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Discussion Topic: What should our clients do in 2010 relating to Wills, Trusts and Gifting?

1. You discover a problem with your instrument after a client has already died in 2010. - you could institute a reformation proceeding to carry out the intent of the settlor, see AS 13.36.350 and .355. However it is unclear whether or not the IRS would be bound by a local court determination under the rationale of Comm'r. v. Bosch, 387 US 456 (1967). Query- would the rationale of this case apply where a local court's decision was in accordance with a state remedial statute? Also consider the ramification of a spouse's taking an elective share despite what the trust or will may say, AS 13.12.201 et. seq.

2. Thus, it is important to discover problems before they occur and place the burden on client to see you.

A. Notify clients warning them that the unexpected has happened. Perhaps your letter to might say:

“In 2010 due to the repeal of the estate and GST tax and the use of formula provisions which derived their meaning from tax concepts that are not presently applicable in 2010, your testamentary wishes may not be carried as you would have anticipated. As such it is strongly advised that you call and make an appointment in order that these documents can be reviewed. Furthermore, as a result of unexpected changes which have occurred in the tax code, it may be possible to benefit from these changes, as can be more fully discussed at our meeting.”

3. At the meeting you discover a problem and the clients are unwilling to make substantial changes that take into account the changes in the law because they think they will survive 2010. On the other hand if they were to die in 2010 a disproportionate amount of their estate would be distributed to either the credit shelter share or the marital share and they want a quick fix that would dispose of the assets in the manner they had contemplated had they died prior to January 1, 2010. Consider a quick fix by amending their trust and will to say:

“If the grantor (testator) dies after December 31, 2009 and before January 1, 2011, all provisions of this will or trust (if applicable) which refer to the federal estate and generation skipping tax law shall be interpreted and applied with respect to the estate and generation skipping transfer tax laws that were in effect as to estates of decedents dying on December 31, 2009, if the will or trust contains a formula that:

- a. Refers to any of the following: "Unified credit," "estate tax exemption," "applicable exemption amount," "applicable credit amount," "applicable exclusion amount," "generation-skipping transfer tax exemption," "marital deduction," "maximum marital deduction," or "unlimited marital deduction;
- b. Measures a share of an estate or trust based on the amount that can pass free of federal estate taxes or the amount that can pass free of federal generation-skipping transfer taxes; or
- c. Is otherwise based on a provision of federal estate tax or federal generation-skipping transfer tax law similar to the provisions in (a) or (b) of this subsection.

The reference to January 1, 2011, in this section refers, if the federal estate and generation-skipping transfer tax becomes effective before that date, to the first date on which such tax becomes legally effective.”

4. You have a new client or an old client who wants to be proactive by taking full advantage of the new modified basis rules and don't want to squander a possible basis adjustment.

A. At the death of the first spouse consider distributing the property to a QTIP trust also which is characterized as “qualified spousal property” under IRC § 1022.

B. If you have a deceased client which has property in excess of that which would qualify for adjusted 3 million spousal basis increase, then you could have the excess go to a typical credit shelter trust in which the children, etc. could be named as discretionary beneficiaries along with the surviving spouse. This could be done by the spouse making a partial disclaimer to the credit shelter trust or by using a formula disclaimer which allocates the excess to the creditor shelter trust. A disadvantage of using the disclaimer approach is threefold: 1. The possibility of missing the 9 month deadline; 2. the spouse can not be given a non-general power of appointment in the credit trust shelter trust and 3. getting the spouse to disclaim because it saves taxes (the 4th big lie). Note: a formula disclaimer was blessed in the recent 8th Circuit Court of Appeals case of Estate of Christiansen, decided November 18, 2009.

C. Two advantages of using the QTIP approach are: (1) being able to make a separate state QTIP election, which might be particularly important if your clients move to Washington, Oregon or 10 other states where a separate state QTIP election is possible

(even if there is an eventual estate tax) and (2) if there is retroactive legislation you can make a partial QTIP election to make a tax effective division of the trust. For instance in regard to the "QTIP trust" which would qualify or not qualify for the marital deduction, which I refer to as the Decedent's Trust you could say:

"Upon the death of a Settlor, the provisions of the Decedent's Trust shall be irrevocable. The Trustee may segregate the assets of the Decedent's Trust into separate sub-trusts and the Trustee may elect that part or all of the Decedent's Trust (or any sub-trust established under this article) qualify for the marital deduction. If the Decedent's Trust is segregated into two sub-trusts, one of such sub-trusts shall be referenced herein as the Credit Shelter Trust and the other shall be referenced as the Marital Deduction Trust. Such sub-trusts may be further divided in the discretion of the Trustee to accomplish the Settlor's tax and other planning objectives.

The Settlor's intend that only property qualifying for the marital deduction be allocated to a Marital Deduction trust and that the Trustee elect to treat such property as Qualified Terminable Interest Property pursuant to Section 2056(b)(7).

Notwithstanding anything to the contrary contained elsewhere in this trust instrument or the Will of the Decedent, if the assets of a trust qualify for the federal and/or state estate tax marital deduction, then none of the assets which are to be allocated to this trust shall contribute to any estate, inheritance or succession tax chargeable against the Decedent's estate, or any interest or penalties thereon.

Furthermore, any distribution provided for herein qualifying for the marital deduction is intended to qualify as a "fractional share" gift that shares proportionately in appreciation or depreciation in the trust estate, and not a "pecuniary" gift (as both are defined in Revenue Procedure 64-19, 1964-1 C.B. 682). Prior to making any distribution of such portion of the trust estate, the Trustee is authorized to agree with the Surviving Settlor to make an approximately equal division of the Settlor's former community property and to make non-pro rata allocations of the Surviving Settlor's interest and the Decedent's Trust interest. The Trustee may then allocate the assets of the Decedent's Trust between the fractional portions in any manner determined in the Trustee's discretion, so long as all assets that are substituted for the pro rata shares of other assets shall be valued as of the date or dates of distribution (in accordance with Revenue Procedure 64-19 referenced above) and no assets are allocated to the Marital Deduction Trust that do not qualify for the estate tax marital deduction. Before making any such non-pro rata distribution, the Trustee shall first consider any possible adverse federal estate, income or generation-skipping transfer tax consequences that might result."

D. Consider including a provision in the will giving the personal representative the authority to allocate basis increases, otherwise you could have controversy regarding basis adjustment for non-probate assets by virtue of the definition of “executor” in IRC § 2203, and query: should this be a personal representative who is not a beneficiary? Maybe this basis adjustments should be done on a pro-rata basis to avoid controversy.

E. Provide for the \$1,300,000 basis adjustment **at the death of the surviving spouse**. You might want to consider any existing trust in which typical bypass trust planning has been implemented and there exists the possibility that the surviving spouse could die in 2010 and not be able to benefit from the \$1,300,000 basis adjustment. Assume a husband and wife and children with no children from a preexisting marriage. Husband died in 2002 with \$2,000,000 of separately owned assets with a zero basis. \$1,000,000 is directed to the bypass trust and \$1,000,000 passes to a QTIP trust. At the surviving spouse’s death in 2010 neither the amount in the bypass trust or the QTIP trust will be eligible for the \$1,300,000 basis adjustment. The remaindermen of these trusts are wondering why you failed to advise their parents of this result. You explain this was a typical bypass plan to save estate tax but this falls on deaf ears in 2010 when there is no estate tax. What can you do now to avoid this argument later?

Provide in your document that a Special Trustee appointed by the Court can make an outright distribution. The following provision was suggested many years ago by Steve O’Hara and modified in part by me with errors being solely mine.

“Should the modified carry-over basis provisions of IRC §1022 be in effect, a Special Trustee (defined and appointed pursuant to this paragraph), may, in the Special Trustee’s absolute discretion, distribute to the Primary Beneficiary part or all of the principal of any trust, to the extent that the Special Trustee determines that the distribution is in the best interests of the Primary Beneficiary. The authority of the Special Trustee shall be limited to making distributions under this paragraph, and the Special Trustee shall not participate in any actions or decisions of any other fiduciary under this instrument. Under no circumstance shall the Special Trustee be liable for the acts or omissions of any other fiduciary, beneficiary or other party in interest, even where such acts or omissions constitute fraud or gross negligence. The Special Trustee shall have no duty to keep informed as to the acts or omissions of others or to take action to prevent or minimize loss. The Special Trustee’s exercise or non-exercise of discretion in good faith shall be conclusive on all persons. Notwithstanding any other provision of this instrument, during the lifetime of the Primary Beneficiary, no person shall be entitled to remove the Special Trustee. For purposes of this paragraph “Special Trustee” means any individual (other than the Primary Beneficiary), preferably an attorney or accountant, or entity who is nominated by the Primary Beneficiary and appointed by the Superior Court for the State of Alaska, Third Judicial District, at Anchorage, as Special Trustee of the trust

named for the Primary Beneficiary.”

Query- if your existing bypass trust doesn't include this provision, can it be decanted under AS 13.36.157 to a new bypass trust which includes this provision?

5. Gifting to take advantage of the 35% rate in 2010. (Aren't you the lucky person who has a client who is willing to do this.) A 35% gift tax translates into a 25.9% tax given the tax exclusive nature of the estate tax. This is dramatically lower than a possible 60% estate tax for an extremely wealthy person who dies in 2011 if no changes are made in the law. Consider having the wealthy spouse creating an inter-vivos QTIP trust for other spouse with remainder to children. You could delay making the decision to make the gift taxable or not until October 15 of the 2011 if the income tax return is extended to that date. You have to make the QTIP election on a timely filed gift tax return and there is no possibility of getting relief if a late election is made.