estate planning briefs®

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"Scrivener's error" corrected

Taxpayer had a wide-ranging estate planning discussion with his attorney in Year 1. The result was creation of powers of attorney, medical powers and living wills. Two Grantor Retained Annuity Trusts (GRATs) also were created, one with a four-year term and one for 15 years. The trusts were funded with Company Stock. The remainderman for each GRAT was a trust for Taxpayer's four children. That trust was revocable by Taxpayer.

In Year 2 an accountant was retained by Taxpayer to prepare the gift tax return for the transfers to the GRATs. The accountant noticed that having a revocable trust be the remainderman for a GRAT would defeat the GRAT's purpose. He contacted the attorney who had drafted the instruments, but the attorney insisted that nothing was amiss, that the accountant didn't understand state law on the matter. The accountant wrote a contemporaneous memo for the file, and then he went ahead with the gift tax filing.

Several years later, Taxpayer hired a financial planner. In the course of reviewing Taxpayer's estate planning documents, the financial planner also noticed the error. The financial planner took the initiative to have another attorney review the documents to confirm his conclusion. When the original attorney continued to insist on the correctness of his documents, Taxpayer hired the second attorney to have the children's trust reformed under state law. The restated trust made clear that the trust was intended to be irrevocable and that Taxpayer retained no power over it.

Given the correspondence and unambiguous documentation about Taxpayer's original intent in creating the GRATs, and because the tax filings were consistent with that intent, the IRS will respect the reformation. The private letter ruling concluded that as a result of the reformation of Children's Trust to correct the scrivener's errors: (1) the transfers of the remainder interests in GRAT 1 and GRAT 2 were completed gifts, and upon the completion of the respective GRAT terms, the distribution of the remainder interests to Children's Trust will not cause Taxpayer to make an additional gift; (2) the assets of Children's Trust will not be included in the gross estate of Taxpayer when he dies (provided Taxpayer survives the annuity period of the respective GRATs); and (3) the Court's reformation of Children's Trust will not cause any current or future beneficiary of the trust to make a gift to any other current or future beneficiary of the trust.

—*Private Letter Ruling 201442045*

COMMENT: Blanche Lark Christerson provides a more detailed dissection of

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this Ruling in "Fixing a 'Scrivener's Error'", [*Estate Planning Review The Journal*, Wolters Kluwer CCH, Volume 40, No. 11, p 226]. She sums up with a reminder that only irrevocable transfers will avoid later estate inclusion. If the grantor wants to be trustee, it is vital that any discretionary powers be limited by an ascertainable standard.

Limits of reliance

Virginia Escher died on December 30, 2008, at age 92, with an estate worth some $12.5 million. Her cousin, Janice Specht, was named executor of the estate. She had no experience at being an executor, never had owned stock, and, in fact, never had been in an attorney's office. Nevertheless, she accepted the job. Ms. Escher's lawyer was Mary Backsman, who had 50 years of experience in estate planning. Ms. Specht retained Ms. Backsman as the estate's attorney.

Backsman did not reveal that she was battling brain cancer at the time.

Specht knew that a substantial estate tax was going to be due, and she knew the due date. She also knew that shares of UPS stock would have to be sold to raise the needed cash. Specht followed up with Backsman concerning progress on administering the estate, and she was assured that everything was fine. The assurances continued after Specht received notices from the probate court that estate accountings had not been timely filed. When the deadline for the estate tax went by, Backsman reported that she had filed for an extension, but she had not. Additional irregularities piled up, but Specht did not act.

Fourteen months after the estate tax should have been paid, Specht obtained a new attorney, who filed an estate tax return within 90 days. The IRS assessed some $1.1 million in penalties and interest, which the estate paid. The estate, in turn, sued Backsman for malpractice, a suit that was settled about a year later.

Now the estate seeks a refund of the penalties and interest, because the estate had relied upon the advice of counsel. No such relief is available, the Court holds, even if the attorney involved were incompetent. Specht had many warning signs of trouble. Her failure to act sooner amounted to willful neglect of the problem. The disability of the attorney did not render Specht disabled.

The Court noted that, in view of the malpractice action against Backsman, the State of Ohio had refunded the late penalty and interest on its estate taxes. "It is truly unfortunate that the United States did not follow the State of Ohio's lead," the Court concluded.

—*Janice C. Specht et al. v. U.S., No. 1:13-cv00705*

New special needs trust alternative

Congress sent a tax extenders bill to President Obama in December, which he signed into law on December 19, 2014. The Tax Increase Prevention Act of 2014 [TIPA, P.L. 113-295] provided for a one-year retroactive extension of most of the provisions that had expired 11½ months earlier, for the 2014 tax year. TIPA also included the Achieving a Better Life Experience Act [ABLE], a permanent expansion of IRC Sec. 529 savings accounts for the benefit of disabled young people. The purpose is to encourage private savings to support disabled individuals in a manner that supplements, but does not supplant, other benefits that may be provided by private insurance, Medicaid, the supplemental security income program, or the beneficiary's employment.

Qualified ABLE programs. A new section has been added to the Tax Code, IRC §529A, Qualified ABLE programs. ABLE programs will need to be established in each of the states, as with Sec. 529 college savings plans. ABLE accounts will be available only to residents of the state establishing the program [§529A(b)(1)(C)]. A disabled person is limited to a single ABLE account [§529A(b)(1)(B)], except that creating a successor account for rollover purposes is permitted.

Contributions to an ABLE account generally must be made in cash [§529A(b)(2)]; an exception allows for the rollover of funds to another ABLE account for the same beneficiary or an eligible individual who is a family member of the beneficiary [§529A(c)(1)(C)]. As with 529 college savings plans, there is no deduction for making a contribution to an ABLE account. Investment changes are limited to twice each year [§529A(b)(4)].

More than one donor may contribute to an individual's ABLE account, but the aggregate of such

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contributions may not exceed the amount of the gift tax annual exclusion in any calendar year ($14,000 in 2015) [§529A(b)(2)(B)].

The beneficiary of an ABLE account must have become disabled or blind before reaching age 26 [§529A(e)(1)].

Amounts accumulated in 529A ABLE accounts generally will not be counted for purposes of means-testing eligibility for federal programs. However, amounts distributed for housing expenses will not be disregarded for the supplemental security income program. In the event that the ABLE account balance exceeds $100,000, SSI benefits may be suspended, but Medicaid benefits will not be [TIPA Division B, Sec. 103].

Tax treatment. In contrast to a conventional special needs trust, which has the same broad goals as an ABLE account, these accounts offer the potential for freedom from income tax. No taxes are imposed upon the investment earnings of ABLE accounts [§529A(a)]. Similarly, there are no income taxes on distributions for qualified disability expenses [§529A(c)(1)(B)]. Qualified disability expenses are defined quite broadly, and include "education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative expenses, legal fees, expenses for oversight and monitoring, funeral and burial expenses," and any other expenses as may be provided in future Regulations [§529A(e)(5)].

On the other hand, distributions not used for qualified disability expenses are taxable to the beneficiary, and a 10% penalty tax applies as well [§529A(c)(3)]. The distribution may not be treated as a taxable gift [§529A(c)(2)].

There is a price to pay for the tax favors accorded to the ABLE account. At the death of the ABLE account beneficiary, the state may make a claim on the account up to the total medical assistance paid for the beneficiary after the establishment of the account [§529A(f)].

—Public Law 113-295

COMMENT: Once ABLE programs are established by the states, the ABLE accounts will have the advantage of simplicity coupled with tax freedom. However, some observers believe that the low annual limit on contributions coupled with the clawback of state benefits will make ABLE accounts less attractive than the alternative of conventional special needs trusts. The JCT apparently does not agree, as it scored the provision as reducing tax revenue by a whopping $2 billion over the next 10 years.

Speculative sale not an element of estate tax value

Erminio Giustina and two of his brothers entered the lumber business in Oregon in 1917. Over time they purchased lumber mills and substantial timberlands. However, by 1988 the lumber mills had been sold, and the family business was limited to managing the timber. Erminio's two sons, Natale and Ehrman, ran the business for many years, and then their sons took over management. The partnership agreement governing the business limited transferability of ownership interests, and provided that only general partners had the power to sell the company's timber or property. At his death in August 2005, Natale owned a 44.128% limited partnership interest.

The estate hired experts to appraise the value of that interest, and that figure, $12,995,000, was reported on the estate tax return. The IRS considered that number far too low, believing that $33.5 million was closer to the mark. At trial the estate defended its value by capitalizing the cash flows that could be expected from the company in the coming years. The IRS expert took that approach as well, but also asserted that the liquidation value of the company was $150 million and offered a final valuation that blended the two figures. The Tax Court stipulated that there was a 25% chance that the firm would be liquidated, and assigned that probability to the asset-based element of the calculation. The Tax Court's final figure for estate tax determinations was $27,454,115. Despite the fact that this amount was double what the estate had reported on the estate tax return, the Court held that the estate had acted in good faith and relied upon qualified experts. Accordingly, the accuracy-related penalty was not assessed [*Estate of Natale B. Giustina et al. v. Comm'r,* T.C. Memo 2011-141].

On appeal, the Ninth Circuit rejects the Tax Court's methodology as clear error. "Although the

Tax Court recognized that the owner of the limited interest could not unilaterally force liquidation, it concluded that the owner of that interest could form a two-thirds voting bloc with other limited partners to do so, and assigned a 25% probability to this occurrence. This conclusion is contrary to the evidence in the record." The Court outlined the nearly preposterous chain of events needed to get to a sale:

> In order for liquidation to occur, we must assume that (1) a hypothetical buyer would somehow obtain admission as a limited partner from the general partners, who have repeatedly emphasized the importance that they place upon continued operation of the partnership; (2) the buyer would then turn around and seek dissolution of the partnership or removal of the general partners who just approved his admission to the partnership; and (3) the buyer would manage to convince at least two (or possibly more) other limited partners to go along, despite the fact that "no limited partner ever asked or ever discussed the sale of an interest."

The possibility of sale was too speculative. Accordingly, the decision was reversed and remanded for a determination of value based only upon the capitalization of cash flows, and ignoring the theoretical liquidation value of the firm's holdings.

—Estate of Natale B. Giustina et al. v. Comm'r, CA-9, No. 12-71747

COMMENT: Back in 1967, the firm had a run-in with the IRS over the proper tax treatment of reimbursements to the company of the payment of real property taxes [*Giustina v. U.S., 267 F. Supp. 40, 19 ATFR2d (RIA) 1013]*.

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