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Newsletter

Estate Planning in Turbulent Times: The Good, The Bad, and The Ugly

We see the same headlines every day: the financial markets are collapsing, the real estate bubble has burst, and thousands are losing their jobs. Our clients—even our higher net-worth clients—are scared, and the last thing they want to do is come talk to us about their estate planning. Who, after all, needs an estate planner when the federal estate tax exemption has increased to $3.5 million and investments of all types have suffered double-digit declines? Despite the downturn, we can't ignore the very real effect that the current economic situation imposes on our clients. What follows are some of the good, the bad, and the ugly effects of the economic downturn on our practices.

The Good

For those clients who still have taxable estates, the current economic climate provides some excellent tax-planning opportunities. Consider the following:

Gifts of Depreciated Stock. Usually, we're reluctant to advise our clients to make in-kind gifts of stock due to the adverse income consequences associated with such gifts. In today's market, however, it is not unusual for a client's portfolio to be composed mostly of depreciated stock. Consider advising clients to make in-kind gifts of depreciated stock to younger generations. For donees of depreciated stock, gains are calculated based on the donor's original basis, while losses are only allowed to the extent that the loss occurred after the donee acquired the asset. So if Grandma bought her Google stock at $500 per share and it's now worth $350 per share, gifting the stock to her grandchildren means that the grandchildren won't recognize any gain unless the stock is sold above $500 per share. If, however, a grandchild sells the stock at $340, the grandchild's loss is only $10 per share. Obviously Grandma could sell the stock now, take the losses herself, and then gift the cash to her grandchildren, but gifting the stock gives the grandchildren a chance to earn more in the long run and encourages them to hold on to long-term investments.

Qualified Personal Residence Trusts. The depressed real estate market means that more property can be given away with fewer gift tax implications than just a few years ago. Combined with lower interest rates under IRC § 7520, transferring real property to a qualified personal residence trust (QPRT) in today's market is extremely attractive. A QPRT is an irrevocable trust to which a grantor transfers ownership of his or her residence or vacation home for a term of years. During the term of the trust, the grantor retains the right to use the property; after the term expires, the property is distributed to the named beneficiaries. The original transfer to the trust is a taxable gift to the named beneficiaries, but the gift amount is discounted based on the interest rate under IRC § 7520 (which for March 2009 was only 2.4%) and mortality tables. With interest rates at all-time lows and property values in decline, any property transferred to a QPRT today can be gifted on an extremely discounted basis.

Intentionally Defective Grantor Trusts. A sale to an intentionally defective grantor trust (IDGT) is an estate-freezing strategy that works particularly well in today's environment. The basics of such a transaction are: (1) your client creates an irrevocable trust that is "defective" for income tax purposes and (2) the client sells an asset that she expects to appreciate to the defective trust and in exchange receives a promissory note for

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the value of the transferred asset. Because the IDGT is defective, no gain is recognized on the sale for income tax purposes, but the asset has been removed from the client's estate for estate tax purposes, thereby "freezing" the asset at today's value.

IDGTs are always an effective tool for our higher net-worth clients, but they are especially attractive in today's market. First, the depressed market has significantly decreased the value of assets that are good candidates to sell to IDGTs (income-producing real property and closely held business interests). Second, the interest rate for the note is based on the applicable federal rate (AFR), which is hovering around historical lows. Finally, for an added bonus, consider adding a self-cancelling installment feature to the note so that, in the event the client dies before the note is paid in full, any balance owing on the note is not included in the client's estate.

Charitable Lead Annuity Trusts. For our clients with charitable intentions, a charitable lead annuity trust (CLAT) is another device that works particularly well in a low interest rate environment. A CLAT is a planning strategy whereby a charity or charities are paid a fixed amount every year from a trust for a period of years or for life, with the remainder to be distributed to children or other named beneficiaries at the end of the term. Because the annual payout is based in part on the AFR, a CLAT can be set up today with relatively small annual distributions required, resulting in more assets available for distribution to the client's noncharitable beneficiaries.

The Bad

Value of Specific Bequests. Many of us have drafted estate plans that use specific bequests to equalize distributions among a client's intended beneficiaries. For example, if Daughter has been an integral part of a family business and Son has no involvement, we may have drafted a plan that gave the business to Daughter and perhaps the family vacation home to Son to equalize distributions between the children. In today's market, the family business (or the vacation home for that matter) may be worth much less than originally expected. These plans should be reexamined in light of drastic changes in asset values so that equality can be maintained.

Support of Surviving Spouse. Some estate plans provide that some (or all) of the client's exemption amount is to be distributed to nonspousal beneficiaries on the death of the first spouse. This plan may have been crafted at a time when, even after the bequest to nonspousal beneficiaries, the estate was anticipated to be large enough to adequately support the surviving spouse. These plans should be reevaluated with the client. Planners should consider using disclaimers to make the plan more flexible.

Prenuptial Agreements. Prenuptial agreements should be reviewed in light of declining asset values. Has the client's financial situation changed so dramatically that the prenuptial is no longer effective or even justified? Have one spouse's assets declined significantly while the other's have remained relatively unchanged? When drafting future prenuptial agreements, consider building flexibility into the agreement by using formulas (*e.g.,* a lump-sum settlement equal to the lesser of $1 million or 25% of the client's net worth) or by making asset division contingent on the value or status of assets at a future date.

Advising Fiduciaries. In this market, and with the recent attention on the Uniform Prudent Management of Institutional Funds Act, the actions of fiduciaries will be even more closely scrutinized by beneficiaries. In light of this, consider the following:

> *Trust Protectors.* The appointment of a trust protector can provide increased flexibility by allowing the trust instrument to address almost every conceivable future circumstance. For this reason, the use of a trust protector is increasingly popular. Some powers commonly vested in a trust protector are (1) remove, add, and replace trustees; (2) eliminate or alter trust distributions; (3) control investment decisions; (4) amend the trust with respect to administrative provisions; and (5) terminate the trust. Although utilizing a trust protector may be considered somewhat of an administrative burden for the trustee, the peace of mind it creates for our clients may outweigh the negative effects to the trustee.
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> *Investment Committees.* An investment committee's overall purpose is to work with the fiduciary to coordinate and oversee the client's investment portfolio. The committee will help the fiduciary determine the client's desired financial objectives and appropriate investment risk level. The committee is also responsible for monitoring investment performances. Having such an organization not only helps alleviate client concerns, but also creates peace of mind for the fiduciary and beneficiaries.

The Ugly

Generally, estate taxes must be paid in a lump sum within nine months of a decedent's date of death. However, IRC § 6166 provides that payment of estate taxes may be made over a 14-year period provided that at least 35% of the decedent's adjusted gross estate was composed of closely held business interests. The primary benefit of § 6166 is obvious: it reduces the need for immediate liquidity, which in turn reduces the potential for fire sales. With declining values of closely held businesses, however, some clients who may have qualified under § 6166 a few years ago may no longer be eligible. If liquidity is an issue, consider additional life insurance or an aggressive gifting program.

There are two kinds of people in this world: those who run from tough situations and those who take advantage of them. In these tough economic times, we have an opportunity to assist our clients by first pointing out the good, the bad, and the ugly, and then making each work best to our client's advantage.

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Estate Tax Audits: How to Avoid Them and Suggestions to Resolve Them Efficiently

Although practitioners are rarely confronted with a federal estate tax audit, they should be cognizant of the factors that trigger an audit, understand the procedures once an audit commences, and properly determine when an Internal Revenue Service ("IRS") appeal should be recommended.

Factors That Increase Audit Risk

To minimize audit selection risk, it is crucial to understand the IRS's selection process. The only published guidance of which this author is aware is the *Examination Technique Handbook for Estate Tax Examiners*, where the examiner is advised:

> "Look at the estate tax return as an integrated picture of the decedent, both before and at the time of death. Page through the return noting decedent's age, cause of death, occupation, financial interests, assets and the deductions claimed. Your job is not simply to inspect books and records to verify items reported in the return. An estate tax examiner must exercise a high degree of skill to determine if all assets are disclosed and the credibility of data submitted pertaining to valuation of assets."[1]

Based on the aforementioned quote and the author's experience, the following actions should be considered prior to filing an estate tax return (the "return"):

Incomplete or Inaccurate Answers. The return relies on several "catch-all" questions to capture a decedent's assets. If any such questions are left unanswered (or partially answered), that fact alone may result in an audit. Additionally, misreporting the value of publicly traded securities is another "red flag," as the "Cincinnati Service Center[2] classification units may verify the valuation of listed and over-the-counter securities as part of the estate and gift tax returns classification process."[3]

Missing Documents. A return without required attachments (*e.g.,* a living trust or an art appraisal) is grounds for automatic taxpayer contact.

Controversial or Technical Issues. The practitioner should be cautious when advising the executor to take an aggressive position currently under IRS scrutiny. For example, in response to the Supreme Court's decision in *Commissioner v. Estate of Hubert*,[4] the Treasury Department issued regulations under §§ 2055 and 2056 that limit the executor's ability to claim an income tax deduction for the administration expenses paid from income earned on assets allocable to the decedent's surviving spouse (or charity) without incurring estate tax on such income diverted from the spouse (or charity) to pay such expenses. An aggressive interpretation of such regulations has resulted in an audit.

Another IRS focal point concerns the overuse and potential abuse of family limited partnerships ("FLPs") and family limited liability companies ("FLLCs"). These entities are often used by inexperienced practitioners and their clients who fail to comprehend the ramifications of such an undertaking, which results in the IRS including the full FLP/FLLC value in the client's estate at its date-of-death value. Clients who undertake this strategy should be competent in business matters and be willing to follow the rules associated with business ownership. These entities should only be utilized by clients who knowingly consider the risks.

While on the topic of FLPs and FLLCs, the practitioner should be cognizant of the fact that any mention of the word "discount" on the client's return to explain an asset's valuation is a "red flag." According to the IRS, "discounted values demonstrate an intent to reduce the value of the gross estate and thus deserve special attention."[5]

Other sensitive audit-generating issues involve qualified terminal interest property trust provisions, application of the special use valuation rules, cash hoards, art valued over $20,000, discounted notes, foreign assets, fractional interests, and claims against the estate by its heirs.

Internal Inconsistencies. The internal inconsistencies that most often trigger an audit are:

- the decedent's will contains a specific bequest of personal items, but the return fails to include them;
- the decedent's will exercises a power of appointment, but the return does not reference such power of appointment;
- a real estate tax deduction is reflected on Schedule K, but no real estate asset appears on the return; or
- the return fails to disclose items typically associated with the decedent's occupation. For example, an accountant or attorney without accounts receivable, a salesman without deferred commissions due in the future, or a farmer without farm equipment or animals/crops is clearly a sign to the IRS that there may be omitted assets.

Returns Selected for Audit

A common complaint from practitioners involved in estate tax audits is the length of time that elapses from first contact to the audit's conclusion. While many are quick to blame the IRS examiner, he or she is not the cause. When a return is filed, it is received and processed by the Cincinnati Service Center where it is assigned a document locator number and is prepared for classification.[6] Typically, the return is reviewed within 30 days of filing to ascertain its audit potential. If not selected for examination, the return will be stamped "accepted as filed."

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While that appears to eliminate further decedent audit exposure, such belief is misplaced as "acceptance" does not mean the IRS has "accepted" the underlying fair market values listed on the return's asset schedule; such categorization means only that the decedent's return was not chosen for audit.

Returns selected for audit are forwarded to the IRS field office where the decedent was domiciled at death. Once assigned to an examiner, the examiner's first job is to contact the decedent's representative (usually by mail) to provide notice of the forthcoming estate tax audit. According to the *Internal Revenue Manual* ("*IRM*"), the initial letter should request supporting information for what was reported on the decedent's return, as well as all relevant legal authority for the positions taken.[7] In essence, the IRS wants the practitioner to prove-up the calculations that compose the decedent's gross estate.[8] If the practitioner was not involved in preparing the return that was filed, it may be useful to begin with a review of the decedent's (i) books and records; (ii) three years' worth of bank statements, canceled checks, brokerage account statements, and personal income tax returns; (iii) gift tax returns; (iv) financial records for the last three years of any partnership or closely held corporation; and (v) insurance policies.[9]

Closing the Estate Tax Audit by Agreement

Fortunately, most estate tax audits are settled at the examination level, which limits delays and minimizes client costs. Where the examiner and practitioner agree on proposed adjustments to the decedent's estate, and after the practitioner has independently verified the altered estate tax liability, the practitioner will be expected to execute a waiver on IRS Form 890,[10] which permits the IRS to immediately assess the estate tax deficiency.

However, the majority of these examinations reach a point where some, but not all, of the audit items are resolved. This is commonly referred to as a "partially agreed case." At this juncture, there are two paths available to the practitioner. Some practitioners perceive that more issues brought to IRS Appeals will increase the probability of a favorable settlement. If such approach is taken, the IRS will deem the audit "unagreed," and the examiner will solicit a formal statement of the estate's position on each issue prior to the examination's conclusion. The examiner will also explain the availability and mechanics of an administrative appeal, as well as the option to pay the assessed deficiency and file for a refund.[11] Alternatively, the practitioner can allow assessment on all agreed items, thereby limiting what is reviewed on appeal. Generally, resolving all uncontested items at the examination level shows a good-faith attempt to settle the audit, leaving only the most contested and pertinent issues for the appeal.

Estate Tax Audit Appeals

If the practitioner disagrees with the examiner's audit report, the practitioner can request a meeting with the examiner's manager. If all open items remain unresolved after such a meeting, the IRS will issue a 30-day letter. This letter provides the executor with the option of either agreeing with the examiner's proposed changes or requesting an Appeals conference. If the executor fails to respond within such 30-day period, a statutory notice of deficiency (commonly referred to as a "90-day letter") will be issued. This gives the executor 90 days from the date the notice is mailed to do one of three things: (1) The executor may file a Tax Court petition to protest the deficiency. If this is done, the client is not required to pay the tax assessed in the deficiency notice. However, interest will continue to accrue unless and until the client makes a § 6603 deposit, which will halt further interest accrual; (2) The executor can pay the deficiency and sue for a refund in district court or the U.S. Court of Federal Claims; or (3) If the client takes no action within this 90-day period, the client will have foregone any further administrative remedies. In such a case, the tax is immediately assessable.

If the executor requests an Appeals conference within this 30-day period, the appellate process is initiated by answering the 30-day letter by written protest. The protest should focus on explaining and supporting the client's rationale for the positions taken on the return. The stronger the support provided, the more settlement leverage is gained as the Appeals officer must consider the hazards of litigation when entertaining any settlement offer that follows the protest.

Estate Tax Closing Letter

If the audit is resolved at either the examination or Appeals level, the IRS will send an estate tax closing letter to the executor. This letter provides evidence that the estate's tax return has been accepted as filed or has been accepted after an adjustment. This letter ensures that the estate's federal tax liabilities have been satisfied, although it is not deemed a formal closing agreement pursuant to § 7121. Since the closing letter does not equate to a closing agreement, many practitioners are left to wonder under what circumstances a decedent's estate can be reopened by the IRS after issuing a closing letter.

The answer was provided in the Tax Court case of *Estate of Bommer v. Commissioner of Internal Revenue.*[12] Here, the decedent owned stock valued at $1.334 million on the federal estate tax return. The IRS conducted an examination and concluded it in 1992 by issuing a "no change" closing letter. In 1993, however, the IRS advised the estate's attorney that the examination was being reopened to avoid a "serious administrative omission." In 1994, an assessment was issued for $5.51 million as a result of the stock's revaluation.

The decedent's estate opted to sue in Tax Court, claiming that the IRS was prohibited from reopening the case because (i) Sixth Circuit law prohibited a reopening to take a "new view of old facts," (ii) the IRS abused its discretion when it disregarded its own limitations set forth in the closing letter, and (iii) the closing letter equated to a contract to which the IRS was bound. The Tax Court rejected all three arguments. First, the Tax Court said the cited Sixth Circuit law was incorrect as there was ample Sixth Circuit case law to support reopening an examination under such circumstances. Concerning the second argument, the Tax Court, citing Revenue Procedure 85-13,[13] stated that the IRS could reopen the case in order to avoid "a serious administrative omission." As to the third argument, the Tax Court dismissed it on the grounds that a closing letter is not equivalent to a contract, as it does not come within the purview of a closing agreement.

While an estate tax closing letter can be deemed a final determination of federal estate taxes in most circumstances, it is best for practitioners to familiarize themselves with Revenue Procedure 94-68,[14] which superseded and replaced Revenue Procedure 85-13, and to advise their clients of the closing letter's nonbinding nature.

Revenue Procedure 94-68 states that the IRS will not reopen a closed case to make an unfavorable adjustment to an estate unless (i) there is evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of material facts; (ii) the prior closing involved a clearly defined substantial error predicated on an established IRS position existing at the time of the previous examination; or (iii) other circumstances are present that indicate a failure to reopen the examination would be a serious administrative omission. It is this last point that offers the IRS significant "wiggle" room, particularly in light of the Tax Court's willingness to review the basis for the IRS's decision to reopen a case.

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Endnotes

1 *IRS Examination Technique Handbook for Estate Tax Examiners* § 332(1) (1980).
2 All estate tax returns are initially reviewed by the Cincinnati Service Center.
3 *Internal Revenue Manual* (hereinafter "*IRM*") 4.25.1.1.1.3 (Dec. 31, 2002).
4 520 US 93 (1997).
5 *IRS Examination Technique Handbook for Estate Tax Examiners* § 333(8).
6 *IRM* 4.25.1.1.1.1.
7 *IRM* 4.25.1.1.2.
8 Treas Reg § 20.2031-1.
9 If valuing art in excess of $20,000, the IRS has an Art Advisory Panel that will review the appraisal and request a color transparency of such artwork. The practitioner should prepare for such a request in advance.
10 Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment Estate, Gift and Generation-Skipping Transfer Tax.
11 *IRM* 4.25.1.1.7.
12 69 TCM (CCH) 2541 (1995).
13 1985-1 CB 514.
14 1994-2 CB 803.

Practice Tips in an Ever-Changing Market

Practice Tip #1: Choosing a formula clause in an ever-changing financial market is a difficult task for the cautious estate planning attorney. The selection of a formula impacts two aspects of estate taxes: (1) the income tax consequences of funding the trusts, and (2) which trust will share in the post-death/pre-funding asset appreciation or depreciation. With a pecuniary marital formula, the amount to be allocated to the marital trust is fixed as of the date of death (or alternate valuation, if used) and all post-death appreciation or depreciation accrues to, or comes from, the non-marital trust. With a pecuniary credit shelter formula, the amount to be allocated to the non-marital trust is fixed, and all post-death changes in value impact the marital trust. A fractional formula splits the risk by allocating post-death appreciation or depreciation proportionately between the marital and non-marital trusts. Thus, practitioners should consider using a fractional formula clause given that the markets are so volatile and the post-death values are a moving target. This will provide for more planning flexibility at the death of the first spouse when funding either the marital or non-marital trust.

Practice Tip #2: GST funding also becomes problematic in an uncertain exemption climate, particularly when funding a GST exempt trust where one spouse has died some years prior and now the practitioner is faced with funding the GST trust upon the death of the second spouse. With the increase in the GST exemption, formula allocations that are based on the maximum amount of GST exempt property available in many cases will no longer carry out the client's expectations. Thus, consider defining the second death allocations as the lesser of a designated percentage and the amount of GST exempt property, or cap the GST funding to 2008 exemption levels.

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How to Avoid Unintended Consequences of Estate Planning in Dissolution Court

Numerous issues arise when a client gifts assets to his or her child during life or at the client's death and that child's marriage ends in divorce. Even though your client may not have intended those assets to be shared with his or her child's ex-spouse, the issue is often left to a determination by the dissolution court. The dissolution court first determines if the asset was acquired during the marriage, which makes it a marital asset. If the property at issue was acquired before the marriage, then the court considers only what is just and proper under the circumstances in distributing that property.

As such, the asset is subject to the rebuttable presumption of ORS 107.105(1)(f) that each spouse contributed equally to the acquisition of the marital asset and, therefore, that each spouse is entitled to one-half of the marital asset upon the dissolution of their marriage. The presumption is rebuttable by evidence that the asset was acquired without any contributions by the other spouse.

When the marital asset is a gift, the rebutting spouse must prove, by a preponderance of the evidence, that (1) the nonrecipient spouse did not contribute to the inheritance, and (2) the nonrecipient spouse was not the object of the donor's donative intent. To satisfy the second prong of the test, the rebutting spouse must offer affirmative evidence that the nonrecipient spouse was not an object of the donor's donative intent.

However, even if the recipient spouse rebuts the presumption, the court can find that it is just and equitable to divide the asset between the parties if the parties have integrated the asset into their financial lives.

A line of recent Oregon Court of Appeals cases outlined below shows the problems encountered when clients gift assets to a married child during lifetime or at death and that child later dissolves his or her marriage.

In re Marriage of Olesberg, 206 Or App 496 (2006)

The Olesbergs had been married 27 years when they decided to dissolve their marriage. Shortly before they separated in 2001, the husband's mother died. The husband inherited $65,000 from his mother's estate. The estate's personal representative simply divided the estate equally between the decedent's three children: the husband, his sister, and his brother.

The dissolution judgment awarded the husband the full amount of his inheritance from his mother. The question on appeal was whether the trial court erred in failing to award the wife an equal share of the husband's inheritance from his mother. The court of appeals reversed the trial court and found that the wife should have received an equal share of the husband's inheritance from his mother. The court found that the inheritance was a marital asset because it was acquired during the marriage. The inheritance is subject to the rebuttable presumption of ORS 107.105(1)(f) that each spouse contributed equally to the acquisition of the marital asset and, therefore, that each spouse is entitled to one-half of the marital asset upon the dissolution of their marriage. The presumption is rebuttable by evidence that the asset was acquired "free of any contributions from the other spouse." *Kunze and Kunze*, 337 Or 122, 135 (2004). When the marital asset is a gift, one spouse may rebut the presumption by evidence that "the other spouse neither contributed to its acquisition nor was the object of the donative intent." *Tsukamaki and Tsukamaki*, 199 Or App 577, 583 (2005). In this case, the evidence necessary to rebut the presumption is that (1) the wife did not contribute to the inheritance, and (2) the wife was not the object of her mother-in-law's donative intent.

In this case, the wife did not contribute to the inheritance; the evidence shows that the inheritance was simply the result of an equal division of the mother's estate among her three children. Therefore, the husband met his evidentiary burden as to the first prong. To meet his burden on the second prong, the husband had to provide affirmative evidence that the wife was not an object of her mother-in-law's donative intent. The husband failed to meet this burden because he could provide no evidence that his mother did not intend for the wife to benefit from the inheritance.

In re Marriage of Gano-Ridge, 211 Or App 393 (2007)

Before the parties' marriage in 1995, the husband's mother made the husband a joint owner of some of her assets, including a Paine Webber investment account, as part of her estate plan. When the husband's mother died in 1996, he became the sole owner of the Paine Webber account. At trial, the wife asserted that the husband "inherited" the Paine Webber account during the marriage and, thus, it was a marital asset. Alternatively, she contended that the husband's use of funds from the Paine Webber account to pay the couple's living expenses converted the entire account into a marital asset.

The trial court held that the Paine Webber account was not a marital asset and, therefore, that the wife was not entitled to half of the value of that account upon dissolution of the marriage. The court of appeals affirmed the trial court's finding that the Paine Webber account was not a marital asset. The court agreed with the wife's assertion that any interest in the Paine Webber account acquired by the husband during the marriage (i.e., his deceased mother's half interest) was a marital asset. As such, the presumption of equal contribution applied, but the husband successfully rebutted the presumption with respect to the Paine Webber account. The evidence showed that (1) he was joint owner of the account before the marriage, and (2) upon his mother's death, without any further action on her part, he became the sole owner of that account.

Further, going to the wife's second contention, the evidence showed that the husband never intended to make the Paine Webber account a marital asset: (1) he never added the wife's name to the account, and (2) he placed his name only on titles to real property that he purchased with account funds.

In re Marriage of Gardner, 212 Or App 148 (2007)

The parties were married in 1993. In 1997, the wife's mother gifted to the wife $400,000 in the form of a check made out solely to the wife. The wife deposited the check into a bank account held in her name alone. For purposes of preparing her gift tax return for 1997, the wife's mother made handwritten notes indicating that she had made the gift to the wife only and that she did not name the husband as recipient. Subsequently, the wife used $371,935 of the proceeds of her mother's gift to purchase real property that became the couple's marital residence as well as the permanent residence of the wife's mother. The property was titled solely in the wife's name. Finally, while the wife's mother resided with the couple, the wife was her mother's constant caregiver.

From the time of acquisition of the property in 1998 until the marriage dissolution in 2005, the property's value appreciated by $70,816 due in part to work performed on the property by both the husband and wife during the marriage.

The trial court held that the husband was entitled to half of the appreciation in value of the property during the marriage but not to the cost of acquisition of the property or to any of the proceeds of the mother's gift to the wife. The court of appeals affirmed the trial court's finding that the husband was entitled only to half of the property's appreciation in value.

The wife successfully rebutted the presumption of equal contribution by meeting both prongs of the *Tsukamaki* test. The preponderance of the evidence showed that (1) the husband did not contribute to the receipt of the gift, and (2) the wife's mother's actions clearly demonstrated that only the wife was to be the recipient of the gift: the check was made out to the wife, the notes for the mother's gift tax return made it clear that she intended to make the gift solely to the wife, and it was understood that after receipt of the gift that the wife would become her mother's primary caretaker. The husband was properly excluded from receiving a share of the initial amount of the gift.

In re Marriage of Brown, 219 Or App 475 (2008)

The husband was the beneficiary of two trusts: the Brown-Moore Trust and the Brown Trust. The Brown-Moore Trust was created by the husband's grandmother and granted to the husband a monthly mandatory distribution of the trust's income. The Brown Trust was created by the husband's father and granted to the husband and his two sisters a monthly mandatory distribution of the trust's income until the youngest sibling reached age 55, at which time each of the three siblings would receive one-third of the trust corpus.

In 2002, the couple retired. The idea to retire was the husband's, as the wife enjoyed her job and was concerned about their financial ability to both (1) help their daughter fund her college education and (2) support their lifestyle in retirement (they were each only in their mid-50s). To convince the wife, the husband assured her that upon retiring, they would have sufficient income from various sources, in particular from his dispersals from the trusts. In fact, the trust income made up half of the income that the husband said the couple could rely on when they left their jobs and moved from Montana. At the time, the husband was receiving $1,000 per month from the Brown Trust and $430 per month from the Brown-Moore Trust. After the sale of their home, the couple had $120,000 in assets. The couple decided to dissolve their marriage in 2004.

The trial court held that the husband's trust interests had been "completely integrated into the financial planning of the parties" and granted the wife a judgment of $400 per month from the husband's future trust income distributions. The court of appeals affirmed the trial court's ruling in awarding the wife a portion of the husband's interest in the trusts. Although the husband successfully rebutted the ORS 107.105(1)(f) presumption of equal contribution, it was "just and proper" to divide the interests in both trusts between the husband and wife.

The trust income was deemed marital property. However, the husband met his evidentiary burden under the *Tsukamaki* two-part test, thereby rebutting the presumption that the trust income should be divided equally between the spouses: (1) the trusts were created by the husband's father and grandmother, (2) the wife was not an intended beneficiary of either trust, and (3) the wife did nothing to contribute to the husband's interests in the trusts. Were there no other considerations, the husband would have been entitled to keep all of his interest in each trust. However, the facts indicate that the wife was not ready to retire in 2002, but the husband convinced her that they would be able to fund their daughter's education and their retirement in significant part with the future trust income. The wife's change of position, in reliance on the husband's actions and assurances, made it "just and proper" in the opinion of the trial court to divide the interests in both trusts between the husband and wife.

In re Marriage of Olson, 218 Or App 1 (2008)

The husband was the sole devisee under his father's will and the personal representative of his father's estate. The principal asset of the estate was an 80-acre parcel of real property. Pursuant to the terms of the will, the husband executed a personal representative's deed conveying the property to himself. At the time of the conveyance, the property was worth $330,000.

The husband and wife disputed whether the husband intended that the wife own any interest in the property. The evidence, however, showed that they acted as if it were jointly owned:

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(1) the wife was actively involved in the efforts to complete the estate; (2) the wife was actively involved in valuing the property to determine whether it might be eligible for a Measure 37 claim; (3) the wife paid $3,000 in property taxes out of the couple's joint account; (4) in 2004, the couple filed a joint income tax return in which they claimed a loss for the property as a farming operation; (5) the couple performed substantial cleanup and garbage removal work on the property; and (6) they used the property as their private recreational area.

After being married for 11 years and having two children together, the husband and wife dissolved their marriage in 2006. At the time of trial, the property was worth $465,000.

Based on the above facts, the trial court held that the property was a marital asset. The court awarded the inherited property to the husband and then equalized the overall marital property division by awarding the wife a judgment in the amount of $155,000. The issue on appeal was whether the trial court erred in equally dividing the value of the inherited property (which included both the property's inherited value and the property's appreciation in value) between the husband and wife. The court of appeals affirmed the trial court's ruling, but modified the division of the value of the real property, stating the trial court went too far in equally dividing the inherited value of the real property between the husband and wife. Rather, only 25 percent of the inherited value was distributable to the wife. An equal distribution of the property's appreciation in value during the marriage was appropriate.

In summary, the client's donative intent must be clearly demonstrated as to the intended recipient when making gifts to a married child either during the client's lifetime or at death. Unfortunately, how such a gift is treated by the dissolution court most often depends on action on the part of the donee child, who may or may not be your client. At the very least, estate planning attorneys should counsel their donor clients about the unintended consequences outlined in the above cases when making gifts to a married donee and assist them in clearly indicating the object of their donative intent. To do so, consider adding language to estate planning documents as follows: A spouse of a married beneficiary/donee, whether married at the time of this gift or in the future, is specifically omitted as a recipient of such gift and is expressly excluded as a recipient of my donative intent hereunder.

Lisa Bertalan
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Probate Mediation Is on the Way to Deschutes County

Most attorneys know mediation is an effective way to assist our clients in resolving their disputes without having to suffer the expense and emotional stress of trial. Mediation is a confidential process in which impartial third parties (mediators) meet with the parties to facilitate the discussion of concerns and disputes to assist the parties in reaching a mutually agreed upon settlement. In the probate arena, litigation is adversarial and often strains family relationships. This is particularly true in contested probate cases where parties' conflicts most often stem from complex familial dynamics. Thus, mediation in this context is a particularly useful tool to resolve such cases out of court while leaving family relationships intact.

Beginning in June of 2009, attorneys filing probate petitions in Deschutes County Circuit Court, whether estate administration-, conservatorship-, or guardianship-related, that wind up contested, will be referred to mandatory mediation. Under the leadership of attorney Donald Cole, Deschutes County Circuit Court Mediation Coordinator; Julie Sorick, Director of Central Oregon Mediation, Inc.; and a generous grant from The Oregon Mediation Association and a committee of local professionals, program policies and procedures were generated and presented for approval by the Deschutes County Circuit Court Judges. Those policies are expected to be adopted in the next couple of weeks, and training of mediators will begin in May. Program Policies and Procedures are as follows:

Policy

The Deschutes County Circuit Court will refer appropriate probate guardianship/conservatorship cases to mediation. Mediation services will be provided by Central Oregon Mediation. This policy and the procedures that follow are established pursuant to the authority given to the Deschutes County Family Court Department in ORS 3.408 and 3.417.

Referral

After a petition is filed in a probate guardianship/conservatorship case, or at any time during the pendency of the matter, the case may be referred to mediation on the motion of the court. The court will sign an Order for Mediation and route the file to the Probate Commissioner for scheduling. Also, at any time during pendency of the matter, a party or interested person may request mediation by filing a Request for Mediation and serving copies of the request on interested persons and parties. If the court approves the request, the court will sign an Order for Mediation and route the file to the Probate Commissioner for scheduling.

When an Order for Mediation has been signed, the mediation will be scheduled within 14 days. The Probate Commissioner will contact Central Oregon Mediation to schedule the mediation. The Probate Commissioner will promptly complete a Mediation Intake Form and provide that information to Central Oregon Mediation. The parties and interested persons will be notified by mail of the scheduled mediation, with a copy of the Order for Mediation and a copy of the Central Oregon Mediation brochure.

If there is an emergency and the court believes the need for mediation to be urgent, the court will bring this urgency to the attention of the Probate Commissioner. The mediation will then be scheduled on the very next Tuesday, not sooner than four calendar days. In addition to the notification procedures described above, the Probate Commissioner will notify the parties and interested persons by telephone.

Mediators

The mediators will be experienced mediators, selected from the rosters of the court-connected mediation program and Central Oregon Mediation. All of the mediators will have training and experience that meets or exceeds the requirements for "general civil mediators," as articulated in the Oregon Judicial Department Court-Connected Mediator Qualifications Rules. In addition, the mediators will have completed advanced substantive training in probate guardianship/conservatorship.

Mediations will be conducted at the office of Central Oregon Mediation, 1029 NW 14th Street, Bend, Oregon, or at such other location as Central Oregon Mediation may designate. If the court determines significant security issues exist and if space is available, the judge may direct the mediation to be conducted in the Deschutes County Justice Building, 1100 NW Bond Street, Bend, Oregon.

Mediation Participants

All affected persons will participate in the mediation, including the petitioner, the proposed protected person and his or her representative, and other necessary interested parties. If the proposed protected person is not able to participate, his or her representative may do so as deemed appropriate by the court and the mediators. Other persons, including attorneys and service providers, may participate in the mediation as necessary and helpful. The court visitor may participate, at the discretion of the parties and court visitor. However, the court visitor shall not be compensated for mediation time. His or her report shall be available in any event. The mediators will assist the parties in deciding who, among this group, should participate in the mediation. Interpreters will be provided by Central Oregon Mediation when needed.

Post Mediation

When the mediation is concluded, Central Oregon Mediation will provide a Report of Mediation to the court including information about the case number, case name, the date mediation concluded, and whether or not an agreement was reached. When a referred case does not result in mediation, Central Oregon Mediation will provide a Report of Mediation to the court with a brief explanation. If mediation results in a written Mediation Agreement, such written Agreement shall be filed with the court upon the consent of the parties. To the extent the court deems consistent with Oregon law, terms of the Mediation Agreement will be reflected in the Orders of the court.

Confidentiality

Mediation communications are confidential, including communications made to the mediators during case development. The mediators will not be called to testify in any proceedings subsequent to the mediation. Participants will sign a confidentiality agreement at the beginning of the first mediation session. The confidentiality agreement shall articulate exceptions to confidentiality regarding allegations of child abuse and elder abuse, or for threats to commit a crime that pose a serious danger to a person or property. Mediators may report such communications to the staff of Central Oregon Mediation for notification of the appropriate authorities. If a participant in the mediation is a mandatory reporter of child abuse or elder abuse, that fact shall be made clear at the beginning of the first mediation session. The parties may agree, in writing, to keep some or all terms of a Mediation Agreement confidential. Any Mediation Agreement filed with the court shall not be confidential.

Fees

Central Oregon Mediation will charge the parties a fee for mediation services. The fee will be established by Central Oregon Mediation, not to exceed a total of $500.00. The fee will be apportioned and paid as agreed by the parties by prior arrangement with Central Oregon Mediation. For modest-means clients, the fee will be on a sliding scale, according to the party's ability to pay.

Donald Cole
Oregon Justice Department

Julie Sorick
Central Oregon Mediation

Questions, Comments, or Suggestions About This Newsletter?

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What's New

Connall v. Felton

In *Connall v. Felton*, 225 Or App 266 (2009), the personal representative (the "PR") of the Estate of Carolyn Felton brought an action seeking to quiet title to real property that Carolyn had transferred to her stepson, during her lifetime, reserving a life estate for herself. The PR sought to have a constructive trust imposed, based on claims that Carolyn had transferred the property to her stepson solely for the purpose of avoiding probate, and that Carolyn had intended that her stepson hold the property in trust for the benefit of the stepson and Carolyn's six children. The trial court held that a resulting trust (as opposed to a constructive trust) had been created, and ordered that the property be transferred to the estate to be administered pursuant to the terms of the will. The Oregon Court of Appeals reversed.

At Carolyn's death, she was married to her second spouse, Clifford. After they had married, Carolyn and Clifford executed reciprocal wills. Each spouse's will named the other as the primary beneficiary and Carolyn's six children and stepson (Clifford's son) as equal contingent residual beneficiaries. When Clifford died, Carolyn became the sole owner of the property by operation of law, because Carolyn and Clifford had held the property as tenants by the entirety.

Carolyn transferred the property to her stepson shortly before her death, reserving a life estate for herself. She prepared the deed herself, using some language from a form she had obtained from a friend. The deed provided that "[t]he true and actual consideration paid for this transfer is $-0-; estate planning." The decedent then executed the deed and had it notarized and recorded.

Based on the deed's reference to "estate planning" and conversations that the PR had had with Carolyn shortly before her death but after the property had been transferred, the PR believed that the deed was for the purpose of avoiding probate and that Carolyn's intention was that the property or its proceeds would be shared equally by the decedent's children and stepson, in the same manner as Carolyn's other property distributed pursuant to her will. The trial court found that the term "estate planning" was ambiguous. However, the trial court concluded that Carolyn had intended that the property be transferred to the children and stepson, and held that a resulting trust had been created based on the dispositive provisions of Carolyn's will and the testimony of her children regarding statements that she had made to them prior to her death.

On de novo review, the court of appeals agreed with the trial court that the facts did not support the imposition of a constructive trust, which, it pointed out, is a procedural device to avoid unjust enrichment, where there has been a violation of a confidential or fiduciary relationship. The court of appeals, however, disagreed that a resulting trust should be imposed. It pointed out that a resulting trust arises where property is transferred under circumstances that give rise to an inference that the person who made the transfer does not intend the transferee to take a beneficial interest in the property. In addition, according to the court, to establish a resulting trust, the evidence must be clear and convincing that the property was conveyed in trust, contrary to the express terms of the deed. The court concluded that the trial court had erred in finding that the deed was ambiguous, which had been the basis for the trial court's consideration of the extrinsic evidence testimony of conversations between the decedent and family members.

The court of appeals found the deed to be plain on its face, despite its reference to "estate planning." In reaching this conclusion, the court noted that there was no mention of a trust in the deed. In addition, the court pointed out that the deed contained language transferring an absolute interest to the stepson, subject only to a life estate. In the court's view, such a transfer was consistent with the phrase "estate planning" since, by conveying the property to her stepson, Carolyn avoided having the property subject to probate administration. According to the court, the fact that the term "estate planning" had been borrowed from another deed supported this conclusion.

The court stated the standard for imposing a resulting trust contrary to the express terms of a deed as follows:

> If a resulting trust is to be established contrary to the express terms of a deed absolute on its face, it must be based on definite, clear, and convincing evidence of the circumstances and conditions at the time of conveyance of the property showing an intention to convey the property in trust, and it cannot be established by subsequent acts of the participants. *Shipe et al.*, 206 Or. at 570-71, 292 P.2d 123; *see also Bowns v. Bowns*, 184 Or. 603, 619, 200 P.2d 586 (1948). "Clear and convincing evidence means that the truth of the facts asserted is highly probable." *Supove v. Densmoor et ux.*, 225 Or. 365, 372, 358 P.2d 510 (1961). The evidence must be of "extraordinary persuasiveness." *Pantano v. Obbiso*, 283 Or. 83, 87, 580 P.2d 1026 (1978) (quoting *Hughes v. Helzer*, 182 Or. 205, 224, 185 P.2d 537 (1947)).

The court held that the above standard had not been met and remanded the case for entry of judgment quieting title in the stepson.

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Wilson v. Wilson

In *Wilson v. Wilson*, 224 Or App 360 (2008), the Oregon Court of Appeals considered claims that the spousal elective share should be available to defeat a husband's transfers of assets to a revocable living trust, where the husband's intention was to exclude such assets from the statutory elective share available to the wife at the husband's death. The court held that the spousal election was unavailable to defeat these transfers. Complicating the facts of the case were the wife's incapacity at the time the action was filed and her death prior to disposition of the case on appeal.

Following the husband's death, the wife's conservator filed a lawsuit against the husband's estate, asserting the following claims for relief: (1) that the revocable trust was a fraud on the wife's marital rights, (2) that the transfer of assets to the trust was a fraudulent conveyance because it was designed to disinherit the wife, (3) that the creation of the trust was an illusory transfer because the husband retained substantial interests in the property held in the trust, (4) that the transfers to the trust were void as against public policy, and (5) an assertion of the spousal election on behalf of the wife. To support some of the claims, the wife's conservator testified that, after the husband's death, the wife told him that if she had known about the creation of the revocable living trust, she would have divorced her husband.

The trial court ruled in favor of the husband's estate on a summary judgment motion. The court of appeals affirmed, holding that the testimony of the wife's conservator was inadmissible hearsay. The court held further that the conservator's authority to claim the wife's elective share was dependent on the wife's need for support, and that need ended with her death. In arriving at this holding, the court cited its prior decision in *Kirkeby v. Covenant House*, 157 Or App 309 (1998), to the effect that the spousal election cannot be filed by any person other than the surviving spouse, and ORS 114.155, permitting the election to be filed by a conservator only for the support of a surviving spouse.

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Save the Date: June 19, 2009

Upcoming CLE on the "Crossroads of Estate Planning and Family Law"

- Introduction on the Differing Perspectives of Family Lawyers and Estate Planners (Conrad Hutterli)
- Panel Discussion on Issues in the Crossroads (Gary Zimmer, Russ Lipetsky, John Draneas, and Jonathan Levy)
- Life Insurance and Beneficiary Designations Following Divorce (Stephen Kantor and Paul DeBast)
- Prenups and Postnups (Michael Yates)
- The Spousal Elective Share in Probate (if pending bill is passed)

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