

# Tax Issues in Trust & Probate Litigation

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*Presented by*

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*“For every complex problem there is an  
answer that is clear, simple, and wrong.”  
- H. L. Mencken*

# Table of Contents

I.	INTRODUCTION .....	1
II.	ESTATE TAX .....	2
	A.    IRC § 2053 Deductions .....	2
	B.    Effect of a Court Decree .....	4
	C.    Consent Decrees .....	5
	D.    Estimated Amounts .....	5
	E.    Administration Expenses Generally .....	6
	F.    Attorney’s Fees .....	7
	G.    Miscellaneous Expenses .....	8
	H.    Deducting Marital Obligations as Claims .....	8
	I.    Estate Tax Return (Form 706) Issues .....	9
	J.    Extension of time for paying tax .....	12
	K.    Time Limitations on Payment of Expenses/Debts .....	12
	L.    Proposed Regulations .....	12
III.	GST TAX .....	22
	A.    Settlement Agreements .....	23
	B.    Judicial Construction .....	24

IV.	GIFT TAX .....	25
	A. Settlement Agreements .....	25
	B. QTIP Trusts .....	27
V.	INCOME TAX .....	29
	A. Gain or Loss from Disposition of a Term Interest .....	29
	B. Miscellaneous Income Tax Issues .....	30
VI.	PRIVATE LETTER RULINGS .....	31
	A. Required Checklist .....	31
	B. Applicability after Change of Fiduciary/Trust Situs .....	32
	C. Estate Tax PLRs .....	32
	D. GST Tax PLRs .....	34

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## I. INTRODUCTION

At a top current rate of 45%, the federal estate tax automatically makes the IRS the single largest creditor for most large estates. If the estate tax is looming in the background, it's imperative that every decision made by the parties and their lawyers with respect to how they characterize and prosecute their trust/probate claims be considered against this backdrop. Whether a dispute is resolved through litigation or settlement, the nature of the underlying action determines the proper tax consequences.<sup>2</sup> The taxability of a settlement is controlled by the nature of the litigation.<sup>3</sup> The nature of the litigation is in turn controlled by the origin and character of the claim that gave rise to the litigation.<sup>4</sup> And it's the parties – not the IRS – that ultimately controls this initial link in the causal chain. With a reasonable amount of sensitivity to these issues at the outset claims and settlement agreements can often be shaped in a manner likely to result in the desired tax consequences.

This outline addresses the issue of taxes in the trust and probate litigation context with two basic goals in mind. First, creating win-win settlement opportunities by mining the tax code for new funds with which to settle disputes. Second, pointing out tax-related pitfalls unique to these cases that can sour even the best settlement agreement or trial-court result. 8.14% of all estate tax returns filed in 2008 and 0.42% of gift tax returns filed in 2008 were audited by the IRS.<sup>5</sup> No one wants to learn their hard-won settlement agreement/trial-court victory has triggered

some cascading tax nightmare for the first time on audit.<sup>6</sup>

Finally, it should be noted that basically any tax code provision that could conceivably apply in an *un*-contested trust or probate administration could also come into play if litigation breaks out. As counsel you can't focus on all things at all times. This outline is simply one lawyer's attempt to point out those tax code provisions warranting special attention in the litigation context; it is not intended to be all encompassing, others have published excellent articles covering this same ground from very different perspectives.<sup>7</sup>

## **II. ESTATE TAX**

### **A. IRC § 2053 Deductions**

IRC § 2001 imposes a tax on the transfer of the "taxable estate" of every U.S. decedent, citizen or resident. The taxable estate is the excess of the decedent's "gross estate" (as defined by IRC §§ 2031 – 2046) over the total amount of the decedent's permitted estate tax deductions, which can include: (a) the IRC § 2053 deduction for funeral and administration expenses, claims against the estate, and unpaid mortgages and debts on property included in the estate; (b) the IRC § 2054 deduction for casualty or theft losses during the administration of the estate; (c) the IRC § 2055 deduction for charitable transfers; and (d) the IRC § 2056 marital deduction.

In the litigation context, IRC § 2053 is what you want to focus on. IRC § 2053 authorizes estate tax deductions for all claims and expenses falling under any of the following categories that are otherwise "allowable by the law of the jurisdiction:"<sup>8</sup>

- funeral expenses;
- administration expenses;
- claims against the estate (including taxes to the extent set forth in

Reg. § 20.2053-6 and charitable pledges to the extent set forth in Reg. § 20.2053-5); and

- unpaid mortgages on, or any indebtedness in respect of, property, the value of the decedent's interest in which is included in the value of the gross estate undiminished by the mortgage or indebtedness.

The IRC § 2053 regulations divide these payments into two broad categories depending upon whether the assets used to make the payment were or were not subject to claims of the decedent's creditors. The first category consists of payments made with "property subject to claims."<sup>9</sup> The second category consists of payments made with assets that are NOT subject to claims of the decedent's creditors. Payments falling under this second category remain deductible under IRC § 2053 if they otherwise qualify for the deduction *and* were paid before the expiration of the period of limitation for assessment provided in IRC § 6501. For estate tax purposes, this means that administration expenses of property not subject to claims against the estate will normally have to be paid within 45 months after the decedent's death.<sup>10</sup>

**Example:**

The only item in the gross estate is the decedent's homestead residence valued at \$250,000, which the decedent and his surviving spouse held as tenants by the entirety. Under the local law this real property is not subject to claims. Funeral expenses of \$1,200 and debts of the decedent in the amount of \$1,500 are allowable under local law. Before the prescribed date for filing the estate tax return, the surviving spouse paid \$2,200, \$1,200 in funeral expenses and \$1,000 of the decedent's debts. The remaining \$500 of the debts was paid by her after the prescribed date for filing the return. The total amount allowable as deductions under section 2053 is limited to \$2,200, the amount paid prior to the prescribed date for filing the return.<sup>11</sup>

**B. Effect of a Court Decree**

In *United States v. Bosch*, 387 U.S. 456 (1967), the Supreme Court held that where the underlying substantive rule involved in determining property interest passing under a will with respect to federal estate taxes is based on state law, the state's highest court is the best authority on its own law and must be followed. In contrast, the decision of a state *trial court* on a question involving state law doesn't bind the IRS or federal courts where there is no decision by the highest court of the state on the matter; in those instances the federal authorities can make their own interpretation of state law giving "proper regard" to relevant rulings of other courts of the state.

Under Reg. § 20.2053-1, which was adopted before *Bosch* and applies a less restrictive standard, the decision of a local court as to the amount and legitimacy (or, as phrased by the regulations, "allowability")<sup>12</sup> under local law of a claim or administration expense will ordinarily be accepted if the court passes upon the facts upon which deductibility depends. If the court does not pass upon those facts, its decree will not be followed. For example, if the question before the court is whether a claim should be allowed, the decree allowing it will ordinarily be accepted as establishing the validity and amount of the claim. However, the decree will not necessarily be accepted even though it purports to decide the facts upon which deductibility depends. It must appear that the court actually passed upon the merits of the claim. This will be presumed in all cases of an active and genuine contest.<sup>13</sup> An apparently unreasonable result is evidence that there was not such a contest, but it may be rebutted by proof of the contrary.

The decree will not be accepted if it is at variance with state law; as, for example, an allowance made to a personal representative in excess of that prescribed

by statute. On the other hand, a deduction for the amount of a bona fide indebtedness of the decedent, or of a reasonable expense of administration, will not be denied because no court decree has been entered if the amount would be allowable under local law.

**C. Consent Decrees**

If the decree was rendered by consent, it will be accepted, provided the consent was a bona fide recognition of the validity of the claim (and not a mere cloak for a gift) and was accepted by the court as satisfactory evidence upon the merits. It will be presumed that the consent was of this character, and was so accepted, if given by all parties having an interest adverse to the claimant.

**Example:**

Where the maximum amount of commissions allowable under the applicable state (Maryland) statute was \$19,107, but a local court had (with the consent of all the beneficiaries) issued an order approving the personal representative's request for \$32,000 of commissions, the estate's deduction was limited to \$19,107.<sup>14</sup>

**D. Estimated Amounts**

The due date for filing the estate tax return may be too early to permit determination of the exact amount of every deductible item. The ultimate cost of such items as commissions and attorney's fees may be uncertain, particularly where the estate faces legal complications that may require litigation. Estimated deductions may be taken on the estate tax return if the exact amount is not yet known, provided that the amount is ascertainable with reasonable certainty, and will be paid. No deduction may be taken on the basis of a vague or uncertain estimate. If the amount of a liability was not ascertainable at the time of final audit of the return and, as a consequence, the amount was not allowed as a deduction, and later the amount of the

liability is ascertained, the estate can seek relief by a Tax Court petition or a refund claim.

**Example:**

In *Estate of Graegin v. Comm'r*, 56 T.C.M. (CCH) 387, 1988 WL 98850 (1988), the estate borrowed money from a third party to pay estimated estate taxes, rather than sell stock owned by the estate. The estate deducted the entire estimated balloon interest payment on its return as an administrative expense. The government disallowed the deduction. The Tax Court reinstated the deduction as “actually and necessarily incurred” under Treas. Reg. § 20.2053-3(a). “To avoid a forced sale of its assets, the estate had to borrow money to satisfy its Federal estate tax liability. Expenses incurred to prevent financial loss to an estate resulting from forced sales of its assets in order to pay estate taxes are deductible administration expenses.” *Graegin*, 56 T.C.M. (CCH) 387 (citing *Estate of Todd v. Comm'r*, 57 T.C. 288, 1971 WL 2614 (1971); *Huntington*, 36 B.T.A. 698 (1937)). The real issue in *Graegin*, since the interest was not yet fully due, was how likely it was that interest would actually be paid, because the note was to an “insider.” The Tax Court chose not to second guess the possibility that the interest would not be paid and allowed the complete deduction.

**E. Administration Expenses Generally**

The amounts deductible from a decedent’s gross estate as “administration expenses” are limited to such expenses as are actually and necessarily incurred in the administration of the decedent’s estate; that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee, whether the trustee is the personal representative or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual

benefit of the heirs, legatees, or devisees, may not be taken as deductions. Administration expenses include executor's commissions; attorney's fees; and miscellaneous expenses.<sup>15</sup>

**F. Attorney's Fees**

**1. Estate's Attorneys**

An estate tax deduction is allowed for attorney's fees that either have been actually paid or, at the time the return is filed, may reasonably be expected to be paid. Attorney's fees that haven't been paid and haven't been awarded by the proper court by the time of the final audit of the estate tax return will nevertheless be allowed if the IRS is reasonably satisfied that the amount claimed will be paid and that it does not exceed a reasonable remuneration for the services rendered, considering the size and character of the estate and the local law and practice.<sup>16</sup>

**Practice Pointer:**

If the attorney's fees haven't been paid at the time of the final examination of the return, the deduction must be supported with an affidavit, or statement signed under the penalties of perjury, by the personal representative or the attorney stating that the amount has been agreed upon and will be paid.<sup>17</sup> IRS Form 4421 can be used as a declaration or affidavit to fix the payment of attorney's fees for deduction at the time of final examination.

**2. Beneficiary's Attorneys**

Attorney's fees incurred by estate beneficiaries in litigation as to their respective interests are not deductible by the estate unless the litigation is "essential to the proper settlement of the estate" within the general tests for deductible administration expenses. If the attorney's fees don't meet these tests, the estate can't deduct them as an administration expense even if a probate court approves them as

an expense payable or reimbursable by the estate.<sup>18</sup> Attorney's fees for services essential to proper estate settlement don't lose their value to the estate by also being essential (and possibly more beneficial) to a beneficiary personally.<sup>19</sup>

#### **G. Miscellaneous Expenses**

The catch-all term "miscellaneous" administration expenses comprises all administration expenses other than executor's compensation and attorney's fees; for example, court costs, surrogate's fees, accountant's fees, appraisers' fees, clerk hire, etc. Miscellaneous administration expenses also include necessary expenses of preserving and distributing the estate, including the cost of storing or maintaining property of the estate where its immediate distribution is not possible. Outlays for additions or improvements to estate property are not deductible as costs of preserving the property.<sup>20</sup> The purpose of miscellaneous expenses must be established even though the probate court approves them.<sup>21</sup>

#### **H. Deducting Marital Obligations as Claims**

Generally, the relinquishment or promised relinquishment of the right to dower or courtesy, or statutory substitutes for either, or of other marital rights in the decedent's property or estate, are not consideration in money or money's worth.<sup>22</sup> Consequently, in the absence of some statutory exception to this rule, a claim against an estate arising out of a prenuptial agreement will not meet the consideration test in order to be deductible. Fortunately, IRC § 2053(e) creates just such an exception. Under this exception, an estate tax deduction is allowed for transfers under a written agreement in settlement of marital or property rights that would have qualified for non-taxability under IRC § 2516(1) for gift tax purposes. Thus a transfer to either spouse under an agreement between a husband and wife in settlement of their marital and property rights may be considered made for adequate and full consideration in

money and money's worth. To qualify, the agreement must be in writing and the divorce must occur within the 3-year period beginning on the date 1 year before the agreement is entered into (regardless of whether the divorce decree approves the agreement). As a result of this exception, if the transferring spouse dies before completing the transfers the written agreement requires, there is no estate tax on the property the estate transfers to satisfy claims arising under the agreement.<sup>23</sup>

### I. Estate Tax Return (Form 706) Issues

When an estate is being litigated, the litigation often extends beyond the time that the decedent's federal estate tax return ("Form 706") is required to be filed and the federal estate taxes are required to be paid. If due to the litigation additional estate tax deductions become available and the assessment period has NOT expired, the estate has two options: (i) file a supplemental information or (ii) a claim for refund.

#### 1. Claim for Refund

There is no provision in the IRC for filing an "amended" estate tax return after the due date. To "correct" an estate tax return, the estate either can file supplemental information with the IRS – **which will be associated with the return and may well trigger an audit** – or it can file a claim for refund. The fiduciary should consider filing a claim for refund if the fiduciary finds, after filing an estate tax return where there is no audit, that too much estate tax may have been paid. This situation arises where the estate has: reported assets not required to be included in the estate; overvalued assets; not taken certain deductions or credits; or underestimated the amount of deductions or credits. A fiduciary files a claim for refund of estate taxes on Form 843.<sup>24</sup> The Form 843 requires a calculation and an explanation of the overpayment of estate taxes. Refund claims are either accepted as filed or examined.

When claims are examined, the procedures are generally the same as in the audit of estate tax returns; ultimately, the claims are either allowed or denied.

**Practice Pointer:**

If the estate has not been audited, the claim for refund should be filed after a closing letter has been issued and just before the statutory period for the assessment of estate taxes is about to expire (normally **45 months** after the decedent's death).<sup>25</sup> After the expiration of the assessment period, the IRS can only disallow the claim, allow the claim in whole or in part, or allow the claim with an off-set up to the amount of the claimed refund for a deficiency; the IRS is precluded from raising any new issues, except as an offset to the extent of the refund claimed. Accordingly, the best strategy in such a case might be to pay the tax and file a refund claim just before the statutory period for assessments expires, when there is no opportunity for the IRS's review of the claim to result in an additional assessment.

**2. Protective Refund Claims**

Because the fiduciary must file the refund claim before the limitations period for filing a refund claim expires, a "protective" claim should be filed where there is uncertainty as to whether a claim can be made or will be successful. The Form 843 should be captioned "PROTECTIVE" or the transmittal letter should state that the enclosed Form 843 is intended to be "protective". The Form 843 should state the amount of the claim, or, in cases where the amount is not yet determined, it should estimate the amount and add a proviso to the effect of "or such other amount as is determined". It is also prudent to add a "catch-all" claim for the additional attorney's and other fees and expenses incurred in any administrative or judicial appeal. The description of the matter should be sufficiently detailed to enable the IRS to ascertain the matter to which the claim relates.

**Practice Pointer:**

On April 23, 2007, the IRS issued proposed regulations under IRC § 2053 regarding the extent to which post-death events may be considered in determining the deductible amount of a claim against the estate (see discussion below). Where the validity of the claim has not been resolved before the statute of limitations closes on the estate tax return, the Proposed regulations direct that a protective refund claim should be filed. The IRS's 2008-2009 Priority Guidance Plan,<sup>26</sup> dated 9/10/08, lists 15 projects under the heading of "Gifts and Estates and Trusts," including plans to issue guidance with respect to the procedures for filing and perfecting protective refund claims for amounts deductible under IRC § 2053. This guidance will be necessary if the proposed IRC § 2053 regulations are finalized, as they introduce the need for a protective claim in some circumstances.

**3. Supplemental Information**

A Form 706 can't be amended after the expiration of any extension period obtained for filing the return.<sup>27</sup> However, supplemental information may later be filed that may result in a finally determined tax different from the amount shown as the tax on the return.<sup>28</sup> If a personal representative finds that he must change something on an estate tax return that has already been filed, the personal representative should:

- file another Form 706,
- enter "Supplemental Information" across the top of page 1 of the form, and
- attach a copy of pages 1, 2, and 3 of the original Form 706 that has already been filed.

If the personal representative has already been notified that the return has been selected for examination, he should provide the additional information directly to the IRS office conducting the examination.<sup>29</sup>

**J. Extension of time for paying tax**

At the request of the personal representative, the district director or the director of a service center may grant a reasonable extension of time to pay any part of the tax shown on an estate tax return. Unless there is reasonable cause, the extension can't be for a period of more than 12 months from the date prescribed for payment of the tax. If there is reasonable cause, the extension can be for up to 10 years.<sup>30</sup> Reasonable cause for an extension of time to pay tax is present where an estate includes a claim to substantial assets which cannot be collected without litigation. Consequently, the size of the gross estate is unascertainable at the time the tax is due.<sup>31</sup>

**K. Time Limitations on Payment of Expenses/Debts**

Generally, the right to deduct a debt or expense for estate tax purposes does not depend on actual payment of the amount.<sup>32</sup> This general rule has two exceptions, which call for actual payment within a specified period after the decedent's death, under penalty of forfeiting the estate tax deduction. These time limitations apply: (a) when amounts payable out of property subject to claims exceed the value of such property;<sup>33</sup> and (b) when expenses are incurred in administering property not subject to claims.<sup>34</sup>

**L. Proposed Regulations**

The deductibility, for estate tax purposes, of claims against a decedent's estate which become unenforceable during the administration of the estate, has been a highly litigious issue, and the conclusions reached by the courts have not been consistent. There are those circuits that strictly follow the 1929 Supreme Court decision in *Ithaca Trust Co. v. United States*, 279 U.S. 151, 49 S.Ct. 291, 73 L.Ed. 647 (1929), and its general rule that post-death events must not be considered in

valuing the amount of the deduction, as “[t]he estate so far as may be is settled as of the date of the testator’s death.”<sup>35</sup> And, there are those that follow the 1929 Eighth Circuit decision in *Jacobs v. Commissioner*, 34 F.2d 233 (8th Cir.1929), *cert. denied*, 280 U.S. 603, 50 S.Ct. 85, 74 L.Ed. 647 (1929), and its approach that post-death events must be considered, as “[t]he claims which Congress intended to be deducted were actual claims, not theoretical ones.”<sup>36</sup>

According to the IRS, the result of this lack of consistency in the case law is that similarly situated estates are being treated differently for estate tax purposes, depending only on the jurisdiction in which the personal representative resides.<sup>37</sup> To resolve this inconsistency, the IRS issued proposed regulations on April 23, 2007.<sup>38</sup> Under the proposed regulations the IRS would adopt an “actual payment amount” approach, rather than the “date of death value” approach, to the treatment of claims owed by an estate.<sup>39</sup> Under the proposed approach, which would also apply for other expenses deductible under IRC § 2053, post-death events would be taken into account in determining the deductible amount, and deductions would be limited to amounts actually paid by the estate in satisfaction of deductible claims and expenses. The proposed regulations would be effective for estates of decedents dying on or after the date the regulations are adopted in final form.<sup>40</sup>

### **1. General Rule: Deduction for Claims**

Claims against a decedent’s estate are deductible from his gross estate to the extent allowable under the applicable law of the jurisdiction under which the estate is being administered.<sup>41</sup> The proposed regulations would modify the above rules to provide that an estate could deduct, under IRC § 2053(a)(3), only amounts *actually paid* in settlement of claims against the estate. Specifically, the proposed regulations would provide that the amounts that could be deducted as claims against a decedent’s

estate would be limited to amounts for legitimate and bona fide claims that (a) represent personal obligations of the decedent existing at the time of the decedent's death, (b) are enforceable against the decedent's estate at the time of payment, and (c) *are actually paid* by the estate in settlement of the claim.<sup>42</sup> Events occurring after the date of the decedent's death would be considered when determining the amount deductible by the decedent's estate.<sup>43</sup>

## **2. Potential and Unmatured Claims**

Claims that are unmatured on the date of the decedent's death – *and that later mature and are paid* – would be deductible by the estate. No deduction could be taken on an estate tax return for a potential or unmatured claim. If the claim matures and is paid before the expiration of the period for filing a refund claim, the estate could file a refund claim. Under the proposed regulations, a protective refund claim could be filed before the expiration of the period for filing a refund claim, in order to preserve the estate's right to claim a refund once the claim against the decedent's estate has matured and the claim either is paid, or may be estimated, as provided under Prop Reg § 20.2053-1(b)(4). The protective claim would not have to state a particular dollar amount or demand an immediate refund. The protective claim would have to (a) identify the outstanding liability or claim that would have been deductible as a claim against the estate if it had already been paid and (b) describe the reasons and contingencies delaying actual payment of the liability or claim. Action on protective claims would proceed after the personal representative notifies the IRS that the contingency has been resolved.<sup>44</sup>

## **3. Contested Claims**

No deduction may be taken on an estate tax return for a claim against the decedent's estate to the extent the estate is contesting the decedent's liability.<sup>45</sup>

**Example:**

Decedent (“D”) is sued by claimant (“C”) for \$100x in a tort proceeding and responds asserting affirmative defenses available to D under applicable local law. D dies and the executor (“E”) is substituted as defendant in the suit. D’s estate tax return is due before a judgment is reached in the case. D’s gross estate includes only property subject to claims and exceeds \$100x.

E may not take a deduction on the return for the claim under section 2053(a)(3). A deduction may be claimed on the return, however, for expenses incurred prior to the filing of the estate tax return in defending the estate against the claim if the expenses have been paid in accordance with §20.2053-3(c) or (d)(3) or as an estimate under §20.2053-1(b)(4).

E may file a protective claim for refund before the expiration of the period of limitations for claims for refund of the estate tax in order to preserve the estate’s right to claim a refund if the amount of the liability will not be paid or cannot be ascertained with reasonable certainty by the expiration of that period of limitations. If payment is subsequently made pursuant to a court decision or a settlement, a deduction for the payment, as well as expenses incurred incident to the claim and not previously deducted, may be taken and relief may be sought by supplementing a previously filed protective claim or by filing a claim for refund as provided by section 6511.<sup>46</sup>

**Example:**

The facts are the same as in the first Example except that, before the return is timely filed, the court enters a decision in favor of C, no timely appeal is filed, and payment is made. A deduction is allowed for the amount paid in satisfaction of the claim pursuant to the final decision of the local court, including any interest accrued prior to D’s death, under section 2053(a)(3). In addition, a deduction may be available under §20.2053-3(d)(3) for expenses incurred prior to the filing of the estate tax return in defending the estate against the claim

and in processing payment of the claim.<sup>47</sup>

**Example:**

The facts are the same as in the first Example except that, before the return is timely filed, a settlement is reached between D's estate and C for \$80x and payment is made. A deduction is allowed for the amount of the settlement paid to C (\$80x) under section 2053(a)(3). In addition, a deduction may be available under § 20.2053-3(d)(3) for expenses incurred prior to the filing of the estate tax return in defending the estate, reaching a settlement, and processing payment of the claim.<sup>48</sup>

**Example:**

During life, D contracts with C to perform specific work on D's home for \$75x. Under the contract, additional work must be approved in advance by D. C performs additional work and sues D for \$100x for work completed including the \$75x agreed to in the contract. D dies and D's estate tax return is due before a judgment is reached in the case. E contests liability for \$25x. E may take a deduction on the return for \$75x if it has been paid or if it meets the requirements of an estimated amount. In addition, a deduction may be claimed on the return for expenses incurred in defending the estate against the claim if they have been paid under §20.2053-3(c) or (d)(3) or as an estimate under §20.2053-1(b)(4). E may file a protective claim for refund before the expiration of the period of limitations on claims for refund of the estate tax in order to preserve the estate's right to claim a refund if payment on any amount in excess of \$75x is subsequently made in resolution of a claim that would qualify for a deduction under section 2053. To the extent that the expenses incurred in defending the estate against the claim are not deducted as an estimate, they may be included in the protective claim for refund.<sup>49</sup>

#### **4. Claims Against Multiple Parties**

If the decedent or the decedent's estate is one of two or more parties against

whom the claim is being asserted, the estate may only deduct the portion of the total claim due from and paid by the estate, reduced by the total of any reimbursement received from another party, insurance, or otherwise. The estate's deductible portion will also be reduced by the amount or contribution the estate could have collected from another party or an insurer but which the estate declines or fails to attempt to collect. If, however, the estate establishes that the burden of necessary collection efforts would have outweighed the benefit from those efforts, the potential reimbursement will not reduce the estate's deductible portion of the total claim. If the estate establishes that the party from whom a potential reimbursement could be collected could only pay a portion of the potential reimbursement, then only that portion that could reasonably have been expected to be collected will reduce the estate's deductible portion of the total claim.<sup>50</sup>

**Example:**

The facts are the same as in the first Example except that the suit filed by C lists D and K, an unrelated third-party, as defendants. If the claim is not resolved prior to the time the estate tax return is filed, E may not take a deduction for the claim under section 2053(a)(3) on the return. If payment is subsequently made of D's share of the claim pursuant to a court decision or a settlement holding D liable for 40 percent of the amount due and K liable for 60 percent of the amount due, then the estate may take a deduction for the amount paid in satisfaction of the claim representing D's share of the liability as assigned by the court decree (\$40x), plus any interest on that share accrued prior to D's death, under section 2053(a)(3). If the court decision finds D and K jointly and severally liable for the entire \$100x and D's estate pays the entire \$100x but could have reasonably collected \$50x from K in reimbursement, the estate may take a deduction under section 2053(a)(3) and paragraph (b)(3) of this section for only \$50x and the interest on \$50x accrued prior to D's death. In both instances, a deduction may also be available under

§20.2053-3(d)(3) for expenses incurred and not previously deducted in defending the estate against the claim and processing payment of the amount due from D.<sup>51</sup>

**Example:**

The facts are the same as in the first Example except that the suit filed by C lists D and K, an unrelated third-party, as defendants. D's estate settles with C for \$10x and payment is made before the return is timely filed. E may take a deduction for the amount paid to C in satisfaction of the claim. In addition, a deduction may be available under §20.2053-3(d)(3) for expenses incurred prior to the filing of the estate tax return in defending the estate, reaching a settlement, and processing payment of the claim.<sup>52</sup>

**5. Claims by Related Parties & Beneficiaries**

According to the proposed regulations, “relationships with and among a decedent and the decedent’s family members, related entities, and beneficiaries may create the potential for collusion in asserting invalid or exaggerated claims in order to reduce the decedent’s taxable estate.” Thus, under the proposed regulations there will be a rebuttable presumption that claims by a “family member”<sup>53</sup> of the decedent, a “related entity,”<sup>54</sup> or a beneficiary of the decedent’s estate or revocable trust are not legitimate and bona fide and therefore are not deductible. Evidence sufficient to rebut the presumption may include evidence that the claim arises from circumstances that would reasonably support a similar claim by unrelated persons or non-beneficiaries. Similarly, a settlement between a decedent’s estate or revocable trust and a family member, a related entity, or a beneficiary of the decedent’s estate or revocable trust will be presumed to not be deductible absent evidence of the legitimacy and bona fide nature of the claim.<sup>55</sup>

## **6. Unenforceable Claims**

Claims that are unenforceable prior to or at the decedent's death are not deductible, even if they are actually paid. Claims that become unenforceable during the administration of the estate are not deductible to the extent that they are paid after they become unenforceable.<sup>56</sup>

### **Example:**

D is sued by C for \$100x in a tort proceeding but the claim is barred by the applicable period of limitations and there is no other recourse available to C. A deduction is not allowed for the claim under section 2053(a)(3) whether or not the estate actually pays money in satisfaction of the claim. A deduction may be available, however, under §20.2053-3(d)(3) for expenses incurred in defending the estate against the claim.<sup>57</sup>

## **7. Claims Founded upon a Promise**

For a claim based on a promise or agreement (other than a charitable or similar pledge)<sup>58</sup> to be deductible, it isn't enough that the claim be supported by adequate consideration. The claim must also have been contracted bona fide and for an adequate and full consideration in money or money's worth.<sup>59</sup> For this purpose, the proposed regulations would define "bona fide and for an adequate and full consideration in money or money's worth" as requiring that the promise or agreement must have been made in good faith, and that the price must have been an adequate and full equivalent reducible to a money value.<sup>60</sup>

## **8. Recurring Payments**

### **a. Non-contingent Obligations**

If a decedent is obligated to make recurring payments on an enforceable and certain claim that are not subject to a contingency and if the payments will continue

for a period that will likely extend beyond the final determination of the estate tax liability, the obligation may be deducted as an estimated amount using the rules in §20.2053-1. The amount deductible is the present value of the payments on the decedent's date of death as determined under §20.2031-7(d). (See §§20.7520-1 through 20.7520-4). If there is a reasonable likelihood that full satisfaction of the liability will not be made, then the obligation will be deemed to be subject to a contingency for purposes of this section.<sup>61</sup>

**Example:**

D's property settlement agreement incident to D's divorce, signed three years prior to D's death, obligates D or D's estate to pay to S, D's former spouse, \$20x per year for 10 years. The payments are not conditioned on whether or not S remarries. If S dies prior to the last payment, the terms of the agreement state that the remaining payments are to be made to S's estate or as S may appoint in S's will. Prior to filing D's estate tax return, D's estate pays the first of the 7 payments remaining as of D's death. The estate may take a deduction for the present value of these payments. (See §§20.7520-1 through 20.7520-4).<sup>62</sup>

**b. Contingent Obligations**

If a decedent has a recurring obligation to pay an enforceable and certain claim, but the decedent's obligation is subject to a contingency or is otherwise not described in Prop Reg § 20.2053-4(b)(7)(i), the estate's deduction is limited to amounts actually paid by the estate in satisfaction of the claim.<sup>63</sup>

**Example:**

D's property settlement agreement incident to D's divorce, signed three years prior to D's death, obligates D or D's estate to pay to S, D's former spouse, \$20x per year for 10 years. The obligation to make the annual payments ceases upon S's remarriage or S's death

prior to the due date of the last payment. Prior to filing D's estate tax return, D's estate pays the first of the 7 payments remaining as of D's death. E may take as a deduction on the return the amount of the 1 payment made prior to the filing of D's estate tax return. Additional payments become deductible as they are paid. E may file a protective claim for refund before the expiration of the period of limitations for claims for refund of the estate tax in order to preserve the estate's right to claim a refund if the amount of the liability will not be paid or is not ascertainable with reasonable certainty by the expiration of the applicable period of limitations. If the total amount to be paid in satisfaction of the liability is not ascertainable with reasonable certainty at the time of examination of the return, relief may be sought by a claim for refund (either actual or protective) as provided by section 6511.<sup>64</sup>

**c. Purchase of Commercial Annuity**

If a decedent has a recurring obligation (whether or not contingent) to pay an enforceable and certain claim and the estate purchases a commercial annuity from an unrelated dealer in commercial annuities in an arms-length transaction to satisfy the obligation, the amount deductible by the estate is the sum of (i) the amount paid for the commercial annuity; and (ii) any amount actually paid to the claimant by the estate prior to the purchase of the commercial annuity.<sup>65</sup>

**Example:**

D's property settlement agreement incident to D's divorce, signed three years prior to D's death, obligates D or D's estate to pay to S, D's former spouse, \$20x per year for 10 years. D's estate purchases a commercial annuity from an unrelated dealer in commercial annuities, XYZ, in a bona fide sale to satisfy the obligation to S. E may deduct the entire amount paid to XYZ to obtain the annuity, regardless of whether or not the obligation to S was contingent.<sup>66</sup>

## **9. Interest on Claims**

The interest on a deductible claim is itself deductible as a claim under section 2053, but only to the extent of the amount of interest accrued at the date of the decedent's death and actually paid, even if the personal representative elects the alternate valuation method under section 2032. (Post-death accrued interest may be deductible in appropriate circumstances either as an estate tax administration expense under section 2053 or as an income tax deduction.)<sup>67</sup>

## **III. GST TAX**

The generation-skipping transfer ("GST") tax does not apply to any GST from a trust if the trust was: (i) irrevocable on September 25, 1985;<sup>68</sup> (ii) under a will or revocable trust instrument executed before October 22, 1986 and the decedent died before January 1, 1987;<sup>69</sup> or (iii) under a will or revocable trust instrument executed before October 22, 1986 and the decedent was under a mental disability on October 22, 1986 until his death.<sup>70</sup> A trust that is exempt under one of the three exceptions to the GST tax effective date provision is called an "exempt trust". Such a trust is said to be "grandfathered" for GST tax purposes, and so is also often called a "grandfathered trust".

Anyone contemplating a reformation, consolidation, merger, partition, construction, or any other act or proceeding affecting the terms of, or resulting in a transfer to, an effective-date exempt trust must consider the effect of these actions on the trust's effective-date exempt status. In the litigation context, problems most commonly arise when the parties seek to reform an effective-date exempt trust. Regulations issued on December 20, 2000, address changes to grandfathered trusts.<sup>71</sup> These regulations address (1) the exercise by a trustee of a discretionary power to distribute trust principal from an effective date trust to a new trust; (2) court approved

settlements regarding effective-date trusts; (3) judicial construction of effective-date trusts; and (4) modification of effective-date trusts.

**A. Settlement Agreements**

A court-approved settlement of a bona fide controversy regarding the administration of a trust, or the construction of terms of the governing instrument, will not cause a grandfathered trust to be subject to the GST tax if: (1) the settlement is the product of arm's length negotiations and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.<sup>72</sup>

According to the IRS, the purpose of this rule is to not restrict safe harbor protection to only those settlements that reach the result a court could reach if the issue was litigated. Rather, the rule is intended to afford the parties a greater degree of latitude to settle a case than would be available if a court had to decide the issue. Thus, a settlement "within the range of reasonable outcomes" would include a compromise that reflects the parties' assessment of their relative rights and the strengths and weaknesses of their respective positions. The settlement need not (and the IRS assumes that in most cases it won't) resolve the issue in the same manner as a court decision on the merits. On the other hand, a settlement that, for example, creates beneficial interests that did not exist under a reasonable interpretation of the instrument will not satisfy the regulations.<sup>73</sup>

**Example:**

A and B are the sole remainder beneficiaries of a grandfathered (exempt) trust established by their parent. They disagree as to the portion of the remainder each is entitled to under the terms of the trust when the trust terminates. So they enter into a settlement agreement dividing the corpus equally among A, B, and C, B's child and the grandchild of the parent who established the trust. Because C is not a potential remainderman under any construction of the trust agreement, the settlement is not considered within the range of reasonable outcomes for purposes of the second requirement for a settlement.<sup>74</sup>

**B. Judicial Construction**

A judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a drafting error will not cause an exempt trust to be subject to the GST tax if (1) the judicial action involves a bona fide issue, and (2) the construction is consistent with applicable state law that would be applied by the highest court of the state.<sup>75</sup> A construction that does not satisfy these requirements will not cause a grandfathered trust to lose its GST tax exempt status if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.<sup>76</sup> According to the IRS, the judicial construction rule covers ambiguities and scrivener's error. So it was not necessary to expand the scope of that safe harbor to cover any request for court instructions, or any similar proceedings such as requests to modernize the trust instrument or adapt the instrument to unforeseen changed circumstances, because

these and similar actions are properly addressed under the modification safe harbor.<sup>77</sup>

**Example:**

In 1980, a grantor (G) established an irrevocable trust for the benefit of G's children, A and B, and their issue. The trust is to terminate on the death of the last to die of A and B, at which time the principal is to be distributed to their issue. However, the provision governing the termination of the trust is ambiguous regarding whether the trust principal is to be distributed per stirpes, only to the children of A and B, or per capita among the children, grandchildren, and more remote issue of A and B. In 2002, the trustee files a construction suit with the appropriate local court to resolve the ambiguity. The court issues an order construing the instrument to provide for per capita distributions to the children, grandchildren, and more remote issue of A and B living at the time the trust terminates.

The court's construction resolves a bona fide controversy regarding the proper interpretation of the instrument (thus, the first requirement for a construction is satisfied) and is consistent with applicable state law as it would be interpreted by the highest court of the state (thus, the second requirement for a construction is satisfied). So, the trust will not be subject to the GST tax.<sup>78</sup>

#### **IV. GIFT TAX**

##### **A. Settlement Agreements**

Pursuant to Reg. § 25.2511-1(g)(1), the gift tax is not applicable to a transfer for full and adequate consideration in money or money's worth, or to ordinary business transactions, described in Reg. § 25.2512-8. In applying these regulations within the context of settlements arising from family disputes, the factors that will be considered by the IRS in determining whether a gift was made include: (1) whether a genuine controversy existed between the parties, (2) whether the parties were represented by and acted upon the advice of counsel, (3) whether the parties

engaged in bona fide arm's-length negotiations, (4) whether the value of the property involved was substantial and (5) whether the settlement was motivated by the parties' desire to avoid the uncertainty and expense of litigation.<sup>79</sup>

In *Friedman v. Commissioner*, 40 T.C. 714 (1963), a widow transferred property to her stepchildren in settlement of claims they filed asserting their right to property from her husband's estate. The Court held that the transfer was a business exchange, and that even though the claims by the stepchildren were unliquidated, their release had a recognizable value in money or money's worth. Although the settlement was reached prior to litigation, it was based upon the advice of independent counsel and was presumed to be economically advantageous to all of the parties. The Tax Court stated:

Gertrude and the children were in serious disagreement over the content of Jacob's estate. The children further believed that they were entitled to at least a part of the Florida and Indiana properties and apparently were willing to institute suit to determine their rights. Gertrude might successfully have resisted this suit, but, as with all litigation, the outcome could not be predetermined. The settlement was made upon advice of her attorney under circumstances which it may be assumed both Gertrude and her attorney regarded as "advantageous economically." Therefore, it is our view that the transfer by Gertrude of a remainder interest in the properties in question was made for an adequate and full consideration in money or money's worth.<sup>80</sup>

Similarly, in *Beveridge v. Commissioner*, 10 T.C. 915 (1948), appeal dismissed (4th Cir. 1948), a taxpayer's transfer of \$120,000 to a trust for the benefit of her estranged daughter in settlement of a threatened lawsuit by the daughter was held to be a transfer for an adequate consideration within the meaning of the gift tax statutes.

## **B. QTIP Trusts**

So-called “blended families” are fertile breeding grounds for trust and probate litigation, particularly when a person dies leaving both a surviving spouse and children from a prior marriage. Often some form of qualified terminable interest property (“QTIP”) is caught in the middle of the dispute. (Think QTIP marital trust for step mom for life, remainder to children from first marriage.) The tax rules affecting QTIP property are complex and their impact often draconian. Any form of trust litigation resulting in the termination, severance or sale of QTIP property must factor in these rules.<sup>81</sup>

If a gift tax marital deduction or an estate tax marital deduction was allowed for the transfer of property creating a “qualifying income interest for life” under the QTIP rules, any disposition by the donee or surviving spouse of all or part of her qualifying income interest for life is treated for gift and estate tax purposes as a transfer by gift of *all* interests in the property other than the qualifying income interest.<sup>82</sup> The amount treated as a transfer is equal the fair market value of the entire property subject to the qualifying income interest, determined on the date of the disposition, including any accumulated income and not reduced by any gift tax annual exclusion allowed for the transfer creating the interest, less the value of the qualifying income interest in the property on the date of the disposition. The gift tax consequences of the disposition of the qualifying income interest are determined separately under Reg § 25.2511-2.<sup>83</sup>

### **Example:**

A decedent (D) was survived by his spouse (S). Under D’s will, a personal residence valued, for estate tax purposes, at \$250,000 passed to S for life, and, after S’s death, to D’s children. D’s executor made a valid QTIP election for the property. When the fair market value of

the property was \$300,000 and the value of S's life interest in the property was \$100,000, S sold her interest in the property to D's children for \$100,000. Under IRC § 2519, S made a gift of \$200,000 (\$300,000 less the \$100,000 value of the qualifying income interest in the property). S did not make a gift of the income interest under the rules that generally apply for gift tax purposes, because the consideration received for S's income interest was equal to the value of the income interest.<sup>84</sup>

The amount treated as a transfer in connection with a lifetime disposition by a donee or surviving spouse of her income interest in qualified terminable interest property is reduced by the amount the donee or surviving spouse is entitled to recover under IRC § 2207A(b) (which gives the spouse the right to recover, from the person receiving the property the additional gift tax resulting from the application of IRC § 2519). If the spouse is entitled to recover gift tax under IRC § 2207A(b), the amount of gift tax recoverable and the value of the remainder interest treated as transferred under IRC § 2519 is determined by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability (*i.e.*, "net gift" treatment).<sup>85</sup>

However, if, as a result of the lifetime transfer of the qualifying income interest, the treatment of the entire value of the property as a taxable transfer uses up some or all of the spouse's unified credit, the spouse isn't permitted to recover the credit amount from the remainderman.<sup>86</sup> Note also that the spouse is required to use her lifetime gift-tax credit; she may NOT opt to intentionally trigger a taxable gift by refusing to use her gift-tax credit.<sup>87</sup> Finally, there is no right of recovery from any person for the property received by that person for which a deduction was allowed for the total amount of gifts, if no gift tax is attributable to the property. The right of recovery arises at the time the gift tax is actually paid by the transferor.<sup>88</sup>

## V. INCOME TAX

### A. Gain or Loss from Disposition of a Term Interest

#### 1. No-Basis Rule

In determining gain or loss from sales or other dispositions of “term interests”<sup>89</sup> in property acquired by gift or transfer in trust or from a decedent, that part of the adjusted basis of the interest determined under IRC § 1015 (if it was acquired by gift or transfer in trust), or IRC § 1014 (if it was acquired from a decedent) is disregarded to the extent that the adjusted basis is a portion of the entire adjusted basis of the property.<sup>90</sup> Thus, if a term interest is sold, the full sales price is taxable, unreduced by any basis.<sup>91</sup> Any resulting gain or loss will, in most cases, be a capital gain or loss.<sup>92</sup> The no-basis rule applies to the following so-called “term interests in property”:

- a life interest in property,
- an interest in property for a term of years, or
- an income interest in a trust.<sup>93</sup>

#### **Example:**

Unimproved land having a fair market value of \$18,800 at the date of the decedent’s death on January 1, 1970, is devised to A, a male, for life, with remainder over to B, a female. The estate does not elect the alternate valuation allowed by section 2032. On January 1, 1971, A sells his life interest to S for \$12,500. S is not related to A or B. At the time of the sale, A is 39 years of age. By reference to §20.2031-7A(c), the life estate factor for age 39, male, is found to be 0.79854. Therefore, the present value of the portion of the uniform basis assigned to A’s life interest is \$15,012.55 ( $\$18,800 \times 0.79854$ ). This portion is disregarded under section 1001(e). A realizes no loss; his gain is \$12,500, the amount realized. S has a basis of \$12,500 which he can recover by amortization deductions over A’s life expectancy.<sup>94</sup>

## 2. Exception to “No-Basis” Rule

There is no loss of basis upon a sale or other disposition of a term interest in property as a part of a single transaction in which the entire interest in the property is transferred to a third person or to two or more other persons, including persons who acquire such entire interest as joint tenants, tenants by the entirety, or tenants in common.<sup>95</sup> Thus, where a life tenant and a remainderman simultaneously sell their interests in a single transaction the life tenant’s gain would be the excess of the sales price of his interest over his regular basis.<sup>96</sup>

### Example

The facts are the same as in the first Example above except that on January 1, 1971, A and B jointly sell the entire property to S for \$25,000 and divide the proceeds equally between them. A and B are not related, and there is no element of gift or compensation in the transaction. By reference to §20.2031-7A(c), the remainder factor for age 39 male, is found to be 0.20146. Therefore, the present value of the uniform basis assigned to B’s remainder interest is \$3,787.45 ( $\$18,800 \times 0.20146$ ). On the sale A realizes a loss of \$2,512.55 ( $\$15,012.55$  less  $\$12,500$ ), the portion of the uniform basis assigned to his life interest not being disregarded by reason of section 1001(e)(3). B’s gain on the sale is \$8,712.55 ( $\$12,500$  less  $\$3,787.45$ ). S has a basis in the entire property of \$25,000, no part of which, however, can be recovered by amortization deductions over A’s life expectancy.<sup>97</sup>

### B. Miscellaneous Income Tax Issues

Just about any income tax issue that may arise in an estate proceeding could become significant in the context of litigation. The following is a checklist of items to consider:

- The general exclusion from income for property received by gift, bequest, devise, or inheritance.<sup>98</sup>

- Choosing between income and estate/GST tax deductions.<sup>99</sup>
- The limited exception to no-double-deductions rule.<sup>100</sup>
- The characterization and timing of trust distributions for “simple” and “complex” trusts.<sup>101</sup>
- The separate share rule.<sup>102</sup>
- The charitable set-aside rule.<sup>103</sup>
- The 65-day rule.<sup>104</sup>
- Rules governing income in respect of a decedent (“IRD”).<sup>105</sup>
- Rules governing deductions in respect of a decedent.<sup>106</sup>
- Income tax **basis rules** for: (i) property acquired from a decedent,<sup>107</sup> (ii) the exception for certain property gifted within one year of death,<sup>108</sup> (iii) IRD property,<sup>109</sup> (iv) property received by gift,<sup>110</sup> and (v) rules for determining a donee’s basis when the donor’s basis is unknown.<sup>111</sup>

## VI. PRIVATE LETTER RULINGS

In the trust and probate litigation context, private letter rulings are often used to provide the parties with certainty as to the tax results they’re looking for from a particular settlement agreement structure. Especially in complex cases, the binding effect of settlement agreements and related consent decrees are often explicitly made subject to obtaining a private letter ruling.<sup>112</sup>

### A. Required Checklist

In addition to the information required in a regular letter ruling request,<sup>113</sup> private letter ruling requests on estate, gift, and generation-skipping transfer tax issues must be accompanied by the checklist contained in Rev Proc 91-14.<sup>114</sup> That

checklist must be completed and placed on top of the ruling request, along with the checklist contained in Appendix C of Rev Proc 2009-1.<sup>115</sup> A reproduction of the checklist contained in Rev Proc 91-14 in substantially the same form as it appears in the revenue procedure may be used.<sup>116</sup> Failure to complete and submit a checklist with the ruling request will result in the request being returned. Also, failure to submit any information required by the checklist (e.g., disclaimer, copy of any deed of gift, or will) will result in the request being returned. In extraordinary circumstances, the IRS may retain the request and defer substantive consideration until the checklist is provided.<sup>117</sup>

**B. Applicability after Change of Fiduciary/Trust Situs**

Private letter rulings issued to an estate or trust are applicable to the estate or trust requesting the ruling. A request from a personal representative of an estate or a trustee of a trust is viewed as a request from the office of that personal representative or trustee, rather than from the individual or entity holding the office. Therefore, if the facts or law with respect to a particular ruling request have not changed, the ruling will remain applicable to the estate or trust even though the person or entity holding the office of personal representative or trustee may change and even though the situs of the trust may move from one state to another.<sup>118</sup>

**C. Estate Tax PLRs**

The IRS will issue letter rulings on transactions affecting the estate tax on the prospective estate of a living person. The IRS will not issue letter rulings for prospective estates on computations of tax, actuarial factors, and factual matters.

With respect to the transactions affecting the estate tax of the decedent's estate, generally the IRS issues letter rulings before the decedent's estate tax return is filed. If you are requesting a private letter ruling regarding a decedent's estate tax

and the estate tax return is due to be filed before the letter ruling is expected to be issued, you should obtain an extension of time for filing the return and notify the IRS office branch considering the letter ruling request that an extension has been obtained. If the return is filed before the letter ruling is received from the IRS, you must disclose on the return that a letter ruling has been requested, attach a copy of the pending letter ruling request to the return, and notify the IRS office that the return has been filed. According to the IRS, they will make every effort to issue the letter ruling **within 3 months** of the date the return was filed.<sup>119</sup>

With respect to letter rulings addressing the estate tax on the prospective estate of a living person, these rulings will be issued only if there is an executed will, trust instrument, deed of conveyance, or contract or if the individual on whose behalf the ruling is requested states in writing, under penalty of perjury, that such individual has a present intention to execute the will, trust instrument, has a present intention to execute the will, trust instrument, deed of conveyance, or contract. A copy of such executed or proposed document must be included in the request. Each such ruling request must contain a statement why the law in connection with the request is uncertain and specifically why the issue is not adequately addressed by statute, regulations, decisions of the Supreme Court, revenue rulings, or revenue procedures. Areas in which advance estate tax rulings will not be issued include:

- Computations of the tax.
- Actuarial factors.
- Factual matters, such as determining the fair market value of property.
- Any area covered by a prohibition against ruling in Rev. Proc. 88-1, as modified by Rev. Proc. 88-18, 1988-1 C.B. 694, or Rev.

Proc. 88-3, except as provided in section 4.01 of Rev Proc 88-50,  
1988-2 CB 711.<sup>120</sup>

**D. GST Tax PLRs**

In general, the IRS issues letter rulings on proposed transactions that affect the GST tax and on completed transactions that occurred before the estate tax return is filed. In the case of a GST trust or trust equivalent, letter rulings are issued either before or after the trust or trust equivalent has been established.<sup>121</sup>

\* \* \* \* \*

## END NOTES

1. **Juan C. Antúnez** is a partner with STOKES MCMILLAN MARACINI & ANTÚNEZ P.A. ([www.smpalaw.com](http://www.smpalaw.com)), a boutique trusts and estates law firm located in Miami, Florida. Trusts and estates litigation, probate administration and estate planning is all he does as a lawyer. In addition to practicing law and chronicling Florida's ever evolving trusts-and-estates landscape on the FLORIDA PROBATE & TRUST LITIGATION BLOG ([www.flprobatelitigation.com](http://www.flprobatelitigation.com)), he frequently lectures on trusts and estates related topics. Mr. Antúnez recently co-authored the Florida probate chapter of *International Succession*, published by Oxford University Press (publication date: February 2010). Mr. Antúnez is an adjunct law professor for the LL.M. in Estate Planning program at the University of Miami School of Law, and also teaches continuing legal education seminars for the National Business Institute and other professional groups on areas related to trusts and estates. He is a graduate of Florida International University's business school (B.A. in finance with honors), the New York University School of Law (J.D.), and the University of Miami School of Law (LL.M. in Estate Planning). Mr. Antúnez has been awarded an AV® Peer Review Rating by LexisNexis Martindale-Hubbell. Prior to his legal career Mr. Antúnez served in the United States Marine Corps Reserve from 1987 to 1993 (4th ANGLICO, West Palm Beach, Florida), including combat duty during the first Gulf War. In addition to managing not to get himself shot, after "Gulf I" he ended up with the Combat Action Ribbon, Kuwaiti Liberation Medal, National Defense Service Medal, Southwest Asia Service Medal, Army Commendation Medal, and Meritorious Unit Citation.
2. *Getty v. Commissioner*, 913 F.2d 1486, 1490 (9th Cir. 1990), *revq.* 91 T.C. 160 (1988); *Tribune Publishing Co. v. United States*, 836 F.2d 1176, 1177 (9th Cir. 1988).
3. *Raytheon Production Corp. v. Commissioner*, 144 F.2d 110, 114 (1st Cir. 1944), *affg.* 1 T.C. 952 (1943); *Victor E. Gidwitz Family Trust v. Commissioner*, 61 T.C. 664, 673 (1974).
4. *United States v. Gilmore*, 372 U.S. 39 (1963); *Victor E. Gidwitz Family Trust v. Commissioner*, *supra*.
5. Treasury Inspector General for Tax Administration, Trends in Compliance Activities Through Fiscal Year 2008, Figure 46.
6. See Miller, *Common Estate Tax Audit Triggers and How to Avoid Them*, Estate Planning Journal, Aug 2007.
7. See, e.g., Pratt and Karibjanian, *Filing a Supplemental Estate Tax Return After Probate Litigation*, 36 ETPL 09 (Sept. 2009); Rubin, *Tax Results of Settling Trust Litigation Involving QTIP Trusts*, 36 ETPL 01 (Jan. 2009); Tescher and Klingsberg, *Tax Consequences of Settlements of Estate and Trust Disputes* (Part 1), 33 ETPL 29 (Nov. 2006); Tescher and Klingsberg, *Tax Consequences of Settlements of Estate and Trust Disputes* (Part 2), 33 ETPL 29 (Dec. 2006); and Eve de Ganon, *Maximizing the Benefit of Deducting an Estate's Debts and Expenses*, 23 ETPL 6 (July 1996).

8. The phrase “**allowable by the law of the jurisdiction**” means allowable by the law governing the administration of decedents’ estates. The phrase has no reference to amounts allowable as deductions under a law which imposes a State death tax. Reg. § 20.2053-1(a)(1).

9. The phrase “**property subject to claims**” is defined in IRC § 2053(c)(2) as meaning the property includible in the gross estate which, or the avails of which, under the applicable law, would bear the burden of the payment of these deductions in the final adjustment and settlement of the decedent’s estate. However, for the purposes of this definition, the value of property subject to claims is first reduced by the amount of any deduction allowed under IRC § 2054 for any losses from casualty or theft incurred during the settlement of the estate attributable to such property. Reg. § 20.2053-1(c).

10. The regular assessment period for estate tax is **three years** after the estate tax return was actually filed. Code Sec. 6501(a). An estate tax return (Form 706) must ordinarily be filed within **nine months** after the date of the decedent’s death. Code Sec. 6075(a). An early return is considered filed on the last day prescribed by law for the filing. Code Sec. 6501(b)(1). Assuming the return was timely filed, the assessment period would, therefore, expire three years (36 months) plus 9 months, or **45 months**, after the decedent’s death. Any later filing (with or without formal extension by IRS) of the return automatically extends the assessment period. Code Sec. 6501(a). Thus, in the case of a late filed return, these administration expenses must be paid within three years after the filing of the return. Where the IRC extends the assessment period, the period for payment of administration expenses relating to property not subject to claims is likewise extended. Code Sec. 2053(b).

11. Reg § 20.2053-1, **Example (1)**.

12. Reg § 20.2053-1(b)(2).

13. See Technical Advice Memorandum 9246008 (At the request of an estate, a probate court issued a decree approving the estate’s payment of expenditures. No party filed in opposition to the estate’s petition. At the time the decree was issued, one of the five estate beneficiaries had retained an attorney to dispute one of the proposed expenditures, and the other beneficiaries had not yet executed their affidavits consenting to the expenditure. No consents were ever filed in probate court. The IRS has ruled that it would be able to independently determine if the estate’s expenses are allowed under state law, and thus deductible under federal law, even if the court’s decree was on the merits or by consent, as described in Reg § 20.2053-1(b)(2). The IRS then determined that the probate decree was not a decree on the merits or a consent decree and that it was thus **not entitled to a presumption** under Reg § 20.2053-1(b)(2)).

14. *Tehan, Timothy J. Est.*, (2005) TC Memo 2005-128, RIA TC Memo ¶; 2005-128, 89 CCH TCM 1374.

15. Reg §20.2053-3(a).

16. Reg § 20.2053-3(c)(1).

17. Form 706 , (8/2008), p. 24, Instructions to Schedule J.
18. Reg § 20.2053-3(c)(3).
19. In *Pitner v. United States*, 388 F.2d 651 (5th Cir. 1967), the principal issue in the State court litigation was the effect to be given to an alleged oral agreement between brothers as to the disposition of property upon death. The Government sought to resist the deduction of attorneys' fees incurred by various claimants in connection with the State court litigation on the ground that such litigation brought no new assets into the estate. The Court of Appeals held that the fees were deductible as administration expenses necessary to the settlement of the estate, since they were incurred with respect to the interests of the beneficiaries in the estate in general and not simply to determine the beneficiaries' share in the estate as against other beneficiaries. Moreover, the Court of Appeals noted that the litigation "need not have concerned increasing the size of the estate." See 388 F.2d at 660.
20. Reg § 20.2053-3(d)(1).
21. See *Estate of Melville v. Commissioner*, T.C.Memo. 1993-484 ("The requirements of section 2053 are twofold: first, the administration expense must be allowable under State law; and second, it must be allowable under the Federal regulations." (Citing *Estate of Reilly v. Commissioner*, 76 T.C. 369, 372 (1981); *Estate of DeWitt v. Commissioner*, T.C.Memo. 1987-502.))
22. IRC § 2043(b)(1).
23. IRC § 2043(b)(2). See also *Natchez v. United States*, 705 F.2d 671, at 673 - 674 (2d Cir.1983):

To prevent the use of marital agreements as a device to deplete an estate and avoid taxation the Internal Revenue Code provides that claims against an estate that are "founded on a promise or agreement" will be deductible from the value of the gross estate if they are "contracted bona fide and for an adequate and full consideration in money or money's worth." [26 U.S.C. § 2053(c)(1)(A)]. Furthermore, § 2043(b) of the Code provides that a relinquishment of marital rights in a decedent's estate "shall not be considered to any extent a consideration 'in money or money's worth.'" Section 2043(b) "was aimed at cases involving complicity between the husband and wife who remain married and who are merely attempting to avoid estate tax." *Estate of Glen v. Commissioner*, 45 T.C. 323, 334 (1966); see also *Commissioner v. Estate of Watson*, 216 F.2d 941, 944 (2d Cir.1954).

When a claim against an estate by a decedent's former spouse is founded on a divorce decree, however, as opposed to a "promise or agreement," the estate is entitled to deduct the full amount of the claim under § 2053(a)(3). Such claims are deductible even if based on the relinquishment of marital rights, without regard

to consideration, for the transfer is deemed an involuntary liability, imposed on the estate not by agreement but by law. *Harris v. Commissioner*, 340 U.S. 106, 110, 71 S.Ct. 181, 183-184, 95 L.Ed. 111 (1950); *id.* at 114, 71 S.Ct. at 185-186 (Frankfurter, J., dissenting). When spouses transfer marital rights pursuant to a divorce and they or their representatives are dealing at arm's length, *id.*, at 112, 71 S.Ct. at 184-185; *Estate of Glen, supra*, 45 T.C. at 334, "[t]he motive of such transfers is certainly not to deplete the estate inter vivos, so as to escape ultimate estate taxes upon death." *McMurtry v. Commissioner*, 203 F.2d 659, 662 (1st Cir.1953). Even if the legal effectiveness of the separation agreement is not conditioned on a divorce decree, the claim will be deemed to be founded on the decree and not on the agreement in cases where the divorce court had jurisdiction to alter or modify the agreement. *Commissioner v. Maresi*, 156 F.2d 929, 930-31 (2d Cir.1946).

24. Form 843 (Rev. February 2009) is available on the IRS website at: <http://www.irs.gov/pub/irs-pdf/f843.pdf>.

25. A claim for credit or refund of a tax paid by return must be filed within the later of: 3 years from the date the return was filed (or the due date if filed earlier), or 2 years from the date the tax was paid. IRC § 6511(a). An estate tax return (Form 706) must ordinarily be filed within 9 months after the date of the decedent's death. IRC § 6075(a). An early return is considered filed on the last day prescribed by law for the filing. IRC § 6501(b)(1). Assuming the return was timely filed, the assessment period would, therefore, expire three years (36 months) plus 9 months, or **45 months**, after the decedent's death. Any later filing (with or without formal extension by IRS) of the return automatically extends the assessment period. IRC § 6501(a). A longer refund claim period is provided where the taxpayer and IRS execute a consent (Form 872) extending the period for assessment. In this case the period for filing a claim does not expire before six months after the expiration of the period within which assessment may be made under the agreement. IRC § 6511(c)(1).

26. See [www.irs.gov/pub/irs-il/2008-2009pgp.pdf](http://www.irs.gov/pub/irs-il/2008-2009pgp.pdf).

27. For an excellent article discussing supplemental estate tax returns, see Pratt and Karibjanian, *Filing a Supplemental Estate Tax Return After Probate Litigation*, 36 ETPL 09 (Sept. 2009).

28. Reg § 20.6081-1(d).

29. The instructions to Form 706, "Amending Form 706" (Rev. August 2008), are available on the IRS website at: <http://www.irs.gov/pub/irs-pdf/i706.pdf>.

30. IRC § 6161(a)(2).

31. Reg § 20.6161-1(a)(1), **Example (3)** ("An estate includes a claim to substantial assets which cannot be collected without litigation. Consequently, the size of the gross estate is unascertainable as of the time the tax is otherwise due.")

32. *Leewitz v. U.S.*, 110 Ct. Cl. 645, 75 F. Supp. 312 (1948) (“There is no requirement that the amounts must have been allowed by an order of court **or have been paid** in order to be deducted. It is sufficient if they are proper deductions in the administration of an estate and will finally be allowed. (Citing *Bourne v. U.S.*, 76 Ct.Cl. 680, 2 F.Supp. 228, 3 USTC P 1028, 11 A.F.T.R. 1273 (Ct.Cl. Jan 09, 1933)). (Emphasis added.)

33. The total allowable amount of deductions for funeral expenses, administration expenses, claims, and unpaid mortgages and debts which the applicable state law would allow out of property subject to claims (if enough such property were available) is limited to the sum of: (a) the value of property included in the decedent’s gross estate which is subject to claims (less any deduction for casualty and theft losses incurred during administration), plus (b) amounts paid (out of property not subject to claims against the decedent’s estate) within nine months after the decedent’s death – the period within which the estate tax return must be filed – or within any extension granted for filing. IRC § 2053(c)(2); Reg § 20.2053-1(c).

34. A deduction is allowed for expenses incurred in administering property included in a decedent’s gross estate but not subject to claims against the estate if (1) the expenses are in the nature of expenses that would be allowed as administration expenses if the property were subject to claims and (2) the expenses are paid before the expiration of the period of limitation provided in IRC § 6501 for assessment of the estate tax. IRC § 2053(b).

35. *See Estate of McMorris v. Commissioner*, 243 F.3d 1254 (10th Cir.2001); *Estate of Smith v. Commissioner*, 198 F.3d 515, 521 (5th Cir.1999); *Estate of Van Horne v. Commissioner*, 720 F.2d 1114 (9th Cir.1983); *Propstra v. United States*, 680 F.2d 1248 (9th Cir.1982); *Greene v. United States*, 447 F.Supp. 885 (N.D.Ill.1978)(where the district court suggested that the matter is “obviously yearning for legislative clarification”); *Estate of Lester v. Commissioner*, 57 T.C. 503, 1972 WL 2478 (1972); *Russell v. United States*, 260 F.Supp. 493 (N.D.Ill.1966); *Winer v. United States*, 153 F.Supp. 941 (S.D.N.Y.1957).

36. *See Estate of Kyle v. Commissioner*, 94 T.C. 52, (1990); *Estate of Sachs v. Commissioner*, 856 F.2d 1158 (8th Cir.1988); *Commissioner v. Shively’s Estate*, 276 F.2d 372 (2d Cir.1960); *Estate of Hagmann v. Commissioner*, 60 T.C. 465, 1973 WL 2507 (1973), *aff’d per curiam*, 492 F.2d 796 (5th Cir.1974); *Commissioner v. State Street Trust Co.*, 128 F.2d 618 (1st Cir.1942); *see also Nesselrodt Est. v. Commissioner*, 51 T.C.M. (CCH) 1406, 1986 WL 21992 (1986).

37. Preamble to Prop Reg § 25.2053-4, 4/23/2007.

38. REG - 143316-03, 72 Fed. Reg. 20,080 (4/23/07); *see* <http://www.irs.gov/pub/irs-irbs/irb07-21.pdf>.

39. For an excellent article discussing the proposed regulations *see* Blattmachr and Zeydel, *Prop. Regs. On the Deduction for Administration Expenses and Claims*, 34 ETPL 10 (Oct. 2007).

40. Prop Reg §§ 20.2053-1(e) , 20.2053-4(e).

41. IRC § 2053(a)(3); Reg § 20.2053-1(a)(1)(iii).
42. Prop Reg § 20.2053-4(a)(1)(i) – (iii).
43. Prop Reg § 20.2053-4(a)(2).
44. Prop Reg § 20.2053-4(b)(1).
45. Prop Reg § 20.2053-4(b)(2).
46. Prop Reg § 20.2053-4(d), **Example (1)**.
47. Prop Reg § 20.2053-4(d), **Example (2)**.
48. Prop Reg § 20.2053-4(d), **Example (3)**.
49. Prop Reg § 20.2053-4(d), **Example (6)**.
50. Prop Reg § 20.2053-4(b)(3).
51. Prop Reg § 20.2053-4(d), **Example (4)**.
52. Prop Reg § 20.2053-4(d), **Example (5)**.
53. For purposes of this regulation, the term “**family members**” includes the spouse of the decedent; the grandparents, parents, siblings, and lineal descendants of the decedent or of the decedent’s spouse; and the spouse and lineal descendants of any such grandparent, parent, and sibling. Family members include adopted individuals.
54. For purposes of this regulation, the term “**a related entity**” means an entity in which the decedent, either directly or indirectly, had a beneficial ownership interest at the time of the decedent’s death or at any time during the three-year period ending on the decedent’s date of death. Such an entity, however, shall not include a publicly-traded entity nor shall it include a closely-held entity in which the combined beneficial interest, either direct or indirect, of the decedent and the decedent’s family members, collectively, is less than thirty percent of the beneficial ownership interests (whether voting or non-voting).
55. Prop Reg § 20.2053-4(b)(4).
56. Prop Reg § 20.2053-4(b)(5).
57. Prop Reg § 20.2053-4(d), **Example (7)**.
58. *See* Reg § 20.2053-5 (Deductions for charitable, etc., pledges or subscriptions).

59. IRC § 2053(c)(1)(A).
60. Prop Reg § 20.2053-4(b)(6).
61. Prop Reg § 20.2053-4(b)(7)(i).
62. Prop Reg § 20.2053-4(d), **Example (8)**.
63. Prop Reg § 20.2053-4(b)(7)(ii).
64. Prop Reg § 20.2053-4(d), **Example (9)**.
65. Prop Reg § 20.2053-4(b)(7)(iii).
66. Prop Reg § 20.2053-4(d), **Example (10)**.
67. Prop Reg § 20.2053-4(c).
68. Reg § 26.2601-1(b)(1)(i).
69. Reg § 26.2601-1(b)(2)(i).
70. Reg § 26.2601-1(b)(3)(i).
71. TD 8912, 65 Fed. Reg. 79,735–79,740 (Dec. 20, 2000), *corrected*, 66 Fed. Reg. 11,108 (Feb. 22, 2001).
72. Reg § 26.2601-1(b)(4)(i)(B).
73. Preamble to TD 8912, 12/19/2000.
74. Preamble to Prop Regs, 11/18/1999.
75. Reg § 26.2601-1(b)(4)(i)(C) .
76. Reg § 26.2601-1(b)(4)(i)(D)(1) .
77. Preamble to TD 8912, 12/19/2000.
78. Reg § 26.2601-1(b)(4)(i)(E), **Example (3)**.
79. *See Estate of Natkanski v. C. I. R.*, T.C. Memo. 1992-380, T.C.M. (RIA) ¶; 92380, 64 T.C.M. (CCH) 55 (1992); *Estate of Friedman v. Commissioner*, 40 T.C. 714, 720 (1963); *Beveridge v. Commissioner*, 10 T.C. 915, 918 (1948); *Estate of Noland v. Commissioner*, T.C. Memo. 1984- 209.

80. 40 T.C. at 720.

81. For an excellent article discussing these tax issues in detail, *see* Rubin, *Tax Results of Settling Trust Litigation Involving QTIP Trusts*, 36 ETPL 01 (Jan. 2009). It should also be noted that splitting QTIP trusts isn't always the best solution. Using a case-study approach the authors of *The Appropriate Withdrawal Rate: Comparing a Total Return Trust to a Principal and Income Trust*, 31 ACTEC J. 118 (2005), do a great job of explaining in plain English how trustees can resolve many QTIP-trust related disputes by converting such trusts into "unitrusts".

82. IRC § 2519(a).

83. Reg § 25.2519-1(c)(1).

84. Reg § 25.2519-1(g), Example (2).

85. Reg § 25.2519-1(c)(4). The IRS permits the following formula to be used to arrive at the "true tax" (gift tax) to be deducted from the transferred property's value:  $\text{Tentative Tax} \div (1 + \text{Rate of Tax}) = \text{True Tax}$ . *See* Rev Rul 75-72, 1975-1 CB 310. IRS Publication 904 illustrates how to determine the tax in a net gift situation. Publication 904 has been declared obsolete by the IRS. This was presumably done because the illustrations contained in Publication 904 use an estate tax rate schedule that is no longer in effect, and because the illustrations refer to outdated dollar amounts for the unified credit. However, the methods illustrated in Publication 904 should still be valid and taxpayers should be able to use those methods to make interrelated computations by substituting the current estate tax rates and the current unified credit amount.

86. H Rept No. 97-201 (PL 97-34) p. 162 .

87. *See* Rev. Rul. 79-398, 1979-2 CB 338 ("The unified credit provided in section 2505 of the Code is mandatory, and a donor must use it in computing the net gift tax."); Rev. Rul. 84-11, 1984-1 CB 201 ("[T]he unified credit is mandatory any unified credit that is allowable must be applied to the extent of gift taxes that are imposed under section 2501.").

88. Reg § 25.2207A-1(a).

89. "Term interest" refers to an interest, present or future, in the income from property or the right to use property which will terminate or fail on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur. It doesn't refer to remainder or reversionary interests in the property itself or other interests in the property which will ripen into ownership of the entire property upon termination or failure of a preceding term interest. A "term interest in property" also includes any property received upon a sale or other disposition of a life interest in property, an interest in property for a term of years, or an income interest in a trust by the original holder of the interest, but only to the extent that the adjusted basis of the property received is determined by reference to the adjusted basis of the term interest so transferred. Reg § 1.1001-1(f)(2) .

90. IRC § 1001(e)(1).

91. S Rept No. 91-552 (PL 91-172) p. 204.

92. See Rev Rul 72-243, 1972-1 CB 233 (The Internal Revenue Service will follow the decision of the United States Court of Appeals for the Second Circuit in the case of *Beulah Eaton McAllister v. Commissioner*, 157 F. 2d 235 (1946), *certiorari denied*, 330 U.S. 826 (1946), which held that the proceeds received by the life tenant of a testamentary trust in consideration for the transfer of her entire interest in the trust to the remainderman, are to be treated as an amount realized from the sale or exchange of a capital asset under section 1222 of the Internal Revenue Code of 1954.)

93. IRC § 1001(e)(2).

94. Reg § 1.1014-5(c), **Example (3)**.

95. IRC § 1001(e)(3); Reg § 1.1001-1(f)(3).

96. S Rept No. 91-552 (PL 91-172) p. 204 .

97. Reg § 1.1014-5(c), **Example (4)**.

98. IRC § 102(a).

99. A decedent's estate may have administration expenses and losses for which a deduction is allowable in computing the decedent's taxable estate for federal estate tax purposes and in determining the estate's taxable income for income tax purposes. For instance, administration expenses which also qualify as deductible nontrade or nonbusiness expenses would be in this category. However, the law does not allow the estate to take both deductions for the same item. Thus, administration expenses and losses during administration may be taken either (1) as a deduction (or as an offset against the sales price of property in determining gain or loss) in computing the estate's taxable income for income tax purposes or (2) as a deduction in computing the decedent's taxable estate for estate tax purposes. IRC § 642(g).

100. The bar to allowance of a deduction on both the income tax return and the estate tax return applies to administration expenses and to losses incurred by the estate during administration. It does not apply to the following items, which may be deducted on both the income and estate tax returns, (i) deductions "in respect of a decedent" for interest, taxes, business and nonbusiness expenses or (ii) divorce payments made by estate. An estate which is obligated to make payments to decedent's former spouse under a divorce decree may deduct the commuted value of the ongoing payments as a claim against the estate and may also deduct the payments as estate distributions within the limits of distributable net income. Rev Rul 67-304, 1967-2 CB 224.

101. Sections 651, 661, 662, and 663.

102. For the sole purpose of determining the amount of distributable net income (“DNI”) in the case of a single estate having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the estate are treated as though each share represented a separate estate. IRC § 663(c).

103. A charitable deduction is allowed to an estate for any amount of income, without limitation, which under the terms of the governing instrument is, during the tax year, permanently set aside for a purpose specified in IRC § 170(c) or is to be used (whether within or outside of the U.S. and its possessions) exclusively for religious, charitable, scientific, educational or literary purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a nonprofit public cemetery. IRC § 642(c)(2); Reg § 1.642(c)-2. Proposed regulations would allow an estate to deduct income permanently set aside for a IRC § 170(c) purpose only if the record keeping and return requirements in Reg § 1.170A-13 (relating to charitable contributions of certain property in excess of \$5,000) are satisfied. Prop Reg § 1.642(c)-2(e).

104. A personal representative may elect to treat an amount properly paid or credited within the first 65 days of any tax year of the estate as paid or credited on the last day of the preceding tax year. IRC § 663(b).

105. The gross income items an individual is entitled to at death that aren’t properly includible in that individual’s final tax return (such as compensation he earned, but didn’t receive before death), retain their character as gross income items. They are taxed as such to the taxpayer’s estate or others who acquire the right to the IRD amounts after the taxpayer dies. IRC § 691(a)(1).

106. Deductions for business and non-business expenses, interest, taxes and the foreign tax credit, to the extent they are not allowable in the decedent’s final return (or any earlier taxable year) are available to the estate, if the estate is the taxpayer liable for the obligation to which the deduction or credit relates. IRC § 691(b)(1). Otherwise, they may be taken by the person who acquires, subject to that obligation, an interest in the decedent's property from the decedent by reason of the decedent's death or by bequest, devise, or inheritance. IRC § 691(b)(1)(B). In this connection, a beneficiary's right to receive after-death income of the decedent would qualify as an interest in the decedent's property, but any other form of property interest would be equally sufficient. Reg § 1.691(b)-1(a).

107. The basis of property acquired from a decedent, which has not been sold, exchanged, or otherwise disposed of before the decedent’s death, is generally stepped up (or down) to its fair market value at the date of the decedent’s death (IRC § 1014(a)(1)), except that: (i) if the fiduciary (i.e., the decedent’s representative) elects for estate tax purposes to value the decedent’s gross estate at the alternate valuation date, the basis of the property is its fair market value at the appropriate valuation date (IRC § 1014(a)(2); Reg § 1.1014-3(e).); or (ii) if the fiduciary elects for estate tax purposes the special use valuation method of valuing farm or other closely held business real property included in the decedent’s gross estate, the basis of the real property is its value determined for purposes of the special use valuation election, rather than its fair market value (IRC § 1014(a)(3)); or (iii) if the fiduciary elects for estate tax purposes the qualified conservation easement exclusion, the basis of the land subject to the exclusion is a carryover basis from the decedent rather than its fair market value

(IRC § 1014(a)(4)).

108. A donor (or the spouse of the donor) of “appreciated property” may reacquire the property from the donee if the donee later dies. If the conditions described below are met, the basis of the reacquired property to the donor (or spouse) is the adjusted basis of the property to the donee-decedent immediately before the death of the donee-decedent. This “adjusted basis rule” (rather than the “stepped-up basis” rules) applies only if: (i) the property was acquired by the donee-decedent by gift and the donee dies within one year of the gift; and (ii) the property is acquired from the donee-decedent by (or passes from the donee-decedent to) the donor (or the donor’s spouse). IRC § 1014(e). By denying a basis step-up for the property, the adjusted basis rule prevents the avoidance of income tax by the donor on the appreciation of the property before the donee’s death. Thus, an owner of appreciated property cannot make a gift of the property to a terminally ill person and then reacquire the same property from the donee-decedent with a higher (estate tax value) basis, if the donee dies within one year after the gift.

109. If property consists of a right to receive income in respect of a decedent (“IRD”), the stepped-up basis rules don’t apply. IRC § 1014(c). The property right is includible in an estate, for estate tax purposes, at its fair market value. But its collection is also taxable income to the beneficiary or the estate as if collected by the decedent in his lifetime. The double taxation is mitigated only by a deduction for income tax purposes of the estate tax attributable to the right to the income. IRC § 691(c).

110. For determining gain and for depreciation, depletion, or amortization, the basis of property acquired by gift (whether the gift was made outright or in trust) is the same as it would be in the hands of the donor or, in the case of successive gifts, of the last preceding owner by whom it was not acquired by gift. IRC § 167(c); IRC § 168(d)(1); IRC § 612; IRC § 1015(a); Reg § 1.1015-1(a).

111. Where the facts necessary to determine the basis of property in the hands of the donor or last preceding owner by whom it was not acquired by gift are unknown to the donee, the district director must, if possible, obtain these facts from the donor or last preceding owner, or any other person cognizant of the facts. If the district director finds it impossible to get the facts, the basis in the hands of the donor or last preceding owner will be the fair market value of the property as found by the district director as of the date or approximate date at which, according to the best information the district director is able to obtain, the property was acquired by the donor or last preceding owner. IRC § 1015(a); Reg § 1.1015-1(a)(3).

112. *See, e.g.*, Private Letter Ruling 200844010, in which the assets of a Marital Trust consisted of marketable securities. Due to different investment philosophies and risk tolerances, Spouse, X, Bank and the presumptive remainder beneficiaries of Marital Trust (Child 1 - Child 5), disagreed about the investment and management of Marital Trust. Child 1 instituted litigation in Florida State Court against Spouse, X, and Bank, as Co-Trustees of Marital Trust, and the other remainder beneficiaries, Child 2 - Child 5. In an effort to resolve this litigation, Court directed a mediation which resulted in the interested parties entering into Settlement Agreement. The Court issued an order approving the agreement on Date 3. Settlement Agreement provides that no later than the Effective

Date of the agreement, the principal of Marital Trust will be divided into five trusts (Settlement Trusts). All of the Settlement Trusts are trusts for the life benefit of Spouse, with each of Child 1 through 5 being the presumptive remainder beneficiary of one such trust. The Effective Date is the date that the IRS issues a private letter ruling on the transaction.

- 113. Reg § 601.201(e)(2); Rev Proc 2009-1, Sec. 7.01(1), 2009-1 IRB 1; Rev Proc 2009-4, Sec. 9.02(1), 2009-1 IRB 118.
- 114. Rev Proc 2009-1, Appendix E, §01, 2009-1 IRB 1; Rev Proc 91-14, 1991-1 CB 482.
- 115. Rev Proc 2009-1, Sec. 7.01(18), 2009-1 IRB 1.
- 116. Rev Proc 91-14, Sec. 4, 1991-1 CB 482.
- 117. Rev Proc 91-14, Appendix A, 1991-1 CB 482.
- 118. IRS Letter Ruling 9317007.
- 119. Rev Proc 2009-1, Sec. 5.06, 2009-1 IRB 1.
- 120. Rev Proc 88-50, 1988-2 CB 711.
- 121. Rev Proc 2009-1, Sec. 5.09, 2009-1 IRB 1.

# Tax Issues in Trust & Probate Litigation

September 14, 2009 NBI National Teleconference

*Presented by*

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## Demonstrative Exhibits

In **Private Letter Ruling 200844010**, the assets of a Marital Trust consisted of marketable securities. Due to different investment philosophies and risk tolerances, Spouse, X, Bank and the presumptive remainder beneficiaries of Marital Trust (Child 1 - Child 5), disagreed about the investment and management of Marital Trust. Child 1 instituted litigation in Florida State Court against Spouse, X, and Bank, as Co-Trustees of Marital Trust, and the other remainder beneficiaries, Child 2 - Child 5. In an effort to resolve this litigation, Court directed a mediation which resulted in the interested parties entering into Settlement Agreement. The Court issued an order approving the agreement on Date 3. Settlement Agreement provides that no later than the Effective Date of the agreement, the principal of Marital Trust will be divided into five trusts (Settlement Trusts). All of the Settlement Trusts are trusts for the life benefit of Spouse, with each of Child 1 through 5 being the presumptive remainder beneficiary of one such trust. **The Effective Date is the date that the IRS issues a private letter ruling on the transaction.**

### **Attached Demonstrative Exhibits:**

1. Order Approving Mediation Settlement Agreement pursuant to which Private Letter Ruling 200844010 was obtained.
2. Mediation Settlement Agreement pursuant to which Private Letter Ruling 200844010 was obtained.

IN THE CIRCUIT COURT OF THE  
[REDACTED] JUDICIAL CIRCUIT IN AND  
FOR [REDACTED] COUNTY, FLORIDA

IN RE [REDACTED] TRUST  
dtd. [REDACTED] /

PROBATE DIVISION

[REDACTED],

Plaintiff,

CASE NO. [REDACTED]

vs.

[REDACTED]  
and [REDACTED], as Trustees of the  
Trust for the Benefit of [REDACTED] (the  
"Marital Trust") under the Trust Agreement  
dated [REDACTED] created by [REDACTED]

[REDACTED], [REDACTED]  
[REDACTED], and  
[REDACTED]

Defendants.  
/

ORDER APPROVING MEDIATION SETTLEMENT AGREEMENT

[REDACTED]'s Motion to Approve a Mediation Settlement Agreement ("Agreement")  
executed by the parties on [REDACTED], 2007 came on for hearing and the Court having considered  
the reports of two guardians ad litem and being fully advised in the premises, it is ordered that the  
Mediation Settlement Agreement is approved and in accordance with the agreement the Court  
authorizes the actions described in the following paragraphs:

1. Pursuant to §736.0417, Fla. Stat. the Marital Trust shall be divided into five equal  
shares called the Settlement Trust as more specifically described in paragraph 2 of the Agreement.

2. Pursuant to §738.1041, Fla. Stat. and paragraph 3b of the Agreement, the four  
Settlement Trusts for the benefit of [REDACTED], [REDACTED], [REDACTED] and [REDACTED] are converted to [REDACTED]%  
Unitrusts.

[REDACTED] Trust  
Case No. [REDACTED]

3. With respect to the Settlement Trust for the benefit of [REDACTED] the Court exercises its power granted by §736.04113 to judicially modify that Trust because circumstances not anticipated by the settlor cause compliance with the terms of the Trust to defeat or substantially impair a material purpose of the Trust and accordingly the Court terminates the Trust as specifically authorized by §736.04113(2)(b) in accordance with the terms and conditions in paragraph 4 of the Agreement.

4. The Court notes that pursuant to paragraph 14 of the Agreement, the Order of approval shall state that it is contingent only on issuance of a satisfactory Private Letter Ruling and accordingly this Order is contingent in that respect. In addition, as provided in paragraph 14 of the agreement, the Court reserves jurisdiction to enter a Final Judgment after receipt of the Private Letter Ruling or alternatively to return this cause to the status quo ante as provided in paragraph 4b of the Agreement.

4A. THE REPORTS OF THE GAL'S ARE INCORPORATED  
5. The Court reserves jurisdiction over the parties and subject matter for enforcement <sup>(HLM)</sup> HEREIN  
of this Order. BY REFERENCE. THE GAL ←

DONE AND ORDERED in [REDACTED], Florida this [REDACTED]  
AND [REDACTED]  
day of [REDACTED] 2007. ARE [REDACTED]

[REDACTED]  
[REDACTED]  
CIRCUIT COURT JUDGE

Copies furnished to:  
All counsel on attached service list.

[REDACTED]

IN THE CIRCUIT COURT OF THE  
[REDACTED] JUDICIAL CIRCUIT IN AND  
FOR [REDACTED], FLORIDA

IN RE [REDACTED] TRUST  
dtd. [REDACTED]

PROBATE DIVISION

[REDACTED]  
Plaintiff,

CASE NO. [REDACTED]

vs.

[REDACTED],  
and [REDACTED], as Trustees of the  
Trust for the Benefit of [REDACTED] (the  
"Marital Trust") under the Trust Agreement  
dated [REDACTED] created by [REDACTED]  
[REDACTED]; and  
[REDACTED]

MEDIATION SETTLEMENT AGREEMENT

The Parties to the above-styled litigation, [REDACTED]; [REDACTED]  
individually and as Trustee of the Marital Trust created by [REDACTED] under agreement  
dated [REDACTED] ("Marital Trust") (and incorporated by reference, as applicable); [REDACTED]  
[REDACTED], individually and as Trustee of the Marital Trust; [REDACTED],  
individually and as Trustee of the Marital Trust; [REDACTED]; [REDACTED]  
[REDACTED]; and [REDACTED], and additional interested parties, [REDACTED]  
[REDACTED]; and [REDACTED]  
and [REDACTED] Trust Company, as Co-Trustees of the [REDACTED] Trust as set

In re [REDACTED] Trust  
Case No. [REDACTED]

forth in Revocable Trust Agreement created by [REDACTED] under agreement dated [REDACTED]  
[REDACTED] hereby having conducted a court ordered mediation on [REDACTED] at which certain  
agreements were reached, agree as follows:

1. Effective Date. The "Effective Date" as such term is used herein shall be the later  
to occur of the issuance of a satisfactory Private Letter Ruling pursuant to paragraph 4(b) hereof and  
issuance of an order from the [REDACTED] Probate Court granting approval of this Mediation  
Settlement Agreement pursuant to paragraph 14 hereof.

2. Division of the Marital Trust Pursuant to Fla. Stat. § 736.0417.

- a. All accrued and accumulated net income in the Marital Trust as of the  
Effective Date shall be distributed to [REDACTED] as soon as practicable on or after  
such Effective Date. If the Effective Date is prior to [REDACTED], 2008, [REDACTED]  
will continue to receive distribution of all net income on the Marital Trust  
through [REDACTED], 2007. If the Effective Date is on or after [REDACTED]  
2008, [REDACTED] will continue to receive distribution of all net income on the  
Marital Trust until the Effective Date, and all such net income received by  
[REDACTED] will be offset from her unitrust payment as provided below.
- b. Upon the Effective Date (or earlier, if deemed advisable by the Co-Trustees  
of the Marital Trust), the principal of the Marital Trust shall be divided and  
distributed, in kind, in five equal shares, to five trusts, having as  
remaindermen, respectively, [REDACTED] and [REDACTED]  
(hereinafter, the "Settlement Trusts"). To the extent assets cannot be

In re [REDACTED] Trust

Case No. [REDACTED]

conveniently divided in kind, assets valued at fair market value shall be allocated to the Settlement Trusts to provide that each shall have the same fair market value. Assets which would incur a capital gain upon sale shall be distributed in equal shares to the extent possible.

- c. [REDACTED] shall serve as sole Trustee of the Settlement Trust for [REDACTED] for purposes of making the payment described in paragraph 4 below.
- d. Upon the Effective Date as defined herein, [REDACTED] as Co-Trustee of the Marital Trust, will be discharged with no further duties. [REDACTED] shall be discharged as a Co-Trustee of the Marital Trust upon termination and distribution of [REDACTED] Settlement Trust as provided in paragraph (4)(c) hereof, and shall thereafter have no further duties as a Co-Trustee.

3. The Settlement Trusts for [REDACTED]

- a. [REDACTED], Esq. has been appointed guardian ad litem for the minor and unborn children of [REDACTED] to represent the interests of such minors and unborns in the litigation. In connection with this Mediation Settlement Agreement, Mr. [REDACTED] shall not represent [REDACTED] children who shall be represented by a separate guardian ad litem. The fees and costs payable to such guardians ad litem, and any other costs incurred by or on behalf of such guardian ad litem, shall be paid from the Marital Trust and shall be allocated equally to all five Settlement Trusts to be created therefrom. Any other expenses, payments or costs required as a condition of

[REDACTED] Trust  
Case No. [REDACTED]

obtaining the approval of Mr. [REDACTED] as guardian ad litem, of this Agreement, shall be paid from the Marital Trust and set off, in full, from the amount to be distributed to each of the four Settlement Trusts for [REDACTED], [REDACTED], [REDACTED] and [REDACTED] only. For the guardian ad litem to be appointed for [REDACTED]'s minor and unborn issue in connection with [REDACTED]'s Settlement Trust, the provisions of paragraph 4 hereof shall apply.

b. Upon the Effective Date hereof, the four Settlement Trusts created pursuant to paragraph 2 above, for [REDACTED], shall be held in further trust as follows:

i. Each of these four Settlement Trusts shall be held and administered pursuant to the provisions of Article II(B)(1) of the [REDACTED]'s Revocable Trust under agreement dated [REDACTED], 1983 (see Exhibit A), except as modified by this paragraph 3. Pursuant to the terms of the Marital Trust, there is no right of invasion of principal of the four Settlement Trusts, discretionary or otherwise, by [REDACTED], [REDACTED], [REDACTED] or [REDACTED].

ii. Commencing as of [REDACTED], 2008, each of these four Settlement Trusts shall be converted to a 4% unitrust pursuant to Florida Statute, §738.1041, with the unitrust amount payable to [REDACTED] in monthly installments. To the extent there are any capital gains realized by the sale of assets held in the Settlement Trusts, such capital gains shall

In re [REDACTED] Trust

Case No. [REDACTED]

not be part of the Distributable Net Income ("DNI") carried out in connection with the unitrust payments made to [REDACTED].

iii. Each of [REDACTED], [REDACTED], [REDACTED] and [REDACTED] shall serve as a Co-Trustee of his or her respective Settlement Trust, along with a corporate Co-Trustee to be selected by [REDACTED] with the approval of each of [REDACTED], [REDACTED], [REDACTED] and [REDACTED], respectively, which approval shall not be unreasonably withheld.

iv. Each of [REDACTED], [REDACTED], [REDACTED] and [REDACTED] as Co-Trustee of his or her respective Settlement Trust, will be entitled to reasonable annual compensation as a Trustee thereof in an amount not to exceed 2% of the fair market value of such individual's separate Settlement Trust, computed on the value of such Trust on December 31<sup>st</sup> of the prior year, to be paid in quarterly installments from the principal thereof.

[REDACTED], [REDACTED], [REDACTED] and [REDACTED] shall be fully responsible for any tax liability whatsoever, including interest and penalties, incurred in connection with the payment of compensation to him or her. Additionally, each agrees to repay to his or her respective Settlement Trust any amount of trustee's compensation paid to him or her which is determined to have been in excess of reasonable compensation which does, will, or may incur any type of tax liability other than income tax.

In re [REDACTED] Trust  
Case No. [REDACTED]

- v. The corporate Co-Trustee of each Settlement Trust shall be entitled to reasonable compensation or such compensation agreed upon among [REDACTED], the corporate Co-Trustee of the Settlement Trust, and the individual Co-Trustee of such Settlement Trust.
- vi. Upon [REDACTED]'s death, the assets of each of [REDACTED], [REDACTED] and [REDACTED]'s Settlement Trust will be paid to that individual's Children's Trust and distributed as provided in [REDACTED]'s Revocable Trust under agreement dated [REDACTED], 1983.
- c. [REDACTED] agrees that she shall have no claim or cause of action against the Co-Trustees of any of the Settlement Trusts for [REDACTED], [REDACTED] and [REDACTED] for acting in such fiduciary capacity, except to the extent that the claim is based on a breach of trust committed in bad faith or with reckless indifference to the purposes of the Settlement Trust or [REDACTED]'s interests as income beneficiary.
- d. In the event that the Settlement Trust for [REDACTED] is terminated for any reason prior to [REDACTED]'s death, [REDACTED] hereby agrees to execute a new trust, to be administered by her and a corporate fiduciary of her choosing as co-trustees, with a unitrust payment to [REDACTED] of 5% annually, and to pay the full amount distributed to [REDACTED] net of all tax liabilities, interest and penalties, to such trust ("[REDACTED]'s Contingency Trust"). If [REDACTED] survives [REDACTED]'s Contingency Trust shall terminate at [REDACTED]'s death, and all assets thereof

In re [REDACTED], Trust  
Case No. [REDACTED]

distributed to [REDACTED], outright. If [REDACTED] predeceases [REDACTED]'s Contingency Trust shall continue for [REDACTED]'s lifetime, with all income thereon accumulating in such Trust, and on [REDACTED]'s death, all assets of [REDACTED]'s Contingency Trust (including accumulated income) shall be paid in equal shares to [REDACTED] and [REDACTED]'s respective Children's Trusts.

4. [REDACTED]'s Settlement Trust.

- a. A guardian ad litem will be appointed immediately upon execution of this agreement by all parties for [REDACTED]'s minor and unborn children, to represent the interests of such minors and unborns in connection with this Mediation Settlement Agreement. The fees and costs payable to such guardian ad litem, and any other costs incurred by or on behalf of such guardian ad litem, shall be paid from the Marital Trust and shall be allocated equally to all five Settlement Trusts to be created therefrom. Any other expenses, payments or costs required as a condition of obtaining the guardian ad litem's approval of this Agreement shall be paid from the Marital Trust and set off, in full, from the amount to be distributed to [REDACTED]'s Settlement Trust only.
- b. The parties agree that the Co-Trustees shall apply for a **Private Letter Ruling** from the Internal Revenue Service immediately on full execution of this Agreement concerning the transfer tax implications of distribution of [REDACTED]'s Settlement Trust, i.e., the **Private Letter Ruling** will be deemed satisfactory if it concludes that the termination and distribution of [REDACTED]'s Settlement Trust

In re [REDACTED], Trust  
Case No. [REDACTED]

(per the terms of this Agreement) will not trigger the provisions of IRC § 2519 so as to cause gift tax liability to any of the other Settlement Trusts.

All expenses and attorneys' fees incurred in obtaining such Private Letter Ruling shall be paid from the Marital Trust and shall be allocated to all five Settlement Trusts to be created therefrom. If the Private Letter Ruling concludes that the termination and distribution of [REDACTED]'s Settlement Trust (per the terms of this Agreement) will trigger the provisions of IRC § 2519 so as to cause gift tax liability to any of the other Settlement Trusts, then this Mediation Settlement Agreement is void *ab initio* and the parties shall return to the status quo ante and resume litigation unless, within thirty days of the issuance of the Private Letter Ruling, [REDACTED] with the written consent of [REDACTED], [REDACTED], [REDACTED], and [REDACTED], elects to proceed with this settlement, in which case this Mediation Settlement Agreement will remain fully binding on all parties.

c. Within ten days from the Effective Date, [REDACTED]'s Settlement Trust shall be terminated pursuant to Florida Statute § 736.04113, because, *inter alia*, compliance with the trust terms will defeat or substantially impair a material purpose of the trust, *i.e.* preservation and transfer of wealth, on the following terms and conditions:

- i. an amount of the corpus of [REDACTED]'s Settlement Trust shall be calculated based on the actuarial value of [REDACTED]'s income interest in such Trust

In re [REDACTED], Trust  
Case No. [REDACTED]

(based on her age on her birthday nearest to the Effective Date), pursuant to Treas. Reg. § 25.2512-5(d)(2)(iii), Table S in Treas. Reg. § 20.2031-7(d)(7), utilizing the rate pursuant to IRC § 7520 on the Effective Date, and such amount shall be distributed to [REDACTED] in full and final satisfaction of her life estate and all interests in [REDACTED]'s Settlement Trust. In satisfying this distribution to [REDACTED], the cash, stocks and bonds held in [REDACTED]'s Settlement Trust shall be distributed pro-rata to [REDACTED] valued as of the date of distribution.

- ii. [REDACTED] and [REDACTED]'s attorneys shall calculate the total transfer tax liability incurred as a result of termination and distributions under this paragraph 4 of [REDACTED]'s Settlement Trust. This amount, plus additional amounts for interest and penalties, shall be deducted from the distribution to be made to [REDACTED] and will be held in escrow pursuant to an escrow agreement to be executed concurrently herewith.
- iii. All transfer or gift tax liability as a result of the termination and distribution of [REDACTED]'s Settlement Trust, including any interest and penalties, shall be paid from the amount held in escrow. If such escrow amount is insufficient, [REDACTED] shall be personally and solely responsible for any such remaining tax liability paid or payable as a result of termination of [REDACTED]'s Settlement Trust, and [REDACTED] indemnifies and holds harmless [REDACTED] from all such tax liability, including interest

In re [REDACTED], Trust

Case No. [REDACTED]

and penalties.

- iv. The remainder of [REDACTED]'s Settlement Trust shall be distributed to [REDACTED] in full and final satisfaction of his interests in the Marital Trust, including any interest in the Settlement Trusts and Children's Trusts held for the benefit of [REDACTED], [REDACTED], [REDACTED] and [REDACTED]
- v. In furtherance of the foregoing sub-paragraphs, [REDACTED] will exercise her right of recovery under IRC Section 2207A to have the gift tax attributable to the transfer under IRC Section 2519 paid by the person receiving the property as defined in Treas. Reg. Section 25.2207A-1(d), i.e., [REDACTED]. [REDACTED] agrees to pay any and all gift or transfer tax attributable to [REDACTED] releasing her interest in the sub-trust under IRC Section 2511. Accordingly, [REDACTED] or his agents will prepare the proposed IRS Form 709 and will submit such form to [REDACTED] for signature. [REDACTED] is fully responsible for defending a tax audit, if any, of the Form 709 and attendant tax payment, and [REDACTED] is fully and individually responsible for any and all penalties and interest assessed by the IRS, as well as all professional and other expenses associated with such audit, and hereby indemnifies and holds harmless [REDACTED], [REDACTED]' agents, attorneys, accountants, heirs, fiduciaries and assigns in this regard.

5. [REDACTED]'s Role After Execution of this Agreement. After execution of this

In re [REDACTED], Trust  
Case No. [REDACTED]

Agreement by all parties, [REDACTED] shall continue as the Corporate Co-Trustee of the Marital Trust for administration and investment purposes but shall have no involvement in connection with effecting the terms hereof (other than division and distribution of assets), including but not limited to preparing or approving submissions to the IRS for any **Private Letter Ruling** or negotiating with guardians ad litem and, commensurate with such limitation on [REDACTED]'s role as Co-Trustee, [REDACTED] will have no liability with respect to such issues and activities. [REDACTED] shall continue to act as a Co-Trustee (as limited herein) until a successor corporate trustee has accepted its appointment as such.

6. Trustees' Compensation. The Co-Trustees of the Marital Trust shall receive regular trustee's compensation, pro rata, through the Effective Date hereof. None of the Co-Trustees of the Marital Trust shall receive any terminating commissions, paying out commissions, or extraordinary compensation in connection with effecting the terms of this Mediation Settlement Agreement.

7. Additional Consideration.

- a. In consideration for [REDACTED] dismissing his claims against each of the Co-Trustees of the Marital Trust and releasing them from all liability for their administration of the Marital Trust through the Effective Date hereof, within five days of the Effective Date, [REDACTED] shall pay to [REDACTED] the sum of \$ [REDACTED] ([REDACTED] dollars), and [REDACTED] shall pay to [REDACTED] the sum of \$ [REDACTED] ([REDACTED] dollars), for a total combined payment to [REDACTED] from [REDACTED] and [REDACTED] of \$ [REDACTED]

In re [REDACTED] Trust  
Case No. [REDACTED]

[REDACTED] (dollars), with such payments to be made in U.S. dollars by wire transfer or by checks. The Parties agree that such payments to [REDACTED] are made for the purposes of settlement of claims and lawsuits against the Co-Trustees, for full and adequate consideration. In the event that there is any tax liability whatsoever incurred as a result of the payments to [REDACTED] provided herein, [REDACTED] shall bear sole responsibility for any and all such tax liability that is assessed, including interest and penalties and hereby indemnifies and holds harmless [REDACTED] and [REDACTED], their agents, attorneys, accountants, heirs, fiduciaries and assigns in this regard.

- b. In consideration for [REDACTED], [REDACTED] and [REDACTED] waiving all claims and potential claims against the Co-Trustees of the Marital Trust and releasing them from all liability for their administration of the Marital Trust through the Effective Date hereof, within five days of the Effective Date, [REDACTED] shall pay to each of the Settlement Trusts for [REDACTED], [REDACTED], and [REDACTED], the sum of \$ [REDACTED] ([REDACTED] dollars). The parties agree that such payments to the Settlement Trusts for [REDACTED], [REDACTED] and [REDACTED] are restoration of principal made for the purposes of settlement of claims and lawsuits against the Co-Trustees, for full and adequate consideration. In the event that there is any tax liability whatsoever incurred as a result of the payments to the Settlement Trusts for [REDACTED], [REDACTED] and [REDACTED] provided herein, each such Settlement

In re [REDACTED] Trust  
Case No. [REDACTED]

Trust shall bear responsibility for any and all such tax liability that is assessed, plus interest and penalties, and hereby indemnifies and holds harmless [REDACTED], [REDACTED] and [REDACTED], their agents, attorneys, accountants, heirs, fiduciaries and assigns in this regard.

- c. As additional consideration for the dismissals of [REDACTED]'s claims and their mutual releases, within ten days of the Effective Date, [REDACTED] agrees to pay [REDACTED] an amount equal to (i) the actuarial value of [REDACTED]'s income interest in [REDACTED]'s Settlement Trust as calculated pursuant to paragraph 4(c)(i), minus (ii) [REDACTED]% of the value of [REDACTED]'s Settlement Trust on the date of termination, and [REDACTED] agrees to pay [REDACTED] the sum of \$[REDACTED]. The Parties agree that such payments are made for the purposes of settlement of claims and lawsuits, for full and adequate consideration. In the event that there is any tax liability whatsoever incurred as a result of the payments provided herein, the recipient of such payment shall bear sole responsibility for any and all such tax liability that is assessed, including interest and penalties, and the recipient hereby indemnifies and holds harmless the payor, his/her agents, attorneys, accountants, heirs, fiduciaries and assigns in this regard.

8. Attorneys' Fees.

- a. The parties ratify and consent to the retention by each of the Co-Trustees of their own counsel in connection with the proceedings concerning the Marital Trust. All attorneys' fees and costs (including fees paid or payable to any

In re [REDACTED] Trust  
Case No. [REDACTED]

expert consultants or witnesses) incurred by the Co-Trustees from [REDACTED] 2007 and thereafter will be allocated to and/or paid from the four Settlement Trusts for [REDACTED], [REDACTED], [REDACTED] and [REDACTED] in equal shares, unless this Mediation Settlement Agreement is deemed void, in which case such payments shall be paid from or allocated to the Marital Trust in its entirety. Subject to such allocation, the parties consent to immediate payment of all outstanding attorneys' fees and costs incurred by the Co-Trustees from the Marital Trust and prompt payment of all ongoing attorneys' fees and costs incurred by the Co-Trustees through the date on which each of the Co-Trustee's resignation is effective.

- b. Because of the benefits each of these parties have conferred upon the Marital Trust in this proceeding, all attorneys' fees and costs (including fees paid or payable to any expert consultants or witnesses) up to the amount of \$ [REDACTED] incurred by each of [REDACTED], [REDACTED], [REDACTED] and [REDACTED] in connection with the proceedings in [REDACTED] and [REDACTED] concerning the Marital Trust, whether such legal fees, costs and expenses are outstanding or previously paid personally by any of the parties, shall be paid from the Marital Trust and allocated in equal shares to the four Settlement Trusts for [REDACTED], [REDACTED], [REDACTED] and [REDACTED] within five days of the Effective Date. Any legal fees and costs incurred by [REDACTED], [REDACTED], [REDACTED] and [REDACTED], or any of them, in excess of \$ [REDACTED] shall be paid from that individual's Settlement Trust only.

In re [REDACTED] Trust  
Case No. [REDACTED]

c. [REDACTED]'s attorneys fees and costs (including fees paid or payable to any expert consultants or witnesses) shall be [REDACTED]'s sole and individual responsibility.

9. Acceptance of Accounting. On the Effective Date, the parties consent to the entry of a decree by the Surrogate's Court of [REDACTED] County settling the interim account of proceedings of the Co-Trustees of the Marital Trust through this date subject to and in accordance with the terms of this Agreement, consent to and approve all transactions and payments as reflected herein, and release and forever discharge the Co-Trustees from any and all liability or claims in connection with matters disclosed or reasonably ascertainable from the Co-Trustees' accounting. The Co-Trustees shall prepare and file a supplemental accounting of the Marital Trust for the period of [REDACTED] 2007 through the Effective Date. The parties also consent to and approve all transactions and payments undertaken by the Co-Trustees in the ordinary course of administration for the period of [REDACTED], 2007 through the Effective Date as reflected in such supplemental accounting, and release and forever discharge the Co-Trustees from any and all liability or claims in connection with all such matters.

10. [REDACTED]' Representation as to Health. [REDACTED] represents that she is in good health and has not been diagnosed with any life-threatening or shortening disease or condition which would cause her to live less than her normal life expectancy.

11. The Florida Marital Trust Case. On the Effective Date, [REDACTED] and [REDACTED] shall dismiss the Florida action concerning the Marital Trust (captioned above), with prejudice.

In re [REDACTED], Trust  
Case No. [REDACTED]

12. The [REDACTED] Marital Trust Case. On the Effective Date, all parties will dismiss their claims concerning the Marital Trust now pending in the [REDACTED] County Surrogate's Court, File No. [REDACTED] (the [REDACTED] Case"), with prejudice.

13. The Promissory Note Case. The litigation proceeding between [REDACTED], as Plaintiff, and [REDACTED], as Defendant, pending in the Circuit Court, Civil Division, of [REDACTED] County, Case No. [REDACTED] (the "Promissory Note Case"), is intentionally excluded from this Agreement, and any and all claims and defenses which have been asserted in the Promissory Note Case as of the Effective Date are expressly reserved, notwithstanding any release of liability contained herein.

14. Court Approval. This Mediation Settlement Agreement shall be effective only upon court approval. The Agreement shall be submitted for court approval after the guardians ad litem have submitted their reports. The order of approval shall state that it is contingent only on issuance of the satisfactory Private Letter Ruling. For purposes of this settlement only, and without prejudice, all parties to this Agreement concede to and bestow upon the court hearing the Marital Trust Case all jurisdiction and authority necessary to hear and rule upon the effectiveness of this Agreement. All parties to this Agreement shall join in an application to that court to approve this Agreement. The court will receive jurisdiction over the parties and subject matter to enforce the Agreement.

15. No Admission of Liability. This Mediation Settlement Agreement provides for a settlement of claims among the parties and is not an admission of liability, culpability, wrongdoing, negligence, or breach of duty by [REDACTED], by [REDACTED], or by [REDACTED].

In re [REDACTED], Trust

Case No. [REDACTED]

16. Confidentiality. The parties hereby executing this Mediation Settlement Agreement agree to keep the terms hereof confidential and agree not to disclose any of the terms hereof to any other person or entity except as necessary to effect the Agreement or as required by law.

17. General Releases. Within five days of the Effective Date, all parties hereby will execute and exchange General Releases of all other parties of all claims that were raised or could have been raised as of the Effective Date hereof, except for claims and defenses in the Promissory Note Case, as set forth in paragraph 13 above.

18. Amendments. The provisions of this Agreement may not be amended, supplemented, waived or changed orally, but only by a writing signed by the party as to whom enforcement of any such amendment, supplement, waiver or modification is sought and making specific reference to this Agreement.

19. Binding Effect. All of the terms and provisions of this Agreement shall be binding upon, inure to the benefit of, and be enforceable by the parties and their respective administrators, executors, legal representatives, heirs, successors and permitted assigns, whether so expressed or not, upon approval of this Mediation Settlement Agreement by the Probate Court of [REDACTED] County by duly entered order. If such court approval is not obtained within four (4) months from the date the last person or entity to execute this Agreement so signs, it shall be entirely null and void.

20. Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which taken together shall constitute one and the same instrument. Confirmation of execution by electronic transmission of a facsimile signature page or by e-mail shall be binding upon any party so confirming.

In re [REDACTED] Trust  
Case No. [REDACTED]

21. Enforcement Costs. If any civil action, arbitration or other legal proceeding is brought (1) for the enforcement of this Agreement, (2) or because of an alleged dispute, breach, default or misrepresentation in connection with any provision of this Agreement, (3) or in connection with relating to, or arising under this Agreement, the successful or prevailing party or parties shall be entitled to recover reasonable attorneys' fees, sales and use taxes, court costs and all expenses even if not taxable as court costs (including, without limitation, all such fees, taxes, costs and expenses incident to arbitration, appellate, bankruptcy and post-judgment proceedings), incurred in that civil action, arbitration or legal proceeding, in addition to any other relief to which such party or parties may be entitled. Attorneys' fees shall include, without limitation, paralegal fees, investigative fees, administrative costs, sales and use taxes and all other charges billed by the attorney to the prevailing party, which shall be defined as the party obtaining a final judgment, decision or order from a court of competent jurisdiction, or the party obtaining the relief sought by it, whether by withdrawal, dismissal, summary judgment, or other disposition.

22. Entire Agreement. This Agreement and all exhibits and schedules attached to this Agreement, if any, represent the entire understanding and agreement between the parties with respect to the subject matter of this Agreement, and supersedes all other negotiations, understandings and representations (if any) made by and between such parties.

23. Governing Law. This Agreement and all transactions contemplated by this Agreement shall be governed by, and construed and enforced in accordance with, the laws of the State of Florida, but the fact that the governing law of this Agreement is Florida shall have no bearing upon the issue of the governing law of the Marital Trust or any issue which was or could be

In re [REDACTED], Trust  
Case No. [REDACTED]

raised in either of the pending proceedings concerning the Marital Trust in [REDACTED] or [REDACTED].

The parties agree that, in the event that court approval hereof is not obtained or this settlement is not consummated for any reason, the parties shall be precluded from referencing or raising this choice of applicable law provision in any manner in the pending proceedings.

24. Headings. The headings contained in this Agreement are for convenience of reference only, are not to be considered a part of the Agreement and shall not limit or otherwise affect in any way the meaning or interpretation of this Agreement.

25. Jurisdiction and Venue. The parties acknowledge that a substantial portion of the negotiations, anticipated performance and execution of this Agreement occurred in [REDACTED] County, Florida. Any civil action or legal proceeding arising out of or relating to this Agreement shall be brought in the state court of record of the State of Florida in [REDACTED] County. Each party consents to the jurisdiction of such court in any such civil action or legal proceeding and waives any objection to the laying of venue of any such civil action or legal proceeding in such court. Service of any court paper may be effective on such party by mail, as provided in this Agreement, or in such other manner as may be provided under applicable laws, rules of procedure or local rules.

26. Additional Documents and Actions. All parties shall cooperate fully and execute any and all supplementary documents and to take all additional actions which may be necessary or appropriate to give full force and effect to the basic terms and intent of this Agreement.

27. No Construction Against Draftspersons. The parties acknowledge that this is a negotiated agreement, and that in no event shall the terms of this Agreement be construed against

In re [REDACTED] Trust

Case No. [REDACTED]

any party on the basis that such party, or his, her or its counsel, drafted this Agreement.

[REDACTED], Individually and as Co-Trustee of the  
Trust for the benefit of [REDACTED] created by  
[REDACTED], under agreement dated  
[REDACTED]

[REDACTED]  
[REDACTED], Individually and as Trustee

[REDACTED] Individually and as Trustee

[REDACTED], Individually and as Trustee

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]