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Some Best Practices in Accounting

By Heather O. Gilmore
Heather O. Gilmore PC
Salem, OR

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https://www.courts.oregon.gov/courts/marion/programs-services/Pages/probate.aspx

Click on "Best Practices," then click on "Accounting Additional Information" and "Accounting Form Example."

As revocable trusts are used more frequently as will substitutes, properly conducting a probate proceeding can seem like a lost art. Here are some tips in preparing good probate and conservatorship accountings.

Accounting Periods

Use the proper accounting period.

Oregon Uniform Trial Court Rule ("UTCR") 9.160(1) requires an accounting to state the first and last date of the accounting period. For annual accountings, the last day of the accounting period shall be within 30 days of the anniversary of appointment.

Defining the accounting period.

State in the first paragraph of the accounting the period to be used. A best practice is to include the accounting period at the top of the asset schedule or in the header of each exhibit. The beginning balance of the accounting and each asset within the accounting is *always* the ending balance of the last accounting or the inventory value. Remember, an accounting is a *snapshot* of what the assets look like on two exact dates, the first date of which is always the date of death (or date of appointment for a conservatorship) *or* the last date (not the day after the last date) of the prior accounting. The accounting period in estates begins on the date of death, not the date of appointment or taking possession of the assets from a prior fiduciary like a conservator or agent under a power of attorney.

Adjusting the accounting period.

If you believe it is more cost-effective to use an accounting period that is the last day of the month, in the first accounting, ask the court to modify the accounting period (for example, a change from February 1 to January 31). Don't just start accounting in that manner – get *prior* court approval via a motion and order to avoid difficulties. Don't ask for an accounting period that

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exceeds one year. Account under the existing timeframe and later use an earlier date for the next accounting if you are requesting an adjustment to the accounting period. There is no authority for an accounting to exceed one year unless: 1) you get prior court permission, 2) it is timely, and 3) it has a basis such as moving from a mid-month accounting date to a month-end date.

If you file the accounting late, the ending date of the accounting is *not* three months into the late accounting (which causes you to be able to file three months later next year). The accounting end date remains within 30 days of the anniversary of appointment.

Consistency on end date of accounting.

If monthly statements issued by different banks don't all end on the same date, it is tempting to use different end dates for the end of the accounting period for the different accounts. However, the accounting needs to consistently use the same end date. If the statement is issued on a date other than the last day of the accounting period, you must do the math. So, if the bank statement's starting and ending date straddles the end of the accounting period, this means adding any receipts made before the last day of the accounting period and subtracting any receipts made after the last day of the accounting period. The same is true of disbursements made before and after the accounting period. Make sure you have documents that support the values you are reporting.

Estimating Income

When preparing conservatorship accountings, add a description of the income to help you and your staff properly calculate this amount. Show the math right on your accounting. For example:

Social Security @ $892/mo x 12 = $10,704
Pension @ $650/mo x 12 = $7,800
Bank Interest based on prior year = $50
Annuity Payments @ $600/quarter = $2,400
Estimate of Brokerage Account Dividends based on total from prior year = $2,100
(This is easy to find on all brokerage account statements where they list dividends to date. You can prorate from the prior calendar year and add the current calendar year for the estimate.)
Rent from property @ $930/mo x 12 = $11,160
Total Estimated Income: $34,214

Bonds

A bond is a requirement of the statute. There is a duty for attorneys to be forthright with the courts. Don't try and ignore the requirement that all assets need to be bonded. Either increase the bond or address the matter directly and get permission to reduce the amount of the bond or restrict the assets. Further, you must include the date of the order restricting assets. UTCR 9.160(1)(b)(iv). Don't make the court look through numerous approvals of accountings to find it. If you do, you are slowing down the process for other attorneys and the court.

If you want to reduce a bond, remember to do three things. First, provide a valid reason for the reduction. If it is just a limited amount over, such as $5,000 or less, then explain that to the court. If the cost of adjusting the bond will exhaust the amount in excess of the current bond, include that information. Second, provide the court with information that demonstrates the assets objectively will be protected without the bond. Third and finally, tell the court the difference between the amount that should be bonded, the amount of the current bond, and the amount you want the bond to be.

Do the math for the court in a way the court can see it. If you detail it with a written narrative, also show the math for clarity. For example:

Total assets and estimated income	$180,000
Current bond	$150,000
Difference	$30,000

In this case, assume the fiduciary requests that the bond remain the same because the amount in excess of the current bond will be reduced as follows:

Attorney fees requested in this accounting	$5,000
Conservator fees requested in this accounting	$1,000
Care bill due (month of the accounting)	$7,000
Care bill due (month following the accounting)	$7,000
Total:	$20,000

This represents a difference of only $10,000 between the total assets and estimated income and the amount of the bond. If the estimated income will be earned over the upcoming accounting period, due to the cost of care over that same accounting period, the amount managed by the fiduciary at any one time will not exceed the amount of the bond.

Listing Assets in the Accounting

Begin your draft of the accounting with the asset schedule from the inventory or the prior accounting and address each asset that existed on the inventory or the prior accounting in the same order in which it appears on the inventory or prior accounting. Remember to include the request for waiver of the vouchers in the prayer of the motion to approve accounting *and* in the order or judgment approving the accounting.

When there are changes in assets during the accounting period (and there always are), provide a narrative on items such as the following: 1) sales or other dispositions of assets; 2) change in the name of the financial institution (include this information on the asset schedule and exhibits as well); 3) closing and opening accounts (explain the reason); 4) change in needs of protected person that affect receipts or disbursements; 5) changes in social security or pensions, or increases in health insurance bills; and 6) anything else that affects how the numbers and the assets might be perceived. It's better to overdisclose than underdisclose (especially in light of the holding in the *Fuentes* case discussed below).

With conservatorships, it is helpful if you include in the narrative a brief background. For example, the reason the protected person is financially incapable, his or her age, the relationship of the conservator to the protected person, where he or she lives, prior budget approvals, annuity payment terms, the protected person's activities that are reflected in the disbursements (such as horseback riding, lunch with a friend/paid companion, extra caregivers, challenging behaviors), and so on.

Adequate Disclosures

In general, report anything "squishy." That is, any interaction that involves benefits or payments to a fiduciary or the fiduciary's attorney. UTCR 9.170 requires disclosure of certain transactions. The disclosures required cover a broad range of transactions and reflect the UTCR committee's concern regarding many different kinds of actions by fiduciaries. It requires disclosures of any transactions "with a person or entity with whom the fiduciary has a relationship which could compromise or otherwise affect decisions made by the fiduciary." UTCR 9.170(2). This provision specifically includes, but is not limited to, payment for goods, services, rent, reimbursement of expenses, or any other like transactions. *Id.* The rule requires disclosure of any payment for goods or services provided to either a person who is not engaged in an established business providing such goods or services to the public, or where such payment is at a rate higher than that ordinarily charged to the general public. UTCR 9.170(3).

"Out" these transactions in your accounting. Have your client own it and deal with it at the time. It is better to disclose and address the matter in the year the transaction occurred as opposed to failing to disclose the issue and the court finding out later – which can be grounds for removal.

Be sure you know which transactions require prior approval. If, during the preparation of the account, you find that one of these has inadvertently occurred, file a motion asking for approval with the accounting and provide an explanation of why the transaction occurred without prior approval. Common examples where this might arise include: payments to the fiduciary or the attorney for the fiduciary (ORS 125.095(3)); gifts of more than $250 in a calendar year to one individual or exceeding an aggregate total of $1,000 in a calendar year (ORS 125.435); sale of the protected person's residence (ORS 125.430); payment of room and board to a conservator who is also the guardian (ORS 125.320(2)); conveyance or release of joint tenancy for assets like bank accounts (ORS 125.440(1)); creation of trusts (ORS 125.440(2)); and other limitations listed in ORS 125.440.

The court does not have total recall of all files. If the court previously approved a transaction (e.g., gift over the statutory amounts, payment of fiduciary or attorney fees, sale of the protected person's residence, creation of a trust, etc.), it is extremely helpful if the listing of the transaction includes a reference to the date of the order approving the transaction. This saves time searching through the file.

Don't forget to report changes in business practices for a professional fiduciary, and to update professional fiduciary disclosures if there are any changes from the disclosures made at the time of appointment.

"Bounced checks" are another problem area. The fiduciary is charged with properly managing the protected person's finances. Absent some unusual situation like fraud or the protected person continuing to access accounts without the fiduciary's knowledge, there should not be bank fees for bounced checks, late payment fees, etc. The fiduciary will be expected to explain such charges and will generally be required to reimburse the protected person for them unless due to circumstances beyond the fiduciary's control.

The finality of accountings, and of objections to them, are addressed in *Fuentes v. Tillett*, 263 Or App 9 (2014). In *Fuentes*, the Court of Appeals found that where objections relate to matters not disclosed in the accountings, the orders approving the accountings cannot cut off the protected person's rights to complain about those undisclosed matters. Intermediate accounting orders are final only as to the conservator's liability regarding the matters that were actually presented to, and considered by, the probate court when it approved the interim accountings.

Counsel representing a fiduciary should be sure that each interim accounting is full and complete, especially for things that could look problematic. Without full disclosure, the accounting and the order approving it will not actually cut off the fiduciary's liability for misdeeds not disclosed in the accounting. The Court of Appeals did not give any direct guidance in *Fuentes* as to how specific and clear such disclosure must be, but obviously, the clearer and more specific the disclosure the more likely it is that the order will have the preclusive effect that we all would expect it to have.

Finally, in light of *Fuentes*, the best practice may be to keep all records until after the close of the proceeding – including retention of vouchers.

Elder Abuse

ORS 124 contains the civil action for elder abuse. ORS 124.100(5) provides that an action may be brought "*against a person for permitting another person to engage in physical or financial abuse if the person knowingly acts or fails to act under circumstances in which a reasonable person should have known of the physical or financial abuse.*" (Emphasis added.)

ORS 124.110(1) sets out circumstances of abuse:

> (a) When a person wrongfully takes or appropriates money or property of a vulnerable person, without regard to whether the person taking or appropriating the money or property has a fiduciary relationship with the vulnerable person.
>
> (b) When a vulnerable person requests that another person transfer to the vulnerable person any money or property that the other person holds or controls and that belongs to or is held in express trust, constructive trust or resulting trust for the vulnerable person, and the other person, without good cause, either continues to hold the money or property or fails to take reasonable steps to make the money or property readily available to the vulnerable person when:
>
>> (A) The ownership or control of the money or property was acquired in whole or in part by the other person or someone acting in concert with the other person from the vulnerable person; and
>>
>> (B) The other person acts in bad faith, *<u>or knew or should have known of the right of the vulnerable person to have the money or property transferred as requested or otherwise made available to the vulnerable person</u>*. [Emphasis added.]

Remember that judges are mandatory elder abuse reporters and also mandatory reporters (like all attorneys) to the Oregon State Bar for ethics violations.

Avoid being a bystander who gets run over by the bus in an elder abuse action against the fiduciary. Withdraw if necessary. You have Professional Liability Fund insurance (hopefully in an amount that would cover your client's taking) and you are a deep pocket. Your flake of a fiduciary may not even have a bond. Even if the flaky fiduciary has a bond, it is unlikely that the bond is in an amount equal to three times the economic damages *plus* reasonable attorney fees and reasonable fees for the services of a successor guardian or conservator. The treble damages and attorney fees are the award for a successful civil action for elder abuse.

Fees

If the proceeding is a conservatorship and the attorney fees are paid from any source in which the protected person has an interest or where the fiduciary later desires to be reimbursed, the attorney fees must be approved by the court. In particular, a protected person's beneficial interest in a trust is an asset the court may consider to be "funds of a person subjected to a protective proceeding" under ORS 125.095(1). This is based on *Helmig v. Farley, Piazza & Associates*, 218 Or App 622, 627 (2008), where the court found a property interest sufficient to justify a conservatorship because "[t]here is clear and convincing evidence that Lea's beneficiary interest in the trust was not being properly managed."

Taking fees without prior court approval is an ethical violation. In *In re Altstatt*, 321 Or 324, 333 (1995), the Oregon Supreme Court stated:

> Since *Coe*, this court has held that estate lawyers who take attorney fees from an estate without obtaining prior court approval engage in unethical conduct. *See In re Devers*, 317 Or. 261, 266, 855 P.2d 617 (1993) (lawyer licensed to practice law in both Oregon and Michigan who, while representing a personal representative in Michigan, collected a $2,775 fee from the heirs but did not disclose the fee to the probate court, violated DR 2 106(A)); *In re Phelps*, 306 Or. 508, 517, 760 P.2d 1331 (1988) (lawyer disbarred for, *inter alia*, retaining attorney fees "although he had not obtained authorization from the court as required by ORS 116.183(1)"); *In re Weidner*, 320 Or. 336, 338 39, 341, 883 P.2d 1293 (1994) (lawyer violated DR 2 106(A) when he collected attorney fees from an estate without applying to the probate court or obtaining an order from that court, as required by ORS 116.183). The rule to be derived from those cases is that it is impermissible to collect attorney fees from an estate in probate without prior court approval. Any such attorney fee that is collected without approval is unlawful and, hence, an "illegal" fee. Therefore, *the accused's receipt of the attorney fees without court approval in this case was the collection of an illegal fee and was unethical conduct* under DR 2 106(A). [Emphasis added; footnotes omitted.]

Altstatt is an estate case, but the rule is the same for protective proceedings and there have been subsequent disciplinary proceedings applying the concept in conservatorships.

General Accounting Rules and Best Practices

The following are a list of important rules and tips that should be rules for all accountings. As an initial matter, don't assume what the court should know from the file or prior accountings. On the description of disbursements, state the name of the payee and the purpose. If you just put "Walgreens," for example, it is not clear whether it was a prescription, personal hygiene products, or wine for the conservator. Use as much detail as possible. If you pay a doctor, use the term "medical expense" in the "purpose" column.

Notices.

Make it easy for your staff and the court by creating a document that is a table with the interested persons' names and addresses. Then, block copy the names and addresses of interested persons and insert in any pleadings that require information on interested persons, insert in the notice itself, and insert in the proof of service. This will help your staff keep it consistent and help the court to efficiently review the accounting.

The asset schedule.

Under the column for "Description of Asset" include: institution name, account number, type of account, address for property and tax account number, in a conservatorship insert the date the real property abstract was recorded and filed with the court, and for new assets include the date of acquisition or disposition if it occurred during the accounting period.

Real property abstract.

File a copy of the recorded abstract with the court contemporaneously with the inventory or as soon thereafter as reasonably possible. On the asset schedule and the exhibit, reference the date of recording and filing of the abstract and in the first accounting if the abstract has not been separately filed or attached to the inventory then attach a copy to the real property exhibit. See ORS 125.470(3) for the requirement of filing an abstract for any protective proceeding that includes real property. The form of the abstract is also statutory.

Disposition and acquisition of assets.

If an asset is transferred, disposed of, or abandoned or exhausted during the accounting period, or if the form changes (for example, cash to a CD), include this detail in the description on the asset schedule. It saves court staff from flipping back and forth between the narrative and the asset schedule and trying to put together sometimes poorly written narrative with numbers and exhibits.

For new financial accounts opened during the accounting period, the value of the later acquired asset column is zero. The account starts out with zero dollar value. An example of this is closing accounts in the protected person/decedent's own name and moving the accounts to the new checking account for the fiduciary. These new accounts have a later acquired value of zero. Then, as part of the reconciliation of the new account, all receipts and disbursements are shown.

Restrictions.

UTCR 9.160(2)(a)(i) requires that the description of any asset that has been restricted pursuant to court order must include the date and title of the order. Best practice is to also include the date the formal Affidavit and Acknowledgment of Restriction was filed with the court. This serves as a way to double check you have done everything you need to do and simplifies review by the court, allowing accountings to be processed more efficiently.

Itemize.

Itemize receipts and disbursements separately, as required by UTCR 9.160. Also, provide the total of each list of receipts and disbursements at the end of each list. If you fail to do this, don't be surprised if your accounting gets returned to you for failure to comply with the UTCR.

For investment accounts, it is sufficient to show for each month "gain in investment value" or "loss in investment value." The court may request all the brokerage statements for any given accounting period.

UTCR 9.160(3)(a) requires the receipts and disbursements to be in chronological order, not organized by check number or some other method.

Be sure to avoid a huge common error by listing all transactions that occurred during the accounting period, and not listing transactions outside of the accounting period. In other words, if the accounting period ends on May 1, a check written on April 30 should be listed, but a check written May 2 should not be listed, even if it is shown on the bank statement that confirms the ending balance on May 1.

Final Review Items

The attorney must review the accounting. In 2003, an attorney was suspended for 60 days for failing to review accountings before filing them. See In re Roberts, 335 Or 476 (2003). The opinion does not recite the facts, but those can be found in the Bar Bulletin archives here: http://www.osbar.org/publications/bulletin/03augsep/discipline.html.

The following are some common items worth reviewing.

Total all the columns on the asset schedule as required by UTCR 9.160(2)(b).

Review the accounting exhibits specifically for prohibited disbursements, which include: 1) any payments to a guardian, conservator, or attorney without prior court approval (although cost reimbursement is OK with proper documentation and if reasonable); 2) any payment of room or board to a guardian without prior court approval; and 3) gifts greater than $250 to one person or totaling more than $1,000 combined among all donees for one accounting year.

Review the accounting exhibits specifically for transactions with an actual or potential conflict of interest. Conflicts of interest include: 1) loans to or from the conservator; 2) sales or purchases of assets with or to the conservator, a family member, or close friend of the conservator or an employee of the conservator; and 3) payments to relatives of the conservator for services provided to the protected person.

Review the math on the reconciliation and compare the beginning balance and the ending balance to the financial institution statement for each asset. If it is well organized by staff, this should be a quick process. If it is not a quick process for the reviewing attorney, then it is not a quick process for the court staff and you are creating delays for both the court and other attorneys.

Verify that the closing statement on the old/disposed of asset matches the amount transferred to the other account. If you can't find it quickly, then it's also a problem for the court.

Malpractice!

By Philip N. Jones
Duffy Kekel LLP
Portland, OR

The 2018 Annual Report of the Professional Liability Fund (PLF) of the Oregon State Bar included the following paragraphs:

> Following a national trend among legal malpractice carriers, the PLF is beginning to receive a larger number of claims relating to estate planning. We assume this is, in some part, related to the aging of the baby boom generation. Therefore, it is likely we will continue to see an increase in these claims over the next few years. A good number of the more difficult claims we see involve long-term familial disputes and resentments. These sometimes come to a head and find a forum when a parent dies. We also find that previously fractured families may find common ground and unite behind claims against the estate planning attorney.
>
> In 2017, the number of estate planning cases more than tripled and remained at that level in 2018. Equally concerning is the cost related to these claims. In 2018, the PLF closed 111 estate planning claims. The cost relating to these claims was $2,286,655. This is approximately double the amount paid in each of the previous three years for these types of claims.

Read those paragraphs three times. Read them again every morning when you arrive at work. Does this make you feel as if someone has painted a target on your back? It should. This is a frightening situation for estate planners. One might think that malpractice claims are caused by inexperience or lack of knowledge of estate planning law. That might be true, in part. But the PLF is telling us that "a good number of the more difficult claims we see involve long-term familial disputes and resentments," and that "previously fractured families" are sources of difficult malpractice claims.

Of course, the PLF is not able to discuss any of their cases in any detail, due to the requirement of confidentiality. ORS 9.080(2)(a)(E). Some of their cases may have been resolved prior to trial, and some might have been resolved at trial without an appeal. Those cases usually do not become subject to public discussion. But some PLF cases end up in appellate decisions, which are all public. For example, one recent case might possibly fit the mold described above. In *Sherertz v. Brownstein, Rask, Sweeney, Kerr, Grim, Desylvia & Hay, LLP*, 288 Or App 719 (2017), a child from a second marriage of the decedent brought a malpractice suit against his father's estate planning attorney, claiming that the attorney had made an express or implied promise to the decedent that an irrevocable life insurance trust would be adequate to pay the decedent's estate taxes. The attorney, in defense, argued that no such promise had been made. (The facts are more complex than that, but you get the general idea.) The attorney prevailed at trial, but the plaintiff appealed and the Oregon Court of Appeals reversed due to a faulty jury instruction. The appellate opinion hinted that part of the problem was the conflicting interests of three daughters from a prior marriage. Thus the recipe described by the PLF in its annual report may have been present: a dysfunctional family quarreling over dad's estate and looking to the estate planning attorney (and the PLF) to add some money to the formula so that that all of the family members can walk away happy. Everyone would be happy, except the attorney, his law firm, and the PLF – and all of us who pay premiums to the PLF each year.

I have no inside information about the *Sheretz* case, but that does not prevent me from using it as an educational opportunity. Since the primary issue appears to be whether the attorney made an express or implied promise that the ILIT would be sufficient to satisfy the decedent's estate taxes, in hindsight we can say that the attorney might have staved off the lawsuit had he a letter in his file to his client stating that the attorney makes no promise as to the sufficiency of the ILIT to cover the estate taxes.

Of course, you might find it amusing that an attorney needs to state in writing to his client that the attorney does not have a crystal ball and cannot predict with accuracy what the amount of the client's estate taxes will be, and whether a particular amount of insurance will cover those taxes. And of course, my suggestion that the attorney should have written such a letter is made in complete hindsight; I cannot say that I would have had the presence of mind to have written such a letter.

But the lesson is nevertheless clear: what you think is obvious and need not be stated in writing between an attorney and client is not necessarily what a family member might later think when the estate tax bill arrives nine months after dad died. And it is not necessarily what a clever plaintiff's attorney might think. And your client, with whom you had a clear and complete understanding of what you were (and were not) promising to accomplish, is dead and cannot testify. And so the careful attorney, wishing to minimize the chance of a malpractice suit, will start writing lengthy letters to every client pointing out exactly what is not promised.

And to whom should this letter be addressed? To the client, of course. But who is the actual unstated recipient of this letter? Eventually, in the long run, the intended recipient of the letter is the surviving spouse, children, grandchildren, PLF, plaintiff's attorney, trial court judge, jury, and appellate court. Particularly in the case of blended families, and in the case of dysfunctional families, such letters might do a world of good.

Of course, such letters will be difficult to write. Who can predict which family members will feel slighted by an estate plan? Who can predict what novel theories might be developed after your client dies? But spending a few minutes trying to conjure up such theories might be time well spent.

And of course, attorneys should always keep detailed notes of every conversation with the client. *See* Philip N. Jones & James Cartwright, *Protecting an Estate Plan Against Contests*, Oregon State Bar Estate Planning and Administration Section Newsletter, Oct. 2011.

On a related subject, the PLF has kindly provided a list of common malpractice claims against attorneys that the Fund has received in recent years in connection with estate planning matters, apart from the situations described above. The PLF files are confidential (as noted above) and thus details are not available, but the PLF has provided brief summaries of some of the typical claims it has recently experienced. By including a claim in this brief summary, no indication is made whether the claim was valid or if damages were actually paid. Instead, this is merely a list of some cases in which allegations of malpractice were made. In each of these cases, an attorney was alleged to have engaged in one or more of the following acts:

- Undertaking to prepare a deathbed will where there were significant changes regarding beneficiaries. In these cases, the lawyer may be vulnerable to attack unless there is good evidence to show that the client had capacity and fully understood the result of the changes.
- Changing a will or trust but forgetting that the changes required other changes in the same document or in other documents, such as the renumbering of other paragraphs because of cross-references or other references to the same property elsewhere in the document. In these cases, the actions of the attorney may have caused confusion about the testator's intent because the various provisions were inconsistent. When making a change, all of the dispositive provisions and all of the boilerplate need to be re-examined.
- Confusion about who is preparing a certain tax return or making a certain tax election, the lawyer

or the accountant. Obviously, it is very important to make a list of the forms that need to be submitted and to confirm, in writing, who is taking responsibility for filing each type of form. Late filings and late elections can result in penalties and interest, and often the damages cannot be repaired.

- Representing an unsophisticated personal representative or trustee without making sure that the fiduciary understands the duties and responsibilities to be undertaken and fulfilled. This comes down to good selection of clients, careful education of clients, or both.
- Confusion about who the lawyer is representing. As in every area of law, being clear about who the client is, and who is not, is important, particularly when more than one family member is involved. Sometimes, even the lawyer is not sure of who the client is. An engagement letter will often prevent this problem, and a letter to the other parties explaining that the attorney does not represent them will also help.
- Not considering whether an action taken will result in a claim against an estate by the Department of Human Services. Extra care must be taken whenever a client or a beneficiary is receiving government benefits, and often an expert in that field needs to be consulted.
- Failure to be aware of dishonesty on the part of a personal representative, trustee, or conservator, and failure to take action regarding suspicious activities. Oftentimes, the attorney will be blamed for not noticing red flags.
- Failure to anticipate tax consequences and failure to provide advice in that regard. This could include income tax, gift tax, estate tax, and/or generation skipping tax.
- Failure to understand what constitutes a valid disclaimer. If the disclaimer does not comply with the federal and state statutes governing disclaimers, tax consequences may occur or the disclaimer might be invalid or ineffective.
- Failure to fund a trust or failure to recognize which assets belong in which trust (the marital trust, the bypass trust, or the survivor's trust), and failure to maintain those distinctions over time.

Each of these situations has an easy solution that could be taken care of in advance, if the attorney has the presence of mind to predict what kinds of problems might surface in the future. Our job is to predict those problems and take care of them before they start. Therein lies the challenge.

Spousal Limited Access Trust aka the "SLAT": An Overview

By D. Charles Mauritz
Duffy Kekel LLP

A spousal limited access trust is intended to take advantage of the currently generous (and possibly temporary) federal transfer tax exemption, and the lack of any Oregon gift tax, to remove the future appreciation of assets from the gross estates of both spouses, without losing all access to the transferred assets by irrevocably giving them to descendants or other third parties.

Technique: One spouse ("donor spouse") transfers some of his or her separate assets to an irrevocable trust created for the benefit of the other spouse ("donee spouse"). The donee spouse may receive income and principal distributions from the trust if needed to meet the donee spouse's living standard. On the death of the donee spouse, the assets remaining in the trust, including all accumulated earnings and appreciation in value of those assets, are excluded from both spouses' gross estates. The trust assets will be distributed to the successor beneficiaries identified in the trust without any state or federal estate tax liability.

Variations: The donee spouse may be given the power to unilaterally withdraw all of the income of the trust at any time and/or the power to make gifts from the trust (a "limited power of appointment"). A limited power of appointment may be a broad power (e.g., to other family members, friends, and charities during life and at death) or a very narrow power (e.g., only to other family members at death). The trust may continue far beyond the lifetime of the donee spouse for the benefit of children and grandchildren. If the final distribution scheme in the trust is consistent with the donee spouse's desired distribution scheme at his or her death, the donee spouse may combine ("pour over") the remaining assets of his or her estate with those of the trust and avoid creating a new trust to accomplish the same purposes. Many other variations exist, and the availability of some variations may depend on the state in which the trust is created.

Asset Consumption: The trust represents a financial safety net for the donee spouse rather than a primary source of support. Ideally, each spouse has ample other assets to use for maintaining the family lifestyle, thereby making distributions from the trust unnecessary. An important part of the financial plan is to let the trust assets grow during the lifetime of the donee spouse without depletion, essentially achieving the same result as if the assets had been transferred to a trust for the benefit of children and other family members (rather than for the benefit of the donee spouse). Moreover, the assets outside of the trust likely will be included in the donor spouse's taxable estate, so the family's routine consumption of those assets will further reduce the final estate tax burden arising at the death of the surviving spouse.

Asset Selection: Selecting the most appropriate assets to transfer to the trust is a critical element in the overall success of the plan. The trust assets will eventually pass to future beneficiaries. The assets with the highest appreciation and income production potential during the term of the trust should be highest on the list of candidates. Family business interests are particularly attractive for contribution to the trust, as are commercial real estate investments, intellectual properties, diversified portfolios, and similar passive investment assets. The least attractive assets are cash, depreciating assets, fixed income securities, personal use assets, and similar non-growth and depleting assets.

Gift Tax Reporting: The mechanism underlying the spousal access trust is a taxable gift to a spouse. The gift must be in a form that does not qualify for the unlimited gift tax deduction for transfers between spouses. If the gift is taxable, then the federal gift tax exemption (currently, $11.4 million) must be applied to eliminate any actual gift tax liability.[1] The donor of a taxable gift must file a federal gift tax return to report the transfer and the use of the exemption.[2] Since the gift tax and the exemption are applied cumulatively over the lifetime of the donor, the available exemption in any year is limited to the difference between the amount of the exemption in effect that year and the amount of the exemption the donor has used in prior years. The gift tax return is due at the same time as the donor's personal income tax return in the year after the year the gift is made.[3]

Asset Valuation: The valuation of the assets transferred to the trust is another vitally important element in the planning. The donor is obligated to report a value for each asset transferred. The valuation standard is "fair market value," i.e., the price paid by a hypothetical willing buyer to a hypothetical willing seller, each being aware of all of the relevant facts and circumstances, and neither being under any compulsion to buy or sell.[4] The IRS may examine the gift tax return and the values used. However, the option to audit the gift tax return lasts only three years from the date the return is filed if all of the details regarding the methodology for arriving at the asset values are "adequately disclosed" in the return.[5] Failure to properly disclose or substantiate the values used leaves the statute of limitations open for the IRS to review the gift tax return at any time, even after the death of the donor.

1 Internal Revenue Code ("IRC") § 2505.
2 IRC § 6019.
3 IRC § 6075(b).
4 Treas Reg § 20.2031-1(b).
5 IRC § 6501(a).

Adequate disclosure is a high standard that requires the donor to produce substantial evidence supporting the values used in the tax return. That is especially true of hard-to-value assets such as interests in family businesses, real estate, intangibles, etc. If no public market exists for the transferred assets (i.e., a public stock exchange for listed securities), it is virtually impossible to meet the disclosure standard without an independent appraisal conducted by a "qualified" appraiser.[6] The Treasury Regulations presume the adequate disclosure standard is met if such an appraisal report is attached to the gift tax return.[7] While these appraisals may be expensive, they are the only means by which the donor can be assured that the gift values will be respected, after the three-year audit period lapses.

Income Taxes: Because one spouse creates the trust for the benefit of the other spouse, the trust is a "grantor" trust for income tax purposes during the lifetime of the donor spouse.[8] That means the trust is completely disregarded as a separate taxpayer. The donor spouse reports all of the income, gain, and loss of the trust on his or her income tax returns (which may be joint returns filed by both spouses).[9]

At the death of the donor spouse, the trust becomes a separate taxpayer and is required to file its own fiduciary income tax returns (unless the surviving donee spouse is treated as the "grantor" of the trust, as described below).[10] Thereafter, a surviving donee spouse reports all income distributed to him or her on his or her personal income tax returns. The trustee reports any income retained by the trust and all capital gains and losses on the trust's fiduciary income tax returns.

As noted above, the donor spouse must report the income and gain of the trust on the donor spouse's personal tax return and is liable for payment of any tax during his or her lifetime. However, the trust may allow reimbursement of income taxes actually paid by the donor spouse.[11] Ordinarily, the donor spouse is encouraged to pay the income tax liability without receiving reimbursement from the trust. By paying the tax on the trust's income, the donor spouse effectively augments the trust by avoiding its depletion for the payment of taxes. Payment of income taxes operates as an economic addition to the trust, yet is not regarded as another taxable transfer to the trust by the donor spouse. That is because the liability for the tax legally lies with the donor spouse. In some cases, the trust

6 *See* Treas Reg § 301.6501(c)-1(f).
7 Treas Reg § 301.6501(c)-1(f)(3).
8 IRC § 677(a).
9 IRC § 671.
10 IRC § 641.
11 Any reimbursements should be within an independent trustee's discretion. A mandatory income tax reimbursement provision would cause inclusion of the trust assets in the grantor's gross estate under IRC § 2036(a)(1). *See* Rev Rul 2004-64, 2004-2 CB 7.

is designed to continue that augmentation through the lifetime of a surviving donee spouse as well. This is done by giving the donee spouse certain powers over the trust income or principal that result in the donee spouse being legally responsible for payment of the trust's tax liability, whether or not the donee spouse receives any distributions or reimbursements from the trust.[12]

Selection of Trustee: The donor spouse may designate the donee spouse as the trustee of the trust, either alone or as a co-trustee with another person or entity. While technically permissible, additional risks arise when the donee spouse acts as sole trustee. In that case particular caution must be exercised when making distributions to the donee spouse to be certain that each distribution conforms to the ascertainable distribution standard stated in the trust. Excessive or repeated erroneous distributions can lead to a claim by the IRS that the donee spouse's abuses of the distribution limitations are equivalent to full ownership. This would prompt the IRS to try to include the trust assets in the donee spouse's taxable estate. Whenever possible, a safer alternative is to designate a co-trustee or independent trustee to reduce the risk of inadvertent errors in the trust administration.

Administration Requirements: The success of the spousal access trust is largely dependent on the self-discipline exercised by the donor spouse and the donee spouse after the trust is created and assets are transferred to it. Successfully transferring the assets to a properly designed trust does not end the risk that the assets will be included in the taxable estate of the donor spouse or the donee spouse. It is also necessary to constantly and consistently confirm that all ownership of, access to, and control over the trust assets conforms to the terms of the trust. To meet this standard is it essential to deal with the trust assets and the trustee in a formal fashion, regardless of who serves as trustee.

- The trust assets must be titled in the name of the trust (i.e., John Smith, Trustee of the Smith Spousal Access Trust) and kept separated from the remaining assets of the donor spouse and the donee spouse.
- The trust must have its own financial accounts.
- All receipts must be received directly by the trustee, and all disbursements must be made by the trustee and solely as authorized by the trust.
- All investment decisions affecting the trust and its assets must be made exclusively by the trustee acting in that capacity. While the donor spouse and the donee spouse may consult with the trustee and advise the trustee, neither can direct the trustee's actions or inactions.
- The trustee must remain independent of the donor spouse and the donee spouse at all times and fulfill the fiduciary duty the trustee owes to all of the beneficiaries of the trust, both the donee spouse and the final beneficiaries.
- The trustee's activities must comply with administrative requirements imposed by state law (which may vary depending on the state in which the trust is created or administered). For example, an Oregon trustee will be required to notify beneficiaries of the existence of the trust, prepare and distribute annual reports to beneficiaries, invest trust assets prudently, etc.

All of these requirements are intended to consistently demonstrate that the donor spouse and the donee spouse have not exercised, even tacitly, any powers over the trustee or the trust assets that are not permitted by the trust agreement. That is the reason we encourage the use of a co-trustee or an independent trustee. It is much easier to adhere to these operating guidelines if the trust administration activities are conducted by someone other than the donee spouse alone.

Flexibility: The principal aim of the SLAT is avoidance of estate taxes on future appreciation and accumulated earnings of trust assets without complete loss of beneficial access to those assets. As described above, this requires the client to irrevocably transfer assets to the trust. But times change, as do the tax laws and the needs and desires of the family, so the trust needs a mechanism to respond to those changes.

The Oregon Uniform Trust Code includes several methods to modify irrevocable trusts within certain guidelines. It may be more efficient, however, to include a modification process in the terms of the trust agreement. Designating an independent trustee in the trust agreement and granting that trustee the authority to exercise special powers to respond to future events could prove to be an invaluable addition. For instance, the independent trustee could be empowered to grant the donee spouse a general power of appointment to force the inclusion of the trust assets in the donee spouse's estate, thereby securing a stepped-up basis of those assets. The independent trustee also could have authority to add or delete beneficiaries, authorize distributions beyond those limited by an ascertainable standard, and/or extend or shorten the term of the trust.

Reciprocal Trusts: In many cases, each spouse will create a trust for the benefit of the other spouse. That planning strategy allows both spouses to use their transfer tax exemption, for a total wealth transfer of up to $22.8 million in 2019. The plan should succeed unless the two trusts are "reciprocal" in the eyes of the IRS and courts. The trusts will be considered "reciprocal" if (i) the trusts

12 *See* IRC § 678(a)(1).

are "interrelated," and (ii) the economic position of each donor spouse does not materially change as a result of creating the trusts and transferring assets to them.[13] If the reciprocal trust doctrine applies, each trust will be included in the donor spouse's gross estate, as if the donor spouse had established the trust for his or her own benefit.[14]

Reciprocal trust treatment is avoided by creating trust documents with different terms. Many variations are available to distinguish the terms of the documents, including the following.

- The trusts can be created at different times.
- Each trust can be funded with different assets.
- Distributions to one spouse can be mandatory, while similar distributions to the other spouse may be discretionary.
- The powers of appointment to make gifts, withdraw principal,[15] or change the beneficiaries can be different.
- The final disposition of the assets to the ultimate beneficiaries can occur at different times or in different forms.

Each of these variations establishes the uniqueness of each trust.

Risks and Results: The objective is to exclude the transferred assets, together with all of their appreciation and income, from the gross estates of both spouses. If the actual transaction history of the trust during the lifetimes of the donor and donee after the creation of the trust reveals that either spouse exercised more control over or received more benefits from the trust than permitted by its terms, the value of the trust assets will be included in the estate of the donor or donee spouse as if the original gift to the trust had never been made. The increased estate tax costs to the beneficiaries could be very significant if the transfer tax exemption amount happens to be less at that time or if the trust assets have greatly appreciated in value.

13 *United States v. Estate of Grace*, 395 US 316 (1969).
14 *See id.* at 325.
15 Any power to withdraw principal for a purpose other than an ascertainable standard should be limited as described in IRC § 2041(b)(2).

Events Calendar

OSB Fall Basic CLE:
Basic Estate Planning for
Oregon Taxable Estates
November 15, 2019
Multnomah Athletic Club, Portland, OR

64th Annual Estate Planning Seminar
November 18-19, 2019
Washington State Convention Center
Seattle, WA

The Editors want to include announcements of upcoming events that are open to the public and may be of interest to our readers. If you know of an event, please send basic information, including point of contact information to Chris Cline at *chriscline@riverviewbank.com* for inclusion in the next issue of the Newsletter.