payment or delivery of any money or property, including property held in a safety deposit box, of the deceased customer described in the affidavit to the heirs or legatees of the deceased customer and the surviving spouse in community, if any, in the percentages listed therein, by the association having such money or property in its possession or under its control. The transfer of the money or delivery of property identified in the affidavit to the persons named in the affidavit constitutes a full release and discharge for the payment of money or delivery of property and any creditor, heir, legatee, succession representative, or other person whatsoever shall have no right or cause of action against the association paying the money or delivering the property pursuant to the provisions of this Subsection on account of the payment, delivery, or transfer.**

E. Upon proper authority, an association may transfer the contents of a safety deposit box belonging to an interdict or a minor to the legal representative of such interdict or minor. The letters issued to the legal representative by a court of competent jurisdiction shall constitute proper authority for making the transfer, which when so made and receipted for, shall be full protection to the association.

~~E.~~**F.** Conclusive proof to the association of the letters testamentary, letters of administration, or letters of independent administration of the succession representative, or of the judgment of possession, and of the jurisdiction of the court rendering them, shall be as provided in R.S. 6:325(D).

Section 2. Code of Civil Procedure Art. 3434 is hereby amended and reenacted to read as follows:

Art. 3434. Endorsed copy of affidavit authority for delivery of property

A. A multiple original of the affidavit authorized by Article 3432 **or 3432.1,** shall be full and sufficient authority for the payment or delivery of any money or property of the deceased described in the affidavit to the heirs **or legatees** of the deceased and the surviving spouse in community, if any, in the percentages listed therein, by any ~~bank,~~ **federally insured depository institution,** financial institution, trust company, warehouseman, or other depositary, or by any person having such property in his possession or under his control. Similarly, a multiple original of an affidavit satisfying the requirements of this Article shall be full and sufficient authority for the transfer to the heirs **or legatees** of the deceased, and surviving spouse in community, if any, or to their assigns, of any stock or registered bonds in the name of the deceased and described in the affidavit, by any domestic or foreign corporation.

B. The receipt of the persons named in the affidavit as heirs **or legatees** of the deceased, or surviving spouse in community thereof, constitutes a full release and discharge for the payment of money or delivery of property made under the provisions of this Article. Any creditor, heir, **legatee,** succession representative, or other person whatsoever shall have no right or cause of action against the person paying the money, or delivering the property, or transferring the stock or bonds, under the provisions of this Article, on account of such payment, delivery, or transfer.

C.(1) A multiple original of the affidavit, to which has been attached a certified copy of the deceased's death certificate, shall be recorded in the conveyance records in the office of the clerk of court in the parish where any immovable property described therein is situated, after at least ninety days have elapsed from the date of the deceased's death.

(2) An affidavit so recorded, or a certified copy thereof, shall be admissible as evidence in any action involving immovable property to which it relates or is

affected by the instrument, and shall be prima facie evidence of the facts stated therein, including the relationship to the deceased of the parties recognized as heir, **legatee,** surviving spouse in community, or usufructuary as the case may be, and of their rights in the immovable property of the deceased.

(3) An action by a person, who claims to be a successor of a deceased person, but who has not been recognized as such in an affidavit authorized by Article 3432 **or 3432.1**, to assert an interest in property formerly owned by the deceased, against a third person who has acquired an interest in the property, or against his successors by onerous title, is prescribed two years from the date of the recording of the affidavit in accordance with this Paragraph.

Section 3. This Act shall become effective upon signature by the governor or, if not signed by the governor, upon expiration of the time for bills to become law without signature by the governor, as provided by Article III, Section 18 of the Constitution of Louisiana. If vetoed by the governor and subsequently approved by the legislature, this Act shall become effective on the day following such approval.

B. TOD ACCOUNTS

ACT No. 167 (2021 Regular Session)

AN ACT

To enact Chapter 4 of Code Title I of Code Book III of Title 9 of the Louisiana Revised Statutes of 1950, to be comprised of R.S. 9:1711 through 1711.9, relative to securities and successions; to provide for uniform transfer on death of certain securities; to enact the Louisiana Uniform Transfer on Death Security Registration Act; to provide certain definitions, terms, procedures, conditions, requirements, exceptions, effects, and applicability; and to provide for related matters.

Be it enacted by the Legislature of Louisiana:

Section 1. Chapter 4 of Code Title I of Code Book III of Title 9 of the Louisiana Revised Statutes of 1950, comprised of R.S. 9:1711 through 1711.9, is hereby enacted to read as follows:

CHAPTER 4. LOUISIANA UNIFORM TRANSFER ON DEATH SECURITY REGISTRATION ACT

§1711. Definitions

In this Chapter, the following definitions shall apply unless the context otherwise requires:

(1) "Beneficiary form" means a registration of a security that indicates the present owner or co-owners of the security and the designation of the person in whose name the security is to be registered upon the death of the owner or co-owner.

(2) "Good faith" has the same meaning as provided in R.S. 10:1-201.

(3) "Registering entity" means a person who originates or transfers a security title by registration, and includes a broker maintaining security accounts for customers and a transfer agent or other person acting for or as an issuer of securities.

(4) "Security" means a share, participation, or other interest in movable property, in a business, or in an obligation of an enterprise or other issuer, and includes a certificated security, an uncertificated security, and a security account. It shall not include a share, participation, or other interest in immovable property.

(5) "Security account" means (a) a reinvestment account associated with a security, a securities account with a broker, a cash balance in a brokerage account, cash, interest, earnings, or dividends earned or declared on a security in an account, a reinvestment account, or a brokerage account, whether or not credited to the account before the owner's death, or (b) a cash balance or other property held for or due to the owner of a security as a replacement for or product of an account security, whether or not credited to the account before the owner's death.

(6) "State" includes any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession subject to the legislative authority of the United States.

§1711.1. Registration in beneficiary form

Only individuals whose registration of a security shows sole ownership by one individual or multiple ownership by two or more with right of survivorship, rather than as co-owners in indivision or tenants in common, may obtain registration in beneficiary form.

§1711.2. Registration in beneficiary form; applicable law

A. A security may be registered in beneficiary form if the form is authorized by this or a similar statute of the state of organization of the issuer or registering entity, the location of the registering entity's principal office, the office of its transfer agent or its office making the registration, or by this or a similar statute of the law of the state listed as the owner's address at the time of registration. A registration governed by the law of a jurisdiction in which this or similar legislation is not in force or was not in force when a registration

in beneficiary form was made is nevertheless presumed to be valid and authorized as a matter of contract law.

B. The registration in beneficiary form shall be executed by the owner in authentic form or an act under private signature executed in the presence of two persons.

§1711.3. Form of registration in beneficiary form

Registration in beneficiary form may be shown by the words "transfer on death" or the abbreviation "TOD", or by the words "pay on death" or the abbreviation "POD", after the name of the registered owner and before the name of a beneficiary, or when registration is in the names of multiple owners by the words "joint tenants with the right of survivorship" or the abbreviation "JTWROS".

§1711.4. Effect of registration in beneficiary form

A registration of a security in beneficiary form does not constitute a donation inter vivos or mortis causa. A registration of a security in beneficiary form may be canceled or changed at any time by the sole owner or by any of the surviving owners without the consent of the beneficiary.

§1711.5. Registration on death of owner

A. On proof of death of a sole owner or the last to die of all multiple owners, and after compliance with any applicable requirements of the registering entity, a security registered in beneficiary form may be registered in the name of the beneficiary or beneficiaries who survived the death of all owners, in compliance with this Chapter, but this registration in the name of the beneficiary or beneficiaries has no effect on ownership.

B. The provisions of this Chapter shall apply notwithstanding the fact that the decedent designates a beneficiary by last will and testament.

§1711.6. Registering entity

A. A registering entity is not required to offer or to accept a request for security registration in beneficiary form. If a registration in beneficiary form is offered by a registering entity, the owner requesting registration in beneficiary form assents to the protections given to the registering entity by this Chapter.

B. By accepting a request for registration of a security in beneficiary form, the registering entity agrees that the registration shall be implemented on death of the deceased owner as provided in this Chapter.

C. A registering entity shall not be held liable and is discharged from all claims to a security by the estate, surviving spouse, creditors, heirs, legatees, or forced heirs of a deceased owner if it registers a transfer of the security in accordance with this Chapter and does so in good faith reliance (a) on the registration in beneficiary form, (b) on this Chapter, and (c) on information provided to it by affidavit of the succession representative of the deceased owner, or by the surviving beneficiary or by the surviving beneficiary's representatives. The protections of this Chapter do not extend to a registration or payment made after a registering entity has received written notice from any claimant to any interest in the security objecting to implementation of a registration in beneficiary form. No other notice or information available to the registering entity affects its right to protection under this Chapter.

D. The protection provided by this Chapter to the registering entity of a security does not affect the rights of succession representatives, surviving spouses, heirs, legatees, forced heirs, or creditors in disputes between themselves and other claimants to ownership of the security transferred or its value or proceeds.

§1711.7. Terms, conditions, and forms for registration

A. A registering entity offering to accept registrations in beneficiary form may establish the terms and conditions under which it will receive requests (a) for registrations in beneficiary form, and (b) for implementation of registrations in beneficiary form, including requests for cancellation of previously registered beneficiary designations and requests for reregistration to effect a change of beneficiary.

B. The terms and conditions so established may provide for proving death, avoiding or resolving any problems concerning fractional shares, designating primary and contingent beneficiaries, and substituting a named beneficiary's descendants to take in the place of the named beneficiary in the event of the beneficiary's death.

C. Substitution may be indicated by appending to the name of the primary beneficiary the letters "LDPS", standing for "lineal descendants per stirpes" or "LDR" for "lineal descendants by representation". This designation substitutes a deceased beneficiary's descendants who survive the owner for a beneficiary who is deceased, the descendants to be identified and to share in accordance with the law of the owner's domicile at the owner's death governing inheritance by descendants of an intestate succession.

D. Other forms of identifying beneficiaries who are to take on one or more contingencies, and rules for providing proofs and assurances needed to satisfy reasonable concerns by registering entities regarding conditions and

<u>identities relevant to accurate implementation of registrations in beneficiary form, may be contained in a registering entity's terms and conditions.</u>

<u>§1711.8. Short title; rules of construction</u>

<u>A. This Chapter shall be known as and may be cited as the "Louisiana Uniform Transfer on Death Security Registration Act" or the "Louisiana Uniform TOD Security Registration Act".</u>

<u>B. The provisions of this Chapter shall be liberally construed.</u>

<u>C. Unless displaced by the particular provisions of this Chapter, the principles of Louisiana law supplement provisions of this Chapter.</u>

<u>§1711.9. Application of Chapter</u>

<u>A. This Chapter shall become effective on January 1, 2022, and shall apply only to registrations of securities in beneficiary form made on and after January 1, 2022.</u>

<u>B. This Chapter shall not preclude or govern the application of payable on death accounts and other transfers by a bank or savings institution as authorized by Title 6 of the Louisiana Revised Statutes of 1950.</u>

Section 2. The Louisiana State Law Institute is hereby directed to prepare Official Comments to the provisions of this Act, and to revise those Official Comments in the future as may be necessary.

Section 3. The provisions of this Act shall become effective on January 1, 2022.

II. Successions and Donations: Jurisprudence

A. Testaments: Capacity, Form, and Related Matters

1. Succession of Liner, 320 So. 3d 1133 (La. 2021)

- **Gist:** This opinion came before the Louisiana Supreme Court on rehearing and the court reversed its earlier decision and signaled a significant change in its view of formal defects in wills.

- **Background:** Mr. Liner's notarial will contained an attestation clause that did not precisely track the language in the Civil Code. Rather than the prescribed language of the Civil Code, his will included the following:

    - The foregoing instrument, consisting of eight (8) pages, and read aloud in the present of the Testator and of each other, such reading having been followed on copies of the Will by Notary and witnesses, and the Testator declared that he heard the reading of the Will by the Notary, and the Will was signed and declared by JAMES CONWAY LINER, III, Testator and above named, in our presence to be his Last Will and Testament, and in the presence of the Testator and each other we have hereunto subscribed our names on this 3rd day of June, 2015.

- **Issue:** When the LASC first considered the case it determined that the failure of the attestation clause to indicate that the testator signed on every page and at the end rendered the will invalid. On rehearing, the court took a different view.

- **Holding:** LASC held the will valid. In doing so, the court clearly endorsed a more liberal view of will defects, particularly with respect to attestation clauses. The opinion, however, was not unanimous. It will be interesting to see how this issue develops in the future.

2. Succession of Bradley, 309 So. 3d 397 (La. App. 5 Cir. 2020)

- **Background:** D died in 2019 at age 87 survived by his wife of almost 28 years and 5 children from a previous marriage. D's son filed a will the day after D's death that was dated a few days before D's death. The surviving spouse, W, filed a petition to annul the will on the basis that D lacked capacity when it was executed and that D was subject to the undue influence of his children. She apparently also challenged the will as to form. W sought to probate an earlier will.

- After a trial on the merits, the trial court upheld the 2019 will as valid. W stipulated to capacity at trial.

- D was sick in the last years of his life. W was his primary caretaker and enjoyed a good relationship with D's children for most of their marriage. In the last years of D's life, W asked the kids for more help and their relationship deteriorated. At some point the kids informed W that D wanted a divorce. W also alleged the kids kept her from seeing her husband alone, threatened to report her for elder abuse.

- Kids hired attorneys to draw up a new will and institute divorce filings on D's behalf.

- **Holding: <u>Affirmed.</u>**

  - **Form of the Will.** The will appeared to be in proper form on its face. W argued that the witnesses did not see each other sign the will. Indeed, their testimony was equivocal and contradictory. But, the testimony of the attorney/notary was clear that all formalities were followed. The testimony of the witnesses was, therefore, insufficient to rebut the presumption of validity.

  - **Undue Influence.** The burden of proof in UI cases in in La. Civ. Code art. 1483. The alleged influencers were relatives of D (his children). Thus, clear and convincing evidence was required regardless of whether they were in a confidential relationship with D.

    - W's testimony mainly pointed the fact that the children isolated D from her around the time of the will and that the will was inconsistent with her understanding of their relationship. But, the testimony of the attorney, D's doctor, and others was that D was not under any influence or impaired mental state. W failed to meet her burden.

3. Succession of Coon, 318 So. 3d 947 (La. App. 1 Cir. 2020)

- **Background**: D died in 2019. His daughter, Pamela, sought appointment as administrator claiming he was intestate. Kathleen, D's wife, sought to probate a copy of D's 2018 will on the basis that the original was destroyed in a fire. After a hearing, the trial court probated the copy and appointed Kathleen as executor.

- **Holding: <u>Affirmed</u>**. "When a will cannot be found at the testator's death, there arises a presumption that the testator has destroyed the will with the intent of revoking it." But, that presumption can be overcome by "clear proof" of the following: "(1) that the testator made a valid will; (2) of the contents or substantiality of the will; and (3) that the will was not revoked by the testator."

- Kathleen met the requisite standard. The copy of the will established the first two elements. Kathleen's testimony was that the will was in their house when the house burned to the ground. Pamela's testimony did not really refute Kathleen's and Kathleen was more credible in the view of the trial court.

4. Succession of Enos, 310 So. 3d 236 (La. App. 3 Cir. 2020)

- **Background**: D died survived by her husband of 29 years and adult children. One son, Mark, opened her succession claiming she was intestate and was put into possession of D's entire estate. Mark then notified D's husband, John, that he had to vacate the home he had lived in with D for many years. John then located a purported olographic wills and sought to reopen the succession and probate the wills. The trial court denied his petition finding that the purported wills were invalid. John appealed.

- **Holding: <u>Reversed and remanded</u>.** The documents presented by John were dated and entirely handwritten by D. On the first page she demonstrated testamentary intent and clearly made dispositions in favor of John. Her signature appeared at the top of the second page and was followed by some language identifying her property more specifically. Mark argued the will lacked a signature. On appeal, the court disagreed: "The fact that Linda's placement of her signature at the top of the second page immediately following the bequests rather than squeezed into the remaining space of the first page does not amount to a lack of formality that would invalidate her will.

- The second document, however, was invalid as a will because it lacked testamentary intent and was not signed.

5. Succession of Landry, 315 So. 3d 949 (La. App. 4 Cir 2021)

- **Background:** D executed a 2016 will leaving all his property to his daughter, Vanessa, and named her as executor. In 2017, D executed another will that left Vanessa the funds in his bank account, left the remainder of his estate to his nephew, Sandy, and named Sandy as executor. A dispute over which will control ensured. The trial court determined that the 2016 will was valid, the 2017 will was not due to lack of capacity. Sandy appealed.

- **Issue:** Did Mr. Landry have capacity to execute the 2017 will?

- **Holding: <u>Remanded with instructions</u>**. Vanessa bore the burden of proving by clear and convincing evidence that D lacked capacity when he executed the 2017 will. D's medical records were apparently important to the case and were admitted at the hearing. However, they were not included in the record on appeal. For the court to properly consider the appeal, it must have D's medical records. Thus, the court remanded for purposes of correcting the record.

6. Succession of Westerchil, 309 So. 3d 790 (La. App. 3 Cir. 2020)

- **Background:** Chuck (the decedent) and Kim married in 1997. The had a separate property agreement that provided that "to the extent the parties may acquire property jointly, said property shall be considered community property insofar as it is an advantage of the taxpayer for the purposes of computation of taxes due…" Chuck and Kim both had children from previous relationships.

    - In 1998, Kim donated a ½ interest in immovable property to Chuck.

    - Chuck was diagnosed with dementia in 2012. Kim closed her business and started working with Chuck and Chuck's daughter at Chuck's business. In 2013, Chuck signed a power of attorney in Kim's favor. In 2014, Chuck signed a will that made particular legacies to Kim and left the remainder of his estate to an irrevocable trust.

    - The trust was established by Kim and Chuck that same date. Kim was first trustee. Kim and Chuck were lifetime beneficiaries of income. Their kids had various successor interests.

    - Chuck died in 2016 and some of his children sought to annul the will and trust on the basis of lack of capacity, undue influence, and defects in form.

    - The trial court upheld the will, Chuck's children appealed.

- **Holding: Affirmed**.

    - **Form:** The only alleged defect in form was that the otherwise typewritten will had the dates filled in by hand by the notary. Obviously, this argument was without merit and did not succeed. A notarial testament must be dated. But it does not need to be dated in the handwriting of the testator.

    - **Mental Capacity:** The fact that D had an Alzheimer's diagnosis does not mean that he lacked capacity. Mr. Cook--the attorney who prepared the will--testified. He has been in practice for 38 years, has prepared hundreds of wills and many trusts. He met with Chuck several times in connection with his will. D's daughter was present at one meeting and testified that she did not think her father paid attention, read the documents, or really knew what was going on.

- Mr. Cook also testified that he knew of the dementia diagnoses, but that Chuck appeared fine when he signed the will. He did not inquire into Chuck's medical condition any further.

- Chuck's doctors testified as well. Chuck did pretty well early on. Sometime in 2014 his condition started to decline. The doctors could not say whether Chuck had capacity on the day he signed the will. One doctor explained that "Alzheimer's patients have good days and bad days and without having actually seen him that day, he does not know whether [the date of the will] was a good day or a bad day."

- Additional testimony told a similar story. Chuck's capacity had declined by 2014, but he probably did not categorically lack capacity. Thus, the court on appeal will defer to the findings of the trial court.

- **My observation:** It seems as though Chuck's capacity was probably borderline when he executed the will. MRPC 1.14 (and the ACTEC commentaries thereto) provides guidance for clients with diminished capacity. Ideally, the attorney would have taken some additional steps to better document Chuck's capacity on the day he executed the will and taken some additional steps to ensure Chuck's capacity.

B. <u>ADMINISTRATION OF SUCCESSIONS</u>

1. Succession of Chisholm, 314 So. 3d 1056 (La. App. 2 Cir. 2021)

- **Background**: D died intestate survived by a minor child. D's father was appointed administrator. The mother (Rachael) of D's child intervened in the succession to protect her child's interest. D owned a 51% interest in a Mississippi LLC at his death. Administrator filed notice of intent to sell the LLC interest at private sale describing the LLC interest as "marketable securities." Rachael was not served with the petition. Administrator sold the interest for $10k to D's former business partner. The court then approved the final account and discharged the Administrator. Rachael was not served with those filings either.

  - Rachael filed a motion for a new trial and petition to nullify the sale of the LLC interest and for damages. Her motion was denied and she appealed.

- **Holding: <u>Reversed and Remanded</u>**.

  - **Sale of LLC Interest.** On appeal, the court agreed with Rachael that the trial court erred in authorizing the sale of the LLC interest using the procedure for sale of stocks and bonds rather than sale of movables.

        - The Code of Civil Procedure outlines the method for selling movable property in a succession subject to ordinary administration. There is an exception to that method for “bonds and shares of stock” that have “rates prevailing in the open market.” Interest in a closely held LLC clearly does not fall within the scope of that exception.

    - **Motion for New Trial**. Administrator argued the motion was untimely because Rachael was aware of pending proceedings and that the filing of the final account was sufficiently advertised. The court disagreed on appeal.

        - Code of Civil Procedure article 3335 clearly requires that the final account be served upon heirs and that proof of service must be filed in the succession proceeding prior to homologation. Administrator failed to do that.

        - Having decided Rachael’s motion for new trial was timely, the court then found the trial court erred in failing to grant her motion on substantive grounds. Code of Civil Procedure article 1972 requires a new trial when the judgment is clearly contrary to the law and the evidence. Authorizing sale of the LLC interest was clearly contrary to the law.

2. Succession of Robiho, 312 So. 3d 673 (La. App. 4 Cir. 2020)

- **Background:** Attorney Bowes represented Melvin Robiho, Jr. in connection with his parents’ successions. Their original contract (dated Oct. 26, 2009) provided that Melvin would pay Bowes the greater of $20,000 or $250 per hour, which ever was greater. Payment was due upon either the sale of a parcel immovable property or a Judgment of Possession in mom’s succession. Attorney Bowes also represented Melvin in his sister’s succession (she died intestate in 2011). They amended their contract to include that legal work at an hourly rate.

- In 2014, a different attorney replaced Bowes as counsel of record and filed an interim accounting showing the fees owed to Bowes as an unpaid debt of mom’s succession. The interim accounting was homologated by judgment signed Sept. 24, 2014. The immovable was sold in 2018. In 2019, Bowes sought to intervene in the succession and seek payment of his legal fees. The executor responded arguing prescription. The trial court granted the exception and Bowes appealed.

- **Issue:** What prescriptive period applies to the legal fees?

- **Holding:** <u>**Reversed and Remanded**</u>. Legal fees are ordinarily subject to a 3 year prescriptive term under La. Civ. Code art. 3494. Bowes argued (and the court agreed) that his fees were “estate debts” as contemplated by La. Civ. Code art.

1415. As such, they are governed by La. Civ. Code art. 3276 and are a privileged debt, not subject to the 3 year prescriptive period.

C. EXECUTORS AND ADMINISTRATORS

1. Succession of Ackel, 309 So. 3d 849 (2020)

- **Background:** George died in 2009 survived by his spouse and 4 children from previous marriages. His ancillary succession was opened in Jefferson Parish and Mr. Power was appointed provisional administrator.
  - In 2014 the court ordered Mr. Powell to file an accounting. The accounting showed one remaining asset and 9 remaining outstanding claims.
  - In 2017 Mr. Power sought to sell immovable property known as "Monterrey Plaza" owned by the decedent.
  - In 2018 the court ordered Mr. Power to "take all steps necessary to finalize and close the succession." Thereafter, Mr. Power filed a motion to authorize payment of estate debts sand tableau of distribution. Those filings noted there were 4 remaining creditors--three of which had disputed claims. The court set the matter for hearing and also ordered Mr. Power to appear and testify regarding deficiencies in the succession accounting.
  - One creditor--KMW--objected. KMW pointed out that 11 persons and entities had filed proofs of claim but that the more recent filings showed only 4 debts remaining and there was no explanation as to what happened to those other debts. KMW also sought to remove Mr. Power and to require him to file a final account.
  - Eventually, the trial court ordered that Mr. Power be removed and appointed Mr. Molaison as the successor administrator.
- **Issue:** Mr. Power appealed arguing that the "trial court erred in removing him as administrator *sua sponte* without convincing evidence being introduced to support its action."
  - **Holding: Affirmed**. On appeal, the court noted that Mr. Power admitted he failed to file annual accounts unless the court ordered him to do so, that he did not know what happened to some items of succession property, and that he had disposed of various assets and paid debts without the required court approvals. On appeal the court also noted that the trial court had repeatedly expressed concerns about Mr. Power's actions and deficiencies in his accountings. The trial court was within its power to remove Mr. Power.

- **Issue:** The creditor, KMW, sought damages and attorney fees for the appeal under La. Code Civ. Proc. art. 2164.

  - **Holding:** <u>**Denied**</u>. The court noted that damages for frivolous appeals are only allowed where the action was "unquestionably frivolous" and that Mr. Power's appeal did not rise to that level.

2. Succession of Bailey, 311 So. 3d 422 (La. App. 4 Cir. 2020)

- **Background:** D died testate in 1998 and her granddaughter, Ms. Henry, was appointed executor. Ms. Henry failed to provide a thorough accounting for her 2 decades as executor. As a result, legatees intervened in the proceedings.

  - In 2018, Ms. Henry and Ms. Gaines (a daughter of the decedent and legatee) entered into a consent judgment that would allow Ms. Henry to provide an accounting and tableau of distribution within 60 days.

  - Ms. Henry did not comply. In 2019, Ms. Gaines filed a rule to hold Ms. Henry in contempt and to remove her as executor. Ms. Henry was removed following a hearing and found in contempt. The trial court also ordered her to pay attorney's fees and costs.

  - Ms. Gaines then filed a second rule for contempt claiming that Ms. Henry failed to turn over the succession property or render an accounting as the court had ordered. At the ensuing hearing, Ms. Henry's new attorney begged for more time. Ms. Henry was now facing imprisonment for her civil contempt of court. The court gave her two more weeks to comply. Apparently, she failed to do so and this appeal followed.

- **Holding:** <u>**Affirmed**</u>. On appeal, Ms. Henry complained of being held in criminal contempt without the right standard. The record was clear, however, that she had been held in civil contempt. The record reflected that the required proceedings had been adhered to by the court below.

3. Successions of Brown, 318 So. 3d 348 (La. App. 4 Cir. 2021)

- **Background**: D died in 2017. Apparently, D executed a will in 1993. One of D's daughters (Paula) opened her succession claiming D was intestate and sought appointment as administrator. Because Paula lived in Nevada, she appointed an agent in Louisiana. Paula also sought appointment as administrator of her pre-deceased step-father's succession. Paula's sister, Sheila, resided in property owned by D and was served a 5 day notice to vacate because Paula intended to sell it.

- Shelia intervened in the succession to oppose Paula's appointment/demand her removal. She also sought to probate the 1993 will.

- **Issue:** Sheila's various arguments basically objected to Paula being administrator and to not being allowed to testify at the hearings seeking Paula's removal.

- **Holding: Reversed and remanded**. On appeal, the court explained that a trial court has the power to remove a succession representative and that the party seeking removal has the burden of "proving by convincing evidence that the representative either breached their fiduciary duty…or should be disqualified because of one of the grounds for removal." The court also noted that removal actions require the trial court to hold a rule to show cause and full evidentiary hearing.

    - In this case, however, the court failed to do so. "The trial court cannot rely solely upon the pleadings and arguments of counsel when a factual finding must be made."

    - Neither appellant nor appellee were present at the hearing, thus the court "failed to fully address the factual and legal issues presented through a full evidentiary hearing…"

4. Succession of Logan, 320 So. 3d 461 (La. App. 3 Cir. 2021)

- **Background:** D died intestate survived by his father and his minor children. D died in a workplace accident. D's father sought appointment as administrator. Ms. Labry, the mother of D's minor children, sought to remove father ad administrator and to be appointed. Ms. Labry pointed out that D's father was not an heir, legatee, or creditor of D. D's father argued he was a creditor because he had paid for D's funeral. Later evidence revealed that D's employer actually paid for the funeral expenses. D's father was removed and Ms. Labry was appointed as administrator because she represented D's only heirs--his children. D's father appealed.

- **Holding: Affirmed**. La. Code Civ. Proc. art. 3097(B) provides that a person cannot be appointed as administrator unless he is a "surviving spouse, heir, legatee, legal representative of an heir or legatee, or a creditor of the deceased, or a creditor of the estate of the deceased, or the nominee of the surviving spouse, heir, legatee, or legal representative of an heir or legatee of the deceased, or a co-owner of immovable property with the deceased." D's father met none of those requirements. Ms. Labry did.

    - Further, D's father failed to even allege he was a creditor in his pleadings and by the time of the hearing it appeared that he had been fully paid for any debts he expended in connection with the funeral.

5. Succession of Theobald, 309 So. 3d 878 (La. App. 5 Cir. 2020)

- **Background:** These litigants previously appeared (in this court and in this CLE program) in connection with the proceeds from a wrongful death case. Thereafter, the Succession of Raymond Theobald was consolidated with that of his deceased wife, Edna. Litigants are siblings and half-siblings. In particular, Edna had sones David and Paul from a previous marriage. Then she had 4 more children with Raymond, including Emily. Emily filed a petition for declaratory judgment and return of estate assets against David and Paul alleging that they breached their fiduciary duties to Raymond and Edna "by siphoning off their assets and engaging in a calculated and systematic scheme to funnel to themselves all financial assets belonging to Edna and Raymond's estates with the intent to deprive their halfsiblings from receiving any of their parents' financial assets.

- David and Paul filed exceptions, including one of prescription. The trial court granted their exception of prescription. Emily appealed.

- **Issue:** What prescriptive period applies to Emily's claims?

- **Holding: <u>Reversed and remanded</u>**. The trial court found that Emily's allegations involved a claim for the accounting of community assets, which would prescribe under La. Civ. Code art. 2369 on the date 3 years from the date of Edna's death. On appeal, the court disagreed:

    - "Emily specifically alleges that David breached fiduciary duties to Raymond as the independent executor of his estate, and that Paul breached fiduciary duties to Raymond pursuant to the power of attorney Paul procured from Raymond."

    - Breach of fiduciary duty is a personal action that is subject to a liberative prescription of 10 years.

        - **Observation:** While I agree with the court's conclusion here, I might disagree with the test the court uses to determine whether a fiduciary relationship existed in the first place. *See* Elizabeth R. Carter, *Fiduciary Litigation in Louisiana: Mandataries, Succession Representatives, and Trustees*, 80 LA. L. REV. 661 (2020) [LINK].

    - With respect to David, Emily's claim against him relates to his actions as executor of Raymond's succession. La. Rev. Stat. 9:5621 sets forth a 2 year prescriptive period that begins to run upon the judgment homologating the final account. Because there has been no such judgment, prescription has not even commenced. Moreover, the court pointed out that the 2 year period does not apply to "actions for the recovery of any funds or other property misappropriated by the succession representative." Those remain subject to a 10 year prescriptive period.

- With respect to Paul, Emily's claim stems from Paul's actions under a mandate given to him by Raymond. That mandate ended upon Raymond's death. Such claims are also subject to a 10 year prescriptive period--and Emily's suit was timely filed.

D. PROCEDURE

1. Succession of Rousselle, 309 So. 3d 856 (La. App. 5 Cir. 2020)

- **Background:** D died testate and left his entire estate to his wife. She was put into possession of his estate without an administration. After the expiration of the time for taking a devolutive appeal from the judgment of possession, D's father sought to reopen D's succession and to nullify the judgment of possession.
  - Dad's issues related to the 2002 sale of an immovable form Dad to his children--including D. Dad argued the sale was really a simulation, that the property was intended to be D's separate property. Dad also tried to attack D's will.
  - Dad and D's wife had tried to reach an agreement for her to sell her interest in the immovable to Dad. They eventually reached a settlement agreement whereby Dad would pay wife the appraised value as determined by a mutually agreed upon appraiser. The parties dismissed Dad's action without prejudice because of the settlement agreement.
  - But, Dad was not happy with the appraised value and refused to go through with the settlement. He then sought to reopen the succession and re-assert the same arguments. After some back and forth and a hearing on the matter, the trial court denied Dad's petition to reopen with prejudice. The trial court noted that Dad knew about the will, knew that Wife was universal legatee because he had negotiated with her both before and after the petition of possession in her favor.
- **Issue:** Dad appealed claiming the trial court "wrongly applied La. C.C.P. art. 2087, which delineates the time for taking a devolutive appeal; and…wrongly applied La. C.C. P. art. 3393, which governs the reopening of a succession.
- **Holding**: **Affirmed.** On appeal the court pointed out that the decision to reopen a succession generally rests within the discretion of the trial court and that proper cause for reopening is extremely limited. The most common reason is when assets have been overlooked--which was not the issue in this case. Rather, Dad's proper remedy was to appeal the judgment of possession.

- Dad also complained that he did not get notice of the judgment of possession and argued that he should not be held to the time limit for taking a devolutive appeal in the absence of notice.

- The court, however, pointed out that Dad did not demonstrate how he was deprived of any legal rights or property belonging to him. He was not a legatee of the succession and he in fact knew that his son left his estate to his wife.

2. New Orleans and Baton Rouge Steamship Pilots Association v. Wartenburg, 316 So. 3d 39 (La. App. 1 Cir. 2020)

- **Background:** Connie Wartenburg was entitled to receive her deceased husband's pension proceeds until her death or remarriage. Her son, David, arranged with NOBRA to have the pension sent via direct deposit to her account. Connie Died in Nov. 2017. NOBRA did not learn of her death until nearly a year later. NOBRA had deposited more than $200k in Connie's account after her death. Connie's succession had not been opened. NOBRA filed suit against her succession and requested service be made on her son (who had not administered, accepted, or even opened his mother's succession). David and the succession filed exceptions in response arguing that NOBRA could not proceed because it had not filed a formal proof of claim in the succession. The trial court granted those exceptions and NOBRA appealed.

- **Holding: <u>Affirmed in part, reversed in part</u>**. On appeal the court held that dismissal of NOBRA's claims was appropriate, but for different reasons.

  - The court pointed out that without proper service and citation there could be no proper proceedings. There was no proper service or citation here because the succession was not opened and the son had not accepted.

  - Rather, NOBRA had options. NOBRA, as a creditor, could seek to open the succession and have an administrator appointed. NOBRA could have sued the decedent through an attorney appointed by the court. NOBRA did neither.

  - The court observed that, normally, "insufficiency of service of process must be pled prior to judgment or it is waived." In this case, however, "there was no one with legal authority to submit the unopened succession to the jurisdiction of the court…"

III. TRUSTS: JURISPRUDENCE

National Collegiate Student Loan Trust 2006-1 v. Thomas, 322 So. 3d 374 (La. App. 3 Cir. 2021)

- **Background**: NCSLT sued Thomas to collect on her outstanding student loan debt and interest. Thomas filed preemptory exceptions of no right of action, no cause of action, and prescription. Thomas argued that NCLST lacked procedural capacity because it was a Delaware trust and under Louisiana law, only the trustee has capacity to appear as a plaintiff. NCLST, in response, argued that it is a Delaware statutory trust which is an unincorporated association with the ability to sue in its own name. The trial court agreed with Thomas and gave NCLST 45 days to amend its petition. NCLST failed to do so and this appeal followed.

- **Issue:** Is NCLST an express trust? The trial court held that NCLST was an express trust and, as such, could only sue through its trustee.

- **Holding: Reversed and remanded**. NCLST was a statutory/business trust established under Delaware law. The issue, then, was whether that made it an express trust or an unincorporated association under Louisiana law. The latter can sue and be sued in its own name. The former cannot. On appeal, the court pointed out that NCLST did not really fit the definition of a Louisiana trust under the Louisiana Trust Code because there was no transfer of ownership of property to a trustee. Rather, "NCLST owns Ms. Thomas's loan and other loans in its portfolio." Rather, NCLST was akin to an unincorporated association in Louisiana and could sue in its own name.

IV. MANDATE & INTERDICTION

A. LEGISLATION

ACT No. 163 (2021 Regular Session)

AN ACT

To enact Code of Civil Procedure Article 4566(K), relative to the management of affairs of an interdict; to provide for the establishment and maintenance of deposit accounts; and to provide for related matters.

Be it enacted by the Legislature of Louisiana:

Section 1. Code of Civil Procedure Article 4566(K) is hereby enacted to read as follows:

Art. 4566. Management of affairs of the interdict

***

K. Notwithstanding the requirements of Article 4270 or any other provision of law to the contrary, a curator shall have authority to access deposit accounts held in the name of the interdict and authority to establish and maintain deposit accounts in the name of the "curator on behalf of the interdict", unless the letters of curatorship expressly limit such authority.

REC. DEVELOPMENTS IN SUCCESSION & DONATIONS

B. JURISPRUDENCE

1. Interdiction of Gambino, 309 So. 3d 427 (La. App. 5 Cir. 2020)

- **Background:** Calvin and Eunice Gambino married in 1952 and had 10 children, one of whom predeceased them. In 2017, Mr. Gambino executed an Act of Donation donating immovable property to one of those children--Brad. Later in 2017, 8 of the couple's children sought to interdict both parents. Brad did not join either petition for interdiction. The petition to interdict Mr. Gambino failed. A consent judgement was entered interdicting Mrs. Gambino on the basis of her advanced dementia and Alzheimer's disease. Children Calvin Jr. and Cynthia were named as curators. Mr. Gambino was named undercurator.

- In May 2018 (following the interdiction), the curators filed a "Petition to Terminate Community Property Regime, and to Annul Donations." In particular, they sought to annul the 2017 donation to Brad on the grounds that: "(1) the immovable property was community property; (2) Mrs. Gambino did not have capacity to consent to the donation of the immovable property due to her medical condition; and (3) Mrs. Gambino did not jointly execute the written donation."

- **Trial Court:** Found sufficient evidence to rebut the presumption of community property and upheld the donation.

- **Appeal**: <u>**Reversed and remanded**</u>. On appeal, the court held there was insufficient evidence to rebut the presumption of community property.

2. Interdiction of Gambino, 313 So. 3d 1239 (Mem.) (La. 2021)

- **Issue:** The previous decision was appealed and the LASC reinstated the trial court holding upholding the donation. The LASC noted that the trial court's decision was to be reviewed for "manifest error" and that the presumption of community could be rebutted by a preponderance of the evidence.

- The LASC agreed with the trial court that Mr. Gambino sufficiently rebutted that presumption by showing the funds used to purchase the donated immovable were separate funds that he received from his parents as gifts and inheritances.

- **Observation:** While these two cases provide an interesting discussion of the classification of assets as community or separate, they are also interesting to elder law attorneys for a different reason. They illustrate one way that the would-be heirs can litigate classification issues before the decedent's death.

V. END OF LIFE ISSUES

FEMA Relief for COVID Related Funerals

- **LINK**
- "Under the Coronavirus Response and Relief Supplemental Appropriations Act of 2021 and the American Rescue Plan Act of 2021, FEMA is providing financial assistance for COVID-19 related funeral expenses incurred after January 20, 2020."
- Details are available online.

VI. MISCELLANEOUS LEGISLATION OF INTEREST

A. PARTITION

ACT No. 27 (2021 Regular Session)

AN ACT

To amend and reenact Civil Code Article 811 and Code of Civil Procedure Articles 4607, 4622, 4624, and 4625, relative to property; to provide for partitions by private sale; to provide relative to absentee or non-consenting co-owners; to provide for petition requirements; to provide for sale requirements; to provide for an effective date; and to provide for related matters.

Be it enacted by the Legislature of Louisiana:

Section 1. Civil Code Article 811 is hereby amended and reenacted to read as follows:

Art. 811. Partition by licitation or by private sale

A. When the thing held in indivision is not susceptible to partition in kind, the court shall decree a partition by licitation or**, as provided in Paragraph B of this Article,** by private sale and the proceeds shall be distributed to the co-owners in proportion to their shares.

B. In the event that one or more of the co-owners are absentees or have not consented to a partition by private sale, the court ~~may set the terms of the sale and shall order~~ a partition by private sale **and shall give first priority to the private**

REC. DEVELOPMENTS IN SUCCESSION & DONATIONS

sale between the existing co-owners, over the sale by partition by licitation or private sale to third parties. The court shall order the partition by private sale between the existing co-owners as identified in the conveyance records as of the date of filing for the petition for partition by private sale. The petition for partition by private sale shall be granted first priority, and the sale shall be executed under Title IX of Book VII of the Code of Civil Procedure.

Section 2. Code of Civil Procedure Articles 4607, 4622, 4624, and 4625 are hereby amended and reenacted to read as follows:

Art. 4607. Partition by licitation or by private sale

When a partition is to be made by licitation, the sale shall be conducted at public auction and after the advertisements required for judicial sales under execution. When a partition is to be made at private sale without the consent of all co-owners, the sale shall be for not less than ~~two-thirds~~ of the appraised value of the property, and **documents required pursuant to a court order** shall be ~~made~~ **executed on behalf of the absentee or non-consenting co-owner** by a court-appointed representative, who may be a co-owner, after the advertisements required for judicial sales under execution are made. All counsel of record, including curators appointed to represent absentee defendants, and persons appearing in proper person shall be given notice of the sale date. At any time prior to the sale, the parties may agree upon a nonjudicial partition.

* * *

Art. 4622. Petition

A. The petition for the partition of property in which an absentee owns an interest, under the articles of this Chapter, shall allege the facts showing that the absent and unrepresented defendant is an absentee, as defined in Article 5251, shall describe the property sought to be partitioned and allege the ownership interests thereof, and shall be supported by an affidavit of the petitioner or of his counsel that the facts alleged in the petition are true.

B.(1) If the partition is to be made by private sale, the petition **for partition between the co-owners shall have first priority status by the court and** shall ~~describe~~ include all of the following:

(a) ~~the~~ **The** primary terms of the proposed sale~~,~~**.**

(b) The name of the proposed purchaser and whether the proposed purchaser is a co-owner or third party in accordance with Civil Code Article 811(B). ~~identify the proposed purchaser, if any, disclose whether the proposed purchaser is related to any co-owner,~~

(c) The source or location of funds to be used in the sale.

(d) If the proposed purchaser is a juridical entity, including but not limited to corporations, limited liability companies, partnerships, and sole proprietorships, and whether that entity has a relationship with any co-owner. ~~and disclose to the petitioning co-owners~~

(e) ~~whether~~ **Whether** any costs associated with the sale will be paid to any person related to the petitioning co-owners within the fourth degree or a juridical entity in which the co-owner has a direct or indirect financial interest.

(2) Upon judgment of the court ordering the sale, payment shall be made within twenty-four hours using cash or certified funds.

* * *

Art. 4624. Publication of notice

Notice of the institution of the proceeding shall be published at least once in the parish where the partition proceeding is instituted, in the manner provided by law. This notice shall set forth the title and docket number of the proceeding, the name and address of the court, a description of the property sought to be partitioned, and the primary terms of the private sale and shall notify the absent defendant that the plaintiff is seeking to have the property partitioned by licitation or by private sale **under** **Civil Code Article 811 and Chapters 1 and 2 of this Title**, and that the absent defendant has fifteen days from the date of the publication of notice, or of the initial publication of notice if there is more than one publication, to answer the plaintiff's petition.

Art. 4625. Trial; judgment ordering sale

A. Except as otherwise provided in Article 4630, if the petitioner proves on the trial of the proceeding that he is a co-owner of the property and entitled to the partition thereof and that the defendant is an absentee who owns an interest therein, the court shall render judgment ordering either the public sale of the property for cash by the sheriff to effect a partition, after the advertisement required by law for a sale under execution or the private sale of the property ~~for cash by the court-appointed representative to effect a partition~~, **executed on behalf of the absentee or non-consenting co-owner by a court-appointed representative, who may be a co-owner, under Chapters 1 and 2 of this Title,** and after the advertisement required by law for a sale under execution.

B. The judgment shall determine the absentee's share in the proceeds of the sale, and award a reasonable fee to the attorney appointed to represent him to be paid from the absentee's share of the proceeds of the sale.

Section 3. This Act shall become effective upon signature by the governor or, if not signed by the governor, upon expiration of the time for bills to become law without signature by the governor, as provided by Article III, Section 18 of the Constitution of Louisiana. If vetoed by the governor and subsequently approved by the legislature, this Act shall become effective on the day following such approval.

B. CIVIL PROCEDURE

ACT No. 68 (2021 Regular Session)

AN ACT

To amend and reenact Code of Civil Procedure Articles 193, 194, 195, 196.1, 863(A), 891(A), and 1313(C) and R.S. 9:2603(B)(2), and to repeal Code of Civil Procedure Article 196 and R.S. 9:2603(B)(4)(a), relative to civil procedure; to provide for the adoption of local court rules; to provide with respect to the power of district courts to act; to provide with respect to judicial proceedings; to provide for the signing of orders and judgments; to provide with respect to pleadings and petitions; to provide for service by electronic means; to provide with respect to the Louisiana Uniform Electronic Transaction Act; to provide for an effective date; and to provide for related matters.

Be it enacted by the Legislature of Louisiana:

Section 1. Code of Civil Procedure Articles 193, 194,195, 196.1, 863(A), 891(A), and 1313(C) are hereby amended and reenacted to read as follows:

Art. 193. Power to adopt local rules; publication

A. A court may adopt rules for the conduct of judicial business before it, including those governing matters of practice and procedure ~~which~~ **that** are not contrary to the rules provided by law. When a court has more than one judge, its rules shall be adopted or amended by a majority of the judges thereof, sitting en banc.

~~The rules may provide that the court may call a special session of court during vacation, and that any action, proceeding, or matter otherwise required by law to be tried or heard in open court during the regular session may be tried or heard during the special session.~~

B. The rules shall be entered on the minutes of the court. Rules adopted by an appellate court shall be published in the manner ~~which~~ **that** the court considers most effective and practicable. ~~Rules adopted by a district court shall be printed in pamphlet form, and a copy shall be furnished on request to any attorney licensed to practice law in this state.~~

Art. 194. Power of district court to act ~~in chambers~~; signing orders and judgments

The following orders and judgments may be signed by the district judge in ~~chambers~~ **any place where the judge is physically located**:

(1) Order directing the taking of an inventory; judgment decreeing or homologating a partition, when unopposed; judgment probating a testament ex parte; order directing the execution of a testament; order confirming or appointing a legal representative, when unopposed; order appointing an undertutor or an undercurator; order appointing an attorney at law to represent an absent, incompetent, or unrepresented person, or an attorney for an absent heir; order authorizing the sale of property of an estate administered by a legal representative; order directing the publication of the notice of the filing of a tableau of distribution, or of an account, by a legal representative; judgment recognizing heirs or legatees and sending them into possession, when unopposed; all orders for the administration and settlement of a succession, or for the administration of an estate by a legal representative~~;~~**.**

(2) Order to show cause; order directing the issuance and providing the security to be furnished by a party for the issuance of a writ of attachment or sequestration; order directing the release of property seized under a writ of attachment or sequestration and providing the security to be furnished therefor; order for the issuance of a temporary restraining order and providing the security therefor; order for the issuance of a writ, or alternative writ, of habeas corpus, mandamus, or quo warranto~~;~~**.**

(3) Order for the seizure and sale of property in an executory proceeding~~;~~**.**

(4) Order for the taking of testimony by deposition; for the production of documentary evidence; for the production of documents and things for inspection, copying, or photographing; for permission to enter land for the purpose of measuring, surveying, or photographing~~;~~**.**

(5) Order or judgment deciding or otherwise disposing of an action, proceeding, or matter ~~which~~ **that** may be tried or heard in chambers~~;~~**.**

(6) Order or judgment that may be granted on ex parte motion or application, except an order of appeal on an oral motion~~; and~~**.**

(7) Any other order or judgment not specifically required by law to be signed in open court.

Comments – 2021

This Article has been amended to codify the current practice of the district court judges of signing orders and judgments wherever the judge is physically located. With the use of electronic signatures as provided for in Articles 253(C) and 1911(A), judges are authorized to sign orders and judgments electronically, and this Article authorizes them to do so wherever they are physically located.

Art. 195. ~~Same; judicial~~ **Judicial** proceedings **in chambers**

The following judicial proceedings may be conducted by the district judge in chambers **or by any audio-visual means**:

(1) Hearing on an application by a legal representative for authority, whether opposed or unopposed, and on a petition for emancipation~~;~~**.**

(2) Homologation of a tableau of distribution, or of an account, filed by a legal representative, so far as unopposed~~;~~**.**

(3) Trial of a rule to determine the nonexempt portion of wages, salaries, or commissions seized under garnishment and to direct the payment thereof periodically by the garnishee to the sheriff;.

(4) Examination of a judgment debtor~~; and~~**.**

(5) Trial of or hearing on any other action, proceeding, or matter ~~which~~ **that** the law expressly provides may be tried or heard in chambers.

Art. 196.1. Power of ~~courts to act during emergencies~~ **judges to sign orders and judgments while outside of the court's territorial jurisdiction**

~~A. A~~ **The judge of a** district court or a court of limited jurisdiction may sign orders and judgments while outside of ~~it's~~ **the court's** territorial jurisdiction ~~during an emergency or disaster declared as such pursuant to R.S. 29:724(B) if the emergency or disaster prevents the court from operating in its own jurisdiction~~.

~~B. The court shall indicate the location where the order or judgment was signed on any order or judgment signed outside of the court's territorial jurisdiction pursuant to this Article.~~

Comments – 2021

This Article has been amended to allow the judge to sign orders and judgments while outside of the court's territorial jurisdiction, regardless of whether there is an emergency or disaster. This amendment does not confer or extend the subject matter jurisdiction of a court when one of its judges signs a judgment or order outside of the court's territorial jurisdiction. See Articles 2 and 3.

* * *

Art. 863. Signing of pleadings; effect

A. Every pleading of a party represented by an attorney shall be signed by at least one attorney of record in his individual name, whose physical address **and email address** for service of process shall be stated. A party who is not represented by an attorney shall sign his pleading and state his physical address **and email address, if he has an email address,** for service of process. If mail is not received at the physical address for service of process, a designated mailing address shall also be provided.

* * *

Art. 891. Form of petition

A. The petition shall comply with Articles 853, 854, and 863, and, whenever applicable, with Articles 855 through 861. It shall set forth the name, surname, and domicile of the parties; shall contain a short, clear, and concise statement of all causes of action arising out of, and of the material facts of, the transaction or occurrence that is the subject matter of the litigation; shall designate ~~an~~ **a physical** address, not a post office box, **and an email address** for receipt of service of all items involving the litigation; and shall conclude with a prayer for judgment for the relief sought. Relief may be prayed for in the alternative.

* * *

Art. 1313. Service by mail, delivery, or electronic means

* * *

C. Notwithstanding Paragraph A of this Article, if a pleading or order sets a court date, then service shall be made ~~either~~ by registered or certified mail or as provided in Article 1314, ~~or~~ by actual delivery by a commercial courier**, or by emailing the document to the email address designated by counsel or the party. Service by electronic means is complete upon transmission, provided that the sender receives an electronic confirmation of delivery**.

* * *

Comments – 2021

Paragraph C of this Article has been amended to allow service of a pleading or order setting a court date by emailing the party or his counsel at a designated email address, provided that the sender receives an electronic confirmation of delivery. See R.S. 9:4845(2). If such confirmation is not received, the sender will need to use one of the other alternative methods of service provided in Paragraph C.

Section 2. R.S. 9:2603(B)(2) is hereby amended and reenacted to read as follows:

§2603. Scope

* * *

B. This Chapter shall not apply to:

* * *

(2) A transaction to the extent it is governed by the provisions of Title 10 of the Louisiana Revised Statutes of 1950~~, other than R.S. 10:1-107~~.

* * *

Section 3. Code of Civil Procedure Article 196 and R.S. 9:2603(B)(4)(a) are hereby repealed in their entirety.

Section 4. This Act shall become effective January 1, 2022.

C. PRESCRIPTION

ACT No. 414 (2021 Regular Session)

AN ACT

To amend and reenact Civil Code Articles 2041, 2534, and 3463, relative to prescription; to provide for prescription of the revocatory action; to provide for prescription of actions for redhibition and breach of the warranty of fitness for use; to provide for the interruption of prescription; to provide with respect to prescription of actions for recognition of inheritance rights; and to provide for related matters.

Be it enacted by the Legislature of Louisiana:

Section 1. Civil Code Articles 2041, 2534, and 3463 are hereby amended and reenacted to read as follows:

Art. 2041. Action must be brought within one year

The action of the obligee must be brought within one year from the time he learned or should have learned of the act, or the result of the failure to act, of the obligor that the obligee seeks to annul, but never after three years from the date of that act or result.

~~The three year period provided in this Article shall not apply in cases of fraud.~~

Revision Comments - 2021

This revision changes the law by deleting the second paragraph of prior Article 2041, which was added in 2013 and which created an exception to the three-year period in the first paragraph in cases of fraud. The 2013 amendment had the potential to create instability in title to immovables, as any instance in which a transfer of property occurred "fraudulently" and in violation of the law on revocatory actions potentially allowed the original transferor to recover the property within "one year from the time he learned or should have learned of the act, or the result of the failure to act." The three-year period provided in this Article creates an important protection for third parties and an obvious effort "to protect the security of transactions." In addition, the 2013 amendment risked re-injecting the concept of fraud into the revocatory action - a concept that was eliminated in the general revision to the law of obligations in 1984 because of the confusion and uncertainty that the concept of fraud caused. Accordingly, the 1984 revision eliminated the concept of fraud from the revocatory action and in its place substituted the concept of insolvency. This revision restores Article 2041 to its original text as revised in 1984.

* * *

Art. 2534. Prescription

A.~~(1)~~ The action for redhibition against a seller who did not know of the existence of a defect in the thing sold ~~prescribes~~ **<u>and the action asserting that a thing is not fit for its ordinary or intended use prescribe</u>** in ~~four~~ **<u>two</u>** years from the day **<u>of</u>** delivery of ~~such~~ **<u>the</u>** thing ~~was made~~ to the buyer or one year from the day the defect **<u>or unfitness</u>** was discovered by the buyer, whichever occurs first.

~~(2) However, when the defect is of residential or commercial immovable property, an action for redhibition against a seller who did not know of the existence of the defect prescribes in one year from the day delivery of the property was made to the buyer.~~

B. The action for redhibition against a seller who knew, or is presumed to have known, of the existence of a defect in the thing sold prescribes in one year from the day the defect was discovered by the buyer **<u>or ten years from the perfection of the contract of sale, whichever occurs first</u>**.

C. In any case prescription **<u>on an action for redhibition</u>** is interrupted when the seller accepts the thing for repairs and commences anew from the day he tenders it back to the buyer or notifies the buyer of his refusal or inability to make the required repairs.

Revision Comments - 2021

(a) This revision changes the law to create uniform prescriptive periods for movables and immovables. It maintains the distinction between sellers who knew or should have known of the defect in the thing sold as opposed to those sellers who did not. Prior law created separate prescriptive periods for the sale of movables and for the sale of "residential or commercial immovable[s]," and in many instances it provided a longer prescriptive period for the sale of movables than for immovables. Moreover, the creation of a special prescriptive period for redhibitory defects in "residential or commercial immovable property" created uncertainty as to the prescriptive period for other immovable property. See, e.g., MGD Partners, LLC v. 5-Z Investments, Inc., 145 So. 3d 1053 (La. App. 1 Cir. 2014) (holding that a claim for redhibitory defects in undeveloped immovable property is subject to "the four-year prescriptive period and/or discovery rule of La. Civ.

Code art. 2534(A)(1)… and not the one-year prescriptive period found in La. Civ. Code art. 2534(A)(2), which, by its terms, pertains to residential or commercial immovable property.") This revision makes all good faith sellers subject to a uniform prescriptive period of two years from the day of delivery of the thing to the buyer or one year from the day the defect was discovered by the buyer, whichever occurs first.

(b) This revision also unifies the relevant prescriptive periods for actions in redhibition and those for breach of the warranty of fitness for use. Prior law provided no specific prescriptive period for breach of the warranty of fitness for use. Consequently, the ten-year prescription in Article 3499 prevailed. Because the law on redhibition and fitness for use is largely overlapping, the dichotomy between the prescriptive periods could create stark differences in outcome. See, e.g., Cunard Line Ltd. Co. v. Datrex, Inc., 926 So. 2d 109 (La. App. 3 Cir. 2006). This revision unifies the law on prescription for purposes of redhibition and fitness for use. Because the law of sales does not distinguish between good faith and bad faith sellers for purposes of the warranty of fitness for use, this revision does not purport to create different prescriptive periods on that basis.

(c) This revision also provides clarity regarding the prescriptive period for bad faith sellers. Comment (b) to the 1993 revision suggested that in all cases, "an action in redhibition prescribes ten years from the time of perfection of the contract regardless of whether the seller was in good or bad faith. See C.C. Art. 3499." Article 3499, by its terms, however, applies only to personal actions in which a prescriptive period is not "otherwise provided by legislation," whereas this Article comprehensively provides for different prescriptive periods depending both upon the characterization of the property and the good faith or bad faith of the seller. Moreover, courts' rulings were not consistent in holding whether Article 3499 was applicable in the context of redhibition. See, e.g. Tiger Bend, L.L.C. v. Temple-Inland, Inc., 56 F. Supp. 2d 686 (M.D. La. 1999); Mouton v. Generac Power Systems, Inc., 152 So. 3d 985 (La. App. 3d Cir. 2014); Grenier v. Medical Engineering Corp., 243 F. 3d 200 (5th Cir. 2001). This revision adopts a legislative solution to this issue and provides that liberative prescription for an action against a bad faith seller accrues in one year from when the defect was discovered by the buyer or ten years from the perfection of the contract of sale, whichever occurs first. For the time of perfection for a contract of sale, see Article 2439.
* * *

Art. 3463. Duration of interruption; abandonment or discontinuance of suit

A. An interruption of prescription resulting from the filing of a suit in a competent court and in the proper venue or from service of process within the prescriptive period continues as long as the suit is pending.

B. Interruption is considered never to have occurred if the plaintiff abandons **the suit**, voluntarily dismisses the ~~action~~ **suit** at any time either before the defendant has made any appearance of record or thereafter, or fails to prosecute the suit at the trial. ~~A settlement and subsequent~~ **The** dismissal of a ~~defendant~~ **suit** pursuant to a

~~transaction~~ or compromise ~~shall not qualify as~~ **does not constitute** a voluntary dismissal ~~pursuant to this Article~~.

Revision Comments - 2021

The 2021 revision makes semantic changes and is not intended to change the law.

REC. DEVELOPMENTS IN SUCCESSION & DONATIONS

VALUATIONS | MERGERS & ACQUISITIONS | ADVISORY SERVICES

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Sale of Division or Business Line

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Practical Drafting Under the Trust Code; 2020 Revision Considerations[1]

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[1] This summary is designed to provide general information. It is not intended to provide, and should not be relied upon as, legal, accounting, or other professional advice. No portion of these materials may be used or relied upon or for taking a position on a tax return or avoiding penalties under applicable tax law. Before taking any position on a tax return or engaging in tax planning, participants should consult with their own professional advisors and independently the tax and other consequences of any particular transaction or suggestion.

I. New allocation of income and principal provisions - Changes to Trust Default Rules on Allocation of Receipts and Expenses

One of the chief advantages of a trust is the ability to control distributions to the beneficiary. The Trustee is required to distribute income to the income beneficiary at least once every six months unless the trust provides a contrary stipulation. La. R.S. 9:1962. The trust instrument can provide for income distributions at more frequent or longer intervals, the accumulation of income, the distribution of accumulated income and principal to the income beneficiary at specified times or in the Trustee's discretion and the allocation of accumulated income to principal. La. R.S. 9:1961, 9:1963 and 9:2068. However, if the income and principal beneficiaries are not identical, invasions of principal (but not accumulated income) for the benefit of the income beneficiary must be made under objective and ascertainable standards stipulated in the trust instrument, such as for the care, comfort, support, maintenance, medical expenses or educational expenses of the beneficiary in accordance with the beneficiary's accustomed standard of living. La. R.S. 9:2068A and 9:1963.

A Trustee who is not a beneficiary of the trust can be given the discretion to allocate income in different amounts among the income beneficiaries (e.g., a "spray" provision) or to allocate income to principal. La. R.S. 9:1961 and 9:1964.

Louisiana's spray provisions and invasion of principal limitations are far more restrictive than those in other states due to the concept of immediate vesting of principal.

If the income beneficiary is not also the principal beneficiary, distributions of principal to the income beneficiary must be limited by an ascertainable standard, even if the trustee is not a beneficiary. La. R.S. 9:2068.A.

> The trust instrument may express the income beneficiary's interest as the greater of: (1) actual net income; or (2) some fixed dollar amount or percentage of the fair market value of the trust and if actual net income is less, any deficit is to be paid from principal. La. R.S. 9:2068A.
>
> The trust may direct or prevent a Trustee to pay principal to the income beneficiary for support, maintenance, education and medical expenses, or, pursuant to an objective standard, for any other purpose.
>
> La. R.S. 9:2068A. The trust may direct the Trustee to pay all or part of the principal to an income beneficiary upon the request of the beneficiary. La. R.S. 9:2068A. The above exceptions (e.g., the right to withdraw "all or part of the principal" by request to the trustee, and the right to receive "a stipulated amount or percentage") accommodate annual exclusion withdrawals, annuity trusts and unitrusts. La. R.S. 9:2068.A.
>
> Note, however, that payment of principal attributable to legitime cannot be made to an income beneficiary (other than the forced heir). La. R.S. 9:2068 and 9:1847.

The policy behind restrictions like the above is to limit the circumstances under which the settlor, acting through the trustee, can impede the rights of a vested principal beneficiary. In addition, although not a vesting issue of the principal beneficiary's interest in the trust, certain invasions of principal for the benefit of an income beneficiary can substantially reduce the value of the principal beneficiary interest and ultimate distribution.

Anticipating related concerns a settlor may wish to avoid simply giving one beneficiary the right to income. Instead, the settlor may give a beneficiary the right to receive a monthly income based upon a certain percentage of the value of the trust assets each year, also known as a "unitrust" amount. This unitrust amount would represent the amount of reasonable income that the settlor would hope to provide the beneficiary, and it would free the trustee to invest in assets that would produce a return that benefits all beneficiaries.

Sample unitrust language in a Louisiana last will and testament is included in subsection (i) of the Trust Drafting Considerations attached hereto.

A. Background

1. The current Louisiana Trust Code was adopted in 1964. Its provisions allocating receipts and expenses between income and principal were based largely upon the Uniform Principal and Income Act (UPIA) of 1962, which was a revision of the earlier 1931 UPIA. However, the 1962 UPIA was revised in 1997 and then amended in 2000 and 2008 and more recently in July 2018 (now called the Uniform Fiduciary Income and Principal Act or "UFIPA").

2. There have been only a few amendments to the 1962 version of the UPIA adopted in Louisiana's Trust Code over the last 55 years. *See, e.g.*, power to adjust adopted from the 1997 UPIA in 2001 as La. R.S. 9:2158-2163.

3. Upon recommendation of the Louisiana Law Institute, many of the provisions on allocating receipts and expenses were updated in the 2020 Louisiana legislative regular session (Act No. 17), effective January 1, 2021. Louisiana did not incorporate all of the provisions of UPIA (1997) or UFIPA (2018).

B. Allocation to Beneficiaries of Income and Principal (La. R.S. 9:2142)

1. The allocation of a trust receipt or expense to income, principal or partly to both is governed by the terms of the trust, including any provision giving the Trustee discretion, but if there is no provision in the trust to the contrary, then in accordance with the provisions of the Trust Code. It is important to note that the updated rules are <u>default</u> rules, assuming the trust instrument does not specify for a different result, such as the allocation of mineral royalties and timber receipts between income and principal.

2. If neither the trust instrument nor the Trust Code applies, under prior law the receipt or expense was allocated entirely to principal. The new law changes this default rule. It provides that the allocation shall be made in accordance to "what is reasonable and equitable" in view of those entitled to income and principal in an attempt to be fair to all beneficiaries.

C. Succession Receipts and Expenses (La. R.S. 9:2148)

1. Prior law allocated succession receipts and expenses to a legacy interest held in trust in accordance with Louisiana law regulating donations *mortis causa.*

2. Under the new law, such receipts and expenses are allocated in accordance with what is "reasonable and equitable" in view of interests of both income and principal beneficiaries, assuming nothing in the trust instrument to the contrary. Revision Comments indicate that information from the succession representative may be helpful to the Trustee in making the appropriate allocation between the income and principal beneficiaries, but recognizes that in some cases, it may be very difficult for a Trustee to reconstruct the nature of an expense allocated to the legacy during the succession administration, in which case the Trustee is granted the flexibility of allocating receipts and expenses upon a "reasonable and equitable" basis.

D. Allocation of Receipts from Juridical Persons (La. R.S. 9:2149)

1. When Louisiana incorporated portions of the 1962 UPIA in its Trust Code, the dominant form of business was the corporation. The new law deletes provisions regarding "corporate" distributions and substitutes the term "juridical persons", which includes corporations, partnerships, and limited liability companies. La. R.S. 9:2146 and 9:2149.

2. The new law classifies as principal all non-monetary property distributions to the trust received on account of the trust's interest in a juridical person. La. R.S. 9:2149B(1).

3. Monies received in a partial liquidation of an interest in a juridical person owned by a trust generally are allocated to principal. A partial liquidation is defined to occur if the total amount of money and property received in a distribution or series of related distributions is greater than 20% of the juridical person's gross assets as reflected in year-end financial statements immediately preceding the initial receipt (La. R.S. 9:2149C). Money is not considered received in partial liquidation nor is it taken into account for purposes of the 20% or more test, to the extent that it does not exceed the income tax that the Trustee or beneficiary must pay on taxable income of the juridical person that distributes the money. (La. R.S. 9:2149D).

    a. Revision Comments (b) to La. R.S. 9:2149 notes that a cash distribution may be large from a juridical person (such as more than 10% but less than 20% of a juridical person's assets), such as cash from a source other than the conduct of its normal business operations because it sold an investment asset, or sold a business asset other than one held for sale to customers in the normal course of business and did not replace it, or borrowed a large sum of money and secured the loan with a substantial asset. In such cases, the Trustee, after considering the total return from the portfolio as a whole and the income component of that return, may decide to exercise the power to adjust under La. R.S. 9:2159 between income and principal.

4. Notwithstanding La. R.S. 9:2149, if the receipt is one to which a more specific provision of the Trust Code applies, a Trustee may allocate the receipt based upon the source or character of the receipt and may rely upon a statement made by the

juridical person regarding the source or character of the receipt (La. R.S. 9:2149E). For example, if the source of the receipt is due to the Trust's interest in an LLC deriving funds from minerals, then the Trustee may allocate the receipt in accordance with La. R.S. 9:2152 dealing with receipts from minerals.

E. Obligation to Pay Money (La. R.S. 9:2150)

1. The revision is based on Section 406 of the UPIA (1997).

2. However, the revision changes the law by providing that the entire <u>increase</u> in value of discount obligations is attributable to income if the obligation purchased or acquired by the Trustee has a maturity of less than one year.

F. Sole Proprietorship (La. R.S. 9:2151)

1. Revised to make it clear that this provision applies only to the Trustee's operation of a sole proprietorship (which is not a juridical person).

2. The operation of other business forms now is covered under La. R.S. 9:2149 (juridical persons).

G. Insurance Contracts (La. R.S. 9:2151.1)

1. New provision dealing with insurance proceeds is based upon Sec. 407 of the UPIA (1997).

H. Deferred Compensation, Annuities and Other Similar Payments (La. R.S. 9:2152.2)

1. To the extent payments from certain types of deferred compensation, phantom stock plans and similar plans are characterized as interest, a dividend or payment in lieu thereof, such payments are to be allocated to income, with the balance of such payment allocated to principal. [La. R.S. 9:2152.2A(1)].

2. With respect to IRAs or other similar arrangements, if the payment is required to be made (either under federal income tax rules, or, in the case of a plan not subject to those rules, under the terms of the plan) and no part of the payment is characterized as interest, a dividend, or an equivalent payment, then 10% of the amount received is to be allocated to income and the balance to principal. All other payments are to be allocated to principal, including payments made to a Trustee in exercising a right of withdrawal. [La. R.S. 9:2152.2A(2)].

3. Nevertheless, if a trust is intended to qualify for a marital deduction, the Trustee may allocate an additional amount to income as may be necessary to preserve the marital deduction. (La. R.S. 9:2152.2B). *See also* La. R.S. 9:2164.

I. Proceeds of Mineral Interests (La. R.S. 9:2152)

1. Unlike the UPIA, new revision allows for allocation of royalties, overriding royalties, shut-in payments, take-or-pay payments, or bonus in accordance with what is "reasonable and equitable" in view of the interests of those entitled to income and principal. [La. R.S. 9:2152A(3)]. Prior law allocated the royalty payments associated with oil and gas leases 72.5% to income and 27.5% to principal.

2. An allocation of a receipt under La. R.S. 9:2152 is "presumed" to be reasonable and equitable if allocated 10% to income and 90% to principal, but any other allocation by the Trustee is not to be presumed to be unreasonable or inequitable. (La. R.S. 9:2152D). The 90% to principal represents a drastic change from 27.5%. Note that a trust instrument providing for a specific allocation supersedes the Trust Code default rule.

3. For oil and gas interests already included in a trust as of January 1, 2021, the Trustee has discretion in deciding whether to apply the old or new default rules. (La. R.S. 9:2152C).

J. Timber (La. R.S. 9:2153)

1. New law retains the allocation of timber receipts in accordance with what is reasonable and equitable in view of the interests of both the income and principal beneficiaries, assuming the trust instrument itself does not provide a specific allocation.

2. Similar to the allocation of mineral interests, an allocation of 10% to income and 90% to principal is presumed to be reasonable, but any other allocation by the Trustee is not to be presumed to be unreasonable or inequitable. (La. R.S. 9:2153B).

K. Other Property Subject to Depletion (excluding mineral and timber interests) (La. R.S. 9:2153)

1. Under prior law, receipts in excess of 5% of the trust's inventory value were allocated to income and the balance to principal.

2. New law makes the depletion allowance consistent with the "reasonable and equitable" standard for mineral royalty interests and timber interests and adopts a 90% to principal, 10% to income safe harbor.

L. Charges (La. R.S. 9:2156)

1. Deletes references for depreciation allowances chargeable to income in favor of a new provision in La. R.S. 9:2156.1.

2. Deletes allocation of taxes upon receipts defined as income and payable by the Trustee in favor of a new provision in La. R.S. 9:2156.2.

3. Deletes the provision that allocated to principal all expenses not otherwise allocated to income in favor of new provision in La. R.S. 9:2142.3.

M. Transfers from Income to Principal for Depreciation (La. R.S. 9:2156.1)

1. Prior law required the Trustee to charge a reasonable allowance for depreciation against income for depreciable property (other than residential property used by the beneficiary).

2. New law gives the Trustee discretion to transfer to principal a reasonable amount of the net cash receipts from a principal asset that is subject to depreciation.

N. Income Taxes (La. R.S. 9:2156.2)

1. New law addresses the allocation of taxes required to be paid by the Trustee on the trust's share of a juridical person's taxable income. (La. R.S. 9:2156.2C).

2. A tax required to be paid by a Trustee on its share of a juridical person's taxable income (such as from an S corporation or partnership) is to be made from income or principal receipts to the extent that receipts from the juridical person are allocated to each. If such tax exceeds the total receipts from the juridical person, such excess is to be paid from principal.

3. However, after applying the foregoing provision, the Trustee is required to adjust income or principal receipts to the extent that the Trust's taxes are reduced because the Trust receives a distribution deduction for payments made to a beneficiary. (La. R.S. 9:2156.2D).

O. Allocations to Beneficiaries of Usufruct and Naked Ownership

1. Allocations to beneficiaries of usufruct and naked ownership interests (La. R.S. 9:2143) were also updated in the 2020 Louisiana legislative regular session (Act No. 17), effective January 1, 2021, upon recommendation of the Louisiana Law Institute.

2. This revision modifies the law, in part, by making minor semantic clarifications and by deleting the "prudent man" rule that existed under prior law because persons of "ordinary prudence, discretion, and intelligence" do not generally consider the interests of successor beneficiaries in managing their own affairs. *See, e.g.*, UPIA (1997) §103, Comment. Trustees, however, should consider the interests of all beneficiaries in discharging their fiduciary obligations.

P. Federal Tax Rules Recent Guidance - Certain Deductions of Trusts and Estates

1. The Tax Cuts and Jobs Act of 2017 made the ability to deduct previously deductible expenditures of a trust or of an estate unclear. Specifically, the Tax Cuts and Jobs Act suspends all miscellaneous itemized deductions from 2018 through 2025 by adding section 67(g) to section 67. The enactment of new § 67(g), which states that "no miscellaneous itemized deduction" is allowed until 2026, left many estates and trusts wondering whether their investment-related and tax-related

expenses (e.g., return preparation fees, trustee fees, financial advisor fees, etc.) peculiar to the administration of an estate or trust remain deductible, either in whole or in part.

2. On July 13, 2018, the IRS announced in Notice 2018-61 that Treasury and the IRS do not read new § 67(g) to disallow all investment- and taxrelated expenses of estates and non-grantor trusts. Thus, the Treasury Department and the IRS intend to issue regulations clarifying that estates and non-grantor trusts may continue to deduct investment and tax-related expenses just as they could prior to the enactment of new § 67(g). Notice 2018-61 also announced that Treasury and the IRS are aware of concerns surrounding whether new § 67(g) impacts a beneficiary's ability to deduct investment- and tax-related expenses pursuant to § 642(h) (unused loss carryovers and excess deductions) upon termination of an estate or non-grantor trust. Treasury and the IRS intend to issue regulations addressing these concerns as well.

3. On May 11, 2020, the IRS issued proposed regulations clarifying that certain deductions allowed to an estate or non-grantor trust are not miscellaneous itemized deductions. REG-113295-18, Effect of Section 67(g) on Trusts and Estates, 85 F.R. 27693 (5/11/20); these proposed regulations were finalized on September 21, 2020; T.D. 9918; Treas. Regs. Sec. 1.67-4; Treas. Regs. Sec. 1.652(h)-2; Treas. Regs. Sec. 1.642(h)-5). Based upon comments received pursuant to Notice 2018-61 above, the IRS issued proposed regulations clarifying that deductions described in § 67(e)(1) and (2) are not miscellaneous itemized deductions. The proposed regulations would amend Reg. § 1.67-4 to clarify that § 67(g) does not deny deductions described under § 67(e)(1) and (2) for estates and nongrantor trusts. These deductions generally include administration expenses of the estate or trust which would not have been incurred if the property were not held in such trust or estate and the personal exemption deduction of an estate or non-grantor trust. Such deductions are allowable in arriving at adjusted gross income (AGI) and are not considered miscellaneous itemized deductions under § 67(b).

   The proposed regulations also provide guidance under § 642(h) in relation to net operating loss and capital loss carryovers under subsection (h)(1) and the excess deduction under (h)(2). They implement a more specific method aimed at preserving the tax character of three categories of expenses. Thus, fiduciaries are required to separate deductions into at least the following three categories: (1) deductions allowed in arriving at adjusted gross income, (2) non-miscellaneous itemized deductions, and (3) miscellaneous itemized deductions. Under this regime, each deduction comprising the § 642(h)(2) excess deduction retains its separate character which passes through to beneficiaries on termination of the estate or trust. Separately stating these categories of expenses facilitates proper reporting by beneficiaries.

   The proposed regulations adopt the principles used under Reg. § 1.652(b)-3 in allocating items of deduction among the classes of income in the final year of a trust or estate for purposes of determining the character and amount of the excess deductions under section 642(h)(2). In general, Reg. § 1.652(b)-3 provide that deductions attributable to a particular class of income retain their character. Any remaining deductions that are not directly attributable to a specific class of income are allocated to any item of income (including capital gains) with a portion allocated to any tax-exempt income. *See* Reg. § 1.652(b)-3(b), (d). The character and amount of each deduction remaining represents the excess deductions available to the beneficiaries.

II. Power to Make Property Productive of Income (La. R.S. 9:2164)

A. The new law repeals La. R.S. 9:2155 dealing with underproductive property in general and replaces it with La. R.S. 9:2164.

B. A spouse may make an appropriate demand that the Trustee "take action" to make trust assets more productive of income if the following conditions are met:

1. A marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the spouse with sufficient income from or use of trust assets; and

2. The amounts that the Trustee transfers from principal to income under the power to adjust (La. R.S. 9:2158) and distributes to the spouse from principal pursuant to the terms of the Trust are insufficient to provide the spouse an interest required to obtain the marital deduction.

3. The spouse's demand may be for the Trustee to make property productive of income, convert property within a reasonable time, or exercise the power to adjust. Once the spouse makes an appropriate demand, the Trustee must decide which action or combination of actions to take.

C. La. R.S. 9:2127 provides that "[a] trustee's investment and management decisions are to be evaluated in the context of the trust property as a whole…" The law in prior La. R.S. 9:2155 gave each income beneficiary a right to receive a portion of the proceeds from the sale of underproductive property as "delayed income." This provision applied on an asset-by-asset basis and not by taking into consideration the trust portfolio as a whole and thus conflicted with the basic precept in La. R.S. 9:2127. Moreover, in determining the amount of delayed income, the prior law did not permit the trustee to take into account the extent to which the trustee may have distributed principal to the income beneficiary, under principal invasion provisions in the terms of the trust, to compensate for insufficient income from the unproductive asset. Under prior La. R.S. 9:2158, a trustee must consider prior distributions of principal to the income beneficiary in deciding whether and to what extent to exercise the power to adjust.

III. Power To Adjust

A. A Trustee owes duties to all trust beneficiaries and therefore is not supposed to favor investments which generate income (for the income beneficiaries) over investments which appreciate (for principal beneficiaries) or vice versa. Because modern investment theories and the expected return on certain investments constantly change (e.g. the recent period of low interest rates and high asset appreciation), Louisiana granted a trustee the power to adjust so that the trustee can make prudent investments which may not be productive of current income but still make distributions to income beneficiaries.

B. Under certain circumstances, a Trustee may make adjustments between income and principal when it is appropriate to invest for total return. La. R.S. 9:2158-63. Generally, the power to adjust applies to all trusts created on or after January 1, 2002, and with respect to trusts created before January 1, 2002, commencing January 1, 2004. However, the power to adjust can apply at an earlier date if designated in the trust instrument or approved in writing by all current beneficiaries. Generally, a Trustee may make adjustments from principal to income to bring net income up to 5% of the net fair market value of the trust assets at the beginning of the year or may make adjustments from income to principal to bring net income down to no less than 5% of the net fair market value of the trust assets at the beginning of the year. Court approval is required if adjustment from principal to income would increase net income beyond 5% or adjustment from income to principal would reduce net income below 5%. La. R.S. 9:2161.

One concern is whether a corporate Trustee would exercise this power, even up to 50%, without prior court approval, thus defeating the intent that the Trustee alone should exercise this discretion without incurring the legal costs and expenses of seeking court approval.

IV. Beneficiary's Release of Trustee Liability (La. R.S. 9:2207 as amended by Act 18, effective August 1, 2020)

A. New law clarifies that the beneficiary's authorized representative, such as a mandatary, tutor, or curator, may act on behalf of the beneficiary.

B. New law also removes the limitation which prevented a beneficiary from agreeing to relieve a Trustee for "improperly advancing or conveying property" to a beneficiary of a spendthrift trust or a trust with restrictions on the beneficiary's right to alienate the beneficiary's interest.

V. Transfer on Death (TOD) or Payable on Death (POD) Accounts

A. Recent trends across the nation have provided for a low-cost and automatic method to transfer financial accounts of a decedent without the necessity of a probate through a POD or TOD revocable beneficiary designation on the account in which the owner retains all ownership rights while living. *See* Uniform Transfer on Death Securities Registration Act. Many states also have adopted versions of the Uniform Real Property Transfer on Death Act (URPTODA).

B. Banks, savings banks, credit unions and mutual associations are authorized to offer POD accounts. La. R.S. 6:314, La. R.S. 6:1255D, La. R.S. 6:653.1, and La. R.S. 6:766.1.

C. In 1997, the Louisiana State Legislature adopted a resolution directing the Louisiana Law Institute to study and make recommendations regarding the possible adoption in Louisiana of the Uniform Transfer on Death Security Registration Act. Legislation was proposed to adopt a version of the UTDSRA in 1997, 1998, 1999, 2004, 2005 and recently in 2020. Such legislation failed to pass until Act No. 167, described below.

D. Despite the fact that Louisiana has not adopted the UTDSRA (until Act No. 167, described below), many brokers for Louisiana residents open brokerage accounts as TOD or POD as well as tenants-in-common (TIC), joint tenants (JT) or joint tenants with rights of survivorship (JTROS). Are such designations valid?

1. *Succession of Robert Schimek, Sr.*, 2019-CA-1069 (La. App. 4th Cir. 6/10/2020): Dr. Schimek, a New Orleans physician and businessman, had a TOD securities account with Vanguard which provided that upon his death, 50% would be paid to one of his two sons from a previous marriage and 50% to his surviving spouse. Vanguard made payment in accordance with the TOD designation. The co-Executors sought to have the account, worth about $2.1 million, paid to the succession account for distribution in accordance with Dr. Schimek's Last Will. Under the terms of the Vanguard Transfer on Death Agreement signed by Dr. Schimek which designated his TOD beneficiaries, the TOD account was governed under Pennsylvania law. Pennsylvania adopted a version of the UTDSRA. <u>Held</u>, that the issue was one of "contract" law and choice of law. The court determined that under the Vanguard contract establishing the TOD account, Pennsylvania law should be applied and therefore, the TOD designation should be given effect, unless the contract violated Louisiana public policy. The court noted that although the Louisiana legislature had not explicitly authorized or specifically prohibited TOD transfers for securities accounts, Louisiana allows assets to pass to designated beneficiaries for retirement accounts, life insurance, pensions and certain POD bank accounts. Furthermore, the son, who was a 50% TOD beneficiary, argued that under the Louisiana Commercial Laws (La. R.S. 10:8-102 and 10:8-107), TOD transfers were allowed. The court found the co-Executors' argument that TOD violated Louisiana public policy "unpersuasive".

2. Note that *Schimek* did not involve issues of community property or forced heirship. Furthermore, *Schimek* involved a written contract executed by the account owner with a specific choice of law state which recognizes TOD designations (other than Louisiana).

3. Some brokers are registering accounts as tenants-in-common. A TIC designation is an arrangement in which two or more people have ownership interests in the account but with no rights of survivorship so that upon one owner's death, his or her interest passes to his or her estate. This can present practical problems for community-owned accounts for Louisiana spouses unless a 50/50 percentage is designated or the financial institution agrees to recognize the account as community property. TIC could result in loss of tax basis adjustment for the entire community security at death.

E. Notwithstanding the foregoing, Act No. 167, effective January 1, 2022, and applicable only to registrations of securities in beneficiary form made on or after January 1, 2022, enacts La. R.S. 9:1711 through 1711.9.

From a drafting standpoint, if by will D leaves his estate to X, but has a TOD brokerage account which D did not disclose to the attorney or opens a TOD account after executing his will, it would appear that the will trumps since TOD is not determinative of "ownership" as in other states. Wills may have to specifically exclude any TOD accounts existing at the date of death.

Act No. 167 is summarized as follows:

New law enacts the Louisiana Uniform Transfer on Death Security Registration Act, which provides for the transfer of certain securities to a beneficiary on the death of the owner of such securities.

Provides definitions. Defines "security" as a share, participation, or other interest in movable property, in a business, or in an obligation of an enterprise or other issuer, and includes a certificated security, an uncertificated security, and a security account. It shall not include a share, participation, or other interest in immovable property.

Provides that only individuals whose registration of a security shows sole ownership by one individual or multiple ownership by two or more with right of survivorship, rather than as co-owners in in division or tenants in common, may obtain registration in beneficiary form.

Provides that a registration of a security in beneficiary form does not constitute a donation inter vivos or mortis causa. A registration of a security in beneficiary form may be canceled or changed at any time by the sole owner or any of the surviving owners without the consent of the beneficiary.

Provides that, on proof of death of a sole owner or the last to die of all multiple owners, and compliance with any applicable requirements of the registering entity, a security registered in beneficiary form may be registered in the name of the beneficiary or beneficiaries who survived the death of all owners, but such registration in the name of the beneficiary or beneficiaries has no effect on ownership.

Provides certain procedures. Provides that by accepting a request for registration of a security in beneficiary form, the registering entity agrees that the registration will be implemented on death of the deceased owner as provided in new law. Further provides that such registering entity is discharged from all claims to a security by the estate, surviving spouse, creditors, heirs, legatees, or forced heirs of a deceased owner if it registers a transfer of the security in accordance with the new law and does so in good faith reliance (a) on the registration, (b) on the new law, and (c) on information provided to it by affidavit of the succession representative of the deceased owner, or by the surviving beneficiary or by the surviving beneficiary's representatives.

Provides that its protections do not extend to a registration or payment made after a registering entity has received written notice from any claimant to any interest in the security objecting to implementation of a registration in beneficiary form. No other notice or information available to the registering entity affects its right to protection under the new law. Also provides that its protections to the registering entity of a security does not affect the rights of succession representatives, surviving spouses, heirs, legatees, forced heirs, or creditors in disputes between themselves and other claimants to ownership of the security transferred or its value or proceeds.

Authorizes certain terms, conditions, and forms for registration.

Provides that it shall become effective on January 1, 2022, and shall apply only to registrations of securities in beneficiary form made on and after that date. Also provides that it does not preclude or govern the application of payable on death accounts and other transfers by a bank or savings institution as authorized by Title 6 of the Louisiana Revised Statutes of 1950.

Effective January 1, 2022.

(Adds La. R.S. 9:1711-1711.9)

VI. Trust Modification

A. Louisiana law is relatively restrictive in the methods and extent to which an irrevocable trust can be modified.

Although a Settlor may reserve the power to modify and revoke a trust under La. R.S. 9:2021, he cannot delegate that power in full to others. La. R.S. 9:2025 provides: A settlor may delegate to another person the right to terminate a trust, or to modify the administrative provisions of a trust, but the right to modify other provisions of a trust may not be delegated except as provided in La. R.S. 9:2031.

Additional provisions apply for trusts with non-natural persons as beneficiaries.

La. R.S. 9:2031 provides:

> A. A trust instrument may authorize a person who is in being on the date of the creation of the trust to modify the provisions of the trust instrument in order to add or remove beneficiaries, or modify their rights, if all of the affected beneficiaries are descendants of the person given the power to modify. A beneficiary added pursuant to this Section may be a person who is not in being when the trust is created, provided the individual is in being at the time the power to add is exercised.
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> B. As to a class trust, a trust instrument may authorize a person who is in being on the date of the creation of the trust, or a person who is not yet in being but is a member of the class, to modify the provisions of the trust instrument in order to remove beneficiaries or modify their rights or add only those beneficiaries included within the scope of La. R.S. 9:1891, if all of the affected beneficiaries are descendants of the person given the power to modify.

We see several situations daily where clients request trust modifications. First, ancestors often create trusts for young descendants with the idea that the trust should terminate when the descendant attains a particular age (like 25). Unfortunately, many trust beneficiaries do not mature or behave as hoped (e,g,, if non-productive economically, socially and/or personally) or become dysfunctional (e.g., drug or alcohol addiction) such that the termination of a trust at the specified term is not in the best interest of this "difficult beneficiary" or that such a distribution thwarts the Settlor's intention as expressed in the trust instrument. This would not seem to be permitted under 9:2031. Second, there is often a need to amend or modify a trust to address or update successor trustee provisions. This seems to be permitted under Section 9:2031. A third situation that often arises where trust modifications are desired relates to alternate beneficiaries under shifting of interest clauses (who take if a principal beneficiary dies prematurely). This seems to be permitted under Section 9:2031.

If a Settlor knows or suspects a beneficiary is or may become "difficult," the Settlor may consider adding a provision to the trust authorizing an ascendant of the difficult beneficiary to modify the trust to remove the difficult beneficiary or modify his/her rights.

The Settlor may authorize a person who is in being on the date of the creation of a non-class trust to modify its provisions in order to add or remove beneficiaries, or modify their rights, if all of the affected beneficiaries are descendants of the person given the power to modify. A beneficiary added to a non-class trust who is not in being when the trust is created must be in being at the time the power to add is exercised.

The Settlor of a class trust may authorize who is in being on the date of the creation of the trust, or a person who is not in being but is a member of the class, to modify the provisions of the trust in order to remove beneficiaries or modify their rights or add only those beneficiaries included within the scope of permissible class beneficiaries under La. R.S. 9:1891, if all of the affected beneficiaries are descendants of the person given the power to modify. La. R.S. 9:2031B.

A proper court may order a modification of a trust if the continuance of the trust unchanged would defeat or substantially impair the purposes of the trust. If the trust is terminated, the court is required to provide for a distribution of the trust property, including principal and undistributed income, to the beneficiaries in a manner that conforms as nearly as possible to the Settlor's intention. La. R.S. 9:2026A.

Other states permit settlors, trustees and beneficiaries to enter into non-judicial settlements to modify or restate trusts. Cf., La. R.S. 9:2028 (providing that except as otherwise provided by law or the trust instrument, the consent of all settlors, trustees, and beneficiaries shall not be effective to terminate the trust or any disposition in trust).

Despite restrictive Louisiana law and often times a trustee's best efforts to ensure effective trust administration, a need to amend or modify a trust (whether to deal with a difficult beneficiary or otherwise) may persist. In such an instance, a trustee may:

i. Consider judicial permission to deviate from the administrative provisions in the trust instrument if compliance would defeat or substantially impair the purposes of the trust. La. R.S. 9:2004.

ii. Consider judicial permission to deviate from administrative provisions imposed under the Louisiana Trust Code. La. R.S. 9:2065.

iii. Consider judicial permission or direction to deviate from the investment provisions of the trust instrument. La. R.S. 9:2066.

iv. Consider exercising the Trustee's power to adjust between income and principal, with or without court approval. La. R.S. 9:2158-2163.

v. Consider seeking court instructions.

Either the Trustee or the beneficiary may seek court instructions concerning the trust, its interpretation or its administration. La. R.S. 9:2233.

However, where the Trustee is granted discretion, it has a duty to act and use its judgment in reaching a fair and reasonable decision and not to abdicate its discretionary authority to a judge. As the court stated in *Marlin Abadie Inter Vivos Trust*, 2000-CA-2029 (La. App. 4 Cir. 2001), 791 So.2d 181, 189, *rehearing denied*;

> The Supreme Court of Louisiana has held that a trustee may apply to the court for instructions only when there is a reasonable doubt as to its duties or powers. *In Re Gulf Oxygen Welder's Supply Profit Sharing P. & T.A.*, 297 So.2d 663 (La. 1974). The Supreme Court further held that the trustee may not seek instructions as to issues that might not arise <u>or as to matters resting within the discretion of the trustee</u>. (Emphasis added).

In seeking court instructions with regards to the relative rights and interest of various beneficiaries in a trust, the Trustee should not argue for a particular construction, even if the Trustee believes it knows the "correct" interpretation, since the Trustee generally has a duty to act impartially towards all beneficiaries and should not favor, or expend funds litigating, the interest of one beneficiary over another. *See Estate of Coulet v. Goulet*, 898 P.2d 425 (Calif. 1995) (dissenting opinion of Justice Kennard); *The Northern Trust Company v. Heuer*, 560 N.E.2d 961 (Ill. App. 1990).

Sample trust modification language in a Louisiana trust codicil is included in subsection (ii) of the Trust Drafting Considerations attached hereto.

vi. Consider merging into a non-Louisiana trust.

B. Trust Modification - Recent Trust Jurisprudence in other Jurisdictions

1. *Keybank v. Thalman*, 2016 Ohio 2832 (Ohio Court of Appeals 2016); 2018 Ohio App. LEXIS 3639 (2018); *Keybank National Association v. Thalman*, 2020 Ohio 660 (2020): Howard Couse was an attorney that authored several law textbooks. He created a trust for his children and grandchildren from the proceeds of the sales of textbooks. Thereafter, the trust income beneficiaries were his granddaughter (Clough) and grandson (Schlitt). From 1957 through 2006, the trust was administered without incident. In 2006, Schlitt wrote to the trustee calling the income "pathetic and totally inadequate" and threatening to change the trustee. Clough did not want the trust administration modified or a trustee change and was focused on long-term asset growth. In response, the trustee proposed division of the trust into Clough and Schlitt shares. The trust division was completed 2 years later, and 5 weeks after Clough's death. They informed the beneficiaries about the division, the assets were divided, and from that point forward the trusts separately administered for all purposes (including access to information). Several letters from the trustee confirmed the separation. The trustee informed the Clough remainder heirs that upon Schlitt's death they would receive the assets in the Clough trust, and the Schlitt remainder heirs that upon Schlitt's death they would receive the assets in the Schlitt trust. The Schlitt heirs threatened to sue, the trustee changed the final distribution terms to recombine the trusts, and the Clough heirs sued.

Moral: Amendment, revocation, reformation, modification and termination of non-charitable trusts. Claims that trustee breached duties by recombining trusts that had been previously divided survived summary dismissal. On remand, trial court cannot disregard court of appeals finding that a trust has been divided by the trustee. Correct execution of the directives of the court of appeals precludes further pursuit of counterclaims against trustee.

2. *Cleary v. Cleary*, 2020 Md. App. LEXIS 1209 (2020): Upon his death, Victor funded trusts for the benefit of his wife and children. The trusts were funded with interests in Vincent's packaging and shipping company and his wife, Shirley, served as sole trustee. His son, Vincent Jr., was named as first successor trustee and his son, William, was named as second successor trustee. Jr. tried to force Shirley to sell her shares in the company to him, and if she refused threatened to take employees, form a competing company, and destroy his father's company. Shirley dismissed Jr. from the company. Jr. then formed his own company to perform the same business and directly compete with the trust-owned company and tok several employees with him. Shirley sued Jr. and the employees and petitioned to modify the trust to remove Jr. as the first successor trustee. The trial court granted and the Maryland Court of Special Appeals affirmed. The trial court decision was based on the present strife between the two competing companies, which was not contemplated by the settlor (thus trust modification allowed under the Maryland Uniform Trust Code). A purpose of the trust was to grow trust assets for all the beneficiaries, and not just Jr. The modification benefitted all beneficiaries. Jr. started a company that would directly compete with the trust-owned company, and the existence of that company is material evidence supporting the trial court's decision. The competing companies were not contemplated by the settlor, and the strife between Shirley and Jr. did not arise until after the settlor's death.

Moral: Fiduciary appointment and succession. Trust modified to remove named successor trustee who started company to directly compete with company held in trust.

VII. Interim and Final Accounting Considerations

In Louisiana, a Trustee is required in provide an annual accounting to trust beneficiaries as well as a final accounting. 9:2088 and 9:2234.

Many ancestors who create trust for tax purposes or to provide for the long term needs of their descendants do not want their descendants to know about the existence of a trust or its assets for fear that it will cause such descendants to become unproductive or "trust fund babies." In practice most non-professional trustees do not render accountings to trust beneficiaries – often because the Settlor has requested same for the reasons set forth above.

Louisiana appears to require Trustees to keep trust financial records in perpetuity as well (especially where no accountings are provided). *See Chouest v. Chouest*, 2018 CA 1484 (La. App. 1st Cir. 12/19/2019). This also creates an unreasonable burden that few Trustees actually comply with.

Other states have solved this problem by authorizing the creation of silent trusts for which accountings need not be provided to beneficiaries but may be provided to someone else instead or only upon request.

VIII. Shifting of Interests

In limited situations, a vested principal interest may shift to substitute beneficiaries selected by the settlor. La. R.S. 9:1973 *et seq*.

In certain circumstances, upon the principal beneficiary's death, the settlor of the trust may define the substitute principal beneficiaries who take the deceased principal beneficiary's interest, rather than the interest passing to the beneficiary's heirs or legatees.

Since 2016 substitutions have been generally allowed in favor of the beneficiary's descendants only. La. R.S. 9:1973.A(1). Substitutions in favor of others are generally allowed if the beneficiary dies without descendants. La. R.S. 9:1973.A(1). However, if the principal interest in trust represents the beneficiary's forced portion, the shift can only occur if the beneficiary also dies intestate and without descendants. La. R.S. 9:1973.A(2).

La. R.S. § 9:1973 provides the statutory framework for shifting interest in principal:

> A.(1) Except as to the legitime in trust, the trust instrument may provide that the interest of an original or a substitute principal beneficiary of an irrevocable trust vests in one or more of his descendants upon the death of the beneficiary either during the term of the trust or at its termination. The trust instrument may provide that the interest vests in another person if the beneficiary dies without descendants.
>
> (2) With respect to the legitime in trust, the trust instrument may provide that the interest of an original or a substitute principal beneficiary vests in another person upon the death of the beneficiary either during the term of the trust or at its termination, only if a beneficiary dies intestate and without descendants.
>
> B. The trust instrument may provide that the interest of a designated principal beneficiary of a revocable trust shifts to another person, if the substitution occurs no later than the date when the trust becomes irrevocable.

Substitute beneficiaries are also subject to Louisiana's "in being and ascertainable" vesting rules. If the substitute beneficiaries are descendants of the settlor, they only need to be "in being and ascertainable on the date of death of the principal beneficiary." Otherwise, the "in being and ascertainable" requirement applies at the creation of the trust. La. R.S. 9:1975, 1978.

For class trusts, the shifting of interest rules are even more restrictive. La. R.S. § 9:1895 provides:

> A. An interest of a member of the class who dies during the term of the trust vests in his heirs or legatees, unless the trust instrument provides any one of the following:
>
> (1) That the interest of a member of the class who dies intestate and without descendants during the term of the trust vests in the other members of the class.

(2) Except as to the legitime in trust, that the interest of a member of the class who dies without descendants during the term of the trust or at its termination vests in the other members of the class.

(3) Except as to the legitime in trust, that the interest of a member of the class who dies leaving one or more descendants vests in the beneficiary's descendant heirs.

B. For this purpose the term "other members of the class" shall include the successors to the interests of any members of the class who predecease such deceased class member, unless the trust instrument provides otherwise.

IX. Delegation of Trustee Duties

The Louisiana Trust Code prohibits a trustee from delegating to others the doing of acts which he can reasonably be required to perform. La. R.S. 9:2087. However, a trustee may delegate those duties which a person of ordinary prudence might in like circumstances in the management of his own affairs entrust others to perform. *Indian Head National Bank v. Theriault*, 97 N.H. 212, 84 A.2d 828, 830 (1951); *G.C. Bogert & G.T. Bogert, Handbook of the Law of Trusts* § 92, at 330–331 (2d ed. 1973); *see also* La. R.S. 9:2127(A).

La. R.S. § 22087(B)(1) and (2) were amended and reenacted again in 2015. *See* 2015, La. Acts. No. 219 (Regular Session). As amended, those subsections provide as follows:

§ 2087. Delegating performance

B(1) A trustee may, by power of attorney, delegate the performance of acts that he could not reasonably be required to perform personally and the performance of ministerial duties.

B(2) A power of attorney granted by a trustee authorizing a mandatary to alienate, acquire, lease, or encumber specifically described property on specific terms, shall be considered the delegation of the performance of a ministerial duty as provided by Paragraph (1) of this Subsection. The recitation by the trustee in a power of attorney that he has approved the specific terms of the transaction shall be sufficient to demonstrate that the trustee has delegated to the mandatary the performance of a ministerial duty.

The comments to the section indicate respectively (a) that the authority to delegate includes ministerial *and* discretionary duties; (b) that B(2) specifies acts that are ministerial when the trustee specifies the terms on which the mandatary may consummate a transaction, and also notes that any non-ministerial aspects of a transaction should not be delegated unless the trustee could not be reasonably expected to perform them; and (c) that the list of actions specified in B(2) is illustrative and not exhaustive.

The comments following § 2087 state that this section is "similar to § 171 of the Restatement of Trusts 2d, and the laws of most states." The comments following § 171 of the Restatement note the lack of a clearcut line dividing the acts which a trustee can and cannot properly delegate. *Restatement (Second) of Trusts* § 171, comment b (1959). *City of New Orleans v. Cheramie*, 509 So. 2d 58, 60 (La. Ct. App.), *writ denied*, 512 So. 2d 463 (La. 1987).

Whether or not an act is ministerial is a facts and circumstances analysis. Using check signing for an example, if the trustee, or her accountant or bookkeeper prepare the checks and the agent only signs them, the action might be considered ministerial and delegable. If the agent writes a check to purchase hay for cattle on a ranch, this might be ministerial decision if it is a routine function and delegable. If the agent writes a check to purchase an adjacent property or to make a major improvement to a trust-owned property, that likely is a discretionary function that should not be delegated unless the trustee could not be reasonably expected to perform it.

Note that The Restatement Third of Trusts and the Uniform Trust Code both distinguish the trustee's delegation to an agent from the trustee's delegation to another trustee. The Uniform Trust Code states that a trustee "may not delegate to a cotrustee the performance of a function the settlor reasonably expected the trustees to perform jointly." The comment gives the rationale: "the settlor selected cotrustees for a specific reason and … this reason ought to control the scope of the permitted delegation to a cotrustee." There remains a concern about cotrustees "dividing up" the trusteeship functions when not authorized to do so by the settlor.

Using the above check signing example, check signing may be delegated to an agent if it is a ministerial duty or a non-ministerial duty that the trustee could not reasonably be required to perform personally, in either instance based on the facts and circumstances. If the check signing authority is delegated, consideration should be given to using an agent and not a fellow trustee. The delegating trustee should continue to supervise and monitor any delegated duties.

X. Combinations and Divisions of Trusts

Louisiana does authorize a Trustee to combine or divide trusts. Under 9:2030, a Trustee may combine trusts as long as the combination does not impair the rights of beneficiaries nor adversely impact the purposes of a trust. Trust merger provisions may be used as a method to modify certain trust provisions indirectly.

Trust decanting is also permitted in other states. In Louisiana, an existing trust could be named as the beneficiary of another. It is not clear the extent to which distributions from one trust can be made to a trust created thereafter. The Trust code does authorize a trustee to make distributions for the benefit of a beneficiary but it is not clear how broadly this can be applied.

Due to the special virtues of revocable trusts, the Trust Code protects the deferred ascertainment of beneficiaries upon the creation of the trust up until the time the trust becomes irrevocable. La. R.S. 9:2011-2014.

Until the time when the principal beneficiaries are determined, the persons who would be the principal beneficiaries had the time arrived shall be known as "provisional principal beneficiaries" and if such provisional principal beneficiary is not the income beneficiary of the trust, then one provisional principal beneficiary is not considered a beneficiary for any purposes under the Trust Code. La. R.S. 9:2012.

Matter of Niki and Darren Irrevocable Trust, C.A. No. 2019-0302-SG (Delaware Chancery Court 2020): Ildiko created an irrevocable California trust in 2012, with herself as trustee and sole life beneficiary. The trust provided for income only, and not principal, to her as she requested. On her death, the trust would divide into shares – 55% for her daughter Niki and 45% for Niki's husband Darren. In 2014, Ildiko moved the trust to Delaware, changed the governing law to Delaware, and appointed a Delaware bank as co-trustee. Ildiko settled a new Delaware trust with the bank as sole trustee, and then Ildiko and the bank decanted the first trust assets into the second trust. The trustees signed the decanting resolution and all three beneficiaries signed statements of non-objection to the decanting. The second trust allowed principal distributions to Ildiko and also provided that, upon divorce from Niki, Darren's share (which was increased to 50%) would immediately vest, rather than vesting be delayed until Ildiko's death as in the first trust. Niki and Darren divorced. In 2019, the bank petitioned to declare the decanting void. Ildiko supported the petition. The court held the petition was barred by the doctrine of unclean hands on the following grounds: Ildiko, with the bank, seeks to void the decanting as noncompliant with the decanting statute (because the first trust did not allow principal distributions, and also alleging the second trust differed too greatly from the first) four years later – a decanting that Idilko and the bank executed themselves as trustees of the first trust. Idilko is asking the court to void her own action that now appears to be to her and her daughter's detriment (in what is an attack of late-onset settlor's remorse). Ildiko enjoyed the benefits of the decanting, including presumably principal distributions, and only when conditions made her regret her action did she and the bank decide to attack the legitimacy of their own actions. Having previously acted in a fiduciary capacity to decant through what she now asserts were illegal means, Ildiko cannot evoke equity for relief in her own self-interest – relief that would be to the detriment of a beneficiary to whom she owes fiduciary duties.

Moral: Decanting. Petition by trustee to invalidate prior decanting barred by doctrine of unclean hands.

XI. Powers of Appointment

In other states trust settlors routinely include in their trusts "powers of appointment", under which persons other than the settlor determine who will ultimately receive some of the benefits of the trust.

One type of power of appointment routinely drafted elsewhere is to make the surviving spouse the initial beneficiary, and give her the power to "appoint" the corpus; and, in the absence of the exercise of the power, the corpus goes to the descendants of the settlor. Previously the power of appointment caused many Louisiana individuals who wanted to give their surviving spouse their entire estate, but, in order to get the benefit of the "applicable credit amount' (a/k/a "the unified credit") under Section 2010 of the Internal Revenue Code, thereby reducing the overall U.S. estate tax, they could only give the spouse only an income interest in part of their estate. If the spouse were given a power to appoint among the descendants, the spouse would have something closer to full ownership without foregoing the use of the unified credit.

Section 2025 of the Trust Code, consistent with Civil Code article 1572, generally restricts powers of appointment, with the following seen as exceptions to that rule:

> Section 1961C allows the trust instrument to give a trustee (who is not a beneficiary) the authority to allocate income among the designated income beneficiaries, with or without objective standards.
>
> La. R.S. 2024 provides that "all surviving competent settlors must concur in a modification of the trust." This appears to permit the trust instrument to allow a surviving settlor to modify the provisions of a trust even as to the interest of a deceased settlor.
>
> La. R.S. 2045 allows delegation of the right to revoke, which can change who gets the corpus of the trust.

In addition, La. R.S. 2031 states, in part, that a trust instrument may authorize a person who is in being on the date of the creation of the trust to modify the provisions of the trust instrument in order to add or remove beneficiaries, or modify their rights, if all of the affected beneficiaries are descendants of the person given the power to modify. La. R.S. 2031 supports taking a position that Louisiana allows a very limited power of appointment.

Under this provision, for example, a married person could put property in trust for the surviving spouse as income beneficiary, and their joint children as principal beneficiaries, and could authorize the spouse to modify the trust to change the percentage interests of the children, even to add more remote descendants. In this manner the surviving spouse, if also named as trustee, has rights that come very close to full ownership but without losing the ability to exempt this part of the first spouse's estate from being taxed at either spouse's death.

XII. Trust Protectors and Advisory Committees

The Louisiana State Law Institute rejected legislation for Trust Protectors and instead clarified the law on bifurcation of Trustee duties among Trustees (see "Delegation of Trustee Duties" section above). Case law in Louisiana is somewhat uncertain on the legality of a Trust Protector (depending on his functions) and even if authorized, there remains the issue of drafting regarding fiduciary duties, obligations, and liability of a Trust Protector.

However, such Trust Protectors and Advisors Committees are increasingly popular requests we receive when drafting trust agreements.

Sample language related to such an advisory committee and trust protector in a Delaware trust agreement is included in subsection (iii) of the Trust Drafting Considerations attached hereto.

(i) TRUST DRAFTING CONSIDERATIONS

Sample Unitrust Language

A. The name of this trust shall be the [•] Income Trust.

B. This is a spendthrift trust.

C. All trust income shall be distributed to my wife, the income beneficiary, until her death, not less than quarterly. In addition, should the trustee determine, on the advice of a practicing licensed physician, that my wife needs particular medical care, attention or treatment (including nursing home care or home health care), and should the trustee further determine, in its sole discretion, that my said wife needs resources for such purposes in addition to her income from the trust, the trustee may at any time distribute principal to or for the account of my wife for such purposes, provided that my trustee may, at its discretion, consult one or more additional practicing licensed physicians for advice concerning the need and propriety of the recommended care, attention or treatment or the quality, medical reputation, and status of any particular hospital or other medical facility chosen by her or recommended by her attending physician; provided, further, that this provision shall be strictly construed and in no event shall the trustee have the authority to invade principal for any purpose other than for the bona fide medical expenses of my wife and then only to the extent the trustee determines the need in accordance with the standard above set forth.

Trust income is, to the extent legally permissible, hereby defined to be the greater of ordinary net income (including, but not by way of limitation, rentals, interest and dividends) for each year or three and one-half (3.5%) percent of the fair market value of the trust on January 1st of each calendar year. The purpose of this income definition is to prevent there being a conflict between the fiduciary duty due an income beneficiary versus the duty due the principal beneficiary and to encourage the trustee to invest trust corpus to obtain a good total return without having to consider the differences between capital appreciation and ordinary income in relationship to its duties to the income beneficiary versus its duties to the principal beneficiary. For purposes of calculating income taxes, all distributions to [•] shall be first deemed to be a distribution of ordinary income, second to be deemed a distribution of capital gains, and third to be deemed a distribution of principal.

…

(ii) TRUST DRAFTING CONSIDERATIONS

Sample Trust Modification Language

a. The Trustee is authorized to modify the administrative provisions hereof.

b. Any Trustee who is a descendant of Settlor may add his or her descendants as beneficiaries to the trust.

c. The Trustee shall have the power to divide the trust into separate trusts for each beneficiary and to merge said trusts into other trusts. In connection with any division of trusts, the Trustee may allocate different assets to different trusts provided that the allocation is fairly representative of the appreciation and depreciation from the federal estate tax values through the date of division of all assets available for division at that time. In connection with any merger of trusts, the Trustee may merge the trusts into other trusts provided that the merger does not impair rights of any beneficiary or adversely affect the purpose of the trust and that all beneficiaries with a current interest in the trust are notified in writing by the Trustee of such merger.

…

(iii) TRUST DRAFTING CONSIDERATIONS

Sample Language Related to Advisory Committee and Trust Protector

TENTH Investment Direction Adviser. Notwithstanding any other provision of this Agreement, there may at any time be one or more Investment Direction Advisers (the "Investment Direction Adviser" or "Investment Direction Advisers") to serve in accordance with this Article ____. The role and function of the Investment Direction Adviser is set forth in this Article ____. The Investment Direction Adviser shall serve in a fiduciary capacity and conform to the purposes of this Agreement.

(a) Role and Function. The Investment Direction Adviser shall hold and exercise the full power to direct the Trustee as to the investments of the Trust. Notwithstanding the foregoing, during such time as either Grantor is serving as Investment Direction Adviser, such Grantor shall not participate in any investment decision regarding the Special Holdings. The Investment Direction Adviser's power to manage the investments of the Trust estate (other than the Special Holdings as to either Grantor) shall include, but not be limited to, the power to direct the Trustee to purchase, sell and retain all of the Trust assets, and the power to direct the Trustee to exercise voting, subscription, conversion, option and similar rights with respect to such property and to participate in and consent to any voting trust, reorganization, merger, dissolution or other action affecting any such property. The Trustee shall follow the direction of the Investment Direction Adviser with respect to all matters relating to the management and investment of Trust assets (other than the Special Holdings as to either Grantor). The Investment Direction Adviser (other than either Grantor) shall hold and exercise the full power to direct the Trustee with respect to the management and investment the Special Holdings. In the event no Investment Direction Adviser other than a Grantor is then serving, the Trust Protector shall hold and exercise the full power to direct the Trustee with respect to the management and investment the Special Holdings. In the event no Investment Direction Adviser is then serving, the Trustee shall hold and exercise the full power to manage and invest the Trust assets, including the Special Holdings.

(b) Liability of Trustee. At any time that an Investment Direction Adviser is serving, the Investment Direction Adviser shall have sole responsibility (and the Trustee shall have no responsibility) for the investment and management of the assets of the Trust and the Trustee shall make only such sales and investments as the Investment Direction Adviser directs. The Trustee shall be under no obligation to review the Trust assets, make any investment recommendations with respect to them, solicit any direction from the Investment Direction Adviser, value the assets if they are non-marketable, or insure the assets. The Trustee need not review whether the Investment Direction Adviser is satisfying its responsibilities hereunder. The Trustee shall incur no liability for any act or failure to act by the Investment Direction Adviser, or for acting on a direction of the Investment Direction Adviser or with respect to its implementation of any such direction of the Investment Direction Adviser and the Trustee shall not be liable for any loss resulting from action taken by the Investment Direction Adviser, or taken by the Trustee in accordance with the Investment Direction Adviser's direction.

(c) Indemnification. The Trustee shall, to the extent of the Trust assets and solely payable from the Trust assets, indemnify the Distribution Adviser for all losses, costs, damages, expenses and charges, public and private, including reasonable attorneys' fees, including those arising from all litigation, groundless or otherwise that result from the performance or non-performance of the powers given to the Distribution Adviser under this Agreement (unless the Distribution Adviser has acted in a manner that does not comply with the standard of liability applicable to the Distribution Adviser).

(d) Resignation of Distribution Adviser. Any Distribution Adviser serving hereunder may resign at any time by providing written notice to the Trustee, the Trust Protector and the Notice Recipients. Such resignation shall become effective at such time as the resigning Distribution Adviser shall provide in the notice of resignation.

(e) Removal of Distribution Adviser. The following individuals, in the order named, shall have the power to remove any Distribution Adviser by providing written notice to such Distribution Adviser, the Trustee and the Notice Recipients. The removal shall become effective at such time as indicated in the notice of removal.

1. The Grantors, jointly, while living and competent, followed by the surviving Grantor, while living and competent;

2. Prior to the division of the Trust estate in accordance with section __ of Article ____, and after the death and/or incapacity of both Grantors, a majority of the Grantors' Children who have attained the age of forty (40) years; and

3. After the division of the Trust estate in accordance with section __ of Article ____, and after the death and/or incapacity of both Grantors, the Primary Beneficiary, if the Primary Beneficiary is competent and at least forty (40) years of age; provided, if the Primary Beneficiary is under the age of forty (40) years or incapacitated, a majority of the Grantors' descendants who are competent and have attained the age of forty (40).

ELEVENTH Trust Protector. Notwithstanding any other provision of this Agreement, there shall at all times be one or more Trust Protectors (the "Trust Protector" or "Trust Protectors") to serve in accordance with the provisions of this Article. The role and function of the Trust Protector is set forth in this Article. Unless otherwise indicated in this Agreement, the Trust Protector shall serve in a fiduciary capacity and conform to the provisions of this Agreement.

(a) Role and Function. The Trust Protector shall have the following roles, powers and duties as well as any other powers conferred upon the Trust Protector pursuant to this Agreement; provided, however, prior to taking any action under this Agreement, the Trust Protector shall provide thirty (30) days advance written notice to the Grantors, while living and competent, and thereafter their survivor, while living and competent, unless such written notice is waived or reduced by the Grantors, on a case by case basis, in a written instrument delivered to the Trust Protector and the Trustee:

(1) To amend the administrative and technical provisions with respect to any trust created by or pursuant to this Agreement in accordance with Article ____of this Agreement, at such times as the Trust Protector may deem appropriate for the proper administration of the Trust and for tax purposes. In particular, the Trust Protector shall have the power to modify or amend the provisions of this Agreement to ensure that this Agreement is a qualified disposition under the Delaware Qualified Dispositions in Trust Act, 12 Del. C. § 3570, et. seq. (the "Act").

(2) To designate the law of any jurisdiction (under which the terms of any trust created by or pursuant to this Agreement shall be capable of taking effect) to be the governing law of any trust created by or pursuant to this Agreement, as provided in Article ____of this Agreement.

(3) To add to and remove from the permissible class of beneficiaries anyone other than the Trust Protector, his or her estate, his or her creditors, the creditors of his or her estate, or any party who is a related or subordinate party to the Trust Protector under Section 672(c) of the Code, and to release such power in accordance with section __ of Article ____ of this Agreement. The Trust Protector's power to add to and remove from the permissible class of beneficiaries, and to release the power, shall be exercisable in a non-fiduciary capacity and without the approval or consent of any person in a fiduciary capacity.

(4) To direct the Trustee to divide the Trust estate as set forth in section __ of Article ____ of this Agreement.

(5) To add to or remove from the class of beneficiaries designated in the Contingent Beneficiaries provision anyone other than himself or herself, his or her estate, his or her creditors, the creditors of his or her estate, or any party who is a related or subordinate party to the Trust Protector under Section 672(c) of the Code, in accordance with section __ of Article ____ of this Agreement and to release such power to add to or remove from the class of beneficiaries designated in the Contingent Beneficiaries provision in accordance with section __ of Article ____. The Trust Protector's power to add to or remove from the class of beneficiaries designated in section __ of Article ____ and to release such power shall be exercisable in a non-fiduciary capacity and without the approval or consent of any person in a fiduciary capacity.

(6) To acquire any Special Holdings (and, in the event of the incapacity of both of the Grantors, any other assets) constituting the Trust estate by substituting therefor other property of equivalent value in accordance with Article ____ of this Agreement. The Trust Protector's power to acquire any Special Holdings (and, in the event of the incapacity of both of the Grantors, any other assets) constituting the Trust estate by substituting therefor other property of equivalent value shall be exercisable in a non-fiduciary capacity and without the approval or consent of any person in a fiduciary capacity.

(7) To terminate the Grantors' or Trust Protector's power to reacquire or acquire Trust property in accordance with Article ____ of this Agreement. The Trust Protector's power to terminate the Grantors' or Trust Protector's power to reacquire or acquire Trust property shall be exercisable in a non-fiduciary capacity and without the approval or consent of any person in a fiduciary capacity.

(8) To terminate the Trustee's power to distribute Trust income and principal to a Grantor for purposes of reimbursing a Grantor for income tax liability in accordance with section ___ of Article ____ of this Agreement. The Trust Protector's power to terminate the Trustee's power to distribute Trust income and principal to a Grantor for purposes of reimbursing a Grantor for income tax liability shall be exercisable in a non-fiduciary capacity and without the approval or consent of any person in a fiduciary capacity.

(9) To remove and replace the Trustee as provided in Article ____ of this Agreement.

…

(i) TRUST DRAFTING CONSIDERATIONS

Sample Language Related to Power of Appointment

I.

A. The Trustee shall distribute such portions or all of the principal of the Trust estate, to, or in trust for the benefit of, the limited class of beneficiaries consisting of the Grantor's parents' descendants and any one or more Charitable Organizations, upon such conditions and terms, including outright or in further trust, specifically referring to this limited power of appointment, in such manner as the Grantor's Spouse may appoint and direct by his Last Will and Testament admitted to probate or pursuant to an instrument executed by the Grantor's Spouse during the Grantor's Spouse's lifetime and delivered to the Trustee; provided, the exercise of such power of appointment shall not take effect until Grantor's Spouse's death and subject to the following terms, conditions and limitations:

1. The amount that can be appointed to Charitable Organizations is limited to twenty percent (20%) of the then value of the Trust estate;

2. The amount that can be appointed to a particular family line of the Grantor may not be less than fifteen percent (15%) of the then value of the Trust estate.

B. **Making Appointment**. The appointment shall be made either (i) by specific reference to this power in the Beneficiary's probated will or (ii) in a signed, written instrument from the Beneficiary delivered to the Trustee and filed in the trust records during the Beneficiary's lifetime, but not effective until the Beneficiary's death, making specific reference to the power and then stating the details of the appointment. If the Beneficiary exercised his or her power of appointment both in the Beneficiary's will and in a signed, written instrument delivered to the Trustee during the Beneficiary's lifetime and the terms of such appointments conflict, the document that the Beneficiary executed closest to the Beneficiary's death shall control.

II. Alternative Retained Power of Appointment clause

Trustor's Power of Appointment. The Trustee shall transfer, convey, and pay over the Administrative Trust Estate to or for the benefit of such one or more persons or organizations, to such extent, in such amounts and proportions, and in such lawful interests or estates, whether outright or in trust (including, but without limitation, the grant of a presently exercisable general or non-general power of appointment), as the Trustor may by his last will, appoint by a specific reference to this power. Notwithstanding the generality of the foregoing, the Trustor shall not be authorized to exercise this power in favor of the Trustor, the Trustor's estate, the Trustor's creditors, or creditors of the Trustor's estate. The Trustor may, at any time and from time to time during the Trustor's life, by written instrument executed and acknowledged by the Trustor and delivered to the Trustee prior to the Trustor's death, irrevocably release such power of appointment with respect to any or all of the property of the Trust Estate subject to such power and may further limit the persons in whose favor this power may be exercised.

How Far Reaching is

Estate of Miriam M. Warner, et al. v. Commissioner, T.C., 2021-17

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"You don't pay taxes – they take taxes." – Chris Rock

The Tax Court case of Estate of Warner v. Commissioner is a cautionary tale of a testatrix who kept too much control of family assets and unwisely split a valuable asset between two charitable organizations. The holdings in Warne have far-reaching implications that touch not just on charitable planning, but also planning for utilization of the marital exemption, apportionment of estate taxes, and tax planning for pecuniary, specific and residuary bequests.

I. Synopsis of *Estate of Warne v. Commissioner*

A. Background

Miriam and Thomas Warne were a married couple residing in California who amassed considerable real estate holdings, the majority of which were held in five LLCs. The LLCs were owned by a revocable trust (the Warne Family Trust). Mr. Warne died in 1999 and Mrs. Warne died in 2014. Mrs. Warne was the trustee of the Warne Family Trust and by virtue of the fact that she was the trustee, she was also the managing member of each LLC. On December 27, 2012, Mrs. Warne gave fractional interests of the five LLCs to her two sons and her three granddaughters. She died on February 20, 2014.

At the time of Mrs. Warne's death the LLCs were owned as follows: WRW Properties, LLC was owned 78% by the Warne Family Trust and 22% by William Warne (one of Mrs. Warne's sons); VJK Properties, LLC was owned 86.3% by the Warne Family Trust, 0.5% by

Tom Warne (one of Mrs. Warne's sons) and 4.4% by each of the three granddaughters; Warne Ranch, LLC was owned 72.5% by the Warne Family Trust, 26% by Tom Warne and 0.5% by each granddaughter; Warne Investments, LLC was owned 87.432% by the Warne Family Trust and 12.568% by a sub-trust of the Warne Family Trust; and Royal Gardens, LLC was owned 100% by the Warne Family Trust. All of the operating agreements of the LLCs gave significant power to the majority interest holder, such as the ability to unilaterally dissolve the LLCs and to appoint and remove managers.

Mrs. Warne left the 100% interest in Royal Gardens to two charities: 75% of the LLC went to the Warne Family Charitable Foundation and the remaining 25% went to St. John's Lutheran Church. While the facts do not state how the remaining LLC interests were divided, it can be assumed they were either distributed outright to the children and grandchildren, or these LLC interests remained in trust the benefit of the children and grandchildren. The estate valued Royal Gardens at $25,614,695.

On May 19, 2015, Mrs. Warne's estate filed a gift tax return for the 2012 donations which showed that Mrs. Warne donated 18% of WRW Properties, LLC to William Warne, 22% of Warne Ranch, LLC to Tom Warne, and 0.4% of VJL Properties, LLC to each granddaughter. This return was filed late and no reason was given for its late filing. Also on May 19, 2015, Mrs. Warne's estate filed an estate tax return, which was timely filed. The estate took valuation discounts for the bequests to the children and grandchildren but did not take a valuation discount for the charitable bequest. Instead, the estate deducted 100% of the value of Royal Gardens. The estate determined the aggregate value of the LLCs to be $73,704, 000.

The Commissioner assessed a gift tax deficiency on the 2012 transfers of $382,462 because the Commissioner declined to accept the valuation discounts and also issued a penalty for failure to timely file the gift tax return. The Commissioner also assessed an estate tax deficiency of $8,351,970 because the Commissioner declined to accept the valuation discounts applied to the bequests to individuals and also argued that a valuation discount should be applied to the charitable bequests. The estate challenged both the assessment of the gift and estate tax deficiency.

The relevant issues at trial were (1) the proper discounts for lack of control and marketability for the LLCs; and (2) whether the discounts applied to the charitable bequest of Royal Gardens, LLC were appropriate.

II. Court's Analysis

The Court began its analysis by stating the basic principles of gift and estate valuations. The value of a gift is the fair market value of the property on the date the donor made the gift and the value of an asset which is included in the decedent's gross estate is the fair market value of the assets on the date of the donor's death (unless an alternative valuation date is elected). Fair market value is the price a willing buyer would pay a willing seller when neither is acting under compulsion and both have reasonable knowledge of the facts and circumstances. Estate of Warne v. Commissioner, T.C. Memo 2021-17, 207. Valuation of property is a question of fact that is determined by examining the entire record and the value of property may be increased or decreased depending on whether premiums or discounts are applied. *Id*.

A. Discounts for Lack of Control and Marketability

1. Lack of Control Discount

A discount for lack of control is the reduction of value in a minority owner's interest in a company due to the minority owner's lack of ability to exercise control over the company. Appraisers will take into consideration whether the minority owner has the ability to control decisions such as liquidation, distribution of profits, electing and removing managers, setting company policies, and determining compensation, among other factors.

The Court found that the discount for lack of control for the majority interests by the Warne Family Trust should be low. The Court reasoned that because the Warne Family Trust owned a majority interest in all of the LLCs and the operating agreements gave significant power to the majority interest holder, including the ability to unilaterally dissolve the LLCs and appoint and remove managers, the discounts applied should be small. The Court stated that it has held in similar situations that such no discounts should be applied, but that because the parties had agreed to a discount for lack of control, it would allow one. *Id* at 209-210.

The expert for the IRS stated that the appropriate discount for lack of control is 2% and arrived at that conclusion by looking at nine closed-end funds. The Court found that the closed-end funds were too dissimilar in nature from the LLCs because the closed-end funds did not directly own real estate and only held minority interests. The Court also thought the sample size the appraiser for the Commissioner used was too small.

The appraiser for the taxpayer unsurprisingly argued for a higher discount than the appraiser for the Commissioner and proposed a discount of 5%-8%. The appraiser for the taxpayer argued that a higher discount should be applied to account for the risk of potential litigation in the event the majority interest holder exercised its power to liquidate the LLCs. The appraiser for the taxpayer stated that any attempt by the Warne Family Trust to liquidate the LLCs would be met with strong opposition and potential litigation other family members but did not provide any basis for this conclusion. The Court rejected this argument and found that the appraiser for the taxpayer failed to show that this outcome was "reasonably probable". *Id*. at 210. The Court cited Olson v. United States, 292 U.S. 246, 257 (1934), which stated that

"Elements affecting value that depend upon events or combinations of occurrences which, while within the realm of possibility, are not fairly shown to be reasonably probable should be excluded from consideration for that would be to allow mere speculation and conjecture to become a guide for the ascertainment of value." The Court found that the method of the appraiser for the taxpayer was sounder than the one for the Commissioner, but because the Court refused to take into account potential litigation, it found that a discount of 4% for lack of control was appropriate.

2. Lack of Marketability Discount

"Marketability" is defined in the International Glossary of Business Valuation Terms as "the ability to quickly convert property to cash at minimal cost" and some authorities add that in addition to that ability, there's a high degree of certainty of realizing the anticipated amount of proceeds. The International Glossary of Business Valuation Terms defines a lack of marketability discount as "an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability."

In Warne, both appraisers allowed for discounts for lack of marketability, however, the Court found the analysis of the appraiser for the taxpayer more persuasive because the appraiser included a thorough explanation for his findings while the appraiser for the Commissioner gave little basis for his conclusion of the appropriate discount. The appraiser for the taxpayer found that a discount of 5%-10% should be applied and the appraiser for the Commissioner found that a discount of 2% should be applied. The Court adopted the discount proposed by the appraiser for the taxpayer but felt it should be on low end. The Court determined that the appropriate discount was 5%.

C. Charitable Discount

Mrs. Warne died owning 100% of the Royal Gardens, LLC and upon her death she split that interest between two charities: 75% to the Warne Family Charitable Foundation and 25% to St. John's Lutheran Church. The estate claimed that 100% of the value of the LLC should be deducted from the estate and the Commissioner claimed that since the interest was split between two charitable entities, a discount should be applied for lack of control and lack of marketability. The estate took the position that since 100% of the LLC was donated to charities, that 100% of the value of the entity should be deductible by the estate and that finding otherwise would subvert the public policy of encouraging charitable donations. Warne at 211. The Court disagreed.

Both parties relied on the case Ahmanson Foundation v. United States, 674 F.2d 761 (9th Cit. 1981). In this case the decedent owned a revocable trust which owned 100 shares of a corporation. One share was voting and the other ninety-nine shares were non-voting. The decedent left the one voting share to his son and the ninety-nine non-voting shares to a charitable foundation. The Court of Appeals for the Ninth Circuit stated that "[t]here is nothing in the statutes or in the case that suggests that valuation of the gross estate should take into account that the assets will come to rest in several hands rather than one." *Id*. at 768. The Court in Ahmanson further found that when property is split as part of a charitable bequest that "the testator may only be allowed a deduction for estate tax purposes for what is actually received by the charity – a principle required by the purpose of the charitable deduction". *Id*. at 772.

The Court in Warne took the same position and stated that when valuing an asset for purposes of calculating the value of the estate, the entire interest is valued without regard to the later disposition of the entity. Warne at 212. However, when the property is later split between one or more charities, a different principle applies: the value is what the charities actually received not what the estate contributed. *Id*. And the value of what a charity actually received is subject to discounts when the charity receives a fractional interest in an LLC. The Court concluded that while the estate had to include 100% of the value of the LLC in the estate tax return, the estate could only deduct the 25% and 75% interests received by the charities and those interests are subject to discounts. *Id*.

III. Takeaways from Warne

Warne should serve as a cautionary tale for estate planners who are trying to split assets among individual heirs and charities.

A. Discounts for Lack of Control and Lack of Marketability

1. Lack of Control

In Warne the Court suggested that it only allowed for a discount for lack of control because both parties stipulated that a discount should be applied. The Court stated that "[w]hen a majority interest holder exerts control to that which the Family Trust can exercise in the LLCs, we have held that no discount for lack of control applies." *Id*. at 209. Estate planners should carefully construct operating agreements of LLCs so that a majority interest holder cannot unilaterally make significant decisions for the LLC such as dissolving the LLC and appointing and removing managers. Estate planners should also be aware when working with an appraiser, that a discount based on events that might happen (such as potential litigation) should only be taken into account if the occurrence of the event is reasonably probable.

2. Lack of Marketability

The Court found that the appraiser for the taxpayer was more credible in the determination of the applicable discount for lack of marketability because his report included additional metrics and a more thorough explanation of his process. The Court stated" [w]hen an expert does not provide enough evidence to support his opinion, we decline to adopt that opinion." *Id*. at 211. For estate planners, it is important when an appraiser is hired, the appraiser is willing and able to provide detailed explanations of his or her process.

B. Discounting Charitable Bequests

Perhaps the most alarming finding in Warne is the application of a discount on the LLC which was split between a family foundation and a church. The estate was required to report the full value of the LLC on the estate tax return but could only deduct a discounted amount as the charitable deduction was split between two charitable entities. This could have been avoided if the entire LLC had been bequeathed to the family foundation, which could then distribute an interest to the church. For clients who do not have a family foundation, the entire LLC interest could have been bequeathed to a donor advised fund and the advisors to the fund could have directed a portion of the LLC to the church. The reasoning of the court with respect to assets left to charity also applies to assets left to a spouse and which qualify for the marital deduction.

In Estate of Disanto v. Commissioner, T.C. Memo 1999-421, the deceased spouse owned a 53.5% interest in a closely held corporation. In his will the decedent left the stock to a trust for his wife and children. The surviving spouse disclaimed part of her interest in her husband's estate and she was therefore only entitled to a minority interest in the closely held corporation. The decedent's estate took a marital deduction for the value of the stock which passed to his wife and which was based on an appraisal that did not include a discount for lack of control. The court found that the stock had to be valued for purposes of the marital deduction by taking into account valuation discounts for minority ownership, thus reducing the amount of the marital deduction. This finding was based on the fact that the spouse had disclaimed part of the stock resulting in her receiving a minority interest in the corporation. This aligns with the reasoning of Warne that the value the estate can deduct must be what the recipient actually received.

C. Who Should Pay the Tax?

1. Federal

The Internal Revenue Code ("IRC") imposes the liability for payment of estate taxes on the executor of the estate. IRC § 2002. The liability applies to the entire federal estate tax on the gross estate, which includes probate and non-probate assets (such as life insurance owned individually and retirement accounts). Reg. § 20.2002-1.

The IRC has a number of statutes regarding apportionment of estate taxes. The statute most relevant to this discussion is § 2270B. This statute provides that an executor has a right of reimbursement for taxes attributable to the inclusion of § 2036 property in the estate of the decedent. The executor can demand reimbursement from the recipient of the property in an amount which bears the same ratio to the total federal estate tax which has been paid as the value the property bears to the taxable estate. This right of recovery is inapplicable if the decedent waived this right of recover in his or her will (or revocable trust). IRC § 2207B(a)(2).

In Warne the question (which was not before the Court) becomes, can the executor of Mrs. Warne's estate demand reimbursement from the charities for the taxes due with regards to the LLC interests which those charities received? Who is responsible for paying the estate taxes assessed by the Tax Court?

2. State

The law of Louisiana regarding apportionment of estate taxes is articulated in La. R.S. § 9:2432:

> A. If the decedent has made no provision in his testament for the apportionment of taxes among the persons interested in the estate, the tax shall be apportioned among them

by the court in the proportion that the value of the interest of each person interested in the estate bears to the total value of the interests of all persons interested in the estate. The values used in determining the tax shall be used for this purpose.

B. If the deceased has provided in his testament for the apportionment of the tax among all the persons interested in the estate, the court shall apportion the tax as directed by the deceased.

C. If the deceased has provided in his testament for the apportionment of the tax of some, but not all of the persons interested in the estate, the amount of the tax which has not been apportioned shall be apportioned by the court among those as to whom no provision has been made, in the same manner as provided in Sub-section A of this Section.

La. R.S. 9:2435 expands upon the apportionment rules:

A. In making an apportionment, allowances shall be made for any exemptions granted, any classification made of persons interested in the estate, and for any deductions and credits allowed by the law imposing the tax.

B. Any exemption or deduction allowed by reason of the relationship of any person to the decedent or by reason of the purpose of the gift shall inure to the benefit of the person bearing such relationship or receiving the gift, except when an interest is subject to a prior present interest which is not allowable as a deduction, the tax apportionable against the present interest shall be paid from principal.

C. Any deduction for property previously taxed and any credit for gift taxes or death taxes in a foreign country paid by the decedent of his estate shall inure to the proportionate benefit of all persons liable for apportionment.

D. Any credit for inheritance, succession or estate taxes, or taxes in the nature thereof in respect to property or interests includable in the estate shall inure to the benefit of the persons or interests chargeable with payment thereof to the extent that or in proportion as the credit reduces the tax.

E. To the extent that property passing to or in trust for a surviving spouse or any charitable, public or similar gift or bequest does not constitute an allowable deduction for purposes of the tax solely by reason of an inheritance tax imposed upon or deductible from the property, the property shall not be included in the computation provided for in La. R.S. 9:2432, and to that extent no apportionment shall be made against the property. This Subsection shall not apply where the result will deprive the estate of a deduction otherwise allowable under Section 2053(d) of the Internal Revenue Code of 1954 of the United States, relating to deduction for state death taxes on transfers for public, charitable, or religious uses.

Under the laws of Louisiana, the executor cannot go to the charity (or the spouse) and demand that the charity (or the spouse) contribute to the payment of the estate tax. The estate tax would have to come from the other, non-charitable, non-spousal, legatees of the estate. This illustrates the need for careful drafting when working with a client whose estate will incur estate tax. The drafter of the will should consider including a tax apportionment clause, especially if there are legatees of specific bequests and residuary legatees. Oftentimes, the testator will not want the legatees of the specific bequests to have to contribute towards the estate tax, but this will have to be spelled out in the will. It's also worth noting that if a charity is the residuary legatee, and estate taxes will be paid from the residuary estate, the payment of estate taxes will reduce the value the charity receives and will also reduce the charitable deduction, resulting in a larger estate tax.

An example of how an apportionment clause can cause problems for an estate is Estate of Fagan v. Commissioner, T.C. Memo 1999-46. In Fagan, the decedent's will stated that all estate taxes will be paid from the residuary estate, without apportionment, prior to distribution to the residuary legatee. The residuary legatee was a revocable *inter vivos* trust created by decedent. The beneficiaries of the trust were the two children of the decedent and four charities. The trust instrument provided that the portion of the trust attributable to the charities would not be reduced by estate tax. The estate argued that it was clear from reading the trust and the will together that the decedent did not want the charitable bequest to be reduced by payment of estate tax. The Commissioner took the position that because the decedent stated in his will that estate taxes were payable from the residuary estate prior to distribution, that instruction avoided application of a North Carolina statute which is almost identical to Louisiana's statute La. R.S. 9:2435 (E) which prohibits apportionment of estate taxes to charitable organizations unless the testator provided otherwise in his will. The court agreed with the Commissioner and found that because the decedent specified that payment of estate taxes was to come from his residuary estate, that the amount passing to the revocable trust, including the charitable beneficiaries, would be reduced by the estate taxes. This decision is founded upon IRC § 2055.

IRC § 2055(a) states that the value of the estate shall be determined by deducting from the value of the gross estate the amount of all bequests to charitable organizations. § 2055(c) states that the deduction shall be reduced by any amounts paid out of the bequest for taxes. This reiterates the line of reasoning that the charitable deduction will reflect what the charity actually received.

D. Funding Bequests

1. Allocation by Executor

Warne raises the issue that when marital or charitable bequests are funded with fractional interests in assets, there can be a mismatch between the valuation of the assets for estate tax purposes and the marital or charitable deduction allowed (which was reduced because of discounts for lack of control and/or marketability). One way to avoid this situation is to allow the executor to allocate assets to satisfy bequests. For example: if the testator stated that a charity would be the legatee of 50% of the residuary estate and a child would be the legatee for the other 50% of the estate, rather than forcing the executor to split all assets in half, if the executor can allocate assets, then the executor can allocate 100% ownership in some assets to the charitable legatee (therefore preventing discounts from being applied and obtaining a charitable deduction for 100% of the value of the asset) and 100% ownership of other assets to the non-charitable beneficiary. Of course, there may be circumstances where the executor has no choice but to allocate fractional interests of assets.

2. Impact of Discounts on Pecuniary Bequests

Another issue which Warne present is whether the impact of valuation discounts should be considered when making pecuniary bequests. If the succession does not have enough cash to satisfy a bequest, the executor may distribute assets to satisfy the bequest. If the asset is subject to a valuation discount because it is a fractional interest, then the fraction to be distributed to the pecuniary legatee would have to be increased to reflect the decreased value. This may not reflect what the testator wanted, and care should be taken in drafting such bequests.

The issue in Warne, of a mismatch between the value of the asset the estate must claim on the estate tax return and the amount of the deduction which can be taken by the estate, also presents issues for the funding of pecuniary bequests for a spouse. A will could be drafted to state that the surviving spouse shall receive the smallest amount necessary to achieve zero taxes with the remainder allocated to other heirs. If the executor must allocate fractional interests in a business entity to the spouse, there would be a mismatch between the value of the entity for estate tax purposes and the marital deduction because the estate could only deduct what the spouse actually received and, by virtue of the holding in Warne, the entity would have to be discounted.

E. Community Property

For married couples who did not opt out of Louisiana's community property regime, there is already a discount built into the estate of the first-to-die spouse. The first spouse to die owned 50% of the community property assets and it can be assumed, especially in light of Warne, that those assets (if they are business entities) may have a lower valuation for lack of marketability and lack of control.

When a spouse dies and one of the assets was a business entity, the appraiser will have to apply discounts when determining the value of the entity. Since valuation discounts would already be applied, the holdings in Warne would have less of an effect.

F. Income Tax Considerations in Funding Particular, Residuary and Pecuniary Legacies

Income generated by estate assets and which are not included in distributable net income (DNI) will be taxed to the estate and not the legatees. DNI is the income allocated to a legatee of the estate by reason of the legatee receiving the income. The legatee becomes responsible for payment of the income tax associated with the DNI and the estate can deduct the DNI and therefore avoid a double tax (once at the estate level and once at the legatee level).

However, some distributions from the estate to a legatee do not carry out DNI and therefore does not shift the tax burden from the estate to the legatee. Examples of this principle are distributions of bequests of a specific sum of money or a specific property and charitable distributions from gross income. IRC § 663(a). In order to qualify as a bequest of a specific sum or money or specific property the amount of money or the identity of the specific property must be ascertainable under the terms of the testator's will as of the date of the testator's death. Examples are the bequest of the testator's interest in an LLC to a son and an amount of money equal to the testator's interest in the LLC to a daughter. A bequest to a spouse of a fraction of the estate, which can be satisfied with money or property and the executor must select assets to satisfy the bequest is not a bequest of a specific sum of money or property and income tax attributable to such property would be carried out to the spouse and deductible by the estate. Other examples of bequests which are not specific sums of money or property are residuary bequests, annuities, and bequests which must be paid out in three or more installments.

Warne brings up the issue that if the charitable or marital deduction is reduced, because the will left a fractional interest in an asset to a charity or spouse, then the reduction of the charitable or marital deduction could result in increased income taxes owed by the estate. Legatees of a specific or pecuniary bequest would not be affected by the increased tax burden, but the residuary estate would be reduced by payment of those taxes by the estate, or the residuary legatee(s) would be responsible for payment of the increased taxes if the estate had been distributed to the legatee(s).

G. Will Drafting Considerations

Estate planners should take care when drafting wills for clients who may incur estate taxes. One of the biggest lessons from Warne is that assets should not be split between two or more charities. If a client wants more than one charity to be the legatee of an asset, the testament should leave the asset to a donor-advised fund or a family foundation. The donor-advised fund or family foundation can then distribute out percentages of the asset to the charities.

Estate planners should discuss the impact of apportionment of taxes and draft language designed to carry out the testator's intent. Some testators may have no issue with legatees of specific or pecuniary bequests contributing to the payment of taxes, but others will want to exempt those legatees from such contribution.

The testament should give the executor the ability to allocate assets in order to satisfy bequests. This will give the executor some flexibility in asset distribution and may allow the executor to preserve the entire marital or charitable deduction.

Estate planners working with clients who own closely-held businesses should review the operating agreements to make sure that if the client is a majority owner, he or she doesn't have too much power thus reducing or eliminating the discount for lack of control.

Forms:

Apportionment Clause

Apportionment of Federal Estate Tax. The federal estate tax due by my succession (including any portion thereof attributable to the inclusion of property in my estate by virtue of Section 2044 of the Internal Revenue Code ["Section 2044 property"]) shall be apportioned among my legatees and the persons receiving Section 2044 property in the proportion that the value, as finally determined for estate taxes, allocated to each person either as legatee or under Section 2044 bears to the total value of my estate inclusive of 2044 property. Any right of recovery provided by Section 2207A of the Internal Revenue Code is limited to the extent provided herein.

Tax Dispensation Clause

Tax Dispensation. I dispense the legatees in *subsection##s* from contributing to the Federal estate tax payable by my succession, and I direct that the Federal estate taxes payable by any legatee or legatees be paid by my Residuary Estate.

Allocation Clause

Power to Allocate Assets. My Succession Representative shall have the broadest authority under the laws of Louisiana and shall have full power to allocate or assign specific assets to an heir or legatee in order to satisfy bequests expressed in terms of quantum or value.

Testamentary Planning in Louisiana: Tax & Non-Tax Considerations

(Or You Can't Be an Estate Planner & Not Know This Stuff)

LSU

51st Annual Estate Planning Conference
November 18-19, 2021

Geaux Tigers!

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TESTAMENTARY PLANNING IN LOUISIANA

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Testamentary Planning in Louisiana: Tax & Non-Tax Considerations (Or You Can't Be an Estate Planner & Not Know This Stuff)

By: R. Fritz Niswanger

I. Introduction – First Things First

a. What is Testamentary Planning - What Are We Even Talking About?

This presentation is intended to provide you with a discussion of basic level considerations that go into a well-drafted last will and testament. Hopefully it is largely a review and reminder for you, but I also hope that it sparks some thought and creativity with regard to various ways to up your game in this area. We will discuss tax implications and strategies (because those things matter greatly to our clients, which means they should matter greatly to us and we should at least be vaguely aware enough to spot the issues and ask for help), but we will also focus on the things that matter to our clients whether they have a $100 million estate or a $100 estate.

So what is testamentary planning? It is helping a client plan for what will happen to their estate and family at their death through the use of a last will and testament.

The primary contrast here is between testamentary planning and lifetime planning - as made plain by LA Civil Code article 1467: "Property can neither be acquired nor disposed of gratuitously except by donations inter vivos or mortis causa, made in one of the forms hereafter established" (emphasis added). And as further explained by LA Civil Code article 1570: "A disposition mortis causa may be made only in the form of a testament authorized by law" (emphasis added).

Therefore, a client can plan for the disposition of their property and make it effective currently (i.e., during their lifetime) through various forms of donations inter vivos (including donations directly to one or more named natural persons, donations to or through trusts or juridical persons such as LLCs or limited partnerships, or any number of other hybrid strategies involving the lifetime gifting of certain ownership interests or rights). Alternatively, that client can plan for the disposition of their property to be effective only at their death through a testament, retaining all rights to control and benefit (although with all associated burdens and liabilities too!) during the entirety of their lifetime.

I also make a distinction here between other types of planning that, while they might become effective at death similar to donations mortis causa, are not accomplished through a testament nor are they governed by the testament. Examples are any type of nonprobate assets, such as qualified retirement plans or life insurance or annuities with beneficiary designations, usufructs in property created through donations inter vivos of the client or the donations mortis causa of someone else, inter vivos or living trusts (even if funded through a pour-over testament), etc. While those types of strategies still cause assets or rights to transfer at death, they do not require a testament to accomplish the transfers, and are most often largely if not completely unaffected by the terms of the testament.

So after all that, what is testamentary planning? Basically, it's when you do a last will and testament for a client.

The Importance of Testamentary Planning in LA – Why Should I Care?

Why should we care about testamentary planning? One great reason is because that's what most clients or potential clients think is all we do, or at least all they need. Many folks know they need a will, and they know that if we're an estate planning attorney, then we can do a last will and testament for them. I can't recall how many potential clients I've met with over the years who say that "I guess need a will," and yes, they're right, but they also need so much more. They often end up realizing (or being helped to see) that they need a living will / advance health care directive (i.e., a written declaration directing the directing the withholding or withdrawal of life-sustaining procedures in the event such person should have a terminal and irreversible condition), one or more powers of attorney of various types, one or more trusts of whatever particular flavor they prefer, various limited liability entities, help with beneficiary designations or titling of various financial accounts, help with cleaning up the estate of a deceased loved one, and so on and so on. The list is endless of what clients actually end up needing and paying you to help them with. But the point is that the perceived pain point often starts with a testament. That's where you come in, and you'd better be competent at it, or at least be able to discuss it competently.

Another great reason we should care about testamentary planning is because every estate plan, even for large federally-taxable and very complicated estates whose plan is relying on lifetime planning or other nonprobate transfer strategies, needs a testament. Even if you're a trust-based planning and probate-avoidance advocate whose skin crawls at the thought of having to publicly probate a will and judicially administer the estate, you'd better incorporate at least a simple pour-over testament into your clients' plans to catch any unexpected assets not already transferred into the living trust, to appoint tutors for any minor children, etc. Even if you're a big-wig wealth advisor who blows their nose with hundred dollar bills because you only advise clients with federally-taxable estates, and you eat, breathe, sleep, and live in the alphabet-soup world of lifetime planning with GRITs, GRATs, CRTs, CLTs, IDGTs, DAPTs, FAPTs, SLATs, FLPs, etc., you're probably going to need a well-drafted testament for the same reasons as the probate-avoidance guy and also to appoint an independent executor with the proper powers to make tax elections and file the 706.

At the end of the day, we and our clients know the truth of the old saying - those who fail to plan are planning to fail. And the foundation (or at the very least an indispensable part) of any estate plan worth its salt, is the testament. So we'd better know how to do it well.

b. Options – Let's See What This Baby Can Do

So what can you do with a testament? Let's take a look at the primary component parts.

i. Legacies - Leaving Your Stuff to Somebody

The main thing everyone thinks of when they think of a testament is leaving your stuff to someone. So we'll spend a lot of time and attention on this subject. Testamentary dispositions are covered in more detail in article III of this presentation.

ii. Tutors - Leaving Your Kids to Somebody

This is often the main thing that parents of young children, particularly mothers, are concerned about - if something happens to both them and their spouse, who will be the tutor/guardian for their minor children? Tutorship is covered in more detail in article IV of this presentation.

iii. Executors - Leaving An Adult in Charge of the Show

This is NOT the main thing that clients think of with regard to a testament, but it is a crucially important piece - who will be the person in charge of running my estate? Executorship is covered in more detail in article V of this presentation.

iv. Nonprobate Assets - Not So Fast, It Doesn't Work for Some of Your Best Stuff!

Testaments tell all the stuff you own where to go at the time of your death, right? That's how the client perceives it. But then we have to explain to them that while yes, that's generally true, it doesn't necessarily work for ALL your stuff. In fact, some pretty important assets can be left out, either because you don't truly own that asset anymore, or you've contracted away important rights with a third party, or because a different set of laws governs that particular type of asset. Nonprobate assets are covered in more detail in subsection III.d.v of this presentation.

c. Tax Planning – Death & Taxes

We've all heard the old saying - "There's nothing certain in life except death and taxes." And while we hopefully won't ever suffer death by taxes, we all know we have to consider the taxes of death. With testamentary planning, the primary considerations are whether and to what extent federal transfer taxes might apply and how we might minimize or even avoid them, and whether and to what extent death might cause some income tax consequences (although that can often be good!).

i. Estate Taxes for Everyone!

Even clients of very modest estate sizes, well below the federally-taxable level, often come in with this notion lodged in their minds that they need to worry about death taxes and therefore they should be giving away $10,000 each year to each family member. Otherwise the government is going to take all their money. Often one of the greatest and simplest reliefs we can give these types of clients is to tell them that no, they do not have to worry about estate taxes, at either the state or federal level.

However, for those clients to whom the estate tax does apply, even if they won't do any lifetime planning to minimize or altogether avoid this tax, we still owe them a duty to help do what we can in their testament, which can be a great deal of help to them. Transfer taxes are covered in more detail in section III.h of this presentation.

ii. Income Taxes Actually Are for Everyone

Income taxes, on the other hand, actually do need to be taken into account by almost every single client. Even if the focus is simply on not losing certain tax benefits or minimizing the number of tax returns that will need to be filed or allocating certain types of assets among the legatees, we as estate planners need to keep income taxes in mind in almost every planning engagement. Income taxes are covered in more detail in section III.h of this presentation.

II. Formalities - Getting the Basics Right

Alright, so if we're going to do this, we might as well do it right. This article, and a great deal of this presentation as a whole, is focused on getting the little things right that go into a well-drafted testament. Nothing fancy, no eye candy, nothing sexy. Just making sure the testaments you draft are valid, legally enforceable, and accomplish at least the basic goals the client has stated.

Why is this important? As the great Vince Lombardi once said:

> "Football is two things. It's blocking and tackling. I don't care about formations or new offenses or tricks on defense. You block and tackle better than the team you're playing, you win."

Furthermore, this section doesn't even rise to the level of basic blocking and tackling. This is just making sure we know and follow the basic rules that let us even step on the playing field and run a play without being flagged for a penalty. Not fun to learn or practice, but critically important - it's hard to win a game without getting these things right. In other words, it's stuff that if we estate planners don't get right, our testaments won't be valid, won't be legally enforceable, and won't accomplish even the client's basic goals. That's a result no one will be happy with, except our competitors.

a. Statutory Requirements - Obey the Law or Else

So let's start with the basics that we all learned in law school. What does the law say that we need to get right for the testament to be valid in Louisiana?

i. Notarial Testaments - Our Bread & Butter

The primary LA Civil Code articles regarding testamentary formalities are the following:

> A disposition mortis causa may be made only in the form of a testament authorized by law. La. Civ. Code Ann. art. 1570.
>
> A testament may not be executed by a mandatary for the testator. Nor may more than one person execute a testament in the same instrument. La. Civ. Code Ann. art. 1571.
>
> Testamentary dispositions committed to the choice of a third person are null, except as expressly provided by law. Testamentary dispositions committed to the choice of a third person are null, except as expressly provided by law. A testator may delegate to his executor the authority to allocate specific assets to satisfy a legacy expressed in terms of a value or a quantum, including a fractional share. The testator may expressly delegate to his executor the authority to allocate a legacy to one or more entities or trustees of trusts organized for educational, charitable, religious, or other philanthropic purposes. The entities or trusts may be designated by the testator or, when authorized to do so, by the executor in his discretion. In addition, the testator may expressly delegate to his executor the authority to impose conditions on those legacies. La. Civ. Code Ann. art. 1572.
>
> **The formalities prescribed for the execution of a testament must be observed or the testament is**

absolutely null. La. Civ. Code Ann. art. 1573 (lots of emphasis added!).

There are two forms of testaments: olographic and notarial. La. Civ. Code Ann. art. 1574.

A notarial testament is one that is executed in accordance with the formalities of Articles 1577 through 1580.1. La. Civ. Code Ann. art. 1576.

The notarial testament shall be prepared in writing and dated and shall be executed in the following manner. If the testator knows how to sign his name and to read and is physically able to do both, then: (1) In the presence of a notary and two competent witnesses, the testator shall declare or signify to them that the instrument is his testament and shall sign his name at the end of the testament and on each other separate page. (2) In the presence of the testator and each other, the notary and the witnesses shall sign the following declaration, or one substantially similar: "In our presence the testator has declared or signified that this instrument is his testament and has signed it at the end and on each other separate page, and in the presence of the testator and each other we have hereunto subscribed our names this ____ day of _________, ____." La. Civ. Code Ann. art. 1577 (emphasis added).

A person cannot be a witness to any testament if he is insane, blind, under the age of sixteen, or unable to sign his name. A person who is competent but deaf or unable to read cannot be a witness to a notarial testament under Article 1579. La. Civ. Code Ann. art. 1581.

The fact that a witness or the notary is a legatee does not invalidate the testament. A legacy to a witness or the notary is invalid, but if the witness would be an heir in intestacy, the witness may receive the lesser of his intestate share or the legacy in the testament. La. Civ. Code Ann. art. 1582.

A person may not be a witness to a testament if that person is a spouse of a legatee at the time of the execution of the testament. The fact that a witness is the spouse of a legatee does not invalidate the testament; however, a legacy to a witness' spouse is invalid, if the witness is the spouse of the legatee at the time of the execution of the testament. If the legacy is invalid under the provisions of this Article, and if the legatee would be an heir in intestacy, the legatee may receive the lesser of his intestate share or legacy in the testament. Any testamentary terms or restrictions placed on the legacy shall remain in effect. La. Civ. Code Ann. art. 1582.1.

ii. Notarial Testaments for Clients with Special Needs

If you have the privilege of serving a client who qualifies under any one or more of the following: (1) who is literate and sighted but physically unable to sign; (2) who is unable to read; (3) who knows how to and is physically able to read braille; or (4) who has been legally declared physically deaf or deaf and blind and who is able to read sign language, braille, or visual English; then special formalities must be followed for that client’s testament to be valid. See La Civil Code articles 1578 through 1580.1.

iii. Practical Application - What Do We Do With All This?

So what do we do with all this? Make sure that we’re sure that we’re sure that we know these formalities down cold. Make sure that our document templates strictly comply with the required statutory formalities. Have another set of legal eyes look over our templates. Teach the required signing formalities to our staff, so that they hold us accountable on them. Insist on the formalities. Every. Single. Formality. With. Every. Single. Client. Every. Single. Time.

I know this can seem tedious, but I also know we all hear the horror stories in ethics updates at CLEs about attorneys who ran afoul of one of these rules, and they and their client paid the price. I also know we all make mistakes at times, even us attorneys, and that's why I've found such value in taking the time to teach my staff these rules so that they can help remind me and catch unintentional mistakes, like an ineligible witness about to sign, or if a witness gets up and is about to leave the room during a signing meeting.

I've also heard the advice to just copy the LA Civil Code article 1577 attestation clause straight from the code article, to avoid any mistakes or paraphrasing that causes inadvertent compliance. And I think that's excellent advice. But I try to avoid archaic legalese whenever I can and stick to the plain English, and the obsessive tinkerer in me can't help but mess with the code article language just a tad. So hopefully the following sample language, which I respectfully submit for your consideration, is "substantially similar" to the code's attestation clause:

> In our presence the Testator or Testatrix has declared or signified that this instrument is his or her testament and has signed it at the end and on each other separate page, and in the presence of the Testator or Testatrix and each other we have signed our names on this testament at ________________, ________________ Parish, Louisiana, on November ______, 2021.

No earthshattering changes, I know. Mainly just replaced "hereunto subscribed our names" with "signed our names on this testament," and formatted the date the way most everyday people would write it. But hopefully a little plainer English and still valid.

b. <u>Who Else Can Do This - Competitors & Why They Stink Compared to You</u>

Let's be real. Other people can do what we do for a living. Other attorneys and even non-attorneys can wade into the market of testamentary planning (if you can call it actual planning when some of them do it). One basic way we can differentiate ourselves is by doing the little things right, because a lot of times our competitors will simply disqualify themselves from the very start by not even getting the basic formalities right.

So who are some of our biggest competitors in the testamentary planning market? Setting aside whether some of these groups should or are even legally allowed to enter our market, some of our main competitors (besides other LA-licensed attorneys) are the following: (1) clients themselves, through olographic testaments; (2) Louisiana notaries public; (3) non-LA-licensed attorneys; and (4) non-attorney online or remote providers of last wills and testaments.

i. Olographic Testaments - DIY in the Law

So what is an olographic testament? It is:

> A. An olographic testament is one entirely written, dated, and signed in the handwriting of the testator. Although the date may appear anywhere in the testament, the testator must sign the testament at the end of the testament. If anything is written by the testator after his signature, the testament shall not be invalid and such writing may be considered by the court, in its discretion, as part of the testament. The olographic testament is subject to no other requirement as to form. The date is sufficiently indicated if the day, month, and year are reasonably ascertainable from information in the testament, as clarified by extrinsic evidence, if necessary. B. Additions and deletions on the testament may be given effect only if made by the hand of the testator. La. Civ. Code Ann. art. 1575.

This is Louisiana law's do-it-yourself version of our notarial testament. Helpful to have in a pinch, if someone doesn't have access to an attorney, whether at all or at the time of need, or if someone cannot afford an attorney. However, as many of us can attest from personal experience reviewing client-drafted olographic testaments, and as the case law can confirm as well, the dangers and pitfalls of a client drafting their own testament can be severe, frequent, and difficult for the client to see. It is incredibly easy for a client to run afoul of even the basic formalities required in article 1575, let alone succeed with all the substantive subtleties of getting the testamentary dispositions correct.

If a client needs this option, they should feel free to pursue it. But if having you help them with a notarial testament is at all an option, that will generally be a far more successful option for them in the long-term.

ii. LA Notaries Public - Permitted & Helpful

Louisiana notaries public, even when not attorneys, are legally permitted to draft and notarize notarial testaments. Because they are trained and tested on this subject matter, my experience is that they can be very helpful for clients who need an alternative to an attorney. However, for a client who needs a great deal of planning with their testament, rather than just a simple testament, will likely still benefit greatly from your education and experience.

iii. Other States' Attorneys & Legal Zoom - Inferior Poachers

I won't get into the legalities of testaments done non-Louisiana-licensed attorneys or online or other remote service providers. But I can speak to their ability to compete with us. Louisiana law is substantially different from the law of other states in the area of testamentary planning, both on the level of basic required formalities and all the substantive rules and strategies that we will discuss later in this presentation. We are attorneys who have been extensively educated in these matters, and we likely have a great deal of experience applying this law with actual real life clients. Don't be fooled into believing that these groups can actually compete with your service offering - they cannot. If a potential client cannot appreciate the value you offer above and beyond these so-called competitors, then they are better off rolling the dice with one of these folks, and you are better off serving the next client who comes in who will appreciate the value you offer in protecting them, their family, and their legacy, and be willing to compensate you for it.

III. Testamentary Dispositions – Who Gets Your Stuff?

a. In General

Alright alright alright. We now have the basic formations down pat. We know the rules of the game. NOW we can turn to the basic blocking and tackling that we need to succeed.

This subject, testamentary dispositions, is really what most clients think of when they think of getting you to do a last will and testament for them - who are they going to leave their stuff to? So this is one area we REALLY better get right!

b. Types of Legacies – What Do They Get

So how do we leave things to people in a testament? Through testamentary dispositions, of which there are three types:

> Testamentary dispositions are particular, general, or universal. La. Civ. Code Ann. art. 1584.
>
> A universal legacy is a disposition of all of the estate, or the balance of the estate that remains after particular legacies. A universal legacy may be made jointly for the benefit of more than one legatee without changing its nature. La. Civ. Code Ann. art. 1585.
>
> A general legacy is a disposition by which the testator bequeaths a fraction or a certain proportion of the estate, or a fraction or certain proportion of the balance of the estate that remains after particular legacies. In addition, a disposition of property expressly described by the testator as all, or a fraction or a certain proportion of one of the following categories of property, is also a general legacy: separate or community property, movable or immovable property, or corporeal or incorporeal property. This list of categories is exclusive. La. Civ. Code Ann. art. 1586.
>
> A legacy that is neither general nor universal is a particular legacy. La. Civ. Code Ann. art. 1587.
>
> A legacy to more than one person is either joint or separate. It is separate when the testator assigns shares and joint when he does not. Nevertheless, the testator may make a legacy joint or separate by expressly designating it as such. La. Civ. Code Ann. art. 1588.

So we can leave one or more people the following: (1) certain specific things (a particular legacy); (2) certain parts of the estate not intended to be all the estate or all the estate after any particular legacies (a general legacy); or (3) all the estate, or at least all the estate after any particular legacies.

As an example, “I leave to my wife all my interest in my primary residence at the time of my death” is a particular legacy.

As another example, “I leave to my good friend, Ed Orgeron, 25% of my estate remaining after the particular legacy made in the preceding sentence” is a general legacy.

As another example, if instead of the general legacy to Coach O, we said “I leave to my good friend, Joe Burrow, all my separate property at the time of my death,” then that would also be a general legacy.

As another example, if instead of the general legacies to Coach O and Burrow, we said “I leave to my children all my estate remaining after the particular legacy made in the preceding sentence,” then that would be a universal legacy.

Why do these distinctions matter? Because it can affect who gets what. Are our legacies crystal clear in exactly what we want to go where? Do we make it clear how the legacies relate to one another? Or do the legacies appear to contradict one another? In other words, do we make clear the client’s intent to apply this legacy first and then another legacy - we don’t want to leave the same thing to two different people. Also, are we clear on how much property we’re leaving in a legacy and how we describe it? As an example, I see legacies of “25% of all my interest in XYZ LLC” when what the client really intended was “all my 25% interest in XYZ LLC.”

These distinctions also matter because it can affect accretion (who gets the legacy if it lapses (such as if the legatee dies or renounces it)), and who is liable for the payment of estate debts and administrative expenses. The different types of legacies are treated differently for each of these issues, and you need to be able to structure the testamentary dispositions so that the client’s wishes on these issues are most likely to be fulfilled.

c. <u>Types of Legatees – Who Gets It</u>

It can matter greatly the identity of exactly who we’re leaving property to as well, not just what property gets left to them. Are we leaving it to a spouse? To descendants? To non-family members of the client? To a trust? To a charity? Each of these different types of legatees can be treated differently for important purposes, such as interpretation, accretion and representation, their ability to challenge the testamentary dispositions through legislative restrictions of the freedom of testamentary intent, etc. We will cover each of these in more depth below.

d. <u>What Can't You Do? Legislative Father Knows Best</u>

It is important to know that there are certain restrictions on your client's freedom to leave his or her property however they like to whoever they like. We will cover some of the primary restrictions below.

i. <u>Marital Portion - After Putting Up With You, She Deserves Something</u>

Louisiana law provides for something called the marital portion:

> When a spouse dies rich in comparison with the surviving spouse, the surviving spouse is entitled to claim the marital portion from the succession of the deceased spouse. La. Civ. Code Ann. art. 2432.
>
> The marital portion is an incident of any matrimonial regime and a charge on the succession of the deceased spouse. It may be claimed by the surviving spouse, even if separated from the deceased, on proof that the separation occurred without his fault. La. Civ. Code Ann. art. 2433.
>
> The marital portion is one-fourth of the succession in ownership if the deceased died without children, the same fraction in usufruct for life if he is survived by three or fewer children, and a child's share in such usufruct if he is survived by more than three children. In no event, however, shall the amount of the marital portion exceed one million dollars. La. Civ. Code Ann. art. 2434.
>
> A legacy left by the deceased to the surviving spouse and payments due to him as a result of the death are deducted from the marital portion. La. Civ. Code Ann. art. 2435.

The marital portion provided under Article 2432 of the Louisiana Civil Code, whether in full property or usufruct only, or any portion thereof, may be placed in trust, if: (1) The net income accruing to the surviving spouse therefrom is payable to the surviving spouse not less than once each year; (2) The surviving spouse's interest is subject to no charges or condition, except that the trust instrument may place restrictions upon the alienation of the marital portion in trust; and (3) The term of the trust, as it affects the marital portion, does not exceed the life of the surviving spouse. La. Stat. Ann. § 9:1851.

An unconditional principal and income interest in trust, with income payable not less than annually for the life of the beneficiary, satisfies the marital portion to the same extent as would the full ownership not in trust of the same property; however, during the term of the trust, the trustee may pay principal from the trust property for support, maintenance, education, medical expenses, or welfare of the beneficiary and, upon termination of the portion of the trust that affects the marital portion, the principal shall be delivered to the surviving spouse or his heirs, legatees, or assigns free of trust. La. Stat. Ann. § 9:1852.

A usufruct in trust, or an unconditional income interest in trust, without an interest in principal, payable not less than annually for a term or for the life of the beneficiary satisfies the marital portion to the same extent as would a usufruct not in trust on the same property for the same term. La. Stat. Ann. § 9:1853.

A provision of a trust instrument that is incompatible with the provisions of this Subpart shall be reformed to comply herewith. La. Stat. Ann. § 9:1854.

The marital portion means that, in Louisiana, in certain circumstances, you cannot leave your spouse too little property. You must leave them a sufficient amount to satisfy the marital portion, as calculated in the cited code articles.

The marital portion cannot be waived by the surviving spouse prior to the death of the deceasing spouse, so a separate property agreement cannot validly prohibit or waive it. However, one wonders whether a spouse could plan ahead in sufficient time to place assets in trust that would be outside of his probate estate and thereby avoid the marital portion?

Regardless, most spouses want to take care of their surviving spouse, and therefore this is often not an issue. But in subsequent marriages where a spouse has children from other than the current marriage, and would like to leave the bulk, if not all, the wealth that pre-existed the marriage to that spouse's own children, then the marital portion can be an issue.

In that circumstance, through good testamentary planning and a well-drafted testament, the marital portion can be satisfied while still preserving the ultimate benefit to the predeceasing spouse's children. The primary way to do this is through either granting the surviving spouse a lifetime usufruct of property of sufficient value or leaving that spouse an income interest in trust, with the predeceasing spouse's children as either naked owners or principal beneficiaries (or successor income beneficiaries).

Obviously, the marital portion does not apply if the spouses are no longer married at the time of death. However, one additional item to note is that if spouses divorce after the signing of a testament, a legacy to the ex-spouse is considered revoked, unless the decedent provides to the contrary. See LA Civil Code article 1608(5).

ii. <u>Forced Portion - Gotta Take Care of Your Kids Too</u>

As we all know, of all the United States, Louisiana alone grants certain descendants the rights to claim a forced portion from the estate of their ascendants:

> A. Forced heirs are descendants of the first degree who, at the time of the death of the decedent, are

twenty-three years of age or younger or descendants of the first degree of any age who, because of mental incapacity or physical infirmity, are permanently incapable of taking care of their persons or administering their estates at the time of the death of the decedent. B. When a descendant of the first degree predeceases the decedent, representation takes place for purposes of forced heirship only if the descendant of the first degree would have been twenty-three years of age or younger at the time of the decedent's death. C. However, when a descendant of the first degree predeceases the decedent, representation takes place in favor of any child of the descendant of the first degree, if the child of the descendant of the first degree, because of mental incapacity or physical infirmity, is permanently incapable of taking care of his or her person or administering his or her estate at the time of the decedent's death, regardless of the age of the descendant of the first degree at the time of the decedent's death. D. For purposes of this Article, a person is twenty-three years of age or younger until he attains the age of twenty-four years. E. For purposes of this Article "permanently incapable of taking care of their persons or administering their estates at the time of the death of the decedent" shall include descendants who, at the time of death of the decedent, have, according to medical documentation, an inherited, incurable disease or condition that may render them incapable of caring for their persons or administering their estates in the future. La. Civ. Code Ann. art. 1493.

A forced heir may not be deprived of the portion of the decedent's estate reserved to him by law, called the legitime, unless the decedent has just cause to disinherit him. La. Civ. Code Ann. art. 1494.

Donations inter vivos and mortis causa may not exceed three-fourths of the property of the donor if he leaves, at his death, one forced heir, and one-

> half if he leaves, at his death, two or more forced heirs. The portion reserved for the forced heirs is called the forced portion and the remainder is called the disposable portion. La. Civ. Code Ann. art. 1495.
>
> To determine the legitime of a forced heir when all forced heirs are of the first degree, the division of the forced portion is made by heads. When representation occurs for purposes of forced heirship, the division is made by roots among those qualifying as forced heirs or being represented. Within each root, any subdivision is also made by roots in each branch, with those qualifying as forced heirs by representation taking by heads. Nevertheless, if the fraction that would otherwise be used to calculate the legitime is greater than the fraction of the decedent's estate to which the forced heir would succeed by intestacy, then the legitime shall be calculated by using the fraction of an intestate successor. La. Civ. Code Ann. art. 1495.1.
>
> No charges, conditions, or burdens may be imposed on the legitime except those expressly authorized by law, such as a usufruct in favor of a surviving spouse or the placing of the legitime in trust. La. Civ. Code Ann. art. 1496.

We all know about forced heirs, so why bring it up? One, because it's important, and not all clients know about forced heirs, particularly if they are new to Louisiana. Second, it is my anecdotal experience that the existence and rights of forced heirs can often get overlooked in the testamentary planning process, and this can be critically detrimental to the client's estate plan. Why? Because while we cannot completely avoid forced heirs (without extensive and sufficiently well-done lifetime giving), we can draft around the forced portion to help the client accomplish their desires as much as possible.

For example, even in a nuclear family where the client wants to make sure that their children are taken care of, it can be less than desirable for a minor child to receive property directly in their name. Sometimes tutorship issues can arise, sometimes the client just might not want their child receiving certain rights to property or to cause trouble the moment they turn 18. Often the client prefers to leave everything, or at least all the rights they can, to the surviving spouse and parent. What can be done?

First, the client can leave all property to the spouse with some contingency language for forced heirs. Sample language for a maximum spousal usufruct follows:

> 1.1. Primary; All to Spouse. I leave all the property that I own at the time of my death to my beloved spouse, Minnie Mouse ("Minnie"). If I leave any one or more forced heirs, then I leave to Minnie the maximum usufruct over the forced portion, in addition to the universal legacy in the preceding sentence. This usufruct allows the usufructuary to dispose of nonconsumables, including the right to alienate by donation inter vivos, and does not require security from the usufructuary.

Second, the client can leave any forced portion to a trust, so long as the trust is properly drafted to comply with the restrictions on placing the legitime in trust. Sample language to leave the forced portion to a trust follows:

> 1.2. Contingent; Forced Portion to Trust. If I leave any one or more forced heirs, then I leave the forced portion to the trustee of the Mickey Mouse Family Testamentary Trust, the trust settled by me in article 2 of this testament (the "Family Trust"), to be held in equal shares for the benefit of each such forced heir on the terms of the Family Trust.

So long as the trust is properly drafted and the one or more trustees are properly chosen and properly administer the trust, then the spouse gets maximum freedom to treat all their predeceasing spouse's property as their own while the children should receive some protection of their share. However, depending on how much the client trusts their spouse, consideration might be given to the degree of freedom given to the surviving spouse in the usufruct (e.g., maybe not allow donations of property subject to the usufruct, or maybe not allow disposition of nonconsumables without the consent of the trustee (who would not be the surviving spouse) holding the forced portion), and to any responsibilities or rights given to the surviving spouse in the trust (e.g., such as whether or not the surviving spouse is permitted to serve as trustee or to the degree of freedom or autonomy granted to the surviving spouse in administering the trust).

These considerations for forced heirs can be rendered moot if a forced heir can be disinherited. See LA Civil Code article 1617 *et seq*.

One additional consideration when naming descendants as legatees under a testament is that the normal rules of accretion when a legacy lapses is altered as follows:

> If a legatee, joint or otherwise, is a child or sibling of the testator, or a descendant of a child or sibling of the testator, then to the extent that the legatee's interest in the legacy lapses, accretion takes place in favor of his descendants by roots who were in existence at the time of the decedent's death. The provisions of this Article shall not apply to a legacy that is declared invalid or is declared null for fraud, duress, or undue influence. La. Civ. Code Ann. art. 1593.

iii. <u>Prohibited Substitutions - If They Own It Then They Own It</u>

The restriction against prohibited substitutions is likely fairly simple to us estate planning attorneys, but can be a trap for the unwary client who might try his hand at either an olographic testament or an out-of-state attorney or online or remote seller of testaments. A prohibited substitution is defined as follows:

> A disposition that is not in trust by which a thing is donated in full ownership to a first donee, called the institute, with a charge to preserve the thing and deliver it to a second donee, called the substitute, at the death of the institute, is null with regard to both the institute and the substitute. La. Civ. Code Ann. art. 1520.

So we can't leave full ownership to one person and then at their death try to leave full ownership to another person. But we can accomplish very similar things through either survivorship provisions (see section VI.a of this presentation), through separate donations of usufruct (either singular or multiple and successive) to one or more persons and naked ownership to another person (permitted under LA Civil Code article1522), or through income interests (singular or multiple and successive) to one or more persons and principal interest to other one or more persons (permitted in article 1520 cited above).

That is one of countless reasons why it is vital that we find out what the client actually wants, help the client avoid impermissible ways to accomplish those objectives, and help the client find the best among several permissible ways to accomplish those objectives.

iv. Against Public Policy - Don't Do Bad Stuff

This last of the Civil Code restrictions on testamentary dispositions is a fairly broad catch-all category that covers pretty much anything a client might conceive of doing that would be against public policy:

> In all dispositions inter vivos and mortis causa impossible conditions, those which are contrary to the laws or to morals, are reputed not written. La. Civ. Code Ann. art. 1519.

The following are some examples of testamentary provisions held to violate this restriction: (1) designating an attorney for the estate (see Succession of Jenkins, Sup.1986, 481 So.2d 607); (2) broadly prohibiting alienation of property (see Parker v. Parker, W.D.La.1974, 377 F.Supp. 455; but imposing a right of first refusal was held valid (see Succession of Russell, App. 3 Cir.1991, 590 So.2d 606)); and (3) certain penalty, challenge, or no-contest provisions that attempted to deter heirs, legatees, or beneficiaries from acting contrary to the testator's wishes (such as by selling property, objecting to a legacy, or contesting a testament in whole or in part; see Parker v. Parker, W.D.La.1974, 377 F.Supp. 455; Succession of Kern, App. 4 Cir.1971, 252 So.2d 507; but see Succession of Wagner, App. 4 Cir.1983, 431 So.2d 10).

Even if our client wants a provision that doesn't squarely fall under one of these categories, but that seems to be something that would go against law, good morals, or public policy, such as a discriminatory provision of some kind, this article gives good grounds to talk the client out of it.

v. Nonprobate Assets - Play By Their Own Set of Rules

The final item in this section on testamentary dispositions is that, contrary to what some clients think, a testament does not necessarily control the leaving of ALL their property, depending on what types of assets they own. There are certain types of assets that pass outside of a testament according to other law. Examples of these are the following: (1) qualified retirement plans (e.g., IRAs, 401(k)s, etc.); (2) life insurance; (3) annuities; (4) assets held in trusts (other than when the client might hold a valid limited power of appointment that can be exercised through a testament); (5) contract rights that by their terms either expire or pass to someone else (such as rights to ownership interests in business entities that by the terms of their governance agreements (e.g., LLC operating agreements, partnership agreements, corporate bylaws, buy-sell agreements, etc.) pass to another person on the death of an owner); (6) financial accounts with transfer-on-death or pay-on-death beneficiary provisions (warning - in Louisiana these can permit the financial institution to pay the designated beneficiary but they do not necessarily result in that beneficiary being the legal owner of the funds); (7) US savings bonds (ownership passes by federal law, not Louisiana law); etc.

With regard to nonprobate assets, it is vitally important that we do each of the following with our testamentary planning clients: (1) make sure that they are aware that the disposition of any such nonprobate assets is not governed by their testament; (2) find out if they have any such nonprobate assets, what type, value; where located, account details, etc.; (3) find out if they expect our assistance with coordinating the disposition of any such nonprobate assets; (4) document their expectation, one way or the other; and (5) if they expect our assistance, then carry it out (and charge for it!).

e. Family Dynamics - the Fine Art of Leaving a Legacy That Helps Not Hurts

There's a quote attributed to Ambrose Bierce that says: "Death is not the end. There remains the litigation over the estate." If we were new to the practice of estate planning, we might think this wouldn't be the case with family, who were often raised in the same home, eating at the same table, with decades of experience resolving disputes together over toys, time with Mom and Dad, the remote, phones, allowances, bedrooms, cars, etc. But there's another quote attributed to Johann Kaspar Lavater that says: "Never say you know a man until you have divided an inheritance with him."

We all know that family dynamics can be some of the most fragile relationships of all. Petty rivalries and old grudges thought long since settled can resurface when Mom and Dad are no longer there to referee, and when there is money and property at stake. And, paradoxically, the fights over items with purely sentimental value can be the bitterest of all.

So with this in mind, what are we as estate planners to do when counseling a client with their testamentary planning? Some helpful actions are the following:

i. Listen to the Client

The first thing we ought to do is ask the client to tell us about their family. And then shut up and listen. If they won't talk, ask probing questions that require more than yes or no answers like the following: (1) tell me about your family; (2) tell me about your spouse/children; (3) what concerns you the most about your spouse/children after your death?; (4) how do you think they will get along if we set it up this way?; etc.

This takes time, which we often don't have. But hopefully we can with experience learn to discern the red flags that should alert us to potentially explosive situations. Sometimes those red flags can be obvious: (1) subsequent marriages with children not of the current marriage; (2) estranged children; (3) family members that have depended on the client financially; (4) family members with substance abuse issues; etc. I don't mean to cast aspersion on any client in such a situation; sometimes these families work things out wonderfully well and it's the nuclear family that blows up!

ii. Educate the Client

After listening properly to understand the client's situation, sometimes it is appropriate (and sometimes necessary!) to educate the client on having the proper perspective. Some things to consider: (1) estate planning is an area with room for an almost unlimited degree of creativity and flexibility, limited primarily by the imagination and the budget, not by the law - so if we give it some thought, we might be able to come up with a structure that helps rather than hurts healthy family dynamics; (2) equal is not necessarily fair, and fair is not necessarily equal - sometimes the fairest thing you can do is to treat different legatees unequally if you have valid reasons and a good narrative to explain it; (3) this estate plan does not have to be 100% perfect to be signed, and once signed it does not have to be set in stone and never changed - get a good (even if imperfect) plan in place ASAP and let's revisit and revise it as needed over time; etc.

iii. Structure Wisely

We must help the client think about asset allocation and how the legatee will receive the legacy.

For asset allocation, we should help the client consider on an asset-by-asset basis the following: (1) who most uses or enjoys the asset (e.g., a home, recreational property, vehicle, social/recreational club membership, etc.); (2) who helped create or build or continues to run or manage the asset (e.g., a business, a recreational property, etc.); (3) who can best continue to care for the asset (e.g., a farm, an animal, a firearm, artwork, etc.); (4) who most needs the asset (consider, for example, a special needs loved one (or their special needs trust), a low-income loved one who is doing well but doing without, a legatee who could most benefit or be least burdened by the tax characteristics of the asset, etc.); etc.

With asset allocation, we can allocate assets entirely to the one or more chosen legatees to avoid the need for future cooperation among legatees. If that is not possible or desirable, then we can still split up the ownership of the asset in whatever way permits the most healthy dynamics (such as splitting up usufruct and naked ownership or voting interests and nonvoting interests, appointing one or more legatees as managers or trustees but not appointing other legatees to those positions, etc.). It can be particularly helpful in this regard if the legatees are either or both receiving an interest in a limited liability entity rather than in the asset directly, or receiving an interest held in trust rather than an interest directly in the asset or the limited liability entity.

iv. Encourage Client Communication with Family

Once all this is done, we have hopefully helped the client prepare as much as possible to position their family for success. From here, it is can be very effective if the client then timely and properly communicates the essentials of the plan to their family.

Such communication might not be easy, even in the best of families, but it can greatly influence the ultimate success of the plan. With many legatees, if they know and heard directly from the client that this was in fact their wish, it can make them far more likely to accept and not challenge the plan.

v. Hope for the Best but Prepare for the Worst

We hope that all this works, and the plan is a roaring success for the client and their family that leaves the legacy as a blessing and not a burden, for generations to come. But at the end of the day in this fallen world, sometimes that will not be the case. To prepare for such situations, we must communicate that possibility to the client. We must internally document our discussions with the client. We must maintain a healthy dose of skepticism when dealing with the client's family members - trust but verify! We want to do everything we can to help the client succeed, but we also want to live to fight another day.

f. Charity - When You Can't Decide Just Give It All to Charity

What about when the client wants to give some or all their property to a charitable legatee? That's great! Incredible amounts of public and private good have been done in our world by extremely generous testamentary donations to deserving charities. But what are some of the considerations we should keep in mind when assisting with a charitable testamentary plan?

First is when to make the charitable donation. At death through a testament is often the easiest and the simplest way, but not necessarily the best way. One, a testamentary donation gets an estate tax deduction, but not a current income tax deduction. So it benefits the client's estate, but not the client. On the other hand, if given during life, the donation gets a charitable contribution deduction during the client's lifetime, which benefits the client. It also reduces the client's estate. A lifetime gift also lets the client enjoy the emotional benefits of being able to see the public good they've done, and often enjoy the benefit of being able to directly participate in the charitable activity as well. However, it also means that the client is generally parting ways with the asset or its income during their life, which the client or their loved ones might later need. Making the contribution at death through the testament preserves the client's economic benefits from the asset and retains the right of control and the right to revoke the gift up until the very end of their life.

Second, if the client decides to make the charitable donation at death through the testament, then how best to give it? And what asset is best to give? For practical purposes, it is easiest and simplest just to leave a set dollar amount of cash to the one or more charities. But what if that ends up being too large or too little an amount of cash given the overall value or liquidity in the estate at that time?

So what if you specify a certain percentage or fraction of the estate? That means the amount would increase or decrease in proportion to the rest of the estate value or liquidity. The difficulty with that then arises that the charitable legatee then has an interest in just about every decision affecting the estate. As a general or universal legatee, they share in all the benefits or burdens of increases or decreases in estate value, estate expenses, tax elections, etc. Do you really want to have to work with a the legal representative of a charitable organization to explain all those matters and, if necessary, get them to sign off on it? Maybe not. The answer will likely depend on the client, the charity, the asset, your particular preferences, etc.

g. <u>Trusts – Because You Don't Trust Somebody</u>

There's an old saying that an inheritance gained too early in life is not a blessing in the end. For those clients concerned about how their legatees might be impacted by what they are left in the testament, leaving those legacies to a trust might be a good answer. Trusts are a more advanced estate planning tool, and can be used to accomplish objectives that no other tool can adequately accomplish. There are an almost infinite variety of types of trusts that can be utilized to help the client accomplish his or her objectives, from basic trusts set up to hold a minor child's property until he or she reaches the age of majority, to spousal trusts providing benefit to a surviving spouse but preserving the principal for the client's children, to special needs trusts to take care of a family member with special needs by supplementing but not supplanting their public benefits, to charitable trusts where the client or the client's loved one might retain either an income or principal interest, and the list goes on and on and on from there.

But is utilizing a trust in the client's testament the right move for that particular client in that particular situation? At a minimum you and the client should consider the following questions.

i. What Purpose?

What would the client like to accomplish with a trust? Often clients use trusts for the following purposes (among many others): (1) to reduce federal income taxes and federal transfer taxes (i.e., estate, gift, and generation-skipping transfer); (2) to protect assets from legal guardians of minor children beneficiaries or from adult beneficiaries who might waste those assets; (3) to protect assets from creditors or predators, whether those who might attack the client or those who might attack the beneficiaries of the trust; (4) to take care of family members with special needs without endangering their eligibility for public benefit programs; (5) to protect assets from nursing homes or government programs if the client or the beneficiary ever requires long-term nursing home care; (6) to avoid the public scrutiny, delay, and expense of the court-supervised probate process; etc.

ii. Which Beneficiaries?

Who would the client like to benefit with the trusts? Often clients will set up trusts for one or more of the following (along with an almost infinite combination of these and other persons): (1) their surviving spouse - a testamentary spousal access trust can be a great help in ensuring the structural integrity of the overall plan (e.g., so that the spouse's inheritance is protected from creditors and so that children who are beneficiaries actually end up receiving their intended inheritance); (2) their minor children - it can be of great benefit to have a trust to hold those minors' assets until they are of either or both sufficient age or character to prudently handle those assets; (3) all their descendants - even if the beneficiaries are of sufficient age or character to prudently

handle the assets, it can still be desirable to have those assets protected from potential creditors in a trust to which the beneficiaries can have certain rights of access or control;
(4) special needs family members who are receiving or might be eligible to receive public benefits - a special needs trust can be an absolutely critical need in such a situation; etc.

iii. Who Gets What When?

Which beneficiaries of the trusts will receive what amounts at what times? Trusts have income beneficiaries who receive the income generated by the property of the trust, whether at specified intervals, on specified events, or in the discretion of the trustee. Trusts also have principal beneficiaries who receive the property remaining in the trust at its termination.

iv. How Long?

How long does the client want the trusts to last, and when does the client want them to terminate? Trusts can terminate on specified dates, on specified events, or in the discretion of the trustee. Louisiana, unlike some other states, does not permit so-called dynasty trusts, which are sometimes permitted to last in perpetuity. The statutory limits (depending on whether or not a class trust) on how long trusts can last are as follows:

> If the trust instrument stipulates a term and unless an earlier termination is required by the trust instrument, or by the proper court, a trust shall terminate at: (1) The death of the last surviving income beneficiary or the expiration of twenty years from the death of the settlor last to die, whichever last occurs, if at least one settlor and one income beneficiary are natural persons; (2) The death of the last surviving income beneficiary or the expiration of twenty years from the creation of the trust, whichever last occurs, if none of the settlors is a natural person but at least one income beneficiary is a natural person; (3) The expiration of twenty years from the death of the settlor last to die, if at least one settlor is a natural person but none of the income beneficiaries is a natural person; (4) The expiration of fifty years from the

creation of the trust, if none of the settlors and none of the income beneficiaries is a natural person. La. Stat. Ann. § 9:1831.

A. Notwithstanding the provisions of R.S. 9:1803, R.S. 9:1831 through 1835, and R.S. 9:1841 through 1847, but subject to the restrictions stated in this Subpart, a person may create an inter vivos or testamentary trust in favor of a class consisting of some or all of the children, grandchildren, great grandchildren, nieces, nephews, grandnieces, grandnephews, and great grandnieces and great grandnephews of the settlor or of the settlor's current, former, or predeceased spouse, or any combination thereof, although some members of the class are not yet in being at the time of the creation of the trust, provided at least one member of the class is then in being. Such a trust is called a class trust. If the trust instrument so provides, the interest of each beneficiary in the class shall be held in a separate trust after the class has closed.
B. If the class includes members related to the settlor's current, former, or predeceased spouse who are not also related to the settlor, the interests of those members shall be determined as if they were related to the settlor in the same manner as they are related to the settlor's current, former, or predeceased spouse, unless the trust instrument provides otherwise…. La. Stat. Ann. § 9:1891.

A trust created under the provisions of this Sub-part shall not terminate before the closing of the class. The term of the trust thereafter is determined by the rules prescribed by R.S. 9:1899 through 9:1906. La. Stat. Ann. § 9:1897.

v. <u>Trustee?</u>

Who does the client want to be in charge of the trust and its property? This person will be responsible for investing and managing the trust property, dealing with any professional advisors of the trust or the beneficiaries, making sure the trust complies with all laws, and then terminating the trust and distributing the property at the one or more appropriate times. I generally like to have the client come up with at least three names for this position, if possible. The trustee must be someone the client trusts completely to handle property and deal with the client's family members in a professional and trustworthy manner!

vi. Sole Trustee or Co-Trustees?

Does the client want one person serving as the sole trustee, with the authority to act by himself or herself? Or would the client prefer to have two or more persons serving as co-trustees, who can act only when all or a majority of them agree and sign off on the action? When the client's spouse, a child, or other trusted family member is named as the trustee, often they are allowed to serve as the sole trustee, which has the advantage of convenience and permits the trustee to take quick action without having to wait for consent and signatures from others. However, this is not required, and if the client does not trust the trustee completely, then it can be risky.

vii. Individual, Professional, or Institutional Trustee?

Does the client want an individual (such as a spouse, child, or other trusted family member), a professional (such as an attorney, CPA, or investment adviser), or an institution (such as a bank or trust company) serving as the trustee? Naming an individual to serve as the trustee generally offers the advantages of having someone who knows the beneficiaries personally, who often can act quickly and unilaterally, and who does not charge a fee for his services as trustee, but the disadvantages are that abuse or other loss of trust funds is more prevalent with an individual trustee, who often will not have deep pockets from which to recover. Naming a professional to serve as trustee generally offers the advantages of having a knowledgeable advisor or manager of the trust property, who sometimes can act relatively quickly and unilaterally, and who has relatively deep pockets in case of abuse or other loss of trust property, but the disadvantages are that most professionals will not serve as a trustee and those who do will generally charge substantial fees for their services as trustee (often an hourly rate, billed monthly, that will vary from month-to-month and be hard to budget in advance). Naming an institution to serve as trustee generally offers the advantages of having a conservative protector of the trust property and someone with deep pockets in case of abuse or other loss of trust property, but the disadvantages are that the institution generally does not know the beneficiaries personally, cannot act quickly or unilaterally, and will charge a substantial fee for its services as trustee (often a percentage of trust property billed annually).

h. <u>Taxes – Uncle Sam is a Part of Your Family</u>

As we all know, Uncle Sam is that member of your family that you never asked for and often least want. Yet he gets a commanding seat at the table in almost every estate, and so we must pay attention to the role taxes play. I will not get into too much depth on these topics in this presentation. The bulk of this information will be covered by our esteemed colleague, Jacob C. White, in his presentation at this conference tentatively titled “Basic Gift & Estate Tax Planning for Medium Size Estates.”

i. <u>Estate Taxes versus Income Taxes - Pick Your Poison</u>

Generally when considering tax minimization in estate planning for an estate large enough to be federally taxable, the tradeoff is between avoiding federal transfer taxes or avoiding income taxes. This is primarily due to the fact that appreciated assets (i.e., those assets which have a fair market value in excess of basis, whether because either or both the asset’s fair market value appreciated or the asset’s basis was depreciated) owned or deemed to be owned by a decedent at the time of death receive a step-up in basis to the fair market value at the date of death. However, if that asset is owned or even deemed to be owned by the client at the time of his death, then generally that asset will be included in the client’s gross estate and therefore potentially subject to estate tax. This leads to the tradeoff- we must help the client evaluate and choose what is best for the client, whether or not: (1) to get the asset out of the client’s estate and therefore avoid estate taxes, but also give up the income tax benefits of the stepped-up basis; or (2) to keep the asset in the client’s estate and therefore gain the income tax benefits of the stepped-up basis, but also to incur the burden of estate taxes.

Some helpful strategies are to minimize the impact of losing the stepped-up basis by removing high-basis assets from the estate (i.e., assets for which the stepped-up basis would be minimal anyway), and retaining assets that would benefit the greatest from the stepped-up basis (i.e., assets for which the built-in gain is the greatest) and which will hopefully be sheltered from estate taxes by either the client's own remaining exclusion (or the marital deduction or the charitable deduction.

ii. Income Taxes - Some General Things to Keep in Mind

One note is that although we often refer to the "stepped-up basis," the relevant provision of the federal income tax code (IRC section 1014) actually operates for the property passed from the decedent as a readjustment of the basis of that property's basis to "the fair market value of the property at the date of the decedent's death." This readjustment could be a step up, if the basis is lower than the fair market value. But it could also be a step down, if the basis is lower than the fair market value! So one very important strategy is to gift out property that has depreciated in value to preserve the excess basis through the carryover basis provisions of IRC section 1015 for property gifted during life.

Another consideration for income tax planning is to consider the tax characteristics of the assets being allocated. Some types of assets or income do not receive a stepped-up basis, such as income in respect of a decedent (see IRC section 1014(c), such as wages/salary/bonuses/interest/dividends or other income earned but not yet paid prior to death, retirement plan assets and distributions, etc.), while other assets are received free of income tax, such as life insurance (generally!). Therefore, you want to consider how the tax characteristics of the asset will impact the intended legatee. From a tax perspective, qualified retirement plans (other than Roth accounts) are often best left to surviving spouses, who can roll it over to their own plan and best avoid income taxes (as well as avoiding estate taxes for a time by virtue of the marital deduction). High-tax assets are often best left to charitable legatees or legatees in lower income tax brackets.

One final note here is that we also want to consider designing the income tax classifications of our trust and limited liability entities to best fit the client's situation and desired allocation of assets. C corporations and S corporations do not get a stepped-up basis in the inside basis of their assets, making them poor choices of tax classifications to hold appreciating or depreciable property with a long useful life. Trusts that are or will be taxed as complex trusts, rather than simple or grantor trusts, face highly compressed income tax brackets (reaching the top tax bracket of 37% in 2021 at $13,050 of taxable income, while a married filing jointly taxpayer does not reach that same top tax bracket until $628,300); therefore, for certain brackets of income it is highly desirable for income tax purposes to draft your trusts to obtain classification as a simple trust or a grantor trust (whether as to one or more of the settlors or as one or more of the beneficiaries).

iii. Marital Deduction - QTIP, Usufructs, & Trusts

The estate of a taxpayer is allowed a deduction for property left to the surviving spouse in a qualifying manner as follows:

> (a) Allowance of marital deduction. For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsection (b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate. IRC section 2056(a).

In addition, later in that same section, subsection 2056(b)(7) permits the executor of a decedent's estate to elect on the decedent's federal estate tax return, IRS form 706, whether to include certain qualified terminable interest property in the gross estate of the decedent, and thereby gain the marital deduction for the decedent's estate (with the subsequent inclusion of that property in the surviving spouse's estate). Therefore, one of the key estate tax considerations for us is properly planning and drafting testamentary usufructs or spousal trusts as QTIP, so that the executor of the client's estate can decide post-mortem whether or not to make the QTIP election for some or all that property or properties. For more detail on this topic, please refer to Jacob White's presentation at this conference. Please also see section V.f of this presentation for relevant sample form language.

iv. Credit Shelter / Bypass Trusts

A credit shelter or bypass trust is one that is intended to soak up all a decedent's remaining exclusion amount for federal and state transfer tax purposes. With the federal estate tax system now allowing portability of unused exclusion amount and Louisiana no longer having any state transfer tax, there is now little tax benefit for this type of trust, other than to freeze the value of the property allocated to the credit shelter trust and thereby allow the appreciation to escape estate taxation at the death of the surviving spouse. However, that potential benefit must be weighed against the potential loss of the income tax benefit from gaining a stepped-up basis at the death of the surviving spouse if included in that spouse's gross estate. For more detail on this topic, please refer to Jacob White's presentation at this conference.

v. Valuation Discounts - Leaving Undivided Interests

One additional tax consideration, for both income and transfer taxes, is the potential impact of valuation discounts for the fair market value of assets. When valuing an asset in a decedent's estate, the appraiser can take into account certain discounts such as a discount for lack of marketability (i.e., a discount to reflect the real economic impact on sale price of not being able to quickly liquidate an asset that might not have a readily-tradeable market) or a discount for lack of control (i.e., a discount to reflect the real economic impact on sale price for not having voting control of the entity and therefore being unable to cause distributions or liquidation).

From an estate tax perspective, valuation discounts are helpful - they reduce the size of the taxable estate. But from an income tax perspective, they are detrimental - they reduce the stepped-up basis that would otherwise be achieved. Helping the client structure their testament to achieve the proper balance of transfer tax planning and income tax planning is often a difficult task, but one which can be of great value to our clients. For more detail on this topic, please refer to Jacob White's presentation at this conference.

vi. Charitable Deduction - Doing Well by Doing Good

The estate of a taxpayer is allowed an estate tax deduction for property left to qualified charitable legatees under IRC section 2055. For some practical considerations, and a light discussion of some tax considerations, that go into the testamentary planning involving charitable legatees, see section III.f of this presentation. For more detail on the tax considerations, please refer to Jacob White's presentation at this conference.

IV. Tutorship – Take My Kids, Please!

a. In General

Often one of the most important issues with which you can help clients with young children is who will succeed them as legal guardians of the minor children, a position which in Louisiana is called the tutor. The relevant LA Civil Code provisions are as follows:

> There are four sorts of tutorships: Tutorship by nature; Tutorship by will; Tutorship by the effect of the law; Tutorship by the appointment of the judge. La. Civ. Code Ann. art. 247.
>
> Tutorship by nature takes place of right, but the natural tutor must qualify for the office as provided by law. In every other kind of tutorship the tutor must be confirmed or appointed by the court, and must qualify for the office as provided by law. La. Civ. Code Ann. art. 248.
>
> Upon the death of either parent, the tutorship of minor children belongs of right to the other. Upon divorce or judicial separation from bed and board of parents, the tutorship of each minor child belongs of right to the parent under whose care he or she has been placed or to whose care he or she has been entrusted; however, if the parents are awarded joint custody of a minor child, then the cotutorship of the minor child shall belong to both parents, with equal authority, privileges, and responsibilities, unless modified by order of the court or by an agreement of the parents, approved by the court awarding joint custody. In the event of the death of a

parent to whom joint custody had been awarded, the tutorship of the minor children of the deceased belongs of right to the surviving parent. All those cases are called tutorship by nature. La. Civ. Code Ann. art. 250.

The right of appointing a tutor, whether a relation or a stranger, belongs exclusively to the father or mother dying last. The right of appointing a tutor, whether a relation or a stranger, also belongs to a parent who has been named the curator for the other living spouse, when that other living spouse has been interdicted, subject only to the right of the interdicted parent to claim the tutorship should his incapacity be removed by a judgment of a court of competent jurisdiction. This is called tutorship by will, because generally it is given by testament; but it may likewise be given by any declaration of the surviving father or mother, or the parent who is the curator of the other spouse, executed before a notary and two witnesses. La. Civ. Code Ann. art. 257.

If the parents are divorced or judicially separated, only the one to whom the court has entrusted the care and custody of the children has a right to appoint a tutor for them as provided in Article 257. However, if the parents have been awarded joint custody of the children, then the right to appoint a tutor for them belongs to the parent dying last, but either parent may appoint a tutor of the property of the children as provided in Article 257. In the event that both parents appoint a tutor of the property of the children, the tutors shall separately administer that portion of the children's property which is attributable to the respective parent's estate. The court shall decide which tutor shall administer that portion of the children's property which is not attributable to either parent's estate. La. Civ. Code Ann. art. 258.

b. Appointment & Successors – Who Gets The Kids?

I generally like to have the client provide at least three names for tutor, whether as co-tutors or as successor tutors. I also try to discuss with the client whether co-tutors make sense in a given situation, and whether any conditions to someone serving as a tutor or co-tutor should apply.

Sample form language for the appointment of successor tutors and co-tutors is as follows:

> Appointment of Tutor. If my spouse survives me, then I hereby confirm that my spouse is to serve as the tutor or tutrix over the person and property of my one or more minor or otherwise legally incapable children (collectively my “Minor Children” and each my “Minor Child”). If my spouse is or becomes unable or unwilling to serve as the tutrix, then I hereby appoint either or both of my parents, _ _____________ and _____________________, who is willing and able to serve as the first successor co-tutors over the person and property of my Minor Children. If both of them are or become unable or unwilling to serve as the co-tutors or sole tutor, as applicable, then I hereby appoint __ ___________________ to serve as the second successor tutor or tutrix (so long as he or she is able and willing to serve, and is living or actually moves to ________________ Parish, Louisiana) over the person and property of my Minor Children. If ________________ is or becomes unable or unwilling to serve as the co-tutor or tutrix or sole tutor or tutrix, as applicable, or has not yet satisfied any other condition imposed on them in this section, then, I appoint either or both ___________________ or ________________ ______ as the co-tutor or co-tutrix of my minor children. Each of the tutors or tutrixes named in this section (the “Tutor”) may use the family residence located at ________ ________________________________, or whichever house and lot is my home at the time of my death, during the time that the Tutor is serving as the Tutor over the person and property of my Minor Children, for so long as the Tutor desires to use that family residence.

c. Precatory Requests – I Can’t Make You But Please Do It Anyway

Certain language in testaments can be used that is merely precatory, expressing the client’s wishes, but which are not legally binding on the relevant person. A place this is commonly seen is in language of direction left to tutors with regard to the raising of minor children, such as the language below.

Sample form language for a specific type of upbring is as follows:

> Precatory Request for Godly Upbringing. I hereby make known my heartfelt desire that the Tutor over the person and property of my Minor Children shall use his or her best efforts, to the extent reasonably practicable, to ensure that my Minor Children faithfully attend the same church I am attending at the time of my death, faithfully attend the same school they each are attending at the time of my death, and receive such other instruction in the word of God and the gospel of Jesus Christ as they require. Realizing that this language is precatory and not legally binding on any Tutor, I nonetheless know the eternal importance of training up my Minor Children in the way they should go by raising them in the discipline and instruction of the Lord, and therefore strongly urge all Tutors to fulfill my requests in this section as closely as they possibly can.

V. Executorship – Somebody Please Be an Adult Here

a. In General

Depending on the estate, choice of who will fill this fiduciary position can be relatively unimportant, or it can be absolutely crucial to the success of the estate plan. The more complex the estate, the larger the estate, the more difficult the family dynamics, and the less probate avoidance planning has been done, the more important the selection of the executor becomes. As the fiduciary tasked with overseeing the estate, from probate of the testament, to administration of the estate, to filing tax returns, to closing the succession, to paying expenses and liabilities, and to distributing legacies, the responsibility and time and headaches involved can be tremendous, as can the opportunity for abuse.

b. Appointment & Successors – Who Gets to Be in Charge?

Article 3081 of the LA Code of Civil Procedure permits the person named as executor in the testament to petition the court to be confirmed as executor and for the issuance of letters testamentary to evidence the executor's authority.

I generally like to have the client provide at least three names for executor, whether as co-executors or as successor executors. Sample form language for the appointment of successor executors is as follows:

Appointment of Executor. I hereby appoint my spouse as the executor or executrix of my estate. If my spouse is or becomes unable or unwilling to serve as the executrix, then I hereby appoint ___________________ as the first successor executor or executrix of my estate. If _________ ______ is or becomes unable or unwilling to serve as the first executor or executrix, then I hereby appoint ________ _____________ as the second successor executor or executrix of my estate.

c. Executor Powers – What Can They Do?

Article 3191 of the LA Code of Civil Procedure provides a great deal of authority to the executor as follows:

> A. A succession representative is a fiduciary with respect to the succession, and shall have the duty of collecting, preserving, and managing the property of the succession in accordance with law. He shall act at all times as a prudent administrator, and shall be personally responsible for all damages resulting from his failure so to act. La. Code Civ. Proc. Ann. art. 3191.A.

However, without the powers of independent administration (see the section following this one), much of the administrative process must be approved by the court for the executor to have power to act on behalf of the estate. One question is if co-executors are appointed, does the client intend for them to have to act jointly, or can they act separate and independently? I recommend the client decide this question and you draft a direct answer into the testament. Article 3192 of the LA Code of Civil Procedure provides as follows:

> If there are several succession representatives, all action by them shall be taken jointly, unless: (1) The testator has provided otherwise; or (2) The representatives have filed in the record a written authorization to a single representative to act for all. La. Code Civ. Proc. Ann. art. 3192.

Sample form language for the separate authority of co-executors is as follows:

Separate Authority of Co-Executors. Each co-Executor, if any, may act independently of and separate from each other as if each co-Executor was the sole Executor, with each co-Executor having full authority to act on behalf of my estate without the necessity of consent by any other co-Executor. If any co-Executor is at any one or more times no longer able or willing to serve as the Executor, then each co-Executor who is still able and willing may continue to serve as a co-Executor, if one or more other co-Executors are able and willing to continue to serve, or may serve as the sole Executor, if that co-Executor is the sole remaining co-Executor who is able and willing to continue to serve. If the co-Executors disagree on a matter relating to my estate, then a majority of the co-Executors may decide that matter. However, if only two co-Executors are currently serving or if no majority can agree, then the co-Executor named earliest in section 0 with regard to the one or more opposing co-Executors may decide that matter. Each person dealing with the co-Executors may assume that the co-Executors are not in disagreement on a matter relating to my estate, and that person is not to be held liable to my estate for that assumption and reliance upon that assumption, unless and until that person receives express written notice of a disagreement between the co-Executors.

d. Independent Administration – No Judge Required

Article 3396.2 of the LA Code of Civil Procedure provides the ability for the client to grant (or to deny) independent powers of administration to the executor as follows:

> A. When a testament provides for independent administration of an estate, the court shall enter an appropriate order granting independent administration of the estate. B. A statement in a testament to the effect that the succession representative may act as an “independent administrator” or “independent executor” is sufficient to constitute authorization for independent administration of an estate. La. Code Civ. Proc. Ann. art. 3396.2.
>
> A testator may expressly provide that no independent administration of his estate may be allowed. In such case,

his estate, if administered, shall be administered in accordance with the other provisions of Book VI. La. Code Civ. Proc. Ann. art. 3396.13.

Except as expressly provided otherwise in this Chapter, an independent administrator shall have all the rights, powers, authorities, privileges, and duties of a succession representative provided in Chapters 4 through 12 of this Title, but without the necessity of delay for objection, or application to, or any action in or by, the court. La. Code Civ. Proc. Ann. art. 3396.15.

Sample form language granting independent administration of the decedent's estate is as follows:

Independent Executor. The Executor may administer my succession pursuant to the independent administration laws of any state in which my succession is administered, free from court supervision, notice requirements, and legal delays, to the fullest extent permitted under applicable law.

e. Security & Accountings – How Much Do You Trust Them?

The LA Code of Civil Procedure provides for the ability of an independent executor to operate without security or interim accounting (although the heirs and legatees must waive a final accounting) as follows:

Except where the testament provides otherwise, an independent administrator shall not be required to provide security for the administration of the estate. If an interested person, such as an heir, legatee, or creditor of the estate requests security, then upon application by such party, and after a contradictory hearing, the court may order the independent administrator to furnish security as the court determines to be adequate. La. Code Civ. Proc. Ann. art. 3396.14.

An independent administrator is not required to file an interim accounting. Nevertheless, any person interested in the estate may demand an annual accounting from the independent administrator as provided in Article 3331. Further, the court on application of any interested person may require an independent administrator to furnish accountings at more frequent intervals. La. Code Civ. Proc. Ann. art. 3396.17.

Unless the heirs and legatees waive a final accounting, the independent administrator shall file a final account with the court. After homologation of that account, the court shall enter an order discharging the succession representative. The final account shall be served in accordance with Chapter 9 of Title III of Book VI. La. Code Civ. Proc. Ann. art. 3396.19.

Sample form language regarding security and accountings is as follows:

> No Security; No Audit. Each of the executors or executrixes named in this article (the "Executor") may serve without bond or security. No successor Executor or other fiduciary is obligated to audit the accounts of any predecessor Executor or other fiduciary, but rather the successor Executor or other fiduciary may accept the account provided to it by any predecessor Executor or other fiduciary.

f. Tax Elections - Make Paying Taxes Elective

As discussed earlier in section III.h of this presentation, the client can grant the executor a great deal of discretion in making tax elections for the estate, such as the QTIP election, the portability election, etc.

Sample form language for a QTIP election is as follows:

> QTIP Election. If my spouse survives me, the Executor may elect to treat certain interest in my property as "qualified terminable interest property" under section 2056(b)(7) of the Internal Revenue Code, in order to secure a marital deduction to my gross estate for federal estate tax purposes. The Executor shall consider the exercise of the election to reduce my estate taxes and to defer their payment insofar as practical. The exercise of that election might increase the value of assets subsequently includable in my spouse's gross estate for federal estate tax purposes. I consider the investment return and appreciation of those assets, otherwise subject to tax in

my gross estate, and the reduced need for liquid assets at my death, as likely to offset any increase in my spouse's potential estate taxes. However, if after considering all information available to the Executor, the Executor determines that such might not occur, the Executor must consider exercising the election. In case of reasonable doubt, the Executor should exercise the election in order to obtain a larger marital deduction at my death.

QTIP Savings Clause. If the Executor elects to have all or any portion of any legacy qualify for the marital deduction in whole or in part, then it is my intent that such legacies or portion thereof are to qualify for the marital deduction for federal estate tax purposes. Therefore, notwithstanding any other provision of this testament to the contrary, each and every provision of this testament is to be interpreted and construed so as to permit the property passing to my spouse to qualify for the marital deduction for federal estate tax purposes, and any provision which cannot be so interpreted and construed shall be limited or modified so that the property passing to my spouse qualifies for such marital deduction. Any provision of this testament which cannot be so limited or modified, and which is inconsistent with such intent, is to be void.

g. Representative Tax Liability – Somebody's Gotta Pay

Regardless of the type of return involved, whether for income tax or transfer tax, please be aware that care must be exercised in filing the return, especially if the client requests his attorney to serve as the personal representative or as an advisor to the client, who may have been appointed as the personal representative or who is acting in another fiduciary capacity. A fiduciary is any person in a position of confidence acting on behalf of any other person. A fiduciary assumes the powers, rights, duties, and privileges of the individual or entity on whose behalf he or she is acting. Examples of fiduciaries include administrators, conservators, designees, executors, guardians, receivers, trustees of a trust, and any person in a position of confidence acting on behalf of another person. The IRS requires that IRS form 56 be filed notifying the IRS of the creation or termination of a fiduciary relationship under IRC section 6903. Fiduciaries are treated by the IRS as if he or she is actually the taxpayer. A separate form 56 should be filed for the deceased individual and for that decedent’s estate. Upon appointment, the fiduciary automatically has both the right and the responsibility to undertake all actions the taxpayer is required to perform. These responsibilities include filing returns and paying any taxes due on behalf of the taxpayer. Note that an authorized representative and a fiduciary, although similar, are not the same in the eyes of the IRS. Practitioners should exercise caution when assuming the role of a fiduciary.

Under 31 U.S.C. Section 3713, generally referred to as the Federal Claims Priority Act, when a decedent's estate is not sufficient to pay all the decedent's debts, the estate must pay a U.S. government claim first. A representative of a person or estate who pays any part of a debt of the person or estate before paying a U.S. government claim is liable to the extent of the payment for unpaid claims of the government.

In addition, under IRC sections 6901(b) and 7701(a)(6), the executor of an estate is personally liable for the unpaid claims of the United States to the extent of a distribution from the estate when each of the following apply: (1) the executor had control of the assets of the estate and distributed those assets to individuals or entities other than the U.S. government; (2) the estate was insolvent (including the unpaid tax liabilities) at the time of the distribution or the distribution rendered the estate insolvent; and (3) the executor knew or should have known of the United States’ claim and that it had not been paid.

Please note - attorneys and succession representatives should exercise extreme caution when it appears that an estate might not be able to pay all taxes due. **Personal liability for the unpaid taxes could be imposed upon the succession representative**, and ultimately upon the attorney (through a professional malpractice claim).

VI. Administrative Options – It’s the Little Things That Count

The administrative options that can go into a testament can really make a difference in helping an estate plan to succeed. They often only apply in remote probability scenarios, but on the rare occasion when they do apply, they can be incredibly helpful, and you and your client will be so glad you had the foresight to think ahead and draft around the problem they never saw coming.

a. <u>Survivorship – Avoiding the Law School Hypotheticals</u>

Survivorship provisions help avoid the problem of the contemporaneous or near-in-time death of an otherwise surviving legatee. If husband dies, and within a short period of time after that, the wife dies, it is far less than ideal to first have to probate the husband's estate and close it, and then be able to probate and close the wife's estate as a legatee of the husband. A survivorship provision helps avoid this problem by treating an otherwise surviving legatee who dies within a certain amount of time after the decedent as having predeceased the decedent, so that the legacy lapses and therefore passes by accretion to whoever is next in line to receive that legacy.

> The disposition by which a third person is called to take a gift or legacy in case the donee or legatee does not take it is not a prohibited substitution. A testator may impose as a valid suspensive condition that the legatee or a trust beneficiary must survive the testator for a stipulated period, which period shall not exceed six months after the testator's death, in default of which a third person is called to take the legacy. In such a case, the right of the legatee or trust beneficiary is in suspense until the survivorship as required is determined. If the legatee or trust beneficiary survives as required, he is considered as having succeeded to the deceased from the moment of his death. If he does not survive as required, he is considered as never having received it, and the third person who is called to take the bequest in default of his survival is considered as having succeeded to the deceased from the moment of his death. A survivorship condition as to the legitime of a forced heir shall only be valid if the forced heir dies without descendants, or if he dies with descendants and neither the forced heir nor the descendants survive the stipulated time. La. Civ. Code Ann. art. 1521.

Please note that in Louisiana you can have a survivorship provision provide for a survivorship period of as long as six months. The maximum length of time might be preferable to you and your client. Just keep in mind that you cannot close the estate until the stipulated time has passed.

Sample form language for a survivorship provision is as follows:

> Survivorship. Each of the legacies made in this testament is subject to the suspensive condition that the legatee must survive me for at least 90 days. If any legatee or heir fails to survive me for at least 90 days, then that legatee or heir must be treated for purposes of this testament and my succession as though that legatee or heir had predeceased me. If this provision is declared to be in violation of Louisiana law at the time of my death, then it must be construed as broadly as possible so as to comply with the Louisiana law in effect at the time of my death.

b. Collation – No Such Thing as a Free Lunch so Give It Back Jack

Collation, much like forced heirship (to which collation historically has been closely related), is unique to Louisiana among all the United States. Collation was originally intended to help ensure that a decedent's children were treated equally in the distribution of the estate, even if it took clawing back lifetime gifts to do it. This was based on a presumption that when a parent had given gifts to one or more of his or her children during his or her lifetime, such gifts were merely advances on what that child or those children were to receive at the parent's death. In other words, this is basically the idea that parents would want to take an overall lifetime perspective on the economic benefits they give their children, and that death would be the time to balance out the accounts.

Collation calls to mind the biblical story of the prodigal son, where the father gave his wayward youngest son that son's half of his estate during his lifetime (which that son promptly squandered!), and the remaining half of the estate was to be held for ultimate benefit of the diligent oldest son.

> The collation of goods is the supposed or real return to the mass of the succession which an heir makes of property which he received in advance of his share or otherwise, in order that such property may be divided together with the other effects of the succession. La. Civ. Code Ann. art. 1227.

> A. Children or grandchildren, coming to the succession of their fathers, mothers, or other ascendants, must collate what they have received from them by donation inter vivos, directly or indirectly, and they cannot claim the legacies made to them by such ascendants unless the

donations and legacies have been made to them expressly as an advantage over their coheirs and besides their portion. B. This rule takes place whether the children or their descendants succeed to their ascendants as legal or as testamentary heirs. La. Civ. Code Ann. art. 1228.

The obligation of collating is founded on the equality which must be naturally observed between children and other lawful descendants, who divide among them the succession of their father, mother and other ascendants; and also on the presumption that what was given or bequeathed to children by their ascendants was so disposed of in advance of what they might one day expect from their succession. La. Civ. Code Ann. art. 1229.

Collation must take place, whether the donor has formerly [formally] ordered it, or has remained silent on the subject; for collation is always presumed, where it has not been expressly forbidden. La. Civ. Code Ann. art. 1230.

But things given or bequeathed to children or other descendants by their ascendants, shall not be collated, if the donor has formally expressed his will that what he thus gave was an advantage or extra part, unless the value of the object given exceed the disposable portion, in which case the excess is subject to collation. La. Civ. Code Ann. art. 1231.

The declaration that the gift or legacy is made as an advantage or extra portion may be made in the instrument where such disposition is contained, or afterwards by an act passed before a notary and two witnesses, or in the donor's last will and testament. Unless expressly stated to the contrary, a declaration of dispensation from collation made in the last will and testament of the donor shall be effective as a dispensation from collating donations made both before and after execution of said testament. La. Civ. Code Ann. art. 1232.

The declaration that the gift or legacy is intended as an advantage or extra portion, may be made in other equivalent terms, provided they indicate, in an

> unequivocal manner, that such was the will of the donor. La. Civ. Code Ann. art. 1233.
>
> The right to demand collation is confined to descendants of the first degree who qualify as forced heirs, and only applies with respect to gifts made within the three years prior to the decedent's death, and valued as of the date of the gift. Any provision of the Civil Code to the contrary is hereby repealed. La. Civ. Code Ann. art. 1235.

Following the many changes made to the laws of forced heirship and collation in the 1990s, collation is now a very limited concept and seems to apply very rarely. However, unless your client specifically wants his or her children to have to collate and account for lifetime gifts made to them, it generally seems like best practice to have the client dispense with collation by the default language of the testament.

Sample form language dispensing with collation is as follows:

> No Collation. No legatee or heir is obligated to collate any gift received from me, whether received from me inter vivos or by reason of my death, it being my intention that each such gift is to be treated as an extra portion.

Alternative sample form language:

> Donations are Extra Portions. Each donation made to any Trust, whether made by either or both of the Testator or Testatrix or by any other donor, must be treated as an extra portion and must not be subject to collation, unless the relevant donor expressly designates in a writing delivered to the Trustee that this section is not to apply to that donation and that that donation is to be subject to collation.

c. No-Contest – Take It or Leave It

No-contest clauses, also called penalty, forfeiture, or in terrorem clauses, are an attempt by a testator to prevent a legatee from attempting to contest or otherwise challenge the validity of the testament or any part of the testament or any action with regard to the testament or the estate. The stick used, or threatened to be used, against the contentious legatee is that the executor or trustee could use the no-contest clause to strip the legatee of some or all his or her legacy.

While they are not outright prohibited by either statute (unless they violate LA Civil Code article 1519 by being contrary to the laws or to morals) or the courts in Louisiana, and can occasionally be enforced (see Succession of Laborde, 2017-1334 (La. App. 1 Cir. 5/31/18), 251 So. 3d 461), courts are highly unlikely to enforce them. Instead, courts are more likely to work hard to find a way to rule that the no-contest clause does not apply because the action taken by the legatee is not actually a contest, or that the action is indeed a contest but that the intent of the testator causes that particular clause not to apply to that particular contest. See any number of the various cases in which Louisiana courts have declined to enforce a no-contest clause (e.g., Succession of Robinson, 52,718 (La. App. 2 Cir. 6/26/19), 277 So. 3d 454, writ denied, 2019-01195 (La. 10/15/19), 280 So. 3d 613; Succession of Rosenthal, 369 So. 2d 166 (La. Ct. App.), writ denied sub nom. Succession of Rosenthal., 371 So. 2d 1345 (La. 1979); Succession of Rouse, 144 La. 143, 156, 80 So. 229, 234 (1918)).

No-contest clauses come in an almost infinite number of variations. See Wood Brown, *Provisions Forbidding Attack in a Will*, 4 TUL. L. REV. 421, 422 (1930) ("[T]he variations [on conditions] are limited in number only by the limitations of human ingenuity."). A few sample form language clauses follow:

> No-Contest. The legacies in this testament are made on the express condition that each legatee or beneficiary shall not oppose or contest the validity of this testament, or any part of this testament, in any manner. Any legatee or beneficiary who contests the validity of this testament, or any part of this testament, or in any way assists in such an act is to automatically forfeit whatever legacy he or she would otherwise have been entitled to receive under the terms of this testament.
>
> No-Contest. Notwithstanding anything to the contrary in this testament, if any legatee or beneficiary contests any one or more terms of this testament, including, without limitation, filing a contest of the probate of this testament in any jurisdiction, that legatee or beneficiary will not be entitled to any legacy under the terms of this testament,

and for all purposes of this testament, that legatee or beneficiary is then to be deemed to have predeceased me.

d. <u>Allocation of Assets & Receipts – Comparing Apples to Oranges & Who Gets Which</u>

TESTAMENTARY PLANNING IN LOUISIANA

Your client as the testator or testatrix can, and certainly should give a great deal of thought, to allocation of assets to fund certain legacies. However, no amount of forethought and preplanning can replace the ability to make postmortem decisions using the most current information. Therefore, it is immensely helpful to ensure that the executor, if chosen well as someone the client trusts implicitly, has the discretion to make those postmortem decisions regarding the allocation of certain assets to fund the client's legacies, and the allocation of receipts during estate administration to income or principal.

This delegation of discretion with regard to allocation of assets is permitted by the following Civil Code article:

> Testamentary dispositions committed to the choice of a third person are null, except as expressly provided by law. A testator may delegate to his executor the authority to allocate specific assets to satisfy a legacy expressed in terms of a value or a quantum, including a fractional share. The testator may expressly delegate to his executor the authority to allocate a legacy to one or more entities or trustees of trusts organized for educational, charitable, religious, or other philanthropic purposes. The entities or trusts may be designated by the testator or, when authorized to do so, by the executor in his discretion. In addition, the testator may expressly delegate to his executor the authority to impose conditions on those legacies. La. Civ. Code Ann. art. 1572.

This delegation of discretion with regard to allocation of receipts is permitted by the following Civil Code article:

> In the absence of an express testamentary provision or applicable provision of law, receipts and expenditures are allocated in accordance with what is reasonable and equitable in view of the interests of the successors who are entitled to the fruits and products as well as the interests of the successors who are entitled to ownership

of the property, and in view of the manner in which persons of ordinary prudence, discretion, and intelligence would act in the management of their own affairs.
The compensation of the succession representative and professional fees incurred after death, such as legal, accounting and appraisal fees, shall be allocated between debts of the decedent and administration expenses in accordance with the provisions of this Article. La. Civ. Code Ann. art. 1426.

(a) The concepts set forth in this article are not new. The article is modeled closely on the provisions of Louisiana Revised Statutes 9:2142 and 9:2143, which are located in the Trust Code. The principles that it enunciates are general principles, and the Comments to the Trust Code articles should be equally applicable to this article. No hard and fast rule can serve to determine how each and every receipt or expenditure should be classified, and for that reason the article refers to "what is reasonable and equitable" and further references the interest of successors who are entitled to fruits and products (such as usufructuaries or income interests in trust) as well as those entitled to ownership of property (such as naked owners and principal beneficiaries in trust). The article also incorporates the well-known and universally accepted principle that the rules should be viewed the way that persons of "ordinary prudence, discretion and intelligence would act in the management of their own affairs." La. Civ. Code Ann. art. 1426, comment (a).

Sample form language regarding the executor's authority to allocate assets and receipts is as follows:

Broadest Discretion. The Executor may have the broadest power and discretion available under Louisiana law in effect at the time of my death to do any or all of the following: (1) to select assets to satisfy the quantum or value of those legacies and bequests which are stated in this testament either by formula or by specific sum; (2) to make such distributions while my succession is in the process of administration as the Executor deems advisable, without awaiting determination of any taxes due by my estate for the discharge of the Executor; and

(3) to allocate receipts, whether capital gain or ordinary income, to principal or income accounts.

e. Allocation of Debts & Expenses – Who Has to Pay the Piper?

The Louisiana Civil Code provides a series of articles governing the default allocation of estate debts and estate expenses, found at articles 1415 through 1429. However, the Code also grants the testator the freedom to vary the default allocation of estate debts.

This can be an important right if the client wants to make sure that certain legatees, such as the surviving spouse or certain particular legatees, receive the economic benefit of certain assets without necessarily bearing the economic burden of the debt encumbering those assets; thereby hopefully ensuring a certain standard of living for that legatee.

Some of the relevant Civil Code provisions are as follows:

> Estate debts are debts of the decedent and administration expenses. Debts of the decedent are obligations of the decedent or those that arise as a result of his death, such as the cost of his funeral and burial. Administration expenses are obligations incurred in the collection, preservation, management, and distribution of the estate of the decedent. La. Civ. Code Ann. art. 1415.
>
> The provisions of this Section pertaining to responsibility of the successors among themselves for estate debts do not prevent that responsibility from being otherwise regulated by the testament or by agreement of the successors. Nevertheless, the rights of creditors of the estate cannot be impaired by the testament or by agreement among the successors. La. Civ. Code Ann. art. 1420.
>
> Unless otherwise provided by the testament, by agreement of the successors, or by law, estate debts are charged against the property of the estate and its fruits and products in accordance with the following articles. La. Civ. Code Ann. art. 1421.

Sample form language for leaving a debt-free legacy is as follows:

> <u>Free of Debt</u>. It is my intent that the particular legacies left to my spouse in this section be given to my spouse free of debt. Therefore, I direct that, in addition to all other legacies made to my spouse in this section, the Executor also pay off any mortgage or other financing associated with the things left to my spouse in this section.

f. <u>Allocation of Taxes – Who Has to Deal with the 800 Pound Gorilla?</u>

Similar to the allocation of estate debts and expenses (discussed above), the Louisiana Civil Code ancillaries in Title 9 of the Louisiana Revised Statutes provide a series of sections governing the default allocation of the estate tax, found in the Louisiana Estate Tax Apportionment Law at sections 2431 through 2439. However, that law also grants the testator the freedom to vary the default allocation of estate tax among the legatees.

This can be an important right if the client wants to make sure that certain legatees, such as the surviving spouse or certain particular legatees, receive the economic benefit of certain assets without necessarily bearing the economic burden of the estate tax that would otherwise be imposed on those assets; thereby hopefully ensuring a certain standard of living for that legatee.

However, these types of tax allocation provisions must be carefully explained to, and fully discussed with, your client, and then carefully drafted by you. We really want to avoid unintentionally allocating the tax burden to a legatee that should not have borne the economic burden of someone else's taxes, unless that was your client's intentional choice.

The primary relevant section of the apportionment law is as follows:

> A. If the deceased has made no provision in his testament for the apportionment of the tax among the persons interested in the estate, the tax shall be apportioned among them by the court in the proportion that the value of the interest of each person interested in the estate bears to the total value of the interests of all persons interested in the estate. The values used in determining the tax shall be used for this purpose. B. If the deceased has provided in his testament for the apportionment of the tax among all the persons interested in the estate, the

> court shall apportion the tax as directed by the deceased. C. If the deceased has provided in his testament for the apportionment of the tax of some, but not of all the persons interested in the estate, the amount of the tax which has not been apportioned shall be apportioned by the court among those as to whom no provision has been made, in the same manner as is provided in Subsection A of this Section. La. Stat. Ann. § 9:2432.

Sample form language for tax apportionment is as follows:

> General Transfer Tax Apportionment. All transfer taxes, including any local, state, federal, or international estate, generation-skipping, inheritance, or other gift or transfer taxes ("Transfer Taxes"), which become payable by reason of my death are to be apportioned as provided by governing law, including the Louisiana Estate Tax Apportionment Law at LA RS 9:2431 *et seq*. (the "LA Estate Tax Apportionment Law"). However, no such Transfer Taxes are to be apportioned to or paid out of any property which qualifies for the marital deduction. Also, any such Transfer Taxes that are attributable to property included in my estate which is subject to a usufruct are to be apportioned as agreed upon by the usufructuary and the naked owners, but in the absence of such an agreement, are to be apportioned neither to the usufructuary nor to the naked owners, but instead to the property subject to the usufruct and that property is to be sold or otherwise disposed of to provide funds to pay the Transfer Taxes; however, if the liability for the Transfer Taxes is apportioned by such an agreement, or if the property subject to the usufruct is sold or otherwise disposed of to pay the Transfer Taxes, then no debt is to be created from the usufructuary to the naked owners or from the naked owners to the usufructuary.
>
> QTIP Transfer Tax Apportionment. If any property is included in my gross estate by IRC section 2044 (or any one or more successor provisions of law, as might be amended at any one or more times) or any other governing law of similar substance, in which I had a qualified income interest ("QTIP Property"), then the Transfer Taxes attributable to such QTIP Property are to

also be apportioned in accordance with governing law, including the LA Estate Tax Apportionment Law.

g. Boilerplate – From Good to Great with Your Boilerplate

Boilerplate is all the standardized or generic general or miscellaneous provisions that us attorneys love to stuff into the tail end of our contracts. However, these can serve an important purpose to help the smooth functioning of the estate and overcoming any obstacles, whether expected or unexpected, to accomplishing the client's testamentary intent. Boilerplate is a great example of value that our education, experience, and services can provide, but that the client neither knows they need nor really understands. But that's ok; even if the client doesn't appreciate it, we still know the value these types of things bring to the client – it might be rare, but when a rainy day hits they'll be glad we knew to put these types of provisions in their documents for them!

Some sample form language for various helpful boilerplate provisions are as follows:

> Governing Law & Venue. All trusts created in this testament, if any, have their situs in the state of Louisiana, and therefore this testament, the trusts, my estate, and my succession, and all rights, responsibilities, relationships, and disputes between any one or more of the settlor, Testator or Testatrix, Executors, tutors, legatees, heirs, trustees, and beneficiaries arising from or relating to this testament, the trusts, my estate, or my succession, whether based in either or both of contract and tort law, will be governed by, interpreted under, and enforced in accordance with the laws of Louisiana applicable to agreements to be performed entirely in Louisiana, without regard for Louisiana's conflict of law principles. Those one or more of the settlor, Testator or Testatrix, Executors, tutors, legatees, heirs, trustees, and beneficiaries shall submit all such disputes between them to the jurisdiction of any federal, state, or city court sitting in _________________ Parish, Louisiana, such court being hereby considered as the "proper court" within the meaning of Louisiana Revised Statutes section 9:2235.
>
> Interpretation. All headings or titles in this testament are inserted only for convenience and ease of reference and

are not to be considered in the construction or interpretation of any provision of this testament. Common nouns and pronouns must be deemed to refer to the masculine, feminine, neuter, singular, and plural, as the identity of that person or entity might in the context require. Furthermore, unless expressly specified to the contrary, each reference in this testament to any one or more "children" or "descendants" or classes or groups of "children" or "descendants" includes those by blood, adoption, and who might be specifically named as such in this testament (even if not legally recognized as a child or descendant by blood or adoption).

Severability. If any provision, or any portion of any provision, of this testament is for any reason held to be illegal, invalid, or otherwise unenforceable in any respect, that provision, or that portion of that provision, is to be reformed to comply with applicable law while still maintaining the original intent of the Testator or Testatrix as closely as possible. If reformation is not possible, not allowed, or is impractical, then that invalidity, illegality, or unenforceability is not to affect the remaining provisions, or the remaining portions of any provision, and each provision, and each portion of each provision, of this testament is to exist separately and independently so that every other provision, or every other portion of such provision, of this testament is to be construed as if such illegal, invalid, or unenforceable provision, or such portion of such provision, never existed.

VII. Practical Considerations – Stuff I Learned the Hard Way

a. Length – Clients Get Hand Cramps & Don't Pay Per Page

When thinking about your client's testamentary planning from their perspective, one small practical issue to consider is that every page of a testament must be signed by the client. Every. Single. Page. Why does that matter? Well, say you have come up with the greatest testamentary planning to ever be planned in the history of planning plans. But that testament ends up being 37 pages long because it contains all the bells and whistles. Primary legacies, contingent legacies several layers deep, particular legacies of the client's best and most treasured heirlooms, long chains of successor fiduciary positions are named, multiple trusts are utilized, you have distilled the essence of the fine art of raising children into precatory language for the tutors, you have crafted and inserted the most brilliant boilerplate ever, and so on and so on. You have quite possibly made estate planning history here. But at 37 pages, all of which the client has to sign, that testament better shine their shoes and also make them breakfast every morning for the next year for the client to truly appreciate its greatness. They will inevitably complain about its length and having to sign so many times. Couldn't you have cut it down some? Did you really need all these words? Are you just trying to make yourself sound smart? I'm not paying you per page, you know.

So one thing I consider is if some of the contents of the testament can be removed from the testament and inserted into standalone documents that don't have to be signed on each page. So long as those contents don't lose their validity or any legal advantages, if you can cut 37 signatures down to say 17 or so (maybe a 12 page testament and 5 standalone documents), then you will save the client some degree of effort and frustration.

Possible candidates here are certain types of trusts that can be switched from testamentary to inter vivos (i.e., living) trusts, appointments of tutors, removing the particular legacies from the testament and putting them in one of the trusts, etc.

Of course, there are ditches on both sides of the road here. When dealing with people, you will never make everyone happy. I've had clients before that confuse brevity and conciseness, with little effort, cutting corners, and low quality. Sometimes cutting the document down too much can hurt you because certain clients associate length and complexity with quality and price. Oh well. We just have to get to know our clients and make the right choice for each unique individual and their idiosyncrasies.

b. <u>Storage of Originals – Lose It or Use It</u>

Due to the fact that a testament can be revoked by physically destroying the testament, if the original of the testament cannot be found, then Louisiana law starts off with the presumption that the testament must have been revoked by the testator physically destroying it. Therefore, to probate a copy, you will potentially have an uphill battle.

Contrast this with the fact that a trust cannot be revoked merely by physical destruction of the trust instrument. An inter vivos trust can only be revoked by one or more of an authentic act, an act under private signature, or a testament. Therefore, if you or the client cannot find the original trust instrument, there is no presumption that the trust was revoked.

This can be helpful, in that a client doesn't necessarily need your services to revoke a testament they no longer desire to have be effective. Among other methods, they can simply destroy the no-longer wanted testament and make sure that at least a witness or two know about it. However, and in my humble experience this tends to be more common, the downside is that if the client or the family loses the testament, they have put the entire estate plan at serious risk just by not keeping track of the originals of the estate plan. Yet if plan relied less on a testament and more on one or more living trusts, then losing the originals should have less of an impact. It should be far easier to deal with a living trust after the death of the client, even if all anyone can find is a copy of the trust instrument (maybe just the one you keep in your files).

We should warn our clients sufficiently about this risk if we give them the originals of their estate planning document for them to safeguard.

A few of the relevant authorities are as follows:

> Revocation of an entire testament occurs when the testator does any of the following: (1) Physically destroys the testament, or has it destroyed at his direction. (2) So declares in one of the forms prescribed for testaments or in an authentic act. (3) Identifies and clearly revokes the testament by a writing that is entirely written and signed by the testator in his own handwriting. La. Civ. Code Ann. art. 1607.
>
> A testament that has been lost or unintentionally destroyed may be probated if it can be established that such a will was executed, what its content was and that after diligent search the testament cannot be found and was never revoked.[1] When a will is proven to have been in the possession of the testator and cannot be found after he dies, such proof gives rise to a presumption that the testator, before his death, revoked the will by destroying it.[1.50] This presumption is rebuttable upon proof that the testator did not revoke the testament.[2] The effect is that the first presumption shifts the burden of proof and raises the question of the testator's intent to revoke…. In

addition, it is necessary to prove that the lost will was not revoked. To accomplish this the presumption of destruction rising from the fact that the will cannot be found must be overcome.[8] § 14:6.Lost wills, 10 La. Civ. L. Treatise, Successions And Donations § 14:6 (2d ed.).

A. A modification, division, termination, or revocation of a trust shall be by authentic act or by act under private signature executed in the presence of two witnesses and duly acknowledged by the person who makes the modification, division, or termination or by the affidavit of one of the attesting witnesses. The modification, division, termination, or revocation is not effective as to a trustee until a copy of the authentic act or a copy of the acknowledged act is received by him. B. A modification, division, termination, or revocation of a trust may also be by testament. Such a modification, division, termination, or revocation is not effective as to a trustee until the trustee receives a copy of the testament and of the order probating it or ordering it filed and executed. La. Stat. Ann. § 9:2051.

c. Limited Scope – Death, Taxes, & CYA

Taxes, whether federal transfer taxes or simply just income taxes, are going to need to be considered in nearly every estate planning engagement. If you as the attorney providing the testamentary planning do not possess sufficient tax expertise to deal competently with these matters, then I strongly recommend the following.

First, communicate this as clearly and unequivocally to the client at the very outset of your engagement.

Second, ensure that you expressly limit, in a writing delivered to and signed by the client, the scope of your engagement to exclude all tax matters, or at least the tax matters that you do not wish to handle.

Third, it is absolutely vital that you work closely from the very beginning with your client's tax advisors, whether a tax attorney or a CPA. If your client does not already have tax advisors, then strongly encourage the client, in a writing delivered to the client, to engage tax advisors.

These steps will help protect you from committing malpractice and suffering any resulting liability, as well as help you provide great value to your client.

d. Feedback – A Better Mousetrap?

I fully understand that there are many people out there who do this testamentary planning thing way better than I do. Because of this, if you have a better mousetrap, a better way of doing or drafting something discussed in this presentation, or just general feedback with your thoughts on anything discussed in or related to this presentation, I am always striving to learn, get better, and grow. Please feel free to contact me to discuss any better strategies, wording of sample language, etc. I would love to learn from you!

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