The Florida Bar Continuing Legal Education Committee
and the Real Property, Probate & Trust Law Section

38th Annual Attorney Trust Officer Conference

– Volume I –

COURSE CLASSIFICATION: INTERMEDIATE LEVEL

August 22-24, 2019

Live Presentation:

The Breakers (Palm Beach)
1 S County Rd
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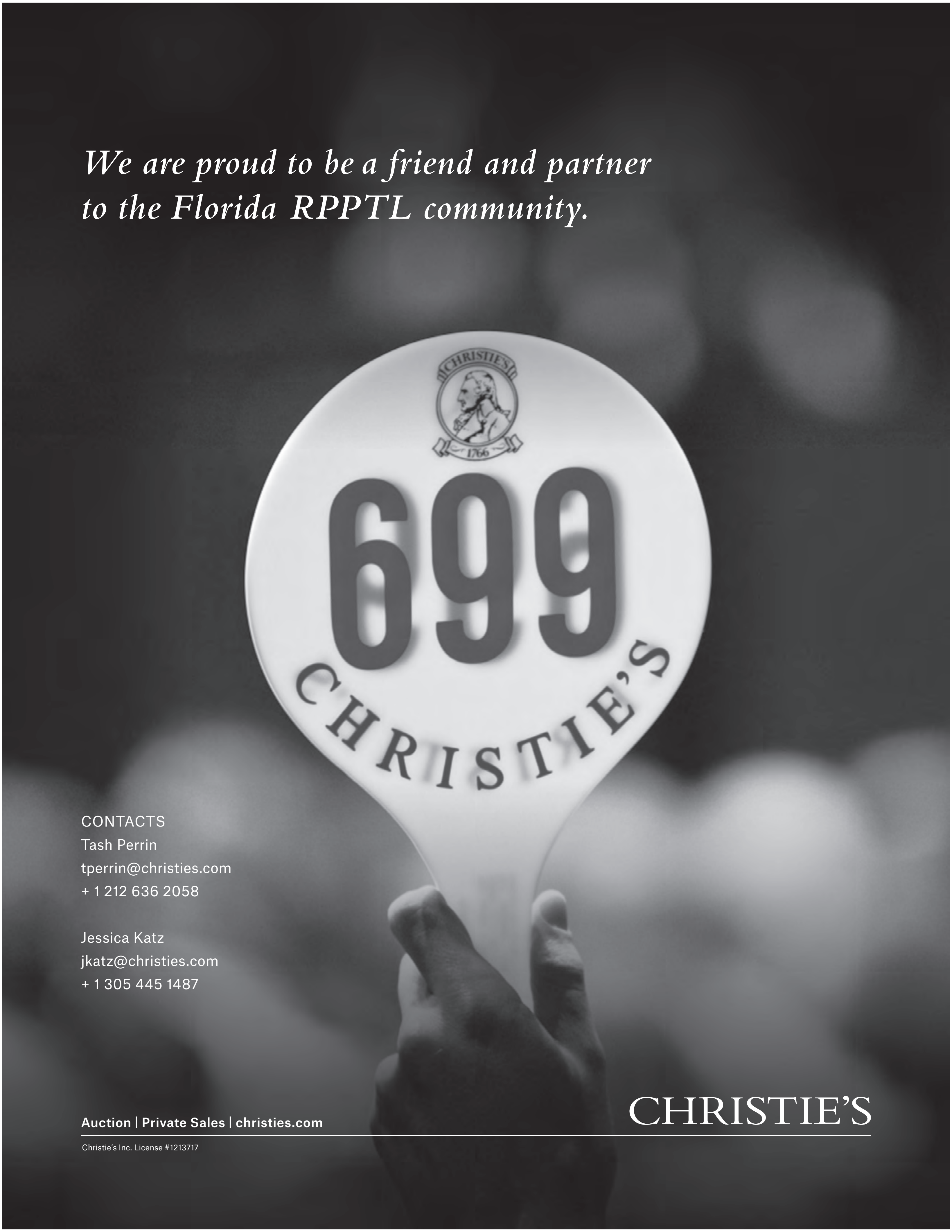
Course No. 3241R



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President
Trust and Wealth Management

305.860.2756

cporter@grovebankandtrust.com

Marta Goldberg, JD
Managing Director
Fiduciary Wealth Advisor

305.860.2716

mgoldberg@grovebankandtrust.com

David Breitwieser
Managing Director
Chief Investment Officer

305.860.2731

dbreitwieser@grovebankandtrust.com

Alex F. Bahamonde, CTFA
Managing Director
Chief Fiduciary Officer

305.860.2719

abahamonde@grovebankandtrust.com

Derrick Garcia, CFP®
Head of Portfolio Management

305.860.2762

dgarcia@grovebankandtrust.com

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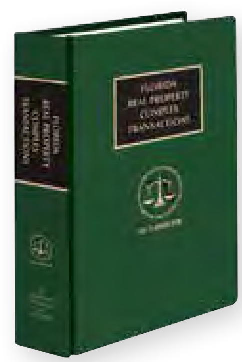
NEW EDITION

Florida Real Property Complex Transactions

NINTH EDITION © 2018

From sales and leases of commercial property, to subdivision development, to mobile home park conversions, *Florida Real Property Complex Transactions* provides practical, step-by-step guidance for negotiating and drafting the necessary documents to complete these multifaceted transactions.



A discussion of federal and state laws governing these complex transactions includes the impact of sales taxes, intangible taxes, and documentary stamp taxes. The manual also contains countless sample provisions and forms, along with checklists and practice pointers to help ensure that all significant issues have been considered.

In addition to revised statutes, rules, and new case law, new coverage has been added on:

- Subdivisions
- Mixed-use developments
- Land acquisition

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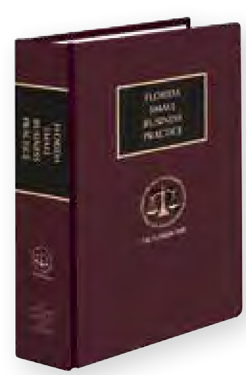
NEW EDITION

Florida Small Business Practice

TENTH EDITION © 2018

Florida Small Business Practice provides a broad understanding and explanation of the laws concerning the creation, purchase, maintenance, and sale of various business entities for the small business client. New in the tenth edition:



- Updated case law, statutes, rules, and regulations
- Updated checklists, tables, and forms
- The Tax Cuts and Jobs Act of 2017 and its impact on the taxation of different business entities
- Discussion of Congress's revamping of the process for auditing partnerships under the Bipartisan Budget Act of 2015
- Discussion of recent estate and gift tax changes related to family limited partnership planning
- Repeal of the technical termination of partnerships beginning in 2018
- Amendment of IRC § 172 as it relates to net operating losses of "C" corporations
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NEW EDITION

Florida Construction Law and Practice

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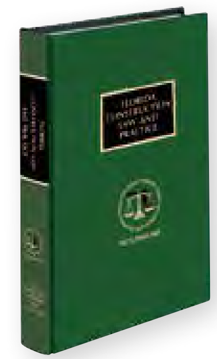

Authored by experienced construction lawyers, this manual provides a thorough treatment of construction law, with chapters that cover:

- Rights and liabilities of parties to construction projects
- The bid process involving public entities
- Alternative dispute resolution
- Trial preparation
- Jury instructions for construction trials

Practical discussions also cover bankruptcy, bond, insurance, and damages issues.

Highlights of the new edition include:

- Specific focus on design professionals within contract and litigation
- Update and explanation of 2017 General Conditions
- Particular considerations given to the 2017 and 2018 amendments to *F.S.* 95.11(c)(3)
- Discussion of the Middle Districts reaction to *Tiara*
- Discussions of the Florida Supreme Court's quashing of Sebo v. American Home Assurance Co.
- Highlighting of venue, construction liens, and statutory updates that impact contractors and construction managers
- Detailed explanation regarding the Arbitration Act and case law regarding attorneys' fees
- Significant rewrite of the chapter sections regarding public-private partnerships and the shift of statutory authority
- New authors with fresh information about trial preparation, specifically regarding electronic stored information
- Statutes, rules of court, federal rules, and case law updated throughout

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NEW EDITION

Florida Real Property Sales Transactions

NINTH EDITION © 2018

Florida Real Property Sales Transactions covers all the issues a practitioner is likely to encounter when involved in a real property sales transaction in Florida: from the initial attorney-client discussion about clauses in a contract for sale and purchase, to the documents required at a closing, as well as most points in between.

Highlights of the ninth edition:

- Impact of the Obergefell decision on same-sex marriages with respect to title considerations.
- Discussion of local government financing of energy-related qualifying improvements under *F.S.* 163.08
- Elaboration on guaranties, specifically regarding the effect the Dodd-Frank Wall Street Reform and Consumer Protection Act
- Updated statutory and case law
- Newly revised contracts and forms

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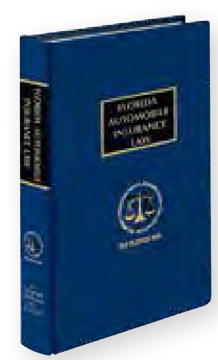
NEW EDITION

Florida Automobile Insurance Law

TENTH EDITION © 2018



In this title, experienced practitioners guide the reader through the intricacies of the ever-changing area of Florida automobile insurance law. Topics include the procedure for handling the typical automobile insurance case from both the plaintiff's and defendant's perspective, as well as the process for determining the order and priority of coverage in cases involving multiple tort feasors and insurance policies.

Sample forms, worksheets, and checklists are provided to aid the practitioner. Highlights of the new Tenth Edition include:

- Complete update and rewrite of Chapter 5, Liability Coverage
- Substantive update and rewrite of Chapter 7, Bad Faith and Unfair Claims
- Case law reviewed and updated
- All statute, regulation, and rules of court procedure references reviewed and updated
- Practical points and sample forms shared by seasoned practitioners

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Common Questions About CLER

1. **What is CLER?**
   CLER, or Continuing Legal Education Requirement, was adopted by the Supreme Court of Florida in 1988 and requires all members of The Florida Bar to continue their legal education.

2. **What is the requirement?**
   Over a 3 year period, each member must complete 33 hours, 5 of which are in the area of ethics, professionalism, substance abuse, or mental illness awareness, and 3 hours in technology.

3. **Where may I find information on CLER?**
   Rule 6-10 of the Rules Regulating The Florida Bar sets out the requirement. All the rules may be found at www.floridabar.org/rules.

4. **Who administers the CLER program?**
   Day-to-day administration is the responsibility of the Legal Specialization and Education Department of The Florida Bar. The program is directly supervised by the Board of Legal Specialization and Education (BLSE) and all policy decisions must ultimately be approved by the Board of Governors.

5. **How often and by when do I need to report compliance?**
   Members are required to report CLE hours earned every three years. Each member is assigned a three year reporting cycle. You may find your reporting date by logging in to your member portal at member.floridabar.org.

6. **Will I receive notice advising me that my reporting period is upcoming?**
   Four months prior to the end of your reporting cycle, you will receive a CLER Reporting Affidavit, if you still lack hours.

7. **What happens if I am late or do not complete the required hours?**
   You run the risk of being deemed a delinquent member which prohibits you from engaging in the practice of Florida law.

8. **Will I receive any other information about my reporting cycle?**
   Yes, you will receive reminders prior to the end of your reporting cycle, if you have not yet completed your hours.

9. **Are there any exemptions from CLER?**
   Rule 6-10.3(c) lists all valid exemptions. They are:
   1) Active military service
   2) Undue hardship (upon approval by the BLSE)
   3) Nonresident membership (see rule for details)
   4) Full-time federal judiciary
   5) Justices of the Supreme Court of Florida and judges of district, circuit and county courts
   6) Inactive members of The Florida Bar

10. Other than attending approved CLE courses, how may I earn credit hours?

Credit may be earned by:

1) Lecturing at an approved CLE program
2) Serving as a workshop leader or panel member
3) Writing and publishing in a professional publication or journal
4) Teaching (graduate law or law school courses)
5) University attendance (graduate law or law school courses)

11. How do I submit various activities for credit evaluation?

Applications for credit may be found on our website, www.floridabar.org.

12. How are attendance hours posted on my CLER record?

You must post your credits online by logging in to your member portal at member.floridabar.org.

13. How long does it take for hours to be posted to my CLER record?

When you post your CLE credit online, your record will be automatically updated and you will be able to see your current CLE hours and reporting period.

14. How may I find information on programs sponsored by The Florida Bar?

You may wish to visit our website, www.floridabar.org/cle, or refer to The Florida Bar News. You may also call CLE Registrations at 850/561-5831.

15. If I accumulate more than 30 hours, may I use the excess for my next reporting cycle?

Excess hours may not be carried forward. The standing policies of the BLSE, as approved by the Supreme Court of Florida specifically state in 6.03(b):

> ... CLER credit may not be counted for more than one reporting period
> and may not be carried forward to subsequent reporting periods.

16. Will out-of-state CLE hours count toward CLER?

Courses approved by other state bars are generally acceptable for use toward satisfying CLER.

17. If I have questions, whom do I call?

You may call the Legal Specialization and Education Department of The Florida Bar at 850/561-5842.

**While online checking your CLER, don't forget to check your
Basic Skills Course Requirement status.**

PREFACE

The course materials in this booklet were prepared for use by the registrants attending our Continuing Legal Education course during the lectures and later in their offices.

The Florida Bar is indebted to the members of the Steering Committee, the lecturers and authors for their donations of time and talent, but does not have an official view of their work products.

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Technology .... 1.0 hour

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(Maximum 14.5 hours)

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Wills, Trusts & Estates.. 14.5 hours
Tax Law.. 1.0 hour

Seminar credit may be applied to satisfy both CLER and Board Certification requirements in the amounts specified above, not to exceed the maximum credit. Refer to Chapter 6, Rules Regulating The Florida Bar, see the CLE link at www.floridabar.org for more information about the CLER and Certification Requirements.

Prior to your CLER reporting date you will be sent a Reporting Affidavit (must be returned by your CLER reporting date). You are encouraged to maintain records of your CLE hours.

CLE CREDIT IS NOT AWARDED FOR THE PURCHASE OF THE COURSE BOOK ONLY.

CLE COMMITTEE MISSION STATEMENT

The mission of the Continuing Legal Education Committee is to assist the members of The Florida Bar in their continuing legal education and to facilitate the production and delivery of quality CLE programs and publications for the benefit of Bar members in coordination with the Sections, Committees and Staff of The Florida Bar and others who participate in the CLE process.

COURSE CLASSIFICATION

The Steering Committee for this course has determined its content to be INTERMEDIATE.

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LECTURE PROGRAM

Wednesday, August 21, 2019

6:00 p.m. - 8:00 p.m.	**Welcome Reception**

Thursday, August 22, 2019

7:50 a.m. - 8:00 a.m.	**Opening Remarks** *Tattiana P. Brenes-Stahl, Boca Raton*
8:00 a.m. - 8:50 a.m.	**Battle of the Titans: Guardians vs. Trustees** *Cady L. Huss, Sarasota* *Elizabeth M. Hughes, Miami*
8:50 a.m. - 9:50 a.m.	**Grantor Trusts: The Good, The Bad,** *Diana S. C. Zeydel, Miami*
9:50 a.m. - 10:05 a.m.	**Break**
10:05 a.m. - 10:55 a.m.	**Florida Community Property Rights Simplified** *Richard M. Warner, Marathon*
10:55 a.m. - 11:45 a.m.	**Is There Substance to my Anxiety? Mental Health and Substance Abuse Issues and Solutions** *J. Eric Virgil, Moderator* *The Hon. Yvonne Colodny, Miami* *Habsi Kaba, Doral*
11:45 a.m. - 12:35 p.m.	**Releases, Waivers, Indemnity, Reserves** *Jack A. Falk, Coral Gables*
12:35 p.m. - 1:35 p.m.	**Lunch**
1:35 p.m. - 2:25 p.m.	**The Long and Winding Road of Remote Online Notarization and Electronic Estate Planning Documents** *Angela M. Adams, St. Petersburg*
2:25 p.m. - 3:40 p.m.	**Cool Charitable Contribution Strategies in the New Tax Climate** *Conrad Teitell, Stanford Ct.*
3:40 p.m. - 3:55 p.m.	**Break**

<u>Thursday, August 22, 2019 (Lecture Program cont.)</u>

3:55 p.m. - 4:45 p.m.	**Here be Dragons: What to do When the UTC (Maybe) Doesn't Help** *Deborah King, North Carolina*
4:45 p.m. - 5:35 p.m.	**Quicksand! Post-Morem Escapes from IRA Beneficiary Disasters** *Robert "Bob" Kirkland, Ocala*

<u>Friday, August 23, 2019</u>

8:00 a.m. - 8:50 a.m.	**The Best Part of Waking Up: Some Current Ethical Concerns That Can Ruin Your Morning Coffee Cup** *Larry Miller, Boca Raton* *Jerry Wolf, Boca Raton*
8:50 a.m. - 9:40 a.m.	**What You Don't Know About International Tax: Topics For Estate And Tax Professionals** *David D. Barnhill, Tampa*
9:40 a.m. - 10:30 a.m.	**Hello Goodbye: Resignation, Removal, and Succession of Personal Representatives and Trustees** *John Moran, West Palm Beach*
10:30 a.m. - 10:45 a.m.	**Break**
10:45 a.m. - 11:35 a.m.	**Case Law Update** *Steve Hearn, Tampa*
11:35 a.m. - 12:25 p.m.	**Legislative Update** *Jon Scuderi, Naples*

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Larry Miller, Boca Raton
Jerry Wolf, Boca Raton

AUTHORS/LECTURERS

ANGELA M. ADAMS practices estate and trust litigation with the Law Office of Wm. Fletcher Belcher in St. Petersburg. She graduated from Vanderbilt University and received her law degree from Stetson University College of Law. She is a Fellow of The American College of Trust and Estate Counsel and a member of the Executive Council of the Real Property, Probate & Trust Law (RPPTL) Section of The Florida Bar. Angela currently chairs the RPPTL Section's Trust Law Committee, co-chairs the Ad Hoc Study Committee on Professional Fiduciary Licensing, and is a member of several other Section committees. She previously served on the Power of Attorney Committee that authored the 2011 Florida Power of Attorney Act. Angela is listed as an AV Preeminent Rated Lawyer by Martindale-Hubbell and is recognized in The Best Lawyers in America and Florida Trend's Florida Legal Elite. She is a frequent lecturer and writer on estate and trust topics.

DAVID BARNHILL works with his high-net-worth individual clients to navigate complex inbound and outbound international tax matters, including international estate tax planning, structuring and restructuring of global business interests, pre-residency planning and expatriation. In all cases, David works together with his clients to find the right balance between maximizing the tax efficiency of his proposed solutions and ensuring that the client's business and personal purposes are achieved. David has advised numerous clients, including trusts and estates, regarding U.S. international income tax and reporting compliance matters. He has experience representing clients before the IRS in penalty proceedings related to FBAR filing compliance, reporting compliance related to his U.S. clients' interests in foreign businesses and trusts, and compliance issues facing foreign owners of U.S. business and real estate assets. David has also served as lead attorney for clients participating in the IRS Offshore Voluntary Disclosure Program, streamlined filing compliance procedures and other compliance alternatives.David also represents clients in all stages of tax controversy proceedings, including IRS examinations, IRS Appeals, United States Tax Court proceedings and Federal appellate litigation. He also advises clients with respect to FATCA and other global compliance issues.

JENNIFER JONES BLOODWORTH is Senior Underwriting Counsel for First American Title Insurance Company and is located in Orlando. She has been with First American since 2012. Jennifer earned her undergraduate degree in 1998 from Emory University in Atlanta, Georgia. A Florida native, she later returned to Florida and graduated, cum laude, from the University of Florida, Levin College of Law in 2003. Jennifer is a member of the Florida Bar and a member of the Executive Council for the Real Property, Probate & Trust Law Section of The Florida Bar.

YVONNE COLODNY is the Administrative Judge of the Probate Division of the Eleventh Judicial Circuit Court. She is a graduate of the Florida State University and the Florida State University College of Law.As the Administrative Judge of the Probate Division, Judge Colodny oversees Mental Health and Guardianship cases, as well as the Marchman and Baker Act Courts. Between 2011-2017, while assigned to the Criminal Court bench, she co-chaired the Mental Health Diversion program. She is the recipient of the Mental Health Transformation in Action, Paul Kaminsky Community Justice

JACK FALK is a shareholder at Dunwody White & Landon, P.A. and focuses on fiduciary law and disputes related to estates and trusts. He serves clients from the firm's offices in Coral Gables, Palm Beach and Naples. Jack has been a Fellow of the American College of Trust and Estate Counsel (ACTEC) since 2003 and is an active member of the Fiduciary Litigation Committee of ACTEC (2003-2019). He is named in the list of the "Best Lawyers in America" by Woodward/White," 10th and all subsequent editions (2003- 2019) and was named "Lawyer of the Year" for 2014 and 2018 in trusts and estates litigation (Miami area) in the Best Lawyers in America publication. Jack graduated magna cum laude from the University of Miami School of Law in 1987 and received a dual business degree magna cum laude from Florida State University in 1983. He has been recognized by: "Florida's Top Lawyers" in Florida Monthly (2004-2018), "Florida's Super Lawyers" (2006-2018), Florida Trends (2012-18) as an estate and trust attorney among "Florida Legal Elite" and as a "Top Lawyer" in the South Florida Legal Guide (2001-2018).Jack is the past Chair (2004-07) of the Probate and Trust Litigation Committee of the Florida Bar RPPTL Section and remains an active member. He served as Chair (2012-2015) of the Ad Hoc Committee on Personal Representative Issues, currently serves as Co-Vice Chair of the Trust Law Committee (2014-19) and served on the Elective Share Committee (2014-16). He also has served for many years as a member of the Probate and Trust Litigation, Trust Law and Probate Law Committees as well as the Ad Hoc Committee on Jurisdiction and Process and formerly served on the Probate Rules Committee (2002-07). He also served as CLE Chair for the Section (2007-09) and was past Chair (2012-14) of the Attorney Trust Officer Liaison Conference Committee. He also was past Chair (2002-03) of the Probate and Guardianship Committee of the Miami-Dade County Bar Association. Jack has lectured and authored extensively on trusts and estates, including for The Florida Bar's statewide seminars, the Attorney Trust Officer Liaison Conference, the Florida Fellows of ACTEC and its Florida Fellows Institute estate and trust litigation series, the Fiduciary Litigation Committee of ACTEC, the Florida Legal Education Association, and for several estate planning councils, bar associations and corporate fiduciary associations in South Florida. As a member of committees of the RPPTL Section, he has been extensively involved in identifying, researching and developing many important statutes in trust and estate law that were enacted by the Florida Legislature and became law. He has served as a lecturer on trust litigation at the Florida Trust School Graduate Program sponsored by the Florida Bankers Association. He also has been published in "The Florida Bar Journal", "The Florida Bankers" Magazine and numerous Florida Bar CLE publications and appeared on the television program "Wealth & Wisdom" on trust and estate law. Jack has served for more nearly 15 years as one of four trustees of The Batchelor Foundation, one of Florida's largest private charitable foundations.

STEVEN L. HEARN is the sole shareholder of his firm, Steven L. Hearn, P.A., in Tampa, Florida. His firm primarily handles disputes in trusts, estates and guardianships; probate administration; and trust administration. He also serves as a mediator and arbitrator in estate or trust disputes in Federal and State Courts. Mr. Hearn received his B.S. in Economics, Summa Cum Laude, from Florida State University, where he also played trombone in the "World Renowned Marching Chiefs." He received his J.D. from the Duke University School of Law, and was a member of the Duke Law Journal, the Duke Moot Court Board, and a teaching assistant for legal research and writing courses. Mr. Hearn is a Fellow of the American College of Trust and Estate Counsel ("ACTEC"), and serves on the ACTEC Fiduciary Litigation Committee. He is a past Chair of the Real Property, Probate, and Trust Law Section of The Florida Bar. He served as Chairman of the Florida Probate Rules Committee from 1997 to 1999 and was the Probate Rules representative to the Florida Rules of Judicial Administration Committee from 1995 to 1999. Mr. Hearn served as chair for the Hillsborough County Bar Association Real Property, Probate & Trust Law Section from 1992 to 1994. Mr. Hearn has given numerous presentations regarding probate and trust litigation, estate and trust administration, guardianship administration, arbitration, and mediation. In his spare time, he likes to .... Wait, there IS no spare time.

ELIZABETH HUGHES is an attorney at Greenspoon Marder in Miami, Florida and represents clients in all aspects of probate, guardianship, trust law and litigation proceedings. She has not only represented clients in such matters but has served and continues to serve as court appointed counsel, guardian ad litem (namely minor settlements), estate curator, guardian, and emergency temporary guardian in Florida probate, trust and guardianship matters. Hughes is a graduate of Class 2 of the American College of Trust and Estate Counsel (ACTEC) Florida Fellows Institute. She obtained her B.S. in Health Science from the University of Florida and her J.D. from the University of Miami School of Law. Hughes has experience litigating and resolving will contests, fee disputes, determination of heir disputes, disputes over appointment of fiduciaries, removal of fiduciaries, elective share disputes, and breaches of fiduciary obligations. She regularly assists individuals and clients serving as fiduciaries in reforming and construing wills and trusts, determining rights in wills and trusts, modifying trusts, as well as terminating trusts. She has represented both petitioners and respondents in Florida Marchman Act proceedings and has served as private counsel for alleged incapacitated persons as well as wards.

CADY L. HUSS is an estate and trust lawyer with Spivey & Huss, PA in Sarasota, Florida. Her primary focus is litigation, including will and trust contests, lack of capacity and undue influence claims, fiduciary disputes, and exploitation of the elderly. Cady is a member of the Sarasota County and St. Pete Bar Associations, the Pinellas Florida Association for Women Lawyers, and The Florida Bar. She is the Chair of the Estate Planning and Probate Section of the Sarasota County Bar and serves on The Florida Bar's Probate Rules Committee. She also an Executive Council member of the Real Property, Probate, and Trust Law Section and a graduate of ACTEC's Florida Fellows Institute.

HABSI W. KABA began her career in the field of mental health in rehabilitation and recovery, nearly 25 years ago. As a Marriage and Family Therapist, her passion as an educator and public speaker on mental health has inspired her work to create understanding, compassion, and connections within the behavioral health community, first responders, and society. Since 2003, Habsi has led the Crisis Intervention Team (CIT) Program of the Eleventh Judicial Circuit Criminal Mental Health Project, in Miami-Dade County. Among numerous certifications, Habsi is a certified Mental Health First Aid and a USA and Florida Department of Law Enforcement Criminal Justice Instructor. To date, she has trained over 10,000 first responders, 911 Communications personnel, mental health professionals, and government officials, including organizations in the private sector. Habsi has served as a consultant on an international, federal, state, and local level, including the Department of Homeland Security, U.S. Immigration and Customs Enforcement Hostage Negotiation Team. Habsi is an internationally recognized expert in the field of crisis intervention best practices and education, curriculum design and development, trauma, first responder self-care, de-escalation techniques, and police and mental health collaboration. She shares her vast experience as a boundary spanner, leader, and resources facilitator in the implementation of behavioral health, criminal justice initiatives, systems transformation, law enforcement, behavioral health, and community liaison services. In 2014, Habsi was named the CIT International Coordinator of the Year, for her many contributions to law enforcement, behavioral health, and her community. Her expertise, celebrated interpersonal skills, and unique style have made her a widely known and sought-after educator, panelist, and conference speaker throughout the United States.

DEBORAH H. KING is Senior Counsel at Wells Fargo Bank, N.A. located in Charlotte, North Carolina. Ms. King primarily provides support to the Investment and Fiduciary Services group. She advises on a variety of fiduciary matters, but spends much of her time advising on closely-held assets, tax and philanthropic issues. Ms. King currently serves as the Liaison between the North Carolina Bankers Association's Bank Counsel Committee and the North Carolina Estate Planning & Fiduciary Law Section Council. Ms. King also participates on the Legislative Committee for the North Carolina Estate Planning & Fiduciary Law Section. Prior to joining Wells Fargo in 2008, Ms. King was in private practice at Culp, Elliott & Carpenter LLP where she assisted individuals with their business succession, estate planning and philanthropic goals. Ms. King holds a LL.M. in Taxation from Boston University, a J.D. from the University of California, Hastings College of the Law (Member of the Coif) and B.A. from the University of New Hampshire. She is admitted to practice in North Carolina and Massachusetts.

BOB KIRKLAND is founding partner of the law firm of Kirkland Woods & Martinsen LLP, which has offices in Liberty, Missouri, Springfield, Missouri, Clayton, Missouri and Overland Park, Kansas. He is licensed to practice law in Missouri and Kansas. He works with a variety of individual clients, handling the preparation of Wills, Living Trusts, Durable Powers of Attorney, Irrevocable Trusts, Charitable Trusts and Minor's Trusts, and counseling clients in the areas of gifting techniques, asset protection, charitable planning and business succession planning. He also advises fiduciaries in estate, conservatorship and trust administration matters. Mr. Kirkland is a Fellow of the American College of Trust and Estate Counsel ("ACTEC"), is a past Missouri State Chair of ACTEC, and a past member of the ACTEC Board of Regents and ACTEC Executive Committee. He is also a member of the Employee Benefits Committee (past Chair), Sponsorship Advisory Committee (Chair), Digital Property Task Force, Membership Selection Committee, Long Range Planning Committee, and Communications Committee of ACTEC. He is listed in the last twenty-plus editions of The Best Lawyers in America and the most recent additions of Super Lawyers. Mr. Kirkland has successfully completed the Effective Probate Mediation Training course sponsored by ACTEC, and frequently serves as a mediator of trust and estate disputes. Bob also served as the ACTEC Observer to the Uniform Law Commission Drafting Committee on Fiduciary Access to Digital Assets, is serving as the ACTEC Observer to the Uniform Law Commission Drafting Committee on Electronic Wills. Among several professional and civic activities, Mr. Kirkland serves as a Vice Chair of the Missouri Bar Probate and Trust Committee, and a member of the editorial board of Trusts and Estates magazine.Mr. Kirkland is a frequent author and lecturer in the estate planning and charitable giving areas. He has lectured on a variety of topics at seminars sponsored by ACTEC, The Heckerling Institute, ALI-CLE, Society of Trust and Estate Practitioners, The Missouri Bar, The Kansas Bar Association, The Iowa Bar, The Ohio Bar, The Idaho Bar, The Florida Bar, The Oklahoma Bar Association, the Hawaii Tax Institute, the Southern Federal Tax Institute, the Notre Dame Estate Planning Institute, the Duke University Estate Planning Conference, the Florida Fellows Institute, the UCLA Institute on Estate Planning, The MO-KAN Trust Conference, the American Heart Association, and the Estate Planning Councils of Baltimore, Greenville, Little Rock, Louisville, New York City, Philadelphia, St. Louis and West Palm Beach. Mr. Kirkland holds a B.S. in accounting from William Jewell College (1980), a J.D. from the University of Missouri-Kansas

City School of Law (1983), and an L.L.M. in estate planning from the University of Miami, Florida School of Law (1985). During his tenure at the UMKC School of Law, he served as Managing Editor of the UMKC Law Review.

LAWRENCE J. MILLER is a shareholder in Gutter Chaves Josepher Rubin Forman Fleisher Miller P.A. in Boca Raton. He earned his undergraduate degree with highest honors from Lehigh University in 1974 and his J.D. from Emory University (Order of Barristers) in 1977. He is a member of the Florida, Georgia and New Jersey Bars. Larry is Director of At Large Members and past Secretary of the Florida Bar's Real Property, Probate and Trust Law Section and is a member of the Section's Executive Committee. He is an active member of the Section's Probate and Trust Litigation Committee, Probate Law and Procedure Committee, Trust Law Committee and Guardianship, Power of Attorney and Advance Directives Committee (Past Vice-Chair). He is past Chair of the RPPTL Professionalism and Ethics Committee and past Ethics Editor for ActionLine. Mr. Miller has been involved as estate planning counsel, probate and trust administration counsel, guardianship counsel and counsel in litigated matters in these areas, including mediation and arbitration, since 1977. Larry is a Fellow of the American College of Trust and Estate Counsel (ACTEC); a Fellow of the American Bar Association Foundation; and a Fellow, Litigation Counsel of America. He has been recognized in Best Lawyers in America, is a AFlorida Super Lawyer@ and has been listed in Florida Law and Leading Attorneys. He practices and frequently writes and lectures in the areas of trusts, estates, guardianships and related litigation (including mediation and arbitration), as well as lawyer professionalism and ethics. He is the 2015 recipient of the RPPTL Section's William S. Belcher Lifetime Professionalism Award, is a past President of the South Palm Beach County Bar Association and former member of the Board of Directors of the Palm Beach County Bar Association.

JOHN C. MORAN is a shareholder with Gunster, Yoakley and Stewart, P.A. in West Palm Beach, Florida. He concentrates his legal practice in the areas of probate, trust, guardianship, and fiduciary litigation, as well as complex estate and trust administration. Mr. Moran is a Fellow of the American College of Trust and Estate Counsel (ACTEC) and a member of ACTEC's Fiduciary Litigation Committee. He is currently a Co-Chair of The Real Property, Probate and Trust Law Section (RPPTL) of the Florida Bar's Continuing Legal Education Committee, and is responsible for all probate and trust division programming. He is the Immediate Past Chair of the RPPTL's Probate Law and Procedure Committee, having served in that role for 5 years. Mr. Moran is a member of the RPPTL's Executive Council, and he serves on the Probate and Trust Litigation Committee, Trust Law Committee, and Guardianship, Power of Attorney and Advance Directives Committee. He is also a past Chair of the Florida Bar Probate Rules Committee. Mr. Moran is a former President of the Craig S. Barnard American Inn of Court in West Palm Beach, Florida. He earned his B.S. degree, magna cum laude, from Florida State University and his J.D. degree, with honors, from The George Washington University School of Law. Mr. Moran is the co-author of "Intestate Succession" and "Will Construction" in Litigation Under Florida Probate Code, published by the Florida Bar. He is a frequent lecturer on probate and trust topics.

JON SCUDERI is a shareholder in the law firm of Goldman Felcoski & Stone, P.A. He practices in the area of trust and estate litigation. He is admitted to practice before the Supreme Court of the United States, the Supreme Court of Florida (all Florida state courts), the United States Court of Appeals, Eleventh Circuit, and the U.S. District Court for the Middle District of Florida. Jon is a Fellow in the American College of Trust and Estate Counsel (ACTEC). He is on the Executive Council of the Real Property, Probate and Trust Law Section of The Florida Bar. He currently serves as co-chair of the Section's Legislation Committee and is the past chair of the Probate and Trust Litigation Committee. Jon is also a member of the American Bar Association. Jon earned his undergraduate degree (B.B.A.) from the University of Notre Dame, his M.B.A. from the University of Miami, and his law degree (J.D.) from the University of Florida.

CONRAD TEITELL is a principal in the Connecticut and Florida law firm of Cummings & Lockwood, based in the firm's Stamford office and chairs the firm's National Charitable Planning Group. He is an adjunct professor (Masters Graduate Program in Estate Planning) at the University of Miami School of Law. He holds an LL.B. from Columbia Law School and an LL.M. from New York University Law School. Teitell, an ACTEC Fellow, has lectured in all 50 states on charitable giving and estate planning. His many articles include columns in Trusts & Estates magazine; he is the editor and publisher of Taxwise Giving, a monthly newsletter and is the author of the five-volume treatise, Philanthropy and Taxation. Conrad Teitell founded and taught the American Bar Association's (ALI/CLE's) public speaking courses for over 25 years. He teaches public speaking to other professional advisers and laypeople and teaches public speaking for the Practicing Law Institute and the New York City Bar Association. He taught public speaking in a six-part PBS television series. Teitell has done a number of PBS programs: On The Money produced by WGBH/Boston and PBS specials on taxes and estate planning. He has been a commentator on National Public Radio's Marketplace. Mr.Teitell has testified at hearings held by the Treasury, the Internal Revenue Service, the Senate Finance Committee, the House Ways and Means Committee and the House Judiciary Committee. He was one of four invited witnesses to testify at the Senate Finance Committee on estate tax revision. One of the other witnesses was the Oracle from Omaha—Warren Buffett.

ERIC VIRGIL is a member of The Florida Bar and the North Carolina State Bar. He is a Fellow of the American College of Trust and Estate Counsel (“ACTEC”) and active in the Real Property, Probate, and Trust Law Section and the Elder Law Section of The Florida Bar. His firm, The Virgil Law Firm, is located in Coral Gables, Florida. In 2011, he was awarded the Judge Maria M. Korvick Award for exemplary service to the bench, bar, and community in probate and guardianship matters and awarded the Bonnie L. Cooper Memorial Probate & Guardianship Award from the Dade County Bar Association Legal Aid/Put Something Back. Eric chaired the Digital Assets and Information Committee and is the past Vice-Chair of the Guardianship Practice and Advanced Directives Committee of the Real Property, Probate, and Trust Law Section of the Florida Bar. Eric is the past chair of the Dade County Bar’s Probate and Guardianship Committee. In addition to his positions already noted, Eric is an active member of the Probate and Trust Litigation Committee and Probate Law and Procedure Committee of the Real Property, Probate, and Trust Law Section of The Florida Bar. He is a member of ACTEC’s Digital Property Committee and its Elder Law Committee. Eric is AV rated by Martindale-Hubbell, the highest rating a lawyer can attain from that nationally-known directory. He graduated with honors from both the University of Miami and from the University of North Carolina-Chapel Hill School of Law. He has lectured before many professional groups on trust, estate, and guardianship administration, trust, estate and guardianship litigation, and related topics.

RICHARD E. WARNER is the sole shareholder of Richard E. Warner PA in Marathon. He graduated magna cum laude from the University of Miami Law School in 1979 where he served on its law review editorial board, after earning undergraduate degrees at University of South Florida and Northwestern College respectively. He practiced in Marathon with the Cunningham, Albritton, Lenzi & Warner PA Law Firm in Marathon from 1979 until 1992, when he opened his solo practice there, Richard E. Warner PA. From 1984 to 2003, he served on the Executive Council of the Real Property, Probate and Trust Law Section and as the Section’s Circuit Representative for the 16th Circuit, and is currently an At Large Member of the Executive Council. He served as a member of the Probate Law Committee of the Section from 1984 to 2002, as Vice-Chair of the Committee during the Florida Probate Code revision project, 1999-2000, and as the Committee's chair from 2000-2002. Mr. Warner has contributed many articles to legal journals, CLE publications and law reviews, is a fellow of the American College of Trust and Estate Counsel, and is a frequent speaker on legal matters in the Keys and around the state and country. In 1992 he co-founded the Monroe County Estate Planning Council, for which he has served as president and journal editor of its "WONK" periodical. Warner is currently and has been designated in Superlawyers and is rated AV by Martindale-Hubbell. He served as dean of the Monroe County People's Law School, a pro bono public education program he established and was the awarded the Florida Supreme Court's Pro Bono award for Monroe County in 2001. Since 2008 he has served on the CCH Tax Advisory Committee for Commerce Clearing House Publications and in 2010 was appointed as Court Magistrate for the 16th Judicial Circuit in and for Monroe County.

JEROME L. "JERRY" WOLF is a member of the Florida and New York Bars. Jerry is certified as a specialist/expert in Wills, Trusts & Estates law by the Board of Legal Specialization and Education of The Florida Bar, and Jerry has also been awarded an "AV" rating by Martindale-Hubbell. Jerry is a Fellow of The American College of Trust and Estate Counsel (ACTEC) and is a founder and Co-Dean of The Florida Fellows Institute. He currently serves as a member of ACTEC's Asset Protection Committee and Estate and Gift Tax Committee. In addition to speaking for the Florida bar, ACTEC and other bar associations, for the past several years, Jerry has chaired the program on Wealth Protection and Preservation for Athletes and Entertainers as part of the ABA's annual Entertainment and Sports Law Symposium. Also, Jerry has taught graduate level courses on "Business Succession Planning" and "Asset Protection Planning" at the Florida Trust School sponsored by the Florida Bankers Association. Jerry is also a frequent author on estate planning subjects. Jerry authored Chapter 7, "Creditors' Rights To Assets in Trust", of ASSET PROTECTION IN FLORIDA, and Chapter 6, "Creditors' Rights and Spendthrift Clauses", of ADMINISTRATION OF TRUSTS IN FLORIDA, each of which is published by The Florida Bar and Lexis Nexis.

DIANA S.C. ZEYDEL is a shareholder and Global Chair of the Private Wealth Services practice of the law firm of Greenberg Traurig, P.A. She is a member of the Florida, New York and Alaska Bars. Diana is a past member of the Board of Regents and past Chair of the Estate & Gift Tax Committee of the American College of Trust and Estate Counsel. She is an Academician of The International Academy of Estate and Trust Law. Diana is a member of The Society of Trust and Estate Practitioners (STEP). She is a member of the Executive Council of the Real Property, Probate and Trust Law Section of the Florida Bar and an ACTEC liaison to the Section. She is ranked Band 1 Nationwide in Wealth Management and Band 1 in Tax in Florida by the Chambers USA 2018 High Net Worth Guide and is a recipient of the 2014 IFLR/Euromoney "Best in Wealth Management" Americas Women in Business Law Awards. Diana has been recognized as a "key figure in shaping the whole wealth management legal profession," Chambers USA 2012 Client's Guide. Diana is a frequent lecturer on a variety of estate planning topics and has authored and co-authored several recent articles, including "Chapter 4: Care and Feeding of a Dynasty Trust: High Protein or Low Fat?" 52nd Annual Heckerling Institute on Estate Planning, 2018; "Is Designating an Independent Trustee a Tax Panacea?" Estate Planning, February 2016; "Chapter 8: Effective Estate Planning for Diminished Capacity – Can You Really Avoid a Guardianship?" 50th Annual Heckerling Institute on Estate Planning, 2016; "Regretting Recent Estate Planning Arrangements?" Estate Planning, October 2015; "Chapter 3: Portability or No: Death of the Credit Shelter Trust?" 49th Annual Heckerling Institute on Estate Planning, 2015; "Supercharged Credit Shelter TrustSM versus Portability," Probate and Property, March/April 2014; "Imposition of the 3.8% Medicare Tax on Estates and Trusts," Estate Planning, April 2013;

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BATTLE OF THE TITANS: GUARDIANS VS. TRUSTEES

By

Cady L. Huss, Sarasota
Elizabeth M. Hughes, Miami

<u>About the Authors:</u>

Elizabeth M. Hughes is an attorney at Greenspoon Marder in Miami, Florida and represents clients in all aspects of probate, guardianship, and trust litigation proceedings. She has not only represented clients in such matters but has served and continues to serve as court appointed counsel, special fiduciary, guardian ad litem, and estate curator in Florida probate, trust and guardianship matters.

Hughes is a Class 2 alumna of the American College of Trust and Estate Counsel (ACTEC) Florida Fellows Institute. She is a graduate of the University of Florida and the University of Miami School of Law.

Hughes has experience litigating and resolving will contests, fee disputes, determination of heir disputes, disputes over appointment of fiduciaries, removal of fiduciaries, elective share disputes, and breaches of fiduciary obligations. She regularly assists individuals and clients serving as fiduciaries in reforming and construing wills and trusts, determining rights in wills and trusts, modifying trusts, as well as terminating trusts. She has represented both petitioners and respondents in Florida Marchman Act proceedings and has served as private counsel for alleged incapacitated persons and wards.

Hughes is a vice-chair of the Dade County Bar Association Probate and Guardianship Committee and manages a pro bono probate attorney mentoring program with Dade Legal Aid's Put Something Back. She serves on the Real Property, Probate, and Trust Law Section's Executive Council as a vice-chair of both the Section's quarterly publication ActionLine and the Law School Mentoring Committee. She can be reached at Elizabeth.hughes@gmlaw.com or (305) 789-2707.

Cady L. Huss is an estate and trust lawyer with Spivey & Huss, PA in Sarasota and St. Petersburg, Florida. Her primary focus is litigation, including will and trust contests, lack of capacity and undue influence claims, fiduciary disputes, and exploitation of the elderly. She is a graduate of the University of Florida and Florida State University College of Law.

Huss is a member of the Sarasota County and St. Pete Bar Associations, the Pinellas Florida Association for Women Lawyers, and The Florida Bar. She is the Chair of the Estate Planning and Probate Section of the Sarasota County Bar and serves as vice-chair of The Florida Bar's Probate Rules Committee. She also an Executive Council member of the Real Property, Probate, and Trust Law Section and a graduate of ACTEC's Florida Fellows Institute. She can be reached at cady@spiveyhuss.com or (941) 840-1991.

Introduction:

As fiduciaries, both guardians and trustees are obligated to work on behalf of their beneficiaries or wards with loyalty and to reject activities solely for their own personal or private gains. *See*, McGovern, Kurtz & Rein, *Wills, Trusts and Estates, Including Taxation and Future Interests* § 12.4 at 511 (Thomson/West 2004). Trustees and guardians are to exhibit the highest level of good faith and candor while they serve in these privileged roles. The term "fiduciary" applies not only to trustees, but to other relationships as well, such as, but not limited to, (1) a guardian and ward; (2) a personal representative of an estate and the estate beneficiaries; and (3) an agent and his or her principal. *See* Stephenson & Wiggins, *Estates and Trusts* § 185 (Prentice Hall 5th ed. 1973). "A guardian… has fiduciary duties comparable to that of a trustee…" Falk, Jr., *The Fiduciary's Lawyer-Client Privilege Does It Protect Communications from Discovery by A Beneficiary?*, Fla. B.J., March 2003, at 18, 26 (citing to Fla. Stat. § 733.602 (2002)).

While the roles of guardians and trustees have many similar duties and responsibilities, there are many grounds on which they differ. By definition, a guardianship is not a trust and although a guardian is also a fiduciary, a guardian is not a trustee. Trustees hold legal title to trust property while guardians do not hold legal title to wards' property. *See, O'Brien v. McMahon*, 44 So.3d 1273, 1280 (Fla. Dist. Ct. App. 2010) citing Restatement (Third) of Trusts § 5 cmt. c (2003). Guardians of minors or incapacitated persons do not become owners of the property which is placed under their charge. The title thereto remains in the ward's name. Guardians have only a naked power, not coupled with an interest. *Id.*

There are other differences between guardians and trustees. A trust is "a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee." Restatement (Third) of Trusts § 2 (2003). "A property arrangement may constitute a trust ... even though such terms as 'trust' or 'trustee' are not used.... Conversely, use of the word 'trust' or 'trustee' does not necessarily mean that a trust relationship is involved." *See,* Restatement (Third) of Trusts § 5 cmt. a (2003); *O'Brien v. McMahon*, 44 So.3d 1273, 1280 (Fla. Dist. Ct. App. 2010). The functions and duties of a guardian are "narrower than those of a trustee, are fixed by law, and do not depend, as in the case of a trust, on the manifestation of anyone's intention." Austin W. Scott, William F. Fratcher, & Mark L. Ascher, *Scott and Ascher on Trusts* § 2.33 (5th ed. 2006).

To further contrast the two roles, there are strict rules regarding who can serve as a guardian and virtually no rules on who can serve as trustee. Florida Statutes § 744.309 identifies the requirements for who can serve as a guardian of resident wards. The statute allows for the appointment of family members, trust companies, and corporate guardians but prohibits convicted felons or those otherwise unsuitable to perform the duties of a guardian. Fla. Stat. § 744.309. Meanwhile, a grantor of a trust is free to select a trustee and has virtually no restriction on that selection. A trustee, unlike a personal representative or guardian, does not have to be a Florida resident, a relative, or appointed by a court.

It is a common scenario in Florida, even where a guardian has been appointed over a ward with respect to certain delegable rights, that some or all of the ward's assets may be titled in a trust.

Consider the issues that may arise in this scenario. What impact or control (if any) does the guardian have over assets held in trust for the ward's benefit? Who receives and potentially objects to the trustee's fiduciary accountings? Is the guardian required to serve the trustee with guardianship accountings? Who ensures that the trustee is acting for the benefit of the ward and prudently administering the trust? What is a guardian to do when he or she suspects that a trustee is self-dealing and vice-versa?

In most circumstances, the probate court – which appointed the guardian – does not have jurisdiction over the trustee or the assets held in trust. Frequently, the trustee controls the assets of the trust and is not the same person as the appointed guardian. Sometimes the trustee subjects themselves to the jurisdiction of the probate court by appearing in the guardianship proceedings. Other times, a trustee avoids the probate court's jurisdiction and objects to any exercise of control by the probate court over trust assets.

These materials will address the interplay between two fiduciary titans – guardians and trustees. The materials will delve into Florida law addressing the distinctions in the two fiduciary roles, discuss jurisdictional issues, and examine the power tug of war when both roles affect a single ward/beneficiary. The following are considerations for those who represent guardians, trustees, wards, and beneficiaries.

Fiduciary Roles

Both guardians and trustees are fiduciaries with numerous obligations to their wards and beneficiaries. While similar, their fiduciary duties are not the same. Guardians are governed by statutes that grant a court the power to make the appointments and ultimately define the role, powers, and obligations of the guardian during the administration. *See* Fla. Stat. §§ 744.341 and 744.345 (2018). While there are still many statutory provisions governing the duties and powers of a trustee, a trustee's role is traditionally outlined in the trust document. *See* Fla. Stat. § 736.0105 (2018). Trustees are generally not subject to court oversight but may be brought into litigation if they fail to abide by their fiduciary duties. Both guardians and trustees may be removed for improper conduct and breaching their fiduciary obligations. Both can be surcharged for the same. *See* Fla. Stat. § 744.446 (3) ("Any activity prohibited by this section is voidable during the term of the guardianship or by the personal representative of the ward's estate, and the guardian is subject to removal and to imposition of personal liability through a proceeding for surcharge, in addition to any other remedies otherwise available.").

Trustees must follow the terms of the governing instrument that appoints them. They must do so while abiding by the statutory obligations of the Florida Trust Code and the Prudent Investor Act. Trustees must act prudently, in good faith, impartially, and administer the trust for the benefit of the beneficiaries. Fla. Stat. §§ 736.0801, 736.0802(1), 736.0803, and 736.0804 (2018). Without evidence that the trustee failed to perform, a court is without authority to remove trust assets from the trustee's control to be administered by the court or a guardian. *Cohen v. Friedland*, 450 So.2d 905 (Fla. 3d DCA 1984), *See also Guardianship of Mount*, 189 So.3d 213 (Fla. 2d DCA 2016).

The Court has numerous options when addressing a breach of trust. It can compel the trustee to perform the trustee's duties, enjoin the trustee, compel the trustee to redress a breach by paying money or restoring property, order the trustee to account, appoint a special fiduciary, suspend the trustee, remove the trustee, reduce or deny compensation to the trustee, void an act of the trustee, or impose any other appropriate relief. Fla. Stat. § 736.1001 (2018). A trustee liable for breach of trust is liable for the greater of (a) the amount required to restore the value of the trust property and trust distributions to what they would have been if the breach had not occurred, including lost income, capital gain, or appreciation that would have resulted from proper administration; or (b) the profit the trustee made by reason of the breach. Fla. Stat. § 736.1002(1) (2018).

Florida Statutes, § 744.361(3) imposes on the guardian that the guardian shall act in good faith. Florida Statutes, § 744.361(4) explains that a guardian may not act in a manner that is contrary to the ward's best interests under the circumstances. Although Florida Statutes, §744.361(11) imposes a specific standard of care on a guardian of the property, it does not impose such a standard on a guardian of the person. *See,* Robert P. Scheb, *Florida Guardianship Practice*, Chapter 14, Guardian of the Person: Duties, Responsibilities, and Liabilities, 10th Ed., 2018. Florida Statutes, § 744.446(4) states: "In the event of a breach by the guardian of the guardian's fiduciary duty, the court shall take those necessary actions to protect the ward and the ward's assets."

Like a trustee, a guardian can be removed for numerous reasons including failure to discharge his or her duties. Fla. Stat. § 744.474 (2018). Guardians may also be removed for actions beyond breach including, but not limited to, fraud in obtaining his or her appointment, incapacity, or illness rendering the guardian incapable of discharging his or her duties, and conviction of a felony. *Id.* Both guardians and trustees may benefit from seeking court approval of a proposed course of action in order to mitigate fiduciary liability and removal.

<u>Jurisdiction</u>

Guardians are appointed by a court and are therefore regarded as officers of the court. Accordingly, guardians obtain court approval for their substantial actions. Trustees can, at times, be appointed by a court, although typically they obtain their position through selection by the settlor in trust instruments and therefore, are not considered officers of the court. A trustee accepts the role by substantially complying with the method for acceptance as outlined in the trust instrument or by accepting delivery of trust property or exercising powers as trustee. Fla. Stat. § 736.0701(2018). Guardianship proceedings are filed and heard by the probate court while trust proceedings are instituted in civil courts. *See, In Re Estate of Black*, 528 So.2d 1316 (Fla. 2d DCA 1988); *Manufacturers Nat'l Bank v. Moons*, 659 So.2d 474 (Fla. 4th DCA 1995); and *Beekhuis v. Morris*, 89 So.3d 1114 (Fla. 4th DCA 2012).

Florida Statutes, § 736.0201 explains that judicial proceedings concerning trusts must be commenced by the filing of a complaint in accordance with the Florida Rules of Civil Procedure and that a court must have personal jurisdiction over a trustee in order to enter a ruling affecting the corpus of the trust. *Covenant Tr. Co. v. Guardianship of Ihrman*, 45 So.3d 499 (Fla. Dist. Ct. App. 2010). Usually, a guardianship court lacks personal jurisdiction with respect to trustees. Further, a guardianship court generally does not have jurisdiction over assets titled to a trust that are directed by a trustee when the trustee is not a party before the court in the guardianship case.

For example, in *Covenant Tr. Co. v. Guardianship of Ihrman*, 45 So.3d 499, 505 (Fla. Dist. Ct. App. 2010), it was reversible error for the guardianship court to require a trustee to use trust assets to reimburse a guardian of a trust beneficiary for guardianship expenses, attorney's fees, and other costs incurred during guardianship. The *Covenant* court announced that the court must have personal jurisdiction over the trustee "in order to enter a ruling affecting the corpus of the trust." *Id.* Thus, if the trial court does not have the requisite *in personam* jurisdiction over the trustee then the trial court erred by entering an order directing the trustee to pay an additional retainer from the trust. *Id. See also*, *Giglio v. Perretta*, 493 So.2d 470 (Fla. 4th DCA 1986); *Manufacturers National Bank of Detroit v. Moons*, 659 So.2d 474 (Fla. 4th DCA 1995) (The fact that the ward in a Florida guardianship is beneficiary of a foreign trust does not give the guardianship court jurisdiction over the nonresident trustee.).

A trustee can end up voluntarily subjecting the trust to the probate court's jurisdiction if not careful to avoid doing so. A family member who is also serving as trustee may be "next of kin" in a guardianship proceeding in his or her individual capacity but not in his or her fiduciary capacity. Appearing in one's individual capacity, does not give the probate court jurisdiction over that individual as a trustee. *See e.g., Beekhuis v. Morris*, 89 So.3d 1114 (Fla. Dist. Ct. App. 2012) (Probate court, in guardianship proceeding filed by ward's son, did not have jurisdiction over ward's trust assets or ward's daughter in her capacity as trustee, where original pleadings never raised any claim over trust or its property, and ward's daughter, who made limited appearances in guardianship proceeding only in her individual capacity, continually asserted that court lacked jurisdiction over trust and trustee.) *See also*, *Harris v. Martin,* 606 So.2d 1212 (Fla. 5th DCA 1992); *In re Estate of Black*, 528 So.2d 1316 (Fla. 2d DCA 1988). A person as an individual and a person as a trustee "are as separate and distinct in law as if they were in fact two different individuals." *In Re Estate of Cleeves*, 509 So.2d 1256 (Fla. 2d DCA 1987), citing *Uhl v. Holbruner*, 200 So. 359 (Fla. 1941). However, a trustee was considered to have submitted the trust to the jurisdiction of the probate court where the trustee entered into (and benefitted from) a mediation settlement agreement with the guardians. *Sowden v. Brea*, 47 So.3d 341 (Fla. Dist. Ct. App. 2010); *See also, Inglis v. Casselberry* 137 So.3d 389 (Fla. 2d DCA 2013) (trustee voluntarily submitted to court's jurisdiction by requesting relief in post dissolution proceedings).

There may be situations where it makes sense for the trustee to submit to the guardianship court's jurisdiction. For example, if it is more cost effective to proceed in the guardianship court regarding a dispute over the ward's expenses or trust distributions, the trustee may consider addressing the issue with the guardianship court in order to avoid the additional expense of filing a separate civil lawsuit. Often, the trustee will voluntarily submit to the guardianship court's jurisdiction for an order reviewing and approving a settlement agreement among a beneficiary ward, the guardian, and the trust. While the probate court does not automatically have jurisdiction over the trust, the trustee must prudently administer the trust for the benefit of the beneficiaries which sometimes requires the most cost-effective approach to resolve a dispute.

Powers to Challenge, Modify, or Revoke a Ward's Estate Plan

Generally, when a person creates a revocable trust (as the "grantor") the grantor usually can amend or revoke the trust at any time prior to their death. But what if that grantor becomes a ward in a guardianship and has been determined incapacitated in some sense. Do they still retain the power to amend or revoke their trust or is this power delegated to their guardian?

To answer this question, a practitioner would want to first look to the trust instrument. *See e.g., In re Guardianship of Muller,* 650 So. 2d 698 (1995) (Guardian authorized to exercise grantor/ward's power to amend trust to replace trustee where trust language read in pertinent part: "It is fully my intent that this Trust shall be a Revocable Trust. I therefore specifically reserve the right to revoke or amend this Agreement at any time in whole or in part.") The trust may have provisions addressing the powers the grantor has or doesn't have upon incapacity. If the trust allows for amendment in this scenario or is silent on this point, the practitioner must consider the Florida guardianship and trust codes. Florida Statutes, § 736.0602 (6) states that, "A guardian of the property of the settlor may exercise a settlor's powers with respect to revocation, amendment, or distribution of trust property only as provided in s. 744.441."

Looking then to Section 744, a guardian may have the authority to modify, amend, or revoke the ward's revocable trust in certain situations. The code includes specific statutes that address a guardian's ability to exercise the rights of a ward in relation to a ward's role as a fiduciary or holder of a power of appointment. Pursuant to Florida Statutes, § 744.441, after obtaining approval of the court pursuant to a petition for authorization to act, a plenary or limited guardian of the property, within the powers granted by the order appointing the guardian, may: "(2) Execute, exercise, or release any powers as trustee, personal representative, custodian for minors, conservator, or donee of any power of appointment or other power that the ward might have lawfully exercised, consummated, or executed if not incapacitated, if the best interest of the ward requires such execution, exercise, or release."

Normally, a court is unlikely to approve the amendment or revocation of a ward's trust as such action would essentially circumvent the ward's prior decision to implement an estate plan using a revocable trust. However, in *Cohen v. Friedland*, 450 So.2d 905 (Fla. 3d DCA 1984), a trustee was not properly using the trust assets to discharge the requirements of the trust to support and care for the ward, and the guardian was able to withdraw assets from the trust or, if necessary, revoke the trust entirely. *Id.* (Reiterating that, in the absence of proof that the trustee has failed to perform or has performed arbitrarily, a court is without authority to remove trust assets from control of trustee to be administered by court or other guardian.)

Florida Statutes, § 744.441(19) also allows a guardian to create or amend revocable trusts or create irrevocable trusts on behalf of the ward's estate in connection with estate, gift, income, or other tax planning. The court retains oversight of the assets transferred to a trust, unless otherwise ordered by the court. Fla. Stat. §§ 744.441(19), 744.368(5) (2018). However, a guardian may not create a new trust with the ward's assets changing the beneficiaries from those designated by the ward prior to the ward's incapacity where doing so was tantamount to amending the ward's will – and where changing the beneficiary had nothing to do with tax or estate planning so as to have been specifically authorized by statute. *In re Guardianship of Sherry*, 668 So.2d 659 (Fla. 4th DCA 1996) (Here, no benefits accrued to the ward's estate and authorizing such a change clearly would have been re-writing the ward's will or testamentary plan other than for the limited purposes authorized by the legislature in Section 744.441(18).).

Several courts have broadly interpreted the guardian's authority, as outlined in the guardianship statutes, to amend or modify a ward's estate plan. The Second District Court of Appeal, in *Goeke v. Goeke*, 613 So.2d 1345 (Fla. 2d DCA 1993), read subsections (17) (gifting powers), (19) (powers to create trusts), and (21) (powers to enter into contracts for the ward's benefit) of Section 744.441 in combination to expand the guardian's authority (on behalf of the ward) to update the ward's estate plan. In *Goeke*, the court allowed a guardian to create, fund, and designate beneficiaries for individual retirement accounts (IRA) when it was in the best interests of the ward.

In *In re Guardianship of Muller*, 650 So.2d 698 (Fla. 4th DCA 1995), the Fourth District Court of Appeal determined that, based on legislative history, Section 744.441(2) should not be restrictively read to limit the possible "powers" of the ward exercisable by the guardian with court approval. The Fourth District, in reversing the trial court, found that the court-appointed guardian of the property did have the authority under Section 744.441(2) (together with Section 744.441(19)) to amend the ward's revocable trust agreement by changing or replacing the appointed trustee based on conflict. The Fourth District read Section 744.441(2) and (19) together to permit the guardian to change the trustee of the ward's revocable trust from the individual the ward had actually designated as his successor trustee to another person, when it was shown that the named successor trustee potentially had a severe conflict of interest with the ward/trust beneficiary. The *Muller* Court found that the "other powers" portion of the guardianship statute permitted the guardian to obtain authority to change the successor trustee upon presentation of sufficient evidence to the court of a conflict such that the court could conclude that the ward, if competent, would likely have changed the successor trustee because of the conflict.

Occasionally, a guardian's authority to alter the ward's estate plan for limited purposes becomes a major problem for a trustee. For example, in *Reddick v. SunTrust Bank, East Central Florida*, 718 So.2d 950 (Fla. 5th DCA 1998), a wife, in her capacity as plenary guardian of her husband's property, unsuccessfully petitioned the court to amend her incapacitated husband's trust under Section 744.441(2) to substitute herself as trustee in place of the bank. Both the trial court and the appellate court found that because her husband regularly used a corporate trustee, his best interest was served by continuing to use the bank as trustee. The court recognized that Section 744.441(2) authorized the guardian, with court approval, to exercise any powers that the ward could lawfully exercise, when competent, if the best interest of the ward required such exercise. However, in this case, the court found that the ward's wife, even where she was willing to serve as an uncompensated trustee, failed to show any overruling benefit to her husband's trust by the substituting herself for the bank (which was certainly a compensated corporate trustee). The court found that the wife was well-intentioned, but due to the size of the trust ($2.8 million) and that the ward had always previously used or indicated a preference for a bank or a corporate entity as trustee or successor trustee, it disallowed the modification.

Similarly, in *Rene v. Sykes-Kennedy*, 156 So.3d 518 (Fla. 5th DCA 2015), the court-appointed guardian, Sykes-Kennedy, sought to amend the ward's trust to appoint herself as trustee instead of the ward's granddaughter. Sykes-Kennedy filed a petition in the guardianship court requesting that the trial court authorize her to amend the trust. She argued it was necessary for her, as guardian, to be able to access the trust assets to care for the ward and provided evidence that she had the education, experience, and relationship to the ward to act as trustee. The trial court granted Sykes-Kennedy's petition and concluded that it was in the ward's best interests to have her serve as trustee despite no finding of wrongdoing by the granddaughter. Citing to Fla. Stat. §§ 736.0201(1), 736.0602(6), and 744.441, the Fifth Circuit held that the Guardianship court had authority to enter order allowing the guardian to amend the ward's revocable trust so as to appoint herself as the trustee, despite contention that Trust Code required a proceeding concerning a trust to be commenced by filing a complaint. The court looked to the Trust Code which specifically allows a guardian of the property of a settlor to exercise the settlor's power to amend a trust. The ward would have had the power, if not incapacitated, to amend the trust and appoint the guardian as the new trustee and as such, it was permitted in this case. (The Court here specifically stated in footnote 2 that this ruling should not be construed to suggest that the trial court may authorize Sykes-Kennedy to amend the trust's provisions regarding the trust beneficiaries.)

Bear in mind that Florida Statutes, § 736.0207 provides that an action to contest the validity of a revocable trust may not be commenced until the trust becomes irrevocable by the settlor's death or by other trust terms, except by the guardian of an incapacitated settlor's property. Prior to the Trust Code provision, no one had the authority to contest the validity of a revocable trust prior to the settlor's death, but this statute opens the door for a guardian to bring a pre-death trust contest. If the guardian is concerned that the trust was created during a time when the settlor lacked capacity or was subject to undue influence, the guardian may be one of the only people that can contest the trust during the life of the incapacitated settlor. The guardian's authority is also included in the Guardianship Code, but there is a rebuttable presumption that an action challenging the ward's revocation of all or part of a trust is not in the ward's best interests if the revocation relates solely to a devise. Fla. Stat. § 744.441(11). The rights of the guardian to challenge a revocable trust while the settlor is alive do not preclude a challenge upon the death of the settlor. A will executed by a ward before the ward's incapacity cannot be revoked later by the ward's guardian. *Whitley v. Craig*, 710 So.2d 1375 (Fla. 5th DCA 1998).

In sum, a guardian takes a risk in attempting to modify a trust under the "other powers" provisions of the Guardianship Code. Trust modifications, in general, are complex and require a lot of analysis under both the Florida Trust Code, Guardianship Code, and case law. A guardian should tread lightly before attempting to modify a trust on behalf of a ward and must ensure always that any action is taken in the best interests of the ward/beneficiary.

Expenses

A guardianship court generally cannot compel the trustee to pay various guardianship expenses or transfer trust funds to the guardianship, without a trust provision directing to do so. *See, Florida Guardianship Practice*, Chapter 7, Use of Trusts, James A. Herb and Rhonda D. Gluck, 10th ed. 2018; *In re Guardianship of Mount*, 189 So.3d 213 (Fla. 2d DCA 2016) (court reversed order that compelled co-trustees to return trust funds held in escrow account to trust's primary bank account). "In the absence of proof that the trustee has failed to perform, or has performed arbitrarily, a court is without authority to remove trust assets from control of the trustee to be administered by the court or other guardian." *See, Cohen v. Friedland*, 450 So.2d 905, 906 (Fla. 3d DCA 1984); *See e.g., Johnson v. Guardianship of Singleton,* 743 So. 2d 1152 (1999) (disallowing guardianship expenses being ordered to pay from the ward's trust).

For example, where the payment of such fees is not mandated by the provisions of the trust, a court has no authority to compel a trustee to use trust funds to pay for the fees of the court-appointed guardian of the beneficiary/ward. *Barnett Banks Tr. Co. v. Hyman*, 504 So.2d 791 (Fla. Dist. Ct. App. 1987). A guardianship court may not order a trustee to pay the ward's creditors or the guardian's legal fees from trust assets. *In re Guardianship of Gneiser*, 873 So.2d 573 (Fla. 2d DCA 2004).

Although, as in many areas of law, there are exceptions to the general rule. In *Sowden v. Brea*, 47 So.3d 341 (Fla. 5th DCA 2010), the trial court in a guardianship proceeding found personal jurisdiction over the trustee of the ward's trust when the trustee submitted to the court's jurisdiction by entering into and benefiting from a settlement agreement with the guardians. The court held that the trial court had authority to enforce its prior order requiring parties to comply with court-approved mediation agreement that allowed trust assets to be used to pay certain costs and fees of the guardians' attorneys.

A trustee has flexibility in paying amounts to or for the benefit of a beneficiary when the beneficiary is incapacitated, unless limited by the provisions of the trust. Fla. Stat. §§736.0816(21) and 736.0815(1) (2018). The trustee can agree to utilize trust assets to pay for the beneficiary's expenses if it is in line with the trustee's authority under the trust agreement or the Florida Trust Code. *See*, *Administration of Trusts*, Chapter 17 (Fla. Bar CLE 9th ed. 2017); James A. Herb and Rhonda D. Gluck, *Florida Guardianship Practice*, Chapter 7, Use of Trusts (Fla. Bar CLE 10th ed. 2018).

Nevertheless, a problem may arise when there is a disagreement between the guardian and the trustee over, for example, a discretionary distribution under a health, education, maintenance and support or other standard. In those situations, the prudent course may be for the trustee to get court approval for a particular distribution pursuant to Fla. Stat. § 736.0201(4)(e) (2018). Recall, however, that this action would typically be a separate civil proceeding and not a guardianship proceeding in the probate court. It is usually a good idea for the trustee and the guardian to communicate early after the guardian's appointment to decipher what expenses have been paid pursuant to the trust and will continue to be paid from trust assets and what will not. Guardians and their counsel should review the terms of the ward's trust to ensure the trustee is properly fulfilling all the distribution provisions of the governing document.

Inventories and Accountings

A guardian is held to the strictest accountability for the funds of his ward. 28 C.J. 1145, Section 244; Firmin v. Sandborn, 119 Fla. 396, 161 So 555. Pursuant to Florida Statutes, § 744.365, a guardian of the property shall file a verified inventory of the ward's property and the verified inventory must include any trusts of which the ward is a beneficiary. This statute does not, however, require that the guardian list the amount or specific beneficial interest in the trust. The guardian should carefully consider how much information should be placed in the inventory, which to some extent is governed by local practice. Lance McKinney, *Florida Guardianship Practice, Special Property Problems of Guardianships*, Chapter 17, Tenth Edition (2018).

Pursuant to Florida Statutes, § 744.3678(2), each guardian of the property must also file an annual accounting with the court. The accounting need not include "any property or any trust of which the ward is a beneficiary but which is not under the control or administration of the guardian." *Id.* Although, some Florida courts have inferred from this language that if the trust is controlled or administered by the guardian, then it may need to be included in the annual accounting. Although, there is scant to no case law to support this position, a guardian is advised to carefully consider what financial information of the ward should be included and disclosed in the guardianship accounting.

Under Florida Statute § 736.0603 the trustee has exclusive fiduciary obligations to the settlor of a revocable trust, while it is revocable. Similarly, the duty to inform and account during the tenure of a revocable trust is only to the settlor of that trust. There are no statutes that address accounting to incapacitated beneficiaries who are also the settlors of revocable trusts and subject to guardianship. There is, however, a representation statute that allows a person who represents a settlor lacking capacity to receive notice and give binding consent on the settlor's behalf. Fla. Stat. § 736.0301(3).

The prudent course for a trustee who administers a revocable trust for the benefit of an incapacitated ward/beneficiary is likely to provide a trust accounting to both the guardian and ward for review and approval. The trustee may also include the six-month statutory notice pursuant to Florida Statutes, § 736.1008 in order to shorten the time that the beneficiary ward or guardian must bring a claim for breach of trust. The guardian may also have the authority to waive the right to an accounting and request bank account statements or other regular information regarding the trust's administration and assets.

If an accounting reveals imprudent administration on the part of a trustee, the guardian may be forced to bring a lawsuit on behalf of the ward. Upon court approval, the guardian has the authority to prosecute or defend claims for the protection of the ward's estate. Fla. Stat. § 744.441(11). The guardian should request and review accountings on at least an annual basis to ensure the trustee is abiding its fiduciary obligations and be prepared to protect the rights of a ward who is a beneficiary. The trustee should adequately disclose all trust information to the qualified beneficiaries and their legal representatives, including guardians.

When a trustee of the ward's trust is also acting as a guardian, there is little authority on who, if anyone, should be provided accountings or trust information during the life of the beneficiary/ward. Next of kin may have the ability to review the management of the ward's estate through the guardianship proceedings but not the management of the ward's trust assets. *See, In re Guardianship of Trost*, 100 So.3d 1205, 1210 (Fla. 2d DCA 2012); *Beekhuis v. Morris,* 89 So. 3d 1114 (2012)(Probate court, in a guardianship proceeding, did not have jurisdiction over ward's trust assets or ward's daughter as trustee, where no claim raised over trust or it's property.) An agent under a durable power of attorney with the appropriate language may have that authority but otherwise, it is unclear. To avoid liability, the guardian/trustee should identify any potential parties that could receive notice on behalf of the settlor/ward/beneficiary and notify them, when appropriate. Counsel for the guardian/trustee may consider the appointment of an administrator ad litem solely to review and approve of accountings.

<u>**Summary**</u>

When there are both a court-appointed guardian and a trustee involved in the same account or case, there can be a difference of opinion on what is in the best interests of the ward/beneficiary. While the best approach is for the guardian and trustee to work together to identify those interests it is rarely an easy partnership. Counsel for guardians, trustees, and wards should be careful to identify the authority outlined in the Florida Guardianship and Trust Codes, as well as the common law that controls the relationship, and utilize it to assist the ward/beneficiary and to avoid liability for failing to get along with a fellow fiduciary.

GRANTOR TRUSTS: THE GOOD, THE BAD, THE UGLY AND THE UNKNOWN

By

Diana S. C. Zeydel, Miami

GRANTOR TRUSTS: THE GOOD, THE BAD, THE UGLY AND THE UNKNOWN

Diana S.C. Zeydel
Global Chair - Private Wealth Services
Greenberg Traurig, P.A.
333 S.E. 2nd Avenue, Suite 4100
Miami, FL 33131
(305) 579-0500
zeydeld@gtlaw.com

I. INTRODUCTION TO GRANTOR TRUSTS

A. Section 671 - Tax Effect of Grantor Trust Status

(1) When the grantor or another person is treated as the owner of any portion of a trust, the grantor (or other person) shall include [on the grantor's income tax return] those items of income, deduction, and credits against tax of the trust which are attributable to that portion.

(2) What is "income"?

Treas. Reg. §1.671-2(b) states, "Accordingly, when it is stated in the regulations under subpart E that "income" is attributed to the grantor or another person, the reference, unless specifically limited, is to income determined for tax purposes and not to income for trust accounting purposes." To refer to income for trust accounting purposes, the phrase "ordinary income" is used.

B. Overview of the Rules - When is a Trust a Grantor Trust?

(1) If grantor has retained a reversionary interest under Section 673.

(2) If grantor or non-adverse party has certain powers over the beneficial interests in the trust under Section 674.

(3) If certain administrative powers over the trust exist under which the grantor can or does benefit under Section 675.

(4) If the grantor or a nonadverse party has a power to revoke the trust or return the corpus to the grantor under Section 676.

(5) If the grantor or a nonadverse party has the power to distribute income to or for the benefit of the grantor or the grantor's spouse under Section 677.

C. **Who is the Grantor?**

(1) The grantor is any person to the extent that person either:

(a) Creates a trust; or

(b) Directly or indirectly makes a gratuitous transfer of property to a trust.

D. **What is a Gratuitous Transfer?**

(1) Any transfer other than a transfer for fair market value.

(a) Transfer does not need to be a completed gift.

(b) A transfer by an entity not for a business purpose is a transfer by the owners of the entity.

E. **What about a Trust to Trust Transfer?**

(1) In general, the grantor of the transferor trust will be treated as the grantor of the transferee trust.

(2) An exception applies if a person exercises a general power of appointment in favor of another trust. The exception does not appear to apply if a general power of appointment lapses.

F. **Is the "Grantor" Taxed?**

(1) Not necessarily because a person who is a grantor is not necessarily an "owner."

(2) To be an owner, one must make a gratuitous transfer to the trust.

G. **What are the Obligations of a Grantor?**

(1) A grantor can have the obligation to file tax returns with respect to the trust (e.g. under Section 6048 for a foreign trust).

(2) Thus, if an attorney creates a trust for a client with $100 and is reimbursed, both are grantors, but only the client is an owner.

H. Will a 678 Power Make You a Grantor?

(1) No.

(2) For example, if a trustee exercises a power to create a second trust after the grantor's death and retains the power to revoke the second trust, the grantor of the original trust is the grantor of the new trust, BUT the trustee is the "owner" of the new trust.

II. TO WHAT EXTENT IS A TRUST A GRANTOR TRUST?

A. The Extent of Grantor Trust Status Is Determined by the "Portion" Rule

(1) Reg. §1.671-3 says a portion may consist of specific trust property, an undivided fractional interest, an interest represented by a dollar amount, only ordinary income or only income allocated to corpus.

(2) A power over corpus can cause the grantor to be taxable on the ordinary income portion as well if ordinary income may be accumulated and thus become subject to the power over corpus.

(3) If a grantor or another person is treated solely as the owner of the ordinary income portion, the grantor will be taxed in the same manner as a current income beneficiary, including expenses allocable to corpus which enter into the computation of distributable net income.

B. Exercise of a General Power

(1) Makes the powerholder the grantor of the new trust, even if the original trust was a grantor trust.

(2) It seems that no other power will change the grantor of the transferee trust.

III. COLLATERAL TAX EFFECTS OF CREATING A GRANTOR TRUST

A. Under Rev. Rul. 2004-64, 2004-2 C.B. 7

(1) The fact that a trust is a grantor trust and the tax attributes of the trust are reported by the grantor will cause neither grantor nor any beneficiary to be treated as making a taxable gift to the trust.

(2) Discretionary power of reimbursement for income taxes paid by the grantor, by itself, will not cause estate tax inclusion.

B. Additional Requirements under Rev. Rul. 2004-64

(1) If trustee has a discretionary power to reimburse the grantor for income taxes paid.

(a) Grantor may not act as a trustee.

(b) Grantor may not remove and replace trustees with related and subordinate parties.

(c) State law must prohibit creditors from accessing the trust by reason of the reimbursement power.

(d) No implied understanding to exercise the power.

C. Other Consequences of Creditors' Rights

(1) Gift to the trust is incomplete.

(a) If grantor can relegate her creditors to the trust then the grantor will be deemed to have retained dominion and control.

(2) Some States have reversed this rule relative to a reimbursement power.

D. What if Trustee Must Reimburse?

(1) Automatic estate tax inclusion

(a) BUT should it be 100% since the effective tax rate is not 100%?

(b) Maybe the fact that income allocated to corpus could produce a taxable gain in excess of accounting income is enough to capture the entire trust.

IV. CREATING A GRANTOR TRUST

A. What Methods Might Be Used to Create a Grantor Trust?

(1) Powers of disposition

(2) Spouse as a discretionary beneficiary

(3) Power of substitution

(4) Power to add beneficiaries

(5) Power of appointment

(6) Actual borrowing

(7) Power to borrow

(8) Decanting

B. Power of Disposition by a Related and Subordinate Party

(1) 674(a) states that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

(2) Adverse Party/Nonadverse Party

(a) An adverse party is any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power which he possesses respecting the trust. A general power of appointment is a beneficial interest, but not automatically substantial.

(b) A nonadverse party – Everyone else.

(3) Independent Trustee Exception

(a) 674(c) says that 674(a) shall not apply to a power exercisable solely by a trustee none of whom is the grantor (or the grantor's spouse) and no more than half of whom are related and subordinate parties who are subservient to the wishes of the grantor.[1]

(4) 672(c) – Related and Subordinate Party

(a) Grantor's spouse **who is living with the grantor**, grantor's father, mother, sister, brother, issue, employee, subordinate employee of a corporation in which grantor is an executive, a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from viewpoint of voting control.

(b) Related and subordinate party is presumed subservient unless shown not to be by a preponderance of the evidence.

[1] Note that even if a trustee is technically independent, it may not be enough if the trustee consistently acts, directly or indirectly, at the direction of the grantor. *Securities & Exchange Commission v. Wyly,* 56 F. Supp. 3d 394 (S.D.N.Y. 2014), *new trial denied,* 117 F. Supp. 3d 381 (S.D.N.Y. 2015). *See, generally,* William E. Keenen and Diana S.C. Zeydel, "Is Designating an Independent Trustee a Tax Panacea?" 43 *Estate Planning* 3 (February 2016).

(5) 672(e) – Spousal Unity Rule

The spousal unity rule of under 672(e) says the grantor is treated as holding any power or interest held by any individual (i) who was the grantor's spouse at the time of the creation of the power or interest (but not considered married if legally separated) or (ii) who became the spouse after the creation of the power or interest.

(6) Reasonably Definite Standard

(a) 674(b)(5) creates an exception for a power to distribute **corpus** provided the power is limited by a reasonably definite standard that is set forth in the trust instrument.

(b) And 674(d) states that 674(a) shall not apply to a power exercisable by a trustee (not the grantor or spouse living with the grantor) to distribute, apportion or accumulate **income** to or for the benefit of beneficiaries if such power is limited by a reasonably definite **external** standard which is set forth in the trust instrument.

(7) Conclusion

To achieve a wholly grantor trust, you need a power of disposition not limited by a reasonably definite (external) standard held by trustees more than half of whom are related and subordinate parties who are subservient to the wishes of the grantor.

(8) What Estate Tax Implication Would That Have?

(a) Rev. Rul. 2004-64 implies that a trustee who is not independent may be presumed to exercise authority in the grantor's favor pursuant to an implied understanding that would attract 2036 inclusion.

(b) Would that apply to a power exercisable in favor of persons other than the grantor?

(9) Rev. Rul 95-58, 1995-2 C.B. 191

(a) Rev. Rul. 95-58 dealing with the donor's retention of a power to remove and replace the trustee states that a power to remove a trustee and replace that trustee with a person that is not related and subordinate to the donor (within the meaning of 672(c)) would not cause the donor to be treated as having retained the trustee's discretionary control over trust income.

(b) Rev. Rul. 95-58 does not address the initial appointment of a related and subordinate trustee.

(c) In *Estate of Vak. v. Commissioner*, 973 F. 2d 1409 (8th Cir. 1992), the initial trustees were related and subordinate trustees and the settlor retained the power to remove the trustees at any time and replace them with trustees who were not related and subordinate to the settlor. Court held the gift to the trust was complete.

(d) Toggling Off

(i) Grantor could retain the power to remove the related and subordinate trustees and replace them with an independent trustee.

(ii) But the grantor cannot have the power to toggle back on by appointing related and subordinate trustees because of Rev. Rul. 95-58.

(10) Problem for an Installment Sale to a Grantor Trust

Generally want independent trustees engaging in the arms length sale of assets from the grantor to the trust to enhance the position that it is a bona fide sale for full and adequate consideration, arm's length and free from donative intent.

(11) Good for an Irrevocable Life Insurance Trust

(a) It might be the right power to use in an ILIT where you want to preserve your opportunities to shift around the policies under Rev. Rul. 2007-13, 2007-11, I.R.B. 684.

(b) Rev. Rul. 2007-13 says that moving a policy for value into a wholly grantor trust qualifies as a transfer to the grantor and is therefore excepted from the application of the transfer for value rule under section 101(a)(2) that would cause the proceeds of a policy that has been transferred for value to be includible in income. Exceptions to the rule exist for transfers to the insured, a partner of the insured, a partnership in which the insured is a partner, and a corporation in which the insured is a shareholder or officer, as well as transfers if the transferee has, at least in part, a carryover basis.

(12) Power over more that 5% of Corpus

(a) 674(b)(3) creates an exception to grantor trust status for a power which can affect beneficial enjoyment only after the occurrence of an event such that the grantor would bit be treated as an owner if the power were a reversionary interest.

(b) In PLR 200846001, the IRS ruled that a power not limited by a standard held by a related and subordinate trustee to distribute the income and principal of a GRAT upon the expiration of the GRAT term, where the actuarial value of the remainder interest exceeded 5%, was sufficient to cause the trust to be a wholly grantor trust. This type of power would also work well for a charitable lead annuity trust, although both GRATs and CLATs are less tax efficient if the remainder is not zero or near zero.

C. GRANTOR'S SPOUSE AS A DISCRETIONARY BENEFICIARY UNDER 677(a)(1) or (2)

(1) "Spouse" appears to mean person to whom you are married and the provision applies "during the period of the marriage" according to the regulations, but would include income accumulated for future distribution to the grantor's spouse after the grantor's death.

(2) 677(a)(1) and (2) provide that the grantor is treated as the owner of any portion of a trust whose income, without the approval or consent of any adverse party, is or in the discretion of the grantor or a nonadverse party or both, may be, distributed to the grantor or the grantor's spouse or accumulated for future distribution to the grantor or the grantor's spouse.

(3) Wholly Grantor Trust

(a) If the trust is to be WHOLLY grantor, the power needs to extend also to "taxable income" allocable to corpus. One possibility is to make the spouse a discretionary beneficiary as to both income and corpus.

(b) Alternatively, make the spouse a discretionary income beneficiary and give the spouse a special power of appointment over the corpus at his death (which would flunk the exception under 674(b)(3) applying the spousal unity rule as to income allocated to corpus that would be deemed accumulated for future disposition by the grantor).

(4) Toggling Off

(a) May present a difficulty in toggling off if you use this method to achieve grantor trust status because the spouse must be removed as a beneficiary.

(b) Even the relinquishment of a discretionary interest by the spouse may have gift tax consequences (albeit difficult to quantify).

(c) One possibility would be to give an independent trustee the power to remove the spouse as a beneficiary, but consider the challenge the trustee would face exercising that power.

(5) Other Problems

(a) Grantor trust status would terminate at the spouse's death.

(b) Spouse cannot split a gift to a trust where spouse's interest cannot be quantified.

(c) If the spouse splits gifts to the trust with the grantor, that will not have any implication other than for gift and GST tax purposes, e.g., if the spouse is a trustee with powers of disposition that do not implicate 2036 or 2038.

D. Power of Substitution

(1) Under 675(4)(C), the power exercisable in a non-fiduciary capacity without the approval or consent of a person in a fiduciary capacity to "reacquire the trust corpus by substituting other property of an equivalent value."

(2) Two Problems

(a) Is the power really held in a non-fiduciary capacity?

(b) Does the existence of the power held in a non-fiduciary capacity create estate tax inclusion concerns?

(3) PLR 20060304; PLR 200606006

IRS refused to rule favorably on the estate tax inclusion issues under 2033, 2036, 2038 and 2039 without a representation that the power was held in a fiduciary capacity.

(4) Estate of King

(a) *Estate of King v. Commissioner*, 37 T.C. 973 (1962), decedent was in the professional banking business and retained investment control over the trust estate.

(b) Each trust provided for income to child for life and remainder to child's issue, *per stirpes*.

(c) Government argued 2036(a)(2) and 2038 alleging the grantor could increase the interests of the life income beneficiaries to the detriment of the remainder beneficiaries, the grantor could dispose of the assets for little or no consideration, and the grantor had an unlimited right to substitute assets of unequal value.

(d) Court held the grantor was constrained by NY law, and his actions were subject to the review of a court in equity.

(e) Therefore, the grantor was in effect a fiduciary and was not at liberty to administer the trust for his own benefit or to ignore the rights of the beneficiaries, even though he no doubt would be permitted wide latitude in the exercise of this discretion as to the types of investments to be made.

(f) HELD, no estate tax inclusion.

(5) Estate of Jordahl

(a) *Estate of Jordahl v. Commissioner*, 65 T.C. 92 (1975) is to the same effect. Life insurance trust over which decedent retained a power of substitution not only as to the policies but also as to the securities and other property in the trust.

(b) Court held that substitutions of property of equal value could not result in shifts of beneficial interests.

(c) Powers would have to be exercised in good faith in accordance with fiduciary responsibility.

(d) Equivalent to a power to direct investments.

(e) Power to substitute policies is not an incident of ownership under 2042.

(f) The requirement of equal value would seem to demand equal cash surrender and face value, comparable premiums and a similar form of policy.

(6) What are the limits on a substitution power?

(a) Can you substitute high income assets for low income assets with an equal fair market value?

(b) It seems that you can substitute one publicly traded stock for another.

(7) Revenue Ruling 2008-22, 2008-16 I.R.B. 796

(a) We think they are trying to help.

(b) Deals only with Section 2036 and 2038.

(c) May not deal with Section 2036(b).

(d) Does not deal with Section 2042.

(e) Ruling provides guidance on whether the corpus of an *inter vivos* trust is includible in the grantor's gross estate under section 2036 or 2038 if the grantor retained the power, exercisable in a non-fiduciary capacity, to acquire property held in trust by substituting other property of equivalent value.

(f) Substitution will not, by itself, cause the value of the trust corpus to be includible in grantor's gross estate if the trustee has a fiduciary obligation (under local law) to ensure the grantor's compliance with the terms of the power by:

   (i) Satisfying itself that the properties acquired and substituted are in fact of equivalent value; and

   (ii) The substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries.

(g) <u>Revenue Ruling 2008-22 – Facts</u>

   (i) Trust for D's descendants.

   (ii) D is prohibited from serving as trustee.

   (iii) D must certify in writing that the substituted property and the trust property are of equivalent value.

   (iv) The trustee has a duty of impartiality in investing and managing trust assets.

   (v) Local law, without restriction in the trust instrument, confers on trustee power to acquire, invest, reinvest, exchange, sell, convey, control, divide, partition and manage the trust property.

(h) <u>Revenue Ruling 2008-22 - Holding</u>

Trustee's fiduciary obligation to ensure grantor's compliance with the terms of the power may be under local law or the trust instrument.

(i) <u>Revenue Ruling 2008-22 - Analysis</u>

   (i) Trustee has duty to "prevent" the exercise of the power if assets being substituted have a lesser value.

(ii) Therefore, D cannot exercise power in a manner that would reduce the value of the trust corpus.

(iii) Duty of impartiality requires T to prevent shifting of benefits between or among the beneficiaries.

- What is meant by "shifting benefits"?
- Either trustee has duty of impartiality and can reinvest, or

(iv) Nature of trust investments or level of income does not impact the respective interests of the trust beneficiaries, such as when the trust is administered as a unitrust or when distributions from the trust are limited to discretionary distributions of principal and income.

(j) Revenue Ruling 2011-28, I.R.B. 2011-49 (12/5/2011)

(i) Extends Rev. Rul. 2009-22 to a life insurance policy.

(ii) The ruling provides guidance regarding whether a grantor's retention of a power, exercisable in a nonfiduciary capacity, to acquire an insurance policy held by the trust by substituting other assets of equivalent value will cause the value of the insurance policy to be includible in the grantor's gross estate under section 2042 of the Code. The ruling provides that a grantor's retention of the power will not, by itself, cause the value of the insurance policy to be includible in the grantor's gross estate under section 2042, provided the trustee has a fiduciary obligation (under local law or the trust instrument) to ensure the grantor's compliance with the terms of this power by satisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value, and further provided that the substitution power cannot be exercised in a manner that can shift benefits among trust beneficiaries.

(iii) See PLR 201235006 (February 27, 2012) for analysis of a life insurance trust created for the primary benefit of taxpayer which was not a grantor trust. Taxpayer formed a new trust which granted the taxpayer a power of substitution. Proposal was to sell the policy from the first trust to the second trust. IRS ruled favorably that the exception to the transfer for value rules for a transfer to the grantor under Section 101 applies, and the policy sale will not be treated as a transfer for value (which would otherwise cause a substantial portion of the policy proceeds to become subject to income tax) and that the policy would not become subject to inclusion in the taxpayers gross estate under Section 2042(2) (incidents of ownership) or Sections 2033, 2036 or 2038. The ruling also confirms that the application of Section 675(4) trumps the application of Section 678 with respect to the powers of withdrawal held by the beneficiaries in the second trust.

(k) Word of Caution

(i) In PLR 200910008, the IRS in the facts recites that the grantor had a power of substitution which, pursuant to section 675(4), would cause the trusts to be grantor trusts. But the conclusion makes the alarming assertion that under the terms of the trusts "the power to reacquire assets of the trust by substituting property of equivalent value affects beneficial enjoyment. Accordingly, the grantors are treated as owners . . . under 674(a)"!

(l) Substitution Clause

(A) Substitutor Powers. With respect to each trust created under this agreement, the Substitutor shall have the power, exercisable at any time in a nonfiduciary capacity (within the meaning of Section 675(4) of the Internal Revenue Code), without the approval or consent of any person in a fiduciary capacity, to acquire or reacquire trust principal by substituting other property of an equivalent value, determined as of the date of such substitution (referred to in this Article as "the Substitution Power"), subject to the following:

(1) Any stock described in Section 2036(b) of the Internal Revenue Code that the Substitutor has transferred to the trust for purposes of Section 2036(b) of the Internal Revenue Code may not be acquired or reacquired by the Substitutor.

(2) Property shall not be deemed of equivalent value if it causes a shift of beneficial interests in any trust under this agreement by any means (directly or indirectly) within the meaning of Revenue Ruling 2008-22 and Revenue Ruling 2011-28, including, without limitation, by enhancing the economic interests of the current beneficiaries to the detriment of the remaindermen or vice versa, or by conferring an uncompensated economic benefit on the Substitutor, and the Substitution Power shall in no event be exercised in a manner that can shift benefits among the trust beneficiaries within the meaning of Revenue Ruling 2008-22 and Revenue Ruling 2011-28.

(3) Without reducing or eliminating the fiduciary duties imposed on the trustees under this agreement or applicable law, the Substitutor shall exercise this Substitution Power by certifying in writing that the substituted property and the trust property for which it is substituted are of equivalent value and the trustees shall have a fiduciary obligation to ensure the Substitutor's compliance with the terms of this Substitution Power by being satisfied in advance of the completion of the substitution that the properties acquired and substituted are in fact of equivalent value, within the meaning of Revenue Ruling 2008-22 and Revenue Ruling 2011-28.

(4) Without limiting the foregoing prohibition upon shifting benefits among trust beneficiaries, the trustees shall have (i) the power to reinvest the principal of the trust and (ii) the duty of impartiality with respect to trust beneficiaries at all times while this Substitution Power is in effect, unless the independent trustee has absolute discretion in making distributions of principal and income among the trust beneficiaries so that the power to reinvest the principal of the trust and the duty of impartiality are not required in order to avoid this Substitution Power potentially causing a shift of benefits among trust beneficiaries, all within the meaning of Revenue Ruling 2008-22 and Revenue Ruling 2011-28, in which case the independent trustee shall have the exclusive fiduciary obligation to ensure the Substitutor's compliance with the terms of this Substitution Power in accordance with the provisions of paragraph (3) of this Subdivision.

(5) The Substitutor may release all or a specific portion of the Substitution Power. Any such release shall be effected by a written instrument signed by the Substitutor and delivered to the trustees. Any such release, once given, shall be irrevocable and the Substitution Power shall not thereafter be exercisable by any person other than an individual appointed by the settlor to act as Substitutor pursuant to Subdivision (B) of this Article (if the appointment power has not been released by the settlor as to all successor Substitutors).

(6) This power is not assignable by the Substitutor, and any attempted assignment by the Substitutor will make this power void.

(7) The Substitution Power shall be exercisable only during the life of the settlor.

(B) Substitutor. The following person or persons shall be the "Substitutor" for purposes of this Article: the settlor, or if he/she has released the Substitution power or is unable to act, the settlor's spouse.

(8) What about Using a Third Party?

(a) Statute refers to "any person" which appears to override the use of the word "reacquire".

(b) Third party with a substitution power should not be a trust beneficiary without special drafting to avoid Sections 2041 and 2042.

(c) Alternatively, use the spouse.

E. Power to Add to Class of Beneficiaries

(1) Exception to the exception appears five times in Section 674.

(2) *Madorin v. Commissioner*, 84 T.C. 667 (1985) court assumed the power conferred grantor trust status and relinquishment of the power eliminated grantor trust status.

(3) A 679 perspective would say if you can add someone, that person is already deemed to be a beneficiary.

(4) But it must mean something.

(5) Other difficulties

(a) Fiduciary discomfort.

(b) Do the persons added have to receive something for it to be real?

(6) Some solutions

(a) Give the power to a non-fiduciary.

(b) Draft the trust so that when a beneficiary is added something beneficial for the existing beneficiaries occurs – such as broader discretion to distribute or required distributions.

(c) Require some distributions to the persons added to the class.

F. Power of Appointment

(1) A presently exercisable power of appointment held by a nonadverse party not acting as a trustee should make a trust a wholly grantor trust.

(2) Should work even if the power holder would be considered independent.

(3) Consider using a related and subordinate party in case the power is deemed held in fiduciary capacity.

(4) Provide for succession of power holders.

G. Actual Borrowing by the Grantor or the Grantor's Spouse – 675(3)

(1) 675(3) says that the grantor will be treated as the owner of any portion of a trust in respect of which the grantor has directly or indirectly borrowed the corpus or income and has not completely repaid the loan, including any interest, before the beginning of the taxable year.

(2) Does not apply if the loan is made for adequate interest and adequate security, if the loan is made by a trustee other than the grantor and other than a related and subordinate trustee subservient to the grantor.

(3) Applies to "spouse" as defined in 672(e)(2) meaning married to and not legally separated from the grantor.

(4) Rev. Rul. 85-13

(a) Rev. Rul. 85-13, 1985-1 C.B. 184, stands for the proposition that transactions between a grantor and her grantor trust are ignored for income tax purposes.

(b) But it also states that if the grantor purchases all the assets of her trust for a note, the trust becomes a grantor trust simultaneously, and there is no gain recognition as a result of the purchase itself.

(c) Facts of 85-13, unsecured promissory note with adequate interest.

(d) IRS views the transaction as an indirect borrowing.

(e) Be aware that *Rothstein v. U.S.,* 735 F.2d 704 (2nd Cir. 1984) is to the contrary. Court held that the transaction constituted an indirect borrowing and caused the trust to become a grantor trust, BUT the transaction itself resulted in gain recognition.

(5) What about Rosen?

(a) If the loan is without adequate security, does *Estate of Rosen*[2] say that it is not arm's length, *bona fide* and for full and adequate consideration?

(b) If you use a related and subordinate party trustee maybe that raises other concerns because it is a transaction with the grantor.

(c) So the issue arises have you cleared the 2036 and 2038 hurdles?

(6) Rev. Rul. 86-82, 1986-1 C.B. 253

(a) States that the trust is a grantor trust for the entire year.

(b) Does that permit you to reverse engineer grantor trust status?

(7) Grantor trust to what extent?

(a) Appears, under *Bennett v. Comm'r,* 79 T.C. 470 (1982), that the trust may be a grantor trust only as to the portion directly or indirectly borrowed.

(b) Therefore, to make the trust wholly grantor, must borrow/purchase the entire corpus.

(c) May present practical obstacles or valuation issues.

H. Power to Borrow

(1) Section 675(2) covers a power exercisable by the grantor or a nonadverse party, or both, that enables the grantor to borrow the corpus or income, directly or indirectly, without adequate interest or without adequate security.

(2) Exception where a trustee (other than the grantor) is authorized under a general lending power to make loans to any person without regard to interest or security.

(3) Need to negate the general lending power.

(4) Should use only an independent trustee to avoid 2036 and 2038 implications.

(5) Probably should only permit loans to the grantor without adequate security.

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[2] Estate of Rosen v. Commissioner, T.C. Memo 2006-115. *See also* Todd v. Commissioner, T.C. Memo. 2011-123.

(6) See PLR 200840025 (non-adverse trustee with power to make loans, with or without security, to the settlor was sufficient to make the trust a grantor trust).

I. Decanting to Achieve Grantor Trust Status

(1) States with a statute:

(a) Alabama,[3] Alaska,[4] Arizona,[5] California,[6] Colorado,[7] Delaware,[8] Florida,[9] Georgia,[10] Illinois,[11] Indiana,[12] Kentucky,[13] Michigan,[14] Minnesota,[15] Missouri,[16] Nevada,[17] New Hampshire,[18] New Mexico,[19] New York,[20] North Carolina,[21] Ohio,[22] Rhode Island,[23] South Carolina,[24] South Dakota,[25] Tennessee[26], Texas,[27] Virginia,[28] Washington,[29] Wisconsin,[30] and Wyoming,[31]

(2) What is Decanting?

(a) *Phipps v. Palm Beach Trust*, 142 Fla. 782 (1940) held that a trustee with absolute discretion to distribute principal among a class of beneficiaries may distribute to a new trust for a member of the class.

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[3] HB 163.
[4] Alaska Stat. §§ 13.36.157, 13.36.158, 13.36.159 and 13.36.215(b).
[5] Ariz. Rev. Stat. § 14-10819.
[6] Part 9 (commencing at 19500) of Division 9 of the CA Probate Code.
[7] CRS 15-16-901, et. seq.
[8] Del. Code Ann. tit. 12 § 3528.
[9] Fla. Stat. § 736.04117.
[10] Ga. Stat. §53.12-62.
[11] 760 Ill. Comp. Stat. 5/§ 16.4 (enacted as of 1/1/13).
[12] Ind. Code Ann. § 30-4-3-36 (West 2011).
[13] Ky. Rev. Stat. § 386.175 (enacted as of 7/12/12).
[14] Mich. Comp. Laws §§ 700.7820(a), 556.115a and 700.7103 (enacted as of 12/28/12).
[15] Minnesota Statutes §502.851 (effective 1/1/16).
[16] Mo. Rev. Stat. § 456.4-419.
[17] Nev. Rev. Stat. 163.37
[18] N.H. Rev. Stat. § 564-B:4-418.
[19] Pending enactment of the Uniform Trust Decanting Act 1/1/2017.
[20] N.Y. EPTL 10-6.6(b)-(s)
[21] N.C.G.S. § 36C-8-816.1.
[22] Ohio Rev. Code § 5808.18 (enacted as of 3/22/12).
[23] R.I. Gen. Laws § 18-4-31 (enacted 6/23/12 and amended 7/15/13).
[24] S.C. Code § 62-7-816A.
[25] S.D. Laws §§ 55-2-15 (amended by 2011 S.C. HB 1155).
[26] Tenn. Code Ann. § 35-15-816.
[27] Texas Prop Code §§112.071-112.087.
[28] Va. Code § 64.2-778.1 (enacted as of 10/1/12).
[29] RCW 11.107.010-.080.
[30] Wisconsin Trust Code §701.0418.
[31] W.S. 4-10-816(a)(xxviii).

(b) Is in the nature of a power of appointment.

(c) Can be used to confer a power of appointment.

(d) Recent Case Law

In *Morse v. Kraft*,[32] the Massachusetts Supreme Judicial Court, in an action brought by the trustee for declaratory relief, became the second court squarely to address whether, under common law, the trustee of a discretionary trust has the power to exercise the trustee's discretion by distributing trust property to a new trust for the beneficiaries of the original trust, without the beneficiaries' consent or court approval. Although the *Morse* court determined that the trustee had the authority to decant, the *Morse* decision could be perceived as far narrower than most would have liked. The court was particularly focused on the discretionary language in the trust instrument expressly permitting distributions "for the benefit" of the beneficiaries, and indicated that given the widespread awareness of decanting, a more recent trust instrument without express decanting authority may create a negative inference that the settlor intentionally omitted the power.[33]

Before *Morse,* the only case directly to address the common law authority to decant is the Florida Supreme Court case of *Phipps v. Palm Beach Trust Company,*[34] which held that a trustee with absolute discretion to distribute trust property "to" its beneficiaries could appoint the entire trust to another trust for its beneficiaries. An interesting aspect of the *Phipps* opinion is that the second trust in question granted the primary beneficiary of the first trust a testamentary power of appointment in favor of the beneficiary's spouse who was not a beneficiary under the first trust. The granting of a testamentary power of appointment in favor of persons who were not beneficiaries under the first trust would appear to derive from the trustee's ability to distribute property outright to a beneficiary, after which the beneficiary could certainly deflect the property to whomever the beneficiary might choose. [35]

[32] *See* Morse v. Kraft, 466 Mass. 92 (2013).
[33] The court repeatedly cited W. Culp & B. Mellen, "Trust Decanting*:* An Overview and Introduction to Creating Planning Opportunities," 45 RPTELJ 1 (Spring 2010) and D. Zeydel & J. Blattmachr, "Tax Effects of Decanting – Obtaining and Preserving the Benefits," 111 JTAX 288 (November 2009).
[34] 142 Fla. 782, 196 So. 299 (1940).
[35] *Id.* at 787, 301.

In affirming that decanting authority exists under the common law, the Florida Supreme Court in the *Phipps* opinion held that,

> "[t]he general rule gleaned from … cases of similar import is that the power vested in a trustee to create an estate in fee includes the power to create or appoint any estate less than a fee unless the donor clearly indicates a contrary intent."[36]

The court in *Phipps* rejected the respondent's argument that the reverse was true, i.e., that the power to create a second trust estate is present under a special power of appointment only where such authority is specifically granted.[37] The court relied on the Restatement of the Law of Trusts, section 17, for the proposition that if a trustee has a special power of appointment, that is a power to appoint among the members of a specified class, then whether the trustee can effectively appoint a trustee for members of the class depends upon the terms of the power vested in him. Thus, the court concluded that, so long as the beneficiaries of the second trust are limited to the class of beneficiaries under the first trust, the power in the trustees to appoint in further trust, much like a power of appointment, is absolute, and to hold otherwise would limit the power of the individual trustee to administer the trust estate in a way not contemplated by the donor of the first trust.

The court in *Morse* declined to follow *Phipps* to that degree. Instead, the court was more inclined to adopt the reasoning of *Wiedenmayer v. Johnson*,[38] wherein the court, finding the trustee to have absolute and uncontrolled discretion, permitted a decanting for the beneficiary's "best interests". Although *Wiedenmayer* is cited as a decanting case, *Wiedenmayer* actually concerned an indirect decanting in that the trustees exercised their power of invasion in favor of the beneficiary contingent upon the beneficiary agreeing to transfer the property in further trust. The court concludes the transfer was in the beneficiary's best interests, describing "best interests" as follows:

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[36] *Id.* at 786, 301.

[37] *Id.*; *see also* BOGERT'S TRUSTS AND TRUSTEES (through 2011 Update), Chapter 39, § 812, under the discussion of the express (and unlimited by an ascertainable standard) power in the Trustees to distribute principal.

[38] 106 N.J. Super. 161, 254 A.2d 534 (App. Div.), *aff'd sub nom.,* Wiedenmayer v. Villaneuva*,* 55 N.J. 81, 259 A.2d 465 (1969).

> "The expression is not limited to a finding that distribution must be to the son's best 'pecuniary' interests. His best interests might be served without regard to his personal financial gain. They may be served by the peace of mind, already much disturbed by matrimonial problems, divorce and the consequences thereof, which the second trust, rather than the old contingencies provided for in his father's trust indenture, will engender. Of what avail is it to rest one's 'best interests' on a purely financial basis, and without regard to the effect upon a man's mind, heart and soul, if the end result would produce a wealthier man, but a sufferer from mental anguish?"

In *Wiedenmayer*, the authority to distribute in the trust instrument included the words "to use for or to distribute and pay to." And the court, as in *Phipps,* construed the authority to distribute to the beneficiary "absolutely, outright and forever" to include the power to safeguard the beneficiary's interests by conditioning the distribution upon his setting up a substituted trust. Thus, the *Wiedenmayer* court did not rely on the authority "to use for" language in the trust agreement, but rather found the authority to distribute in further trust to be encompassed in the ability to distribute outright. The distribution authority expressly required a finding that it be for the beneficiary's best interests, causing the court to analyze whether the distribution would satisfy that standard. Indeed, the consequences of the new trust were that two of the beneficiary's children would lose their remainder interests in the original trust, which the court observed would also have occurred had the distribution been outright to the son. The dissent notes, however, that prior requests for outright distributions had been denied by the trustees. Accordingly, the court found it necessary to condition the distribution on the beneficiary's agreement to contribute the assets to a new trust for his benefit.

A power held by a trustee to invade the corpus of a trust closely resembles a power of appointment for property law purposes.[39] Indeed, as a general rule, the holder of a power of appointment may appoint the property in further trust, which is exactly what the

[39] If the trustee can invade for his or her own benefit, then the power of invasion may constitute a general (estate taxable) power of appointment under sections 2514(c) and 2041(b). The power to invade for one's own benefit (that is, to withdraw property from the trust) may cause the powerholder to be the owner of the trust for purposes of section 671 so that the income, deductions and credits against tax of the trust are attributed to the powerholder. *See* I.R.C. § 678(a). However, if the power is held in a fiduciary capacity, section 678 may not apply. See discussion in Blattmachr, Gans & Lo, *"A Beneficiary as Trust Owner: Decoding Section 678,"* ACTEC JOURNAL, Fall 2009.

trustee possessing a decanting power does.[40] The court in *Morse* cited its prior decision prospectively authorizing the donee of a non-fiduciary power of appointment to exercise the power in further trust in support of its conclusion that a trustee with discretionary distribution authority may do the same.[41] This connection further suggests that if a decanting power is similar to a power of appointment, then, unless the instrument provides otherwise, a trustee who may invade the corpus of a trust may pay it to a different trust for the benefit of the beneficiary or beneficiaries for whom it may be invaded, even if the power to invade does not specifically state it may be exercised "for the benefit of" the beneficiary.[42]

Because the power to decant is deemed held by the trustee, it is, by definition, a fiduciary power. The *Comments* to *Restatement (Third) of Trusts* section 75 draw a distinction between powers held in a fiduciary capacity and those that are held for the powerholder's own benefit. The discussion echoes the conclusions reached in the Reporter's Notes to section 64 of the *Restatement (Third) of Trusts* which also draws a distinction between a personal power that may be exercised for the personal benefit of the donee of the power and a fiduciary power which must be exercised for the purpose for which the settlor created it. The Reporter's Notes to section 64 indicate that if the powerholder's power is personal, the trustee's only duty is to ascertain whether the attempted exercise is or is not within the terms of the trust.

The *Restatement (Second) of Property, Donative Transfers* section 11.1 (1986) took the position that a power of appointment could be held in a fiduciary capacity and that a power of appointment may be exercised in further trust (see section 19.3 thereof). The foregoing distinction between personal and fiduciary powers may explain why the *Restatement (Third) of Property (Wills & Other Donative Transfers)* section 17.1 (2011) clarifies that a fiduciary distributive power is a power of appointment but is not a discretionary power of appointment that may be exercised arbitrarily.[43] The donee of a

[40] *See, generally,* SCOTT ON TRUSTS §3.1.2 at 144–45 (5th ed. 2008) (the trend is to construe the language conferring a power of appointment with increasing liberality, and to hold that the donee of the power has broad discretion as to the manner in which the power may be exercised).
[41] Loring v. Karri-Davies, 371 Mass. 346, 357 N.E.2d 11 (1976).
[42] *See, e.g.,* RESTATEMENT (THIRD) OF PROPERTY (WILLS & OTHER DONATIVE TRANSFERS) § 19.14 (2011) (except to the extent the donor has manifested a contrary intention, the donee of a nongeneral power is authorized to make an appointment, including one in trust and one that creates a power of appointment in another, that solely benefits permissible appointees of the power.)
[43] Comment *g* states "*g. Fiduciary distributive powers.* A fiduciary distributive power is a power of appointment (a nongeneral power), but it is not a discretionary power of appointment. In the case of a discretionary power of appointment, which is the principal subject of this Division, the donee may exercise the power arbitrarily as long as the exercise is within the scope of the power. ... In the case of a fiduciary distributive power, the fiduciary's exercise

power of appointment would seem to have no affirmative duty to act in good faith and could exercise a power of appointment to exclude a person from beneficial enjoyment for personal reasons.[44] A fiduciary, on the other hand, would be precluded by fiduciary duties from acting in a similar manner. Instead, a fiduciary would seem always to be held to a minimum standard of good faith, with an obligation to act consistently with the terms of the trust and the interests of the beneficiaries.[45]

Notwithstanding the foregoing authorities, the *Morse* court's holding is far more narrow. The court relies on fundamental principles that in interpreting a trust, the intent of the settlor is paramount.[46] In determining the settlor's intention, the language of the trust instrument is of particular significance. In addition, in the case of the *Morse* trust, all of the settlor, the attorney/draftsperson and the trustee were available to submit affidavits confirming the settlor's intention. The availability of such extrinsic evidence may be a rare event in the case of an irrevocable trust established prior to the effective date of chapter 13 of the Code. It is interesting, nonetheless, that the court was quite aware of the particular Treasury Regulation that the trustee was attempting to satisfy, namely, Treasury Regulation section 26.2601-1(b)(4)(i)(A)*(1)(i)* which requires that the authority to distribute to a new trust must have been authorized by the terms of the governing instrument of the original trust without consent or approval of any beneficiary or court.

The *Morse* court states that "[a] trustee can only exercise a decanting power, however, in keeping with fiduciary obligations." Although the court finds that decanting authority was present, the court states in footnote 6 that it is not passing judgment on whether the transfer of assets to the new subtrusts was, in fact, in the beneficiaries' best interests or in keeping with the trustee's fiduciary duties. The court considered only the question of whether the trust authorizes such a transfer. This holding appears to raise the question of whether the decanting may have been avoided by the beneficiaries, nonetheless, as a breach of trust, which could, at a minimum, have tax consequences to the beneficiaries who fail to object.[47] Whether the

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is subject to fiduciary obligations as provided in the Restatement (Third) of Trusts." *citing* RESTATEMENT (THIRD), TRUSTS §§ 86 and 50, Comment a.

[44] *See* RESTATEMENT (THIRD) OF TRUSTS § 50 (2003), Comment *a*: "A trustee's discretionary power with respect to trust benefits is to be distinguished from a power of appointment. The latter is not subject to fiduciary obligations and may be exercised arbitrarily within the scope of the power."

[45] *See* UNIF. TRUST CODE § 105 (NAT'L CONF. OF COMM'RS. ON UNIF. STATE LAWS 2010) which prohibits a trust instrument from exonerating a trustee's duty to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.

[46] *See, e.g.,* Hillman v. Hillman, 433 Mass. 590, 744 N.E.2d 1078 (2001).

[47] *See generally,* D. Zeydel, "Developing Law on Changing Irrevocable Trusts: Staying Out of the Danger Zone", *47 Real Prop. Tr. & Est. L.J. 207* (2012).

exercise of authority that turns out to be a breach of trust can satisfy Treasury Regulation section 26.2601-1(b)(4)(i)(A)*(1)(i)* seems doubtful.

Morse v. Kraft is certainly a welcome development in the jurisprudence on decanting, although it can be interpreting as limited to trusts that permit distributions "for the benefit" of the beneficiaries. The court squarely held that the trustees had the authority to distribute in further trust without the need for beneficiary consent or court approval. It may be that the court was concerned that deriving decanting authority from a power to distribute outright would require a finding that an outright distribution is appropriate. However, neither the *Phipps* court nor the *Wiedenmayer* court so held. Instead, both those courts construed decanting as a lesser included power when a trustee may invade outright in favor of a beneficiary. Indeed, one might conclude that a trustee, constrained by a fiduciary duty to act in the best interests of the beneficiaries, must always consider the benefits of a distribution in further trust, rather than outright, because a distribution in trust has the potential to give a beneficiary superior tax and creditor protection, while at the same time affording the beneficiary flexibility that the original trust may not have provided. It will be intriguing to see if further case law develops. For now decanting was from the most recent Priority Guidance Plans published by the Department of Treasury, placing greater importance on flexible drafting (recall that the *Morse* court indicated a potential negative inference from the absence of a decanting power in a current trust instrument) and state law developments.

In *Harrell et al. v. Badger,*[48] the Trustee exercised decanting authority under FTC section 736.04117 without providing notice to the qualified beneficiaries. The purpose of the decanting was to qualify the income beneficiary for government benefits by decanting into a special needs trust as a sub-account of the Florida Foundation for Special Needs Trust ("FFSNT"). The court determined that the decanting was invalid for failing to comply with the requirements of Section 736.04117 with respect to advance notice. The court also

[48] 2015 WL 3631639 (5th DCA 2015) Not Final until Time Expires to File Motion for Rehearing and Disposition Thereof if Filed. *See* Petition of Johnson, 2011-2809/B, NYLJ 1202718164118, at *1 (Surr., NY, Decided January 13, 2015) (decantings that changed the class of permissible appointees under the beneficiary's limited testamentary power of appointment from issue of the beneficiary's mother to issue of the beneficiary's father, and expanded the class of ultimate takers in default to eliminate the New York City Ballet and include intestate distributees of the beneficiary's father were invalid under EPTL 10-6.6(b) and assets were to be returned to the original trusts). It seems that the Johnson court's determination that altering the permissible appointees under a power of appointment constitutes an impermissible addition of beneficiaries to the trust is incorrect. Indeed, in *Phipps,* the beneficiary had no power of appointment at all, and the court permitted a power of appointment to be conferred which was exercisable in favor of the beneficiary's wife, who was not a beneficiary of the original trust.

held that the decanting violated the prohibition on introducing additional beneficiaries into the trust because an FFSNT sub-account provides a contingent interest in favor of other FFSNT subaccounts.

The court did not analyze the portion of FTC section 736.04117 which expressly states that the decanting statute does not abridge the right of a trustee who has a power of invasion to appoint property in further trust that arises under the common law. This provision was intended expressly to permit a decanting under the authority of *Phipps* without the obligation to provide advance notice.

In *In re Kross*,[49] the Trustees also sought approval for invading a trust for the benefit of a beneficiary with disabilities to ensure qualification for Medicaid and Supplemental Security Income benefits. The Attorney General of the State of New York on behalf of the New York State Department of Health objected. The invaded trust was a fully discretionary trust as to income and principal payments until the beneficiary attained age 21, whereupon the beneficiary would become entitled to income in quarterly installments and principal one-third at age 25, one-half the balance at age 30 and the remainder at age 35. Advocating a bizarre reading of the New York decanting statute, the Attorney General argued that the Trustees were not "authorized trustees" with the power to decant. The court disagreed. The Attorney General also argued that the beneficiary's right to principal distributions became vested when the beneficiary attained age 21, and because the decanting did not validly take place prior to that date, the decanted trust was a self-settled trust that did not qualify as a supplemental needs trust. At issue was the validity of the notice of decanting and waiver of the thirty day notice period under the statute. The Trustees gave notice less than thirty days prior to the date the beneficiary attained age 21. The beneficiary's father (who was neither the grantor nor a Trustee) executed a consent to the decanting taking effect immediately. The beneficiary's father was expressly authorized to receive notice and consent on behalf of the beneficiary by the trust agreement. Accordingly, the court found the consent to be valid and effective to permit the decanting to take place five days after notice was given and prior to the beneficiary attaining age 21.

In *Ferri v. Powell-Ferri*,[50] one of the parties to a proceeding for dissolution of marriage was the beneficiary of a third party trust. The trust was governed by Massachusetts law and provided that upon attaining age 35, the beneficiary would have periodically

[49] 2013 WL 5478190 (Surr. Ct. NY Cty 2013).
[50] 326 Conn. 457 (2017) and 326 Conn. 438 (2017).

increasing rights to withdraw principal from the trust. At the time divorce proceedings were initiated, Ferri had the right to withdraw 75% of the trust estate. During the pendency of the proceedings, his withdrawal right would have increased to 100%. The Trustees of the trust, after the divorce proceedings commenced, decanted the trust to a new trust that eliminated the current and future withdrawal rights, and included spendthrift provisions. The Trustees instituted a declaratory action seeking a ruling that they had validly exercised their authority to transfer the assets to the new trust and that the beneficiary's spouse had no interest in the assets of the new trust. The beneficiary's spouse asserted claims of fraud, conspiracy and breach of the requirement not to dissipate marital assets. The court found that because the beneficiary did not participate in the decanting, the beneficiary had no duty to thwart the removal of assets from the marital estate by the Trustees. In addition, the beneficiary had no affirmative duty to recover the marital assets "taken by a third party."

During the course of the proceedings, the Supreme Court of Connecticut certified three questions to the Supreme Judicial Court of Massachusetts: (1) Under Massachusetts law, did the terms of the trust empower its trustees to distribute substantially all of its assets (that is, to decant) to the new trust; (2) if the answer to (1) is "no", should either 75% or 100% of the assets be returned to the original trust; and (3) under Massachusetts law, should a court, in interpreting whether the original trust's settlor intended to permit decanting to another trust, consider an affidavit of the settlor offered to establish the settlor's intent.[51] The Massachusetts court answered question (1) and question (3) in the affirmative, obviating the need to answer question (2).

As in *Morse v. Kraft*, the Massachusetts court refused to recognize a common law authority to decant, but rather, looked to the specific language of the governing instrument to determine whether the settlor intended to confer such authority. The court focused on the language stating that so long as the beneficiary is living, the trustee shall "from time to time, pay to *or irrevocably segregate for later payment to* [the beneficiary] as much of the net income and principal of the trust as [the trustee] shall deem desirable for [the beneficiary's] benefit." (Emphasis added). Powell-Ferri argued that the withdrawal powers held by Ferri were wholly inconsistent with the trustee's authority to decant. The court disagreed because it would follow that the trustee would lose the ability to administer the assets subject to withdrawal, which would make little sense in view of the language giving the trustee authority to pay to or segregate

[51] Ferri v. Powell-Ferri, 476 Mass. 651 (2017).

assets for later payment to the beneficiary during the beneficiary's lifetime. The court pointed out that the trustees continued to hold legal title to the assets, notwithstanding the withdrawal rights, and therefore, had all the authority to administer those assets conferred by the trust agreement. Nonetheless, because the governing instrument did not contain an express authorization to decant, the court found that there to be an ambiguity, permitting consideration of the settlor's affidavit which confirmed his intention that the trustees were authorized to take any action necessary to protect the principal and income of the trust which authority also extended to protecting the assets from the creditors of the beneficiary.

The *Ferri* case might seem incorrect to some, and certainly most decanting statutes do not permit decanting of assets subject to a presently exercisable power of withdrawal, whether a *Crummey* power or a power such as the one held by Ferri. Nonetheless, the Massachusetts court's interpretation of the Ferri trust turned out to be very beneficial to Ferri, as it prevented the trust estate from being considered a marital asset. How important it may have been to the court that the trust estate was largely accumulated during the marriage, and used for investments in franchises, is unknown. The Connecticut court repeated several times that Ferri did not instigate the decanting, or even know about it.

The *Ferri* cases certainly demonstrate the potential benefits of a decanting power, and confirm the holding of *Phipps* that the ability to distribute in further trust derives from the trustee's broad discretion to distribute outright on a principle that the greater includes the lesser. Accordingly, even without express language in the governing instrument, or a state statute, decanting should not be overlooked as a powerful solution that in many ways may be more flexible that a court ordered modification or reformation.

Not all decantings will pass muster, however. In *Hodges v. Johnson,*[52] the settlor created two trusts for his wife, children and step-children and their descendants. The trust agreements expressly authorized discretionary distributions to the beneficiaries and to "distributee trusts." There were disputes within the family concerning the family business, and the settlor approached the trustees about decanting the trusts to exclude certain of the beneficiaries. The trial court found that the decantings were accomplished without consideration of the plaintiffs' beneficial interests, and therefore, held them to be invalid. The trial court implied that the decantings were accomplished solely to achieve the settlor's desires, without consideration of the interests of the

[52] 7th Cir. Ct. - Dover Probate Division, No. 2016-0130 (Sup. Ct. N.H. 2017).

beneficiaries. The Supreme Court held that the trustees were required to give "due regard for the diverse beneficial interests created by the terms of the trusts" and that the trustees breached their duty of impartiality because the trustees failed to treat the beneficiaries equitably in light of the purposes and terms of the trusts. In addition, the court also affirmed the removal of the trustees who engaged in the decanting for cause. The good news is that *Hodges* confirms that decanting is a fiduciary power, subject to review for breach of trust. Accordingly, decanting is properly viewed as the exercise of discretion by the trustee under the trustee's authority to make distributions, and not as an act by the beneficiaries or the settlor to change the beneficial interests under a trust.

(3) GST concerns?

(a) Depends on whether the trustee is deemed to have had the power since the inception of the trust.

(b) Issues are shifting beneficial interests to lower generations or extending the time for vesting.

(c) If converting to a grantor trust is not a gift, should not be a GST event.

(4) Adding powers to cause grantor trust status

(a) Could the trustee do this without the grantor's consent?

(b) Would the trustee do this without the grantor's consent?

(c) What is the effect of the grantor's actual or implied consent?

(5) If you don't have decanting in your State

(a) Add a clause to your governing instrument.

(b) Change situs and governing law to a State that permits decanting – may require court approval depending on the governing instrument. Alaska permits decanting if the trust has an Alaska trustee and the trustees, by an acknowledged statement, shift the principal place of administration to Alaska.

(c) Probably best to have the power in the hands of an independent trustee in any event.

J. Section 677(a)(3)

(1) Grantor is treated as the owner of any portion of a trust whose income without the approval or consent of any adverse party is, or in the discretion of the grantor or a nonadverse party, or both, may be Applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.

(2) In general, under old case law, thought to require the trust actually to own a policy – *see Rand v. C.I.R.*, 40 B.T.A. 233 (1939), *aff'd,* 116 F.2d 929 (8^{th} Cir. 1941) and *Iverson v. Comm'r*., 255 F.2d 1 (8^{th} Cir. 1958).

(3) Actual payment of premiums, even if in violation of the trust agreement, may nevertheless cause grantor trust status – PLR 8839008.

(4) DANGER – IRS NSAR 20062701F

(a) Provisions of foreign trust authorizing the purchase of life insurance on the grantor's life caused the trust to be a grantor trust.

K. Section 678(a)

(1) A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:

(a) Such person has a power exercisable solely by himself to vest the corpus or income therefrom in himself, or

(b) Such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

(2) Section 678(b)

Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom section 679 applies) is otherwise treated as the owner under the provisions of this subpart other than this section.

(3) Genesis of Section 678

(a) *Mallinckrodt v. Nunan*, 146 F.2d 1 (8th Cir. 1945)

(i) Held if grantor taxable as owner because grantor held certain broad powers then third person should also be taxable as a trust's owner if third person holds similar broad powers.

(ii) Trustees were to distribute trust income to the beneficiary upon his request.

(4) 678 and Ascertainable Standard

Under *U.S. v. De Bonchamps*, 278 F.2d 127 (9th Cir. 1960 *en banc*) and *Funk v. Comm'r,* 184 F.2d 127 (3rd Cir. 1950), an ascertainable standard (needs, maintenance and comfort) bars income taxation to the beneficiary.

(5) What about trumping?

In PLR 200730011, the beneficiary of the trust had a 30 day power of withdrawal. The grantor's spouse (who was also the trustee) had the power to **withhold** distributions of trust principal (a power not excepted under section 674(b)). The IRS ruled that under Treas. Reg. 1.671-3(b)(3), the spouse's power over corpus includes both ordinary income and income allocable to corpus making the trust wholly grantor. Accordingly, the grantor was treated as the owner of the entire trust under Sections 674(a) and 678(b).

(6) What happens when the grantor dies?

(a) Who knows?

(b) Two rulings issued on same facts where wife created a trust for husband and gave husband a 30 day power of withdrawal.

(i) PLR 9026036 says powerholder becomes the owner under 678(a).

(ii) PLR 9321050 says powerholder does not become the owner.

(7) PLR 201633021 (April 29, 2016)

(a) Trustee of Trust 1 proposed to transfer funds to Trust 2 for the benefit of the same beneficiaries. The Grantor of Trust 1 is deceased. Trust 2 provides that Trust 1 retains the power, exercisable by Trust 1, to revest the net income of Trust 2 in Trust 1, provided that such power shall lapse on the last day of the calendar year.

(b) Trust 2 provides that income includes (i) any dividends, interest, fees, and other amounts characterized as income under Section 643(b) of the Code, (ii) any net capital gains realized with respect to assets held less than 12 months, and (iii) any net capital gains realized with respect to assets held longer than 12 months.

(c) The IRS concludes that Trust 1 will be treated as a owner of the portion of Trust 2 over which Trust 1 has a power of withdrawal under Section 678(a). Accordingly, Trust 1 must take into account in computing its income tax liability those items which would be included in computing the tax liability of a current income beneficiary, including expenses allocable to which would enter into DNI, and Trust 1 will also take into account the net capital gains of Trust 2.

(d) Genesis of the Beneficiary Deemed Owner Trust ("BDOT"). Can you give a beneficiary the power to withdraw the "taxable income" of the testamentary trust, for example, and thereby reduce the income tax burden of the trust by causing the assets to be taxed at the beneficiary's income rates, rather than at the trust's income tax rates? This proposition appears viable. It is not entirely clear, however, that such a withdrawal right would make the trust a wholly grantor trust with respect to the beneficiary. The Treasury Regulations speak in terms of income and corpus portions, indicating a departure from the use of the word "income" to mean "taxable income." Thus, a sale by a beneficiary to a BDOT may not avoid a taxable capital gain to the same extent as an installment sale by the grantor to a grantor trust would. In addition, as with all withdrawal rights, the potential for estate tax inclusion would have to be carefully managed.

L. Using Section 679

(1) If a U.S. person, directly or indirectly, transfers assets to a foreign trust and if there is a U.S. beneficiary of any portion of the trust, the trust is automatically a grantor trust under Section 679 with respect to the portion attributable to the property transferred.

(2) Can make a trust a foreign grantor trust by giving a foreign person a veto power over a substantial power over the trust.

(3) Difficulties with Section 679

(a) Substantial reporting obligations.

(b) Need a relationship with a foreigner.

(c) Section 684 could apply on the grantor's death to cause an income recognition event.

V. What About A DING?

A. DING Rulings Continue to be Issued[53]

(1) The purpose of a so-called Delaware Incomplete Gift Non-Grantor Trust is to permit the taxpayer to avoid the application of State income tax without making a completed gift. This requires settling a trust in a State that does subject a trust created by a non-resident to State income tax.

(2) In order to avoid grantor trust status, distributions must be in the hands of a Distribution Committee composed of adverse parties for grantor trust purposes. To avoid a completed gift, the grantor must retain sufficient participation in the disposition of the trust property so that the gift to the trust is incomplete. In addition, the State must permit a grantor to create a discretionary trust for the benefit of the grantor and others that would not subject to the trust assets to claims of the grantor's creditors.

B. Rulings Sought in the Typical DING

(1) For so long as the Distribution Committee is serving, no portion of the items of income, deductions, and credits against tax of the Trust shall be included in computing under § 671 of the Code the taxable income, deductions, and credits of the Grantor or any member of the Distribution Committee.

(2) The contribution of property to the Trust by the Grantor will not be a completed gift subject to the federal gift tax.

(3) Any distribution of property by the Distribution Committee from the Trust to the Grantor will not be a completed gift, subject to federal gift tax, by any member of the Distribution Committee.

(4) Any distribution of property by the Distribution Committee from the Trust to any beneficiary of the Trust, other than the Grantor, will not be a completed gift, subject to federal gift tax, by any member of the Distribution Committee.

(5) The members of the Distribution Committee do not possess a general power of appointment within the meaning of § 2041 of the Code and, accordingly, the Trust will not be includible in any Distribution Committee member's gross estate under § 2041 of the Code.

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[53] *See, e.g.,* PLRs 201850001-6; PLRs 20180802-9.

VI. Recent Developments, Problems and Solutions

A. Turning Off Grantor Trust Status

(1) If appears that if the power to turn off grantor trust status is in the hands of a person other than the grantor, it may present problems.

(2) A typical fiduciary, even a Trust Protector, may, under State law, have fiduciary duties extending exclusively to the beneficiaries. In some states, applicable State law requires any Trust Protector to act in the interests of the beneficiaries. This may preclude a Trust Protector from exercising a power to turn off grantor trust status, which would cause the Trust to become its own taxpayer, thereby arguably harming the trust and the beneficiaries.

(3) One solution may be to give the authority to release the grantor trust powers to a person who is expressly stated not to be a fiduciary.

(4) Another solution may be to give the trustee with a decanting power, for example, the express authority to take the interests of the grantor into account.

B. Reimbursement Clauses

(1) The original issue with a tax reimbursement clause was that by permitting the trustee to make payments to the grantor, the trust would be treated as self-settled, and thus, under the common law, available to the grantor's creditors. In that case, gifts to the trust would be incomplete, and the trust would be included in the grantor's gross estate.

(2) Modern state statutes expressly state that a tax reimbursement clause will not make the assets of the trust available to the grantor's creditors.[54]

(3) Nonetheless, a pattern of tax reimbursements to the grantor may implicate Section 2036(a) as an implied understanding that the trustee would make trust income available to the grantor.[55] Such an implied understanding would cause the trust estate to be includible in the grantor's gross estate for Federal estate tax purposes.

[54] *See, e.g.* F.S. §736.505(1)(c).
[55] *See* Rev. Rul. 2004-64, 2004-2 C.B. 7.

(4) In the absence of an express tax reimbursement clause, it appears likely that the grantor will not have standing to apply to court for relief. In *Millstein v. Millstein,*[56] the grantor created two grantor trusts. The settlor requested the trustee for a tax reimbursement, and the trustee declined but made other assets available to the settlor from a third trust. The settlor filed a complaint seeking equitable reimbursement, and a modification of the trust to achieve settlor's tax objectives. The court denied the settlor's request for relief holding that the settlor did not have standing. Instead, an action for modification of a trust to achieve the settlor's tax objectives could be brought only by the trustee or the beneficiaries, but not by the settlor.

C. Enforcing A Substitution Clause

(1) A typical manner in which to achieve a grantor trust is through the use of a substitution clause within the meaning of Section 675(4)(C) of the Code.

(2) What if the grantor tenders property in substitution for assets of the trust estate and the trustee refused to honor the substitution? In *Manatt v. Manatt*,[57] the grantor retained a power of substitution in a non-fiduciary capacity within the meaning of Rev. Rul. 2008-22, 2008-1 C.B. 796. The trustee resisted the substitution arguing that the trustee has a fiduciary duty to ensure compliance with the power of substitution, namely that the property substituted be of equivalent value. The grantor proposed to substitute cash for closely held stock owned by the trust. The court granted summary judgment in favor of the grantor, focusing, in particular, on the language of the substitution clause:

> ". . . Neither the consent of the trustee nor the consent of any other person shall be required. . . . In all events, the trustee shall satisfy himself or herself that the properties acquired and substituted pursuant to this paragraph are, in fact, of equivalent value; . . .."

(3) The court concluded that because the power of the trustee to ensure equivalent value was written in the past tense, the trustee could not block the substitution, but could merely verify the values after the fact, and if necessary, demand additional property from the grantor. The court held that the trustee has the fiduciary duty to determine whether the substitution was of equivalent value but could not abridge, delay of block the grantor from exercising the power of substitution.

[56] 2018 WL 3005347 (Court of Appeals, Eighth District, Cuyahoga County Ohio).
[57] 2018 WL 3154461 (S.D. Iowa, Central Division 2018).

(4) The court cited favorably *Benson v. Rosenthal*[58] in which the grantor was permitted to substitute property of the trust for promissory notes and distinguished *In re Dino Rigoni Intentional Grantor Trust for the Benefit of Christopher Rajzer*[59] where the substitution language did not express the trustee's authority in the past tense.

VII. Basis at Death and Other Problems

A. Do the Assets of a Grantor Trust Receive a Basis Adjustment at the Grantor's Death?

(1) If the assets are includible in the grantor's gross estate, the answer is "yes" under Section 1014(a) where the property is "acquired from the decedent".

(2) But what about a trust that is not included in the grantor's gross estate? It has been argued that such a basis adjustment should exist under the principle that for income tax purposes the property is acquired from the decedent when grantor trust status terminates by reason of the death of the grantor.[60]

(3) In a recent article,[61] Austin Bramwell and Stephanie Vera argue that Treasury should extend the application of Section 1015(b) which provides that for gift tax purposes the assets of a grantor trust have the same basis as they had before death to also apply for income tax purposes.

B. Gain Realization at Death if an Installment Note is Outstanding

(1) Several authors have argued that if a grantor trust has an outstanding obligation to the grantor at death issued in exchange for assets purchased from the grantor, when grantor trust status terminates by reason of the grantor's death, the trust experiences an income tax realization event because the trust will then be deemed to have debt in excess of basis. The foundation for such a position is *Madorin v. Commissioner,*[62] in which a power to add beneficiaries causing a trust to be treated as a grantor trust was released during the grantor's lifetime with the effect that grantor trust status was terminated, resulting in an income tax realization event to the trust because the trust held an interest in a partnership with debt in excess of basis.

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[58] Civil Action No. 15-782, 2016 WL 2855456 (E.D. LA May 16, 2016).
[59] No. 321589, 2015 WL 4255417 (Mich. Ct. App. July 14, 2015).
[60] *See* Blattmachr, Gans & Jacobson, "Income Tax Effects of Termination of Grantor Trust Status by Reason of the Grantor's Death," 97 J. Tax'n 149 (2002).
[61] Bramwell & Vera, "Basis of Grantor Trust Assets at Death: What Treasury Should Do," Tax Notes 793 (August 6, 2018).
[62] 84. T.C. 667 (1985).

(2) A contrary conclusion appears well supported by *Crane v. Commissioner*, in which the court accepted non-recognition of gain in the case of the receipt of encumbered property upon the death of a decedent.[63] The IRS appears to have accepted the application of *Crane* generally when grantor trust status terminates as the result of the death of the grantor. *See, e.g.,* ILM 200923024 in which the Service stated that the death of an owner is not generally treated as an income tax event.[64]

VIII. Avoiding Grantor Trust Status - It Ain't Easy

ARTICLE I

Restrictions Relating to Settlor

(C) Termination of Grantor Trust Status. It is the settlor's intention that, if (i) the settlor's spouse shall cease to be a beneficiary of the trust under Article __________, (ii) the settlor or the settlor's spouse has effectively released the power of substitution under Article _____________, and (iii) the trust estate no longer consists of a policy of insurance on the life of the settlor and/or the settlor's spouse, then thereafter, notwithstanding any other provision of this agreement: none of the settlor, any spouse of the settlor or any other "nonadverse party" as that term is used in Section 672(b) of the Internal Revenue Code shall have the power (i) to purchase, exchange or otherwise deal with or dispose of any principal or income of such trust hereunder for less than an adequate consideration in money or money's worth, or (ii) to borrow any principal or income of such trust hereunder, directly or indirectly, without adequate interest or adequate security; no person in a non-fiduciary capacity shall have the power (i) to vote or direct the voting of stock or other securities of a corporation in which the holdings of the settlor and such trust hereunder are significant from the viewpoint of voting control, (ii) to control the investment of any trust assets either by directing investments or reinvestment or by vetoing proposed investments or

[63] 331 U.S. 1 (1947) (court assumed that an encumbered property received a basis under the predecessor to Section 2014 without recognition of gain).
[64] *See also* Rev. Rul. 73-183, 1973-1 C.B. 364.

reinvestment, to the extent that the trust assets consist of stocks or securities of a corporation in which the holdings of the settlor and the trust are significant from the viewpoint of voting control, or (iii) to reacquire any trust assets or any portion thereof by substituting other property of an equivalent value; the trustees shall not use any income of such trust within the meaning of Section 677 of the Internal Revenue Code (including, without limitation, capital gain) directly or indirectly to pay premiums on policies of insurance on the life of the settlor and/or any spouse of the settlor (including, without limitation, any form of split-dollar arrangement with respect to such insurance); no income or corpus shall be paid or appointed to or for the benefit of the settlor or any spouse of the settlor or the estate, creditors or creditors of the estate of the settlor or of any spouse of the settlor, or accumulated for the future benefit of or disposition by the settlor or by any spouse of the settlor; no court, other than a court within the United States, shall exercise primary supervision over the administration of such trust hereunder and no person, other than a United States person, shall have the authority to control any substantial decision of such trust hereunder, within the meaning of Section 7701(a)(30)(E) of the Internal Revenue Code. It is the settlor's intent that thereafter no part of the income, deductions or credits of any such trust shall be attributed to the settlor under subpart E of part I of subchapter J of chapter 1 of subtitle A of the Internal Revenue Code, and this agreement shall be construed and the trusts administered under this agreement to effectuate this intent.

(D) Limitations on Powers. Notwithstanding any other provision of this agreement to the contrary, no power enumerated in this agreement or accorded to trustees generally pursuant to law, singly or as a whole, shall be construed:

(1) to enable the settlor or the settlor's spouse (i) to become a trustee under this agreement, (ii) to remove any trustee under this agreement other than an independent trustee, (iii) to vote any stock of any controlled corporation within the meaning of Section 2036(b) of the Internal Revenue Code which may at any time be directly or indirectly given to or held by any trust under this agreement, (iv) to exercise any power of appointment with respect to any trust under this agreement, (v) to exercise any power described in Sections 2036(a)(2) or 2038 of the Internal Revenue Code or to exercise, directly or indirectly, any other power with respect to any stock which would cause such stock to be includible in the estate of the settlor under Section 2036(b) of the Internal Revenue Code or (vi) to exercise any incident of ownership within the meaning of Section 2042 of the Internal Revenue Code with respect to any policy of insurance on his or her own life (other than as a party to a so-called "split-dollar" arrangement with the trustees); or

(2) to permit any trust distribution which would have the effect of discharging any legal obligation of the settlor (including any obligation which the settlor may have at any time relating to the support or education of any beneficiary hereunder).

If at any time any person other than the settlor makes a contribution to any trust created under this agreement (other than to a trust as to which such person then has any general power of appointment), such person (the "donor") shall be deemed thereafter to be an additional "settlor" with respect to the addition to the trust receiving such gift (the "donee trust") for the purposes of the restriction provisions set forth in this Article and for the purposes of all limitations, exceptions, restrictions and exclusions referring to the settlor contained in other provisions of this agreement (but only insofar as they relate to the donee trust and the additions made by such donor).

(E) Settlor's Intent. It is the settlor's intent that no portion of any trust hereunder be included in the gross estate of the settlor for federal estate tax purposes. Accordingly, and notwithstanding any provision of this agreement to the contrary, this agreement shall be construed and the trusts under this agreement administered in accordance with and to achieve the foregoing intent.

(F) Settlor's Income Tax. The trustees shall not pay to the settlor or the settlor's personal representatives any income or principal of any trust estate hereunder on account of or in discharge of the settlor's income tax liability (whether Federal, state or otherwise), if any, in respect of property held in any trust hereunder and included in the gross income of the settlor.

IX. Conclusions

A. Always best to use more than one method to create an intentional grantor trust.

B. Make sure you have created the flexibility to toggle off if the tax liability becomes too much generosity for the grantor taking into account the potential that fiduciary duties may preclude release of the relevant powers.

C. Be careful of the debt in excess of basis issue if grantor trust status is terminated during the grantor's lifetime.

D. Tax uncertainty at death may make avoiding outstanding debt, and engaging in asset substitutions prior to death, advisable.

E. Be aware that many more trusts may be grantor trusts than it appears, particularly since the presence of a related or subordinate trustee or a power to accumulate for the benefit of the grantor or the grantor's spouse could attract grantor trust status.

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FLORIDA COMMUNITY PROPERTY RIGHTS SIMPLIFIED

By

Richard M. Warner, Marathon

<u>Florida Community Property Rights Simplified</u>

Richard E. Warner
Marathon, Florida
August 23, 2019 – ATO 2019 at the Breakers

<u>Introduction</u>

Welcome to the world of simplicity. The title of this program, as usual, disguises something which is anything but simple: Florida law stemming from community property in other states. The fun of this presentation today is *critiquing* intensely a complex and treacherous area of Florida law in a very simplified way --- as if striking it with a blunt instrument. This is to create some basic tools for the class to take home and actually use in their practices. So, this is not a survey of this odd field of Florida law where we do not look under the rug. No, that will not be happening here in this presentation. Rug contents matter.

In reality, Florida Community Property Rights is (keep this expression in the singular – let it be known as "CPR" – not to be confused with cardio-pulmonary-resuscitation) and always has been an enigmatic loose cannon rolling about the bilge of Florida law, as it has in virtually every other common law state of the union. Fortunately, since everyone is so afraid of its malignant potential, disputes in this area of law are perennially settled before they get to any elegantly clarifying cases on appeal -- in Florida and elsewhere. That is why this subject is irresistible for any reader who loves a good train wreck. Say, for instance, the author of these materials, who has been waiting decades for the perfect storm fact pattern to put this picture to a juridical test. However, now that storm has arrived --- in a way. *Johnson v. Townsend* from the 4th DCA this year (see cite below and Exhibit D hereto) is currently pending in the Florida Supreme Court, waiting for a ruling on jurisdiction (or it may have already been accepted by the time this goes to press). It has dealt with CPR issues, although it was decided by the appellate court via the claims statute rather than the big issue of community property rights in Florida. It isn't much of a CPR case, but it is the only one we have.

The author is hoping there will not be in the *Johnson* result a major juridical let-down where the CPR aspect is left on the dock and not even touched. That let-down may not happen. Actually, this is a good opportunity in *Johnson* for the Florida Supreme Court to set straight this uniquely complex case into a clarifying icon of judicial writing which will assist not only the Sunshine State, but every common law state in America. The 4th DCA is asking for as much through its certified question of great public importance (see Exhibit D below). That court really wants the Florida Supreme Court to set this issue straight. And our highest state court can do this now, in this case, and hopefully it will.

Finally, before we begin, note that this presentation is highly compressed. Only the greatest hits are showcased. There are no album cuts allowed. Hence, these materials are not intended to be a survey of this area of Florida law. Rather, these materials and the live presentation with its even more dramatic slideshow is intended to be a bellerophonic letter to supporters of the chaotic CPR status quo begging for clarity from the Florida Supreme Court.

I. Ten Simple Steps to Being a Community Property Rights in Florida Specialist

Please be prepared for lots of acronyms and plenty of italics in these materials. Maintaining the pretense that this subject is simple, here are the ten easy steps to being a specialist in Florida Community Property Rights:

Step 1. **[Recognizing community property rights]** Community property rights (referred to by the author as "CPR") of married couples follow their assets into Florida when they move here from a community property ("CP") jurisdiction. The rights follow "moveable assets" brought into Florida. The case *Johnson v. Townsend*[1] from the 4th DCA is now pending before the Florida Supreme Court and will be our case study for this analysis. The case decision below should not be used by anyone as a method to determine how CPR is defined or functions. It is simply is not that kind of generic case. It is too specialized. However, this generality can be stated: Community property as an *estate in property* does not exist in Florida and the other 40 common law states. However, the *rights* in and to community property do exist in Florida, and have always existed here when imported by married couples from community property states[2] using the proceeds of property from the CP states or moveables transferred from those states --- nothing new here. See the case citations below.

Step 2. **[Define CPR correctly]** CPR are fully vested 50% undivided interests for each of the married couple in all property stemming from their imported CP assets (usually cash or securities in accounts) with *no survivorship rights* (unless stated otherwise). This classic CPR 50-50 ownership resembles tenancy-in-common between spouses in common law states. In Florida CPR is "rendered" as tenancy-in-common since it must exist here in some form. *Tracing* the asset and its source is mandatory in this CPR exercise just as it is in Florida marriage dissolution proceedings since we have already slipped CPR into Florida without anyone really noticing or caring. Chapter 61 of the Florida Statutes governing marital dissolution is simply a sub-silentio application of CPR to ALL Florida married couples in divorce

[1] *Johnson v. Townsend*, 259 So.3rd 851 (Fla. 4th DCA 2018); Motion for Rehearing Denied – Motion to Certify Question of Great Public Importance Granted, *Johnson v. Townsend*, 259 So.3rd 851 (Fla. 4th DCA 2018); Appeal to Florida Supreme Court, SC10-102, February 14, 2019. (Attached as Exhibit D below)

[2] Louisiana, Texas, New Mexico, Arizona, California, Nevada, Washington, Idaho and Wisconsin. Whereas, Alaska, Tennessee and South Dakota recently enacted opt-in "community property trust" laws which are not recognized by the IRS, courts in other states, or serious thinkers as reflecting true "community property" state status. True CP status requires a *mandatory* regime, such as Wisconsin initiated in 1983 being formerly a common law jurisdiction. Common law states for our purposes are the other 41 states, which includes Alaska, Tennessee and South Dakota.

cases even though they may have never set foot in a community property state. Most of all, crossing a state line cannot in itself change the fully vested constitutionally protected property rights one owns. All of the above is mostly codified in Florida's uniform CPR statute FUDCPRDA, discussed at length as the now famous: Florida Uniform Disposition of Community Property Rights at Death Act. (Attached as Exhibit C below) But really, doesn't this statute also apply to property rights while both of the couple are still living? Yes. So its title is again misleading.

Step 3. **[Tenancy by the Entireties Differentiated]** Florida Tenancy by the Entireties ("TBE") ownership requires 100% ownership simultaneously by both members of the couple in the Florida property to arise and *maintains survivorship rights*. All five *unities* must exist in TBE ab initio: time, title, interest, ownership and marriage. CPR lacks at least two of these five unities, title and interest. Hence, no TBE where CPR is recognized.

Step 4. **[CPR Property can never be TBE]** Because the property the couple purchases in Florida traceable to CPR is mandatorily owned as 50% interests because of the vested CPR, that new property in Florida cannot attain the status of TBE property unless *later* the couple expressly and with informed consent, changes the CPR property ownership to TBE after arriving. Therefore FUDCPRDA §732.217 which tries to exclude TBE property from CPR application cannot and does not function. It cannot exclude TBE property from CPR application since CPR property can never become TBE on its own since it can never have all five unities. It lacks the title and interest unities and possibly others. No appellate case has of yet addressed this nonsense which was first exposed by the author in the year 2000. Support for the author's position has quadrupled since then in Florida. It went from 1 person, to four supporters in 19 years, feeling that CPR can never be TBE, which can't be disputable. Hence, FUDCPRDA §732.217 is not unconstitutional; it is simply non-functional. Something non-functional can never reach the exalted level of being unconstitutional simply because it does not have the capability of accomplishing anything malignant.

Step 5. **[Titles on CPR Instruments Mean Nothing]**[3] The way deeds, title certificates, account titles etc read means little or nothing as to the ownership and possession of CPR assets. This is much like a divorce proceeding in Florida under Chapter 61. Ownership reflected on deeds or purchase records means little since a divorce court will look to whether the asset is a marital asset or, on the other hand, a separate property asset regardless as to how the name on the title reads. Those which say just "husband and wife" (or with no reference to married status at all) do NOT

[3] Certificate and deed titles for CPR property in some circumstances under CP law may impart a fiduciary duty for *management* purposes but only *between the spouses*. The named title holder on the certificate or deed, if holding primary management powers, is usually deemed to have the fiduciary duty to protect the interests of the other spouse in the property. This has nothing to do with the ownership or possession in the first instance or in establishment of the property interest ab initio. It is a "fair dealing" rule to protect the spouse not doing the management, nothing more. This concept has been a bit confused in the Florida cases on the subject.

change CPR to TBE. CPR property must state survivorship to have survivorship and must be done with informed consent on the part of both of the married couple. Notwithstanding *Stone v Stone*[4], without express pre- or post-marital written agreements employing informed consent, the transformation of CPR to TBE or other survivorship rights does not happen.[5]

Step 6. **[CPR Property can be Constitutionally Homesteaded]** Since Florida constitutional homestead status under Article X of the Florida constitution can apply to whatever interest in the property the homesteader owns (all of it, ½, ¼, life estate etc), a married couple can indeed own co-existing 50-50 tenants-in-common constitutional interests in a Florida residence the minute they close on the purchase of that realty using funds traceable to CP. The CPR aspect of the Florida asset sneaks into application at the time the deed is delivered. The *quantity* of property ownership is determined therefore by CPR at the instant of title vesting. Homestead status can only come later, if it does at all. Hence FUDCPRDA §732.225 with is mandatory termination of CPR in Florida realty is both ineffective as to its purpose but it is also unconstitutional under state and federal law because it divests constitutionally protect vested property rights without informed consent and without due process of law. That is not a stretch; however there is no Florida appellate case yet on that issue.

Step 7. **[Do Your Tracing Inquiry at the Planning & Administrative Stage]** There is an easy way to adjust your practice to accommodate a proper investigation into CPR assets. For all married couples (and survivors of married couples) who have resided in a true CP jurisdiction, make a master list of all assets currently owned, and then below that, insert time period sections. In those time period sections insert the values at the beginning of the time period and at the end, and also the location of the residence, along with the sources of income in general terms. Do that for all periods of the marriage all the way back to the beginning of the current marriage. No need to treat previous marriages unless the amounts from those are vast. Add in a list of all separate property originally owned or since received by each of the couple. With that master list with its sub-lists, compare the values of community property vs separate property, including increments, income and increases in value *even after* they moved into Florida. Then check the law of the original CP state to see if income from separate property is deemed community owned. The majority of CP states hold that it is. With that beautiful body of data, you determine whether to use a double-bucket common law trust or a single-bucket CP trust. The last wills and testaments will be adjusted accordingly although that is not a major change from normal Florida customs not involving CPR.

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[4] *Stone v. Stone*, 157 So.3d 295 (Fla. 4th DCA 2014). The gravamen of this peculiar decision, binding only in the 4th DCA, is a fact intensive result where the married couple actually were well educated as to the waiver of homestead. Hence the net ruling is limited to that factual informed consent. The "hereditaments" concept is actually fluff having little relevance to the core concept that the couple actually employed informed consent for the waiver.

[5] *See* discussion of FUDCPRDA §732.222 below concerning "apparent title" protections for lenders and purchasers.

Step 8. **[Don't Count on the FUDCPRDA Savings Provision]** The original uniform act UDCPRDA included what we have in FUDCPRDA as §732.222 which purports to protect purchasers and lenders for value who seem to assume that the property at death was TBE (or some other ownership) and not CPR. These people are deemed to have depended on the "apparent title" to the property. Nowhere is "apparent title" defined. What is meant is this embarrassingly apologetic scenario: The title examiner looked at the deed, saw it was husband and wife, thought it was TBE property, did not perform a due diligence inquiry, did not do a CPR check, closed the sales transaction assuming the surviving spouse was the sole owner of the property, signed a big title policy on that, and allowed ALL of the sale proceeds to be handed to the surviving spouse. This apparently was intended to be a definition of "apparent title" in the original uniform act. This is also in Florida's version as cited above. In the meantime the true title owner of the 50% worth millions of dollars is given nothing and told that "apparently you did not have title" to something which was a fully vested constitutionally protected property interest. The only good argument supporting the constitutionality of this provision is that the uniform commissioners put it in for fear that without this bizarre provision, no state would adopt the act. This provision has never been subjected to appellate opinion scrutiny let alone adjudication under any constitution. The author posits that this provision is unconstitutionally vague. And a bit humorous. Besides, get this, FUDCPRDA's savings clauses excludes applicability to TBE, the very thing it was intended to protect. This is referred to in other programs by the author as the "FUDCPRDA double negative." It proves that when adding items to uniform acts, special care must be taken.

Step 9. **[Do Not Miss the 100% Adjustment in Capital Gains Basis]** What is usually a major overlooked opportunity for income tax savings, CPR, when properly recognized and determined, achieves a 100% adjustment to the value at the date of death for BOTH halves of the CPR assets of married couples where one dies-- not just 50% as happens in common law states. IRC §1014(a)(6) This has been for almost a century the goal of states desiring to be recognized as CP jurisdiction. When the CPR status is overlooked, is this potential income tax savings lost? Of course it is. However, this is a double-edged sword. If the markets crash as they did in 2008 and values go down, is CPR determination a desired goal? Not desired, but it still is mandatory as the facts warrant. But what if the desired goal of double step up means that the CPR assets go to someone seemingly not intended by your client? Now that is a real bind. The word "cluster" comes to mind. However, in the end, it is the facts and the law which mandate whether or not CPR apply. Of course, that is in the ideal world. In the real world, it is what your client desires.

Step 10. **[Protective Claims WA & Forcing CPR Recognition of Record]** This is practical and innovative stuff: After the first death in a married couple scenario, when CPR exists in Florida, the person desiring to have CPR recognized should file a timely "protective claim" in the probate or, if there is no probate, initiate a probate and do so. Moreover, record on the public records a "Community Property Affidavit" which describes exactly where the CPR is claimed and what it does. Then dare anyone to challenge any of this. These steps are to eliminate the procedural objections claiming that no claim was filed and that some statute of limitations ran. These objections plagued of leading case Q*uintana v. Ordono,* 195 So.2d 577 (Fla 3rd DCA 1967) attached below as Exhibit A, as they indeed did in *Johnson*, as we will see below. In all events, even if the protective claim is not objected to, file immediately a petition to perfect the CPR per FUDCPRDA, and having also recorded the CPR affidavit, you have slammed the world into the position of recognizing the community property rights. If a slander of title suit is filed against this or some other cause of action, defend easily by showing the validity of the rights under FUDCPRDA and the cases. It is unlikely such a SOT case will be filed since it would create a beautiful billboard of CPR recognition. The "WA" stands for "with attitude." The live presentation with explain that.

Coda:

<u>Key Point of CP termination</u>: From the law in all community property jurisdictions, as soon as the CP domiciliaries change their residence from a CP state to a common law state, the community property estate "ends," but the community property *rights* continue --- a very critical factoid.

II. <u>Background of Community Property Rights in Florida</u>

A. <u>There is no such thing as Florida Community Property</u>

<u>**HEADNOTE:**</u> Florida does not recognize community property *as an estate in property*, but the community property *rights* imported into Florida are almost identical to those rights as they were back in the originating community property jurisdiction, except as possibly limited by Florida public policy which now is a very limited exception. That is because FUDCPRDA is the public policy of Florida.

Florida, as one of the 41 "common law" states, does not have an *estate in property* called "community property." In divorce law, as do most other common law states, Florida creates a "marital property" classification in dissolution which mimics the effect of community property, but it is simply a method to divide property in marriage dissolution proceedings and nothing else. It uses evidentiary presumptions and makes it clear that it does not "establish community property in this state." FS §61.075(8). Of course, Chapter 61 can be changed at any time by statute and establishes no constitutional rights to property since it is simply a means to divide properly fairly in divorces applying various fairness factors. Title to property in dissolution proceedings is only accomplished by court order. FS §61.075(8) It is no coincidence that the strongest statutory rejection of community property as an estate in property in Florida is in the above referenced provision. Notice how the applicable Florida divorce statute labors to eliminate any thought of community property entering through Florida's dissolution law or by way of the dissolution proceeding:

> **FS §61.075 (8)** All assets acquired and liabilities incurred by either spouse subsequent to the date of the marriage and not specifically established as nonmarital assets or liabilities are presumed to be marital assets and liabilities. Such presumption is overcome by a showing that the assets and liabilities are nonmarital assets and liabilities. The presumption is only for evidentiary purposes in the dissolution proceeding and does not vest title. Title to disputed assets shall vest only by the judgment of a court. This section does not require the joinder of spouses in the conveyance, transfer, or hypothecation of a spouse's individual property; affect the laws of descent and distribution; **or establish community property in this state. [bold added]**

One of the major mistakes of past approaches to understanding community property rights in Florida has been the assumption that our Florida Uniform Community Property Rights at Death Act (FUDCPRTA) passed in 1998 and updated in 2001 is the fountainhead and focal point of the way we work with community property rights. That is incorrect. Florida's handling of community property *rights* is founded in case law, much of it constitutionally mandated, and was recognized much earlier than the uniform statute. The uniform statute only came later to try to make things easier to understand for common law jurisdictions and to protect established land title interests. It did not exactly accomplish those goals, as will be seen below.

An early statement of this concept that Florida has no community property rights occurred in *Estabrook v. Wise*, 348 So.2d 355 (Fla. 1st DCA 1977). "Florida is not a community property state, and thus is not required to recognize an encumbrance predicated upon a foreign state's community property law." Of course, that case was not addressing the issue of this investigation. In fact this quote is pure dicta, but used here for dramatic function, and it has no precedential value, and it actually is bad law. However, it does billboard the fact that Florida does not recognize the *estate in property* called Community Property.

Hence Florida property, divorce and estate law goes out of its way to make it clear that there is no "community property" in Florida. Of course, what does exist in Florida are community property "rights" imported from community property jurisdictions. This community property thing then is limited to *importation* of rights to Florida and not *origination* of those rights in Florida, which is our second simple truth: Common law states like Florida make a big deal about allowing community property rights to be *imported into* Florida, but *not originated* here. The importation of CPR is founded in the full faith and credit clause of the US constitution and other profound reasons discussed below. So this importation of vest property rights system is a given. This is the guiding principal behind this whole conflict of laws issue presented here.

B. <u>What is community property in the simplest terms</u>?

<u>HEADNOTE</u>: "Community Property" in its simplest terms is the vested ownership in a community property jurisdiction by a married person in an undivided ½ of the assets acquired by either or both married persons during the marriage regardless of who takes legal title to the property, and *without survivorship characteristics.*

An estate planning professional in Florida would react to this definition with a very proper statement: Hey, this looks like tenants-in-common ("TIC") property. That would be about 96% correct. The difference here is that community property rights assets in Florida have additional attributes which purely TIC property in Florida do not have. Each community property jurisdiction has its own nuances concerning its rules which are imported into Florida as part of the CPR asset, so one must be careful to go back to the source CPR law for each asset. In effect, community property rules force ownership as equal tenants-in-common between the spouses no matter what the title document (if any) states, and <u>without survivorship</u>. Income from community property rights assets is also community property or separate property in Florida depending on the state whence the CPR originated. The major of those states show that this income becomes community, a minority of the CP states say not. "Separate property" of each spouse also retains the same characteristics as it does in Florida divorce law. Let us keep it that simple for now in the discussion. Hence, the definition in the headnote above is that which we will use.

The "vested" ownership part of the above is very important. This ½ ownership is a property right in community property states. In common law states, marital rights (if any) in property in which a married person does not own legal title is a matter of legislative grace, and not a property right, let alone a constitutionally protected property right. This is a significant difference. As stated above, Florida divorce law in Chapter 61 is simply a judicial method of dividing property fairly in dissolution. Hence, the author has been preaching that most of Chapter 61 is actually procedural and therefore mostly unconstitutional. But that is another story. Because of this vesting ownership, the community property of the decedent is excluded from the Florida elective estate at death. FPC §732.2045(1)(f), and rightly so. If the surviving spouse *already owns* something exclusively as his or her fair share of an asset, applying the elective share rules to the decedent's one-half would be more than a fair share for the surviving spouse. Let us remember this point when discussing the 4th DCA opinion in the *Johnson* case. Our elective share statute gives proper regard to CPR whereas our case law does not always observe CPR as precisely.

C. <u>Community property style rules are used in Florida divorce law, but not at death</u>

HEADNOTE: Community property closely resembles the way Florida divorce law FS Chapter 61 handles asset rights upon dissolution, looking upon marriage as a partnership with equal vested ownership of all assets instead of property rights being controlled by who holds legal title.

As stated above, Florida and most common law jurisdictions for many years have adopted the "partnership" view of marital assets in divorce law, which is very much, but not exactly identical to community property laws. *See* Chapter 61, Florida Statutes. Keep in mind the vastly important distinction, already beaten to death in this discussion, that while CPR recognizes vested property ownership and possession, Chapter 61 is a statutory methodology for dividing property at death fairly, and is therefore actually a divorce judge's handbook for separating assets in divorce. It recognizes *title to property* only in its court orders.

However, the moment when death occurs, the common law jurisdictions jettison this community property mimicry and switch back over to the common law tradition of looking to legal title ownership and then engrafting legislative graces such as the elective share and exempt property rules to benefit a surviving spouse. Why not just let the partnership idea of marital property flow through the death of the first spouse to die? If that was good enough for determining property rights during life in divorce, why should the death of the first spouse to die change anything? This was the big question of the universe addressed by Wisconsin in the 1980s. Answer: Because we don't want community property to exist in Florida as an estate in property. Since our real property laws have for so long depended upon that fundamental reality, changing to a community property-like system is complex, vastly political and almost universally avoided[6] in the common law states.

D. <u>What if anything does Florida recognize in regard to "community property?"</u>

HEADNOTE: Florida recognizes the *rights* stemming from community property through its movables arriving from married couples transferring their domicile from the originating community property state to the State of Florida. Community property as an estate in Florida is not recognized. Just the *rights* stemming from original community property. What is the difference in this distinction? Not much.

Although Florida does not, as previously stated, have community property as an *estate* in property, Florida must recognize the *rights* of a person in community property. This is a convenient fiction to accommodate the ownership of community property in a common law state. The person bringing community property *or proceeds thereof* from a community property jurisdiction, once crossing the Florida state line, then has community property *rights* in Florida

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[6] Wisconsin is the sole common law state to adopt the Uniform Marital Property Act, which it did beginning in 1983. This uniform act was designed to accomplish the transformation from a common law property at death state to a state where community property characteristics are maintained during life and at the death of the first of a married couple to die. The Wisconsin experience in this area may seem innovative, but it really is not. Nevada, Idaho and Washington, moved from common law rules to the community property in the 19th century merely through the strong influence of California on their economies. Various common law states attempted to take on opt-in community property aspects but were rejected by the IRS and court decisions in pre-WWII cases. So Wisconsin's change to CP is nothing new. There may be more state transformations of this nature in the future as the mass immigration wave into the US continues from CP jurisdictions. Recently, because of the new importance of basis step-up planning (because the federal estate tax impacts so few persons now), common law states are again attempting to attain CP step-up attributes. See Alaska, South Dakota and Tennessee recently. The IRS has not budged on them.

but not community property. Those rights are almost[7] identical to the ownership of community property from the original jurisdiction, but simply with a different name to adapt to the common law jurisdiction milieu. They are fully vested rights. These newcomers to Florida will not own community property in Florida, but they will own property with vested community property *rights, which are constitutionally protected.* Q*uintana.*

What is the difference? Not much. Probably no difference at all. A rose by any other name smells the same – and behaves the same. Because this is a constitutional issue of rights in property, the community property states must maintain the same cross recognition rule. They have a status of property called "Quasi Community Property" for married persons coming from a common law jurisdiction to a community property state to preserve the pre-existing vested marital rights. The community property *rights* imported into Florida are almost identical to those rights as they were back in the originating community property jurisdiction, except as possibly limited by Florida public policy, but that is near nihil since the adoption of FUDCPRDA which is now the public policy of the state. Hence the "public policy" argument against CPR recognition is out the window, as is the "local Florida law" argument when trying to avoid CPR recognition. FUDCPRDA enactment then did accomplish this: it made CPR not only Florida "public policy" but also "local Florida law" for real property purposes. Hence, these easy escape hatches for judicial opinions is no longer available if cases are pled correctly.

E. <u>How do we know community property rights are protected like this in Florida?</u>

HEADNOTE: CPR in Florida is protected by both case law and our famed statute FUDCPRDA. There is no question that CPR property in Florida is fully vested and constitutionally protected as any other such property right. However, applying that rule has been a supreme challenge for our courts and the legal profession in Florida.

The case law and statute are both well known. The primary Florida case *Colclazier v. Colclazier*, 89 So.2d 261 (Fla. 1956) laid out the basics of how community property rights arrive in Florida and are recognized and protected under Florida law. It held that a mortgage interest from New Mexico was controlled by the community property rights imported by the married couple from a community property jurisdiction. This well-crafted opinion laid out the simple truth that CPR is recognized in Florida for married couples arriving in Florida with assets traceable to CP. In this case sourcing law from New Mexico, *Colclazier's* strength lies in its simplicity. It does not try to examine recognition methodology. It just states the rule of recognition of CPR in Florida, as if CPR has always been imported like this. It is like Columbus discovering America. America was always there; all Columbus did was notice it and tell others in Europe what had been sitting there across the water all along.

[7] "almost" -- this word is the little nasty which creates more trouble in the world of Florida community property rights than any other. *Quintana*' dependence on the *Thornton* states that a common law state cannot limit or change incoming community property rights for the constitutional reasons stated in these materials.

The plot of CPR thickened when the Third District Court of Appeal attempted to explain this importation of CPR with greater detail in Q*uintana v. Ordono,* 195 So.2d 577 (Fla 3rd DCA 1967). This case came out of then Dade County and restated the universally prevailing view that community property rights follow a married person coming from a community property jurisdiction (Cuba) into Florida and must be protected just as the common law property rights of all married persons in Florida are protected. Hence they are constitutionally protected vested property rights, unlike say, an elective share or exempt property in Florida after death. *Quintana* cited as authority the *Thornton* case.

There are several constitutional law reasons behind this and it makes sense. If you own a car in Texas and drive it to Florida, when you arrive here, does your ownership of that car change? No. It cannot because it is a fully ascertained (vested) right of ownership. Concepts of equal protection, full faith and credit and the interstate privileges and immunities of the federal and Florida constitutions, among others provide that protection. *Quintana* and *Thornton*. To have it any other way would cause chaos for a federal republic where transiency is a way of life. To its credit, *Quintanna* used as support the leading cases from community property states which strongly hold these rights to be vested and constitutionally protected.

<u>Watch Out: The Trust Exception to Claim Filing Requirement</u>. *Quintanna* also was an early exposition of the "trust exemption" to rule why a creditor claim need NOT be filed in order to have a court recognize CPR recognition in Florida. A protective claim should have been filed in *Quintana*, but was not. If one had been filed, there would have been no need to delve into the trust exception. So *Quintana* confirmed the then controlling rule that since the surviving spouse's ½ of the property was owned by the surviving spouse and was NOT the property of the decedent, then the decedent (and hence the executor of the estate) held the surviving spouse's ½ as a trustee holds someone else's property. The concept is that a probate court does not have jurisdiction to administer property owned by a living person. Moreover, a living person's property can never be a part of a decedent's administered estate. Rigor mortis has not yet set in as to the owner of that property. This applies to any property, not just CPR assets. It was a solid good rule for any property. That made so much good sense that this rule was changed by the adoption of the Florida Probate Code in 1974-1976 so that a claim was and is still required to be filed to assert ownership of "personal property in the possession of the personal representative." FPC §733.702(1). However, our FPC "Marriage of Convenience" did not completely eliminate the trust exception, and that dramatic point is a major part of the *Johnson* epic told below. Anytime a claim filing deadline is missed for CPR, the trust exception must be reviewed. In the intervening years the trust exception has been retained in well-reasoned cases where:

A. The decedent did not "assert sole ownership" of the whole asset before death, and,
B. There is an express trust OR CLEARLY DEFINED MEANS of determining ownership.

Cutting to the chase, these two requirements will haunt the *Johnson* case below where a detailed discussion of this obscure but powerful Trust Except comes to bear. See below in Section IV concerning the author's slicing and dicing of the *Johnson* case.

Therefore *Colclazier* and *Quintana* quite properly outlined those rules for Florida and have stood as the guiding law since then. Beyond these two cases, there is scant case law authority for anything involving CPR for the reasons stated in the introduction. This is like the third rail of Florida estate law. No one wants to touch it. However, the constitutional basis of CPR is necessary to detail as stated in Florida by these two case. Look no further than the most authoritative statement as to the constitutional stature of community property rights. This was stated by the California Supreme Court in *Estate of Thornton*, 1 Cal.2d 1, 33 P.2d 1 (Cal. 1934) (Attached as Exhibit B below). This wonderful California case is the most famous of all community property cases which is used in the community property jurisdictions as authority for CP rights being fully vested constitutional protected rights. *Quintanna* cited it as support and therefore *Thornton* is the basis of Florida's law recognizing CPR. Ironically this case concerns protecting *separate* property rights where a couple moved from a common law state to California, a community property state. The discussion is crystal clear and well-reasoned. The federal courts have considered this issue strictly as a matter of state law and hence have universally given due regard to the holding of *Thorton*, and similar rulings from other community property jurisdictions. Hence, federal courts steer clear of tinkering in the constitutional confines of the *Thorton* ruling and those like it from other community property jurisdictions.

F. What are the community property jurisdictions in the USA?

HEADNOTE: Although treated ad nauseam by other programs, the reason why community property is an estate of property in nine states of the US is because of the strong civil law traditions of the Southwestern states, proximity to those states or through Spanish legal traditions (Louisiana during Spain's occupation), and adoption of the uniform marital property law. (Wisconsin 1983-86)

These are the NINE community property jurisdictions in the US:

1. Louisiana (most authentic)
2. Texas
3. New Mexico
4. Arizona
5. California
6. Nevada
7. Washington
8. Idaho
9. Wisconsin (least authentic) UMPA 1983

All of the above have been accepted by the Internal Revenue Service as true community property jurisdictions. Alaska enacted a community property law in 1998 which has not been accepted by the IRS as a valid community property application.

Alaska & Other State Attempts Rejected by IRS. The reason why the IRS does not recognize Alaska as a "proper" community property jurisdiction is because it feels the Alaska act allows too much flexibility of opting in and out of community property rules. Hence the IRS looks upon Alaska's alleged "community property" regime as more of a tax avoidance device than a unified state property law system. Spouses using the Alaska law may create community property by entering into a community property agreement or by creating a community property trust. Alaska Stat. §§ 34.77.020 - 34.77.995. The U.S. Supreme Court ruled that a similar statute allowing spouses to elect a community property system under then (and later repealed) Oklahoma law would not be recognized for federal income tax reporting purposes. *Commissioner v. Harmon*, 323 U.S. 44 (1944). The IRS takes the position that the *Harmon* holding applies to Alaska's community property regime for tax purposes, and any other state which makes that attempt. The current states attempting this ersatz CP status move are Alaska, Tennessee and South Dakota. As stated, the IRS has not accepted these yet as CP for tax purposes and may never.

Double Step-Up in Basis Benefit. The double step up in basis for capital gains tax purposes is simple enough. In a common law state, when a person dies, the property of the *decedent* receives a step-up to the fair market value at the date of death (or alternate valuation if applicable) if it is included in his or her gross estate for federal estate tax purposes. For community property owned in part by the decedent, not only the decedent's ½ receives the step-up, but also the ½ owned by the surviving spouse receives this. If the reader is seriously interested in being immersed in complexity at the expense of clarity in this study, please feel free to study IRS Publication 555 and research each point stated therein.

Other States Experimented with CPR. Several common law states many years ago "experimented" with community property as a regime and then repealed it. Michigan, Nebraska, Oklahoma (see the *Harmon* case above), Oregon, Pennsylvania and Hawaii temporarily adopted community property regimes from the period 1945-1949 in an attempt to garner tax benefits. However, after *Harmon,* popular support faded for that benefit and the supposed legal confusion which was thought to have resulted pushed all of them to re-adopt common law traditions for marital property rights at death.

G. What other community property jurisdictions are there?

HEADNOTE: The reason why community property is an estate of property in nine states of the US is because of the strong civil law traditions of the Southwestern states, proximity to those states or through Spanish legal traditions (Louisiana during Spain's occupation), and adoption of the uniform marital property law. (Wisconsin 1986).

In the territories of the United States, Puerto Rico has maintained its community property regime for hundreds of years, since well before it became a commonwealth territory of this country.

Beyond the United States, the majority of foreign nations are community property jurisdictions. Virtually all of the nations of Latin America, most of Europe, and some of Africa and Asia, are community property jurisdictions. Jurisdictions with strong ties to the history of the British common law will usually *not maintain community property*. Because so many married people moved to Florida from community property jurisdictions, both foreign and from within United States, this is a very major area of law to understand and use every day.

H. Why does it matter what the IRS thinks about a jurisdiction's community property status?

HEADNOTE: The IRS is very concerned about what are true community property jurisdictions because at death not only does the capital gains basis of decedent's ½ community property interest get stepped-up to the value at death, but also that of the surviving spouse. IRC §1014(a)(6).

IRS Approval Double Step-Up. Because the greatest quantitative benefit of community property status is the double step-up in capital gains basis to the fair market value at death is allowed only for IRS approved community property jurisdictions §1014(a)(6). In an upmarket for assets, the double step-up can be very valuable. In a down market, the opposite can be true.[8]

Proving 50% Inclusion. Another reason why the IRS is concerned is because in the estate tax world of non-resident aliens (properly documented non-immigrant persons), married couples do not have the 50% interest of jointly held property inclusion in the gross estate, IRS §2056(d)(1)(b), on the estate tax return form 706NA. That is, unless the surviving spouse is a US person (citizen or resident alien). IRC §2040(b). So without a US person as a surviving spouse, the decedent's gross estate must include 100% of the asset value unless contribution can be clearly proved. However, where community property rules apply, the 50% is mandatory. This is where the community property determination drops the 100% to the desired 50% simply by applying the community property rights from the sourcing jurisdiction. This can save considerable tax where tracing of contribution is difficult or impossible. This needs the following example:

[8] The double step-up in basis can also mean a double step down in basis in the event the market value of any asset has *decreased* in the interim. The kneejerk reaction to benefit of the double adjustment can turn sour in a down market.

Simple Example: A Swedish couple buys a house in Florida, and then years later the husband dies. Sweden of course is a community property jurisdiction. The record title shows just "husband and wife," with no labeling. For Florida land title purposes this would presume a tenancy by the entireties scenario knowing nothing else. In the world of eyes wide shut, the title companies are most comfortable with not knowing anything about community property status. But does this really constitute a tenancy by the entireties under state law? And even if it is tenancy by the entireties under Florida law, how does the IRS look upon this when the husband's interest is stated as part of the gross estate for estate tax purposes on the 706NA? This is quaint because for non-resident aliens there is no benefit of automatic 50% inclusion even if the property is deemed to be tenancy by the entireties and the surviving spouse is not a US person. For non-resident aliens the presumption is 100% inclusion for any spousal situation unless by tracing contribution one can prove that economic benefit by the surviving spouse. Fifty percent inclusion would happen for a US citizen or resident alien ("green carder"), but not for a non-resident alien no matter if it is tenancy by the entireties or not. But when community property rights enter into the picture, the IRS is forced to accept a 50% inclusion in the gross estate. Hence, community property rights are a handy way of forcing the 50% inclusion when it is difficult or impossible to trace any contribution by the surviving spouse. Often there is no contribution, and here community property rights is excellent at chopping an estate tax bill down by more than one-half. For these reasons the IRS is sensitive about the applicability of community property rights in Florida.

Therefore, an obscure planning point here is that the IRS is very concerned because non-resident alien taxpayers who are married do NOT have the presumption of 50% ownership of jointly held marital property for estate tax purposes. It is only community property rights assets which get you the 50% ownership.

I. How are community property rights identified in a common law jurisdiction?

HEADNOTE: CPR is identified in many ways in common law jurisdictions. This can be by court order, agreement, document issued by a personal representative, and with later court approval, a document issued by a beneficiary, or by a quiet title action, common declaratory judgment, or a simple recorded affidavit by an interested person.

Tracing is the Method. These rights are identified and quantified by tracing --- just like in a divorce case. This is where our job becomes very much like that in a Florida marital dissolution proceeding. One must survey all of the assets of the married couple and classify them as "community" or "separate." Then the assets must be researched backwards in time to see where they originated. Is this labor intensive? Of course it is. The "community" vs "separate" differentiation varies with the originating jurisdiction, so it takes some good help from that jurisdiction. Each originating state has slightly differing rules concerning this important classification point. However, our Florida view of marital vs. separate assets is a good starting point in that study and covers most issues.

Quality of Marital Status. In many community property jurisdictions a valid marriage is *not* necessary to establish community property rights. Hence the local law of the originating jurisdiction is critical in that starting point. California, for instance, will establish community property rights with couples who live together in conjugal relationships which are termed "peripheral marriages." Yes, this makes our study cease to be simple, but in every narrative, there are complicating elements, though not enough to sink the ship of simplicity. However, the IRS takes a strict view of this subject. If a state denominates a legally recognized relationship as a "marriage," then the IRS will allow the couple to use married persons' rights and procedures like joint returns, the estate tax marital deduction etc. Hence, same sex marriages will be recognized for these purposes if they were formalized in a state which allowed them. This applies even if the couple later moves to a jurisdiction which does not allow them. However, where states do not consider the relationship a "marriage," such as the Registered Domestic Partners status in California, Nevada and Washington, those RDP couples will *not* be granted tax related marital rights and procedures even though they are bound by the community property laws of those states like married people.

Separate Property Characteristics. Community property is the group of assets acquired, earned, improved and expanded by married people during the time in which they are married. It may include some pre-existing separate assets if the couple agrees to deem them community. Couples can also sever community property by agreement and make it separate, but this requires informed consent, and that is usually difficult to prove. For the most part, however, community property is computed, evaluated and ascertained during which time the married persons are indeed married. In virtually all of the community property jurisdictions, the presumption is that community property is owned in equal shares between the two married persons regardless of who earned or required it, and most importantly, and regardless of how legal title is taken. Separate property is that property owned by the members of the marriage prior to the marriage or received by inheritance or gift by either of them during the marriage, among a few other unique rules.

American vs Civil/Spanish Income Rules. Income from separate property in some jurisdictions (California, Nevada, Washington, Arizona & New Mexico) follows the "American Rule" which means that the income stays as the separate property of the owner spouse. In other jurisdictions (Idaho, Texas, Louisiana & Wisconsin), the "Civil/Spanish Rule" makes that income community property.

Florida Follows American Rule. This whole asset identification system with the American Rule (income from separate property stays as separate property) mimics the way that Florida law handles "marital" and "separate" assets in the divorce setting. In fact, the "marital asset" rules for Florida, and most other common-law jurisdictions is really the community property idea applied but only for divorce. However, at that magic moment of death in Florida, common law rules of asset ownership and rights take over and community property ideas are jettisoned. So Florida in effect is very much a community property state until the first spouse passes.

J. Do imported community property rights attach to Florida real property?

HEADNOTE: The answer is yes, of course. Our blessed FUDCPRDA makes that clear.

Yes, FPC §732.217(2). Now we are getting close to the question at hand, but not quite, because this statute tries to exclude TBE property. This is how it reads:

732.217 Application.—Sections 732.216-732.228 apply to the disposition at death of the following property acquired by a married person:

(1) Personal property, wherever located, which:

(a) Was acquired as, or became and remained, community property under the laws of another jurisdiction;

(b) Was acquired with the rents, issues, or income of, or the proceeds from, or in exchange for, community property; or

(c) Is traceable to that community property.

(2) **Real property, except real property held as tenants by the entirety, which is located in this state,** and which:

(a) Was acquired with the rents, issues, or income of, the proceeds from, or in exchange for, property acquired as, or which became and remained, community property under the laws of another jurisdiction; or

(b) Is traceable to that community property. [Bold face added]

The other statutory reference to TBE in FUDCPRDA is §732.218(2) which is a blatant double negative and hence that section cannot be used for the support of anything. So it is only the above statutory section which speaks to TBE in its relationship to CPR. But because CPR eliminates the Interest Unity, it is arguable that TBE never arises and this exception is useless and hence inapplicable to this discussion. *See* Section III below for the big conclusion concerning TBE vs CPR.

Land in Florida therefore is indeed included in the CPR attachment system by this statute and the history of CPR constitutional guarantees. As stated, it is possible that the exception stated in FUDCPRDA §732.217(2) is not applicable or enforceable. Although Florida does not have a defining case directly on point concerning apparent tenancy by the entireties property and protected homestead. These community property rights are, as stated, constitutionally protected vested property rights. However, when dealing with real property, the local traditions where the land is situated are much stronger than with movables. Case law from around the country supports this although there is no definitive Florida case on point concerning realty, particularly where it is apparently tenancy by the entireties or protected homestead. However, indications are that in Florida, realty should be treated like movables in regard to community property rights. *Colclazier* controlled mortgage ownership, which is, although an intangible, a real property related interest. Why would a mortgage interest be different from a deed interest? Therefore, there should be no limitation as to real property in this regard. This result is summarized by the following Comment from the Restatement Second of the Conflicts of Laws Comment to Section 234(a) of the Restatement 2d of Conflict of Laws Conflicts of Law:

> **". . .** So if land in a common law state is purchased with funds that are held in community because acquired while the spouses were domiciled in a community property state, the courts of the situs would usually hold that the spouses - at least as between themselves - have the same marital property interests in the land as they formerly had in the fund. On the other hand, these courts would usually apply their own local law in situations where the rights of some third person, such as a creditor or a transferee, are involved."

TBE vs CPR. This sets the issue directly heading for a potential clash dealing with Florida real property rights dealing with tenancy by the entireties and homestead realty. That is played out in Section III below. This clash was supposed to be avoided by the Florida Uniform Disposition of Community Property Rights at Death Act (FUDCRPDA), but was not for the reasons stated above and below. California through its *Thorton* case (cited above) leaves no doubt that marital rights to property are constitutionally protected, which includes all property including realty. Other courts in community property jurisdictions have more recently ruled specifically in accordance with *Thorton* where realty was involved. *Ford v. Ford*, 276 Cal. App. 2d 9, 80 Cal. Rptr. 435 (Ct. App. 1969); *Muckle v. Superior Court*, 102 Cal. App. 4th 218, 125 Cal. Rptr. 2d 303 (Ct. App. 2002). The key to this is that this result occurs when the property was purchased with community property funds and where the issue was the ownership rights as between the spouses. Of course, at death, that is the whole point. The IRS follows this and has made the principal a basis of its treatment of community property rights in IRS Manual Part 25, Chapter 13, 25.13.1.2.6.

Local Law on Realty. FUDCPRDA §732.218(2) is the local law which follows Florida state policy, and it of course applies to Florida realty. Case closed except for TBE and homestead property. However, we have already seen that the TBE exception cannot apply and be functional, and also that the homestead exception fails for the reasons stated above. So ---- CPR applies to Florida real property with no functional exceptions. The federal courts also acknowledge simply hold that local law rules, as stated in this paragraph. See *Woods v. Naimy*, 69 F.2d 892, 894 (9th Cir. 1934).

Florida's View of Death Disposition Rights as Constitutionally Protected. Community property interests are a constitutionally protected vested property interest, and we know that from the *Thornton* case from the California Supreme Court in 1934 shown as Exhibit A at the back end of these materials. As stated, *Quintana* cited as controlling support *In re Thornton's Estate*, 1 Cal.2d 1, 33 P.2d 1 (1934). The other CP states have all considered *Thornton* as the accepted rule on the constitutionally property right issue, and even Florida does through *Quintana,* which cited it as controlling. Review it closely; it is not long. Brilliantly tight, well-reasoned and concise. Florida case law indirectly confirms this result in *Shriners Hospitals V. Zrillic*, 563 So.2d 64 (Fla 1990) It suggests that vested property rights having the historical dignity as community property rights defined by *Thorton* would be treated no differently than any other vested property rights at death. That is, as constitutionally protected vested property rights within the realm of disposition at death. In *Shriner's Hospital* the Florida Supreme Court held that the right to dispose of property at death was a property right protected constitutionally. Owing to the case law like *Thorton* emanating from community property states, supported by *Colclazier* and *Quintana*, there is little doubt that *Shriner's Hospital* would be extended to community property rights dealing with both realty and personal property for all of Florida, even without the enactment of FUDCPRDA. It was FUDCPRDA which cemented the property rights issue as the public policy and local law of Florida.

K. What Does the Florida Uniform Disposition of Community Property Rights at Death Act Accomplish?

HEADNOTE: It statutorily confirmed the previous case law recognizing CPR, it established CPR as the *policy* of the State of Florida, and it confirmed CPR as *local law* in Florida. Our FUDCPRDA has its defects, but those are minor (since they are mostly non-functional) compared to its accomplishments.

Besides the momentous point made in the previous paragraph above, FUDCPRDA gave guidance to the method of recognition. The statute as it now stands is attached as Exhibit C hereto. It attempts to summarize the basic rules of community property rights in order to translate them into a simple way to apply what the case law and constitutional rulings already have mandated. The Florida uniform act is found in FPC §§732.216-228, initially enacted in 1998 and was fully effective on January 1, 2001. There have been only 16 common law states[9] around the country including Florida which have adopted this uniform law, and none recently.

One would think that, with the absolute constitutional mandates which drive the idea of the uniform statute, all 41 common law states would have adopted it by now since it was proposed back in 1971 by the uniform commissioners. However, that has not happened since there has been major pushback against it from both the estate and property bars in the non-adopting common law states. Florida made far more modifications to the act than any other adopting state. This was, in turn, driven by the ardent fear that tenancy by the entireties and homestead land titles would be impaired by the statute. Of course, the statute only replicates in part what the constitutional court rulings mandated in the first place. So those mandates still apply to all states regardless of whether they adopted the uniform law, changed it in adoption (as Florida did) or refused to adopt it at all. Most did not.

The uniform statute attempts to show how community property rights apply to a common law state, but it labors far more diligently to protect the established land title systems in the common law states for which it was intended. Hence, it is a uniquely backhanded uniform act designed almost more to inhibit and limit the importation of community property rights than it

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[9] Alaska, Arkansas, Colorado, Connecticut, Florida, Hawaii, Kentucky, Michigan, Minnesota, Montana, New York, North Carolina, Oregon, Utah, Virginia, and Wyoming

does to foster their enforcement. Florida went several steps further in that motivation. It inserted (as no other adopting state did) several provisions stating that the act was not applicable to any real property which was held as tenants by the entireties or as protected homestead at death. See Section III below for more on those gory details. FUDCPRDA therefore stands as the only adopted version of the uniform act which was injected with heavy doses of realty protective provisions which may not pass constitutional muster. Here are the high points of FUDCPRDA's attempts which are an explication of the points made above:

1. Attempt to prevent imported community property rights in homestead realty.

The RRPTL responded to concerns about "community property rights screwing up homestead titles" by inserting the following underlined text into an otherwise simple and needed uniform provision:

> **732.225 Acts of married persons**.—Sections 732.216-732.228 do not prevent married persons from severing or altering their interests in property to which these sections apply. The reinvestment of any property to which these sections apply in real property located in this state which is or becomes homestead property creates a conclusive presumption that the spouses have agreed to terminate the community property attribute of the property reinvested.

The immediate problem with this attempt to exclude homestead property from CPR attributes is that the title to the land happens far earlier than the establishment of homestead status. The land is purchased first and the homestead status can arise only after that event takes place. So couples never attain title when it is already homestead. The bigger question deals with the word "becomes" in this provision.

To the extent the provision attempts to cancel out CPR when land later "becomes" homestead is clearly unconstitutional. It is a statutory attempt to eliminate a constitutionally protected right. There is no conceivable scenario where this would include informed consent to the waiver of CPR. That is nonsense. Since community property rights are vested and constitutionally protected, and if one accepts that concept from *Thornton*, Laird Lile, and many cases out of the community property jurisdictions, one must conclude that this added text can only be unconstitutional. The only legal concept which could save it is a finding by the Florida Supreme Court that the homestead provision of Article X, Section 4 of the Florida Constitution is a "strong public policy" which cannot be undone by imported property rights. The author considers that argument only marginally debatable since individual property rights constitutionally proclaimed by the highest courts of the states of origin usually trump vague public policy arguments in the receiving states. And here we also have the hot subject of marriage which raises the boiling point of all legal controversies surrounding it. Nonetheless, the protected homestead has been a major Florida public policy fixture since the post-Civil War years and thus we have a very nice engagement of two warring constitutional issues. Tenancy by the entireties does not enjoy quite the same level of public policy endearment as is shown below.

2. Attempt to protect fiduciaries who do not search out community property rights.

Section 732.221 states that unless a beneficiary or creditor demands the determination as to community property rights within three months of the notices to creditors or administration, the fiduciary cannot be held liable for not determining those rights. Florida added nothing to this provision. This was one of the great selling points of the uniform act to a rather skeptical group of common law states.

This is probably constitutional since it deals only with forgiving the personal representative for not being thorough since anyone with an interest at any time can determine rights stemming from community property even long after the estate is closed. Does it protect the attorney for the personal representative for not spotting the community property rights issues? No. Does this matter? Yes.

3. Attempt to protect tenants by the entireties and homestead properties from the presumptions showing community property rights.

§§ 732.217(2) (see above) and 732.218(2) of FUDCPRDA (see Exhibit C and Section III below) were also amended by the RPPTL Section in an attempt to keep homestead property and tenancy by entireties property out of the statute and out of the presumption regime. The debate at RPPTL Executive Council meeting when this was passed by the Section expressed the intent to make sure this statute and its community property rights did not affect tenancy by the entireties property or protected homestead under Article X, Section 4 of the Florida Constitution. See above for why this attempt does not work.

As stated below in Section III, like the potentially non-functional and/or unconstitutional attempt to exclude protected homestead property in §732.225, these two attempts to exclude tenants by the entireties property and protected homestead may fail the constitutionality test, especially where the taking of title in deed form was anything but "informed consent" on the part of both spouses. Children from a previous marriage and creditors will be hot on the trail of finding community property rights so as to upend tenancy by the entireties benefits to the surviving spouse. A similar form of chaos will ensue as to protected homestead, but it will play differently in that the surviving spouse will fare better having community property rights engage: Owning one half outright, and having a life estate or one-half of the other half.[10]

[10] **The Waiver Argument**. If the deed into the couple said nothing about their marital status, the CPR position is the strongest since the couple was married at the time they took title and no attempt at all was made to try to waive any CPR. If the deed referred to them only as husband and wife with nothing else, then no informed waiver could be argued, let alone proved. If the deed refers to them as husband and wife and "as tenants by the entireties," then an argument could be made that there was waiver of CPR, but that can be beaten back by showing that the spouse alleged to have waived never saw the deed, understood the deed to waive anything or even knew about the deed. Any one of these can kill the waiver argument.

4. Attempt to protect purchasers for value and lenders thwarted in Florida.

The provision in §732.222 states that purchasers for value and lenders who rely on the "apparent title" of the asset involved, both real and personal, take free of any claim relating to community property rights. This was one of the big selling points for the statute in Florida and everywhere the uniform act was hawked. The bankers strongly wanted this protection and so did the title companies, although nowhere is "apparent title" defined. That could in itself be chaotic if not unconstitutional. For the other 15 states which passed the act, this protection is intended to protect against the TBE problem. Florida took "tenancy by the entireties property" applicability out of the this apparent title protection provision of the statue directly in §732.217(2) and protected homestead out by the functions of §732.218(2) and §732.225. So for the most vulnerable land issues which the RPPTLs thought needed this protection, the Florida act does NOT grant the most important protection for which it was passed assuming that it is constitutional. Tenancy by the entireties and protected homestead are NOT protected as to their purchasers for value or lenders under §732.222. This hardly could have been the intent of the legislature or the RPPTL Section when it passed this.

Other than the above unique, troubling and actually misconceived additives, FUDCPRDA simply codified law and procedures which were or could have been effectuated since *Colclazier* and *Quintana* in our courts.

L. How are the estate planning documents different in a community property jurisdiction?

HEADNOTE: The big difference is in the use of the "single-bucket" revocable trust where CPR assets are intended to be held in a revocable trust. Don't leave home without it. Splitting the assets into the common husband and wife separate revocable trusts does nothing in and of itself to waiver the CPR property into each of the trusts. Insiders call this syndrome the "CPR Halvesies.[11]"

The big difference is in the form of trusts, particularly revocable trusts. Instead of husbands and wives having separate trusts as is done routinely in common law jurisdictions, a standard community property trust is a unitary "single bucket" trust which resembles a "joint trust" in common law jurisdictions. These do not channel the CPR in the correct manner, and are to be avoided for CPR assets, just as separate spousal common law trusts. However, unlike a

[11] *Halvesies* arrangements in common law state husband and wife trusts which disregard CPR (a major problem in common law states) happen when estate planners transfer assets into the standard husband and wife estate planning trusts, such as common A&B bypass trusts, both QTIP and A-Outright trusts. What happens is that in each of these trusts, quite to the surprise of everyone later, if there is no express and informed waiver by the spouses of the CPR, an undivided ½ of the *assets in each of the trusts* is still owned by the other spouse.

common law joint trust, the community property trust contains unique provisions which protect the unities of community property differently than a common law joint trust. In addition, the community property peculiarities from jurisdiction to jurisdiction are great enough to make any generalities altogether too dangerous. One size does not fit all. The drafting of estate planning documents to perpetuate community property rights is a job for only those who feel comfortable doing something dangerous from the specific jurisdiction whence the community property rights originate. Therefore, this is a mandatory planning point:

> A Florida estate planning attorney should work with a qualified estate planning attorney from the originating community property jurisdiction. That attorney from the community property state drafts the trust while the Florida attorney adapts the document to the Florida execution requirements and other local peculiarities, particularly as to homestead rules.

III. The *Johnson v. Townsend* Decision from the 4th DCA.

This *Johnson* case on appeal was excellently litigated by all parties and the points below were presented in some respect along the way. Again, the full opinion and the certified question are presented in their full text of the case below in Exhibit D. Please review those before continuing here. However, after reviewing the case text, and knowing all of the above, let us take a cruise through this classic CPR fact pattern and case opinion which will elucidate the issues in a dramatic way:

A. Case Facts & Procedural History. *Johnson* is about a very valuable private entity interest ($3 million+) held by a couple derived from community property assets while they were residents of Texas. There is no question the subject asset was sourced from Texas community property. There was and is no question that it is a CPR asset. The couple moved to Florida and established their residence and domicile here in this state. The couple brought the ownership of the asset along with them as they took up residency in the State of Florida. The entity interest before and during this transition was held in solely the husband's name. But he did not "assert" sole ownership in any act for sole benefit over the asset. It was just in his name at all times for reasons unknown to the court. At no time was there a factual determination or even an evidentiary hearing on the issue of assertion of sole ownership or possession by the decedent or anyone else.

B. Asset At Death and Afterward. The asset at the time of the decedent's death was held as a private entity interest and unquestionably a CPR asset. After the death, the personal representative of the husband's estate (the surviving wife) eventually marshaled the CPR ½ of the asset as owned by the estate. However, the big fact depended upon by the 4th DCA was that the entity interest was titled at death solely in the name of dead husband and after that death. There was no doubt that the whole asset was traceable to community property from Texas. The wife lived on but did not file a claim in the estate during the claims period for her CPR one-half of that asset. After the three month and the two-year claims periods elapsed under Chapter 733, she petitioned under FUDCPRDA for her CPR ½ as stated for her by that statute. The trial court looked upon the FUDCPRDA petition as a claim which was not filed timely. It struck the petition and determined that the whole asset was an estate asset and NONE of it belonged to the surviving spouse.

C. Affirmed by 4th DCA – Certified Question to Supreme Court. The 4th DCA agreed and affirmed for the reasons discussed below, but also issued a very worthy question of great public importance. The opinion and certification are shown in Exhibit D hereto. Please review this carefully, although most attendees probably have already memorized this historic opinion.

D. Certified Question Text. Here is the certified question certified by the 4th DCA using the court's own font:

> Whether a surviving spouse's vested community property rights are part of the deceased spouse's probate estate making them subject to the estate's claims procedures, or are fully owned by the surviving spouse and therefore not subject to the estate's claims procedures.

E. Points of Appellate Opinion. The 4th DCA based its ruling on the surviving spouse's failure to file a timely claim under FPC §733.702(1) which is the main claim filing portion of the code. The *Johnson* opinion held that the CPR recognition failed because of the following:

1. The CPR ½ of the surviving spouse was a "cause of action" which needs a timely claim to be filed just like other causes of action against a decedent.
2. The CPR ½ was a *liability* of the decedent to the surviving spouse which needed a claim to be filed.
3. The CPR ½ of the surviving spouse is personal property in the possession of the personal representative of the estate under §733,702(1) and hence a properly filed claim was necessary.
4. The "Trust Exception" did not apply because the surviving spouse had not alleged that there was an express trust or clearly defined means of ascertainment of the subject trust property. Therefore, a properly filed claim was necessary.
5. The "Lien Exception" did not apply, therefore, a properly filed claim was necessary.
6. Most notably, the court did not address, except in its certified question, the important issue of whether it was proper for the CPR ½ of the surviving spouse even to be involved with the estate. That CPR ½ was owned by surviving spouse, a living person, and FUDCPRDA said that the PR of the first to die had no ability to marshal that ½ as an estate asset. This was not

discussed by the 4th DCA in its opinion which appears to depend completely on the failure to file a timely claim in the estate.

F. "Cause of Action" Concept. The CPR "perfection" petition referred to FUDCRDA and in the case is not a "cause of action" contemplated by FPC Claims Statute and the CPR ½ of the asset was not a "liability" of the decedent. It was owned outright by the surviving spouse. A cause of action is not a vested property interest; it is an inchoate property interest and requires a judgment to attain its vested status. The CPR ½ is already a fully vested constitutionally protected property right (as stated above) and needs some form of public notice of record simply to perfect its existence, such as a court order, not establish it. Read FUDCPRDA and see: The court order is for "perfection" of the CPR, not establishment of it. This is a declaration of something which already exists as property owned by a person. Not the creation of a property right. Additionally, the FUDCPRDA petition to perfect is not the sole remedy for CPR determination. FUDCPRDA allows this to be done by a signed instrument by the personal representative or by the beneficiaries with court approval. One can use a declaratory action or a quiet title procedure to accomplish the same thing, or even a simple recorded notice in the public records. There is no indication in FUDCPRDA that the stated methods of recognition are the exclusive methods of recognition. Hence, the "cause of action" theory underpinning the opinion is vulnerable, but the opposing idea is that FUDCPRDA does call for a court filing.

G. "Liability" Concept. Because the CPR ½ of the surviving spouse was fully vested as owned by the surviving spouse, the CPR ½ of the surviving spouse never was a liability of the decedent, since the decedent did not own it or owe it. FUDCPRDA §732.219. Hence that ½ was not a debt owed to the surviving spouse by the decedent. It was property owned by the surviving spouse at the date of death. Hence the liability point of the opinion is insufficient to mandate a timely claim to be filed. Texas law does not need to be reviewed for this, since it is a universal issue. Of course, the 4th DCA in *Johnson* could and did take an opposing view that the decedent "owed" something to the surviving spouse. The duty to manage it fairly was

H. PR "Possession" Concept. This is where the community property issue is met in *Johnson* head-on. The surviving spouse in *Johnson* argued that the CPR ½ of surviving spouse was not "personal property in the possession of the personal representative" of the estate. In other words, at death, the CPR ½ belonged to and was owned by the surviving spouse who thus possessed legal title to her one-half and that: the labeling of the asset in the decedent's name along meant nothing. Possession in the PR did not happen here because it could not happen. FUDCPRDA §732.219 tells us what the PR can marshal. Here the PR could not marshal the surviving spouse's CPR ½. So Florida law, it was argued, leaves it in the possession of the surviving spouse as to her CPR 1/2. Hence, the Florida claims statute does not apply, and the surviving spouse simply owns her CPR ½. There are, of course, no Florida cases as to this. We must look to Texas law whence this CPR originated. Under Texas law, the probate court is required to divide community property equally and cannot assign the ½ of the property of one spouse to the other spouse. *Eggmeyer v. Eggmeyer*, 554 SW2d 137 (Texas 1977). Although *Eggmeyer* was a divorce case, its broad constitutional scope has been applied in death circumstance. The decedent was simply *managing* both halves during his life under Texas CP law and a court cannot assign one spouse's property to the other inequitably. Therefore, the surviving spouse argued that the personal representative of the estate could not have legal possession of her CPR ½. Rightful possession simply remained hers. Under Texas law the impact of having just one name on the asset implicates management duty between the two owners and a protection of third parties, therefore anything possessed by either spouse is still presumed to be community property. V.T.C.A. Fam. Code § 3.003. The opposing view of this is that "possession" of personal property is recognized under Texas law even though it is subjected to "dual management" presumptions, and even though surviving spouse still retains legal ownership of the CPR ½. V.T.C.A. Fam. Code §3.104. These elements of Texas law are indeed relevant to this case even though the parties in *Johnson* did not cite them. Nonetheless, the 4th DCA adroitly used the question certified to the Florida Supreme Court in part to solve this delightful "possession enigma." Since the case is currently pending, it is inappropriate for the author to express preference as to these two choices.

I. <u>Lien Exception</u>. The "Lien Exception" is not applicable or necessary because the CPR ½ of the surviving spouse is owned by her and *it is not owed to her*. FUDCPRDA §732.219.

J. <u>Trust Exception</u>. The "Trust Exception" is where additional fun resides in this case. The children of the prior marriage argued below an at the 4th DCA that the Trust Exception referred to in and explicated in *Quintana* had been basically repealed in the adoption of the Florida Probate Code in 1974-76. This is where the "personal property in possession" claim requirement was introduced in FPC §733,702(1), and for the first time in Florida history, a living person was forced to file a claim in an estate to protect their OWN personal property which is ostensibly in the possession of the personal representative. A good example of a case after *Quintana* but before the Florida Probate Code adoption, is *Fischer v. Creamer,* 332 So.2d 50 (Fla. 3rd DCA 1975). This permitted the procedure without the requirement of filing of a claim in the probate and also made it clear that a resulting or constructive trust is not subject to any statute of limitations. Laches was stated as the only time limiter. However, after the adoption of the Florida Probate Code, two cases primarily have defined what remained after the code adoption: *Velzy v. Estate of Miller*, 502 So.2d 1297 (Fla. 2nd DCA 1987) and Scott v. Reyes, 913 So.2d 13 (Fla. 2nd DCA 2005). Both 2nd DCA cases, both well documented and well rendered. These are the two elements which still remain of the trust exception as per these two cases:

Element A: The decedent did not "assert sole ownership" of the whole asset before death, and, Element B: There is an express trust OR CLEARLY DEFINED MEANS of determining ownership.

In *Johnson*, there was never an evidentiary hearing in the trial (probate) court or even allegation that the decedent husband ever asserted sole ownership over the whole asset. The surviving spouse therefore argued that all elements above were satisfied for the trust exception and therefore no claim needed to be filed. The husband had not asserted whole ownership, and the clearly defined means of determining ownership was FUDCPRDA itself. 50% is 50%. What more could you want for clear ownership? The opposition argued no application because there was nothing left of the trust exception with the adoption of the Florida Probate Code back in 1974-76.

K. A Weaker Case Scenario for Perspective. To put *Johnson* in perspective as to what possession of personal property means in the claims statute in FPC §733.702(1), think through this fact pattern which is weaker for the surviving spouse than the facts in *Johnson*: Imagine a diamond necklace belonging to the surviving spouse being mistakenly placed in a jewelry box in the decedent's house during a time when the couple was separated. There was no "assertion of whole ownership," by the husband during life just as there was none in *Johnson*. The PR after the husband's death receives that jewelry box containing the necklace and holds it for two years and six months in the PR's safe. After both probate claims periods have run the advanced age surviving wife finally notices that the necklace worth $400,000.00 is missing and learns that the PR has it. Wife sues for replevin to get it back (since that statute of limitations has not run). PR moves to strike on the grounds that wife has not filed a claim in the estate under the FPC provision as applied in *Johnson*. The 4th DCA would say under the principles of *Johnson* that the wife is out of luck and that she loses. Here in Johnson the surviving wife has even a stronger case since the PR never had any ownership or rightful possession of the wife's CPR ½ of the asset.

L. Wrongful Possession by PR. Now imagine this fact pattern where the PR *wrongfully* grabbed the necklace from the marital home after the death, and put it into the jewelry box and spirited it away from the marital home into the PR's safe and held it there for 2.5 years. Is that stronger for a ruling in favor of the surviving spouse? Of course it is. But the CPR ½ in *Johnson* was not even spirited away by the PR. It continued to be held in the entity kit simply under the named asset title of the PR. With community property rights in Florida, titles and names on asset mean NOTHING. Thus, the asset was never in the sole physical or even sole nominal possession of the PR in *Johnson* since the surviving was the personal representative. The surviving spouse always held ownership and possession of her own CPR ½ of the . If this issue had arisen in a Florida divorce proceeding under Chapter 61, would the trial court have allowed one party to keep ALL of the asset? Of course not.

M. Lack of Jurisdiction Argument – *Meltzer*. The surviving spouse argued that the probate court never had jurisdiction to determine anything concerning the surviving spouse's CPR ½ because it lacked jurisdiction to probate a living person's property. *Meltzer v. Estate of Norrie*, 705 So.2d 967 (Fla. 5th DCA 1998) The surviving spouse was without a doubt alive after the decedent's death. Quite attractively, *Meltzer* stated that the probate did not have jurisdiction to adjudicate a living person's property since it was not part of the probate estate. That case dealt with a decedent's interest in a joint venture, very much akin to the ownership characteristics of the CPR in *Johnson*. An opposing view is that a joint venture is not similar to CPR and in any event Meltzer is only binding in the 5th DCA. Besides, the Florida claims statute specifically states that personal property of another person living or dead which is held in the possession of the personal representative must have a claim filed. Question: Could it be that this claims statute provision dealing with personal property is unconstitutional? The surviving spouse argued in *Johnson* that it is. The plot thickens. Again, the 4th DCA's apt certified question goes directly to this issue in addition. As a result, here again, the Florida Supreme Court would do well to solve this imbroglio interweaving the CPR issues.

IV. **Conclusion**.

So, *Johnson* needs a good review by the Florida Supreme Court in order to clarify this CPR scene. Although the issue of the "trust exception" could determine it, even that issue needs interpretation in the light of CPR. The Florida Supreme Court should do that in order to be thorough in how CPR interacts with the trust exception. However, courts are duty-bound to solve cases in the simplest way possible. Thus it may be. However, beyond the courts, even Florida commentators in the treatises are a bit skittish about addressing constitutional community property issues. They almost universally hesitate to state the status of CPR being fully vested constitutionally protected property rights. But there is an exception: The Real Property, Probate and Trust Law Section's own Laird Lile, of Naples, Florida. He is the only nationally recognized Florida commentator to address the issue in a bound hard copy published treatise stating that Florida recognizes community property rights as vested constitutionally protected rights. Mr. Lile, alone among all others, has had the courage to state this important legal truth which would finally put an end to all of the collective doubt, in his immortal probate treatise:

> *"[Quintana]* judicially established that community property does not lose its unique characteristics by the owners merely moving to Florida. Property rights acquired in community property jurisdictions are constitutionally protected rights; the property maintains that characteristic." Laird Lile, *Florida Probate,* page 73, George Bisel 1999.

The End

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Exhibit A

195 So.2d 577 (1967)
Carmen Camps De QUINTANA, Individually, Appellant,
v.
Maria Del Pilar Bertha Lopez De Quintana de ORDONO, a/k/a Bertha Ordono, M.L. De Quintana, Jr., and Maria Teresa L. De Quintana, Appellees.

No. 66-230.
District Court of Appeal of Florida. Third District.

February 14, 1967.
Rehearing Denied March 14, 1967.

*578 George H. Salley and Paul D. Barns, Jr., Miami, for appellant.
Redfearn & Simon and Robert P. Kelley, Wall, Roth & Sheradsky, Miami, for appellees.

Before HENDRY, C.J., and PEARSON and CARROLL, JJ.

HENDRY, Chief Judge.

Plaintiffs, children of the deceased by a prior marriage, sought a declaratory decree to determine the rights of the defendant widow, and the estate of the deceased in certain property. The chancellor granted the plaintiffs' motion for summary decree and found that the property was solely owned by the deceased at the time of his death. He therefore decreed that the estate of the deceased is now the owner of the property and the widow, Carmen Camps de Quintana, has no right, title or interest in the property except such interest as may be set off to her by the County Judge's Court of Dade County, Florida under the probate laws of Florida.

There is no substantial conflict as to the material facts. The defendant and the deceased were married on September 10, 1936, in Oriente Province in Cuba. Both parties were Cuban Nationals. Under the then existing laws of Cuba the marriage was under the regime of "Sociedad de Gananciales", a form of community property marriage. The deceased had no assets at the time of his marriage. The husband and wife were domiciled in Cuba until 1960. A Florida domicile was established when the couple moved here in 1960. They remained in Florida up to the time of the husband's death on September 1, 1963. The husband died intestate.

On or about June 12, 1952, the husband purchased for $50,000.00, five thousand shares of Okeelanta Sugar Refinery, Inc. stock, a Florida corporation. An additional five thousand shares was acquired for $50,000.00 on October 30, 1958. On December 29, 1961, as a result of a ten-for-one stock split, these shares were exchanged for one hundred thousand shares.

On October 1, 1963, the husband received the promissory note of Stewart Macfarlane, then President of Okeelanta Sugar Refinery, Inc., payable to the husband in the amount of $810,000.00 and a contract for additional monies from Macfarlane for the *579 alleged sale of the one hundred thousand shares.
The interest of the estate of the deceased and the widow in the promissory note and contract are the subject of this action. An additional issue raised below by the plaintiffs was that if the property is, in fact, owned in some part by the widow, is she estopped from obtaining her interest by a reference to the assets as "estate assets" in the inventory submitted by her as co-administrator of her husband's estate or by failing to file a claim within the six months provided for in § 733.16 Fla. Stat., F.S.A., the non-claim statute.

Paragraph 1401, Civil Code of Cuba provides:

"1401. To the Society of gains belong:

"1. Property acquired by onerous title,[1] during the marriage, at the expense of community property, whether the acquisition is made for the community or for only one of the consorts. [Footnote supplied.]

"2. That obtained by the industry, salaries or work of the consorts or of either of them.

"3. The fruits, rents, interests collected or accrued during the marriage, and which came from the community property, or from that which belongs to either one of the consorts."

Paragraph 1407, Civil Code of Cuba provides:

"1407. All the property of the marriage shall be considered as community property until it is proven that it belongs exclusively to the husband or to the wife."

Initially, it must be determined what interest, if any, the widow had in the one hundred thousand shares of Okeelanta Sugar Refinery, Inc. stock.

The plaintiffs submitted an affidavit of a friend of the family, N.H. Tomayo, in opposition to defendant's motion for summary decree. It is alleged therein that the husband came to Florida in 1951 to act as plant manager and supervise the operation of the Okeelanta Sugar Refinery, Inc. Further, that from 1951 until the time of his death in 1963, almost all of the husband's income and assets were acquired in Florida. It is also alleged that as an inducement to continue working in Florida, the husband was given an opportunity to buy stock in Okeelanta Sugar Refinery, Inc.; and, that while he was employed in Florida, the husband returned to Cuba for weekends and other occasional visits.

The defendant submitted an affidavit which indicated that the source of the purchase price of the stock was from profits and salaries of enterprises within Cuba, and a loan on an estate in Cuba.

Whether the source of the purchase price of the stock was from enterprises within Cuba or Florida is not material. What is material and not in conflict is that the husband and wife were domiciled in Cuba at the time of the acquisition of the stock.

As plaintiffs contend, the law of the situs has primary control over property within its borders. However, by the almost unanimous authority in America, the "Interests of one spouse in movables acquired by the other during the marriage are determined by the law of the domicile of the parties when the movables are acquired."[2] This rule is applicable where the money used to purchase the movables is earned from services performed in a place other than the place of the domicile.[3]We accept *580 this rule, founded on convenience, as the only logical method of determining marital interest in movables.

Section 1407 of the Civil Code of Cuba, the place of the domicile at the time of the acquisition of the stock, provides that all property of the marriage shall be considered as community property until proven to be separate property of the husband or wife. The plaintiffs presented no evidence which would tend to prove that the stock was the separate property of the husband or purchased from proceeds of his separate property. The uncontradicted evidence does show that the husband brought no assets to the marriage.

Therefore, under the laws of Cuba the stock did not vest in the husband but in the "Sociedad de Gananciales".[4] Thus the wife had a vested interest in the stock equal to that of her husband.[5]

The interest which vested in the wife was not affected by the subsequent change of domicile from Cuba to Florida in 1960.[6]

While domiciled in Florida, the husband allegedly sold the stock and received in exchange therefor the promissory note and contract with which we are concerned. The wife denied that the stock was in fact sold, alleging that it was merely transferred to Stewart Macfarlane, as trustee. Whether or not the stock was sold is not material to the determination of the ownership of the assets in question.

Since the promissory note and contract were acquired while the husband and wife were domiciled in Florida, this transaction is controlled by our law.

Under Florida law, if a portion of the consideration belongs to the wife and title is taken in the husband's name alone, a resulting trust arises in her favor by implication of law to the extent that consideration furnished by her is used.[7] A resulting trust is generally found to exist in transactions affecting community property in noncommunity property states where a husband buys property in his own name.[8] Therefore, while the husband held legal title to the note and contract, he held a one-half interest in trust for his wife.

It is well settled that the Florida non-claim statute, § 733.16, supra, does not apply so as to require the cestui to file a claim against the estate of the trustee.

As the estate holds the legal title to the note and contract, it is proper that the administrators of the estate collect the monies, principle and interest due on the note. Such procedure does not estop the wife from obtaining her interest. The administrators of the husband's estate are trustees as to the wife's equitable interest.

The chancellor was correct in his determination that there exists no material issues of fact. However, the applicable law was misapplied in granting the plaintiffs' motion for summary decree and in denying defendant's motion.

*581 Therefore, the decree appealed is reversed and the cause remanded with directions to enter a decree in accordance with this opinion.
Reversed and remanded.

NOTES

[1] Blood v. Hunt, 97 Fla. 551, 121 So. 886 (1929), "`By onerous cause or title,' viz. by purchase or for value paid."

[2] Restatement, Conflict of Law § 290 (1934); Leflar, Conflict of Laws § 176 at 336 (1959); Stumberg, Conflict of Laws 313 (2d ed. 1951); 2 American Law of Property § 7.18 at 163 (Casner ed. 1952).

[3] Shilkret v. Helvering, 78 U.S.App.D.C. 178, 138 F.2d 925, 929 (1943).

[4] See Sanchez v. Bowers, 70 F.2d 715 (2d Cir.1934).

[5] 2 Tiffany, Real Property § 438 (3d ed. 1939); 4 Powell, Real Property pt. 3 § 627 at 688 (1954).

[6] In re Thornton's Estate, 1 Cal.2d 1, 33 P.2d 1, 92 A.L.R. 1343 (1934); Depas v. Mayo, 11 Mo. 314, 49 Am.Dec. 88 (1848); Restatement, supra note 2 § 292; Leflar, supra note 2 § 177 footnote 56; Stumberg, supra note 2 at 314; 2 American Law of Property § 7.18 at 165 (Casner ed. 1952).

[7] Foster v. Thornton, 131 Fla. 277, 179 So. 882, 883, 887 (1938).

[8] Rozan v. Rozan, N.D. 1964, 129 N.W.2d 694, 701; Stone v. Sample, 216 Miss. 287, 62 So.2d 307, 63 So.2d 555 (1953); Depas v. Mayo, supra note 6; Stumberg, supra note 2 at 315; Bogert, Trusts & Trustees § 26 at 221, § 454 at 516 (2d ed. 1964).

Exhibit B

Estate of Thornton (1934) 1 Cal.2d 1

Estate of Thornton , 1 Cal.2d 1
[S. F. No. 14262. In Bank. May 17, 1934.]

In the Matter of the Estate of WILLIAM M. THORNTON, Deceased. JOSEPH A. GARRY, as Executor, etc., Appellant, v. LUCY CRESWELL et al., Respondents.

COUNSEL

Jos. A. Garry, in pro. per., for Appellant.

Chase, Barnes & Chase, and J. L. Royle, as Amici Curiae on Behalf of Appellant.

Carey Van Fleet, Treadwell, Van Fleet & Laughlin, Alan C. Van Fleet, Pillsbury, Madison &

Sutro, Maurice D. L. Fuller, Frank D. Madison and Marshall P. Madison for Respondents.

Marcel E. Cerf, Henry Robinson, Herbert A. Leland, John Perry Wood, John F. McCarthy and Norman T. Mason, as Amici Curiae on Behalf of Respondents.

OPINION

PRESTON, J.

Appeal from order denying petition for distribution of one-half of the estate of William M. Thornton, deceased, to his widow, Helen H. Thornton, also now deceased.

The basic question is that of the constitutionality of so much of section 164 of the Civil Code as provides that all other property (than separate property as defined by sections 162 and 163 of said code) "acquired after marriage by either husband or wife, or both, including ... personal property wherever situated, heretofore or hereafter acquired while domiciling elsewhere, which would not have been the separate property of either if acquired while domiciled in this state is community property ..."

The findings of the court in this cause, which have ample support in the record, show the facts material to this discussion [1 Cal.2d 3] to be as follows: The property involved was acquired by said husband and wife during the years 1885 to 1899 and 1906 to 1919, while they were domiciled in Montana and, under the laws of that state, it was the husband's separate property, subject only to the wife's dower rights. The husband returned to California in 1919, bringing said property with him, and was here domiciled until his death on February 25, 1929. His widow petitioned for distribution of one- half of his estate to her upon the theory that said property was converted into community property when it was brought into this state. The court below, however, upheld the testamentary attempt of the husband to dispose of all of said estate as his sole and separate property. The widow thereupon prosecuted this appeal from the order denying her petition for distribution and the executor of her will has now been substituted as petitioner and appellant in her stead.

[1] Further reflection upon the question presented convinces us that under the compulsion of well-understood constitutional provisions, as well as settled pronouncements of this court, no alternative remains but to declare the above-quoted provision unconstitutional and void.

[2] Since the statute of 1891 (Stats. 1891, p. 425, sec. 172, Civ. Code), enlarging the right of the wife in the community property, it has been consistently and repeatedly held that any interference with the right of ownership or dominion over the common property is a disturbance of a vested right of the husband. (Spreckels v. Spreckels, 116 Cal. 339 [48 P. 228, 58 Am.St.Rep. 170, 36 L.R.A. 497].) Each step taken in recognition of the wife's increasing claims upon said property has been met by express holdings of this court that such statutes are inapplicable to existing community property and could only apply to subsequent acquisitions of the marital union. (Spreckels v. Spreckels, 172 Cal. 775 [158 P. 537]; Roberts v. Wehmeyer, 191 Cal. 601

[218 P. 22]; Stewart v. Stewart, 199 Cal. 318 [249 P. 197]; McKay v. Lauriston, 204 Cal. 557 [269 P. 519].)

[3] If this be true as to the common property, how much plainer must the application of the same principle be to the separate property of either spouse. We then must consider whether separate property acquired by either [1 Cal.2d 4] spouse in a common-law state can be converted to common property by the mere act of bringing it into a community property state and establishing a domicile therein. Again this court has repeatedly spoken with a negative answer over a period of more than fifty years. (Kraemer v. Kraemer, 52 Cal. 302; Estate of Burrows, 136 Cal. 113 [68 P. 488]; Estate of Niccolls, 164 Cal. 368 [129 P. 278]; Estate of Boselly, 178 Cal. 715 [175 P. 4].)

This was the unclouded holding until 1917 when section 164 of the Civil Code was amended to provide substantially as above quoted. The question then arises as to the competency of the state to pass such a statute in view of certain clear, related and co-ordinate inhibitions of section 1 of the 14th amendment to the Constitution of the United States and the due process provision of article I, section 13, of the state Constitution. In the following cases this question was partially determined by holding that the provision was without application to property brought into the state prior to passage of the enactment. (Estate of Frees, 187 Cal. 150 [201 P. 112]; Estate of Arms, 186 Cal. 554 [199 P. 1053].)

Still confident of its power to enact such a statute, the legislature in 1923 supplemented and clarified the amendment by the use of appropriate words to make its provisions apply to such property whether brought into the state before or after passage of the act. Power to legislate as to property reaching a California domicile before passage of the act was again held wanting. (Estate of Drishaus, 199 Cal. 369 [249 P. 515].)

As to property brought into the state subsequent to the amendments of 1917 and 1923, we have certain appellate court decisions which have assumed that the principles of the Frees and Drishaus cases (Estate of Frees, supra; Estate of Drishaus, supra) control and the statute was in those cases held inoperative as to separate property of the spouse brought into the state subsequent to passage of the act (Scott v. Remley, 119 Cal.App. 384 [6 PaCal.2d 536]; Melvin v. Carl, 118 Cal.App. 249 [4 PaCal.2d 954]; Estate of Bruggemeyer, 115 Cal.App. 525 [2 PaCal.2d 534]). This holding was also announced in Brookman v. Durkee, 46 Wash. 578 [90 P. 914, 123 Am.St.Rep. 944, 13 Ann. Cas. 839, [1 Cal.2d 5] 12 L.R.A. (N. S.) 921], and Douglas v. Douglas, 22 Idaho, 336 [125 P. 796].

So long as we are bound by the holding that to limit the right of one spouse by increasing the right of the other in property acquired by their united labors, is the disturbance of a vested right, we entertain no doubt of the application of at least two provisions of the 14th amendment to the Constitution of the United States. If the right of a husband, a citizen of California, as to his separate property, is a vested one and may not be impaired or taken by California law, then to disturb in the same manner the same property right of a citizen of another state, who chances to transfer his domicile to this state, bringing his property with him, is clearly to abridge the privileges and immunities of the citizen. Again, to take the property of A and transfer it to B because of his citizenship and domicile, is also to take his property without due process of law. This is true regardless of the place of acquisition or the state of his residence.

[4] The doctrine that a change of domicile to this state, accompanied by an importation of the personalty is an implied consent to a submission to requirements of this statute, cannot be sustained, for to do so would be to give effect to a restriction prohibited by the Constitution. (Frost v. Railroad Com., 197 Cal. 230 [240 P. 26]; Hartford Acc. etc. Co. v. Delta & Pine Land Co., 292 U.S. 143 [54 S.Ct. 634, 78 L.Ed. 1178, 92 A.L.R. 928], decided by Supreme Court of the United States, April 9, 1934.)

[5] Neither can we hurdle these barriers by holding the amendments in question to be part of our succession laws and hence valid as a statute of succession. For we are met with plain holdings of our own court that such is not the effect of said statute. (Estate of Frees, supra; Estate of Drishaus, supra.)

The judgment is affirmed.

Waste, C.J., Shenk, J., and Seawell, J., concurred.

LANGDON, J.,

Exhibit C

The Florida Uniform Disposition of Community Property Rights at Death Act

732.216 Short title.—Sections 732.216-732.228 may be cited as the "Florida Uniform Disposition of Community Property Rights at Death Act."

732.217 Application.—Sections 732.216-732.228 apply to the disposition at death of the following property acquired by a married person:

(1) Personal property, wherever located, which:

(a) Was acquired as, or became and remained, community property under the laws of another jurisdiction;

(b) Was acquired with the rents, issues, or income of, or the proceeds from, or in exchange for, community property; or

(c) Is traceable to that community property.

(2) Real property, except real property held as tenants by the entirety, which is located in this state, and which:

(a) Was acquired with the rents, issues, or income of, the proceeds from, or in exchange for, property acquired as, or which became and remained, community property under the laws of another jurisdiction; or

(b) Is traceable to that community property.

732.218 Rebuttable presumptions.—In determining whether ss. 732.216-732.228 apply to specific property, the following rebuttable presumptions apply:

(1) Property acquired during marriage by a spouse of that marriage while domiciled in a jurisdiction under whose laws property could then be acquired as community property is presumed to have been acquired as, or to have become and remained, property to which these sections apply.

(2) Real property located in this state, other than homestead and real property held as tenants by the entirety, and personal property wherever located acquired by a married person while domiciled in a jurisdiction under whose laws property could not then be acquired as community property and title to which was taken in a form which created rights of survivorship are presumed to be property to which these sections do not apply.

732.219 Disposition upon death.—Upon the death of a married person, one-half of the property to which ss. 732.216-732.228 apply is the property of the surviving spouse and is not subject to testamentary disposition by the decedent or distribution under the laws of succession of this state. One-half of that property is the property of the decedent and is subject to testamentary disposition or distribution under the laws of succession of this state. The decedent's one-half of that property is not in the elective estate.

732.221 Perfection of title of personal representative or beneficiary.—If the title to any property to which ss. 732.216-732.228 apply is held by the surviving spouse at the time of the decedent's death, the personal representative or a beneficiary of the decedent may institute an action to perfect title to the property. The personal representative has no duty to discover whether any property held by the surviving spouse is property to which ss.732.216-732.228 apply, unless a written demand is made by a beneficiary within 3 months after service of a copy of the notice of administration on the beneficiary or by a creditor within 3 months after the first publication of the notice to creditors.

732.222 Purchaser for value or lender.—

(1) If a surviving spouse has apparent title to property to which ss. 732.216-732.228 apply, a purchaser for value or a lender taking a security interest in the property takes the interest in the property free of any rights of the personal representative or a beneficiary of the decedent.

(2) If a personal representative or a beneficiary of the decedent has apparent title to property to which ss. 732.216-732.228 apply, a purchaser for value or a lender taking a security interest in the property takes that interest in the property free of any rights of the surviving spouse.

(3) A purchaser for value or a lender need not inquire whether a vendor or borrower acted properly.

(4) The proceeds of a sale or creation of a security interest must be treated as the property transferred to the purchaser for value or a lender.

732.223 Perfection of title of surviving spouse.—If the title to any property to which ss. 732.216-732.228 apply was held by the decedent at the time of the decedent's death, title of the surviving spouse may be perfected by an order of the probate court or by execution of an instrument by the personal representative or the beneficiaries of the decedent with the approval of the probate court. The probate court in which the decedent's estate is being administered has no duty to discover whether property held by the decedent is property to which ss. 732.216-732.228 apply. The personal representative has no duty to discover whether property held by the decedent is property to which ss. 732.216-732.228 apply unless a written demand is made by the surviving spouse or the spouse's successor in interest within 3 months after service of a copy of the notice of administration on the surviving spouse or the spouse's successor in interest.

732.224 Creditor's rights.—Sections 732.216-732.228 do not affect rights of creditors with respect to property to which ss. 732.216-732.228 apply.

732.225 Acts of married persons.—Sections 732.216-732.228 do not prevent married persons from severing or altering their interests in property to which these sections apply. The reinvestment of any property to which these sections apply in real property located in this state which is or becomes homestead property creates a conclusive presumption that the spouses have agreed to terminate the community property attribute of the property reinvested.

732.226 Limitations on testamentary disposition.—Sections 732.216-732.228 do not authorize a person to dispose of property by will if it is held under limitations imposed by law preventing testamentary disposition by that person.

732.227 Homestead defined.—For purposes of ss. 732.216-732.228, the term "homestead" refers only to property the descent and devise of which is restricted by s. 4(c), Art. X of the State Constitution.

732.228 Uniformity of application and construction.—Sections 732.216-732.228 are to be so applied and construed as to effectuate their general purpose to make uniform the law with respect to the subject of these sections among those states which enact them.

Exhibit D

JOHNSON V. TOWNSEND,_259 So.3rd 851 (Fla. 4th DCA 2018); Motion for Rehearing Denied – Motion to Certify Question of Great Public Importance Granted, *Johnson v. Townsend*, 259 So.3rd 851 (Fla. 4th DCA 2018); Appeal to Florida Supreme Court, SC10-102, February 14, 2019.

DISTRICT COURT OF APPEAL OF THE STATE OF FLORIDA
FOURTH DISTRICT
JOAN JOHNSON,
Appellant,
v.
LEE TOWNSEND, LESLIE LYNCH, ELIZABETH DENECKE
and **LISA EINHORN,**
Appellees.
No. 4D18-432
[October 24, 2018]

Appeal from the Circuit Court for the Fifteenth Judicial Circuit, Palm Beach County; Karen M. Miller, Judge; L.T. Case No. 502015CP001096XXXNB.

Edward Downey of Downey | McElroy, P.A., Palm Beach Gardens, for appellant.

William E. Boyes of Boyes, Farina & Matwiczyk, P.A., Palm Beach Gardens, for appellees.

GERBER, C.J.

The decedent's wife appeals from the circuit court's final order granting the decedent's daughters' motion to strike the wife's "Petition to Determine and Perfect Surviving Spouse's Community Property Interest in Estate Assets." The circuit court struck the wife's petition, which the wife filed more than two years after the decedent's death, for three reasons: (1) pursuant to section 733.702(1), Florida Statutes (2015), the petition was an untimely claim against the estate; (2) the petition was further barred by the two-year statute of repose contained in section 733.710(1), Florida Statutes (2015); and (3) no exception to those statutory deadlines allowed the wife to file the petition more than two years after the decedent's death.

The wife argues that her petition to determine her community property interest was not a claim, and thus not subject to any statutory deadlines. The wife further argues that if her petition was a claim, then her petition fell within the "trust exception" and "lien exception" to the statutory deadlines.

We agree with the circuit court's conclusions and, therefore, we affirm the circuit court's order. We will present this opinion in the following sections:

1. The estate administration's timeline;
2. The petition's procedural history;
3. The circuit court's order; and
4. This appeal and our review.

1. <u>The Estate Administration's Timeline</u>

On January 21, 2015, the decedent died.

On March 17, 2015, the wife, as the decedent's nominated personal representative under his will, filed a notice of administration of the estate.

On March 19, 2015, the circuit court admitted the decedent's will to probate and, pursuant to the will, appointed the wife as the estate's personal representative. The circuit court also issued letters of administration to the wife.

On March 31, 2015, the wife published a notice to creditors. The notice, pursuant to section 733.702(1), stated in pertinent part:

> All creditors of the decedent and other persons having claims or demands against decedent's estate, on whom a copy of this notice is required to be served, must file their claims with this court ON OR BEFORE THE LATER OF 3 MONTHS AFTER THE TIME OF THE FIRST PUBLICATION OF THIS NOTICE OR 30 DAYS AFTER THE DATE OF SERVICE OF A COPY OF THIS NOTICE ON THEM. All other creditors of the decedent and other persons having claims or demands against decedent's estate must file their claims with this court WITHIN 3 MONTHS AFTER THE DATE OF THE FIRST PUBLICATION OF THIS NOTICE. ALL CLAIMS NOT FILED WITHIN THE TIME PERIODS SET FORTH IN FLORIDA STATUTES SECTION 733.702 WILL BE FOREVER BARRED.

See § 733.702(1), Fla. Stat. (2015) ("If not barred by s. 733.710, no claim or demand against the decedent's estate that arose before the death of the decedent . . . [and] no claim for personal property in the possession of the personal representative . . . is binding on the estate, on the personal representative, or on any beneficiary *unless filed in the probate proceeding on or before the later of the date that is 3 months after the time of the first publication of the notice to creditors or, as to any creditor required* *to be served with a copy of the notice to creditors, 30 days after the date of service on the creditor* . . . .") (emphasis added). 3

The notice further stated, pursuant to section 733.710(1)'s two-year repose deadline:

> NOTWITHSTANDING THE TIME PERIOD SET FORTH ABOVE, ANY CLAIM FILED TWO (2) YEARS OR MORE AFTER THE DECEDENT'S DATE OF DEATH IS BARRED.

See § 733.710(1), Fla. Stat. (2015) ("Notwithstanding any other provision of the code, 2 years after the death of a person, neither the decedent's estate, the personal representative, if any, nor the beneficiaries shall be liable for any claim or cause of action against the decedent, whether or not letters of administration have been issued, except as provided in this section.").

On June 30, 2015, the three-month claims period under section 733.702(1) expired. By that time, the wife had not filed a claim or other pleading against the estate to determine her alleged community property interest.

On January 21, 2017, the two-year repose period under section 733.710(1) expired. By that time, the wife still had not filed a claim or other pleading against the estate to determine her alleged community property interest.

2. <u>The Petition's Procedural History</u>

On September 6, 2017 (two years eight-and-a-half months after the decedent's death), the wife filed her "Petition to Determine and Perfect Surviving Spouse's Community Property Interest in Estate Assets." The wife's petition, filed pursuant to sections 732.216–.228, Florida Statutes (2015) (known as the "Florida Uniform Disposition of Community Property Rights at Death Act") sought to confirm and effectuate her vested 50% community property interest in an investment asset acquired and titled in the decedent's name while the decedent and the wife were domiciled in Texas, a community property state. *See* § 732.219, Fla. Stat. (2015) ("Upon the death of a married person, one-half of the property to which ss. 732.216-732.228 apply is the property of the surviving spouse and is not subject to testamentary disposition by the decedent or distribution under the laws of succession of this state.").

The decedent's daughters filed a motion to strike the wife's petition. The daughters' motion and supplemental memorandum argued that the wife's petition was untimely under sections 733.702(1), 733.710(1), and 732.223. Section 732.223 states:

> If the title to any property to which ss. 732.216-732.228 apply was held by the decedent at the time of the decedent's death, title of the surviving spouse may be perfected by an order of the probate court or by

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> execution of an instrument by the personal representative or the beneficiaries of the decedent with the approval of the probate court. The probate court in which the decedent's estate is being administered has no duty to discover whether property held by the decedent is property to which ss. 732.216-732.228 apply. The personal representative has no duty to discover whether property held by the decedent is property to which ss. 732.216-732.228 apply unless a written demand is made by the surviving spouse or the spouse's successor in interest within 3 months after service of a copy of the notice of administration on the surviving spouse or the spouse's successor in interest.

The wife filed her own memorandum, raising three arguments that her petition to determine her community property interest was not a claim against the estate subject to the statutory deadlines.

First, the wife argued that section 732.223 shows on its face that a spouse's community property interest is not a creditor claim. According to the wife, section 732.223 does not establish a date or timeframe when a surviving spouse must file a petition to perfect a community property interest, and does not refer to the creditor claim statutes in any way. Instead, the wife argued, section 732.223 is designed solely to limit a personal representative's duty to search for community property.

Second, the wife cited section 731.201(4), Florida Statutes (2015), which defines a "claim" as

> a liability of the decedent, whether arising in contract, tort, or otherwise, and funeral expense. The term does not include an expense of administration or estate, inheritance, succession, or other death taxes.

Relying on that definition, the wife argued that her community property interest was not a liability of the decedent, and therefore was not a "claim" under section 731.201(4).

Third, the wife argued that if her petition was a claim, then her community property interest fell within the common law "trust exception" and the statutory "lien exception" to section 733.702(1)'s and section 733.710(1)'s deadlines. We discuss the wife's arguments for each of these exceptions in more detail below.

a. The Common Law "Trust Exception"

In support of the common law "trust exception" to the statutory deadlines, the wife cited the pre-Probate Code case of *Quintana v. Ordono*, 195 So. 2d 577

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(Fla. 3d DCA 1967), and the post-Probate Code case of *Scott v. Reyes*, 913 So. 2d 13 (Fla. 2d DCA 2005), for an explanation of the exception.

In *Quintana*, the Third District held:

> Under Florida law, if a portion of the consideration belongs to the wife and title is taken in the husband's name alone, a resulting trust arises in her favor by implication of law to the extent that consideration furnished by her is used. A resulting trust is generally found to exist in transactions affecting community property in noncommunity property states where a husband buys property in his own name. Therefore, while the husband held legal title to the [property], he held a one-half interest in trust for his wife.
>
> It is well settled that the Florida nonclaim statute, s 733.16, . . . does not apply so as to require the [wife] to file a claim against the estate of the trustee.
>
> . . . Such procedure does not estop the wife from obtaining her interest. The administrators of the husband's estate are trustees as to the wife's equitable interest.

195 So. 2d at 580 (footnotes omitted).

In *Scott*, the Second District held:

> The "trust exception" . . . to the requirements of the nonclaim statute, as those exceptions pertain to recovery of property from an estate, have effectively been limited [by the Probate Code] to those situations where the decedent clearly held the property on behalf of the actual owner either by way of an express trust or some other clearly defined means. . . . If [] the decedent was merely in possession of the property but made no such assertion of ownership prior to his or her death, the assertion of ownership being made by the personal representative or heirs for the first time after the decedent's death would not require the filing of a claim.

913 So. 2d at 18 (citation omitted).

The wife, applying *Quintana*'s and *Scott*'s explanation of the "trust exception," argued that her community property interest qualified for the exception. According to the wife, under Texas law, "a trust relationship exists between husband and wife regarding the community property controlled by each spouse[.]" *Madrigal v. Madrigal*, 115 S.W.3d 32, 35 (Tex. App. San Antonio 2003). Thus, the wife argued, because her community property interest remained titled in the decedent's name upon his death, the decedent held the wife's community property interest as a trustee, and the community property interest was exempt from the statutory deadlines.

b. The Statutory "Lien Exception"

As a second exception to the statutory deadlines, the wife relied upon the lien exceptions contained in sections 733.702(4)(a) and 733.710(3), Florida Statutes (2015).

Section 733.702(4)(a) states: "Nothing in this section affects or prevents . . . [a] proceeding to enforce any mortgage, security interest, or other lien on property of the decedent."

Section 733.710(3) states: "This section shall not affect the lien of any duly recorded mortgage or security interest or the lien of any person in possession of personal property or the right to foreclose and enforce the mortgage or lien."

The wife, applying sections 733.702(4)(a) and 733.710(3), argued that even if her community property interest was considered as a claim, then the vesting of community property interest gave rise to an equitable lien which should be excepted from sections 733.702(1) and 733.710(1).

3. The Circuit Court's Order

The circuit court ultimately entered the order, now on appeal, granting the decedent's daughters' motion to strike the wife's petition. The order's conclusions of law state, in pertinent part:

> The Petition is an untimely claim against the estate pursuant to section 733.702(1), Fla. Stat., as it is a claim or demand against Decedent's estate for personal property in the possession of the personal representative, which claim was filed more than 3 months after the notice to creditors was first published.
>
> The Petition is further barred by section 733.710(1), Fla. Stat. [which bars any claim filed more than two years after the decedent's death]. There is no "trust exception" or any other exception which allows [the wife] to file the Petition more than two years after Decedent's death.

(paragraph numerals omitted).

4. This Appeal and Our Review

This appeal followed. To the extent our review involves interpretation of sections 733.702's and 733.710's deadlines, or an examination of whether the wife qualifies for an exception to those deadlines, our review is de novo. *See Headley v. City of Miami*, 215 So. 3d 1, 5 (Fla. 2017) ("Issues of statutory interpretation are subject to de novo review."); *Inmon v. Air Tractor, Inc.*, 74 So. 3d 534, 537 (Fla. 4th DCA 2011) ("This court has *de novo* review of a circuit court's application of a statute of repose . . . because it involves an issue of law.").

The wife, mirroring her contentions in the circuit court, argues that her petition to determine her community property interest, filed pursuant to the "Florida Uniform Disposition of Community Property Rights at Death Act," was not in the nature of a claim, and thus not subject to any statutory deadlines. The wife further argues that if her petition was a claim, then her community property interest fell within the common law "trust exception" and the statutory "lien exception" to section 733.702(1)'s and section 733.710(1)'s deadlines.

The daughters argue that the circuit court properly struck the wife's petition as untimely pursuant to both section 733.702(1) and section 733.710(1) because the wife's petition is a claim. The daughters further argue that the petition is not excepted from either of the above statutes, because her claim does not constitute a lien, nor does her claim fall within the common law trust exception.

Applying de novo review, we agree with the daughters' arguments in six respects.

First, we agree with the daughters' argument that the wife's petition to determine her community property interest is a "claim" as that term is defined in section 731.201(4). Section 731.201(4) defines a "claim" as

> *a liability of the decedent*, whether arising in contract, tort, or otherwise, and funeral expense. The term does not include an expense of administration or estate, inheritance, succession, or other death taxes.

(emphasis added). The wife's community property interest is "a liability of the decedent." Although the decedent's possession of the community property in his name may have created a resulting trust, *see Quintana*, 195 So. 2d at 580 ("A resulting trust is generally found to exist in transactions affecting community property in noncommunity property states where a husband buys property in his own name."), upon the decedent's death, his estate became liable to the wife for her community property interest. Thus, upon the decedent's death, the wife's community property interest was a claim which the wife had to pursue.

Second, to the extent the decedent possessed the community property in his name at the time of his death, the wife's failure to make a claim upon her community property interest within section 733.702(1)'s three-month claim period barred her later-filed untimely claim (in the form of her petition). *See* § 733.702(1), Fla. Stat. (2015) ("If not barred by s. 733.710, no claim or demand against the decedent's estate that arose before the death of the decedent . . .[and] *no claim for personal property in the possession of the personal representative* . . . is binding on the estate, on the personal representative, or on any beneficiary *unless filed in the probate*

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proceeding on or before the later of the date that is 3 months after the time of the first publication of the notice to creditors or, as to any creditor required to be served with a copy of the notice to creditors, 30 days after the date of service on the creditor . . . .") (emphasis added).

Third, to the extent the wife's petition is not only a "claim" under section 731.201(4) but also a cause of action, the wife's failure to make a claim upon her community property interest within section 733.710(1)'s two-year claim period barred her later-filed untimely claim (in the form of the petition). *See* § 733.710(1), Fla. Stat. (2015) ("Notwithstanding any other provision of the code, *2 years after the death of a person, neither the decedent's estate, the personal representative, if any, nor the beneficiaries shall be liable for any claim or cause of action against the decedent*, whether or not letters of administration have been issued, except as provided in this section.") (emphasis added).

Fourth, the wife's reliance upon the common law trust exception is unavailing. The primary case upon which the wife relies, *Quintana*, construed section 733.16, Florida Statutes, which was repealed in 1974 as part of the Probate Code's adoption in 1976. Thus, *Quintana*'s viability is questionable. *See Scott*, 913 So. 2d at 17 ("[T]he repeal of the former Florida Probate Law and the adoption of the Code call into question the continued viability of some of the earlier decisions that have applied the trust exception to exclude certain types of claims from the operation of the statute."). Upon the Probate Code's adoption, "[t]he 'trust exception' . . . to the requirements of the nonclaim statute, as those exceptions pertain to recovery of property from an estate, have effectively been limited [by the Probate Code] to those situations where the decedent clearly held the property on behalf of the actual owner either by way of an express trust or some other clearly defined means." *Id.* at 18 (citation omitted). In *Scott*, our sister court, applying that limitation, concluded that the trust exception was inapplicable in that case because the wife there "did not allege the existence of an express trust or any other clearly defined means by which the Decedent held the accounts on her behalf." *Id.* Similarly here, the wife did not allege the existence of an express trust or any other clearly defined means by which the decedent held the community property interest on her behalf.

Fifth, the wife's reliance upon the lien exceptions contained in sections 733.702(4)(a) and 733.710(3) is similarly unavailing. To begin with, the wife cites no authority for her argument that the vesting of her community property interest gave rise to an equitable lien falling under either exception. Even if we were to consider that the vesting of her community property interest gave rise to an equitable lien falling under section 733.702(4)(a)'s exception ("Nothing in this section affects or prevents . . . [a] proceeding to enforce any mortgage, security interest, or other lien on property of the decedent."), we could not reach the same conclusion under the plain language of section 733.710(3)'s narrower exclusion. Section 733.710(3) states: "This section shall not affect the lien of any duly recorded mortgage or security interest or the lien of any person in possession of personal property or the

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right to foreclose and enforce the mortgage or lien." The wife's "lien" is not a "duly recorded mortgage or security interest," nor is she, in her individual capacity, "in possession of [the subject] personal property." The wife also has not provided any argument that she has a "right to foreclose and enforce the . . . lien."

Sixth, while we agree with the wife that section 732.223 is designed solely to limit a personal representative's duty to search for community property, we disagree with the wife's argument that sections 732.216–.228's failure to establish a deadline when a surviving spouse must file a petition to perfect a community property interest means no such deadline exists. Rather, as the daughters argue, a two-year deadline exists based on section 733.710(1)'s plain language: "*Notwithstanding any other provision of the code*, 2 years after the death of a person, neither the decedent's estate, the personal representative, if any, nor the beneficiaries shall be liable for any claim or cause of action against the decedent, whether or not letters of administration have been issued, except as provided in this section." (emphasis added).

Conclusion

Upon the decedent's death, the wife had the ability to perfect her community property interest by seeking an order of the probate court pursuant to section 732.223. Because the wife's community property interest was a "claim" as defined in section 731.201(4), the wife had three months after the time she published the notice to creditors to file her claim according to section 733.702(1), and in any event had two years after the decedent's death to file her claim according to section 733.710(1). The wife did neither. As a result, the circuit court properly found that the wife's untimely claim (in the form of her petition) was barred, and that no exception to the statutory deadlines existed. Ruling otherwise would have left no deadline by which the wife had to file a petition to perfect her community property interest, contrary to section 733.710(1).

Affirmed.

LEVINE and KLINGENSMITH, JJ., concur.

* * *

Not final until disposition of timely filed motion for rehearing.

DISTRICT COURT OF APPEAL OF THE STATE OF FLORIDA
FOURTH DISTRICT

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JOAN JOHNSON,
Appellant,
v.
LEE TOWNSEND, LESLIE LYNCH, ELIZABETH DENECKE
and **LISA EINHORN,**
Appellees.
No. 4D18-432
[December 19, 2018]

Appeal from the Circuit Court for the Fifteenth Judicial Circuit, Palm Beach County; Karen M. Miller, Judge; L.T. Case No. 502015CP001096XXXNB.

Edward Downey, R. Lee McElroy IV, and Robert A. Wight of Downey | McElroy, P.A., Palm Beach Gardens, for appellant.
William E. Boyes of Boyes, Farina & Matwiczyk, P.A., Palm Beach Gardens, for appellees.

ON APPELLANT'S MOTION FOR REHEARING AND/OR REHEARING EN BANC OR TO CERTIFY QUESTION TO THE FLORIDA SUPREME COURT AS A MATTER OF GREAT PUBLIC IMPORTANCE

GERBER, C.J.

We deny appellant's motion for rehearing and/or rehearing en banc. However, we grant appellant's motion to certify to the Florida Supreme Court the following question of great public importance:

> Whether a surviving spouse's vested community property rights are part of the deceased spouse's probate estate making them subject to the estate's claims procedures, or are fully owned by the surviving spouse and therefore not subject to the estate's claims procedures.

LEVINE and KLINGENSMITH, JJ., concur.

* * *

No further motion for rehearing shall be permitted.

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IS THERE SUBSTANCE TO MY ANXIETY? MENTAL HEALTH AND SUBTANCE ABUSE ISSUES AND SOLUTIONS

By

J. Eric Virgil, Moderator
The Hon. Yvonne Colodny, Miami
Habsi Kaba, Doral

Is There Substance to my Anxiety?

Mental Health and Substance Abuse Issues and Solutions

Panel Discussion:

Eric Virgil[1] – Moderator

The Honorable Yvonne Colodny – Administrative Judge, Probate and Guardianship Division, 11th Judicial Circuit

Ms. Habsi W. Kaba MS MFT CMS - CIT Miami-Dade and Police Mental Health Collaboration, 11th Judicial Circuit Criminal Mental Health Project

Introduction

Mental illness is the leading cause of disability in the United States. A recent study reveals 8 million Americans suffer from serious psychological distress, some of whom suffer from serious mental health conditions such as bipolar disorder and schizophrenia. Some of this suffering population might include a beneficiary or a co-trustee of a trust we are administering. Many of these individuals lack access to adequate treatment without outside assistance.

Substance abuse is an equally serious issue. Approximately 20 million American adults (aged 12 and older) battle substance abuse disorders. About 38% of adults battle some type of illicit drug use disorder. Roughly 1 out of every 8 adults struggles with both alcohol and drug use disorders simultaneously. Finally, 8.5 million American adults suffer from both a mental health disorder and a substance use disorder, or co-occurring disorders.[2]

These serious issues affect beneficiaries and trustees of trusts we may encounter or administer. Managing beneficiaries with difficult issues may be part of the job description for trustees but those with mental illness or substance abuse problems raise complex issues, as does the issue of possible trustee impairment due to health issues.

Issues

1. Can a trustee be removed merely due to potential for mismanagement due to a substance abuse or mental health problem?

2. Is there any way to know if a beneficiary or a co-trustee has a substance abuse or mental health problem that potentially needs to be addressed?

[1] Thanks to Judge Colodny and Ms. Kaba for their participation on the panel and for their contributions to the materials. Any mistakes or omissions in these materials are solely the responsibility of the moderator.
[2] The exhibits to these materials include details on common mental health and substance abuse issues, further statistics, and resources available to help those in need.

3. How should a trustee or attorney interact with a beneficiary or co-trustee with such problems?

4. What are some steps a trustee can take in trying to address or assist a beneficiary with substance abuse or mental health issues?

Discussion of Issues

1. Can a trustee be removed merely due to potential for mismanagement due to a substance abuse or mental health problem?

The Florida Trust Code provides generally that a trustee may be removed by a court if the "trustee has committed a serious breach of trust." F.S. Section 736.0706(2)(a). Case law prior to the adoption of the Trust Code in 2007 held that to seek removal a plaintiff had to show conduct by the trustee amounting to a breach of trust. *See, e.g., State of Delaware ex rel. Gebelein v. Belin*, 456 So.2d 1237 (Fla. 1st DCA 1984); *Rosen v. Rosen*, 167 So.2d 70 (Fla. 3d DCA 1964). Given this backdrop, how would a trustee be removed merely due to potential for mismanagement caused by a substance abuse or mental health problem?

The answer lies in F.S. Section 736.0706(2)(c), which provides for removal of a trustee on a showing that there is a potential for mismanagement by the trustee. Specifically, the provision states that a court can remove a trustee because of "the unfitness, unwillingness, or persistent failure of the trustee to administer the trust effectively," if the court determines that removal best serves the interests of the beneficiaries. The rationale for removal due to substance abuse or a mental health problem would hinge on the "unfitness" term of the statutory provision.

Although there do not appear to be any reported Florida decisions removing a trustee based on this provision, this is not a novel concept in trust law. The Restatement of Trusts provides for potential removal for demonstrated unfitness such as habitual substance abuse. *See Restatement (Third) of Trusts* §37, Comment e. The F.S. Section 736.0706(2)(c) language allowing removal for "unfitness" appears to adopt the Restatement rule. If such a case were to be brought, a trustee could not be removed without an evidentiary hearing after notice to the trustee. *See Kountze v. Kountze,* 93 So. 3d 1164 (Fla. 2d DCA 2012).

2. Is there any way to know if a beneficiary or a co-trustee has a substance abuse or mental health problem, such as bipolar disorder or schizophrenia, that potentially needs to be addressed?

Whether a beneficiary suffers from these issues is relevant to the trustee in light of its various fiduciary duties. The trustee has a duty to administer a trust in accordance with its stated terms for the best interest of the beneficiaries. *See Horgan v. Cosden,* 249 So. 3d 683 (Fla. 2d DCA 2018). Although some trusts will have specific language relating to beneficiaries with substance abuse or mental health issues, many are silent. The trustee has a duty of impartiality to the beneficiaries. F.S. Section 736.0803. A problematic beneficiary presents challenges that can potentially impact the interests of other beneficiaries. Regarding confidentiality, a trustee has to be careful not to divulge a beneficiary's confidential health information to third parties due to the beneficiary's privacy rights and application of laws such as the Health Insurance Portability and Accountability Act of 1996 (HIPPA). A trustee also has a duty to protect and preserve trust property. F.S. Section 736.0809. If a beneficiary with one of these issues damages property owned by the trust, that can become an issue for the trustee.

Although a beneficiary's substance abuse or mental health problems certainly relate to the trustee's duties, there are obviously limits to what a trustee can do with regard to these issues. Trustees are charged with management and distribution of trust assets in light of the trust instrument and governing law. Trustees are not mental health or substance abuse professionals. They are not trained to diagnose a beneficiary's mental or medical conditions, or to recommend proper treatment options, or to be the guarantors of a beneficiary's conduct. A trustee may become aware of behaviors that appear to evidence these problems but absent legal confirmation or a medical diagnosis a fiduciary must be cautious in how it proceeds.

A starting point for trustees in dealing with this area is to carefully review a trust's language before accepting appointment. If the trust has substance abuse language or special needs provisions, then the trustee should ask questions as to why the provisions were included and whether they relate to specific individuals. Is any potential beneficiary currently suffering from issues? If the trustee receives information confirming that the provisions may be applicable, then it should request detailed information about the potentially-affected beneficiary. The following items are information that may be helpful to a trustee dealing with a beneficiary that potentially suffers from these issues:

• Beneficiary's current living situation (i.e. Living with family, homeless, etc.) including address, phone number and how long the beneficiary has resided there. If the beneficiary has had several living situations in the last 6 months try to find out why

• Behaviors of concern in the recent past (emphasis on the last few weeks) including any behaviors that are considered immediate danger to beneficiary or others

• List of medications beneficiary is currently prescribed

• Date or age of onset of symptoms, list of symptoms

• Any Advanced Directives written by the beneficiary (obtain copy if available)

• Any previous medical diagnosis and history of medical issues

• Family history of mental health diagnosis including relationship to beneficiary (i.e. Maternal grandmother - schizophrenia)

• Schooling completed i.e. High school graduate, completed to 6th grade, etc.

• History of substance abuse

• History of incarcerations

• History of compliance with treatment when in community (not in jail or involuntarily committed)

During the appointment screening process generally, a trustee might also seek to have beneficiaries submit some basic relevant information. This could include items allowing the trustee to create a budget for the beneficiary but may also lead to discovering information relevant to mental health or substance abuse issues. As part of the screening process, if the trustee determines it is not equipped to address an administration involving these issues, it could then decline the appointment.

During administration, a trustee may notice issues or behaviors that can be a red-flag as to substance abuse or mental health problems. These include such things as DUI arrests or other criminal charges, irrational behavior and conduct, antisocial behavior, memory issues, low levels of performance at work leading to frequent job changes or job losses, unstable living arrangements and poor relationships, frequent requests for distributions, etc.

A further complication is in this area is that the affected beneficiary may deny existence of a problem while other family members or interested parties may be telling the trustee that a problem does indeed exist. Part of the complication is the potential self-interest that may exist where one family member urges a trustee not to make distributions to another family member due to an alleged problem.

3. How should a trustee or attorney interact with a beneficiary or co-trustee with such problems?

The trustee must act in accordance with the terms of the trust and trust law. The starting point is the language of the trust. If the trust has substance abuse or mental health provisions, those terms are the starting point for the trustee's analysis. On the flip side, if the trust provides for mandatory distributions to a beneficiary and does not allow for consideration of the beneficiary's issues then the trustee may be bound to make a distribution to a beneficiary who likely will not use the funds wisely.

The trustee should carefully review its discretion under the trust to see what flexibility it has in addressing these issues. Even where the trust has substance abuse provisions, a trustee still must review the provisions carefully. For example, it must determine how the trust defines substance abuse and whether legal drugs, such as alcohol and prescription medicines, are included. The way such trust provisions define abuse also vary.

As noted in the previous section, a trustee may notice signs of a potential health problem with a beneficiary or co-trustee. To the extent that person shares information or that information is provided to others, the individual could be encouraged to voluntarily seek help from a psychiatrist, psychologist, medical doctor, or social worker. This may prevent a crisis and the trust likely would provide for payment of such treatment.

When an individual has become a threat to him/herself or others, and is not willing to receive treatment voluntarily, crisis intervention may be necessary.[3] In South Florida, crisis intervention can be provided by any of the following options: (a) Licensed Mental Health Professional/Mobile Crisis Team; (b) Ex Parte Baker Act (mental health) or Marchman Act (substance abuse) Order; (c) Law Enforcement. Each of these options will require law enforcement involvement at a certain point, therefore, it is important to be familiar with the Crisis Intervention Team (CIT). Many South Florida local law enforcement agencies have Crisis Intervention Teams. CIT officers receive 40-hours of specialized training intended to increase their understanding of mental illness and addiction disorders, permitting for more effective communication when assisting a person in crisis. CIT training teaches recognition of the signs and symptoms of mental illness, de-escalation techniques, and knowledge of the community resources in a county's behavioral health system for linkage to treatment. The CIT program is a collaborative effort among law enforcement, families, the mental health community and other advocates.

Once an individual is admitted into treatment, it may not always be possible for the trustee or family to receive updates from the facility due to privacy laws such as HIPPA. The beneficiary will need to sign a release agreeing to sharing of information, with the exception of minors and those under a guardianship.

4. What are some steps a trustee can take in trying to address or assist a beneficiary with substance abuse or mental health issues?

As noted above, a good first step is careful review of the trust instrument and some intake of the beneficiaries prior to accepting the trust. If there are beneficiaries with substance abuse or mental health issues and the trustee is comfortable with proceeding with the appointment, it should consider who is best to keep the trustee informed of the beneficiary's condition. That may be a family member, a family advisor, a guardian, the beneficiary himself, or a combination of such individuals. The trustee may also consider giving clear direction to the beneficiaries as to the standards

[3] The Miami-Dade CIT materials, with details about crisis intervention procedures and options, is attached as Exhibit C.

and process it will use to make distributions and what information it will require to do so.

In addition to the suggestions in the previous sections, attached to this outline are directories of local and national resources a trustee may refer a beneficiary to or refer to family members or friends of the affected beneficiary.

Finally, if a trustee is administering a trust where it believes the language of the trust does not adequately address the problems it faces with a beneficiary the trustee may consider options such as trust modification or decanting. In addition, some trusts will contain trust protector provisions that allow a third party to amend a trust. These are legal methods of addressing an instrument that is ambiguous regarding substance abuse or mental health administrative issues so that clear or additional terms can be added to the trust instrument to give the trustee the necessary guidance.

Exhibit A

National Recovery Month

Prevention Works • Treatment is Effective • People Recover

september 2018

JOIN THE VOICES FOR RECOVERY
invest in health, home, purpose, and community

DEPARTMENT OF HEALTH & HUMAN SERVICES · USA

SAMHSA
Substance Abuse and Mental Health Services Administration

JOIN THE VOICES FOR RECOVERY

Common Mental Disorders and Misused Substances

*"After speaking to a therapist, I learned
that I was dealing with PTSD from
my childhood and facing anxiety and
depression. Due to the stigma around
behavioral health issues, I hid my
diagnosis, only because I didn't think
people would understand. But once I
realized my peers were suffering too, I
knew I had to share my recovery story.
I have made it my life's mission to help
other youth avoid facing the same
mistakes and hardships I've experience,
because I didn't know about my mental
health, and the importance of minding
my mental health. So, today I stand
before you as a survivor in recovery,
taking control of my life for myself and
my community."*

- Emmanuel Ford

Common Mental Disorders and Misused Substances

Every September, the Substance Abuse and Mental Health Services Administration (SAMHSA) (https://www.samhsa.gov/), within the U.S. Department of Health and Human Services (HHS) (https://www.hhs.gov/), sponsors ***National Recovery Month (Recovery Month***) to increase awareness of behavioral health conditions. This observance promotes the knowledge that behavioral health is essential to overall health, prevention works, treatment is effective, and people can and do recover from mental and substance use disorders.

The 2018 ***Recovery Month*** theme, *"Join the Voices for Recovery: Invest in Health, Home, Purpose, and Community,"* explores how integrated care, a strong community, sense of purpose, and leadership contribute to effective treatments that sustain the recovery of persons with mental and substance use disorders. The observance will work to highlight inspiring stories that help thousands of people from all walks of life find the path to hope, health, and wellness. In addition, the materials support SAMHSA's message that prevention works, treatment is effective, and people can and do recover.

BEHAVIORAL HEALTH PREVALENCE IN THE UNITED STATES

Millions of people in the U.S. live with a mental or substance use disorder. The prevalence of these conditions highlights the importance of focusing funding and attention on behavioral health needs.

- In 2016, there were 20.1 million people (7.5 percent), aged 12 or older who had a substance use disorder in the past year.[1]
- The rate of drug overdose deaths involving heroin increased on average by 19% from 2014 to 2016.[2]
- An estimated 7.3 million of underage persons aged 12 to 20 (19.3 percent) were current drinkers in 2016, including 4.5 million who reported binge alcohol use (12.1 percent) and 1.1 million heavy drinkers (2.8 percent).[3]
- Data from 2016 demonstrated that among adults aged 18 or older, 44.7 million adults (18.3 percent) had any mental illness in the past year.[4] A person with any mental illness (AMI) is defined as an individual having any mental, behavioral, or emotional disorder in the past year that met Diagnostic and Statistical Manual of Mental Disorders (DSM-IV) criteria (excluding developmental and substance use disorders).[5]
    - Among adults aged 18 or older, 10.4 million adults (4.2 percent) had a serious mental illness (SMI) in the past year.[6] A person with a serious mental illness is defined as an individual having any mental, behavioral, or emotional disorder resulting in serious functional impairment, which substantially interfered with or limited one or more major life activities. AMI and SMI are not mutually exclusive categories; adults with SMI are included in estimates of adults with AMI.

- In 2016, an estimated 8.2 million U.S. adults 18 or older reported having co-occurring disorders. This means that within the previous year, they experienced both a mental illness and a substance use disorder.[7]
    - About 6.1 percent of individuals aged 18 to 25 (2.1 million) had co-occurring mental illness and a substance use disorder.[8]
- In 2016, approximately 44,965 Americans died as a result of suicide–on average, more than 123 deaths per day.[9]
    - Suicide was the second leading cause of death in 2015 for two age groups: individuals aged 15 to 24 and 25 to 34.[10]

Read on to learn about common mental disorders and misused substances, as well as alternative names for each disorder or substance; signs, symptoms, and adverse health effects; additional information on prevalence; and the average age of first-time use of a substance.

To learn more about the most common mental and substance use disorders and how SAMHSA works to reduce their impact on America's communities, please visit:

https://www.samhsa.gov/disorders

COMMON MENTAL DISORDERS

Mental Disorder	Signs And Symptoms [11,12,13]	Estimate Description	Surveillance System[14,15,16,17]	Estimate[18]
ANXIETY DISORDERS				
AGORAPHOBIA	Intense fear and anxiety of any place or situation where escape might be difficult; avoidance of being alone outside of the home; fear of traveling in a car, bus, or airplane, or of being in a crowded area	Lifetime Prevalence in the United States Among Youth (13 to 18 Years Old)	NCS-A	2.4% of youth
		Lifetime Prevalence in the United States Among Adults	NCS-R	1.4% of adults
		Average Age of Onset	NCS-R	20 years old
GENERALIZED ANXIETY DISORDER	Excessive worry about a variety of everyday problems for at least 6 months; may excessively worry about and anticipate problems with finances, health, employment, and relationships	Lifetime Prevalence in the United States Among Youth (13 to 18 Years Old)	NCS-A	1.0% of youth
		Lifetime Prevalence in the United States Among Adults	NCS-R	5.7% of adults
		Average Age of Onset	NCS-R	31 years old
OBSESSIVE COMPULSIVE DISORDER (OCD)	Intrusive thoughts that produce anxiety (obsessions), repetitive behaviors that are engaged in to reduce anxiety (compulsions), or a combination of both; unable to control anxiety-producing thoughts and the need to engage in ritualized behaviors	Lifetime Prevalence in the United States Among Adults	NCS-R	1.6% of adults
		Average Age of Onset	NCS-R	19 years old
PANIC DISORDER	Unexpected and repeated episodes of intense fear accompanied by physical symptoms that may include chest pain, heart palpitations, shortness of breath, dizziness, or abdominal distress	Lifetime Prevalence in the United States Among Youth (13 to 18 Years Old)	NCS-A	2.3% of youth
		Lifetime Prevalence in the United States Among Adults	NCS-R	4.7% of adults
		Average Age of Onset	NCS-R	24 years old

Mental Disorder	Signs And Symptoms [11,12,13]	Estimate Description	Surveillance System[14,15,16,17]	Estimate[18]
ANXIETY DISORDERS				
POST-TRAUMATIC STRESS DISORDER (PTSD)	Can develop after exposure to a terrifying event or ordeal (traumatic events that may trigger PTSD include violent personal assaults, natural or human-caused disasters, accidents, and military combat), persistent frightening thoughts and memories of the ordeal, sleep problems, feeling detached or numb, or being easily startled	Lifetime Prevalence in the United States Among Youth (13 to 18 Years Old)	NCS-A	4.0% of youth
		Lifetime Prevalence in the United States Among Adults	NCS-R	6.8% of adults
		Average Age of Onset	NCS-R	23 years old
SOCIAL PHOBIA	A persistent, intense, and chronic fear of being watched and judged by others and feeling embarrassed or humiliated by their actions; this fear may be so severe that it interferes with work, school, and other activities and may negatively affect the person's ability to form relationships	Lifetime Prevalence in the United States Among Youth (13 to 18 Years Old)	NCS-A	5.5% of youth
		Lifetime Prevalence in the United States Among Adults	NCS-R	12.1% of adults
		Average Age of Onset	NCS-R	13 years old
SPECIFIC PHOBIA	Marked and persistent fear and avoidance of a specific object or situation, such as a fear of heights, spiders, or flying	Lifetime Prevalence in the United States Among Youth (13 to 18 Years Old)	NCS-A	15.1% of youth
		Lifetime Prevalence in the United States Among Adults	NCS-R	12.5% of adults
		Average Age of Onset	NCS-R	7 years old

Mental Disorder	Signs And Symptoms [11,12,13]	Estimate Description	Surveillance System [14,15,16,17]	Estimate [18]
MOOD DISORDERS				
BIPOLAR DISORDER	Recurrent episodes of highs (mania) and lows (depression) in mood, changes in energy and behavior, an extreme irritable or elevated mood, an inflated sense of self-importance, risky behaviors, distractibility, increased energy, and a decreased need for sleep	Lifetime Prevalence in the United States Among Youth (13 to 18 Years Old)	N/A	0–3% of youth
		Lifetime Prevalence in the United States Among Adults	NCS-R	3.9% of adults
		Average Age of Onset	NCS-R	25 years old
MAJOR DEPRESSIVE EPISODE	A period of two weeks or longer during which there is either depressed mood or loss of interest or pleasure, and at least four other symptoms that reflect a change in functioning, such as problems with sleep, eating, energy, concentration, self-image or recurrent thoughts of death or suicide	Lifetime Prevalence in the United States Among Youth (12 to 17 Years Old)	NSDUH	12.8% of youth
		Lifetime Prevalence in the United States Among Adults	NSDUH	6.7% of adults
		Average Age of Onset	N/A	N/A[27]
OTHER MENTAL DISORDERS				
ATTENTION-DEFICIT/ HYPERACTIVITY DISORDER (ADD/ADHD)	Inattention or difficulty staying focused; hyperactivity or constantly being in motion or talking; impulsivity, meaning often not thinking before acting	Lifetime Prevalence in the United States Among Youth (13 to 18 Years Old)	NCS-A	9.0% of youth
		Lifetime Prevalence in the United States Among Adults	NCS-R	8.1% of adults
		Average Age of Onset	NCS-R	7 years old
SCHIZOPHRENIA	Hearing voices or believing that others are trying to control or harm the person; hallucinations and disorganized speech and behavior, causing individuals to feel frightened, anxious, and confused	12-month Prevalence in the United States Among Adults	ECA	1.1% of adults

Mental Disorder	Signs And Symptoms [11,12,13]	Estimate Description	Surveillance System [14,15,16,17]	Estimate [18]
OTHER MENTAL DISORDERS				
PERSONALITY DISORDERS	Difficulties dealing with other people and participating in social activities; inflexibility, rigidity, and inability to respond to change; deeply ingrained, inflexible patterns of relating, perceiving, and thinking that cause distress or impaired functioning	12-month Prevalence in the United States Among Adults	DSM-IV	9.1% of adults

COMMONLY MISUSED SUBSTANCES

Substance: Examples of Other Names for Substances[19,20,21]	Negative Immediate Intoxication Effects; Negative Health Effects[22,23]	Estimate Description	Estimate[24,25,26]
ALCOHOL, INHALANTS, AND TOBACCO			
ALCOHOL: BOOZE, BEER, WINE, LIQUOR	*Immediate Effects:* Dizziness, talkativeness, slurred speech, disturbed sleep, nausea, vomiting, impaired judgment and coordination, increased aggression, risky behavior including drunk driving, inappropriate sexual behavior, and impaired judgement *Health Effects:* Irregular heartbeat, stroke, high blood pressure; cirrhosis and fibrosis of the liver; mouth, throat, liver, and breast cancer; and for pregnancy, fetal alcohol spectrum disorders	Past-month Use: Rate Among People Aged 12 and Older	50.7%
		Past-month Use: Number of People Aged 12 and Older	136.7 million
		Past-month Use: Rate Among Youth (Aged 12 to 17)	9.2%
		Past-month Use: Number of People Aged 12 to 17	2.3 million
		Average Age of First Use Among People Aged 12 to 49	17.4 years old
INHALANTS (GASES, NITRITES, AND AEROSOLS): ETHER, CHLOROFORM, NITROUS OXIDE, ISOBUTYL, ISOAMYL, POPPERS, SNAPPERS, WHIPPETS, LAUGHING GAS	*Immediate Effects:* Confusion; nausea; slurred speech; lack of coordination; euphoria; dizziness; drowsiness; disinhibition, lightheadedness, hallucinations/ delusions; headaches; sudden sniffing death syndrome due to heart failure (from butane, propane, and other chemicals in aerosols); death from asphyxiation, suffocation, convulsions or seizures, coma, or choking; For nitrites: enlarged blood vessels, enhanced sexual pleasure, increased heart rate, brief sensation of heat and excitement, dizziness, headache *Health Effects:* Liver and kidney damage; bone marrow damage; limb spasms due to nerve damage; brain damage from lack of oxygen that can cause problems with thinking, movement, vision, and hearing; Increased risk of pneumonia (nitrites only); In pregnancy: low birth weight, bone problems, delayed behavioral development due to brain problems, altered metabolism and body composition	Past-month Use: Rate Among People Aged 12 and Older	0.2%
		Past-month Use: Number of People Aged 12 and Older	600,000
		Past-month Use: Rate Among Youth (Aged 12 to 17)	0.6%
		Past-month Use: Number of People Aged 12 to 17	149,000
		Average Age of First Use Among People Aged 12 to 49	18.2 years old

Substance: Examples of Other Names for Substances[19,20,21]	Negative Immediate Intoxication Effects; Negative Health Effects[22,23]	Estimate Description	Estimate[24,25,26]
ALCOHOL, INHALANTS, AND TOBACCO			
TOBACCO PRODUCTS: CIGARETTES, CIGARS, SMOKELESS TOBACCO, SNUFF, SPIT TOBACCO, CHEW	*Immediate Effects:* Increased blood pressure, breathing, and heart rate *Health Effects:* Greatly increased risk of cancer, especially lung cancer when smoked and oral cancers when chewed; chronic bronchitis; emphysema; heart disease; leukemia; cataracts; pneumonia; In pregnancy: miscarriage, low birth weight, stillbirth, learning and behavior problems	Past-month Use: Rate Among People Aged 12 and Older	23.5%
		Past-month Use: Number of People Aged 12 and Older	63.4 million
		Past-month Use: Rate Among Youth (Aged 12 to 17)	5.3%
		Past-month Use: Number of People Aged 12 to 17	1.3 million
		Average Age of First Use Among People Aged 12 to 49	18.0 cigarettes and 20.4 smokeless tobacco
ILLICIT DRUGS			
COCAINE: BLOW, BUMP, C, CANDY, CHARLIE, COKE, CRACK, FLAKE, ROCK, SNOW, TOOT, WHITE LADY	*Immediate Effects:* Narrowed blood vessels; enlarged pupils; increased body temperature, heart rate, and blood pressure; headache; abdominal pain and nausea; euphoria; increased energy, alertness; insomnia, restlessness; anxiety; panic attacks, paranoia, psychosis; heart rhythm problems, heart attack; stroke, seizure, coma *Health Effects:* Loss of sense of smell, nosebleeds, nasal damage and trouble swallowing from snorting; infection and death of bowel tissue from decreased blood flow; weight loss; lung damage from smoking; Additionally, risk of HIV, hepatitis, and other infectious diseases from shared needles; In pregnancy: premature delivery, low birth weight, deficits in self-regulation and attention in school-aged children prenatally exposed	Past-month Use: Rate Among People Aged 12 and Older	0.7%
		Past-month Use: Number of People Aged 12 and Older	1.9 million
		Past-month Use: Rate Among Youth (Aged 12 to 17)	0.1%
		Past-month Use: Number of People Aged 12 to 17	28,000
		Average Age of First Use Among People Aged 12 to 49	21.8 years old

Substance: Examples of Other Names for Substances[19,20,21]	Negative Immediate Intoxication Effects; Negative Health Effects[22,23]	Estimate Description	Estimate[24,25,26]
ILLICIT DRUGS			
ECSTASY (A TYPE OF HALLUCINOGEN): ADAM, E, MOLLY, ROLL, X, XTC	*Immediate Effects:* Lowered inhibition; enhanced sensory perception; increased heart rate and blood pressure; muscle tension; nausea; faintness; chills or sweating; sharp rise in body temperature leading to kidney failure or death *Health Effects:* Long-lasting confusion, depression, problems with attention, memory, and sleep; increased anxiety, impulsiveness; decreased interest in sex	Past-month Use: Rate Among People Aged 12 and Older	0.2%
		Past-month Use: Number of People Aged 12 and Older	619,000
		Past-month Use: Rate Among Youth (Aged 12 to 17)	0.1%
		Past-month Use: Number of People Aged 12 to 17	29,000
		Average Age of First Use Among People Aged 12 to 49	21.4 years old
HALLUCINOGENS: ACID, BOOMERS, DOSES, HITS, LSD, MICRODOT, PEYOTE, SHROOMS, SUGAR CUBES, TABS, TRIPS, PCP	*Immediate Effects:* (With Lysergic acid diethylamide [LSD]) Rapid emotional swings; distortion of a person's ability to recognize reality, think rationally, or communicate with others; raised blood pressure, heart rate, body temperature; dizziness; loss of appetite; tremors; enlarged pupils (With Phencyclidine [PCP]) Delusions, hallucinations, paranoia, problems thinking, a sense of distance from one's environment, anxiety Low doses: slight increase in breathing rate; increased blood pressure and heart rate; shallow breathing; face redness and sweating; numbness of the hands or feet; problems with movement High doses: nausea; vomiting; flicking up and down of the eyes; drooling; loss of balance; dizziness; violence; seizures, coma, and death *Long-Term Heath Effects:* Frightening flashbacks (called Hallucinogen Persisting Perception Disorder); ongoing visual disturbances, disorganized thinking, paranoia, and mood swings	Past-month Use: Rate Among People Aged 12 and Older	0.5% (includes Ecstasy, LSD, and PCP data)
		Past-month Use: Number of People Aged 12 and Older	1.4 million (includes Ecstasy, LSD, and PCP data)
		Past-month Use: Rate Among Youth (Aged 12 to 17)	0.5% (includes Ecstasy, LSD, and PCP data)
		Past-month Use: Number of People Aged 12 to 17	114,000 (includes Ecstasy, LSD, and PCP data)
		Average Age of First Use Among People Aged 12 to 49	19.6 years (includes Ecstasy, LSD, and PCP data)

Substance: Examples of Other Names for Substances[19,20,21]	Negative Immediate Intoxication Effects; Negative Health Effects[22,23]	Estimate Description	Estimate[24,25,26]
ILLICIT DRUGS			
HEROIN: BIG H, BLACK TAR, BROWN SUGAR, DOPE, HORSE, JUNK, SKAG, SMACK, CHINA WHITE HORSE	*Immediate Effects:* Euphoria; dry mouth; itching; nausea; vomiting; analgesia; slowed breathing and heart rate *Health Effects:* Collapsed veins; abscesses; infection of the lining and valves in the heart; constipation and stomach cramps; liver or kidney disease; Additionally, risk of HIV, hepatitis, and other infectious diseases from shared needles; In pregnancy: miscarriage, low birth weight, neonatal abstinence syndrome	Past-month Use: Rate Among People Aged 12 and Older	0.2%
		Past-month Use: Number of People Aged 12 and Older	475,000
		Past-month Use: Rate Among Youth (Aged 12 to 17)	Less than 0.1%
		Past-month Use: Number of People Aged 12 to 17	3,000
		Average Age of First Use Among People Aged 12 to 49	25.5 years old
MARIJUANA/ HASHISH: BLUNT, DOPE, GANJA, GRASS, HERB, JOINT, BUD, MARY JANE, POT, REEFER, GREEN, TREES, SMOKE, SKUNK, WEED	*Immediate Effects:* Enhanced sensory perception and euphoria followed by drowsiness/relaxation; slowed reaction time; problems with balance and coordination; increased heart rate and appetite; problems with learning and memory; anxiety *Long-Term Health Effects:* Mental health problems, chronic cough, frequent respiratory infections	Past-month Use: Rate Among People Aged 12 and Older	8.9%
		Past-month Use: Number of People Aged 12 and Older	24.0 million
		Past-month Use: Rate Among Youth (Aged 12 to 17)	6.5%
		Past-month Use: Number of People Aged 12 to 17	1.6 million
		Average Age of First Use Among People Aged 12 to 49	19.3 years old
METHAMPHETAMINE: CHALK, CRANK, CRYSTAL, ICE, METH	*Immediate Effects:* Increased wakefulness and physical activity; decreased appetite; increased breathing, heart rate, blood pressure, temperature; irregular heartbeat *Long-Term Health Effects:* Anxiety, confusion, insomnia, mood problems, violent behavior, paranoia, hallucinations, delusions, weight loss, severe dental problems ("meth mouth"), intense itching leading to skin sores from scratching	Past-month Use: Rate Among People Aged 12 and Older	0.2%
		Past-month Use: Number of People Aged 12 and Older	667,000
		Past-month Use: Rate Among Youth Aged 12 to 17	Less than 0.1%
		Past-month Use: Number of People Aged 12 to 17	9,000
		Average Age of First Use Among People Aged 12 to 49	24.6 years old

Substance: Examples of Other Names for Substances[19,20,21]	Negative Immediate Intoxication Effects; Negative Health Effects[22,23]	Estimate Description	Estimate[24,25,26]
PRESCRIPTION DRUGS			
OPIOID PAIN RELIEVERS: VIKE (VICODIN®), OXY, O.C. (OXYCONTIN®), DEMMIES, PERCS, OCTAGONS, SIZZURP, CAPTAIN CODY	*Immediate Effects:* Increased risk of overdose or abuse if misused *Health Effects:* Increased risk of overdose, abuse, or neonatal abstinence syndrome if misused	Past-month Use: Rate Among People Aged 12 and Older	1.2%
		Past-month Use: Number of People Aged 12 and Older	3.4 million
		Past-month Use: Rate Among Youth (Aged 12 to 17)	1.0%
		Past-month Use: Number of People Aged 12 to 17	239,000
		Average Age of First Use Among People Aged 12 to 49	24.4 years old
SEDATIVES: AMBIEN®, ZOLPIDEM, LUNESTA®, SONATA®, RESTORIL®, HALCION®, BUTISOL®, NEMBUTAL®, AND MEBARAL®	*Immediate Effects:* Slurred speech, shallow breathing, sluggishness, fatigue, disorientation and lack of coordination, dilated pupils, reduced anxiety, lowered inhibitions *Health Effects:* Seizures; impaired memory, judgment, and coordination; irritability; paranoid and suicidal thoughts; sleep problems	Past-month Use: Rate Among People Aged 12 and Older	0.2%
		Past-month Use: Number of People Aged 12 and Older	497,000
		Past-month Use: Rate Among Youth (Aged 12 to 17)	0.1%
		Past-month Use: Number of People Aged 12 to 17	23,000
		Average Age of First Use Among People Aged 12 to 49	24.8 years old
STIMULANTS: ADDERALL®, RITALIN®, DESOXYN®, DEXEDRINE®, CONCERTA®	*Immediate Effects:* Increased alertness, attention, energy; increased blood pressure and heart rate; narrowed blood vessels; increased blood sugar; opened-up breathing passages; high doses include dangerously high body temperature and irregular heartbeat; heart disease; seizures. *Health Effects:* Seizures; impaired memory, judgment, and coordination; irritability; paranoid and suicidal thoughts; sleep problems	Past-month Misuse: Rate Among People Aged 12 and Older	0.6%
		Past-month Misuse: Number of People Aged 12 and Older	1.7 million
		Past-month Misuse: Rate Among Youth Aged 12 to 17	0.4%
		Past-month Misuse: Number of People Aged 12 to 17	92,000
		Average Age of First Misuse Among People Aged 12 to 49	24.3 years old

Substance: Examples of Other Names for Substances[19,20,21]	Negative Immediate Intoxication Effects; Negative Health Effects[22,23]	Estimate Description	Estimate[24,25,26]
PRESCRIPTION DRUGS			
TRANQUILIZERS: DOWNERS, BENZOS (ATIVAN®, XANAX®, VALIUM®, LIBRIUM®)	*Immediate Effects:* Slurred speech, shallow breathing, sluggishness, fatigue, disorientation and lack of coordination, dilated pupils, reduced anxiety, lowered inhibitions *Health Effects:* Seizures; impaired memory, judgment, and coordination; irritability; paranoid and suicidal thoughts; sleep problems	Past-month Use: Rate Among People Aged 12 and Older	0.7%
		Past-month Use: Number of People Aged 12 and Older	2.0 million
		Past-month Use: Rate Among Youth (Aged 12 to 17)	0.5%
		Past-month Use: Number of People Aged 12 to 17	121,000
		Average Age of First Use Among People Aged 12 to 49	23.9 years old

The following is not an exhaustive list of all available resources. Inclusion of websites and resources in this document and on the *Recovery Month* website does not constitute official endorsement by the U.S. Department of Health and Human Services or the Substance Abuse and Mental Health Services Administration.

[1] Center for Behavioral Health Statistics and Quality. (2017). ***Key substance use and mental health indicators in the United States: Results from the 2016 National Survey on Drug Use and Health,*** NSDUH Series H-52, HHS Publication No. (SMA) 17-5044. Rockville, MD: Substance Abuse and Mental Health Services Administration. Web. 1 November 2017. Retrieved from https://www.samhsa.gov/data/sites/default/files/NSDUH-FFR1-2016/NSDUH-FFR1-2016.pdf

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[27] **Note:** All data on major depressive episodes comes exclusively from the 2016 National Survey on Drug Use and Health, which did not measure average age of onset.

JOIN THE VOICES FOR RECOVERY

Treatment and Recovery Support Services

"I believe there are many pathways to recovery. Faith has been my pathway to recovery. You have to have will. You have to want to change things. Recovery is possible."

- Evan Figueroa-Vargas

Treatment and Recovery Support Services

Recovery Is Possible

Recovery is defined as a process of change through which individuals improve their health and wellness, live a self-directed life, and strive to reach their full potential.[1] There are numerous treatment and recovery options for mental and substance use disorders and each recovery journey is unique. If you, a family member, or a friend needs help, resources are available. You are not alone.

Each September, the Substance Abuse and Mental Health Services Administration (SAMHSA) (https://www.samhsa.gov), within the U.S. Department of Health and Human Services (HHS) (https://www.hhs.gov/), sponsors ***National Recovery Month*** (***Recovery Month***) (https://recoverymonth.gov) to increase awareness of behavioral health conditions. This observance promotes the knowledge that behavioral health is essential to overall health, prevention works, treatment is effective, and people can and do recover from mental and substance use disorders.

The 2018 ***Recovery Month*** theme, "*Join the Voices for Recovery: Invest in Health, Home, Purpose, and Community,*" explores how integrated care, a strong community, sense of purpose, and leadership contributes to effective treatments that sustain the recovery of persons with mental and substance use disorders. The observance will work to highlight inspiring stories that help thousands of people from all walks of life find the path to hope, health, and wellness. In addition, the materials support SAMHSA's message that prevention works, treatment is effective, and people can and do recover.

Connecting Those in Need to Treatment Services

SAMHSA's 2016 National Survey on Drug Use and Health showed:

- About 1 in 13 people (7.8 percent) needed substance use treatment.[2]
- An estimated 44.7 million adults aged 18 or older had any mental illness (AMI) in the United States, representing 18.3 percent of all adults in the United States.[3]
- About half of the adults with co-occurring AMI and a substance use disorder (SUD) in the past year did not receive either type of service.[4]
- Approximately 11.8 million aged 12 or older – 4.4 percent of the total U.S. population aged 12 or older – misused opioids in the past year.[5]

A person with a mental or substance use disorder may find it difficult to reach out for help alone, but families and support networks can help make the connection to appropriate resources. Getting help may improve the chances of managing a behavioral health condition, and reduce or eliminate associated symptoms, and save a life. For example:

- Treatment for depression improves not only psychiatric symptoms, but also a person's quality of life.[6]
- Treatment for substance use disorders can help people stop substance use, avoid relapse, and lead active lives engaged with their families, workplaces, and communities.[7]
- Treating alcohol dependence and addiction reduces the burden on the family budget and improves life for those who live with the alcohol-dependent individual.[8]

Data show that in 2016, individuals with mental and substance use disorders accessed care to begin the recovery process:

- In 2016, 7.2 percent of young adults aged 18 to 25 (or 383,000 individuals) who needed substance use treatment received it in a specialty facility in the past year.[9]
- In 2016, 1.8 million adults aged 26 or older who needed substance use treatment received treatment in a specialty facility in the past year (12.1 percent of this population).[10]
- Among the 44.7 million adults with AMI, 19.2 million (43.1 percent) received mental health services in the past year.[11]
- An estimated 6.9 percent of adults with co-occurring disorders received both mental health care and specialty substance use treatment in the past year.[12]

Treatment and Recovery Support Services

When mental and substance use disorders go unaddressed, they become more complex and more difficult to treat. Intervening early, before behavioral health conditions progress, is among the best and most cost-effective ways to improve overall health. Addressing the mental and substance use disorders in the impacted family members is also a cost-effective way to improve health and will support whole family recovery. Most communities have trained professionals who can help individuals with behavioral health conditions. Treatment can be provided in different settings—including outpatient, residential, and inpatient—based on the disorder and the intensity of care required. Examples of proven and effective treatments include Cognitive-Behavioral Therapy, Community Reinforcement Approach, and medication-assisted treatment (MAT) for opioid or alcohol use disorder using an FDA-approved medication in combination with counseling and other services. Effective approaches to treatment address all aspects of the illness (for example, biological, psychological, and social). For more information about various types of treatment and recovery support services and the benefits of each, visit SAMHSA's Behavioral Health Treatments and Services webpage at https://www.samhsa.gov/treatment and the Recovery and Recovery Support webpage at https://www.samhsa.gov/recovery.

The "Resources" section of this document provides a list of national and local resources, including toll-free numbers that can connect you to prevention, treatment, and recovery support services.

Resources

Many options are available to help people seek treatment and sustain recovery. Whichever path a person chooses, it is important to find the treatment and recovery support that works best for him or her. A variety of organizations that provide information and resources on mental and substance use disorders, as well as prevention, treatment, and recovery support services, are described below. The list includes toll-free numbers and websites where people can find help, obtain information, share experiences, and learn from others. It also includes mobile applications that support treatment and recovery.

Hotlines & Helplines

- **Crisis Text Line** (https://www.crisistextline.org/): Provides 24/7 support for individuals experiencing a crisis via text message.
- **Loveisrespect.org (formerly National Dating Abuse Helpline)** (http://www.loveisrespect.org): Provides an opportunity for teens and young adults to receive support when dealing with an unhealthy or abusive relationship. The site offers online chats, telephone support, and texting with a peer advocate.
- **National Sexual Assault Hotline** (https://www.rainn.org/): Connects callers to a local sexual assault crisis center so they can receive information and support.

- **SAMHSA's National Helpline, 1-800-662-HELP (4357) or 1-800-487-4889 (TDD)** (https://www.samhsa.gov/find-help/national-helpline): Provides a 24/7, 365-day-a-year information and treatment referral service (in English and Spanish) for individuals and families facing mental and substance use disorders.
- **SAMHSA's National Suicide Prevention Lifeline, 1-800-273-TALK (8255)** (https://www.suicidepreventionlifeline.org/): Provides a free, 24-hour helpline available to anyone in suicidal crisis or emotional distress.

Online Resources

- **Al-Anon/Alateen Family Groups** (https://al-anon.org/): Provides support groups for families and friends of people who struggle with alcohol use.
- **Alcoholics Anonymous** (https://www.aa.org/) Lists resources for those experiencing alcohol dependence; helps individuals find and join a local chapter.
- **Association of Recovery High Schools** (https://recoveryschools.org/?reqp=1&reqr): Connects recovery high schools with training, expertise, resources, and best practices to assist every student who is in recovery.
- **Association of Recovery in Higher Education** (https://collegiaterecovery.org/): Provides the education, resources, and community connection needed to help recovering students in higher education.
- **Celebrate Recovery** (https://www.celebraterecovery.com/): Provides support for those in recovery through summits, groups, and church-centered meetings.
- **Depression and Bipolar Support Alliance** (http://www.dbsalliance.org): Serves as the leading peer-directed national organization focusing on the two most prevalent mental health conditions, depression and bipolar disorder.
- **Faces & Voices of Recovery** (http://facesandvoicesofrecovery.org/): Supports the 23 million Americans living in recovery to ensure their rights and access to needed services as well as demonstrates the power and proof of obtaining long-term recovery.
- **Facing Addiction** (https://www.facingaddiction.org/): Creates campaigns and conducts research to change perceptions about addiction and find solutions for recovery across the nation.
- **Hable. Ellos escuchan.** (https://www.samhsa.gov/hable-ellos-escuchan): Provides Spanish language resources to help families prevent drug use and underage drinking.
- **Life Ring** (https://lifering.org): Offers peer-to-peer support and personal strategies to fight addiction to alcohol and drugs.
- **Mental Health America** (https://www.mentalhealthamerica.net/): Offers resources about mental disorders. Through its affiliates, MHA provides America's communities and consumers with direct access to a broad range of self-help and professional services.
- **Narcotics Anonymous** (https://www.na.org/): Lists resources for those experiencing drug dependence; helps individuals find and join a local chapter.
- **National Center on Domestic Violence, Trauma, and Mental Health** (http://www.nationalcenterdvtraumamh.org/): Provides training, support, and consultation to advocates, mental health and substance abuse providers, legal professionals, and policymakers working to improve agency and systems-level responses to survivors of domestic violence.
- **National Council on Alcoholism and Drug Dependence, Inc.** (https://ncadd.org/): Provides numerous resources and services dedicated to fighting alcoholism and drug addiction.

- **National Domestic Violence Hotline, 1-800-799-SAFE (7233)** (http://www.thehotline.org/): Provides confidential, one-on-one support for women, men, children, and families affected by domestic violence. Crisis intervention and support are offered 24/7, 365 days a year with well-trained, compassionate advocates via phone, online chat, text or video phone (for victims who are deaf or hard of hearing).
- **National Institute on Drug Abuse's (NIDA's) What to Do If Your Adult Friend or Loved One Has a Problem with Drugs** (http://www.drugabuse.gov/related-topics/treatment/what-to-do-if-your-adult-friend-or-loved-one-has-problem-drugs): Includes a list of the warning signs of drug misuse as well as resources and information to help someone who might have a drug use problem.
- **NIDA's What to Do If Your Teen or Young Adult Has a Problem with Drugs** (http://www.drugabuse.gov/related-topics/treatment/what-to-do-if-your-teen-or-young-adult-has-problem-drugs): Provides parents of teens/young adults with information on how to identify and handle possible drug misuse situations.
- **Office of the Surgeon General's 2016 Report on Alcohol, Drugs, and Health** (https://addiction.surgeongeneral.gov/sites/default/files/surgeon-generals-report.pdf): Details substance use statistics and the impacts on American citizens and health care systems.
- **Patient and Family Opiate Treatment Guide** (https://eguideline.guidelinecentral.com/i/706017-asam-opioid-patient-piece): Offers facts about treatment related to opiates and provides resources for responding to an opioid overdose.
- **Phoenix Multisport** (https://thephoenix.org): Fosters a supportive, physically active community for individuals who are recovering from a substance use disorder.
- **Psychology Today's Therapy Directory** (https://therapists.psychologytoday.com/rms): Allows individuals to locate, by city or ZIP Code, a therapist, psychologist, or counselor who specializes in mental disorders.
- **SAMHSA's Addiction Technology Transfer Center Network** (http://www.nattc.org/home/): Provides research and information for professionals in the addictions treatment and recovery services field.
- **SAMHSA's Behavioral Health Treatments and Services webpage** (https://www.samhsa.gov/treatment): Contains information on common mental and substance use disorders and explains how SAMHSA helps people access treatments and services.
- **SAMHSA's Decisions in Recovery: Treatment for Opioid Use Disorder** (https://archive.samhsa.gov/MAT-Decisions-in-Recovery): Helps families make informed decisions about treatment for addiction to pain medication or other opioids, such as heroin or fentanyl.
- **SAMHSA's Find Help webpage** (https://www.samhsa.gov/find-help): Provides links and phone numbers to locators of mental and substance use disorder treatment and recovery services.
- **SAMHSA's Information and resources for families and family-based organizations** (https://www.samhsa.gov/brss-tacs/recovery-support-tools/parents-families): Provides resources for families and family-run organizations supporting behavioral health recovery and resilience for children, youth, and adults.
- **SAMHSA's Medication-Assisted Treatment (MAT) page** (https://www.samhsa.gov/medication-assisted-treatment): Offers resources for providers on MAT.
- **SAMHSA's Opioid Overdose Prevention Toolkit** (https://store.samhsa.gov/product/Opioid-Overdose-Prevention-Toolkit/SMA13-4742): Helps communities and local governments develop policies and practices to prevent opioid-related overdoses and deaths. The toolkit addresses issues of interest to first responders, treatment and service providers, and those recovering from an opioid overdose.

- **SAMHSA's Recovery and Recovery Support webpage** (https://www.samhsa.gov/recovery): Provides information on how recovery-oriented care and recovery support systems help people with mental and substance use disorders manage their conditions.
- **SAMHSA's website** (https://www.samhsa.gov): Provides numerous resources and helpful information related to mental and substance use disorders, prevention, treatment, and recovery.
- **Schizophrenia and Related Disorders Alliance of America** (https://sardaa.org): Promotes improvement in lives affected by schizophrenia and schizophrenia spectrum disorders (mental disorders involving psychosis) and promotes hope and recovery through support programs, education, collaboration, and advocacy.
- **Secular Organizations for Sobriety** (https://www.sossobriety.org/): Offers resources to help individuals achieve and maintain sobriety and abstinence from alcohol and drug addiction.
- **SMART Recovery®** (http://smartrecovery.org): Offers a self-empowering addiction recovery support group network with face-to-face and daily online meetings.
- **The Alcohol Treatment Navigator, from the National Institute on Alcohol Abuse and Alcoholism** (https://AlcoholTreatment.niaaa.nih.gov): Provides a step-by-step strategy to inform a search for evidence-based alcohol treatment.
- **The National Child Traumatic Stress Initiative** (https://www.samhsa.gov/child-trauma): Provides information and resources to help identify and address traumatic stress in children, which increases the risk of behavioral health challenges and for a range of medical conditions.
- **Wellbriety Movement** (https://wellbriety.com/): Provides an interconnected online resource across Native Nations about recovery for individuals, families, and communities.
- **Young People in Recovery** (http://youngpeopleinrecovery.org/): Mobilizes the voices of young people in recovery.

SAMHSA Mobile Applications*

- **KnowBullying:** Provides parents and caregivers with information and guidance on ways to prevent bullying and build resilience in children.
- **MATx (medication-assisted treatment):** Offers health care practitioners support with medication-assisted treatment for opioid use disorder.
- **SAMHSA's Behavioral Health Disaster Response App:** Provides responders with access to critical resources, including the Behavioral Health Treatment Services Locator to identify substance use and mental health treatment facility locations.
- **Suicide Safe:** Helps providers integrate suicide prevention strategies into their practice, address suicide risk among their patients, and make referrals to treatment and community resources.
- **Talk. They Hear You.:** Helps parents and caregivers talk to kids (9-15 years old) about the dangers of underage drinking.

Additional Mobile Applications*

- **Dialectical Behavior Therapy Diary Card and Skills Coach:** Provides individuals with self-help skills, reminders of therapy principles, and coaching tools for coping.
- **I Am Sober:** Allows individuals to track their recovery process. It includes features such as a tracker and notifications for new milestones.
- **PTSD Coach:** Provides useful resources for those suffering from PSTD or PTSD symptoms. The app offers education about the signs and symptoms of PTSD, self-care, and how to find support and emergency access to a suicide hotline or to personal contacts. It also offers relaxation skills, positive self-talk, anger management, and other coping skills for symptoms of PTSD. This app was developed by the Department of Veterans Affairs' National Center for PTSD.
- **Reachout:** Provides social support for people with various health conditions, including mental and substance use disorders. Individuals can share their stories, read others' stories, and interact with one another.
- **SAM Self-Help for Anxiety Management:** Encourages individuals to record their anxiety levels and identify triggers. It includes over 20 self-help options for individuals to deal with the physical, emotional, and mental symptoms of anxiety.
- **Sober Grid:** Provides support and information to help those in recovery. This app provides a social network among people who are in recovery.
- **The Addiction Recovery Guide's Mobile App Listing:** Provides descriptions and links to other apps that support recovery, including self-evaluation, recovery programs, online treatment, and chat rooms. The guide is available at: https://www.addictionrecoveryguide.org/resources/mobile_apps
- **Twelve Steps – The Companion:** Provides resources, information, and stories to help individuals through the 12 steps of Alcoholics Anonymous.

This is not an exhaustive list of all available resources.

Inclusion of websites, mobile applications, and resources in this document and on the *Recovery Month* website does not constitute official endorsement by the U.S. Department of Health and Human Services or the Substance Abuse and Mental Health Services Administration.

*Mobile applications can be found by searching for the name in Apple or Android app stores online.

Exhibit B

SYSTEM OF CARE PARTNERS AND RESOURCES

CIT FLORIDA

The Crisis Intervention Team (CIT) promote and support collaborative efforts to create and sustain more effective interactions among law enforcement, mental health care providers, individuals with mental illnesses, their families and communities while reducing stigma of mental illness.

CIT OFFICER

Law enforcement officers receive 40-hours of specialized training on disorders of mental illness, suicide intervention, substance abuse, de-escalation techniques, trauma, the role of the family in the care of a person with mental illness, mental health and substance abuse laws, and local resources for those in crisis.

CIT training is designed to educate and prepare officers to recognize the signs and symptoms of mental illnesses, and to respond more safely and appropriately to individuals in crisis, navigate through the system of care to access services, treatment and resources. Because police officers are most often first responders to mental health emergencies, it is essential that they know how mental illnesses can impact the behaviors and perceptions of individuals. CIT Officers are skilled at de-escalating crises involving people with mental illnesses, while bringing an element of understanding and compassion to these difficult situations.

THE FLORIDA CIT COALITION is a group of individuals representing each of the communities with CIT programs who have joined together to foster excellence in the CIT Program as well as promote the expansion of CIT throughout the State of Florida. For more information email Msaunders416@comcast.net or Hkaba@jud11.flcourts.org

CIT International, Inc. is nonprofit membership organization whose primary purpose is to facilitate understanding, development, and implementation of Crisis Intervention Team (CIT) programs throughout the U.S. and worldwide in order to promote and support collaborative efforts to create and sustain more effective interactions among law enforcement, mental health care providers, individuals with mental illnesses, their families, and communities and to reduce the stigma of mental illness. www.citinternational.org

National Alliance on Mental Illness (NAMI) Florida
www.namiflorida.org
www.namiflorida.org/helpful-resources.php

NAMI Florida's Mission is to improve the quality of life of individuals and their families affected by mental illness through education, support and advocacy. Our vision is that persons with severe and persistent mental illness can recover and lead productive and meaningful lives within their community of choice.

NAMI Florida is the state affiliate of the National Alliance on Mental Illness and has its headquarters in Tallahassee, FL. We have 27 affiliates in communities across Florida providing education, advocacy, and support groups for people with mental illnesses and their loved ones. Each affiliate includes family members, friends, professionals, and consumers whose lives have been impacted by mental illness. Affiliates also help members access psychiatric services, treatment, benefits, medication, and housing.

NAMI Florida began as the Advocates for the Mentally Ill in 1984. Three years later, the organization was incorporated under Florida Alliance for the Mentally Ill and received its IRS non-profit tax status in 1989. In 1998, the corporation's name was changed to NAMI Florida, Inc. The organizations include four divisions that reflect our mission: Education and Training, Information and Referral Services, Consumer Outreach, and Advocacy and Public Awareness.

Training

NAMI Florida coordinates trainings for teachers and facilitators of NAMI's signature programs, which are Family-to-Family, NAMI Basics, Provider Education, Peer-to-Peer, NAMI Connection, Parents and Teachers as Allies, and Hearts and Minds. NAMI's programs are written by professionals and draw on the expertise of family members and consumers living with mental illness. In addition, NAMI Florida hosts conferences and statewide meetings throughout the year.

Information & Referral

NAMI Florida provides Information and referral services through our telephone line (850) 671-4445 and email at NAMI Florida. Hours are 8:30-5:00, Monday–Friday. NAMI Florida maintains a library, publishes a newsletter and family guide, and provides resources on mental health topics.

Advocacy & Public Awareness

NAMI Florida works with state and federal agencies and elected officials to promote recovery and improved treatment for individuals who have a mental illness and their families. NAMI Florida also works collaboratively with other statewide organizations to achieve a better mental health system for all Florida citizens.

Mental Health First Aid (MHFA)

www.mentalhealthfirstaid.org

Mental Health First Aid is an 8-hour course that teaches you how to identify, understand and respond to signs of mental illnesses and substance use disorders. The training gives you the skills you need to reach out and provide initial help and support to someone who may be developing a mental health or substance use problem or experiencing a crisis.

Mental Health First Aid takes the fear and hesitation out of starting conversations about mental health and substance use problems by improving understanding and providing an action plan that teaches people to safely and responsibly identify and address a potential mental illness or substance use disorder.

Florida Department of Children and Families
Substance Abuse and Mental Health Program (SAMH)

www.myflfamilies.com

SAMH Program is the legislatively appointed state authority for substance abuse, mental health, and methadone designation. The program is governed by Chapters 394 and 397 of the Florida Statutes and is responsible for the oversight of a statewide system of care for the prevention, treatment, and recovery of children and adults with serious mental illnesses or substance abuse disorders.

- Assistance
- Treatment
- Prevention
- Crisis Services
- Program Information

Florida Managing Entities (MEs)

The department contracts for behavioral health services through regional systems of care called Managing Entities (MEs). These entities do not provide direct services;

rather, they allow the department's funding to be tailored to the specific behavioral health needs in the various regions of the State. Executed Managing Entity contract documents are available on the Florida Accountability Contract Tracking System (FACTS), maintained by the Florida Department of Financial Services using the links provided.

Big Bend Community Based Care www.bigbendcbc.org/
Serving Bay, Calhoun, Escambia, Franklin, Gadsden, Gulf, Holmes, Jackson, Jefferson, Leon, Liberty, Madison, Okaloosa, Santa Rosa, Taylor, Wakulla, Walton, and Washington counties.

Broward Behavioral Health Coalition https://bbhcflorida.org/
Serving Broward county.

Central Florida Behavioral Health Network, Inc. https://www.cfbhn.org/
Serving Charlotte, Collier, DeSoto, Glades, Hardee, Highlands, Hendry, Hillsborough, Lee, Manatee, Pasco, Pinellas, Polk and Sarasota counties.

Central Florida Cares Health System http://centralfloridacares.org/
Serving Brevard, Orange, Osceola and Seminole counties.

Lutheran Services Florida https://www.lsfnet.org/
Serving Alachua, Baker, Bradford, Citrus, Clay, Columbia, Dixie, Duval, Flagler, Gilchrist, Hamilton, Hernando, Lake, Lafayette, Levy, Marion, Nassau, Putnam, St. Johns, Sumter, Suwannee, Union and Volusia counties.

South Florida Behavioral Health Network, Inc. https://sfbhn.org/
Serving Miami-Dade, Monroe counties.

Southeast Florida Behavioral Health Network https://www.sefbhn.org/
Serving Indian River, Martin, Okeechobee, Palm Beach and St. Lucie counties.

Mobile Response Teams – Florida

Call your Managing Entity and inquire if there is a Mobile Response Team in your area

Mobile Response Teams provide immediate assessment, intervention, recommendations, referral and support services by licensed clinicians. They also link individuals to appropriate community resources, typically on a 24-hours per day, 7-days a week basis.

Mobile Response Teams are designed to be accessible to anyone in the community at any time. Families and friends of an individual experiencing a mental health crisis can call a crisis team to assist and support their loved one. Many of the families who use the crisis team are parents of children and adolescents. Response teams are available to anyone, regardless of their ability to pay and must be ready to respond to any mental health emergency.

A mental health crisis can be an extremely frightening and difficult experience for both the individual in crisis and those around him/her. Loved ones and caregivers are often ill-equipped to handle these situations and need the advice and support of professionals. All too frequently, law enforcement or EMTs are called to respond to mental health crises and they often lack the training and experience to effectively handle the situation. Mobile Response Teams have the training and know-how to help resolve mental health crises.

By intervening early, Mobile Response Teams can help prevent costly and unnecessary stays in hospitals and jails. They are also effective in connecting people with the community mental health system who had not accessed treatment and services before.

A crisis can occur any hour of any day. It can be caused by a variety of factors. Mobile Response Teams provide an invaluable service to the community by offering immediate intervention to individuals experiencing a psychiatric crisis. Early intervention can efficiently stabilize acute situations.

Military Veterans
Veterans Crisis Line 1.800.273.8255 press 1
Text 838255

Crisis Text Line
Text NAMI to 741-741 to connect with a trained crisis counselor to receive free, 24/7 crisis support via text message.

National Suicide Prevention Lifeline
If you or someone you know is in crisis—whether they are considering suicide or not—please call the toll-free Lifeline at 800-273-TALK (8255) to speak with a trained crisis counselor

2-1-1
In July 2000, the Federal Communications Commission (FCC) reserved the 211 dialing code for community information and referral services. The FCC intended the 211 code as an easy-to-remember and universally recognizable number that would enable a critical connection between individuals and families in need and the appropriate community-based organizations and government agencies. Currently, active 211 systems cover all or part of 50 states.

The U.S. Department of Health and Human Services
Substance Abuse and Mental Health Services Administration
www.samhsa.gov

The National Institute of Mental Health (NIMH)
www.nimh.nih.gov

Exhibit C

Miami-Dade County Crisis Intervention Team (CIT)

Family/Provider Guide for Involuntary Inpatient Mental Health Assessment

Florida Statute 394 (Mental Health, Baker Act)
Florida Administrative Code 65E-5

If you sense changes in your loved one, family member or friend's mental health, talk to them to try and understand what they are experiencing. While everyone occasionally has a bad day there are often early warning signs that can signal greater reasons for concern, such as, changes in sleep or social activities, increased hostility/agitation or reported feelings of loneliness, sadness and suspiciousness. One option is to try to encourage him/her to voluntarily see a psychiatrist, psychologist or social worker. The purpose is to prevent a crisis. However, if the individual has become a threat to him/herself or others, and is *not willing to receive treatment voluntarily*, crisis intervention may be necessary, which can be provided by any of the following options.

- Licensed Mental Health Professional
    - Mobile Crisis Team
- Ex Parte Baker Act Order
- Law Enforcement

Each option will require Law Enforcement involvement at a certain point, therefore, it is important to be familiar with the Crisis Intervention Team (CIT). Most local Law Enforcement agencies have Crisis Intervention Teams. CIT officers receive 40-hours of specialized training intended to increase their understanding of mental illness and addiction disorders, permitting for more effective communication when assisting a person in crisis. CIT training teaches recognition of the signs and symptoms of mental illness, de-escalation techniques, and knowledge of the community resources in Miami-Dade County's behavioral health system for linkage to treatment.

The CIT program is a collaborative effort among law enforcement, families, the mental health community and other advocates. The goal is to improve officer and citizen safety and more effectively meet the needs of individuals with mental illness and their families. CIT Officers are here to assist.

- **Licensed Mental Health Professional** s.394.463F.S.

A Physician, Clinical Psychologist, Psychiatric Nurse, Mental Health Counselor, Marriage and Family Therapist, Clinical Social Worker or Physician's Assistant may execute a certificate stating that he or she has examined a person within the preceding 48 hours and finds that the person appears to meet the criteria for involuntary examination. A professional who is familiar with the person is best but not required.

Mobile Response Team

Banyan Health Systems
(305) 774-3616 (17)

http://www.banyanhealth.org/services/programs/24-hour-crisis-services

The Mobile Response Team consists of Licensed Mental Health Professionals who will visit the home, school or other location as needed 24/7 (response time may be up to 60 minutes). The professional will assess the person in crisis and determine if a person meets criteria for evaluation or alternative services. If the team decides to initiate a Baker Act, Law Enforcement will be contacted to assist with transport. This team is unable to address medical concerns and is a non-emergency service. Please dial 911 if experiencing a life-threatening emergency. (See next page for more tips)

- **Ex parte Baker Act Order** s.394.463 F.S.

Family or providers (petitioner) who witness behavior indicating that an individual is a threat to self or others can visit the **probate court** and request an order for involuntary examination M-F before 3pm:
Dade County Courthouse
73 W. Flagler Street
Miami, Florida 33130 Room 234
http://www.miami-dadeclerk.com/families_probate_baker_act.asp

Once the order is obtained the petitioner will then need to be with the Order, and person in crisis, when police are called/arrive. The caller should advise the dispatcher that they have an **Ex parte Baker Act Order** signed by a judge and that they would like a trained CIT Officer to assist. (See next page for more tips)

- **Law Enforcement** s. 394.463 F.S.

Law Enforcement Officers can assess and transport an individual, meeting criteria for an Involuntary Examination, to a receiving facility. It is appropriate to contact 911 when there is an incident that requires immediate medical attention or assistance involving dangerous behaviors. (See next page for more tips)

Communication with Treatment Facility

Once transported, the family/provider can prepare a written history for the psychiatrist. It is important that this information be submitted either at transport or within hours since the physician will be making decisions soon after arrival.

Written is best because it can be included in the person's medical record. That ensures that the information is accessible and available for review by each member of the treatment team throughout the treatment process. (See page 3 for more detailed guide)

Rev. 06/2018

Interaction with Law Enforcement and Treatment Facilities

Calling 911

Having to call 911 is an extremely stressful situation. It is by definition an emergency. You want to make sure that you give law enforcement enough information so that they will be able to respond effectively and safely. It can be difficult to provide that information when the caller is understandably upset about the current situation.
Try to control the volume of your voice. This can be a very emotionally charged time and if the Operator can cannot understand the information being provided it is not efficiently received. As calmly and clearly as possible, provide information to the Operator and try to answer the Operator's questions, follow any directions you are given, and tell the Operator the following:

1. Your name and address
2. That the person has a mental health issue
   Request a Crisis Intervention Trained (CIT) officer, if available
3. Name of person with mental health issue
4. Your relationship to the person
5. Person's diagnosis
6. Any medication being used
7. Has medication stopped? How long?
8. Describe what the person is doing now.
9. Do you feel threatened?
10. Is there a history of violent acting out?
11. Does the person hear voices?
12. Does the person have fears?
13. Location of person in house?
14. Are there weapons available? (Try to remove them if safe to do so.)

When Law Enforcement Arrives

Officers responding to a 911 emergency call are very focused when they arrive on the scene. First, they will make the scene safe for you, the patient, and themselves. The more informed that the officers are the better likelihood that someone will get the help and support that they require.
Have all the lights in the house turned on so that all occupants can be clearly visible to the arriving officers. Have nothing in your hands if you come out of the house to meet the officers. Do not run up to the officers. They do not know what your involvement is and anything you may carry can possibly be interpreted as a weapon. It is essential that the officers responding to the emergency call assess the current situation and establish an understanding of the environment, everyone involved and whether there is any current level of potential threat. As calmly as possible, identify yourself. Tell the officers:

1. Who you are
2. If there are weapons involved
3. Provide any documents such as court order
4. Who you have called about
5. That the person has a mental illness
6. Your relationship to the person with a mental illness
7. What kind of mental illness it is
8. What medication is being taken
9. Has medication stopped? How long?
10. Is the person violent or delusional/paranoid?
11. History of suicide attempts?
12. The attending psychiatrist's or case manager's names, if any, and their phone #s

Although it can be difficult to do in times of crisis, being calm and patient are essential for a successful outcome. Spend time answering the officers' questions because this information can be crucial when relayed to treatment providers. Answer questions as directly and concisely as you are able. Offer any advice or insight you deem helpful. ** This information was provided courtesy of NAMI California.*

Communication with Treatment Facilities

The intention of submitting a written document is to provide additional information to assist the treating psychiatrist to more accurately complete a comprehensive mental health assessment for the patient. Physicians' schedules are often long hours, sometimes overnight or very early morning and is primarily dedicated to speaking with the patient. This makes speaking with physicians difficult for family and providers.

As much as possible the information should consist of facts only and should be provided to the hospital as soon as possible upon patient arrival.

Preferably no more than 2 pages typed. Use bullets whenever possible.

Bulleted items below are areas of high interest, using these labels may help the intended reader to get to the information of interest. Be sure to include your contact information.

- **Patient Name**
- **Writer's Name**, Contact Information and relationship to patient
- **Patient's current living situation** (i.e. Living with family, homeless, etc.) include address, phone number and how long the patient has resided there. If the patient has had several living situations in the last 6 months indicate why
- **Behaviors of concern** in the recent past (emphasis on the last few weeks) include any behaviors that are considered immediate danger to patient or others (keep brief, but enough detail to get your point across)
- **List of medications** patient is currently prescribed and list taken in past and how patient reacted (include allergies to medications)
- **Date or age of onset** of symptoms, list of symptoms
- Any **Advanced Directives** written by the patient (provide copy if available)
- Any **previous hospitalizations** with admission and discharge dates and name of hospital and treating psychiatrist (if known)
- Any **previous outpatient treatment** with dates and treating psychiatrist (if known)
- **Previous Diagnosis** given, date and name of psychiatrist
- **Family history of mental health diagnosis** including relationship to patient (i.e. Maternal grandmother- schizophrenia)
- **Schooling completed** i.e. High school graduate, completed to 6th grade, etc.
- **History of substance abuse** list name of substance, frequency of use, date last used or if none state "none"
- **History medical issues**
- **History of incarcerations**
- **History of compliance** with treatment when in community (focus on the last few weeks)

Once an individual is admitted into treatment, it may not always be possible for family and friends to receive updates from the facility due to privacy laws. The patient will need to sign a release agreeing to sharing of information, with the exception of minors and Legal Guardianship.

The Health Insurance Portability and Accountability Act of 1996 (HIPPA) addresses disclosure of an individual's health information and privacy rights.

Baker Act Receiving Facilities - Adults

Aventura Hospital and Medical Center
20900 Biscayne Blvd.
Miami, FL 33180
305 682-7000

Banyan Health Systems
3800 West Flagler Street
Miami, FL 33134
305 757-0602

Citrus Health Network
4175 West 20th Avenue
Hialeah, FL 33012
305 825-0300

Community Health of South Florida (CHI)
10300 SW 216th Street
Cutler Bay, FL 33190
305 253-5100

Jackson Behavioral Health Hospital
1695 NW 9th Avenue
Miami, FL 33136
305 355-8234

Jackson Community Mental Health Center
15055 NW 27th Avenue
Opa Locka, FL 33054
786 466-2834

Jackson South Community Hospital
9333 SW 152nd Street
Miami, FL 33157
305 251-2500

Kendall Regional Medical Center
11750 SW 40th Street
Miami, FL 33175
305 227-5500

Larkin Community Hospital
7031 SW 62nd Avenue
South Miami, FL 33143
305 284-7500

Mount Sinai Medical Center
4300 Alton Road
Miami Beach, FL 33140
305 674-2121

North Shore Medical Center
1100 NW 95th Street
Miami, FL 33150
305 835-6000

Palmetto General Hospital
2001 West 68th Street
Hialeah, FL 33016
305 823-5000

Southern Winds Hospital
4225 West 20th Avenue
Hialeah, FL 33012
305 558-9700

University of Miami Hospital
1400 NW 12th Avenue
Miami, FL 33136
305 689-5511

Veterans Affairs Healthcare System
1201 NW 16th Street
Miami, FL 33125
305 575-3214

Westchester General Hospital
2500 SW 75th Avenue
Miami, FL 33155
305 264-5252

Baker Act Receiving Facilities - Minors

Citrus Health Network
4175 West 20th Avenue
Hialeah, FL 33012
305 825-0300

Jackson Behavioral Health Hospital
1695 NW 9th Avenue
Miami, FL 33136
305 355-8234

Larkin Community Hospital
7031 SW 62nd Avenue
South Miami, FL 33143
305 284-7500

Nicklaus Children's Hospital
3100 SW 62nd Avenue
Miami, FL 33155
305 666-6511

Miami-Dade Equipo de Intervención en Crisis (CIT)

Guía de evaluación involuntaria de salud mental para familias y proveedores

Florida Statute 394 (Mental Health, Baker Act)
Florida Administrative Code 65E-5

Si observa cambios en la salud mental de su ser querido, familiar o amigo, intente asistir persona a comprender lo que está sintiendo. Mientras que todos ocasionalmente tenemos un mal día, a menudo hay señales tempranas de advertencia que pueden indicar mayores motivos de preocupación, como cambios en el sueño o actividades sociales, aumento en hostilidad / agitación o sentimientos de soledad, tristeza y desconfianza. Una opción es tratar de animarlo a que vea voluntariamente a un psiquiatra, psicólogo o trabajador social. El propósito es prevenir una crisis. Sin embargo, si el individuo se ha convertido en una amenaza para sí mismo o para otros y *no está dispuesto a recibir tratamiento de forma voluntaria,* puede ser necesario una intervención en caso de crisis, que puede ser proporcionada por cualquiera de las siguientes opciones.

- Profesional de Salud Mental con Licencia
  - Equipo de Crisis Móvil
- Orden de la Ley Ex Parte Baker (Baker Act)
- Oficial de Policía

Cada opción requerirá la participación de un oficial de policía en un cierto punto, por lo tanto, es importante estar familiarizado con el Equipo de Intervención en Crisis (CIT, por sus siglas en inglés). La mayoría de las agencias locales de policía tienen equipos de intervención en casos de crisis. Los oficiales de CIT reciben 40 horas de capacitación especializada con la intención de aumentar su comprensión de las enfermedades mentales y los trastornos de adicción, lo que permite una comunicación más efectiva cuando se ayuda a una persona en crisis. La capacitación de CIT enseña el reconocimiento de los signos y síntomas de la enfermedad mental, las técnicas de desescalar y el conocimiento de los recursos de la comunidad en el sistema de salud conductual del condado de Miami-Dade para vincularlos con el tratamiento.

El programa CIT es un esfuerzo de colaboración entre oficiales de policía, las familias, la comunidad de salud mental y otros defensores. El objetivo es mejorar la seguridad de los oficiales y ciudadanos y cumplir de manera más efectiva las necesidades de las personas con enfermedades mentales y sus familias. Los oficiales de CIT están aquí para ayudar.

- **Profesional de Salud Mental con Licencia**

  s.394.463F.S.

Un médico, psicólogo, enfermero psiquiátrico, consejero de salud mental, terapeuta matrimonial y familiar, trabajador social o asistente médico pueden emitir un certificado que indique que ha examinado a una persona dentro de las 48 horas anteriores y descubre que la persona parece encontrarse los criterios para el examen involuntario. Un profesional que esté familiarizado con la persona es el mejor, pero no obligatorio.

Equipo de Crisis Móvil

Banyan Health Systems
(305) 774-3616 (17)

http://www.banyanhealth.org/services/programs/24-hour-crisis-services

El Equipo de crisis móvil está compuesto de profesionales de salud mental con licencia que visitarán el hogar, la escuela u otro lugar según sea necesario las 24 horas, todos los días (el tiempo de espera puede ser de hasta 60 minutos). El profesional evaluará a la persona en crisis y determinará si una persona cumple con los criterios de evaluación o servicios alternativos. Si el equipo decide iniciar una Ley Baker, se contactará a la Policía para ayudar con el transporte. Este equipo no puede abordar problemas médicos y no es un servicio de emergencia. Marque 911 si tiene una emergencia. (Consulte la página siguiente para obtener más consejos)

- **Orden de la Ley Ex Parte Baker** s.394.463 F.S.

Los familiares o proveedores que presencien un comportamiento que indique que un individuo es una amenaza para sí mismo o para otros, pueden visitar el tribunal de sucesiones y solicitar una orden de examen involuntario L-V antes de las 3:00p.m.

Dade County Courthouse
73 W. Flagler Street
Miami, Florida 33130 Habitación 234

http://www.miami-dadeclerk.com/families_probate_baker_act.asp

Una vez que se obtiene la orden, el peticionario (persona que solicita la orden) deberá estar con la Orden y con la persona en crisis, cuando se llame o llegue la policía. La persona que llama debe avisar al despachador que tiene una orden de la Ley de Baker ex parte firmado por un juez y que les gustaría que despachen un Oficial CIT capacitado. (Consulte la página siguiente)

- **Oficial de Policía** s. 394.463 F.S.

Los oficiales de policía pueden evaluar y transportar a un individuo que cumpla con los criterios para un examen involuntario a un hospital. Es apropiado contactar al 911 cuando hay un incidente que requiere atención médica inmediata o asistencia que involucra comportamientos peligrosos. (Consulte la página siguiente)

Comunicación con el hospital

Una vez transportado, la familia / proveedor puede preparar un historial escrito para el psiquiatra. Es importante que esta información se envíe ya sea en el transporte o en unas horas, ya que el médico tomará decisiones poco después de llegar.

Información escrita es mejor porque se puede incluir en el registro médico de la persona. Eso asegura que la información esté accesible y disponible para su revisión por parte de cada miembro del equipo de tratamiento durante todo el proceso de tratamiento. (Consulte la página 3 para obtener una guía más detallada)

Interaccion con Oficiales de Policia y Hospitales

Llamada al 911

Tener que llamar al 911 es una situación extremadamente estresante. Es por definición una emergencia. Deben asegurarse de brindar a los oficiales de la policía suficiente información para que puedan responder de manera efectiva y segura. Puede ser difícil proporcionar esa información cuando la persona que llama está comprensiblemente molesta por la situación actual.

Intente controlar el volumen de su voz. Este puede ser un momento emocionalmente cargado y si el Operador no puede entender la información que se le proporciona, no se comunicará de manera eficiente. Con la mayor calma y claridad posible, brinde información al Operador e intente responder las preguntas del Operador, siga siguiendo las instrucciones que le den y dígale al Operador lo siguiente:

1. Su nombre y dirección
2. Que la persona tiene un problema de salud mental

Solicite un oficial de policía capacitado en Intervención de Crisis (CIT, por sus siglas en inglés), si está disponible

3. Nombre de la persona con problema de salud mental
4. Su relación con la persona
5. Diagnóstico de la persona
6. Cualquier medicamento que se use
7. ¿Ha dejado de tomar el medicamento? ¿Por cuánto tiempo?
8. Describa lo que la persona está haciendo ahora, en este momento.
9. ¿Te sientes amenazado?
10. ¿Hay un historial de comportamiento violento?
11. ¿La persona escucha voces?
12. ¿Le tiene miedo la persona?
13. Ubicación de la persona en la casa.
14. ¿Hay armas disponibles? (Intente eliminarlos si es seguro hacerlo).

Cuando llegue el Oficial de Policía

Los oficiales de la policía que responden a una llamada de emergencia al 911 están muy concentrados cuando llegan al lugar de los acontecimientos. En primer lugar, se asegurarán que el sitio esté seguro para usted, el paciente y ellos mismos. Mientras más informados estén los oficiales, será más fácil obtener la ayuda y el apoyo necesarios

Tenga todas las luces de la casa encendidas para que todos los ocupantes puedan ser claramente visibles para los oficiales que lleguen. No tenga nada en sus manos al salir de la casa para reunirse con los oficiales. No corras hacia los oficiales. Ellos no saben cuál es su participación y todo lo que lleven puede interpretarse como un arma.

Es esencial que los oficiales que respondan a la llamada de emergencia evalúen la situación actual y establezcan entendimiento del entorno, de todos los involucrados y si existe algún nivel actual de amenaza.

Con la mayor calma posible, Identifíquese Dígale a los oficiales:

1. Quién es
2. Si hay armas involucradas
3. Proporcione cualquier documento, como una orden judicial
4. Nombre de la persona con problema de salud mental
5. Que la persona tiene una enfermedad mental
6. Su relación con la persona con una enfermedad mental
7. ¿Qué tipo de enfermedad mental se trata?
8. ¿Qué medicamento se está tomando?
9. ¿Ha detenido la medicación? ¿Cuánto tiempo?
10. ¿Se trata de una persona violenta o paranoica?
11. ¿Historial de intentos de suicidio?
12. Los nombres del psiquiatra asistente o del administrador de caso, si los hay, y sus números de teléfono.

Aunque puede ser difícil de hacer en momentos de crisis, calmarse y ser paciente es crucial cuando se transmita a los proveedores de tratamiento. Responda a las preguntas de la manera más directa y concisa posible. Ofrezca cualquier consejo o idea que considere útil. **Esta información fue proporcionada por cortesía de NAMI California.*

Interaccion con Oficiales de Policia y Hospitales

Comunicación con Hospitales

La intención de presentar un documento escrito es proporcionar información adicional para ayudar al psiquiatra que realiza el tratamiento a completar con más precisión una evaluación integral de salud mental para el paciente. Los horarios de los médicos son a menudo largas horas, a veces durante la noche o muy temprano en la mañana y se dedica principalmente a hablar con el paciente. Esto hace que poder hablar con los médicos sea difícil para la familia y los proveedores.

En la medida de lo posible, la información debe consistir solamente en hechos y debe ser proporcionada al hospital tan pronto como sea posible después de la llegada del paciente.

Preferiblemente no más de 2 páginas escritas. Use listas siempre que sea posible. **Si es posible escribir en inglés, es preferible.**

La siguiente lista incluye áreas de gran interés, el uso de estas etiquetas puede ayudar al lector a acceder a la información de interés. Asegúrese de incluir su información de contacto.

- **Nombre del paciente**
- **Nombre del escritor**, información de contacto y relación con el paciente
- **La situación de vida actual del paciente** (es decir, vivir con la familia, sin hogar, etc.) incluye la dirección, el número de teléfono y el tiempo que el paciente ha vivido allí. Si el paciente ha tenido varios cambios de situaciones de vida en los últimos 6 meses, indique por qué
- **Los comportamientos de preocupación** en el pasado reciente (énfasis en las últimas semanas) incluyen cualquier conducta que se considere un peligro inmediato para el paciente u otros (manténgase breve, pero con suficiente detalle para expresar su opinión)
- **Lista de medicamentos** que actualmente se recetan al paciente y una lista tomada en el pasado y cómo reaccionó el paciente (incluidas las alergias a los medicamentos)
- **Fecha o edad de inicio** de los síntomas, lista de síntomas
- **Declaración anticipada de Tratamiento** escritas por el paciente (proporcione una copia si está disponible)
- Cualquier **hospitalización previa** con las fechas de ingreso y alta y el nombre del hospital y psiquiatra tratante (si se conoce)
- Cualquier **tratamiento ambulatorio previo** con las fechas y el tratamiento del psiquiatra (si se conoce)
- **Diagnóstico previo** dado, fecha y nombre del psiquiatra
- **Antecedentes familiares de diagnóstico** de salud mental, incluida la relación con el paciente (es decir, abuela materna, esquizofrenia)
- **Nivel de educación alcanzada**, es decir, graduado de la escuela secundaria, completado hasta el grado 6, etc.
- **Historial de abuso de sustancias-** nombre de la sustancia, frecuencia de uso, fecha de última utilización o si ninguno indica "ninguno"
- **Historia de problemas médicos**
- **Historia de encarcelamientos**
- **Historial de cumplimiento del tratamiento** cuando está en la comunidad (enfoque en las últimas semanas)

Una vez que una persona es admitida en el tratamiento, no siempre es posible que familiares y amigos reciban información de la disposición debido a las leyes de privacidad. El paciente puede firmar un comunicado aceptando compartir la información, con la excepción de los menores y el guardián legal.

La Ley de Portabilidad y Responsabilidad del Seguro Médico de 1996 (HIPPA) aborda la divulgación de la información de salud y los derechos de privacidad de una persona.

Baker Act Receiving Facilities - Adultos

Aventura Hospital and Medical Center
20900 Biscayne Blvd.
Miami, FL 33180
305 682-7000

Banyan Health Systems
3800 West Flagler Street
Miami, FL 33134
305 757-0602

Citrus Health Network
4175 West 20th Avenue
Hialeah, FL 33012
305 825-0300

Community Health of South Florida (CHI)
10300 SW 216th Street
Cutler Bay, FL 33190
305 253-5100

Jackson Behavioral Health Hospital
1695 NW 9th Avenue
Miami, FL 33136
305 355-8234

Jackson Community Mental Health Center
15055 NW 27th Avenue
Opa Locka, FL 33054
786 466-2834

Jackson South Community Hospital
9333 SW 152nd Street
Miami, FL 33157
305 251-2500

Kendall Regional Medical Center
11750 SW 40th Street
Miami, FL 33175
305 227-5500

Larkin Community Hospital
7031 SW 62nd Avenue
South Miami, FL 33143
305 284-7500

Mount Sinai Medical Center
4300 Alton Road
Miami Beach, FL 33140
305 674-2121

North Shore Medical Center
1100 NW 95th Street
Miami, FL 33150
305 835-6000

Palmetto General Hospital
2001 West 68th Street
Hialeah, FL 33016
305 823-5000

Southern Winds Hospital
4225 West 20th Avenue
Hialeah, FL 33012
305 558-9700

University of Miami Hospital
1400 NW 12th Avenue
Miami, FL 33136
305 689-5511

Veterans Affairs Healthcare System
1201 NW 16th Street
Miami, FL 33125
305 575-3214

Westchester General Hospital
2500 SW 75th Avenue
Miami, FL 33155
305 264-5252

Baker Act Receiving Facilities – Menores de edad

Citrus Health Network
4175 West 20th Avenue
Hialeah, FL 33012
305 825-0300

Jackson Behavioral Health Hospital
1695 NW 9th Avenue
Miami, FL 33136
305 355-8234

Larkin Community Hospital
7031 SW 62nd Avenue
South Miami, FL 33143
305 284-7500

Nicklaus Children's Hospital
3100 SW 62nd Avenue
Miami, FL 33155
305 666-6511

Exhibit D

2016 National Survey on Drug Use and Health

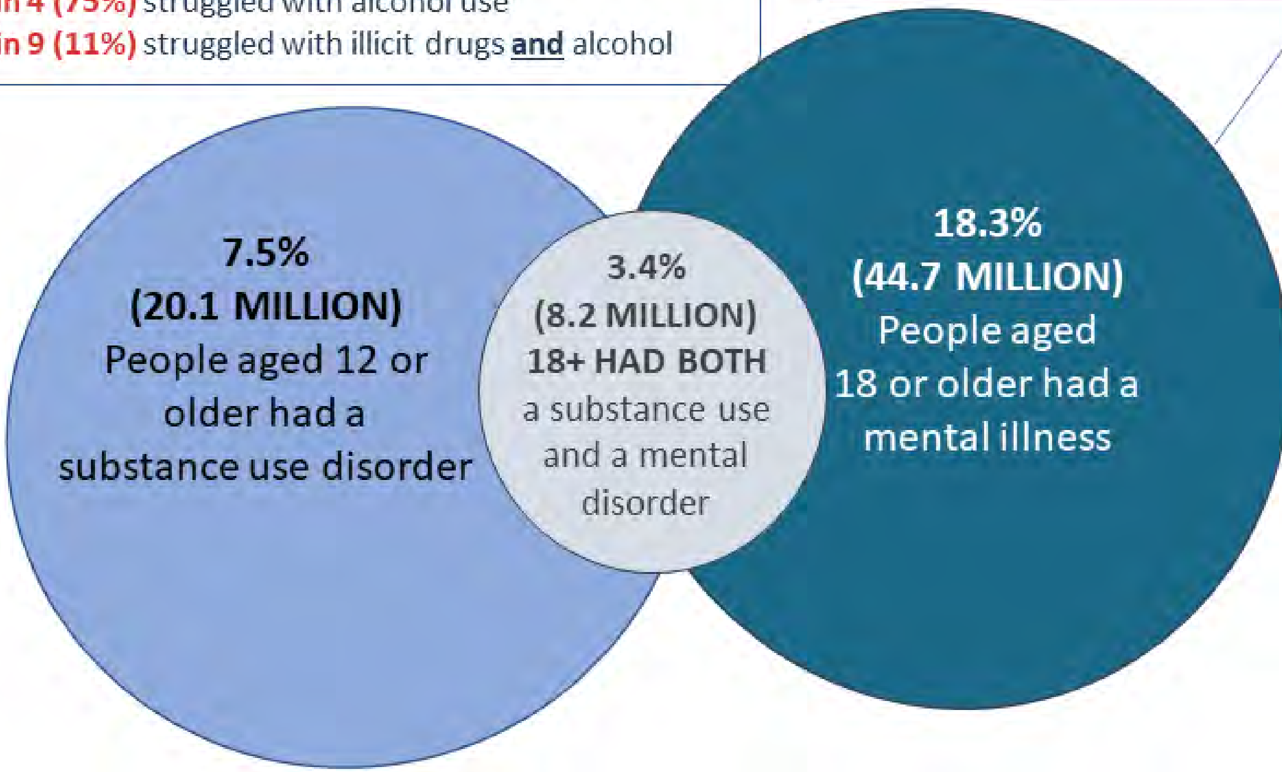
MENTAL AND SUBSTANCE USE DISORDERS IN AMERICA: 2016

Among those with a substance use disorder about:

- **1 in 3 (33%)** struggled with illicit drugs
- **3 in 4 (75%)** struggled with alcohol use
- **1 in 9 (11%)** struggled with illicit drugs **and** alcohol

Among those with a mental illness about:

1 in 4 (25%) had a serious mental illness



Over 2 million in jails and prisons
50% with SUDs
(http://www.prisonerhealth.org)
15-20% with SMI
Torrey EF, et al. 2014

SAMHSA
Substance Abuse and Mental Health Services Administration

Exhibit E

Consequences of Untreated Serious Mental Illness

- Over 11 million with serious mental illness; numbers with suicidality/homicidality/grave disability are relatively small but important
- 140,000 SMI homeless (250K with AMI are homeless) (HUD, 2015)
- 392,000 SMI incarcerated (265,455 SMI in prisons, 125,582 SMI in jails) (26,000 are for murder) (Glaze and Parks, 2012)
- 755,360 SMI on probation or parole (2,360,500 AMI on probation/parole) (Teplin et al., 2005)
- 25% of SMI (3 million) were victims of a violent crime in past year, 11X higher than the general population (Desmarais, et al., 2014)
- Lifetime risk of suicide: schizophrenia 5%; bipolar disorder 10-15%
  (K Hor and M Taylor, 2010)
- Lack of attention for physical health problems contribute to early death; on average 10 years earlier than the general population

SAMHSA
Substance Abuse and Mental Health Services Administration

AVOIDING TRUSTEE LIABILITY FOR TERMINATING TRUST DISTRIBUTIONS

By

Jack A. Falk, Coral Gables

AVOIDING TRUSTEE LIABILITY
FOR TERMINATING TRUST DISTRIBUTIONS

By: JACK A. FALK, JR.
Dunwody White & Landon, P.A.

When an event triggers the termination of a trust, the first thing on the minds of beneficiaries is distributions. For the trustee, things are not so simple. A trustee must administer the trust and that often means retaining professionals, serving notices, paying creditors and taxes, managing assets in the interim and ultimately making distributions. The process of administering a trust after a triggering event can often be lengthy so a trustee must consider whether interim, partial distributions are properly made and determine a proper reserve that should be held until certain or all matters are resolved. This presentation will explore a trustee's powers and duties and a beneficiary's rights concerning terminating distributions and how a trustee can seek to avoid or minimize the risk of liability in connection with this process.

A. When does the trustee have to make distributions and how does the trustee prudently avoid liability for improper distributions?

The interplay between making distributions and reserving assets for the payment of debts, taxes and expenses of administration is generally set out in section 736.0817, Florida Statutes. It says this:

> "Upon the occurrence of an event terminating or partially terminating a trust, the trustee shall proceed expeditiously to distribute the trust property to the persons entitled to the property, subject to the right of the trustee to retain a reasonable reserve for the payment of debts, expenses and taxes. The provisions of this section are in addition to and are not in derogation of the rights under the common law with respect to final distribution of a trust."

The statute was enacted with the adoption of the Florida Trust Code to become effective in 2007. While the statute imposes an obligation on the trustee to "proceed expeditiously to distribute" trust property to beneficiaries, the obligation is explicitly made "subject to the right of the trustee" to retain a reasonable reserve. The plain language of the statute suggests that a trustee is not required to make a distribution if expenses of administration are expected in an amount that would result in insufficient assets to make a required distribution.

The last sentence of the statute invites us to consider the common law on a final distribution of a trust. If this were not apparent, the Staff Analysis for the bill makes it abundantly clear: "The final sentence of the section stating that 'the provisions of the section are in addition to and are not in derogation of the rights of a trustee under the common law with respect to final distribution of a trust' are intended to insure that this section does not override the holdings of cases such as *First Union Nat'l Bank v. Jones*, 768 So. 2d 1213 (Fla. 4th DCA 2000) and *Merrill Lynch Trust Co. v. Alzheimer's Lifeliners Ass'n, Inc.*, 832 So. 2d 948 (Fla. 2d DCA 2002)." *See also* section 736.0106, Fla. Stat. (the "common law of trusts and principles of equity supplement this code, except to the extent modified by this code or another law of this state.").

The statute as such left room for attorneys to argue how the rulings in those two cases apply to distributions in other cases. Thus, it is helpful to understand the contours of each case. In *Jones*, the residuary trust beneficiaries sued the trustee for alleged mismanagement of the trust after the grantor's death. While the case was pending, the trial court entered an order directing total disbursement of the trust assets to the beneficiaries. The trustee appealed and the Fourth District reversed. The court explained that because there were at least two statutory grounds on which the trustee *might* be entitled to recover attorney fees payable from trust assets, the trial court improperly ordered payment of final distributions.

The Fourth District in *Jones* explained that a trustee is entitled to receive payment of its reasonable expenses in administering the trust, including attorney fees, from the assets of the trust. The expenses and attorney fees constitute a lien on the trust assets until paid. Thus, a "trustee cannot be compelled to relinquish his [or her] control of the trust estate until the lien is satisfied." *Id.* at 1214. The trial court's order had the effect of precluding payment from trust assets of any expenses arising in the future. The court found that a trustee can withhold terminating distributions and reserve assets to pay expenses of administration that are due, or that have not yet been fully ascertained:

> "Although a trust instrument directs termination of the trust and the distribution of principal to the beneficiaries upon the settlor's death, the trustee cannot make complete distribution until provision has been made for all expenses, claims and taxes the trust **may** be obligated to pay, and certainly **not before these amounts have been fully ascertained**." *Id*. at 1215 (emphasis supplied).

The court's explanation of a trustee's duties provides a wide array of potentially proper reasons for a trustee to withhold distributions during the administration of a terminating trust. Based on the court's language, a trustee may reserve trust assets for "all" expenses, which normally includes a trustee's attorney fees, accounting and fiduciary fees, claims (presumably this includes creditor, beneficiary and third party claims involving the trust assets), taxes of any kind and other trust obligations related to asset maintenance.

The court plainly recognized that trust obligations may not be certain at a particular point in time, yet a trustee is entitled to reserve assets for those obligations that the trust "may" be obligated to pay. The court also opined that a trustee was not required to pay distributions with trust assets that might be needed to pay obligations before the actual amount of the obligations of the trust "have been fully ascertained." The court found that trust obligations get paid before distributions are to be paid.

The court in *Sheaffer v. Trask*, 813 So. 2d 1051 (Fla. 4th DCA 2002), reaffirmed *Jones* in reversing a trial court order that directed distribution of the sole asset of a trust before payment of trustee fees as well as debts, funeral expenses and administrative expenses of the decedent's estate. Later in *Parker v. Shullman*, 983 So. 2d 643 (Fla. 4th DCA 2008), the Fourth District again affirmed *Jones* in rejecting a claim by beneficiaries that the trustee improperly failed to fund children's subtrusts. The court ruled that the interests of the beneficiaries in having their subtrusts funded was subject to the trustee's duty to pay the expenses of administration and obligations of the grantor's estate.

The Second District issued its opinion in *Alzheimer's Lifeliners Association*, *supra*, addressing a trustee who refused to make final distribution of a trust before obtaining a release or judicial approval of its account. There, the underlying action was brought for a determination of charitable beneficiaries of a trust. After an appeal of the trial court's determination of beneficiaries, the trustee provided an accounting of the trust. The trustee also requested consents and a release from fiduciary liability and agreed it would make prompt distributions upon receipt of the releases. The beneficiaries did not provide signed releases to the trustee.

The beneficiaries then sought execution against the trust assets and to hold the trustee in contempt of court. The basis for this effort was the trial court's order directing distribution to the beneficiaries in accordance with the trust. The trustee then filed an action seeking judicial approval of the accounting. The Second District reversed the finding that the trustee had a duty to distribute assets while an action was pending to determine beneficiaries. It also found that the trustee was not required to distribute assets before (a) the beneficiaries consented to the trustee's accounting and provided a release of fiduciary liability, (b) the expiration of six months after the service of an accounting by which a claim for breach of trust would be barred by the applicable statute of limitations, or (c) approval of the accounting by the court through judicial proceedings.

Notably, the court found that it would be *imprudent* for a trustee to distribute trust assets without consent to the accounting or approval by the court. By failing to do so, "one of the Beneficiaries could object to the accounting after the distribution of the Trust, resulting in litigation over assets that have already been distributed." *Id.* at 954.

It is apparent that Florida common law permits a trustee of a terminating trust to retain assets and decline to distribute them if the assets are, or may be required to, satisfy expenses of administration that are known, unpaid or not fully ascertained. It also appears that in many circumstances, a trustee is permitted to withhold distribution until the trustee receives a release of liability or consent to an accounting, court approval of an accounting, or the statute of limitations expires six months after service of an accounting on all beneficiaries. While not articulated in the cases, we can presume that the right to withhold a partial or complete distribution while awaiting one of these events applies when a distribution might adversely affect full payment of administration expenses or gifts to beneficiaries.

The use of a release to achieve finality concerning trust administration rather than institute legal proceedings to approve a trustee's account is used in other jurisdictions. "In New York, it is a common practice when there is no ambiguity as to who is to get what for the beneficiary to give the trustee a release and indemnity as consideration for the trustee's not seeking judicial approval of his accounts." Rounds & Rounds, *Loring and Rounds*: A Trustee's Handbook, Section 8.2.2 at p. 842 (2012 Ed.).

In Ohio, a release also is often sought by corporate fiduciaries instead of instituting a legal proceeding to approve a trustee's accounting. 24 No. 3 Ohio Probate L.J. NL 7, Moore, *The Trustee's Toolkit: Use of Releases in Achieving Finality.* "[I]t is reasonable for the trustee to desire finality with respect to the trustee's administration before making a partial or final distribution of trust property. Under Ohio Law two alternative mechanisms are available to the *inter vivos* trustee for achieving finality: (1) judicial settlement; or (2) nonjudicial agreement, such as a release. A release often offers the most expeditious and least expensive mechanism for achieving finality." *Id.* at p. 1. The rationale is to enable a trustee to distribute assets to a beneficiary or successor trustee with "reasonable certainty that a beneficiary will not later object to an aspect of the trustee administration when the trustee no longer holds the resources to defend itself or correct an error." *Id*. at p. 7.

B. Drafting to avoid problems with distributions, reserves and release of liability

Often, an explicit provision in a trust overrides and clarifies the duties and rights of a trustee and beneficiary. With respect to terminating distributions under section 736.0817, the estate planner has the option of overriding the code by drafting a provision that provides clarity and protection for the trustee. Section 736.0105(1) provides that "[e]xcept as otherwise provided in the terms of the trust, this code governs the duties and powers of a trustee, relations among trustees, and the rights and interests of a beneficiary." Subsection (2) further provides that "[t]he terms of a trust prevail over any provision of this code except" and lists the mandatory provisions in the Code that cannot be overridden by the terms of the trust. Section 736.0817 is not a mandatory provision listed in subsection (2).

An estate planner thus can address in the trust instrument the specific type of expenses of administration for which a trustee can hold a reserve. A provision also can be included that defines the reserve to include amounts that a trustee determines might be subject to expenses of administration that are either due, unpaid or not yet fully ascertained. An additional provision might be included that provides a trustee with the explicit right to withhold distributions until all beneficiaries provide a release of liability to the trustee, or the court approves an accounting through a judicial proceeding if a beneficiary refuses to provide a release. Of course, such a provision would not relieve a trustee of the duty to act in good faith under the circumstances, which provision is a mandatory duty under the Code. Sections 736.0105(2)(b) & 736.0105(2)(b), Fla. Stat.

C. Setting a Reasonable Reserve

It is conventional and occurs in nearly every trust by a prudent trustee that distributions are withheld for some time period to enable the trustee to ensure that trust obligations have been adequately met before distributions are made. Ordinarily, the questions are then the timing for distributions, whether a reserve must be maintained and, if so, the amount of the reserve at different intervals during administration of the trust assets. To answer these questions, the trustee's attorney should be involved in assisting the trustee in determining the obligations of the trust. As part of this analysis, consideration must be given to creditor claims, administration expenses and taxes arising from a probate estate for which the revocable trust may be held liable. In turn, this requires an analysis of what notices have been given in the probate estate and the applicable time limits that may bar such claims so that all potential claims are taken into account.

Additionally, it is necessary for the trustee and her attorney to determine existing or possible liabilities of the trust such as the following: (1) existing or possible creditor claims against the trust, (2) income, estate and other taxes for which the trust is liable, (3) causes of action that may by brought by beneficiaries challenging the trust, seeking reformation or construction that would alter the beneficial interests, and (4) expenses of administration, including trustee fees, attorney fees and other professional fees. In evaluating trust liabilities, the trustee's attorney usually is called upon to determine whether existing or possible claims affecting the trust can still be brought, or are barred by the applicable statutes of limitations.

When a trust consists of assets that are not readily marketable and the value is not easily ascertained (i.e. closely held business or real property), appraisals of market value are necessary to determine what assets are required to meet trust obligations. For some trusts with illiquid assets, until appraisals are prepared by a qualified appraiser, it will be difficult to determine and compare the amount of the trust's obligations with the assets available to pay such obligations. Further, appraisals do not guarantee that the asset will be sold and net the same amount as the appraised value. Therefore, the trustee and her attorney must take into account the possibility that less than the appraised value of the asset will be obtained upon a sale and a greater amount of assets must be reserved to cover this contingency.

A trustee and her attorney should consider all contingencies applicable to claims, taxes, causes of action and expenses of administration. To protect a trustee, prudence and caution must be exercised when assessing the existence of contingencies and the amount needed to satisfy them. Once partial or complete distributions are made, later arising trust obligations may spawn litigation to recover improper distributions. In addition, the trustee is exposed to potential liability for making improper distributions (i.e. assets that were needed to satisfy trust obligations or differing beneficial interests). A trustee wants to avoid the unenviable task of chasing assets of a beneficiary after making an improper distribution. Sometimes, the trustee will be innocent of wrongdoing if an unforeseeable contingent liability arises after a distribution is made, but the task is nonetheless difficult and unpleasant.

It is helpful for a trustee to document her analysis determining a reasonable reserve. When there are estate taxes involved, the trustee will usually require input from an attorney or certified public accountant who prepares the estate tax return. The tax professional should be able to provide estimates of the estate tax liability before the return is filed; opine on the possibility of additional estate tax that might be assessed by the Internal Revenue Service in a worst case scenario; and estimate the amount that is reasonably reserved to pay any additional estate tax that might be determined to be due, plus all applicable interest and penalties. It is always important that the tax analysis be carefully worded so that it does not harm the estate if it somehow ends up in the hands of the IRS.

When litigation is anticipated or ongoing, it will often be necessary for the attorney and the trustee to estimate the amount of attorney fees, extraordinary trustee fees, expert witness fees and related litigation costs that may be incurred by the trust. In addition, the trustee must consider the possibility that one or more beneficiaries might be awarded attorney fees payable from the assets of the trust and estimate the amount of fees that might be awarded to reserve for this contingency. This analysis also should be documented.

D. Court action to determine reasonable reserve

If a trustee determines the amount of a reasonable reserve, what recourse does a beneficiary have? The trustee's determination of this issue presumably can be contested either by a cause of action to compel a distribution based on an alleged breach of duty and the mandatory language in section 736.0817 ("trustee shall proceed expeditiously to distribute the trust property"), or by a declaratory proceeding to determine a matter involving a trustee and beneficiaries. Section 736.0201(4)(g), Fla. Stat. ("A judicial proceeding involving a trust may relate to the validity, administration, or distribution of a trust, including proceedings to: (g) Determine any other matters involving trustees and beneficiaries.").

Similarly, if the trustee knows a beneficiary disagrees with the reserve established by a trustee, a trustee can avail herself of the provision in section 736.0201(4)(g) and obtain a declaration concerning a reasonable reserve. A declaratory judgment action also may be available under Chapter 86, Florida Statutes, to obtain the same determination. Obviously, a doubt about the exercise of the trustee's right to reserve assets or the amount of the reserve must exist and an actual controversy must exist to properly proceed with a suit for a declaration or determination of rights.

E. Avoiding liability for distributions and reserves

It is commonplace for a trustee to request that a beneficiary provide a release and waiver of a formal accounting. Often, a trustee also requests that the beneficiary sign a refunding agreement and indemnification with respect to the distribution to be made. In most situations, a beneficiary signs these documents to obtain the distribution because it expedites the making of a distribution and reduces the expense involved.

Because a trustee is entitled to seek a court order approving its accounting of a trust, a beneficiary's share of the trust is subjected to the cost of preparation of a formal accounting and attorney fees and costs attendant to a judicial proceeding if the beneficiary refuses to sign a release. *Merrill Lynch Trust Company v. Alzheimer's Lifeliners Association*, 832 So. 2d 948, 953 (Fla. 2d DCA 2002); *Fraser v. Southeast First Bank of Jacksonville*, 417 So. 2d 707 (Fla. 5th DCA 1982); *Rhoades v. Frazier,* 169 So. 379 (Fla. 1936).

Depending on the nature of the assets in the trust and their value, it is possible that a trustee might reasonably withhold distributions until a judicial proceeding to approve an accounting is concluded. If there is a contested proceeding and an appeal, the litigation can hold up distributions for years. Of course, there are circumstances in which partial distributions may be required before or during a judicial proceeding to approve an accounting when the amount of claims, fees, expenses and taxes, actual and contingent, are well exceeded by assets that are readily available (i.e. liquid) to pay such obligations and any change in beneficial interests.

There is scant authority concerning the scope of a release that a beneficiary should be asked to provide to a trustee. A trustee often seeks the broadest release possible, especially if a trustee has deep pockets. A beneficiary who is not considering legal action often provides whatever release is requested by a trustee. However, a beneficiary who has an attorney or is considering possible legal action sometimes will object to an overbroad release, especially if the release is requested in connection with a partial distribution. It is inadvisable for a trustee to threaten a beneficiary that a distribution will be withheld if a release is not signed. Instead, a trustee's proper recourse if a beneficiary refuses to sign a release is to exercise her right to obtain judicial approval of the trustee's account. The entry of a court order entered in a judicial accounting action that approves the accounting is usually accompanied by language that releases and discharges a trustee in connection with the administration of the trust.

While a trustee frequently requires that a beneficiary sign a written refunding agreement to make a distribution, a beneficiary is not required to agree to do so. A trustee usually wants an express refunding agreement so that it is clear that a beneficiary has an obligation to return whatever portion or all of the distribution that later becomes necessary to discharge the trust's obligations. A prudent trustee normally will not make a distribution if she believes the trust assets are needed to discharge trust obligations. Sometimes, an unforeseen tax liability, claim or environmental hazard arises after the distribution of trust assets. In such circumstances, a trustee is required to pursue a beneficiary to recover part or all of a distribution if the trust assets are insufficient to discharge a trust obligation.

Can a trustee recover a distribution from a beneficiary without a refunding agreement? If the distribution is determined to be "paid improperly from a trust," the court can order the beneficiary to return the funds or assets received. Section 736.1018, Fla. Stat. In addition, a court can order the beneficiary to return the income from the assets or interest on the funds from the date of distribution. *Id.* Under the statute, a beneficiary can raise defenses to a claim for what is asserted to be an improper payment from the trust. Other equitable defenses might be raised such as the trustee's negligence in failing to foresee or properly assess a contingency.

The statute explicitly recognizes that a beneficiary can allege defenses that the distribution cannot be questioned because of adjudication, estoppel, or limitations. What if the beneficiary spent the funds? The statute provides that the value of the assets at the date of disposition and income or gain received by the person disposing of the assets shall be returned.

If a trustee is required to enforce a refunding agreement, the language in the agreement may provide a much clearer obligation by a beneficiary to repay or return the distribution. In connection with an improper distribution claim or a cause of action under a refunding agreement, the limitations period is not likely to run until at the earliest the trustee knew or should have knew of a liability for which there is insufficient assets in the trust. This usually creates an open ended obligation of the beneficiary that is unavoidable.

Another means to protect a trustee is to seek from a beneficiary indemnification with respect to a distribution. The beneficiary is not required to agree to indemnify a trustee and a requested indemnity sometimes is much broader than is appropriate. A trustee often seeks indemnity because a beneficiary receives all of the financial benefit of the distribution and a trustee should not be required to pay from personal funds to address later arising and not reasonably foreseeable trust obligations. The scope of a requested indemnity is often limited to the amount of the distribution to be made. A trustee seeks indemnity that covers all liability related to making the distribution, including attorney fees to defend claims that the distribution was improper. This often inures to the benefit of the distributee if the indemnity is properly drawn. An indemnity protects a trustee and a trust in the event that there is litigation over a late arising trust obligation and there are no funds in the trust to defend against such a claim.

A trustee often will ask a beneficiary to waive a formal accounting of the trust in connection with distributions to reduce the expense incurred in making distributions. It is important for a trustee and her counsel to consider whether a waiver and release will be effective given the level of information disclosure that is provided to a beneficiary.

F. Will a release and waiver protect a trustee

A trustee often assumes that a release and waiver of a formal accounting will protect her from liability for any breach of trust that might be alleged at a future time. The Trust Code provides some general guidance on this issue:

> "A trustee is not liable to a beneficiary for breach of trust if the beneficiary consented to the conduct constituting the breach, released the trustee from liability for the breach, or ratified the transaction constituting the breach unless:
>
> (1) The consent, release, or ratification of the beneficiary was induced by improper conduct of the trustee; or
>
> (2) At the time of the consent, release, or ratification, **the beneficiary did not know of the beneficiary's rights or of the material facts relating to the breach.**" (emphasis added) Section 736.1012, Florida Statutes.

A court determination whether a consent, release or ratification by a beneficiary is effective often can be fact intensive. This is particularly true if a trustee must prove that a beneficiary knew of her rights or the material facts relating to the breach. This inquiry is particularly difficult for a trustee to determine in advance because there is no crystal ball to predict what information a court might later determine constitutes a "material fact" related to an alleged breach.

An example of this is found in *Turkish v. Brody*, 221 So. 3d 1206 (Fla. 3d DCA 2016). In *Turkish*, a brother acting as trustee who had a beneficial interest in a trust obtained a written release from his sister, who also was a beneficiary. The release specifically addressed any claim that the sister might have related to a withdrawal of funds from the trust by the brother that had been loaned to his mother to pay her tax liability and waived the sister's right to object to the trustee's actions. The sister later sued to set aside the release and waiver. The court agreed with the sister and set aside the release. In doing so, the court found that the brother did not make sufficient disclosure. In particular, the court ruled that the brother did not disclose that the mother's promissory note that the brother had agreed to contribute to the trust was "virtually worthless" because: (a) the mother did not have the ability to repay the note during her lifetime and (b) her estate would have insufficient assets to repay the loan because the condominium she lived in was not owned by her, but instead was owned by a trust she had created.

When a trustee seeks a waiver or release of rights held by a beneficiary for any possible breach of trust claim against a trustee, a trustee should closely consider the level disclosure that is warranted if maximize protection against claims in the future is the highest priority in reaching an agreement. Even applying this caution, a trustee is always at risk that a waiver or release might be set aside by a court because the level of disclosure provided to a beneficiary can be easily second guessed and often will be if the transaction strikes a court as unfair to the beneficiary.

G. Nonjudicial settlement agreement

An agreement concerning an accounting, distributions and release of a trustee can may constitute a nonjudicial settlement agreement. Section 736.0111, Florida Statutes, provides that matters that may be resolved by a nonjudicial settlement agreement include but are not limited to "approval of a trustee's report or accounting" and "liability of a trustee for an action relating to the trust." Moreover, the statute provides that any person to such an agreement may request court approval. A court order may help prevent later attack on the agreement by a beneficiary who decides to attack the validity of a release and waiver.

THE LONG AND WINDING ROAD OF REMOTE ONLINE NOTARIZATION AND ELECTRONIC ESTATE PLANNING DOCUMENTS

By

Angela M. Adams, St. Petersburg
Jennifer Bloodworth, Winter Park

The Long and Winding Road of Remote Online Notarization and Electronic Estate Planning Documents

Angela M. Adams
Law Office of Wm. Fletcher Belcher, St. Petersburg, FL

Jennifer Jones Bloodworth
Sr. Underwriting Counsel, First American Title Insurance Co, Maitland, FL
August 2019

These materials include much appreciated contributions from our friends, Burt Bruton and Sarah B. Butters.

I. BACKGROUND OF ELECTRONIC DOCUMENTS

Electronic signatures have been accepted as having the same force and effect as a written signature since the passage of F.S. §668.004, Force and Effect of Electronic Signatures, in 1996. Then, in 2000, Florida adopted of the Uniform Electronic Transaction Act ("UETA"), F.S. §668.50, and, in 2007, adopted the Uniform Real Property Electronic Recording Act ("URPERA"), F.S. §695.27. Note that UETA specifically excluded from its scope laws governing the creation and execution of wills, codicils, or testamentary trusts. F.S. §668.50(3)(b)1.

With the electronic signatures, transactions, and recording framework in place, Chapter 2019-71, Laws of Florida, was adopted this past legislative session. This legislation provides that documents can be remotely notarized when the notary and the signer (or "principal") are in different physical locations and are connected via audio-video communication technology.

II. REMOTE ONLINE NOTARIZATION

A. Definitions

1. Part II of Chapter 117, Florida Statutes, begins with a number of new definitions, including the following:

    a. "Appear before," "before," or "in the presence of" means: (i) in the physical presence of another; or (ii) outside the physical presence of another, but able to see, hear, and communicate with the other person by means of audio-video communication technology. F.S. §117.201(1).

b. “Audio-video communication technology” is technology enabling real-time, two-way communication using electronic means in which the participants are able to see, hear, and communicate with each other. F.S. §117.201(2).

c. “Electronic signature” means an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record. F.S. §117.201(4) and §668.50(2)(h).
NOTE: For wills and trusts with testamentary aspects, there is a different definition for “electronic signature” set forth in new F.S. §732.512(4).

d. “Online notarization” is the performance of a notarial act where the principal appears before the notary by means of audio-visual communication technology. §117.201(9)

e. “Online notary public” is a notary who has been commissioned to perform remote notarial acts. F.S. §117.201(10).

f. “Physical presence” means individuals are in the same physical location with each other and close enough to see, hear, communicate with, and exchange credentials with each other. F.S. §117.201(11).

g. “Principal” is the individual whose electronic signature is being acknowledged, witnessed, or attested to or who takes an oath or affirmation. F.S. §117.201(12).

h. “Remote Online Notarization service provider” or “RON service provider” refers to the companies that offer the technology that is critical to the remote online notarization process. F.S. §117.201(14). Although not included in the statutory definitions, the acronym “RON” is generally used to refer to “remote online notaries.”

2. “Original” document is the electronic version, not a paper printout of the document; although, a printout certified by a notary public to be a true and correct copy may be accepted as or deemed to be an original. F.S. §117.05(12)(a).

B. The Remote Online Notarization Process

1. Multi-factor Authentication

The new law requires that an online notary public shall confirm the identity of the principal by (a) personal knowledge of each principal; or (b) all of the following (i) identity proofing of each principal in the form of knowledge-based authentication or another method of identity proofing that conforms to the statute, (ii) remote presentation of a government-issued identification credential by the principal; and (iii) credential analysis of each government-issued identification credential. F.S. §117.265(4).

a. Identity Proofing

The RON service provider will take the prospective principal through a software-driven process to confirm the identity of the principal before connecting him/her with the online notary by audio-video communication technology. F.S. §117.265(2) and (4). While the Florida Department of State can promulgate standards as technology changes, the current approved method for identity proofing is known as “Knowledge Based Authentication” or “KBA.” KBA is a method of evidencing one’s identity by correctly answering questions that are pulled from public and proprietary data sources (such as credit history). The questions are intended to be questions that the principal should be able to answer in a short amount of time and that cannot be easily or quickly researched by a potential imposter. These are sometimes referred to as “out of wallet” questions, meaning that someone would not be able to answer them if they had access to the principal’s wallet.

The new law provides the following KBA requirements:

i. The principal must answer a series of at least 5 multiple choice questions derived from public and/or proprietary databases.

ii. The principal must answer these questions within a 2-minute time period and get 80% of the answers correct. F.S. §117.295(3)(a)3. and 4.

iii. If the principal fails to answer 80% of the questions correctly, or fails to answer the questions within the allotted time, he/she fails and will be afforded only one second opportunity to answer another set of identity verification questions. F.S. §117.295(3)(a)5.

b. Credential Analysis

i. The principal must transmit an image of a government-issued identification credential that is of sufficient quality to enable the online notary public to identify the principal and to perform credential analysis through audio-video communication technology. F.S. §§117.201(15) and 117.265(4)(b)1.

ii. The online notary must then perform credential analysis, which is a process of working through a third-party service provider to affirm the validity of a government-issued identification credential and data thereon through review of public or proprietary data sources. §§117.201(3) and 117.265(4)(b)1.

2. Witnesses

a. Witnesses must go through the same identity proofing and credential analysis processes as the principal. F.S. §117.285(2).

b. If the witnesses are not in the physical presence of the principal, then they must be residents of the United States and must be located in the United States when they witness the electronic document. F.S. §117.285(4).

c. If the witnesses are in the physical presence of the principal, the witnesses must confirm their identity by stating his/her name and current address on the audio-video recording. F.S. §117.285(2).

3. Execution of Online Documents

a. The principal and witnesses (if any) must be connected to the online notary via **audio-video communication** technology (specifications below), the connection must be uninterrupted, and an audio-video recording of the signing, witnessing, and notarizing of the electronic document must be made.

b. The principal executes an electronic document through the RON service provider's software platform, generally by using a computer keyboard, a mouse, or other electronic device.

c. The act of "witnessing" an electronic signature is defined as a "witness" being in the physical or audio-video presence of the principal and **hearing the principal say** that he or she has executed the electronic document. F.S. §§117.285(1) and (3), 689.01(2).

d. The online notary adds his/her electronic notary seal to the electronic document using tamper-evident technology that causes any subsequent change or modification to the electronic document to be evident. F.S. §§117.021(7), 117.255(3), and 117.295(4).

4. Post-execution Transmission

The electronic document is transmitted wherever it needs to go for purposes of the transaction, such as a county recording office, or, in the case of an electronic will, to a "qualified custodian."

If the clerk or county recorder's office is unable to accept electronic documents for recording electronically, then a printed copy, certified by a notary in accordance with Chapter 117 to be a true and correct copy may be recorded. F.S. §28.222(3)(h).

C. Audio-video Communication Technology Requirements (Until the Florida Department of State adopts standards that are equally or more protective)

For those portions of the remote execution and notarization that are required to be recorded, the following specifications and restrictions apply:

- Must be reasonably secure. F.S. §117.285(3)(c)1.

- Must be real-time, two-way communication. F.S. §117.201(2).

- Participants must be able to see, hear, and communicate with each other and there must be sufficient audio clarity and video resolution to enable the remote online notary to communicate with the principal and witnesses and confirm their identities. F.S. §§ 117.201(2) and 117.285(3)(c)1.

- Cannot start/stop – the audio-video recording must be continuous and without pauses. F.S. §117.245(2).

- The audio-video recording must be maintained with the electronic record. F.S. §§117.245 and 732.524(2).

D. Online Notary's Electronic Journal

1. The online notary is required to create and maintain an "electronic journal" of the particulars of the notarial act, including the audio-video recording. Generally, the electronic journal and recording must be retained for a minimum period of 10 years after the notarial act. However, wills have a longer retention period. F.S. §117.245(4).

2. The online notary is permitted to delegate the retention of the journal and the audio-video recording to a custodian approved by the Florida Department of State (generally expected to be the RON service provider or Clerks of Court), provided that the notary notifies the Department of State of that delegation.

3. Upon request, the online notary shall make copies for, and provide access to the audio-video recording to, the following persons:

a. The parties to the electronic document.

b. The qualified custodian of an electronic will.

c. The title or settlement agent or title insurer who insured the electronic document or engaged the online notary in connection with a real estate transaction.

d. The online notary's RON service provider.

e. Any person asked to accept a power of attorney notarized by an online notary.

f. The Department of State pursuant to a misconduct investigation.

g. Any other person pursuant to a subpoena, court order, or law enforcement investigation. These persons may also obtain the last known address of each witness, the principal's responses to the vulnerable adult questions for estate planning documents, and an uninterrupted and unedited copy of the audio-video recording. F.S. §117.285(6).

F.S. §117.255(5).

E. Prohibited Remote Online Notarial Acts

1. Solemnizing the rites of marriage. F.S. §117.209(1).

2. Supervising remote witnessing of a vulnerable adult who is executing a will, trust with testamentary aspects, a health care advance directive, a waiver of spousal rights, or banking and investment powers in a power of attorney. F.S. §117.285(5).

III. ELECTRONIC ESTATE PLANNING DOCUMENTS

The bulk of the new legislation relates to remote notarization of documents generally (hence the name "Electronic Legal Documents"). However, the rules for execution of electronic estate planning documents differ significantly from the framework described above for transactions like loans, real estate closings, etc.

The most significant substantive change resulting from the new legislation is the elimination of the requirement that witnesses to estate planning documents must be physically present with the testator/settlor/principal at the time of execution. The Real Property, Probate, and Trust Law Section of the Florida Bar opposed the elimination that long-standing requirement, but when it became clear that the proposed legislation permitting remote online witnesses would likely pass, the Section worked to add some protections for vulnerable adults and certain powers of attorneys.

A. Wills, Trusts, Health Care Surrogate Designations, Spousal Waivers, and Certain Powers of Attorney

If the electronic document to be signed is

- a will[1],
- a trust with testamentary aspects,
- a health care advance directive,
- a waiver of spousal rights under F.S. §732.701 or §732.702, or
- a power of attorney authorizing any of the banking or investment powers enumerated in F. S. §709.2208,

the following rules apply **with respect to the use of remote online witnesses** (F.S. §117.285(5)):

1. The principal must answer the following series of questions designed to identify a vulnerable adult as defined in F.S. §415.102(28):

   - Are you under the influence of any drug or alcohol today that impairs your ability to make decisions?

   - Do you have any physical or mental condition or long-term disability that impairs your ability to perform the normal activities of daily living?

   - Do you require assistance with daily care?

F.S. §117.285(5)(a).
A vulnerable adult is defined as "a person 18 years of age or older **whose ability to perform the normal activities of daily living or to provide for**

[1] The definition of "Will" in F.S. §731.201(40) was amended to include an electronic will as defined in F.S. §732.521.

his or her own care or protection is impaired due to a mental, emotional, sensory, long-term physical, or developmental disability or dysfunction, or brain damage, or the infirmities of aging." F.S. §415.102(28).

NOTE: These questions and answers are not required to be part of the audio-video recording, and it is anticipated that the RON service provider will ask these questions through a written question and answer session rather than verbally.

2. If the principal answers any of the above questions in the affirmative, then the principal's signature must be witnessed by witnesses who are physically present with the principal. F.S. §117.285(5)(b). Remote online witnessing is **not effective** for witnessing the signature of a vulnerable adult on these estate planning documents. F.S. §117.285(5)(g). **Accordingly, the RON service provider should not let the principal proceed without witnesses being physically present with the principal.**

3. However, the legislation recognizes that there may be vulnerable adults who slip through the cracks by not answering the questions truthfully. For example:

- A principal may be embarrassed to admit he/she needs or receives assistance;
- A principal may not self-identify as a vulnerable adult (such as a paraplegic who is fully cognizant mentally, but whose physical disability makes him/her a vulnerable adult under the statutory definition); or
- A person who knows he/she is a vulnerable adult but nonetheless proceeds for convenience sake.

For these reasons, after the principal responds to the vulnerable adult questions described in III.A.1., above, the RON service provider must give the principal the following written notice (in substantially this form):

> NOTICE: If you are a vulnerable adult as defined in s. 415.102, Florida Statutes, the documents you are about to sign are not valid if witnessed by means of audio-video communication technology. If you suspect you may be a vulnerable adult, you should have witnesses physically present with you before signing.

F.S. §117.285(5)(c).

Note that the RON service provider is not required to provide the principal with the statutory definition of "vulnerable adult," without which, this warning may do little to prevent vulnerable adults who do not self-identify as such from proceeding through the remote online witnessing process. In that event, the vulnerable adult's estate planning document will be invalid.

While some have opined that the automatic invalidation of a vulnerable adult's estate plan is a harsh consequence, such penalties are not new to Florida's wills and trusts jurisprudence. Florida has always demanded strict adherence to the Statute of Wills. <u>See</u>, *In re Bancker's Estate*, 232 So.2d 431, 433 (Fla. 4th DCA 1970) (holding that a testator must strictly comply with the statutory requirements to create a valid will); *In re Neil's Estate*, 39 So.2d 801 (Fla.1949) (holding that where a testator fails to sign his or her will, that document will not be admitted to probate); *In re Estate of Williams*, 182 So.2d 10, 13 (Fla.1965) (holding that the signatures of both the testator and witnesses are needed to have a properly executed will); and *In re Estate of Olson*, 181 So.2d 642, 643 (Fla.1966) (holding that an unattested will should not be admitted to probate because "[t]he obvious intent of the statute requiring the attestation of a will by at least two witnesses is to assure its authenticity and to avoid fraud and imposition.").

Repeatedly, Florida has rejected the more relaxed witnessing and execution requirements that exist in the Uniform Probate Code. Further, Florida has never adopted the "harmless error" or "substantial compliance" tests, which would forgive errors in execution if adequate evidence of capacity and testamentary intent was nonetheless present.

4. Once the vulnerable adult questions are asked and the consumer protection warning in III.A.3., above, is given, the remote online notary must then create an audio-video recording of the notarial act, including his/her communications with the principal. The remote online notary must ask the principal a series of questions to which the principal must provide verbal answers. These questions and answers are designed to build an evidentiary video record relevant to the principal's capacity and any undue influence. Those questions must include the following (but the notary can ask additional questions if desired):

- Are you currently married? If so, name your spouse.
- Please state the names of anyone who assisted you in accessing this video conference today.
- Please state the names of anyone who assisted you in preparing the documents you are signing today.
- Where are you currently located?

- Who is in the room with you?

F.S. §117.285(5)(d).

5. A principal's incorrect answer to a question in III.A.4., above, cannot be the sole basis to invalidate a document, but may be offered as evidence in a proceeding challenging the validity of the document. F.S. §117.285(5)(f). As in a traditional will or trust contest, the validity of a properly executed document should be based upon the totality of the evidence.

6. Remember that a notary public may not notarize a signature on a document if it appears that the person is mentally incapable of understanding the nature and effect of the document at the time of notarization. See, F.S. §117.107(5). This prohibition remains unchanged, but the new legislation directs that the online notary shall consider the responses to the questions in III.A.4., above, in carrying out his/her notarial duties. F.S. §117.285(5)(e). But note that a notary is not likely to know whether the answer provided to a question is correct or not, so this Q & A may have limited value unless or until a will contest proceeding is commenced.

7. With respect to **powers of attorney containing any of the banking and investment powers** enumerated in F.S. §709.2208, those banking and investment powers will be ineffective unless the above procedures are followed. F.S. §117.285(5)(g). However, the power of attorney will be effective as to other non-"superpowers" [2] granted therein. §117.285(5)(h).

8. If the witnesses were present via audio-video communication technology, the audio-video recording must indicate that fact. F.S. §117.285(5)(i). Similarly, the notary's certificate must indicate whether the instrument was signed in the physical presence of the notary or through online notarization. F.S. §117.05(4)(c).

NOTE: The rules outlined in III.A., above, apply only with respect to the use of remote online witnesses for the above-described estate planning documents. Nothing prohibits the use of remote online notarization for such estate planning documents. Even a vulnerable adult may use remote online notarization for estate planning documents.

B. Physical Presence of Witnesses Still Required in Two Circumstances

[2] "Superpowers" refers to the estate planning powers enumerated in F.S. §709.2202(1), which have additional execution requirements as set forth in §709.2202.

1. Vulnerable Adult. A vulnerable adult who is executing any of the estate planning documents described above must have witnesses physically present with him/her at the time of execution. §117.285(5)(b) and (g). (NOTE: Nothing prohibits a vulnerable adult from using the remote online process to sign non-estate planning documents, such as a deed or loan document.)

2. POA With "Superpowers." A power of attorney executed by a principal domiciled in Florida at the time of execution is not effective to grant any of the following superpowers enumerated in F.S. §709.2202(1), unless the witnesses were in the physical presence of the principal at the time of execution (F.S. §709.2202(6)):

a. Create an inter vivos trust;

b. With respect to a trust created by or on behalf of the principal, amend, modify, revoke, or terminate the trust, but only if the trust instrument explicitly provides for amendment, modification, revocation, or termination by the settlor's agent;

c. Make a gift;

d. Create or change rights of survivorship;

e. Create or change a beneficiary designation;

f. Waive the principal's right to be a beneficiary of a joint and survivor annuity, including a survivor benefit under a retirement plan; or

g. Disclaim property and powers of appointment.

However, the power of attorney will be effective as to other non-superpowers granted therein.[3]

C. Electronic Signature for Wills and Trusts

Recall that F.S. §736.0403(2)(b) of the Florida Trust Code states that the "testamentary aspects of a revocable trust, executed by a settlor who is a domiciliary of this state at the time of execution, are invalid unless the trust instrument is executed by the settlor with the formalities required for the execution of a will in this state." Stated simply, testamentary aspects of a Florida resident's revocable trust must be executed with the same formalities as a will. Therefore, the new electronic execution provisions in Chapter 732, Florida Statutes, will carry over to revocable trusts via F.S. §736.0403(2)(b).

[3] But see rules related to banking and investment powers in III.A., above.

1. Definition of “Electronic Signature.”

Although “electronic signature” is defined in new F.S. §117.201(4) to mean an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record, a different definition is applicable for wills and trusts with testamentary aspects. New F.S. §732.512(4) defines “**electronic signature**” to mean “an electronic mark visibly manifested in a record as a signature and executed or adopted by a person with the intent to sign the record.”

2. Electronic Wills With Testator and Witnesses in the Physical Presence of Each Other.

Wills (or trusts with testamentary aspects) created on a computer, tablet, cell phone, or other electronic device which are signed with an electronic signature by the testator in the physical presence of two or more witnesses who sign with an electronic signature in the physical presence of each other and the testator are specifically recognized as valid. F.S. §732.522(1).

3. Electronic Wills With Remote Online Witnesses

a. The requirement that a will (or trust with testamentary aspects) be signed in the presence of witnesses may be satisfied if:

- The witnesses are present by audio-video communication technology that meets the requirements of Part II of Chapter 117 of the Florida Statutes;

- The signing and witnessing comply with all of the requirements described in III.A., above, including the authentication, Q & A, and execution procedures; and

- The witnesses hear the testator/settlor make a statement acknowledging that he/she has signed the electronic record.

F.S. §732.522(2).

b. A will that is signed electronically is deemed to be executed in Florida if it states that the testator intends to execute and understands that he/she is executing the will pursuant to the laws of Florida. F.S. 732.522(4).

D. Self-proof of Electronic Will

An electronic will is self-proved if all of the following requirements are met:

1. The acknowledgment of the electronic will by the testator and the affidavits of the witnesses are made in accordance with F.S. §732.503 and are part of the electronic record containing the electronic will or logically associated with the will;

2. The electronic will designates a qualified custodian;

3. The electronic record containing the electronic will is held by a qualified custodian at all times before being offered to the court for probate; and

4. The qualified custodian who has custody of the electronic will at the time of the testator's death certifies under oath that, to the best of the qualified custodian's knowledge:

- The electronic will has at all times been in the custody of a qualified custodian and

- The electronic will has not been altered in any way since the date of its execution.

F.S. §732.523.

E. Audio-video Recording Requirements

In addition to the requirements set forth in II.C., above, the following audio-video rules have direct application to estate planning documents:

- While some of the required questions can be done though a written Q & A prompt (e.g., questions regarding the authentication of the principal/witnesses and vulnerable adult status), the 5 questions designed to create a record regarding capacity and undue influence must be done on video. F.S. §117.285(5)(d).

- The audio-video recording must be maintained with the electronic record. F.S. §§117.245 and 732.524(2).

- If audio-video recording is lost, the will is treated as a lost will that can be proved up through witness testimony as provided in F.S. §733.207.

F. Storage of Estate Planning Documents

1. Who. Electronic record may be stored by the notary or any Qualified Custodian ("QC"). QCs must comply with the statutory requirements set forth in F.S. §732.524 (regarding Florida domicile and residency; security; confidentiality; furnishing information to the court; change of QC, etc.) and §732.525(1) (regarding bond and liability insurance). For those who may be nervous about storing documents with a newly minted dot com, it is anticipated that the Clerks of Court will be QCs and will be available to hold electronic wills.

2. Security. A QC is required to store the electronic record in a manner that is secure and tamper-evident. F.S. §§732.524(2)(a) and (4)(b)3.d., 117.021(7), 117.255(3), and 117.295(4).

3. How long. The electronic record containing an electronic will must be maintained by a QC until the earlier of the 5th anniversary of the conclusion of the administration of the estate of the testator or 20 years after the death of the testator. F.S. §732.524(3). But note that this extended retention period appears to apply only to wills and not to any other estate planning documents.

4. Access. F.S. §732.504(2) requires the QC to provide access to or information concerning the electronic will and/or record containing the electronic will only to the following persons:

- The testator;
- Persons authorized by the testator in the electronic will or in written instructions signed by the testator with the formalities required for execution of a will in Florida;
- The testator's nominated personal representative; or
- As directed by a court of competent jurisdiction.

5. Death of the Testator. Upon receiving information that the testator is dead, the QC must deposit the electronic will with the clerk of the court without charging a fee.

G. Revocation of Electronic Will

Since the original electronic will or codicil is the electronic document, it cannot be revoked by some of the traditional means of revoking a paper document, i.e., burning, tearing, or defacing. The new legislation provides that an electronic will or codicil may be revoked by deleting, canceling, rendering unreadable, or obliterating the electronic will or codicil, with the intent and for the purpose, of revocation, **as proved by clear and convincing evidence**. F.S. §732.506. Proof of clear and convincing evidence of the intent to revoke is not required for paper wills and codicils. F.S. §732.506.

H. Probate of Electronic Will

1. An electronic will filed electronically with the clerk of the court through the Florida Courts E-Filing Portal is deemed deposited as the original electronic will. F.S. §732.526(1). Alternatively, a paper copy of an electronic will that has been certified by a notary public to be a true and correct copy may be offered for probate and shall constitute an original of the electronic will. F.S. §732.526(2).

2. An electronic will shall not be admitted to probate as a self-proved will if the execution or acknowledgment by the testator and affidavits of the witnesses involved a remote online notarization in which there was a substantial failure to comply with the online notarization procedures. F.S. §733.201(1).

I. Other Amendments to Chapter 709 (Powers of Attorney)

1. F.S. §709.2119 was amended to permit a third party asked to accept a power of attorney to request and rely upon the notary's electronic journal or record if the power of attorney is witnessed or notarized remotely. F.S. §709.2119(d).

2. Similarly, F.S. §709.2120 was amended so that a third party is not required to accept a power of attorney that was witnessed or notarized remotely if: (i) the agent is unable to produce the notary's electronic journal or record, or (ii) if the notary did not maintain an electronic journal or record. F.S. §709.2120(d).

IV. EFFECTIVE DATES

A. The general effective date for the legislation is **January 1, 2020**. Ch. 2019-71, Section 40, Laws of Florida.

B. However, there is a separate effective date of **July 1, 2020**, for Section 33 of the legislation which creates the new F.S. §732.522, dealing with the execution of electronic wills and the testamentary aspects of revocable trusts.

C. The legislation requires that traditional notaries take a minimum of 2 hours of remote notarization educational courses. Those educational courses cannot begin until January 1, 2020. In addition, the Department of State: (i) must adopt rules establishing standards for the required tamper-evident technologies (i.e., technology that will indicate any alteration or change to an electronic document or record after the notarial act is completed) that all electronic notarizations must comply with as of January 1, 2020 (F.S. §117.021(7)), and (ii) will need to promulgate rules for getting traditional notaries registered to do remote notarizations (F.S. §§117.225 and 117.295(2)). This will likely take some time. For these reasons, it is anticipated that remote notarization will not actually start being used until well into the 2020 calendar year (and not until July 1, 2020, for e-wills and e-trusts with testamentary aspects).

CHAPTER 2019-71

Committee Substitute for Committee Substitute for House Bill No. 409

An act relating to electronic legal documents; providing directives to the Division of Law Revision; amending s. 117.01, F.S.; revising provisions relating to use of the office of notary public; amending s. 117.021, F.S.; requiring electronic signatures to include access protection; prohibiting a person from requiring a notary public to perform a notarial act with certain technology; requiring the Department of State, in collaboration with the Agency for State Technology, to adopt rules for certain purposes; amending s. 117.05, F.S.; revising limitations on notary fees to conform to changes made by the act; providing for inclusion of certain information in a jurat or notarial certificate; providing for compliance with online notarization requirements; providing for notarial certification of a printed electronic record; revising statutory forms for jurats and notarial certificates; amending s. 117.107, F.S.; providing applicability; revising prohibited acts; creating s. 117.201, F.S.; providing definitions; creating s. 117.209, F.S.; authorizing online notarizations; providing an exception; creating s. 117.215, F.S.; specifying the application of other laws in relation to online notarizations; creating s. 117.225, F.S.; specifying registration and qualification requirements for online notaries public; creating s. 117.235, F.S.; authorizing the performance of certain notarial acts; creating s. 117.245, F.S.; requiring an online notary public to keep electronic journals of online notarizations and certain audio-video communication recordings; specifying the information that must be included for each online notarization; requiring that an online notary public retain a copy of the recording of an audio-video communication; specifying requirements for such recording; requiring an online notary public to take certain steps regarding the maintenance and security of the electronic journal; specifying that the Department of State maintains jurisdiction for a specified period of time for purposes of investigating notarial misconduct; authorizing the use of specified information for evidentiary purposes; creating s. 117.255, F.S.; specifying requirements for the use of electronic journals, signatures, and seals; requiring an online notary public to provide notification of the theft, vandalism, or loss of an electronic journal, signature, or seal; authorizing an online notary public to make copies of electronic journal entries and to provide access to related recordings under certain circumstances; authorizing an online notary public to charge a fee for making and delivering such copies; providing an exception; creating s. 117.265, F.S.; prescribing online notarization procedures; specifying the manner by which an online notary public must verify the identity of a principal; requiring an online notary public to take certain measures as to the security of technology used; specifying that an electronic notarial certificate must identify the performance of an online notarization; specifying that noncompliance does not impair the validity of a notarial act or the notarized electronic record; authorizing the use of specified information for evidentiary purposes; providing for construction; creating s. 117.275, F.S.; providing fees for online notarizations; creating s. 117.285, F.S.; specifying the manner by which an online notary public may supervise the witnessing of electronic records of online notarizations; specifying the circumstances under which an instrument is voidable; specifying the duties of Remote Online Notarization service providers and online notaries public; providing applicability and jurisdiction; creating s. 117.295, F.S.; authorizing the department to adopt rules and standards for online notarizations; providing minimum standards for online notarizations until such rules are adopted; requiring certain entities to provide a course for online notaries public; creating s. 117.305, F.S.; superseding certain provisions of federal law regulating electronic signatures; amending s. 28.222, F.S.; requiring the clerk of the circuit court to record certain instruments; amending s. 92.50, F.S.; revising requirements for oaths, affidavits, and acknowledgments; amending s. 95.231, F.S.; providing a limitation period for certain recorded instruments; amending s. 689.01, F.S.; providing for witnessing of documents in connection with real estate conveyances; providing for validation of certain recorded documents; amending s. 694.08, F.S.; providing for validation of certain recorded documents; amending s. 695.03, F.S.; providing and revising requirements for making acknowledgments, proofs, and other documents; amending s. 695.04, F.S.; conforming provisions to changes made by the act; amending s. 695.25, F.S.; revising the statutory short form of acknowledgments to include acknowledgment by online notarization; amending s. 695.28, F.S.; providing for validity of recorded documents; conforming provisions to changes made by the act; amending s. 709.2119, F.S.; authorizing the acceptance of a power of attorney based upon an electronic journal or electronic record made by a notary public; amending s. 709.2120, F.S.; prohibiting acceptance of a power of attorney if witnessed or notarized remotely; amending s. 709.2202, F.S.; prohibiting certain authority granted through a power of attorney if witnessed or notarized remotely; amending s. 731.201, F.S.; redefining the term "will" to conform to changes made by the act; amending s. 732.506, F.S.; exempting electronic wills from provisions governing the revocation of wills and codicils; prescribing the manner by which an electronic will or codicil may be revoked; creating s. 732.521, F.S.; providing definitions; creating s. 732.522, F.S.; prescribing the manner by which an electronic will must be executed; creating s. 732.523, F.S.; specifying requirements for the self-proof of an electronic will; creating s. 732.524, F.S.; specifying requirements necessary to serve as a qualified custodian of an electronic will; providing the duties of such qualified custodian; creating s. 732.525, F.S.; requiring a qualified custodian to post and maintain a blanket surety bond of a specified amount and maintain liability insurance; authorizing the Attorney General to petition a court to appoint a receiver to manage electronic records of a qualified custodian; creating s. 732.526, F.S.; specifying conditions by which an electronic will is deemed to be an original will; amending s. 733.201, F.S.; requiring that self-proved electronic wills meet certain requirements for admission to probate;

creating s. 740.11, F.S.; specifying that any act taken pursuant to ch. 740, F.S., does not affect the requirement that a will be deposited within a certain timeframe; providing effective dates.

Be It Enacted by the Legislature of the State of Florida:

Section 1. The Division of Law Revision is directed to:

(1) Create part I of chapter 117, Florida Statutes, consisting of ss. 117.01-117.108, Florida Statutes, to be entitled "General Provisions."

(2) Create part II of chapter 117, Florida Statutes, consisting of ss. 117.201-117.305, Florida Statutes, to be entitled "Online Notarizations."

Section 2. Subsection (1) of section 117.01, Florida Statutes, is amended to read:

117.01 Appointment, application, suspension, revocation, application fee, bond, and oath.—

(1) The Governor may appoint as many notaries public as he or she deems necessary, each of whom must ~~shall~~ be at least 18 years of age and a legal resident of this ~~the~~ state. A permanent resident alien may apply and be appointed and shall file with his or her application a recorded Declaration of Domicile. The residence required for appointment must be maintained throughout the term of appointment. A notary public ~~Notaries public~~ shall be appointed for 4 years and may only ~~shall~~ use and exercise the office of notary public if he or she is within the boundaries of this state. An applicant must be able to read, write, and understand the English language.

Section 3. Subsections (4) and (5) of section 117.021, Florida Statutes, are renumbered as subsections (5) and (6), respectively, subsection (2) of that section is amended, and new subsections (4) and (7) are added to that section, to read:

117.021 Electronic notarization.—

(2) In performing an electronic notarial act, a notary public shall use an electronic signature that is:

(a) Unique to the notary public;

(b) Capable of independent verification;

(c) Retained under the notary public's sole control and includes access protection through the use of passwords or codes under control of the notary public; and

(d) Attached to or logically associated with the electronic document in a manner that any subsequent alteration to the electronic document displays evidence of the alteration.

(4) A person may not require a notary public to perform a notarial act with respect to an electronic record with a form of technology that the notary public has not selected to use.

(7) The Department of State, in collaboration with the Agency for State Technology, shall adopt rules establishing standards for tamper-evident technologies that will indicate any alteration or change to an electronic record after completion of an electronic notarial act. All electronic notarizations performed on or after January 1, 2020, must comply with the adopted standards.

Section 4. Subsection (1), paragraph (a) of subsection (2), subsections (4) and (5), paragraph (a) of subsection (12), and subsections (13) and (14) of section 117.05, Florida Statutes, are amended, and paragraph (c) is added to subsection (12) of that section, to read:

117.05 Use of notary commission; unlawful use; notary fee; seal; duties; employer liability; name change; advertising; photocopies; penalties.—

(1) A ~~No~~ person may not ~~shall~~ obtain or use a notary public commission in other than his or her legal name, and it is unlawful for a notary public to notarize his or her own signature. Any person applying for a notary public commission must submit proof of identity to the Department of State ~~if so requested~~. Any person who violates ~~the provisions of~~ this subsection commits ~~is guilty of~~ a felony of the third degree, punishable as provided in s. 775.082, s. 775.083, or s. 775.084.

(2)(a) The fee of a notary public may not exceed $10 for any one notarial act, except as provided in s. 117.045 or s. 117.275.

(4) When notarizing a signature, a notary public shall complete a jurat or notarial certificate in substantially the same form as those found in subsection (13). The jurat or certificate of acknowledgment shall contain the following elements:

(a) The venue stating the location of the notary public at the time of the notarization in the format, "State of Florida, County of ...."

(b) The type of notarial act performed, an oath or an acknowledgment, evidenced by the words "sworn" or "acknowledged."

(c) Whether ~~That~~ the signer personally appeared before the notary public at the time of the notarization by physical presence or by means of audio-video communication technology as authorized under part II of this chapter.

(d) The exact date of the notarial act.

(e) The name of the person whose signature is being notarized. It is presumed, absent such specific notation by the notary public, that notarization is to all signatures.

(f) The specific type of identification the notary public is relying upon in identifying the signer, either based on personal knowledge or satisfactory evidence specified in subsection (5).

(g) The notary public's ~~notary's~~ official signature.

(h) The notary public's ~~notary's~~ name, which must be typed, printed, or stamped below the signature.

(i) The notary public's ~~notary's~~ official seal affixed below or to either side of the notary public's ~~notary's~~ signature.

(5) A notary public may not notarize a signature on a document unless he or she personally knows, or has satisfactory evidence, that the person whose signature is to be notarized is the individual who is described in and who is executing the instrument. A notary public shall certify in the certificate of acknowledgment or jurat the type of identification, either based on personal knowledge or other form of identification, upon which the notary public is relying. In the case of an online notarization, the online notary public shall comply with the requirements set forth in part II of this chapter.

(a) For purposes of this subsection, the term "personally knows" means having an acquaintance, derived from association with the individual, which establishes the individual's identity with at least a reasonable certainty.

(b) For the purposes of this subsection, the term "satisfactory evidence" means the absence of any information, evidence, or other circumstances which would lead a reasonable person to believe that the person whose signature is to be notarized is not the person he or she claims to be and any one of the following:

1. The sworn written statement of one credible witness personally known to the notary public or the sworn written statement of two credible witnesses whose identities are proven to the notary public upon the presentation of satisfactory evidence that each of the following is true:

a. That the person whose signature is to be notarized is the person named in the document;

b. That the person whose signature is to be notarized is personally known to the witnesses;

c. That it is the reasonable belief of the witnesses that the circumstances of the person whose signature is to be notarized are such that it would be very difficult or impossible for that person to obtain another acceptable form of identification;

d. That it is the reasonable belief of the witnesses that the person whose signature is to be notarized does not possess any of the identification documents specified in subparagraph 2.; and

e. That the witnesses do not have a financial interest in nor are parties to the underlying transaction; or

2. Reasonable reliance on the presentation to the notary public of any one of the following forms of identification, if the document is current or has been issued within the past 5 years and bears a serial or other identifying number:

a. A Florida identification card or driver license issued by the public agency authorized to issue driver licenses;

b. A passport issued by the Department of State of the United States;

c. A passport issued by a foreign government if the document is stamped by the United States Bureau of Citizenship and Immigration Services;

d. A driver license or an identification card issued by a public agency authorized to issue driver licenses in a state other than Florida or in~~,~~ a territory of the United States, or Canada or Mexico;

e. An identification card issued by any branch of the armed forces of the United States;

f. A veteran health identification card issued by the United States Department of Veterans Affairs;

g. An inmate identification card issued on or after January 1, 1991, by the Florida Department of Corrections for an inmate who is in the custody of the department;

h. An inmate identification card issued by the United States Department of Justice, Bureau of Prisons, for an inmate who is in the custody of the department;

i. A sworn, written statement from a sworn law enforcement officer that the forms of identification for an inmate in an institution of confinement were confiscated upon confinement and that the person named in the document is the person whose signature is to be notarized; or

j. An identification card issued by the United States Bureau of Citizenship and Immigration Services.

(12)(a) A notary public may supervise the making of a copy of a tangible or an electronic record or the printing of an electronic record ~~photocopy of an original document~~ and attest to the trueness of the copy or of the printout, provided the document is neither a vital record in this state, another state, a territory of the United States, or another country, nor a public record, if a copy can be made by the custodian of the public record.

CODING: Words ~~stricken~~ are deletions; words underlined are additions.

(c) A notary public must use a certificate in substantially the following form in notarizing a copy of a tangible or an electronic record or a printout of an electronic record:

STATE OF FLORIDA

COUNTY OF ....

On this ...... day of ...., …(year)…, I attest that the preceding or attached document is a true, exact, complete, and unaltered …(copy of a tangible or an electronic record presented to me by the document's custodian)… or a …(printout made by me from such record)…. If a printout, I further attest that, at the time of printing, no security features, if any, present on the electronic record, indicated that the record had been altered since execution.

…(Signature of Notary Public — State of Florida)…

…(Print, Type, or Stamp Commissioned Name of Notary Public)…

(13) The following notarial certificates are sufficient for the purposes indicated, if completed with the information required by this chapter. The specification of forms under this subsection does not preclude the use of other forms.

(a) For an oath or affirmation:

STATE OF FLORIDA

COUNTY OF ....

Sworn to (or affirmed) and subscribed before me by means of □ physical presence or □ online notarization, this ...... day of ...., …(year)…, by …(name of person making statement)….

…(Signature of Notary Public - State of Florida)…

…(Print, Type, or Stamp Commissioned Name of Notary Public)…

Personally Known .... OR Produced Identification ....

Type of Identification Produced . . . .

(b) For an acknowledgment in an individual capacity:

STATE OF FLORIDA

COUNTY OF ....

The foregoing instrument was acknowledged before me by means of □ physical presence or □ online notarization, this ...... day of ...., …(year)…, by …(name of person acknowledging)….

…(Signature of Notary Public - State of Florida)…

…(Print, Type, or Stamp Commissioned Name of Notary Public)…

Personally Known .... OR Produced Identification ....

Type of Identification Produced................................

(c) For an acknowledgment in a representative capacity:

STATE OF FLORIDA

COUNTY OF ....

The foregoing instrument was acknowledged before me by means of □ physical presence or □ online notarization, this ...... day of ...., …(year)…, by …(name of person)… as …(type of authority, . . . e.g. officer, trustee, attorney in fact)… for …(name of party on behalf of whom instrument was executed)….

…(Signature of Notary Public - State of Florida)…

…(Print, Type, or Stamp Commissioned Name of Notary Public)…

Personally Known .... OR Produced Identification ....

Type of Identification Produced................................

(14) A notary public must make reasonable accommodations to provide notarial services to persons with disabilities.

(a) A notary public may notarize the signature of a person who is blind after the notary public has read the entire instrument to that person.

(b) A notary public may notarize the signature of a person who signs with a mark if:

1. The document signing is witnessed by two disinterested persons;

2. The notary <u>public</u> prints the person's first name at the beginning of the designated signature line and the person's last name at the end of the designated signature line; and

3. The notary <u>public</u> prints the words "his (or her) mark" below the person's signature mark.

(c) The following notarial certificates are sufficient for the purpose of notarizing for a person who signs with a mark:

1. For an oath or affirmation:

…(First Name)… …(Last Name)…

…His (or Her) Mark…

STATE OF FLORIDA

COUNTY OF ....

Sworn to and subscribed before me <u>by means of □ physical presence or □ online notarization,</u> this ...... day of ...., …(year)…, by …(name of person making statement)…, who signed with a mark in the presence of these witnesses:

…(Signature of Notary Public - State of Florida)…

…(Print, Type, or Stamp Commissioned Name of Notary Public)…

Personally Known .... OR Produced Identification ....

Type of Identification Produced . . . .

2. For an acknowledgment in an individual capacity:

…(First Name)… …(Last Name)…

…His (or Her) Mark…

STATE OF FLORIDA

COUNTY OF ....

The foregoing instrument was acknowledged before me <u>by means of □ physical presence or □ online notarization,</u> this ...... day of ...., …(year)

…, by …(name of person acknowledging)…, who signed with a mark in the presence of these witnesses:

…(Signature of Notary Public - State of Florida)…

…(Print, Type, or Stamp Commissioned Name of Notary Public)…

Personally Known ………… OR Produced Identification …………

Type of Identification Produced. . . . .

(d) A notary public may sign the name of a person whose signature is to be notarized when that person is physically unable to sign or make a signature mark on a document if:

1. The person with a disability directs the notary public to sign in his or her presence by verbal, written, or other means;

2. The document signing is witnessed by two disinterested persons; and

3. The notary public writes below the signature the following statement: “Signature affixed by notary, pursuant to s. 117.05(14), Florida Statutes,” and states the circumstances and the means by which the notary public was directed to sign ~~of the signing in~~ the notarial certificate.

The notary public must maintain the proof of direction and authorization to sign on behalf of the person with a disability for 10 years from the date of the notarial act.

(e) The following notarial certificates are sufficient for the purpose of notarizing for a person with a disability who directs the notary public to sign his or her name:

1. For an oath or affirmation:

STATE OF FLORIDA

COUNTY OF …………

Sworn to (or affirmed) before me by means of □ physical presence or □ online notarization, this …… day of …………, …(year)…, by …(name of person making statement)…, and subscribed by …(name of notary)… at the direction of ~~and in the presence of~~ …(name of person making statement) …by …(written, verbal, or other means)…, and in the presence of these witnesses:

…(Signature of Notary Public - State of Florida)…

…(Print, Type, or Stamp Commissioned Name of Notary Public)…

Personally Known .... OR Produced Identification ....

Type of Identification Produced . . . .

2. For an acknowledgment in an individual capacity:

STATE OF FLORIDA

COUNTY OF ....

The foregoing instrument was acknowledged before me by means of □ physical presence or □ online notarization, this ...... day of ...., …(year)…, by …(name of person acknowledging)… and subscribed by …(name of notary)… at the direction of ~~and in the presence of~~ …(name of person acknowledging)…, and in the presence of these witnesses:

…(Signature of Notary Public - State of Florida)…

…(Print, Type, or Stamp Commissioned Name of Notary Public)…

Personally Known .... OR Produced Identification ....

Type of Identification Produced . . . .

Section 5. Subsections (2) and (9) of section 117.107, Florida Statutes, are amended to read:

117.107 Prohibited acts.—

(2) A notary public may not sign notarial certificates using a facsimile signature stamp unless the notary public has a physical disability that limits or prohibits his or her ability to make a written signature and unless the notary public has first submitted written notice to the Department of State with an exemplar of the facsimile signature stamp. This subsection does not apply to or prohibit the use of an electronic signature and seal by a notary public who is registered as an online notary public to perform an electronic or online notarization in accordance with this chapter.

(9) A notary public may not notarize a signature on a document if the person whose signature is being notarized does not appear before the notary public either by means of physical presence or by means of audio-video communication technology as authorized under part II of this chapter ~~is not in the presence of the notary public~~ at the time the signature is notarized. Any notary public who violates this subsection is guilty of a civil infraction, punishable by penalty not exceeding $5,000, and such violation constitutes malfeasance and misfeasance in the conduct of official duties. It is no defense

to the civil infraction specified in this subsection that the notary public acted without intent to defraud. A notary public who violates this subsection with the intent to defraud is guilty of violating s. 117.105.

Section 6. Section 117.201, Florida Statutes, is created to read:

117.201 Definitions.—As used in this part, the term:

(1) "Appear before," "before," or "in the presence of" mean:

(a) In the physical presence of another person; or

(b) Outside of the physical presence of another person, but able to see, hear, and communicate with the person by means of audio-video communication technology.

(2) "Audio-video communication technology" means technology in compliance with applicable law which enables real-time, two-way communication using electronic means in which participants are able to see, hear, and communicate with one another.

(3) "Credential analysis" means a process or service, in compliance with applicable law, in which a third party aids a public notary in affirming the validity of a government-issued identification credential and data thereon through review of public or proprietary data sources.

(4) "Electronic," "electronic record," or "electronic signature" has the same meaning as provided in s. 668.50.

(5) "Errors and omissions insurance" means a type of insurance that provides coverage for potential errors or omissions in or relating to the notarial act and is maintained, as applicable, by the online notary public or his or her employer, or a Remote Online Notarization service provider.

(6) "Government-issued identification credential" means any approved credential for verifying identity under s. 117.05(5)(b)2.

(7) "Identity proofing" means a process or service in compliance with applicable law in which a third party affirms the identity of an individual through use of public or proprietary data sources, which may include by means of knowledge-based authentication or biometric verification.

(8) "Knowledge-based authentication" means a form of identity proofing based on a set of questions which pertain to an individual and are formulated from public or proprietary data sources.

(9) "Online notarization" means the performance of a notarial act using electronic means in which the principal appears before the notary public by means of audio-video communication technology.

(10) "Online notary public" means a notary public commissioned under part I of this chapter, a civil-law notary appointed under chapter 118, or a

commissioner of deeds appointed under part IV of chapter 721, who has registered with the Department of State to perform online notarizations under this part.

(11) "Physical presence" means being in the same physical location as another person and close enough to see, hear, communicate with, and exchange credentials with that person.

(12) "Principal" means an individual whose electronic signature is acknowledged, witnessed, or attested to in an online notarization or who takes an oath or affirmation administered by the online notary public.

(13) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form, including public records as defined in s. 119.011.

(14) "Remote Online Notarization service provider" or "RON service provider" means a person that provides audio-video communication technology and related processes, services, software, data storage, or other services to online notaries public for the purpose of directly facilitating their performance of online notarizations in compliance with this chapter and any rules adopted by the Department of State pursuant to s. 117.295.

(15) "Remote presentation" means transmission of an image of a government-issued identification credential that is of sufficient quality to enable the online notary public to identify the individual seeking the notary's services and to perform credential analysis through audio-video communication technology.

Section 7. Section 117.209, Florida Statutes, is created to read:

117.209 Authority to perform online notarizations.—

(1) An online notary public may perform any of the functions authorized under part I of this chapter as an online notarization by complying with the requirements of this part and any rules adopted by the Department of State pursuant to s. 117.295, excluding solemnizing the rites of matrimony.

(2) If a notarial act requires a principal to appear before or in the presence of the online notary public, the principal may appear before the online notary public by means of audio-video communication technology that meets the requirements of this part and any rules adopted by the Department of State pursuant to s. 117.295.

(3) An online notary public physically located in this state may perform an online notarization as authorized under this part, regardless of whether the principal or any witnesses are physically located in this state at the time of the online notarization. A commissioner of deeds registered as an online notary public may perform an online notarization while physically located within or outside the state in accordance with the territorial limits of its

jurisdiction and other limitations and requirements otherwise applicable to notarial acts by commissioners of deeds.

(4) The validity of an online notarization performed by an online notary public registered in this state shall be determined by applicable laws of this state regardless of the physical location of the principal or any witnesses at the time of the notarial act.

Section 8. Section 117.215, Florida Statutes, is created to read:

117.215 Relation to other laws.—

(1) If a provision of law requires a notary public or other authorized official of this state to notarize a signature or a statement, to take an acknowledgment of an instrument, or to administer an oath or affirmation so that a document may be sworn, affirmed, made under oath, or subject to penalty of perjury, an online notarization performed in accordance with the provisions of this part and any rules adopted hereunder satisfies such requirement.

(2) If a provision of law requires a signature or an act to be witnessed, compliance with the online electronic witnessing standards prescribed in s. 117.285 and any rules adopted thereunder satisfies that requirement.

Section 9. Section 117.225, Florida Statutes, is created to read:

117.225 Registration; qualifications.—A notary public, a civil-law notary appointed under chapter 118, or a commissioner of deeds appointed under part IV of chapter 721 may complete registration as an online notary public with the Department of State by:

(1) Holding a current commission as a notary public under part I of this chapter, an appointment as a civil-law notary under chapter 118, or an appointment as a commissioner of deeds under part IV of chapter 721, and submitting a copy of such commission or proof of such appointment with his or her registration.

(2) Certifying that the notary public, civil-law notary, or commissioner of deeds registering as an online notary public has completed a classroom or online course covering the duties, obligations, and technology requirements for serving as an online notary public.

(3) Paying a notary public registration fee as required by s. 113.01.

(4) Submitting a registration as an online notary public to the Department of State, signed and sworn to by the registrant.

(5) Identifying the RON service provider whose audio-video communication technology and processes for credential analysis and identity proofing technologies the registrant intends to use for online notarizations, and confirming that such technology and processes satisfy the requirements of

this chapter and any rules adopted by the Department of State pursuant to s. 117.295.

(6) Providing evidence satisfactory to the Department of State that the registrant has obtained a bond in the amount of $25,000, payable to any individual harmed as a result of a breach of duty by the registrant acting in his or her official capacity as an online notary public, conditioned for the due discharge of the office, and on such terms as are specified in rule by the Department of State as reasonably necessary to protect the public. The bond shall be approved and filed with the Department of State and executed by a surety company duly authorized to transact business in this state. Compliance by an online notary public with this requirement shall satisfy the requirement of obtaining a bond under s. 117.01(7).

(7) Providing evidence satisfactory to the Department of State that the registrant acting in his or her capacity as an online notary public is covered by an errors and omissions insurance policy from an insurer authorized to transact business in this state, in the minimum amount of $25,000 and on such terms as are specified by rule by the Department of State as reasonably necessary to protect the public.

Section 10. Section 117.235, Florida Statutes, is created to read:

117.235 Performance of notarial acts.—

(1) An online notary public is subject to part I of this chapter to the same extent as a notary public appointed and commissioned only under that part, including the provisions of s. 117.021 relating to electronic notarizations.

(2) An online notary public may perform notarial acts as provided by part I of this chapter in addition to performing online notarizations as authorized and pursuant to the provisions of this part.

Section 11. Section 117.245, Florida Statutes, is created to read:

117.245 Electronic journal of online notarizations.—

(1) An online notary public shall keep one or more secure electronic journals of online notarizations performed by the online notary public. For each online notarization, the electronic journal entry must contain all of the following:

(a) The date and time of the notarization.

(b) The type of notarial act.

(c) The type, the title, or a description of the electronic record or proceeding.

(d) The name and address of each principal involved in the transaction or proceeding.

(e) Evidence of identity of each principal involved in the transaction or proceeding in any of the following forms:

1. A statement that the person is personally known to the online notary public.

2. A notation of the type of government-issued identification credential provided to the online notary public.

(f) An indication that the principal satisfactorily passed the identity proofing.

(g) An indication that the government-issued identification credential satisfied the credential analysis.

(h) The fee, if any, charged for the notarization.

(2) The online notary public shall retain an uninterrupted and unedited copy of the recording of the audio-video communication in which an online notarization is performed. The recording must include all of the following:

(a) Appearance by the principal and any witness before the online notary public.

(b) Confirmation of the identity of the principal and any witness.

(c) A general description or identification of the records to be signed.

(d) At the commencement of the recording, recitation by the online notary public of information sufficient to identify the notarial act.

(e) A declaration by the principal that his or her signature on the record is knowingly and voluntarily made.

(f) All of the actions and spoken words of the principal, notary public, and any required witness during the entire online notarization, including the signing of any records before the online notary public.

(3) The online notary public shall take reasonable steps to:

(a) Ensure the integrity, security, and authenticity of online notarizations.

(b) Maintain a backup record of the electronic journal required by subsection (1).

(c) Protect the electronic journal, the backup record, and any other records received by the online notary public from unauthorized access or use.

(4) The electronic journal required under subsection (1) and the recordings of audio-video communications required under subsection (2) shall be maintained for at least 10 years after the date of the notarial act. However, a

full copy of the recording of the audio-video communication required under subsection (2) relating to an online notarization session that involves the signing of an electronic will must be maintained by a qualified custodian in accordance with chapters 731 and 732. The Department of State maintains jurisdiction over the electronic journal and audio-video communication recordings to investigate notarial misconduct for a period of 10 years after the date of the notarial act. The online notary public, a guardian of an incapacitated online notary public, or the personal representative of a deceased online notary public may, by contract with a secure repository in accordance with any rules established under this chapter, delegate to the repository the online notary public's duty to retain the electronic journal and the required recordings of audio-video communications, provided that the Department of State is notified of such delegation of retention duties to the repository within 30 days thereafter, including the address and contact information for the repository. If an online notary public delegates to a secure repository under this section, the online notary public shall make an entry in his or her electronic journal identifying such repository, and provide notice to the Department of State as required in this subsection.

(5) An omitted or incomplete entry in the electronic journal does not impair the validity of the notarial act or of the electronic record which was notarized, but may be introduced as evidence to establish violations of this chapter; as evidence of possible fraud, forgery, impersonation, duress, incapacity, undue influence, minority, illegality, unconscionability; or for other evidentiary purposes. However, if the recording of the audio-video communication required under subsection (2) relating to the online notarization of the execution of an electronic will cannot be produced by the online notary public or the qualified custodian, the electronic will shall be treated as a lost or destroyed will subject to s. 733.207.

Section 12. Section 117.255, Florida Statutes, is created to read:

117.255 Use of electronic journal, signature, and seal.—An online notary public shall:

(1) Take reasonable steps to ensure that any registered device used to create an electronic seal is current and has not been revoked or terminated by the issuing or registering authority of the device.

(2) Keep the electronic journal and electronic seal secure and under his or her sole control, which includes access protection using passwords or codes under control of the online notary public. The online notary public may not allow another person to use the online notary public's electronic journal, electronic signature, or electronic seal, other than a RON service provider or other authorized person providing services to an online notary public to facilitate performance of online notarizations.

(3) Attach or logically associate the electronic signature and seal to the electronic notarial certificate of an electronic record in a manner that is capable of independent verification using tamper-evident technology that

CODING: Words ~~stricken~~ are deletions; words underlined are additions.

renders any subsequent change or modification to the electronic record evident.

(4) Notify an appropriate law enforcement agency and the Department of State of any unauthorized use of or compromise to the security of the electronic journal, official electronic signature, or electronic seal within 7 days after discovery of such unauthorized use or compromise to security.

(5) Make electronic copies, upon request, of the pertinent entries in the electronic journal and provide access to the related audio-video communication recordings to the following persons:

(a) The parties to an electronic record notarized by the online notary public;

(b) The qualified custodian of an electronic will notarized by the online notary public;

(c) The title agent, settlement agent, or title insurer who insured the electronic record or engaged the online notary public with regard to a real estate transaction;

(d) The online notary public's RON service provider whose services were used by the online notary public to notarize the electronic record;

(e) Any person who is asked to accept a power of attorney that was notarized by the online notary public;

(f) The Department of State pursuant to a notary misconduct investigation; and

(g) Any other persons pursuant to a subpoena, court order, law enforcement investigation, or other lawful inspection demand.

(6) The online notary public may charge a fee not to exceed $20 per transaction record for making and delivering electronic copies of a given series of related electronic records, except if requested by:

(a) A party to the electronic record;

(b) In a real estate transaction, the title agent, settlement agent, or title insurer who insured the electronic record or engaged the online notary public with regard to such transaction; or

(c) The Department of State pursuant to an investigation relating to the official misconduct of an online notary public.

If the online notary public does charge a fee, the online notary public shall disclose the amount of such fee to the requester before making the electronic copies.

Section 13. Section 117.265, Florida Statutes, is created to read:

117.265 Online notarization procedures.—

(1) An online notary public physically located in this state may perform an online notarization that meets the requirements of this part regardless of whether the principal or any witnesses are physically located in this state at the time of the online notarization. A commissioner of deeds registered as an online notary public may perform an online notarization while physically located within or outside of this state in accordance with the territorial limits of its jurisdiction and other limitations and requirements otherwise applicable to notarial acts by commissioners of deeds. An online notarization performed in accordance with this chapter is deemed to have been performed within this state and is governed by the applicable laws of this state.

(2) In performing an online notarization, an online notary public shall confirm the identity of a principal and any witness appearing online, at the time that the signature is taken, by using audio-video communication technology and processes that meet the requirements of this part and of any rules adopted hereunder and record the two-way audio-video conference session between the notary public and the principal and any witnesses. A principal may not act in the capacity of a witness for his or her own signature in an online notarization.

(3) In performing an online notarization of a principal not located within this state, an online notary public must confirm, either verbally or through the principal's written consent, that the principal desires for the notarial act to be performed by a Florida notary public and under the general law of this state.

(4) An online notary public shall confirm the identity of the principal by:

(a) Personal knowledge of each principal; or

(b) All of the following, as such criteria may be modified or supplemented in rules adopted by the Department of State pursuant to s. 117.295:

1. Remote presentation of a government-issued identification credential by each principal.

2. Credential analysis of each government-issued identification credential.

3. Identity proofing of each principal in the form of knowledge-based authentication or another method of identity proofing that conforms to the standards of this chapter.

If the online notary public is unable to satisfy subparagraphs (b)1.-3., or if the databases consulted for identity proofing do not contain sufficient information to permit authentication, the online notary public may not perform the online notarization.

(5) An online notary public may change his or her RON service provider or providers from time to time, but shall notify the Department of State of such change within 30 days thereafter.

(6) The online notary public or his or her RON service provider shall take reasonable steps to ensure that the audio-video communication technology used in an online notarization is secure from unauthorized interception.

(7) The electronic notarial certificate for an online notarization must include a notation that the notarization is an online notarization which may be satisfied by placing the term "online notary" in or adjacent to the online notary public's seal.

(8) Except where otherwise expressly provided in this part, the provisions of part I of this chapter apply to an online notarization and an online notary public.

(9) Any failure to comply with the online notarization procedures set forth in this section does not impair the validity of the notarial act or the electronic record that was notarized, but may be introduced as evidence to establish violations of this chapter or as an indication of possible fraud, forgery, impersonation, duress, incapacity, undue influence, minority, illegality, unconscionability, or for other evidentiary purposes. This subsection may not be construed to alter the duty of an online notary public to comply with this chapter and any rules adopted hereunder.

Section 14. Section 117.275, Florida Statutes, is created to read:

117.275 Fees for online notarization.—An online notary public or the employer of such online notary public may charge a fee, not to exceed $25, for performing an online notarization under this part. Fees for services other than notarial acts are not governed by this section.

Section 15. Section 117.285, Florida Statutes, is created to read:

117.285 Supervising the witnessing of electronic records.—An online notary public may supervise the witnessing of electronic records by the same audio-video communication technology used for online notarization, as follows:

(1) The witness may be in the physical presence of the principal or remote from the principal provided the witness and principal are using audio-video communication technology.

(2) If the witness is remote from the principal and viewing and communicating with the principal by means of audio-video communication technology, the witness's identity must be verified in accordance with the procedures for identifying a principal as set forth in s. 117.265(4). If the witness is in the physical presence of the principal, the witness must confirm his or her identity by stating his or her name and current address on the audio-video recording as part of the act of witnessing.

(3) The act of witnessing an electronic signature means the witness is either in the physical presence of the principal or present through audio-video communication technology at the time the principal affixes the electronic signature and the witness hears the principal make a statement to the effect that the principal has signed the electronic record.

(4) A witness remote from the principal and appearing through audio-video communication technology must verbally confirm that he or she is a resident of and physically located within the United States or a territory of the United States at the time of witnessing.

(5) Notwithstanding subsections (2) and (3), if an electronic record to be signed is a will under chapter 732, a trust with testamentary aspects under chapter 736, a health care advance directive, a waiver of spousal rights under s. 732.701 or s. 732.702, or a power of attorney authorizing any of the transactions enumerated in s. 709.2208, the following shall apply:

(a) Prior to facilitating witnessing of an instrument by means of audio-video communication technology, a RON service provider shall require the principal to answer the following questions in substantially the following form:

1. Are you under the influence of any drug or alcohol today that impairs your ability to make decisions?

2. Do you have any physical or mental condition or long-term disability that impairs your ability to perform the normal activities of daily living?

3. Do you require assistance with daily care?

(b) If any question required under paragraph (a) is answered in the affirmative, the principal's signature on the instrument may only be validly witnessed by witnesses in the physical presence of the principal at the time of signing.

(c) Subsequent to submission of the answers required under paragraph (a), the RON service provider shall give the principal written notice in substantially the following form:

NOTICE: If you are a vulnerable adult as defined in s. 415.102, Florida Statutes, the documents you are about to sign are not valid if witnessed by means of audio-video communication technology. If you suspect you may be a vulnerable adult, you should have witnesses physically present with you before signing.

(d) The act of witnessing an electronic signature through the witness's presence by audio-video communication technology is valid only if, during the audio-video communication, the principal provides verbal answers to all of the following questions, each of which must be asked by the online notary public in substantially the following form:

1. Are you currently married? If so, name your spouse.

2. Please state the names of anyone who assisted you in accessing this video conference today.

3. Please state the names of anyone who assisted you in preparing the documents you are signing today.

4. Where are you currently located?

5. Who is in the room with you?

(e) An online notary public shall consider the responses to the questions specified in paragraph (d) in carrying out of the duties of a notary public as set forth in s. 117.107(5).

(f) A principal's responses to the questions in paragraphs (a) and (d) may be offered as evidence regarding the validity of the instrument, but an incorrect answer may not serve as the sole basis to invalidate an instrument.

(g) The presence of a witness with the principal at the time of signing by means of audio-video communication technology is not effective for witnessing the signature of a principal who is a vulnerable adult as defined in s. 415.102. The contestant of an electronic record has the burden of proving that the principal was a vulnerable adult at the time of executing the electronic record.

(h) Nothing in this subsection shall preclude a power of attorney, which includes banking or investment powers enumerated in s. 709.2208, from being effective with respect to any other authority granted therein or with respect to the agent's authority in connection with a real property, commercial, or consumer transaction or loan, to exercise any power specified therein or to execute and deliver instruments obligating the principal or to draw upon the proceeds of such transaction or loan.

(i) The electronic record containing an instrument signed by witnesses who were present with the principal by means of audio-video communication technology shall contain a perceptible indication of their presence by such means.

(j) Nothing in this subsection shall affect the application of s. 709.2119.

(6) Pursuant to subpoena, court order, an authorized law enforcement inquiry, or other lawful request, a RON service provider or online notary public shall provide:

(a) The last known address of each witness who witnessed the signing of an electronic record using audio-video communication technology under this section.

(b) A principal's responses to the questions in paragraphs (5)(a) or (b), as applicable.

(c) An uninterrupted and unedited copy of the recording of the audio-video communication in which an online notarization is performed.

(7) Except as set forth in s. 709.2202, an act of witnessing performed pursuant to this section satisfies any requirement that the witness must be a subscribing or attesting witness or must be in the presence of the principal at the time of signing.

(8) The law of this state governs the validity of witnessing supervised by an online notary public pursuant to this section, regardless of the physical location of the witness at the time of witnessing. State and federal courts in this state have subject matter jurisdiction over any dispute arising out of an act of witnessing pursuant to this section, and may issue subpoenas for records or to require the appearance of witnesses in relation thereto in accordance with applicable law.

Section 16. Effective upon becoming a law, section 117.295, Florida Statutes, is created to read:

117.295 Standards for electronic and online notarization; rulemaking authority.—

(1) For purposes of this part, the Department of State may adopt rules necessary to implement the requirements of this chapter and to set standards for online notarization which include, but are not limited to:

(a) Improvements in technology and methods of assuring the identity of principals and the security of an electronic record, including tamper-evident technologies in compliance with the standards adopted pursuant to s. 117.021 which apply to online notarizations.

(b) Education requirements for online notaries public and the required terms of bonds and errors and omissions insurance, but not including the amounts of such bonds and insurance policies.

(c) Identity proofing, credential analysis, unauthorized interception, remote presentation, audio-video communication technology, and retention of electronic journals and copies of audio-video communications recordings in a secure repository.

(2) By January 1, 2020, the Department of State shall adopt forms, processes, and interim or emergency rules necessary to accept applications from and register online notaries public pursuant to s. 117.225.

(3) Until such time as the Department of State adopts rules setting standards that are equally or more protective, the following minimum standards shall apply to any online notarization performed by an online notary public of this state or his or her RON service provider:

(a) Use of identity proofing by means of knowledge-based authentication which must have, at a minimum, the following security characteristics:

1. The principal must be presented with five or more questions with a minimum of five possible answer choices per question.

2. Each question must be drawn from a third-party provider of public and proprietary data sources and be identifiable to the principal's social security number or other identification information, or the principal's identity and historical events records.

3. Responses to all questions must be made within a 2-minute time constraint.

4. The principal must answer a minimum of 80 percent of the questions correctly.

5. The principal may be offered one additional attempt in the event of a failed attempt.

6. During the second attempt, the principal may not be presented with more than three questions from the prior attempt.

(b) Use of credential analysis using one or more commercially available automated software or hardware processes that are consistent with sound commercial practices; that aid the notary public in verifying the authenticity of the credential by analyzing the integrity of visual, physical, or cryptographic security features to indicate that the credential is not fraudulent or inappropriately modified; and that use information held or published by the issuing source or authoritative source, as available, to confirm the validity of credential details. The output of the credential analysis process must be provided to the online notary public performing the notarial act.

(c) Use of audio-video communication technology in completing online notarizations that must meet the following requirements:

1. The signal transmission must be reasonably secure from interception, access, or viewing by anyone other than the participants communicating.

2. The technology must provide sufficient audio clarity and video resolution to enable the notary to communicate with the principal and any witness, and to confirm the identity of the principal and any witness, as required, using the identification methods described in s. 117.265.

(4) A RON service provider is deemed to have satisfied tamper-evident technology requirements by use of technology that renders any subsequent change or modification to the electronic record evident.

(5) In addition to any coverage it elects to provide for individual online notaries public, maintenance of errors and omissions insurance coverage by a RON service provider in a total amount of at least $250,000 in the annual aggregate with respect to potential errors or omissions in or relating to the technology or processes provided by the RON service provider. An online notary public is not responsible for the security of the systems used by the principal or others to access the online notarization session.

(6) A 2-hour in-person or online course addressing the duties, obligations, and technology requirements for serving as an online notary public offered by the Florida Land Title Association; the Real Property, Probate and Trust Law Section of the Florida Bar; the Florida Legal Education Association, Inc.; the Department of State; or a vendor approved by the Department of State shall satisfy the education requirements of s. 117.225(2). Each such provider shall make the in-person or online course generally available to all applicants. Regardless of membership in the provider's organization, the provider shall charge each attendee the same cost for the course unless the course is provided in conjunction with a regularly scheduled meeting of the provider's membership.

(7) The rulemaking required under this section is exempt from s. 120.541(3).

Section 17. Section 117.305, Florida Statutes, is created to read:

117.305 Relation to federal law.—This part supersedes the Electronic Signatures in Global and National Commerce Act as authorized under 15 U.S.C. s. 7001 et seq., but does not modify, limit, or supersede s. 101(c) of that act, 15 U.S.C. s. 7001(c), or authorize the electronic delivery of the notices described in 15 U.S.C. s. 7003(b).

Section 18. Paragraph (h) of subsection (3) of section 28.222, Florida Statutes, is redesignated as paragraph (i), and a new paragraph (h) is added to that subsection to read:

28.222 Clerk to be county recorder.—

(3) The clerk of the circuit court shall record the following kinds of instruments presented to him or her for recording, upon payment of the service charges prescribed by law:

(h) Copies of any instruments originally created and executed using an electronic signature, as defined in s. 695.27, and certified to be a true and correct paper printout by a notary public in accordance with chapter 117, if the county recorder is not prepared to accept electronic documents for recording electronically.

Section 19. Subsections (1) and (2) of section 92.50, Florida Statutes, are amended to read:

92.50 Oaths, affidavits, and acknowledgments; who may take or administer; requirements.—

(1) IN THIS STATE.—Oaths, affidavits, and acknowledgments required or authorized under the laws of this state (except oaths to jurors and witnesses in court and such other oaths, affidavits and acknowledgments as are required by law to be taken or administered by or before particular officers) may be taken or administered by or before any judge, clerk, or deputy clerk of any court of record within this state, including federal courts, or by or before any United States commissioner or any notary public within this state. The jurat, or certificate of proof or acknowledgment, shall be authenticated by the signature and official seal of such officer or person taking or administering the same; however, when taken or administered by or before any judge, clerk, or deputy clerk of a court of record, the seal of such court may be affixed as the seal of such officer or person.

(2) IN OTHER STATES, TERRITORIES, AND DISTRICTS OF THE UNITED STATES.—Oaths, affidavits, and acknowledgments required or authorized under the laws of this state, may be taken or administered in any other state, territory, or district of the United States, by or before any judge, clerk or deputy clerk of any court of record, within such state, territory, or district, having a seal, or by or before any notary public or justice of the peace, having a seal, in such state, territory, or district; provided, however, such officer or person is authorized under the laws of such state, territory, or district to take or administer oaths, affidavits and acknowledgments. The jurat, or certificate of proof or acknowledgment, shall be authenticated by the signature and official seal of such officer or person taking or administering the same; provided, however, when taken or administered by or before any judge, clerk, or deputy clerk of a court of record, the seal of such court may be affixed as the seal of such officer or person.

Section 20. Subsection (1) of section 95.231, Florida Statutes, is amended to read:

95.231 Limitations where deed or will on record.—

(1) Five years after the recording of an instrument required to be executed in accordance with s. 689.01; 5 years after the recording of a power of attorney accompanying and used for an instrument required to be executed in accordance with s. 689.01; or 5 years after the probate of a will purporting to convey real property, from which it appears that the person owning the property attempted to convey, affect, or devise it, the instrument, power of attorney, or will shall be held to have its purported effect to convey, affect, or devise, the title to the real property of the person signing the instrument, as if there had been no lack of seal or seals, witness or witnesses, defect in, failure of, or absence of acknowledgment or relinquishment of dower, in the absence of fraud, adverse possession, or

pending litigation. The instrument is admissible in evidence. A power of attorney validated under this subsection shall be valid only for the purpose of effectuating the instrument with which it was recorded.

Section 21. Section 689.01, Florida Statutes, is amended to read:

689.01 How real estate conveyed.—

(1) No estate or interest of freehold, or for a term of more than 1 year, or any uncertain interest of, in or out of any messuages, lands, tenements or hereditaments shall be created, made, granted, transferred or released in any other manner than by instrument in writing, signed in the presence of two subscribing witnesses by the party creating, making, granting, conveying, transferring or releasing such estate, interest, or term of more than 1 year, or by the party's lawfully authorized agent, unless by will and testament, or other testamentary appointment, duly made according to law; and no estate or interest, either of freehold, or of term of more than 1 year, or any uncertain interest of, in, to, or out of any messuages, lands, tenements or hereditaments, shall be assigned or surrendered unless it be by instrument signed in the presence of two subscribing witnesses by the party so assigning or surrendering, or by the party's lawfully authorized agent, or by the act and operation of law. No seal shall be necessary to give validity to any instrument executed in conformity with this section. Corporations may execute any and all conveyances in accordance with the provisions of this section or ss. 692.01 and 692.02.

(2) For purposes of this chapter:

(a) Any requirement that an instrument be signed in the presence of two subscribing witnesses may be satisfied by witnesses being present and electronically signing by means of audio-video communication technology, as defined in s. 117.201.

(b) The act of witnessing an electronic signature is satisfied if a witness is in the physical presence of the principal or present through audio-video communication technology at the time the principal affixes his or her electronic signature and the witness hears the principal make a statement acknowledging that the principal has signed the electronic record.

(c) The terms used in this subsection have the same meanings as the terms defined in s. 117.201.

(3) All acts of witnessing made or taken in the manner described in subsection (2) are validated and, upon recording, may not be denied to have provided constructive notice based on any alleged failure to have strictly complied with this section or the laws governing notarization of instruments, including online notarization. This subsection does not preclude a challenge to the validity or enforceability of an instrument or electronic record based upon fraud, forgery, impersonation, duress, incapacity, undue

influence, minority, illegality, unconscionability, or any other basis not related to the act of witnessing.

Section 22. Section 694.08, Florida Statutes, is amended to read:

694.08 Certain instruments validated, notwithstanding lack of seals or witnesses, or defect in acknowledgment~~, etc~~.—

(1) Whenever any power of attorney has been executed and delivered, or any conveyance has been executed and delivered to any grantee by the person owning the land therein described, or conveying the same in an official or representative capacity, and has, for a period of 7 years or more been spread upon the records of the county wherein the land therein described has been or was at the time situated, and one or more subsequent conveyances of said land or parts thereof have been made, executed, delivered and recorded by parties claiming under such instrument or instruments, and such power of attorney or conveyance, or the public record thereof, shows upon its face a clear purpose and intent of the person executing the same to authorize the conveyance of said land or to convey the said land, the same shall be taken and held by all the courts of this state, in the absence of any showing of fraud, adverse possession, or pending litigation, to have authorized the conveyance of, or to have conveyed, the fee simple title, or any interest therein, of the person signing such instruments, or the person in behalf of whom the same was conveyed by a person in an official or representative capacity, to the land therein described as effectively as if there had been no defect in, failure of, or absence of the acknowledgment or the certificate of acknowledgment, if acknowledged, or the relinquishment of dower, and as if there had been no lack of the word "as" preceding the title of the person conveying in an official or representative capacity, of any seal or seals, or of any witness or witnesses, and shall likewise be taken and held by all the courts of this state to have been duly recorded so as to be admissible in evidence;

(2) Provided, however, that this section shall not apply to any conveyance the validity of which shall be contested or have been contested by suit commenced heretofore or within 1 year of the effective date of this law.

Section 23. Section 695.03, Florida Statutes, is amended to read:

695.03 Acknowledgment and proof; validation of certain acknowledgments; legalization or authentication before foreign officials.—To entitle any instrument concerning real property to be recorded, the execution must be acknowledged by the party executing it, proved by a subscribing witness to it, or legalized or authenticated in one of the following forms ~~by a civil-law notary or notary public who affixes her or his official seal, before the officers and in the form and manner following~~:

(1) WITHIN THIS STATE.—An acknowledgment or a proof may be taken, administered, or made within this state by or ~~may be made~~ before a judge, clerk, or deputy clerk of any court; a United States commissioner or

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magistrate; or any ~~a~~ notary public or civil-law notary of this state, and the certificate of acknowledgment or proof must be under the seal of the court or officer, as the case may be. ~~All affidavits and acknowledgments heretofore made or taken in this manner are hereby validated.~~

(2) OUTSIDE ~~WITHOUT~~ THIS STATE BUT WITHIN THE UNITED STATES.—An acknowledgment or a proof taken, administered, or made outside ~~out~~ of this state but within the United States may be taken, administered, or made by or before a civil-law notary of this state or a commissioner of deeds appointed by the Governor of this state; a judge or clerk of any court of the United States or of any state, territory, or district; by or before a United States commissioner or magistrate; or by or before any ~~a~~ notary public, justice of the peace, master in chancery, or registrar or recorder of deeds of any state, territory, or district having a seal, and the certificate of acknowledgment or proof must be under the seal of the court or officer, as the case may be. If the acknowledgment or proof is taken, administered, or made by or before a notary public who does not affix a seal, it is sufficient for the notary public to type, print, or write by hand on the instrument, "I am a Notary Public of the State of ...(state)..., and my commission expires on ...(date)...."

(3) OUTSIDE OF THE UNITED STATES OR WITHIN FOREIGN COUNTRIES.—An ~~If the~~ acknowledgment, an affidavit, an oath, a legalization, an authentication, or a proof taken, administered, or made outside the United States or ~~is made~~ in a foreign country~~, it~~ may be taken, administered, or made by or before a commissioner of deeds appointed by the Governor of this state to act in such country; before a notary public of such foreign country or a civil-law notary of this state or of such foreign country who has an official seal; before an ambassador, envoy extraordinary, minister plenipotentiary, minister, commissioner, charge d'affaires, consul general, consul, vice consul, consular agent, or other diplomatic or consular officer of the United States appointed to reside in such country; or before a military or naval officer authorized by 10 U.S.C. s. 1044a ~~the Laws or Articles of War of the United States~~ to perform the duties of notary public, and the certificate of acknowledgment, legalization, authentication, or proof must be under the seal of the officer. A certificate legalizing or authenticating the signature of a person executing an instrument concerning real property and to which a civil-law notary or notary public of that country has affixed her or his official seal is sufficient as an acknowledgment. For the purposes of this section, the term "civil-law notary" means a civil-law notary as defined in chapter 118 or an official of a foreign country who has an official seal and who is authorized to make legal or lawful the execution of any document in that jurisdiction, in which jurisdiction the affixing of her or his official seal is deemed proof of the execution of the document or deed in full compliance with the laws of that jurisdiction.

(4) COMPLIANCE AND VALIDATION.—The affixing of the official seal or the electronic equivalent thereof under s. 117.021 or other applicable law, including part II of chapter 117, conclusively establishes that the acknowledgment or proof was taken, administered, or made in full compliance with

the laws of this state or, as applicable, the laws of the other state, or of the foreign country governing notarial acts. All affidavits, oaths, acknowledgments, legalizations, authentications, or proofs taken, administered, or made in any manner as set forth in subsections (1), (2), and (3) are validated and upon recording may not be denied to have provided constructive notice based on any alleged failure to have strictly complied with this section, as currently or previously in effect, or the laws governing notarization of instruments. This subsection does not preclude a challenge to the validity or enforceability of an instrument or electronic record based upon fraud, forgery, impersonation, duress, incapacity, undue influence, minority, illegality, unconscionability, or any other basis not related to the notarial act or constructive notice provided by recording.

~~All affidavits, legalizations, authentications, and acknowledgments heretofore made or taken in the manner set forth above are hereby validated.~~

Section 24. Section 695.04, Florida Statutes, is amended to read:

695.04 Requirements of certificate.—The certificate of the officer before whom the acknowledgment or proof is taken, except for a certificate legalizing or authenticating the signature of a person executing an instrument concerning real property pursuant to s. 695.03(3), shall contain and set forth substantially the matter required to be done or proved to make such acknowledgment or proof effectual as set forth in s. 117.05.

Section 25. Section 695.25, Florida Statutes, is amended to read:

695.25 Short form of acknowledgment.—The forms of acknowledgment set forth in this section may be used, and are sufficient for their respective purposes, under any law of this state. The forms shall be known as "Statutory Short Forms of Acknowledgment" and may be referred to by that name. The authorization of the forms in this section does not preclude the use of other forms.

(1) For an individual acting in his or her own right:

STATE OF ......

COUNTY OF ......

The foregoing instrument was acknowledged before me by means of □ physical presence or □ online notarization, this …(date)… by …(name of person acknowledging)…, who is personally known to me or who has produced …(type of identification)… as identification.

…(Signature of person taking acknowledgment)…

…(Name typed, printed or stamped)…

…(Title or rank)…

…(Serial number, if any)…

(2) For a corporation:

STATE OF ......

COUNTY OF ......

The foregoing instrument was acknowledged before me by means of □ physical presence or □ online notarization, this …(date)… by …(name of officer or agent, title of officer or agent)… of …(name of corporation acknowledging)…, a …(state or place of incorporation)… corporation, on behalf of the corporation. He/she is personally known to me or has produced …(type of identification)… as identification.

…(Signature of person taking acknowledgment)…

…(Name typed, printed or stamped)…

…(Title or rank)…

…(Serial number, if any)…

(3) For a limited liability company:

STATE OF......

COUNTY OF ......

The foregoing instrument was acknowledged before me by means of □ physical presence or □ online notarization, this …(date)… by …(name of member, manager, officer or agent, title of member, manager, officer or agent)…, of …(name of company acknowledging)…, a …(state or place of formation)… limited liability company, on behalf of the company, who is personally known to me or has produced …(type of identification)… as identification.

…(Signature of person taking acknowledgment)…

…(Name typed, printed or stamped)…

…(Title or rank)…

…(Serial number, if any)…

(4)~~(3)~~ For a partnership:

STATE OF ......

COUNTY OF ......

The foregoing instrument was acknowledged before me by means of □ physical presence or □ online notarization, this …(date)… by …(name of acknowledging partner or agent)…, partner (or agent) on behalf of …(name of partnership)…, a partnership. He/she is personally known to me or has produced …(type of identification)… as identification.

…(Signature of person taking acknowledgment)…

…(Name typed, printed or stamped)…

…(Title or rank)…

…(Serial number, if any)…

(5)~~(4)~~ For an individual acting as principal by an attorney in fact:

STATE OF ......

COUNTY OF ......

The foregoing instrument was acknowledged before me by means of □ physical presence or □ online notarization, this …(date)… by …(name of attorney in fact)… as attorney in fact, who is personally known to me or who has produced …(type of identification)… as identification on behalf of …(name of principal)….

…(Signature of person taking acknowledgment)…

…(Name typed, printed or stamped)…

…(Title or rank)…

…(Serial number, if any)…

(6)~~(5)~~ By any public officer, trustee, or personal representative:

STATE OF ......

COUNTY OF ......

The foregoing instrument was acknowledged before me by means of □ physical presence or □ online notarization, this …(date)… by …(name and title of position)…, who is personally known to me or who has produced …(type of identification)… as identification.

…(Signature of person taking acknowledgment)…

…(Name typed, printed or stamped)…

…(Title or rank)…

…(Serial number, if any)….

Section 26. Section 695.28, Florida Statutes, is amended to read:

695.28 Validity of recorded electronic documents.—

(1) A document that is otherwise entitled to be recorded and that was or is submitted to the clerk of the court or county recorder by electronic or other means and accepted for recordation is deemed validly recorded and provides notice to all persons notwithstanding:

(a) That the document was received and accepted for recordation before the Department of State adopted standards implementing s. 695.27; ~~or~~

(b) Any defects in, deviations from, or the inability to demonstrate strict compliance with any statute, rule, or procedure relating to electronic signatures, electronic witnesses, electronic notarization, or online notarization, or for submitting or recording ~~to submit or record~~ an electronic document in effect at the time the electronic document was executed or was submitted for recording;

(c) That the document was signed, witnessed, or notarized electronically, and that the document was notarized by an online notary public outside the physical presence of the signer through audio-video communication technology, as defined in s. 117.201, or that witnessing may have been done outside the physical presence of the notary public or principal through such audio-visual communication; or

(d) That the document recorded was a certified printout of a document to which one or more electronic signatures have been affixed.

(2) This section does not alter the duty of the clerk or recorder to comply with s. 28.222, s. 695.27, or any rules adopted pursuant to those sections ~~that section~~.

(3) This section does not preclude a challenge to the validity or enforceability of an instrument or electronic record based upon fraud, forgery, impersonation, duress, incapacity, undue influence, minority, illegality, unconscionability, or any other basis not in the nature of those matters described in subsection (1).

Section 27. Subsections (3) and (4) of section 709.2119, Florida Statutes, are amended to read:

709.2119 Acceptance of and reliance upon power of attorney.—

(3) A third person who is asked to accept a power of attorney that appears to be executed in accordance with s. 709.2105 may in good faith request, and rely upon, without further investigation:

(a) A certified English translation of the power of attorney if the power of attorney contains, in whole or in part, language other than English;

(b) An opinion of counsel as to any matter of law concerning the power of attorney if the third person making the request provides in a writing or other record the reason for the request; ~~or~~

(c) The affidavit described in subsection (2); or

(d) The electronic journal or record made by the notary public pursuant to the laws of the state in which the notary public is appointed if the power of attorney is witnessed or notarized remotely through the use of online witnesses or notarization.

(4) An English translation, ~~or~~ an opinion of counsel, or an electronic journal or record requested under this section must be provided at the principal's expense unless the request is made after the time specified in s. 709.2120(1) for acceptance or rejection of the power of attorney.

Section 28. Subsection (4) of section 709.2120, Florida Statutes, is amended to read:

709.2120 Rejecting power of attorney.—

(4) A third person is not required to accept a power of attorney if:

(a) The third person is not otherwise required to engage in a transaction with the principal in the same circumstances;

(b) The third person has knowledge of the termination or suspension of the agent's authority or of the power of attorney before exercising the power;

(c) A timely request by the third person for an affidavit, English translation, ~~or~~ opinion of counsel, or electronic journal or record under s. 709.2119 ~~s. 709.2119(4)~~ is refused by the agent;

(d) The power of attorney is witnessed or notarized remotely through the use of online witnesses or notarization, and either the agent is unable to produce the electronic journal or record, or the notary public did not maintain an electronic journal or record of the notarization;

(e)~~(d)~~ Except as provided in paragraph (b), the third person believes in good faith that the power is not valid or that the agent does not have authority to perform the act requested; or

(f)~~(e)~~ The third person makes, or has knowledge that another person has made, a report to the local adult protective services office stating a good faith belief that the principal may be subject to physical or financial abuse, neglect, exploitation, or abandonment by the agent or a person acting for or with the agent.

Section 29. Subsection (6) of section 709.2202, Florida Statutes, is renumbered as subsection (7), and a new subsection (6) is added to that section to read:

709.2202 Authority that requires separate signed enumeration.—

(6) Notwithstanding subsection (1) and s. 709.2106(3), a power of attorney, executed by a principal domiciled in this state at the time of execution, that is witnessed remotely pursuant to s. 117.285 or other applicable law by a witness who is not in the physical presence of the principal is not effective to grant authority to an agent to take any of the actions enumerated in subsection (1).

Section 30. Subsection (40) of section 731.201, Florida Statutes, is amended to read:

731.201 General definitions.—Subject to additional definitions in subsequent chapters that are applicable to specific chapters or parts, and unless the context otherwise requires, in this code, in s. 409.9101, and in chapters 736, 738, 739, and 744, the term:

(40) "Will" means a testamentary ~~an~~ instrument, including a codicil, executed by a person in the manner prescribed by this code, which disposes of the person's property on or after his or her death and includes an instrument which merely appoints a personal representative or guardian or revokes or revises another will. The term includes an electronic will as defined in s. 732.521.

Section 31. Section 732.506, Florida Statutes, is amended to read:

732.506 Revocation by act.—A will or codicil, other than an electronic will, is revoked by the testator, or some other person in the testator's presence and at the testator's direction, by burning, tearing, canceling, defacing, obliterating, or destroying it with the intent, and for the purpose, of revocation. An electronic will or codicil is revoked by the testator, or some other person in the testator's presence and at the testator's direction, by deleting, canceling, rendering unreadable, or obliterating the electronic will or codicil, with the intent, and for the purpose, of revocation, as proved by clear and convincing evidence.

Section 32. Section 732.521, Florida Statutes, is created to read:

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732.521 Definitions.—As used in ss. 732.521-732.525, the term:

(1) "Audio-video communication technology" has the same meaning as provided in s. 117.201.

(2) "Electronic record" has the same meaning as provided in s. 668.50.

(3) "Electronic signature" means an electronic mark visibly manifested in a record as a signature and executed or adopted by a person with the intent to sign the record.

(4) "Electronic will" means a testamentary instrument, including a codicil, executed with an electronic signature by a person in the manner prescribed by this code, which disposes of the person's property on or after his or her death and includes an instrument which merely appoints a personal representative or guardian or revokes or revises another will.

(5) "Online notarization" has the same meaning as provided in s. 117.201.

(6) "Online notary public" has the same meaning as provided in s. 117.201.

(7) "Qualified custodian" means a person who meets the requirements of s. 732.525(1).

(8) "Secure system" means a system that satisfies the requirements of a secure repository qualified to retain electronic journals of online notaries public in accordance with s. 117.245 and any rules established under part II of chapter 117.

Section 33. Effective July 1, 2020, section 732.522, Florida Statutes, is created to read:

732.522 Method and place of execution.—For purposes of the execution or filing of an electronic will, the acknowledgment of an electronic will by the testator and the affidavits of witnesses under s. 732.503, or any other instrument under the Florida Probate Code:

(1) Any requirement that an instrument be signed may be satisfied by an electronic signature.

(2) Any requirement that individuals sign an instrument in the presence of one another may be satisfied by witnesses being present and electronically signing by means of audio-video communication technology that meets the requirements of part II of chapter 117 and any rules adopted thereunder, if:

(a) The individuals are supervised by a notary public in accordance with s. 117.285;

(b) The individuals are authenticated and signing as part of an online notarization session in accordance with s. 117.265;

(c) The witness hears the signer make a statement acknowledging that the signer has signed the electronic record; and

(d) The signing and witnessing of the instrument complies with the requirements of s. 117.285.

(3) Except as otherwise provided in this part, all questions as to the force, effect, validity, and interpretation of an electronic will which comply with this section must be determined in the same manner as in the case of a will executed in accordance with s. 732.502.

(4) An instrument that is signed electronically is deemed to be executed in this state if the instrument states that the person creating the instrument intends to execute and understands that he or she is executing the instrument in, and pursuant to the laws of, this state.

Section 34. Section 732.523, Florida Statutes, is created to read:

732.523 Self-proof of electronic will.—An electronic will is self-proved if:

(1) The acknowledgment of the electronic will by the testator and the affidavits of the witnesses are made in accordance with s. 732.503 and are part of the electronic record containing the electronic will, or are attached to, or are logically associated with, the electronic will;

(2) The electronic will designates a qualified custodian;

(3) The electronic record that contains the electronic will is held in the custody of a qualified custodian at all times before being offered to the court for probate; and

(4) The qualified custodian who has custody of the electronic will at the time of the testator's death certifies under oath that, to the best knowledge of the qualified custodian, the electronic record that contains the electronic will was at all times before being offered to the court in the custody of a qualified custodian in compliance with s. 732.524 and that the electronic will has not been altered in any way since the date of its execution.

Section 35. Section 732.524, Florida Statutes, is created to read:

732.524 Qualified custodians.—

(1) To serve as a qualified custodian of an electronic will, a person must be:

(a) Domiciled in and a resident of this state; or

(b) Incorporated, organized, or have its principal place of business in this state.

(2) A qualified custodian shall:

(a) In the course of maintaining custody of electronic wills, regularly employ a secure system and store in such secure system electronic records containing:

1. Electronic wills;

2. Records attached to or logically associated with electronic wills; and

3. Acknowledgments of the electronic wills by testators, affidavits of the witnesses, and the records described in s. 117.245(1) and (2) which pertain to the online notarization.

(b) Furnish for any court hearing involving an electronic will that is currently or was previously stored by the qualified custodian any information requested by the court pertaining to the qualified custodian's qualifications, policies, and practices related to the creation, sending, communication, receipt, maintenance, storage, and production of electronic wills.

(c) Provide access to or information concerning the electronic will, or the electronic record containing the electronic will, only:

1. To the testator;

2. To persons authorized by the testator in the electronic will or in written instructions signed by the testator with the formalities required for the execution of a will in this state;

3. After the death of the testator, to the testator's nominated personal representative; or

4. At any time, as directed by a court of competent jurisdiction.

(3) The qualified custodian of the electronic record of an electronic will may elect to destroy such record, including any of the documentation required to be created and stored under paragraph (2)(a), at any time after the earlier of the fifth anniversary of the conclusion of the administration of the estate of the testator or 20 years after the death of the testator.

(4) A qualified custodian who at any time maintains custody of the electronic record of an electronic will may elect to cease serving in such capacity by:

(a) Delivering the electronic will or the electronic record containing the electronic will to the testator, if then living, or, after the death of the testator, by filing the will with the court in accordance with s. 732.901; and

(b) If the outgoing qualified custodian intends to designate a successor qualified custodian, by doing the following:

1. Providing written notice to the testator of the name, address, and qualifications of the proposed successor qualified custodian. The testator

must provide written consent before the electronic record, including the electronic will, is delivered to a successor qualified custodian;

2. Delivering the electronic record containing the electronic will to the successor qualified custodian; and

3. Delivering to the successor qualified custodian an affidavit of the outgoing qualified custodian stating that:

a. The outgoing qualified custodian is eligible to act as a qualified custodian in this state;

b. The outgoing qualified custodian is the qualified custodian designated by the testator in the electronic will or appointed to act in such capacity under this paragraph;

c. The electronic will has at all times been in the custody of one or more qualified custodians in compliance with this section since the time the electronic record was created, and identifying such qualified custodians; and

d. To the best of the outgoing qualified custodian's knowledge, the electronic will has not been altered since the time it was created.

For purposes of making this affidavit, the outgoing qualified custodian may rely conclusively on any affidavits delivered by a predecessor qualified custodian in connection with its designation or appointment as qualified custodian; however, all such affidavits must be delivered to the successor qualified custodian.

(5) Upon the request of the testator which is made in writing signed with the formalities required for the execution of a will in this state, a qualified custodian who at any time maintains custody of the electronic record of the testator's electronic will must cease serving in such capacity and must deliver to a successor qualified custodian designated in writing by the testator the electronic record containing the electronic will and the affidavit required in subparagraph (4)(b)3.

(6) A qualified custodian may not succeed to office as a qualified custodian of an electronic will unless he or she agrees in writing to serve in such capacity.

(7) If a qualified custodian is an entity, an affidavit, or an appearance by the testator in the presence of a duly authorized officer or agent of such entity, acting in his or her own capacity as such, shall constitute an affidavit, or an appearance by the testator in the presence of the qualified custodian.

(8) A qualified custodian must provide a paper copy of an electronic will and the electronic record containing the electronic will to the testator immediately upon request. For the first request, the testator may not be charged a fee for being provided with these documents.

(9) The qualified custodian shall be liable for any damages caused by the negligent loss or destruction of the electronic record, including the electronic will, while it is in the possession of the qualified custodian. A qualified custodian may not limit liability for such damages.

(10) A qualified custodian may not terminate or suspend access to, or downloads of, the electronic will by the testator, provided that a qualified custodian may charge a fee for providing such access and downloads.

(11) Upon receiving information that the testator is dead, a qualified custodian must deposit the electronic will with the court in accordance with s. 732.901. A qualified custodian may not charge a fee for depositing the electronic will with the clerk, provided the affidavit is made in accordance with s. 732.503, or furnishing in writing any information requested by a court under paragraph (2)(b).

(12) Except as provided in this act, a qualified custodian must at all times keep information provided by the testator confidential and may not disclose such information to any third party.

(13) A contractual venue provision between a qualified custodian and a testator is not valid or enforceable to the extent that it requires a specific jurisdiction or venue for any proceeding relating to the probate of an estate or the contest of a will.

Section 36. Section 732.525, Florida Statutes, is created to read:

732.525 Liability coverage; receivership of qualified custodians.—

(1) A qualified custodian shall:

(a) Post and maintain a blanket surety bond of at least $250,000 to secure the faithful performance of all duties and obligations required under this part. The bond must be made payable to the Governor and his or her successors in office for the benefit of all persons who store electronic records with a qualified custodian and their estates, beneficiaries, successors, and heirs, and be conditioned on the faithful performance of all duties and obligations under this chapter. The terms of the bond must cover the acts or omissions of the qualified custodian and each agent or employee of the qualified custodian; or

(b) Maintain a liability insurance policy that covers any losses sustained by any person who stores electronic records with a qualified custodian and their estates, beneficiaries, successors, and heirs which are caused by errors or omissions by the qualified custodian and each agent or employee of the qualified custodian. The policy must cover losses of at least $250,000 in the aggregate.

(2) The Attorney General may petition a court of competent jurisdiction for the appointment of a receiver to manage the electronic records of a

qualified custodian for proper delivery and safekeeping if any of the following conditions exist:

(a) The qualified custodian is ceasing operation;

(b) The qualified custodian intends to close the facility and adequate arrangements have not been made for proper delivery of the electronic records in accordance with this part;

(c) The Attorney General determines that conditions exist which present a danger that electronic records will be lost or misappropriated; or

(d) The qualified custodian fails to maintain and post a surety bond or maintain insurance as required in this section.

Section 37. Section 732.526, Florida Statutes, is created to read:

732.526 Probate.—

(1) An electronic will that is filed electronically with the clerk of the court through the Florida Courts E-Filing Portal is deemed to have been deposited with the clerk as an original of the electronic will.

(2) A paper copy of an electronic will which is certified by a notary public to be a true and correct copy of the electronic will may be offered for and admitted to probate and shall constitute an original of the electronic will.

Section 38. Subsection (1) of section 733.201, Florida Statutes, is amended to read:

733.201 Proof of wills.—

(1) Self-proved wills executed in accordance with this code may be admitted to probate without further proof. However, a purportedly self-proved electronic will may be admitted to probate only in the manners prescribed in subsections (2) and (3) if the execution of such electronic will, or the acknowledgment by the testator and the affidavits of the witnesses, involves an online notarization in which there was a substantial failure to comply with the procedures set forth in s. 117.265.

Section 39. Section 740.11, Florida Statutes, is created to read:

740.11 Relation to wills.—No act taken pursuant to this chapter is valid to affect the obligation of a person to deposit a will of a decedent as required under s. 732.901.

Section 40. Except as otherwise expressly provided in this act, and except for this section, which shall take effect upon becoming a law, this act shall take effect January 1, 2020.

Approved by the Governor June 7, 2019.

Filed in Office Secretary of State June 7, 2019.

COOL CHARITABLE CONTRIBUTION STRATEGIES IN THE NEW TAX CLIMATE

By

Conrad Teitell, Stanford, CT.

COOL CHARITABLE CONTRIBUTION STRATEGIES IN THE NEW TAX CLIMATE

by

Conrad Teitell, A.B., LL.B., LL.M., S.O.H.K., 98.6*

FLORIDA BAR'S ATTORNEY-TRUST OFFICER CONFERENCE

August 24, 2019

*A principal in the Connecticut and Florida law firm of Cummings & Lockwood, based in the firm's Stamford office. He chairs the firm's National Charitable Planning Group and is an adjunct professor at the University of Miami School of Law and holds an LL.B. from Columbia University Law School and an LL.M. from New York University Law School.

Cummings & Lockwood LLC, Six Landmark Square, PO Box 120, Stamford, CT 06904-0120. Direct phone: (203) 351-4164, Direct fax: (203) 708-3840, Email: cteitell@cl-law.com.

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COOL CHARITABLE CONTRIBUTION STRATEGIES IN THE NEW TAX CLIMATE

Conrad Teitell, A.B., LL.B., LL.M., S.O.H.K., 98.6*

I. CHARITABLE REMAINDER TRUSTS

A. IN THE VERY BEGINNING

1. **Donative intent.** Read no further if you believe that a donor will create a charitable remainder trust solely because of the tax and financial benefits. But if the prospect (client) believes in the charity's cause, then a charitable remainder trust might be the appropriate way to make a gift. If the donor doesn't need income for him- or herself and doesn't wish to provide income for another individual, an outright gift is generally the most appropriate.

2. **Advantages of charitable remainder trusts.** An inter vivos (lifetime) charitable remainder trust (instead of an outright bequest by will) can:

(1) generate an income tax charitable deduction and provide the same estate tax benefits as a bequest;
(2) increase a donor's income;
(3) provide favorable taxation of life-income payments;
(4) reduce or eliminate capital gain taxation on changing investments; and
(5) **enable a donor to have the joy of giving (not possible with a bequest).**

3. Information needed to decide whether a charitable remainder trust is appropriate and if so, the type of charitable remainder trust to use:

(1) donor's wishes
(2) needs and health of beneficiaries
(3) marital status and citizenship of spouses
(4) type of property — securities, real estate, tangible personal property, marketability, Sub-S stock
(5) how property owned — separate, joint, tenants by the entirety, tenants in common, community property
(6) cost-basis and holding period of property
(7) fair market value of property
(8) any mortgages?
(9) any prior negotiations or contracts for sale, options?
(10) corporation about to liquidate, merge, initial public offering?
(11) remainder charity — public charity, private foundation?
(12) for sizable gift, information about donor's (and spouse's) overall estate and financial plan

*A principal in the Connecticut and Florida law firm of Cummings & Lockwood, based in the firm's Stamford office. He chairs the firm's National Charitable Planning Group and is an adjunct professor at the University of Miami School of Law and holds an LL.B. from Columbia University Law School and an LL.M. from New York University Law School.
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B. CHARITABLE REMAINDER UNITRUSTS AND ANNUITY TRUSTS HIGH-SPEED OVERVIEW:

STAN-CRUT—Standard (“Fixed Percentage”) Charitable Remainder Unitrust. Pays the income beneficiary ("recipient") an amount determined by multiplying a fixed percentage of the net fair market value (FMV) of the trust assets, revalued each year. On death of beneficiary or survivor beneficiary (or at end of trust term if trust measured by term of years—not to exceed 20 years) charity gets the remainder. The fixed percentage can’t be less than 5% nor more than 50% and the remainder interest must be at least 10% of the initial net fair market value of all property placed in the trust. These percentage requirements also apply to the following types of charitable remainder trusts.

NIM-CRUT—Net Income With Makeup Charitable Remainder Unitrust. Pays only the trust’s income if the actual income is less than the stated percentage multiplied by the trust’s FMV. Deficiencies in distributions (*i.e.,* where the unitrust income is less than the stated percentage) are made up in later years if the trust income exceeds the stated percentage.

NI-CRUT—Net Income Charitable Remainder Unitrust. Pays the fixed percentage multiplied by the trust's FMV or the actual income, whichever is lower. Deficiencies are not made up.

FLIP-CRUT. A trust set up as a NIM-CRUT or NI-CRUT. On a qualifying triggering event specified in the trust instrument (*e.g.,* the sale of the unmarketable asset used to fund the trust) it switches (flips) to a STAN-CRUT. The regulations sometimes refer to this trust as a "combination of methods unitrust."

FLEX-CRUT. That's my name for a FLIP-CRUT drafted so as to give flexibility in determining when—if ever—a NIM-CRUT or NI-CRUT will flip to a STAN-CRUT. If you want a NIM-CRUT or NI-CRUT to flip on the sale of a parcel of real estate or on a specified date or event say so in the CRT. **BUT** if you want maximum flexibility, specify that the trust is to flip on the sale of an unimportant unmarketable asset that is one of the assets used to fund the trust. That way you have flexibility in determining when—if ever—a NIM-CRUT or NI-CRUT will flip to a STAN-CRUT.

CAPITAL GAIN NIM-CRUT. Post-transfer-to-the-trust capital gains (governing state law permitting) can be treated as income for purposes of paying income to the income beneficiary. This provides another way of making up NIM-CRUT deficits in payments from earlier years.

FULL-MONTY CRUT. That's my coinage for a FLIP-CRUT that goes all the way—has FLEX-CRUT and CAPITAL GAIN CRUT provisions.

ACCELERATED (CHUTZPAH) CHARITABLE REMAINDER UNITRUST. A STAN-CRUT for a very short term of years (*e.g.,* two years) with a sky-high percentage payout (*e.g.*, 80%). The aim was to transform highly appreciated assets into cash returned to the donor while avoiding almost all capital gains tax. IRS announced in 1994 that it would challenge those trusts. The 10% minimum remainder interest and 50% maximum unitrust amount requirements of the 1997 law killed those trusts. And the regulations' grace period rules for making payments after year-end added the final nail to the coffin.

CHARITABLE REMAINDER ANNUITY TRUST (CRAT). Pays the income beneficiary ("recipient") a fixed dollar amount (at least annually) specified in the trust instrument. On the death of the beneficiary or survivor beneficiary (or at end of trust term if trust measured by a term of years—not to exceed 20 years) charity gets the remainder. The fixed dollar amount must be at least 5% but not more than 50% of the initial net fair market value of the transferred assets and the remainder interest must be at least 10% of the initial net fair market value of all property placed in the trust. Additional contributions after the initial contribution may not be made to a CRAT. *Caveat.* CRAT must meet "5% probability test" of Rev. Rul. 77-374, 1977-2 CB 329. But see *Moor*, 43 TCM 1530 (1982). For CRATs created after 8/8/17, alternative to Rev. Rul. 77-374: the early termination qualified contingency provision. Rev. Proc. 2016-42. I strongly recommend not using this early termination provision. The beneficiary's annuity payments may end unexpectedly because of a downturn in the market just when the beneficiary really needs the income.

C. INCOME TAX RULES

1. **Contribution deduction.** Allowed for value of remainder interest—computed using Treasury tables. Be mindful of various percentage-of-adjusted-gross-income ceilings for the income tax charitable deduction and the 5-year carryover rules. **Unitrusts—**IRC §170(f)(2); Reg. §§1.664-3(c) and 1.664-4; IRS Pub. 1458. **Annuity trusts—**IRC §170(f)(2); Reg. §§1.664-2(c) and 20.2031-7, IRS Pub. 1457.

2. **Taxation of payments.** Unitrust and annuity trust payments are taxable under the four-category provisions of IRC §664(b) and Reg. §1.664-1(d)(1). And the income paid to the income beneficiary retains the character it had in the trust. Each payment is treated as follows:

First, as ordinary income to the extent of the trust's ordinary income for the year (and any undistributed ordinary income from prior years). There are tiers of income in this category

Second, as capital gains for the year (and any undistributed capital gains from prior years). There are tiers of capital gain in this category.

Third, as tax-exempt income to the extent of the trust's exempt income for the year (and any undistributed exempt income from prior years); and

Fourth, as a tax-free return of principal.

Note: In categories *First* and *Second*, the income and gains that are taxable at the highest rates are deemed distributed first.

3. **Capital gains.** No capital gain incurred on transfer of appreciated assets to trust. *Rev. Rul. 55-275,* 1955-1 CB 295; *Rev. Rul. 60-370,* 1960-2 CB 203. Nor is there gain to donor on a sale by trust (except as taxable under four-tier system, above). *Exception:* Gain taxable to donor if trust assets sold and proceeds invested in tax-exempt securities pursuant to express or implied agreement between donor and trustee. *Rev. Rul. 60-370,* 1960-2 CB 203. See below.

Nor is there capital gain to the trust. Avoidance of gain on sale by trust enables a donor to avoid tax on changing from one investment to another.

4. **Unrelated business taxable income.** Charitable remainder trusts with UBTI in taxable years beginning after December 31, 2006 remain exempt from federal income tax, but are subject to a 100-percent excise tax on the trust's UBTI.

Background. CRTs were exempt from income tax for a tax year unless the trust had *any* unrelated business taxable income for the year. UBTI includes certain debt-financed income.

Before 2007 a CRT that lost its income tax exemption for a tax year was taxed as a regular complex trust. As such, the trust was allowed a deduction in computing taxable income for amounts required to be distributed in that year (not to exceed the trust's distributable net income for the year).

One taxpayer did battle with IRS on the UBTI issue maintaining that only the unrelated business income was taxable—not all the trust's income. But the Tax Court in *Leila G. Newhall Unitrust,* 104 TC 236 (1995) ruled that a unitrust receiving *any* UBTI is taxable on *all* its income for the year—not just the unrelated income. And a circuit appeals court affirmed the Tax Court. *Leila G. Newhall Unitrust*, 105 F.3d 482 (CA-9) 1997. Wealthy taxpayers in Leila's shoes were no doubt the force behind the new law. What ever Leila wants, Leila gets?

Starting with the 2007 tax year (all CRTs are on a calendar tax year), a 100% excise tax is imposed on the UBTI of a charitable remainder trust. This replaces the rule that took away the CRT's income tax exemption for any year in which it had *any* unrelated business taxable income. UBTI is considered income of the trust for purposes of determining the character of the distribution made to the beneficiary under the four tiers. And, consistent with earlier law, the tax is treated as paid from corpus. A Treasury regulation, TD 9403, 73 Fed. Reg. 35583 (June 24, 2008) gives examples under the new law.

Observation. A 100% tax on unrelated business income will *generally* be better than paying regular taxes on all of a CRT's income—unrelated business income *plus* income from dividends, interest and royalties, for example. **But watch your step.** UBTI includes certain debt-financed income. So if the acquisition indebtedness rules apply on the sale of a highly appreciated asset, a huge capital gain—based on a percentage of the property mortgaged—would be taxable at 100%.

Foregone conclusion. It is better, of course, for a CRT to pay no tax at all. To do that, avoid unrelated business taxable income. Easier said than done for CRTs that invest in LLPs, LLCs, for example. LLPs and LLCs are passthrough entities and often have income from an active trade or business and from debt-financed property. That income flows through the LLP and the LLC as UBTI to a CRT. (Don't you just love all this jargon.)

D. GIFT TAX RULES—INCLUDING MARITAL DEDUCTION RULES

One-life unitrust or annuity trust for donor's life. Value of charitable remainder interest in qualified trust is not subject to gift tax. Donor must report remainder gift (regardless of size because it is a future interest) on federal gift tax return. IRC §6019. Donor takes offsetting gift tax charitable deduction.

One-life unitrust or annuity trust for beneficiary other than donor. Donor who creates a charitable remainder trust calling for payments to another for life, with the principal to be delivered to charity on life beneficiary's death, makes two gifts: one to beneficiary (value of life interest) and one to charity (value of remainder interest).

The charitable remainder interest. Charitable remainder interest is reportable (regardless of size because it is a future interest) on federal gift tax return. Then deductible as a charitable contribution—resulting in a wash. IRC §2522 (c)(2)(A); Reg. §§25.2522(c)-3(c)(2)(iv) and 1.664-4.

Life beneficiary's interest when beneficiary is not donor's spouse. Donor makes gift to life beneficiary of value of life interest. If the life interest is a present interest it will qualify for annual exclusion. If the value of the interest exceeds the annual gift tax exclusion and "tentative" tax on gift is not offset by unified transfer tax credit, gift tax will be due. IRC §2503(a); Reg. §25.2503-3(b).

Life beneficiary's interest when beneficiary is donor's spouse. Rules are the same as above with this positive exception: As long as the trust doesn't have any non-spouse beneficiaries, U.S. citizen spouse's life interest qualifies for automatic unlimited gift tax marital deduction (no election need be made). IRC §2523(g). See below for alien spouse rules.

Two-life unitrust or annuity trust funded with donor's separate property and donor is first beneficiary. Donor who uses his or her own separate property to create a charitable remainder trust—that pays income to donor for life and then to survivor beneficiary for life—makes two gifts: one to charity (remainder interest) and one to survivor beneficiary (right to receive unitrust or annuity trust payments if he or she survives the donor).

The charitable remainder interest. Charitable remainder interest is reportable (regardless of size because it is a future interest) on gift tax return, then deductible as charitable contribution—resulting in a wash.

Second life beneficiary's interest when beneficiary is not donor's spouse.

Donor makes gift to beneficiary of value of survivorship life interest. Gift is of a future interest**—**it does not qualify for the annual gift tax exclusion. If "tentative" tax on gift isn't offset by unified transfer tax credit, gift tax will be due. IRC §2503(a); Reg. §25.2503-3(a).

Pointer. Donor can avoid making gift to survivor by providing in inter vivos trust instrument the right (exercisable only by will) to revoke survivor's life interest. Should donor exercise that right, trust terminates on donor's death. Trust principal then delivered to charity. Donor need not actually exercise right in will; merely retaining the right avoids donor's making completed gift to survivor beneficiary. *Rev. Rul. 79-243,* 1979-2 CB 343; Reg. §§1.664-3(a)(4) and 25.2511-2(c).

Second life beneficiary's interest when beneficiary is donor's spouse. As long as the trust doesn't have any non-spouse beneficiaries, a U.S. citizen spouse's future interest in a charitable remainder unitrust or annuity trust qualifies for automatic unlimited gift tax marital deduction (no election need be made). IRC §2523(g). Alternatively, gift tax concerns can be avoided as discussed above by having donor reserve right in the inter vivos trust instrument to revoke surviving spouse's life interest by will. See below for alien spouse rules and estate tax concerns if American spouses divorce.

Two-life unitrust or annuity trust funded with joint property, tenancy in common property or community property and donors are spouses. Trust should provide payments to donors jointly for life and then to survivor for life.

The charitable remainder interest. Charitable remainder interest is reportable (regardless of size because it is a future interest) on federal gift tax return, then deductible as charitable contribution, resulting in a wash.

The interests of the life beneficiaries. Actuarially older spouse makes gift to actuarially younger spouse of difference in value of their survivorship interests. However, as long the trust doesn't have any non-spouse beneficiaries, gift qualifies for automatic unlimited gift tax marital deduction (no election need be made) for U.S. citizens. IRC §2523(g). Unnecessary for gift tax purposes (although can't hurt) for spouses to reserve the right to revoke, outlined above. But may want to retain right to revoke and actually revoke it if there is a divorce. Won't qualify for estate tax marital deduction if spouses are divorced. A divorce settlement agreement should deal with this issue. See below for alien spouse rules.

Cautions regarding right to revoke a beneficiary's interest.

Although retained in inter vivos instrument creating charitable remainder trust, right to revoke should be exercisable only by will. If right is exercisable during donor's lifetime, trust will be disqualified.

Right to revoke should not be retained unless the donor is herself a trust beneficiary. For example, in a trust providing payments to donor's son for life, with remainder to charity, donor's retaining right to revoke son's interest could disqualify trust because it would be potentially measured by donor's life instead of the son's life. Reg. §§1.664-2(a)(5), -3(a)(5). Absent retained right, son's interest would not be includable in donor's gross estate.

But apparently a non-beneficiary donor can keep a testamentary right to revoke a beneficiary's interest in a term-of-years trust. IRS approved one such trust in *Letter Ruling 8949061*.

Gifts to alien spouse. An unlimited gift tax marital deduction is not allowed. But gifts to a noncitizen spouse qualify for an annual exclusion of $147,000 in 2015, assuming the usual annual gift tax exclusion requirements are met. The annual exclusion is indexed for inflation.

To qualify for the noncitizen spouse $147,000 in 2015 annual gift-tax-exclusion (or the usual annual gift tax exclusion), a gift must be a present interest. So a survivorship income interest in a trust, for example, doesn't qualify.

If the gift is a charitable remainder gift with the noncitizen spouse succeeding to the interest of the donor citizen spouse, gift tax concerns are avoided by the donor-spouse's retaining the right by will to revoke the noncitizen spouse's survivorship interest. If the citizen-spouse does not exercise this right of revocation, the surviving noncitizen-spouse will receive his or her survivorship interest. The citizen-spouse's estate would be able to claim an estate tax marital deduction for the surviving noncitizen spouse's life interest if the Qualified Domestic Trust (QDOT) rules are met.

E. ESTATE TAX RULES—INCLUDING MARITAL DEDUCTION RULES

Donor is the sole beneficiary ("recipient") of an inter vivos unitrust or annuity trust. Value of trust assets at donor's death (or at the alternate valuation date) is includable in the gross estate when donor retains life interest in the trust. Estate deducts value of trust assets as charitable contribution, resulting in a wash. IRC §§2036 and 2055(e)(1)(B); Reg. §1.664-4.

Inter vivos unitrust or annuity trust for beneficiary or beneficiaries other than donor. Value of trust assets not included in donor's gross estate. IRC §2035(d).

Two-life inter vivos unitrust or annuity trust funded with donor's separate property with payments to donor for life, then to non-spouse second beneficiary ("recipient") for life.

Include value of trust assets at donor's death (or alternate valuation date) in the gross estate whether or not second beneficiary survives donor. IRC §2036.

If second beneficiary does not survive donor, deduct as a charitable contribution the amount that was included in the gross estate—resulting in a wash. IRC §2055(e)(1)(B); Reg. §20.2031-7.

If second beneficiary does survive donor, deduct value of charitable remainder as charitable contribution [applicable factor for survivor's age (at nearest birthday) at donor's death and stated percentage x value of trust assets at death (or alternate valuation date)]. In effect, only value of survivor beneficiary's life interest is subject to tax. If alternate valuation date is elected, in computing value of charitable remainder, use value of assets at alternate valuation date, but use age of the survivor beneficiary (at the nearest birthday) at the date of donor's death. IRC §2032(b)(2).

Two-life inter vivos unitrust or annuity trust funded with donor's separate property with payments to donor for life, then to U.S. citizen spouse as second beneficiary for life. Rules are same as discussed above, except that an estate tax marital deduction is allowed for value of surviving spouse's life interest. Trust assets are completely immune from estate tax because charity's remainder interest qualifies for estate tax charitable deduction and surviving spouse's life interest automatically qualifies (no election need be made) for estate tax marital deduction, as long as the trust doesn't have any non-spouse beneficiaries. IRC §2056(b)(8). See above for alien spouse rules.

Two-life inter vivos unitrust or annuity trust funded with jointly owned property when donors who are beneficiaries are spouses. Only half of jointly held property owned by spouses is includable in estate of first spouse to die, regardless of who furnished consideration. IRC §2040(b). Estate of first-to-die receives an estate tax charitable deduction for remainder interest in half of property includable in the gross estate and automatically receives (no election need be made) marital deduction for value of surviving U.S. citizen spouse's life interest in half of joint property includable in the gross estate, as long as the trust doesn't have any non-spouse beneficiaries. IRC §§2055(e)(2)(A) and 2056(b)(8). See below for alien spouse rules. **Attention step-up-in-basis aficionados.** Although not relevant here, IRS has acquiesced in *Hahn*, 110 TC 140 (1998) holding that for a joint interest of spouses created before 1977, 100% of the property's FMV is includable in the gross estate of the first spouse to die except to the extent that the surviving spouse contributed to the asset's purchase price.

Two-life inter vivos unitrust or annuity trust funded by spouses with community property or tenancy in common property and donors are beneficiaries. Include value of half trust assets in the gross estate of first spouse to die. Estate of first-to-die is entitled to charitable deduction for value of charitable remainder interest and marital deduction (automatic) for U.S. citizen spouse's life interest in that half, as long as the trust doesn't have any non-spouse beneficiaries.

Unitrust or annuity trust created by donor's will for benefit of U.S. citizen spouse.

Estate receives estate tax marital deduction (no election need be made) for value of surviving spouse's life interest and estate tax charitable deduction for value of charity's remainder interest. Thus, entire value of trust assets is not subject to tax. IRC §§2055(e)(2)(A) and 2056(b)(8).

Estate tax marital deduction for spouse's life interest is allowable only if spouse is sole beneficiary. See *Letter Ruling 8730004*. For example, remainder trust created by donor's will providing payments to spouse for life, and then to son for life, would not qualify for estate tax marital deduction. Charitable remainder interest would still qualify for estate tax charitable deduction. In *Letter Ruling 200204022* a disclaimer saved the marital deduction, but at a price. The non-spouse beneficiaries had to give up income.

F. Q-TIP/CRUT COMBO

There is no estate tax marital deduction for a CRUT (or CRAT) created by Husband that pays Wife for life, then Son and then remainder to Charity. Instead, Husband's will creates a Q-TIP marital deduction trust for Wife to be followed by a

CRUT for Son, with remainder to Charity. Under the Q-TIP rules, Husband's estate gets a 100% marital deduction. (There's no charitable deduction, but, hey, a 100% marital deduction avoids the estate tax). And the marital deduction is available even though the Q-TIP trust benefits other individuals after the surviving spouse's death.

But wait a minute. The fair market value of the Q-TIP trust will be includable in the surviving Wife's gross estate. **Yes, but.** The surviving Wife's estate will get an estate tax charitable deduction for the value of the charitable remainder interest based on Son's age at her death, the unitrust (or annuity trust) payout, and the applicable federal rate for the month of Wife's death, or either of the two prior months (at the estate's election).

Yet another reason to create a testamentary Q-TIP/CRUT COMBO. With a Q-TIP trust for the surviving spouse, the trustee can make payments to her (or him) out of principal for health, maintenance, support or for other reasons. Authorizing those payments from charitable remainder unitrusts (and annuity trusts) would disqualify those trusts. And even if there is to be no income beneficiary other than the surviving spouse (and thus no marital deduction concerns), a Q-TIP for the surviving spouse's life, with remainder to charity makes sense if principal may be needed by the surviving spouse.

G. SPLIT-INTEREST CHARITABLE GIFTS AND THE CMFR . . . the good and the bad (sometimes really ugly)

Background. The valuation of charitable remainders (for unitrusts, annuity trusts, personal residences and farms), of charitable lead annuity trusts and lead unitrusts, and the gift portion of charitable annuities is determined by using the charitable mid-term federal rate (CMFR) for the month of the gift—or either of the two prior months at the donor's election.

The CMFR is also used for determining the 10%-minimum-remainder interest (MRI) requirement for CRUTs and CRATs; also for determining whether the gift portion of a gift annuity is more than 10%.

Another also: For determining compliance with the 5% probability test (Rev. Rul. 77-374) for charitable remainder annuity trusts, the CMFR is also used.

Alert. If you plow through this stuff, you will see why I believe it could be dangerous to use the two-month lookback for determining whether the 10% MRI requirement is met.

Observation. Aren't all these rules and the jargon beautiful to behold? And this is just the tip of the IRSberg.

Warning. This isn't light reading. But if you want to know the ins and outs of valuing charitable split-interests and meeting the various requirements, read on.

Charitable Mid-Term Federal Rate—more background. Donors who create split-interest charitable gifts are allowed charitable tax deductions (income, gift and estate) for the value of the charity's interest computed using Treasury tables. The tables' interest assumption is pegged to the federal mid-term interest rate, based on the average market yield of U.S. obligations. Each month, Treasury announces an Applicable Federal Rate (AFR). The interest rate for computing charitable gifts—a figure we call the Charitable Mid-Term Federal Rate (CMFR)—is 120% of the annually compounded AFR for mid-term obligations, rounded off to the nearest 0.2%.

Two-month lookback—more rules. For gifts that have no charitable component—e.g., giving a child a remainder interest in a house—the donor uses the applicable rate for the month of the transfer. However, donors whose gifts are partially charitable (e.g., a charitable remainder unitrust) can use the CMFR for the month of the gift or can elect to use the CMFR from either of the two previous months. The two-month "lookback" can actually give a donor four months to choose from, because IRS publishes the CMFR ahead of time—generally about the 21st day of the previous month.

Example. Melvin plans to create a charitable remainder annuity trust in July. He can wait until toward the end of July to see what August's CMFR will be; if it would yield a higher deduction, he can wait until August before funding the trust. Or, if he funds it in July, he can use the July rate or elect to use the CMFR for June or May.

WHY YOU SHOULD WATCH THE CMFR LIKE A HAWK—BRIEFLY STATED. The CMFR—like most things financial—goes up and down. In June 2013, the CMFR was on the low end—1.2%.

First the ugly. With a low CMFR, the 10%-minimum-remainder-interest requirement—especially for charitable remainder annuity trusts—is easily flunked. Ditto for the 5% probability test governing charitable remainder annuity trusts. For charitable gift annuities, the requirement that the gift portion be more than 10% is also easily flunked.

Although charitable remainder unitrusts are affected by swings in the CMFR, for reasons known to the actuaries the effect is much less significant.

Consequences. Flunking the 10% MRI requirement for charitable remainder unitrusts and charitable remainder annuity trusts and the 5% probability test for charitable remainder annuity trusts means loss of income, gift and estate tax charitable deductions—*and* the trusts aren't qualified. Furthermore, if a spouse is involved, the marital deduction will also be lost. And for charitable gift annuities (including deferred payment and flexible starting date gift annuities), if the gift portion doesn't exceed 10%, the *charities* will be taxed under IRC §514(c)(5) and

501(m). Not a good thing.

Can the 10% MRI requirement be met by using the CMFR for either of the two months preceding the month a CRAT or CRUT is created, or must the valuation be made using the CMFR for the month the trust is created? IRC §7520 says you can use either of the two preceding months for computing any income, estate or gift tax charitable deduction. It doesn't say you can use either of those two months for determining whether the 10% MRI requirement is met. Yet IRC §664(d)(1)(D) and IRC §664(d)(2)(D) say the values for meeting the 10% MRI requirement shall be "determined under section 7520," and those Code sections don't carve out the "either-of-the-two-preceding months" election. **Another yet.** IRC §664(d)(2)(D) provides: "with respect to each contribution of property to the trust, the value (determined under section 7520) of such remainder interest in such property is at least 10% of the net fair market value of such property ***as of the date such property is contributed to the trust."*** [emphasis added.]

A splendid argument can be made that for purposes of meeting the 10% MRI requirement, the remainder can be valued using the CMFR for either of the two preceding months or the month of the transfer. *But do you want to have to make that argument to the IRS, or to a court?* The words of Justice Oliver Wendell Holmes, Jr., in *U.S. v. Wurzbach,* 280 U.S. 396, 399 (1930) are instructive: "Whenever the law draws a line there will be cases very near each other on opposite sides. The precise course of the line may be uncertain, but no one can come near it without knowing that he does so, if he thinks." So unless clarification comes from the IRS, cautious individuals will make sure the 10% MRI requirement is met for the month of the transfer.

Fine hairs: For CRUTs and CRATs, the remainder interest (gift portion) must be *at least* 10%. But for gift annuities, the gift portion must be *more than* 10%. Oh, what fun.

Note: The 10%-minimum-remainder-interest rule doesn't apply to pooled income funds.

Now for the beautiful. Charitable lead annuity trusts are treated most favorably when the CMFR is low. The value of the charity's lead interest under a low CMFR is much greater than under a high CMFR. That makes the value of the remainder interest in the lead trust— that typically goes to family members—much smaller. *Result:* A charitable lead annuity trust can pass assets on to family members down the line at greatly reduced or no gift or estate tax. You'll want to take the generation-skipping tax considerations into account. A low CMFR is also beneficial for remainders in personal residences and farms. The lower the rate, the larger is the charitable deduction for the remainder interest.

Is a charitable lead annuity trust when the CMFR is low an abusive arrangement? The topic came up at the April 3, 2008 U.S. Senate Finance

Committee estate tax hearing. In a statement that I prepared for the American Council on Gift Annuities and the National Committee on Planned Giving for the record of the hearing, ACGA and NCPG pointed out that the CMFR is a two-edged sword. Although it can now be highly advantageous to create charitable lead annuity trusts, the charitable deduction is especially low for charitable remainder annuity trusts. And there are many, many more charitable remainder annuity trusts than charitable lead annuity trusts.

Silver lining for gift annuities. With a low CMFR, the charitable deduction is now smaller than it had been. So what's so good about that? For donors who create charitable gift annuities and take the standard deduction, the size of the charitable gift portion is irrelevant. However, a low CMFR means that the part of each payment excluded from income by the annuitant (under IRC §72) will be larger. Depending upon the circumstances, it may be preferable to choose (under the month of the gift and two-month lookback rule), the CMFR that has the lowest valuation of the charitable gift. On the other hand, if appreciated assets are used to fund the gift annuity, the capital gain—computed under the bargain sale rules—will be larger if the value of the charitable gift is smaller. Thus weigh the charitable deduction (whether it can be used or not), the exclusion ratio and the capital gains implications. Piece of cake!

How and when to make the lookback election. You make the election by: (1) stating to do so on the return for the year of the transfer; and (2) identifying the elected month. The election is generally made on a timely filed return, but it may be made or revoked on an amended return that's filed within 24 months after the later of: (1) the date the original return was filed; or (2) the due date for filing the return. Reg. §1.7520-2(b)(1) through (3).

Information required with the tax return whether or not the lookback election is made. To claim a charitable deduction for a split-interest gift, the tax return must contain: (1) a description of the interest that is transferred, including a copy of the instrument of transfer; (2) the valuation date of the transfer; (3) the names and identification numbers of the beneficiaries of the transferred interest; (4) the names and birthdates of any measuring lives; and (5) a computation of the deduction showing the interest rate used to value the transferred interest. Also, if a measuring life is of a person who is terminally ill, that should be stated and explained. For a definition of terminally ill, see Reg. §1.7520-2(a)(4).

Valuation date. If you elect the two-month lookback, the month you look back to is the valuation date for purposes of determining the interest rate. Reg. §1.7520-2(a)(2). Donors who transfer more than one interest in the same property at the same time must use the same interest rate for each interest in the property transferred. Donors who transfer more than one interest in the same property in two or more transfers at different times value each interest by using the interest rate in effect during the month of the transfer, or either of the two months preceding the month of the transfer. Reg. §1.7520-2(a)(3). What is IRS driving at?

I think the following example illustrates what the IRS has in mind:

Example. A donor funds her charitable remainder unitrust with securities. The trust pays income to her son for life with the remainder to charity. The donor must use the same month's rate to value both the son's and the charity's interests. If the donor uses an undivided half-interest in real estate to fund the just-described trust (and assuming the IRS doesn't believe that doing so would violate the self-dealing rules), she must still use the same month's rate to value the son's and the charity's interests. But, if six weeks later, she transfers the other half interest to create another unitrust, that transfer has nothing to do with the first transfer. So the second trust's interests are valued in the month of that transfer—or either of the two preceding months at the donor's election. In short, the donor doesn't use the month's rate selected for the first trust to value the interests in the second trust.

Charitable remainder trust payout dates. If the governing instrument of a charitable remainder trust doesn't specify when the distributions are to be made during the

period, they're presumed to be payable on the first day of the specified period. Reg. §1.664-4(a)(3).

H. TAX-EXEMPT UNITRUSTS AND ANNUITY TRUSTS

Trust funded with tax-free bonds. The investment or reinvestment in tax-free bonds won't disqualify the trust as a charitable remainder trust and will not "affect the trust's exemption from income taxation under section 664(c) of the Code as long as there is no express or implied agreement that the trustee must invest or reinvest in such bonds." *Letter Ruling 7803041.* **Caveat.** Be mindful of diversification issues under state prudent investor laws.

What about a trust funded with appreciated property that is to be sold and the proceeds invested in tax-exempts?

Background. Rev. Rul. 60-370, 1960-2 CB 203 says that, if the trustee is under an express or implied obligation to sell or exchange the transferred property and purchase tax-exempt securities, the donor is deemed to have sold the property himself and given the trustee the proceeds. The gain from the sale is imputed to the donor and includable in his gross income.

Heads IRS wins, tails you lose. If donor loses the *Rev. Rul. 60-370* argument, he has to pay capital gain tax out of his own pocket (not out of proceeds of the trust's sale). If donor wins the *Rev. Rul. 60-370* argument, he doesn't have tax-exempt income until entire gain is deemed distributed to him under the four-tier provision in satisfaction of his annual payments.

I. CRTS—DIVIDING AND SOMETIMES REUNITING

Setting the stage. A recent "published" revenue ruling (on which all can rely and are bound by) tells the tax consequences of a not uncommon situation in which two beneficiaries—typically divorcing spouses—of a CRUT or CRAT split their trust down the middle and then each goes his and her own (perhaps merry) way. The ruling starts out, however, with a not common situation in which a trust with two or more beneficiaries split the original trust into separate trusts for each beneficiary. But in that case, a trust that is split asunder is later reunited. The assets of a beneficiary's separate trust on his or her death are added to the separate trust or trusts of the surviving beneficiaries. Private letter rulings have favorably dealt with the situation of divorcing spouses. (It is said that half the marriages in the United States end in divorce. The other half, as it turns out, end in death. So I ask you, which is worse?) But reunification after the original split is something new.

Alert to worry warts. (Worry Wart was a character in the comic strip, "Out Our Way." He caused others to worry. But since his first appearance in 1956, the term has evolved to mean an individual who worries on his or her own. So in the classic sense, I am the worry wart—the one who causes you to worry. Sorry.) The published ruling follows the private letter rulings, but adds a potentially troublesome rub. And I have a few concerns about stuff not addressed in the ruling. But first the facts, then the ruling, and finally the concerns and the rub.

The plot—Situation 1. Two or more individuals (recipients) of a qualified charitable remainder annuity trust or a qualified charitable remainder unitrust (Original Trust) are each entitled to an equal share of the annuity or unitrust amount, payable annually, during the recipient's lifetime. On the death of one recipient, each surviving recipient becomes entitled for life to an equal share of the deceased recipient's annuity or unitrust amount. Thus the last surviving recipient wins the tontine. A tontine is an investment (and a lottery) in which each participant pays into a common fund. The funds are invested and each participant receives dividends. When an investor dies, his or her share is divided among the other participants. The last surviving participant then gets the whole kit and caboodle, the whole ball of wax, the whole nine yards, the whole shebang—in short, everything. The tontine is named after Lorenzo de Tonti who invented the scheme in France in 1653. Tontines have been banned in the United States and Britain because of the potential incentive of participants to murder other participants to increase their shares) and becomes entitled to the entire annuity or unitrust amount for his or her life. On the death of the last surviving recipient, the trust assets are to be distributed to one or more qualified charities (charitable remainder organizations).

The state court having jurisdiction over Original Trust has approved **a pro rata division** (the rub, as you shall see) of the trust into as many separate and equal trusts as are necessary to provide one separate trust for each recipient living at the time of the division, with each separate trust being intended to qualify as the same type of CRT (e.g., CRAT, STAN-CRUT) as Original Trust. Either a court order or Original Trust agreement incorporates the provisions described in these facts that will govern the separate trusts.

Situation 1—more facts. The separate trusts may have different trustees. To carry out the division of Original Trust into separate trusts, each asset of that trust is divided equally among and transferred to the separate trusts. For purposes of determining the character of distributions to the recipient of each separate trust, each separate trust upon the division of Original Trust is deemed to have an equal share of that trust's income in each tier described in IRC §664(b). Similarly, on each subsequent consolidation of separate trusts by reason of the death of a recipient, the income in each tier of the consolidated trust is the sum of the income in that tier formerly attributed to the trusts being combined.

Same after as before—except. Each of the separate trusts has the same governing provisions as Original Trust, except that: immediately after the division of Original Trust, each separate trust has only one recipient, and each recipient is the annuity or unitrust recipient of only one of the separate trusts (that recipient's separate trust). And each separate trust is administered and invested independently by its trustee(s).

NOW FOR SOMETHING NEW—CONSOLIDATION AFTER THE SPLIT. Upon the death of a separate trust's recipient, each asset of that recipient's separate trust is to be **divided pro rata** (the rub, as you shall see) and transferred to the separate trusts of the surviving recipients. The annuity amount payable to the recipient of each separate CRAT is thereby increased by an equal share of the deceased recipient's annuity amount. The unitrust amount of each separate CRUT is similarly increased as a result of the augmentation of the CRUT's corpus, and each separate CRUT incorporates the requirements of Reg. §1.664-3(b) with respect to the subsequent computation of the unitrust amount from that trust. Upon the death of the last surviving recipient, that recipient's separate trust (being the only separate trust remaining) terminates, and the assets are distributed to the charitable remainder organizations.

The remainder organizations of Original Trust are the remainder organizations of each of the separate trusts and are entitled to the same (total) remainder interest after the division of Original Trust as before. In addition, each recipient is entitled to receive from his or her separate trust the same annuity or unitrust amount as the recipient was entitled to receive under the terms of Original Trust.

Additional facts about unitrusts. Because the annual net fair market value of the assets in each of the separate trusts may vary from one another due to differing investment strategies of the separate trusts, in situations where Original Trust is a CRUT, the amount of the unitrust payments from each separate CRUT may vary over time, both from year to year and among the separate CRUTs. Nevertheless, the unitrust percentage of each separate CRUT remains the same as each recipient's share of the unitrust percentage under the terms of Original Trust. And the recipients and the charitable remainder organizations are entitled to the same benefits after the division of Original Trust as before.

Example. Under the terms of Original Trust (a CRUT), Xenophon, Yenta, and Zhlub are entitled to share equally the annual payments of a 15% unitrust amount (unless all three recipients are actuarially close to death's door, the trust will fail the 10% minimum remainder interest requirement. But, hey, this is the IRS's example. Only the names have been changed by me to protect the innocent) amount (5% each) while all three are living, and upon the death of one recipient, the surviving recipients are entitled to the deceased recipient's share. Thus, if Xenophon dies first, the surviving recipients (Yenta and Zhlub) are entitled to share equally in the annual payments of the 15% unitrust amount (7.5% each) while both are living. Thereafter, if Yenta predeceases Zhlub, then upon the death of Yenta, Zhlub is entitled to receive annual payments of the entire 15% unitrust amount for life.

The three recipients and a horse, who is their lawyer, go into a bar and divide Original Trust into three separate trusts (one for each of Xenophon, Yenta, and Zhlub). Each of the separate trusts holds one-third of the assets of Original Trust. Xenophon, Yenta, and Zhlub are each entitled to annual payments of a 15% unitrust amount from his or her separate trust (15% of one-third of the assets is equivalent to 5% of all the assets of Original Trust). After the division of Original Trust and upon the death of Xenophon, each asset of Xenophon's separate trust is divided pro rata and transferred to Yenta and Zhlub's separate trusts. Yenta and Zhlub each remain entitled to annual payments of a 15% unitrust amount from his or her separate trust, each of which is now funded with the equivalent of one-half the assets of Original Trust (15% of one-half of the assets is equivalent to 7.5% of all the assets of Original Trust). On Yenta's death, the assets of her separate trust are transferred to Zhlub's separate trust, and Zhlub remains entitled to annual payments of a 15% unitrust amount from his separate trust.

These are the same interests to which Xenophan, Yenta, and Zhlub would have been entitled under the terms of Original Trust if that trust had not been divided into separate trusts. (*Note that Xenophon, Yenta and Zhlub have died in alphabetical order.* This is realistic. If you read the obituary pages, you'll see that day after day people die in alphabetical order.)

The plot gets thinner—Situation 2. The facts are the same as in *Situation 1* except that Original Trust has only two recipients, husband and wife, who are U.S. citizens. They are in the process of getting divorced. Instead of the provision described in *Situation 1*, each separate trust in *Situation 2* provides that upon the death of the recipient, that recipient's separate trust terminates and the assets of that separate trust are then distributed to the charitable remainder organizations. Because the charitable remainder organizations of Original Trust (and thus of each separate trust) receive a distribution of one-half of the assets of that trust upon the death of the first spouse to die and the remaining half of the assets upon the death of the surviving spouse (rather than a distribution of all the assets of Original Trust upon the later death of the surviving recipient), the value of the remainder payable to the charitable organizations as a result of the division of Original Trust into separate trusts may be larger than the present value of that interest as computed at the creation of Original Trust. However, no additional *income* tax charitable deduction is permitted. **Why not?** Actuaries should be able to value the larger charitable remainder. On another point, see my comment on page 5 for a possible concern about qualification for the *gift* tax charitable deduction. Oh, by the way, you should take a peek at IRC §1041— Transfers of Property between Spouses or Incident to Divorce.

Each recipient (spouse) is entitled to receive from his or her separate trust the same share of the annuity or unitrust amount as the recipient was entitled to receive under the terms of Original Trust. However, each spouse relinquishes all interests in Original Trust to which he or she would have been entitled by reason of having survived the other.

Pro rata division—the rub as you shall see. To carry out the division of Original Trust in *Situation 1* and *Situation 2*, each asset of Original Trust is divided on a pro rata basis among and distributed to the separate trusts. And on a consolidation (*Situation 1*) upon the death of a separate trust's recipient, each asset of that recipient's separate trust is to be divided pro rata and transferred to the separate trusts of the surviving recipients.

Who foots the bill? The recipients pay all the costs associated with the division of Original Trust into separate trusts, including legal fees of any court proceeding, and the administrative costs of the creation and funding of the separate trusts.

The IRS rules—drum roll:
1. In *Situation 1* and *Situation 2*, the pro rata division of Original Trust (a qualified CRT) into two or more separate trusts doesn't cause Original Trust or any of the separate trusts to fail to qualify as a CRT under IRC §664(d).

2. In *Situation 1* and *Situation 2*, where a trust that qualifies as a CRT under IRC §664(d) is divided pro rata into two or more separate trusts: the division is not a sale, exchange, or other disposition producing gain or loss; the basis under IRC §1015 of each separate trust's share of each asset is the same share of the basis of that asset in the hands of the trust immediately before the division of the trust; and, under IRC §1223, each separate trust's holding period for an asset transferred to it by Original Trust includes the holding period of the asset as held by Original Trust immediately before the division.

3. In *Situation 1* and *Situation 2*, the pro rata division of Original Trust into two or more separate trusts does not terminate under IRC §507(a)(1) Original Trust's status as a trust described in, and subject to, the private foundation provisions of IRC §4947(a)(2), and doesn't result in the imposition of an excise tax under IRC §507(c).

4. In *Situation 1* and *Situation 2*, where Original Trust is divided pro rata into two or more separate trusts, the division doesn't constitute an act of self-dealing under IRC §4941.

5. In *Situation 1* and *Situation 2,* where Original Trust is divided pro rata into two or more separate trusts, the division doesn't constitute a taxable expenditure under IRC §4945.

Rev. Rul. 2008-41

Drafting Information. The principal authors of this revenue ruling are Megan A. Stoner of the Office of Associate Chief Counsel (Passthroughs & Special Industries) and Ward L. Thomas of the Office of the Commissioner (Tax Exempt & Government Entities) Exempt Organizations Ruling Division. For further information regarding this revenue ruling, contact Ms. Stoner regarding issues 1 and 2 at (202) 622-3070 and contact Mr. Thomas regarding issues 3-5 at (202) 283-8913.

Worry warts this is what you may have been waiting for. The major concern (the rub) deals with an issue that you'll find within the four corners of Rev. Rul. 2008-41 itself—the pro rata division of Original Trust. But before getting to that, here are some concerns on stuff not dealt with in the ruling—so that you won't be caught off guard.

· **Gift to other recipient—concern.** In *Situation 2*, the two recipients are divorcing spouses and unlike *Situation 1* after Original Trust is split there is no consolidation of their separate trusts on the death of the first spouse to die. Although not dealt with in the ruling, there could be gift tax implications between the recipients if the younger recipient spouse is not a U.S. citizen or if the two recipients aren't spouses. By surrendering the right to receive the entire annuity amount or unitrust amount on the death of the first spouse to die, doesn't the younger recipient make a gift to the older recipient equal to the difference in value of their survivorship rights? The facts say that the spouses are U.S. citizens so the gift tax marital deduction comes to the rescue. But for alien spouses there isn't a gift tax marital deduction and the gift wouldn't qualify for the $128,000 gift tax annual exclusion for alien spouses. And if the two recipients in *Situation 2* aren't spouses, the gift wouldn't qualify for the $12,000 annual-per-donee exclusion. Why? Those exclusions are for present interests only.

· **Gift tax charitable deduction—concern.** In *Situation 2*, after the separation of Original Trust the charitable remainder organizations get part of the remainder interest on the death of the first of the spouses to die—rather than waiting to get their remainder interest in Original Trust at the death of the survivor of the spouses. So the charities are, in effect, getting an additional gift by getting part of the remainder earlier. The ruling states that there is no *income* tax charitable deduction for this earlier gift of the remainder. But what about a *gift* tax charitable deduction?

Possible gift tax trap—caution. In Letter Ruling 9550026, a NIM-CRUT was funded with community property and both spouses (donors) were to receive life income. Each disclaimed the right to receive income from the other's share of the community property used to fund the trust. Suppose the husband had funded the trust with his own separate property—providing unitrust payments for himself for life with payments to his wife if she survived him. Would the IRS maintain that no *gift* tax charitable deduction is allowable if the donor were to give away his remaining NIM-CRUT life interest and his wife were to give away her survivorship interest? Would IRS maintain that the husband-donor had already transferred an interest in the trust to a noncharity beneficiary, thus disqualifying him for the *gift* tax charitable deduction? Would it make any difference if his wife were to first disclaim her survivorship interest. IRS has allowed a gift tax charitable deduction when one spouse renounced her survivorship interest before the other in Letter Ruling 9529039. IRS stressed that one party was acting before the other. *Reminder:* Letter rulings aren't precedents.

· **Spendthrift trusts—something else to think about.** Some trusts are spendthrift trusts. Simply put, they make it impossible for a beneficiary to sell or give away his or her interest in the trust. So a determination must be made whether a survivor beneficiary has the right to disclaim or relinquish his or her interest. That's determined by state law, the governing instrument, or both.

· **If the trust in *Situation 1* is a CRAT—comment.** Every schoolchild knows that you can't make additional contributions to a charitable remainder annuity trust. Under the section of Rev. Rul. 2008-41 titled "Law and Analysis," the IRS states: "Section 1.664-2(b) provides that a trust is not a CRAT unless its governing instrument provides that no additional contributions may be made to the CRAT after the initial contribution."

Yet, after Original Trust (that can be a CRAT) is divided, the IRS has, in effect, ruled that when the separate trusts are consolidated on the death of a separate trust's recipient, it's ok to add that trust's assets to the other separate trusts. Apparently, the IRS doesn't deem that this is adding to a CRAT. The separate trusts have the same DNA (not to be confused with DNI) as Original Trust.

· **Payment of legal fees—comment.** Rev. Rul. 2008-41 states that the recipients pay all the costs associated with the division of Original Trust into separate trusts including legal fees of any court proceeding and the administrative costs of the creation and funding of the separate trusts. No mention is made whether the recipients of the separate trusts (or the estate of a deceased recipient) will pay legal and administrative costs on a subsequent consolidation of separate trusts on the death of a recipient. Letter Ruling 200616008 held that the CRT itself could pay reasonable legal fees and other expenses for dividing the trust. See also Letter ruling 200301020. Although Rev. Rul. 2008-41's statement of facts recites that the payment of legal and administration costs will be by the recipients, that fact is not recited in any of the ruling's five "holdings."

NOW FINALLY HERE'S THE RUB in Rev. Rul. 2008-41—comments by Lawrence Katzenstein, nationally recognized lawyer (based in St. Louis):

Leave it to the Service to confuse us. Nothing surprising in Rev. Rul. 2008-41 except the statement in the facts that "…each asset of Trust is divided equally among and transferred to the separate trusts." Well—that's a nuisance. Is the Service implying that a non pro rata division is not OK, or that we have capital gain on such a division?

The history is confusing. In PLR 200525008, the Service OK'd a similar division, but there the assets would be divided so that each trust would be funded with assets fairly representative of the aggregate adjusted bases of trust assets and "the division of the assets between Trust A and Trust B must be on a pro rata basis with respect to each major class of investments held at the date of the division, and within each class, must be fairly representative of overall appreciation or depreciation of the assets therein." Similar language is also in PLR 200808018. Neither of these rulings discusses the capital gain implications of these non pro rata distributions.

In non-charitable areas (such as division of trusts for GST purposes), the rulings require only that the assets fairly reflect net appreciation and depreciation…no class of investments language and no discussion of the capital gain issue. See Reg. §26.2654-1(b)(1)(ii): the severance of a trust that is included in the transferor's gross estate (or created under the transferor's will) into two or more trusts is recognized for purposes of chapter 13 if the governing instrument does not require or otherwise direct severance but the trust is severed pursuant to discretionary authority granted either under the governing instrument or under local law; and (among other things) "If severed on a fractional basis, the separate trusts need not be funded with a pro rata portion of each asset held by the undivided trust. The trusts may be funded on a non pro rata basis provided funding is based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding."

So if we now divide a CRT post Rev. Rul. 2008-41, do we need to:

1. Divide each asset?
2. Divide so that assets allocated are fairly representative of the aggregate adjusted bases of the trust assets, on a pro rata basis with respect to each

major class of investments held at the date of the division, and within each class, so that assets are fairly representative of overall appreciation or depreciation?

3. Merely divide so that the assets in each new trust fairly reflect net appreciation and depreciation?

If we do 2 or 3, do we have gain?

P.S.—Immer schlimmer (from bad to worse). In addition to the “pro rata” division concerns raised by Larry Katzenstein regarding ruling 2: Rulings 1, 3, 4 and 5 also state that Original Trust is divided pro rata. So, if the division isn’t on a pro rata basis:

· Will Original Trust and the separate trusts fail to qualify as CRTs under IRC §507(c)?

· Will excise taxes be imposed under IRC §507(c)?

· Will there be self-dealing under IRC §4941?

· Will there be taxable expenditure under IRC §4945?

Iam satis—enough already.

J. GIFT OF REMAINING LIFE INTEREST AFTER GIFT OF REMAINDER INTEREST, THEREBY ACCELERATING CHARITABLE REMAINDER

A donor who has created a charitable remainder unitrust—reserving life income for herself with remainder to charity—gets an income tax charitable deduction if she later contributes her remaining life interest to the charitable remainder organization, thereby accelerating the charitable remainder. The interest transferred can't be less than the donor's entire interest in the contributed property. The amount of the deduction is the then value of the remaining life interest. Reg. §1.170A-6(c)(3)(ii).

Letter ruling on this point. A 9% NIM-CRUT—funded with community property—pays the spouses jointly and then all to the survivor. On the survivor's death, the trust terminates with the remaining assets going to University. The husband has the power—by will—to revoke his wife's interest in the trust as to his community property interest in the trust. The wife has the same right as to her community property interest.

Donors want to now give a 20% undivided interest in their unitrust payments to University to fund the construction of a building. Each donor will disclaim the right to receive the other's unitrust interest and will irrevocably assign the interest to

University.

University's income and remainder interests will merge so it will then have a 20% undivided interest in the entire trust and an 80% undivided interest in the trust remainder. The parties will agree to terminate 20% of the trust and the trustee will then distribute 20% of the trust assets to University. The adjusted bases of the distributed assets will be fairly representative of all the property available. The trustee will continue to hold the balance of the trust assets.

IRS reviewed an earlier published ruling. In *Rev. Rul. 86-60,* 1986-1 CB 302, Alice was the sole beneficiary of a charitable remainder annuity trust that she created in 1980. Her interest wasn't created to avoid the rules prohibiting deductions for "partial interests." In 1984 Alice transferred her remaining retained income interest to the charitable remainder organization. IRS ruled that the gift of her income interest qualified for an income tax charitable deduction because she gave her entire interest in the property. Her gift also qualified for a gift tax charitable deduction because she hadn't made a prior transfer from the trust for private purposes. Thus, the income interest didn't have to be an annuity interest (or other qualified interest) described in IRC §2522 (although it was).

IRS rules—income tax deduction. Donors' situation is analogous to the facts in *Rev. Rul. 86-60*—except that they propose to contribute only 20% of their life interest. Donors claim that they didn't create the trust to avoid the partial interest rule. IRS agrees partly because of the six-year period between the trust's creation and the proposed gift. An income tax charitable deduction is allowable for the value of the undivided interest in the unitrust payments transferred to University, rules IRS.

IRS rules—value of income tax charitable deduction. It's the present value of the spouses' relinquished right to receive annually 9% of the net fair market value of 20% of the trust assets, rules IRS. The spouses' relinquished right is valued using their ages (to their nearest birthdays) at the time of the gift of 20% of their remaining life interest, based on the interest tables in effect for that month or in either of the two prior months—at the spouses' election—and 20% of the then value of the trust assets, rules IRS. *Letter Ruling 9550026.*

Background—gift tax implications for transfer to other income beneficiary. When donors who are spouses fund a two-life unitrust with joint or community property, the actuarially older spouse makes a gift to the actuarially younger spouse of the difference in value of their survivorship interests. However, the gift qualifies for the gift tax marital deduction—if the actuarially younger spouse is a U.S. citizen. Alternatively, the spouses can reserve the right—exercisable only by will—to revoke the other spouse's survivorship interest in one half of the life income gift. That's what the donors in this letter ruling did.

More background—gift tax implications for gift to charity. There's no gift tax deduction for a charitable gift of less than the donor's entire interest in property if the donor has already transferred an interest in that property to a noncharity beneficiary, but a gift tax deduction is allowed for transfers of a donor's undivided portion—a fraction or percentage—of his or her entire interest. IRC §2522(c)(2); Reg. §25.2522(c)-3(c)(2)(i).

IRS rules—gift tax deduction. Since the donors will each disclaim their right to receive the other's unitrust interest, neither is deemed to have made a noncharitable transfer when they created the trust. Their transfer of a 20% undivided interest in their unitrust interests will consist of a fraction or percentage of their entire interest. A gift tax charitable deduction is allowable for the value of the undivided interest in the unitrust payment transferred to University, rules IRS.

IRS rules—value of gift tax charitable deduction. It's the present value of the spouses' right to receive 9% of the net fair market value of 20% of the trust assets—as valued each year. The calculation is based on the spouses' ages (to their nearest birthdays) at the time of the transfer of 20% of their interest using the interest tables in effect for that month or in either of the two prior months—at the spouses' election—and 20% of the then value of the trust assets. The income-only limitation (a "net income with no makeup" unitrust) is disregarded for purposes of valuing the spouses' gifts of a 20% undivided portion of their unitrust interest because the transfer of the undivided portion of the spouses' unitrust interests results in a merger with a 20% undivided portion of University's remainder interest in the trust. But see the recent IRS position (below) on valuing a NIM-CRUT when it is collapsed and the proceeds are divided between the income beneficiary and the charity.

Gift tax trap—caution. Here the trust was funded with community property and both spouses (donors) were to receive life income. Each disclaimed the right to receive income from the other's share of the community property used to fund the trust. Suppose the husband funded the trust with his own separate property providing unitrust payments for himself for life with payments to his wife if she survived him. Would IRS maintain that no gift tax charitable deduction is allowable if the donor were to give away his remaining life interest and his wife were to give away her survivorship interest? Would IRS maintain that the husband-donor had already transferred an interest in the trust to a noncharity beneficiary, thus disqualifying him for the gift tax charitable deduction? Would it make any difference if his wife were to first disclaim her survivorship interest? **Comment:** IRS allowed a gift tax charitable deduction when one spouse renounced her survivorship interest before the other in *Letter Ruling 9529039.* IRS stressed that one party was acting before the other. *Reminder:* Letter rulings are not precedent. If in doubt, get your own ruling.

Income tax charitable deduction—what kind of gift is it? When a non-grantor beneficiary (someone else created the trust for his or her benefit) contributes his or her life interest, IRS treats it as a capital asset, deductible at full fair market value. *Rev. Rul. 72-243*, 1972-1 CB 233. Several letter rulings suggest that when a donor gives away his or her own retained life interest, the interest is a capital asset. *Letter Rulings 8052092* and *8311063*. In *Letter Ruling 8613046*, IRS said that the life interest of a charitable remainder trust's sole beneficiary was a capital asset, entitling her to a deduction for the full fair market value on the date of the contribution.

Spendthrift trusts—something else to think about. Some trusts are spendthrift trusts. Simply put, they make it impossible for a beneficiary to sell or give away his or her interest in the trust. So a determination must be made whether a survivor beneficiary has the right to disclaim or relinquish his or her interest. That's determined by state law, the governing instrument, or both.

IRS rules—capital gains avoidance. Any capital gain that the donors' unitrust had in prior years (before the gift of the 20% interest) that wasn't realized by the donors won't be included in their income solely because of the transfer of 20% of their interest in the unitrust— rules IRS.

K. TERMINATING A CRUT AND DIVIDING ASSETS BETWEEN BENEFICIARY AND CHARITABLE REMAINDER ORGANIZATION

A donor wanted to terminate his unitrust without giving the charity his income interest. Instead, the donor, the trustee and the charity agreed to terminate the trust, with the donor getting assets equal to the then value of his interest, and the charity getting assets equal to the then value of its remainder interest.

Arnold was the donor (a/k/a the settlor, grantor or trustor) and income beneficiary of a unitrust that was to make unitrust payments to him for 20 years with remainder to charity. If he dies during the 20-year period, the payments are to be made for the balance of the term, as he appoints by his will or in default thereof, to his estate.

IRS rules. Arnold (IRS calls him "A") has capital gain equal to the value of his remaining term-of-years interest. Here's how it reached that conclusion:

A is selling A's interest in Trust to the [charitable remainder-organization]. Provided that the property received by A is distributed to A in accordance with A's interest in Trust, the amount that A will realize from the sale of A's interest in Trust is the fair market value of the property received by A.

IRS then reviewed how unitrust amounts distributed to a unitrust beneficiary are taxed under IRC §664(b). But after that recital, IRS said that money or property received by Arnold on the trust's termination doesn't represent a distribution of an annual unitrust amount. Thus the four tiers are inapplicable. Rather, Arnold is disposing of his interest in the trust in exchange for money and property, and his transaction is governed by IRC §1001.

IRS goes into more detail. *Rev. Rul. 72-243*, 1972-1 CB 233 provides that a sale of an income interest in a trust is a sale of a capital asset within the meaning of IRC §§1221 and 1222. The holding period for determining whether gain or loss from the disposition of an income interest is long term or short term commences on the date the taxpayer first held the interest. Apparently, the unitrust was created over a year before the unitrust was terminated because IRS ruled that Arnold will have long term capital gain.

Poor Arnold. IRS said he had no basis in his interest in the trust—it is zero, zip, nada: "Pursuant to section 1001(e)(1), the portion of the adjusted uniform basis assigned to A's interest in Trust is disregarded. The exception contained in section 1001(e)(3) is not applicable, because the entire interest in Trust's assets is not being sold, or otherwise disposed of, to a *third party.*" [Emphasis supplied.]

Comment. IRS concluded that Arnold "is *selling* his interest in Trust to the [charitable remainder-organization]." Apparently, Arnold is the first party. Is the charity the second party? Apparently, IRS doesn't consider it to be a third party. Had Arnold sold his remaining term-of-years interest and the charity sold its remainder interest to Arnold's neighbor (instead of Arnold and the charity whacking up the assets), would Arnold then have sold to a third party and then had a basis greater than zero for determining capital gain?

IRS also rules—no self-dealing. Arnold, as the trust's grantor, is a disqualified person. But Reg. §53.4947-1(c)(2)(i) exempts him from self-dealing. The actuarial amount paid to him representing his term-of-years interest in the trust is derived solely from his right to annual unitrust payments. Just as the unitrust amounts paid over time are excluded from self-dealing, so too is the payment of Arnold's term-of-years interest in the trust. **Reason:** That payment is derived from Arnold's legal right to the unitrust amounts under the trust agreement. So there's no self-dealing when terminating the trust and distributing the assets to Arnold and the charitable remainder-organization.

Caution. If the remainder is to go to a private foundation (rather than a public charity) there would be a prohibited act of self dealing. *Letter Ruling 200525014* revoked by *Letter Ruling 200614032*; *Letter Ruling 200616035*.

IRS places conditions on its favorable ruling. The trust's termination must not be prohibited by state law and must be made under a court order resulting from a proceeding to which the state attorney general is a party. And the amounts distributed to Arnold must be determined under IRC §7520's valuation rules. Any distribution of assets in kind must be made pro rata. *Letter Ruling 200127023*.

Comment on IRC §7520 valuation: For determining income, gift and estate tax charitable deductions for split-interest trusts, a donor may use the IRC §7520 rate for the month of the transfer, or for either of the two proceeding months. However, a charitable deduction isn't available in Arnold's case. So the IRC §7520 rate to use (although IRS didn't discuss this) is the rate for the month the trust is terminated.

L. TERMINATED NI-CRUT—OK IF INCOME BENEFICIARY HEALTHY

Adult child is the sole income beneficiary of a "net income with no makeup" charitable remainder unitrust (NI-CRUT) that pays her 8% of the assets' net fair market value or actual trust income, whichever is lower. Parent (now deceased) created the NI-CRUT so Child is a disqualified person. Church is the charitable remainder organization and Trustee is a Church affiliate.

For several years, the NI-CRUT's payments have been less than 3% of the assets' net fair market value because Trustee has been investing for total return rather than to maximize the annual distributable income. As a result, the NI-CRUT payments have been relatively low and Child has been dissatisfied.

Trustee says it is faced with the uncomfortable situation of balancing its fiduciary obligations to the income and remainder beneficiaries in a marketplace that favors capital appreciation over the production of distributable income. To resolve the situation, the parties want to terminate the NI-CRUT with Child and Church to receive lump-sum payments equal to the present values of their respective interests.

The termination will comply with state law that permits early termination with the consent of all the parties provided that all income and remainder interests are vested, and no individual has retained the right to change the remainder beneficiaries. Child, Church, Trustee, and the state attorney general will all consent to the termination.

Child's good health key to favorable ruling. Child's long-time physician has examined her and signed an affidavit that she has no medical condition that would shorten her life expectancy. Child has also signed an affidavit that she is in good physical health. Stay tuned for why this is important, but you may already have figured it out.

IRS rules. Early termination of the NI-CRUT won't constitute self-dealing under IRC §4941(d). Although the NI-CRUT is silent on early termination, state law allows its early termination and so that's an implied trust provision. The termination payment to Child is derived from her legal right to the unitrust amounts under the trust agreement. So there's no self-dealing when terminating the NI-CRUT and distributing its assets to her and Church. *Note.* If the charity is a private foundation and not a public charity, IRS takes the position that the termination would be a prohibited act of self-dealing. *Letter Ruling 200525014* revoked by *Letter Ruling 200614032*; *Letter Ruling 200616035*.

Back to child's health. IRS was particularly concerned that an early termination might result in a greater allocation of the trust assets to the Child (income beneficiary) to the detriment of the Church (remainder organization), given that Child was a disqualified person with respect to the NI-CRUT. That would be the case if she knew that her life expectancy was shorter than that assumed in the actuarial tables used to value the life and remainder interests.

IRS also noted that all the parties consented to the termination (including the state attorney general), and that the present values of the income and remainder interests would be determined according to the Code and regulations. *Letter Ruling 200208039.*

M. NIM-CRUT TERMINATED—VALUING THE INTERESTS

Donor created a 10% net-income-with-makeup charitable remainder unitrust (NIM-CRUT). He is the income recipient and publicly supported charities are the remainder organizations. Donor is also a trustee along with an independent special trustee.

Donor wishes to terminate the NIM-CRUT and have the trust assets distributed to him and the charities according to their respective interests. The IRS deems the termination to be a constructive sale of the income recipient's interest and he has a zero basis. If the trust was created more than a year before the CRT's termination, Donor's constructive sale is treated as a sale of a long-term capital asset (taxable at a maximum 15% rate). The gain is the difference between the value of the income recipient's interest and zero. Naturally, an income recipient wants the highest-possible valuation of his interest because he gets more assets—and keeps 85% after paying a 15% tax.

The law in Donor's state permits early termination of the trust provided all the parties agree (income recipients, trustees and charitable remainder organizations). The state's attorney general and a court needn't be involved as long as all the parties consent. In addition, the Restatement of the Law of Trusts 3d (2001) provides at section 651(1) that ". . . if all of the beneficiaries of an irrevocable trust consent, they can compel the termination or modification of the trust."

As is commonplace in CRT terminations, when a CRUT or CRAT is measured by an individual's life (as opposed to a term of years) Donor represented to the IRS that he was aware of no physical condition that would decrease his normal life expectancy. He also submitted a statement from his physician confirming that he had examined Donor, and that there was no indication that his life expectancy was less than would otherwise be expected for a man his age. Naturally, if someone is at death's door—or closer to the door than normal—his life interest's value is diminished.

The plot thickens. In Donor's initial ruling request, he stated that the actuarial values of the respective interests (his and the charitable remainder organizations) should be calculated using the discount rate in effect under IRC §7520 on the date of the constructive sale, and the method of valuing a charitable remainder in Reg. §1.664-4.

After discussions with the IRS, Donor, as the income recipient, agreed to a different method of calculating the respective interests in the trust. Specifically, the letter ruling stated:

> The Taxpayer understands and agrees that, contrary to the formula assumed in his earlier letter ruling request, the payout rate to be used in calculating the respective interests will be the lesser of the Code Section 7520 rate in effect at the time of termination of the trust and the stated interest rate [unitrust amount] of 10% contained in the trust agreement.

IRS rules. The appropriate calculation of the actuarial value of the income recipient's interest must take into account the net-income provisions of the trust. That requires the use of a reasonable method for the calculation which doesn't inappropriately inflate the income recipient's interest to the detriment of the charitable remainder organizations. One reasonable method to calculate the actuarial value of the income and remainder interests, rules the IRS:

> The computation of the remainder interest is found using a special factor as indicated in section 1.7520-3(b)(1)(ii) of the regulations. The special remainder factor is found by using the methodology stated in section 1.664-4 for computing the factor for a remainder interest in a unitrust, with the following modification: where section 1.664-4(a)(3) of the regulations provides an assumption that the trust's stated payout percentage is to be paid out each year, instead the assumed payout shall be that of a fixed percentage which is equal to the lesser of the trust's stated payout percentage or the section 7520 rate for the month of termination. The special factor for the non-charitable payout interest is 1 minus the special remainder factor.

Based on this methodology, here's how to calculate Donor's income interest:

> The section 7520 rate for May 2006 is 5.8 percent. Assuming the termination occurred in May 2006, the lesser of this rate and the trust's stated payout percentage is 5.8 percent. The assumed taxpayer's age as of the nearest birthday is 75. Based on Table 90CM, interest at 5.8 percent, an unadjusted payout rate of 5.8 percent, and quarterly payments made at the end of each quarter, the present value of the remainder interest in a unitrust which falls in at the death of a person aged 75 is $0.56904 for each $1.00 of the trust estate. The present value of the payout interest in the same unitrust until such death is $1.00 minus $0.56904, or $0.43096 for each $1.00 of the trust estate.

> The income recipient is not expected to receive more than he would during the full term of the trust under the above-described methodology for valuing his interest in a charitable remainder trust with a net income make-up feature.
>
> *Letter Ruling 200725044*

Comment. One tax Einstein opines that arguably IRS's method of valuing the NIM-CRUT's income interest is solely to determine whether the self-dealing excise tax applies—and the methodology doesn't necessarily apply to determining the share of the assets to be received by the income recipient.

Another tax genius says that the best way—for all purposes—to determine the value of a NIM-CRUT's income interest is to have a qualified appraisal on what in the real world a reasonable buyer would pay a reasonable seller both having knowledge of relevant facts and neither being under compulsion to buy or sell.

For those not relishing a battle with the IRS, here's a suggested plan for favorably valuing a life interest on a gift or constructive sale (the assets are divided between the income recipient and the charitable remainder organization). This plan should result in the NIM-CRUT's life interest being valued using the same method as is used for the charitable deduction for the remainder interest when the trust is initially funded.

Don't draft a plain old NIM-CRUT. Instead, draft the NIM-CRUT with a *flexible* FLIP-CRUT provision. Then if the income recipient wants to contribute his remaining life interest or receive his share of the trust, he pulls the trigger—and voila we're dealing with a STAN-CRUT. Hey, no problem in getting a more favorable valuation without doing battle with the IRS.

What is a flexible FLIP-CRUT (a FLEX-FLIP-CRUT)? A typical FLIP-CRUT provides that a NIM-CRUT shall flip and become a STAN-CRUT on January 1 of the year following the sale of Greenacre (a nonmarketable asset). And that's often an appropriate time to flip a NIM-CRUT. But instead of doing it that way, fund the trust with Greenacre *and* a few shares of nonmarketable securities (e.g., cookthebooks.com). Make the sale of cookthebooks.com the flipping event. Then if you wish to flip the trust earlier than Greenacre's sale, on its sale, or later than its sale, you can flip at will—by selling the shares in cookthebooks.com.

Think of the issues at the outset when drafting the NIM-CRUT. This plan won't help the hapless donor in this letter ruling.

Drafting pointer. IRS takes the position that you can't divide the assets between an income beneficiary and a private foundation remainder organization—that would be self-dealing. So keep the right in the trust instrument to substitute a public charity for the private foundation. Then make the substitution before terminating the trust.

Parthian shot. This letter ruling deals with a net-income-with-makeup unitrust. IRS would likely apply the same computation method to a net-income-with-no-makeup unitrust (NI-CRUT). As a practical matter, the life interest for that trust would be worth even less because deficiencies can never be made up.

N. CRAT — COMMERCIAL ANNUITY INVESTMENT OK; BUT MAJOR CAUTIONS

Situation. Donor wants to create a charitable remainder annuity trust with appreciated real property. The CRAT, it is represented to the IRS, qualifies as a CRAT under IRC §664(d)(1) and the corresponding regulations.

Donor asked the IRS to rule that this provision won't disqualify the CRAT:

> The Trustee shall have the discretion to provide for the annuity payment to Trustor [Donor] by allocating a portion of the trust assets to purchase an annuity contract which will guarantee to pay to the trust a sum equal to or greater than the Trustor's computed annual annuity payout for the duration of the trust. If the Trustee chooses to provide for the Trustor's annuity payment in this manner, the Trustee may only purchase such contract from an insurer with an A.M. Best Company Insurer Financial Strength Rating of "Superior" (A++, A+) or "Excellent" (A, A). After securing such contract, the Trustee may distribute any amount other than the amount described in *Treas. Reg. Section 1.664-2(a)(1)* to the charities named in Schedule B any time during the term of the trust. Upon the termination of all noncharitable interests, the Trustee shall distribute all of the principal and income of the trust (other than any amount due to the Annuity Recipient or the estate of the Annuity Recipient) to the charitable organizations, in the percentages designated, as provided in Schedule B.

More facts. Donor anticipates that Trustee will purchase an annuity contract over which Trust possesses all incidence of ownership and is entitled to all payments, that the annuity contract will pay the annuity amount annually to Trust, and that Trustee will then pay the annuity amount to Donor for his life.

IRS rules. Inclusion of the provision authorizing the purchase of an annuity will not jeopardize the status of the trust as a CRAT under IRC §664(d)(1). *Letter Ruling 201126007.*

Comment. The IRS ordinarily will not rule whether a charitable remainder annuity trust that provides for payments for one or two measuring lives satisfies the requirements of IRC §664.

Why not? In lieu of seeking the Service's advance approval of a CRAT, taxpayers are directed to follow the sample CRAT provisions outlined in Rev. Proc. 2003-53, 2003-2 C.B. 230. By following the models contained in that revenue procedure, taxpayers can be assured, says the IRS, that it will recognize a trust as meeting all the requirements of a qualified CRAT under IRC §664(d)(1), provided that the trust operates in a manner that is consistent with the terms of the trust instrument and that the trust is valid under applicable local law.

So why a ruling here? The CRAT will contain a provision not addressed in Rev. Proc. 2003-53. Thus the IRS ruled on whether a provision providing for the purchase of a commercial annuity would disqualify the trust. Note that the Service did not otherwise bless the CRAT.

General rules for taxation of a beneficiary's payments (but as you'll see in a moment, they won't apply here). Annuity trust and unitrust payments are taxable under the four-tier provisions of IRC §664(b) and Reg. §1.664-1(d)(1). And the income paid to the income beneficiary retains the character it had in the trust. Each payment is treated as follows:

First, as ordinary income to the extent of the trust's ordinary income for the year (and any undistributed ordinary income from prior years);

Second, as capital gains for the year (and any undistributed capital gains from prior years);

Third, as tax-exempt income to the extent of the trust's exempt income for the year (and any undistributed exempt income from prior years); and

Fourth, as a tax-free return of principal.

Note: In tiers *First* and *Second*, the income and gains that are taxable at the highest rates are deemed distributed first.

Payments received by an individual from a commercial annuity. The payments are deemed to be part taxable-interest and part tax-free return of principal. IRC §72(b)(1). The ordinary income part of the payment is taxable up to the highest income tax rate — currently 35%. (By contrast, domestic dividends are taxable at 15%, even for tax-payers in higher tax brackets.)

Payments received by a trust from a commercial annuity. The rule that part of each annuity payment is deemed to be a tax-free return of principal doesn't apply if the annuity holder is a trust — even if the trust is acting as the agent for a natural person. IRC §72(u)(1). So the taxpayer in the Letter Ruling under discussion could have <u>all</u> his annuity trust payments taxable as ordinary income — up to the 35% rate.

Caution re sale of real estate. Generally, no capital gain is incurred on transfer of appreciated assets to a CRT. Rev. Rul. 55-275, 1955-1 CB 295; Rev. Rul. 60-370, 1960-2 CB 203. Nor is there gain to donor on a sale by the CRT (except as taxable under four-tier system, above). *One exception:* the gain is taxable to the donor if the trust assets are sold and the proceeds are invested in tax-exempt securities pursuant

to an express or implied agreement between the donor and trustee. Rev. Rul. 60-370, 1960-2 CB 203.

More to think about: mortgaged property. If real estate is to be transferred to a charitable remainder trust, it must be unmortgaged. Otherwise the CRT will be disqualified under the self-dealing rules, says the IRS. *Letter Ruling 9015049*.

Be careful about requiring specific investments. The trustee shouldn't be *required* to invest in any particular asset. That must be left to the trustee's discretion. Requiring the trustee of a CRAT or CRUT to make or keep investments — no matter how good — could result in IRS's disqualifying the trust. Reg. §1.664-1(a)(3). The donor would lose the charitable deduction **and** be taxed on any capital gain the trust realized when selling the appreciated assets.

Be sure that payments can be made. Funding an annuity trust with a non-productive asset that cannot be readily sold can be hazardous to a donor's wealth. If the asset cannot be sold, and payments aren't made (or not made on time), the trust will be disqualified. *Atkinson,* 115 T.C. 26 (2000), aff'd, 309 F.3d 1290 (11th Cir. 2002), cert. denied, 540 U.S. 946, 124 S. Ct. 388, 157 L.Ed.2d 276 (2003).

Prearranged sale. If the CRAT sells to a buyer with whom the donor had negotiated, and the sale was virtually a done-deal, the capital gain on a sale by the CRAT (or CRUT) would be taxable — and to the donor out of his pocket, not out of the proceeds of the sale by the trust.

Diversification reminder. It's great when a trust passes muster with the IRS. But make sure that trust investments don't run afoul of state diversification requirements.

Parthian shot. The favorable letter ruling (on which only the recipient can rely) deals with an immediate payment commercial annuity payable to a CRAT. The IRS, however, takes a dim view of NIM-CRUTs that invest in deferred payment commercial annuities. In January 2011, the IRS once again said that it will ordinarily not rule whether a trust that calculates the unitrust amount under IRC §664(d)(3) — a net-income-with-makeup trust (NIM-CRUT) — qualifies as an IRC §664 charitable remainder trust if a grantor, a trustee, a beneficiary (or a person related or subordinate to a grantor, a trustee, or a beneficiary) can control the timing of the trust's receipt of trust income from a partnership or a deferred annuity contract. The IRS is concerned that the trust will take advantage of the difference between trust income under IRC §643(b) and income for federal income tax purposes for the benefit of the unitrust recipient. *Translation:* The Service is concerned that the trust will be able to time the receipt of income for the beneficiary (unitrust recipient).

O. CRT CAPITAL-GAIN-AVOIDANCE PLAN QUASHED—FINAL REGULATIONS

Treasury and the IRS just issued final regulations that thwart a capital-gain-avoidance plan. The plan purports to avoid capital gain for a life (or term-of-years) beneficiary of a charitable remainder unitrust or annuity trust on a sale to a third party by the life beneficiary and the charitable remainder organization of their respective interests.

The final regulations adopt last year's proposed regulations and follow up on a 2008 IRS Notice in which the Treasury and the IRS (from now on, I'll mostly just say the IRS) described the plan (scheme*?), required notification to the IRS by participants and imposed costly penalties for non-notification.

IRS Notice 2008-99 said the Donor's basis would be reduced to zero on a trust termination by a sale of a CRT's assets to a third party by the life beneficiary and the charitable remainder organization.

The American Council on Gift Annuities submitted comments, that I prepared, to the IRS on Notice 2008-99. ACGA agreed that abuses should be curbed, but suggested a way to protect the fisc without adversely punishing non-abusive CRT terminations.

ACGA suggested to the IRS that on a sale by the life-income beneficiary and the charitable remainder organization of the trust assets to a third party, the life-income beneficiary's basis be his pro rata share of the charitable remainder unitrust's or annuity trust's basis reduced by any undistributed amounts then in the capital gains category of the four-tier taxation rules. Under Notice 2008-99, the life beneficiary would, in effect, have to pay tax on amounts already distributed to him and which were taxable to him.

Happy to report. The IRS in its proposed 2014 regulations and now in its 2015 final regulations adopted ACGA's suggestion.

Before getting to the final regulations, here is background helpful in understanding them and assuaging concerns about early termination of CRTs in typical "non-abuse" situations.

Stepped-up basis—general rule. For appreciated assets inherited at death, an heir gets a basis equal to the then fair market value (rather than taking over the decedent's lower basis). But a decedent had to give his life to achieve this.

Can the beneficiary of a CRUT or CRAT during his lifetime step up the basis of appreciated assets used to fund the trust (and any other trust assets) and then on an early termination of the trust receive proceeds equal to his interest in the trust free of capital gains tax? That's what concerned the IRS in Notice 2008-99, and in the recently issued final regulations that are the subject of this article.

Three situations follow. Situations 1 and 2 don't concern the IRS and shouldn't concern you. Situation 3 won't deliver the hoped-for benefits.

Situation 1—no problem. Every schoolchild knows that a donor can transfer appreciated assets to a charitable remainder unitrust or annuity trust and avoid capital gain on the trust's funding and not be taxed on the capital gain on a subsequent sale by the trust. The capital gain is, however, taxable to the trust beneficiary but only to the extent that the gain is deemed distributed to him under the four-tier taxation regime in satisfaction of the annual unitrust or annuity trust amount.

Situation 2—no problem. Some beneficiaries terminate their CRTs before the end of the specified term and the trust assets are divided between the beneficiary and the charitable remainder organization according to their respective interests at the CRT's termination. Letter rulings have sanctioned this. The termination is treated as a sale of a capital asset, not to a third party, of the beneficiary's term interest (generally measured by his life but sometimes a term-of-years). The beneficiary is deemed to have a zero basis and have capital gain. If the trust was created more than one year before its termination, the gain is taxed favorably. Although capital gains are taxable, this isn't a penalty situation involving the participants in the transaction. More about this later when the sale is to a third party.

Situation 3—problem. The IRS announced in Notice 2008-99 that it was aware of a transaction (described soon) in which a sale or other disposition of <u>all</u> interests in a charitable remainder trust (subsequent to the contribution of appreciated assets to the trust and their sale and reinvestment by the trust) resulted in the donor or other noncharitable beneficiary getting the value of that person's trust interest and claiming to recognize little or no taxable gain. "The IRS and Treasury Department believe this transaction has the potential for tax avoidance or evasion**, but lack enough information to determine whether the transaction should be identified specifically as a tax avoidance transaction." The IRS identified this transaction and substantially similar transactions as transactions of interest for purposes of Reg. §1.6011-4(b)(6) and IRC §§6111 and 6112. The IRS also alerted persons involved in these transactions to certain responsibilities that may arise from their involvement. More about transactions of interest, listed transactions and reportable transactions later. To keep this article from becoming a book, I won't explain all the Code and regulation sections cited in Notice 2008-99 regarding required notifications to the IRS. Suffice it to say if you're involved in this type of transaction, you'll want to study them.

Here's the transaction of interest to the IRS. *Step 1.* Donor creates a CRUT or CRAT and contributes appreciated assets to the trust. Donor retains an annuity or unitrust interest (the term interest) and designates a charity as the remainder organization. The charity may, but need not, be controlled by the donor; he may, but need not, reserve the right to change the charity designated as the remainder beneficiary.

Step 2. The CRT sells or liquidates the appreciated assets and reinvests the net proceeds in other assets (new assets) such as money market funds and marketable securities often to acquire a diversified portfolio. Because a charitable remainder trust is tax-exempt under IRC §664, the trust's sale of the appreciated assets is exempt from income tax, and the trust's basis in the new assets is the price the trust pays for those new assets. Some portion of the trust's ordinary income and capital gains may become taxable to the term recipient as the periodic annuity or unitrust payments are made by the trust (under the rules of IRC §664 and its regulations).

Step 3. The donor and the charity, in a transaction they claim is described in IRC §1001(e)(3), sell or otherwise dispose of their respective interests in the trust to Unrelated Third Party, for approximately the fair market value of the trust's assets including the new assets.

Step 4. The trust then terminates, and the trust's assets, including the new assets, are distributed to Unrelated Third Party.

Donor takes these positions regarding the tax consequences of this transaction:

· Donor claims an income tax charitable deduction for the portion of the fair market value of the appreciated assets attributable to the remainder interest as of the date of their contribution to the trust.

· Donor claims to recognize no gain from the trust's sale or liquidation of the appreciated assets. When the donor and the charity sell their respective interests in the trust to Unrelated Third Party, the donor and the charity take the position that they have sold the <u>entire</u> interest in the trust within the meaning of IRC §1001(e)(3). Because the <u>entire</u> interest in the trust is sold, the donor claims that IRC §1001(e)(1), which disregards basis in the case of a sale of just the <u>term</u> interest, doesn't apply. The donor also takes the position that, under IRC §1001(a) and related provisions, the gain on the sale of the donor's term interest is computed by taking into account the portion of uniform basis allocable to the donor's term interest under Reg. §§1.1014-5 and 1.1015-1(b), and that this uniform basis is derived from the basis of the new assets rather than the basis of the appreciated assets. (If this works, the donor has achieved Tax Nirvana—a stepped-up basis without giving his life.)

Variations on a scheme:
· A net-income-with-make-up charitable remainder unitrust (NIM-CRUT) is used.

· Trust may have been in existence for some time prior to the sale of trust interests.

· The appreciated assets may already be in the trust before the commencement of the transaction.

· The beneficiary and the seller of the term interest may be the donor and/or another person.
· The donor may contribute the appreciated assets to a partnership or other passthrough entity and then contribute the interest in the entity to the trust.

Claimed tax treatment of the transaction. The gain on the sale of the appreciated assets is never taxed, even though the donor receives his share of the appreciated fair market value of those assets.

Ordinary folks needn't worry. The IRS and the Treasury aren't concerned about the mere creation and funding of a charitable remainder trust with appreciated assets and/or the trust's reinvestment of the contributed appreciated assets. Those events alone don't constitute the transaction subject to Notice 2008-99. And the final regulations echo this.

Who should be concerned? The IRS and the Treasury "are concerned about the manipulation of the uniform basis rules to avoid tax on gain from the sale or other disposition of appreciated assets. Accordingly, the type of transaction described in Notice 2008-99 includes a coordinated sale or other coordinated disposition of the respective interests of the [donor] or other noncharitable [beneficiary] and the charity in a charitable remainder trust in a transaction claimed to be described in §1001(e)(3), subsequent to the contribution of appreciated assets and the trust's reinvestment of those assets. In particular, the IRS and Treasury Department are concerned about [donor's] claim to an increased basis in the term interest coupled with the termination of the trust in a single coordinated transaction under §1001(e) to avoid tax on gain from the sale or other disposition of the Appreciated Assets."

Notice 2008-99's teeth—transactions of interest. Transactions that are the same as, or substantially similar to, those described in Notice 2008-99 "are identified as transactions of interest for purposes of §1.6011-4(b)(6) and §§6111 and 6112 effective October 31, 2008, the date this notice was released to the public. Persons entering into these transactions on or after November 2, 2006, must disclose the transaction as described in §1.6011-4. Material advisers who make a tax statement on or after November 2, 2006, with respect to transactions entered into on or after November 2, 2006, have disclosure and list maintenance obligations under §§6111 and 6112. See §1.6011-4(h) and §§301.6111-3(i) and 301.6112-1(g) of the Procedure and Administration Regulations." **The final regulations say that these teeth continue to bite.**

The IRS's warning—participants who entered into these transactions at any time may already be in hot water:

> "Independent of their classification as transactions of interest, transactions that are the same as, or substantially similar to, the transaction described in this notice already may be subject to the requirements of §§6011, 6111, or 6112, or the regulations thereunder. When the IRS and Treasury Department have gathered enough information to make an informed decision as to whether this transaction is a tax avoidance type of transaction, the IRS and Treasury Department may take one or more actions, including removing the transaction from the transactions of interest

category in published guidance, designating the transaction as a listed transaction, or providing a new category of reportable transaction. "

Who are participants? "Under §1.6011-4(c)(3)(I)(E), each recipient of the term interest and Trust are participants in this transaction for each year in which their respective tax returns reflect tax consequences or a tax strategy described in this notice. Charity is not a participant if it sold or otherwise disposed of its interest in Trust on or prior to October 31, 2008. For interests sold or otherwise disposed of after October 31, 2008, under §1.6011-4(c)(3)(I)(E), Charity is a participant for the first year for which Charity's tax return reflects or is required to reflect the sale or other disposition of Charity's interest in Trust. In general, Charity is required to report the sale or other disposition of its interest in Trust on its return for the year of the sale or other disposition. See §6033 and §1.6033-2(a)(ii). Therefore, in general, Charity will be a participant for the year in which charity sells or otherwise disposes of its interest in Trust."

Time for Disclosure. See Reg. §§1.6011-4(e) and 301.6111-3(e).

Material Advisor Threshold Amount. The threshold amounts in Reg. §301.6111-3(b)(3)(I)(B) are reduced to $5,000.

Penalties—the book will be thrown at those who are required to disclose but don't. "Persons required to disclose these transactions under §1.6011-4 who fail to do so may be subject to the penalty under §6707A. Persons required to disclose these transactions under §6111 who fail to do so may be subject to the penalty under §6707(a). Persons required to maintain lists of advisees under §6112 who fail to do so (or who fail to provide such lists when requested by the

IRS) may be subject to the penalty under §6708(a). In addition, the IRS may impose other penalties on parties involved in these transactions or substantially similar transactions, including the accuracy-related penalty under §6662 or §6662A."

THE FINAL REGULATIONS

The IRS in the proposed regulation discussed Notice 2008-99 detailed at the outset of this article. It then explains the proposed regulations. That explanation applies to the final regulation that adopted the proposed regulation without change.

> [The] . . . regulations provide a special rule for determining the basis in certain CRT term interests in transactions to which section 1001(e)(3) applies. In these cases, the . . . regulations provide that the basis of a term interest of a taxable beneficiary is the portion of the adjusted uniform basis assignable to that interest reduced by the portion of the sum of the following amounts assignable to that interest: (1) the amount of undistributed net ordinary income described in section 664(b)(1); and (2) the amount of undistributed net capital gain described in section 664(b)(2). These . . . regulations do not affect the CRT's basis in its assets, but rather are for the purpose of determining a taxable beneficiary's gain arising from a transaction described in section 1001(e)(3). However, the IRS and the Treasury Department may consider whether there should be any change in the treatment of the charitable remainderman participating in such a transaction.

Issuance of the final regulations doesn't affect the disclosure obligation stated in Notice 2008-99. Some examples from the final regulations:

If these examples spin your head (mine is still spinning), see my simplified examples following the IRS's examples.

Example 7. (a) Grantor creates a charitable remainder unitrust (CRUT) on Date 1 in which Grantor retains a unitrust interest and irrevocably transfers the remainder interest to Charity. Grantor is an individual taxpayer subject to income tax. CRUT meets the requirements of section 664 and is exempt from income tax.

(b) Grantor's basis in the shares of X stock used to fund CRUT is $10x. On Date 2, CRUT sells the X stock for $100x. The $90x of gain is exempt from income tax under section 664(c)(1). On Date 3, CRUT uses the $100x proceeds from its sale of the X stock to purchase Y stock. On Date 4, CRUT sells the Y stock for $110x. The $10x of gain on the sale of the Y stock is exempt from income tax under section 664(c)(1). On Date 5, CRUT uses the

$110x proceeds from its sale of Y stock to buy Z stock. On Date 5, CRUT's basis in its assets is $110x and CRUT's total undistributed net capital gains are $100x.

(c) Later, when the fair market value of CRUT's assets is $150x and CRUT has no undistributed net ordinary income, Grantor and Charity sell all of their interests in CRUT to a third person. Grantor receives $100x for the retained unitrust interest, and Charity receives $50x for its interest. Because the entire interest in CRUT is transferred to the third person, section 1001(e)(3) prevents section 1001(e)(1) from applying to the transaction. Therefore, Grantor's gain on the sale of the retained unitrust interest in CRUT is determined under section 1001(a), which provides that Grantor's gain on the sale of that interest is the excess of the amount realized, $100x, over Grantor's adjusted basis in the interest.

(d) Grantor's adjusted basis in the unitrust interest in CRUT is that portion of CRUT's adjusted uniform basis that is assignable to Grantor's interest under §1.1014-5, which is Grantor's actuarial share of the adjusted uniform basis. In this case, CRUT's adjusted uniform basis in its sole asset, the Z stock, is $110x. However, paragraph (c) of this section applies to the transaction. Therefore, Grantor's actuarial share of CRUT's adjusted uniform basis (determined by applying the factors set forth in the tables contained in §20.2031-7 of this chapter) is reduced by an amount determined by applying the same factors to the sum of CRUT's $0 of undistributed net ordinary income and its $100x of undistributed net capital gains.

(e) In determining Charity's share of the adjusted uniform basis, Charity applies the factors set forth in the tables contained in §20.2031-7 of this chapter to the full $110x of basis.

Example 8. (a) Grantor creates a charitable remainder annuity trust (CRAT) on Date 1 in which Grantor retains an annuity interest and irrevocably transfers the remainder interest to Charity. Grantor is an individual taxpayer subject to income tax. CRAT meets the requirements of section 664 and is exempt from income tax.

(b) Grantor funds CRAT with shares of X stock having a basis of $50x. On Date 2, CRAT sells the X stock for $150x. The $100x of gain is exempt from income tax under section 664(c)(1). On Date 3, CRAT distributes $10x to Grantor, and uses the remaining $140x of net proceeds from its sale of the X stock to purchase Y stock. Grantor treats the $10x distribution as capital gain, so that CRAT's remaining undistributed net capital gains amount described in section 664(b)(2) and §1.664-1(d) is $90x.

(c) On Date 4, when the fair market value of CRAT's assets, which consist entirely of the Y stock, is still $140x, Grantor and Charity sell all of their interests in CRAT to a third person. Grantor receives $126x for the retained annuity interest, and Charity receives $14x for its remainder interest. Because the entire interest in CRAT is transferred to the third person, section 1001(e)(3) prevents section 1001(e)(1) from applying to the transaction. Therefore, Grantor's gain on the sale of the retained annuity interest in CRAT is determined under section 1001(a), which provides that Grantor's gain on the sale of that interest is the excess of the amount realized, $126x, over Grantor's adjusted basis in that interest.

(d) Grantor's adjusted basis in the annuity interest in CRAT is that portion of CRAT's adjusted uniform basis that is assignable to Grantor's interest under §1.1014-5, which is Grantor's actuarial share of the adjusted uniform basis. In this case, CRAT's adjusted uniform basis in its sole asset, the Y stock, is $140x. However, paragraph (c)of this section applies to the transaction. Therefore, Grantor's actuarial share of CRAT's adjusted uniform basis (determined by applying the factors set forth in the tables contained in §20.2031-7 of this chapter) is reduced by an amount determined by applying the same factors to the sum of CRAT's $0 of undistributed net ordinary income and its $90x of undistributed net capital gains.

(e) In determining Charity's share of the adjusted uniform basis, Charity applies the factors set forth in the tables contained in §20.2031-7 of this chapter to determine its actuarial share of the full $140x of basis.

Here are my simplified examples that I hope explain it all:

- Donor creates a CRT on January 2, Year 1 with securities having a zero basis and a fair market value of $100,000. The trust sells the appreciated securities on January 2, Year 2 and buys listed stock for $100,000. The trust's basis in the contributed stock was zero; its basis in the new stock is $100,000. The trust is a Net-Income-With-No-Make-Up CRT (NI-CRUT). Tier Two of the Four Tier distribution rules had $100,000 of capital gain in Year 2. Donor received no income or capital gain in Year 1 or Year 2. Donor and charity sell their respective interests to Third Party on December 31 of Year 2 for $100,000. Based on the value of Donor's life interest, he received $80,000 on the sale. He is deemed have a zero basis in his share of the assets and has an $80,000 capital gain.

- Suppose the trust had been a STAN-CRUT. It earned no income but he received $10,000 in capital gain from the trust in satisfaction of his unitrust payments for Year 1 and Year 2. He has to report $10,000 of capital gain on his income tax returns. On the sale by the donor and the charity of their respective interests to a third party, his capital gain would be $70,000 and not $80,000.

The rule of the regulations in one sentence. On a sale of the trust assets to a third party by the life beneficiary and the charity of their respective interests, the life beneficiary must reduce the basis allocated to his life interest by any capital gain (and ordinary income) not distributed to him (still sitting in Tier One and Tier Two).

Effective dates: The final regulations are effective on August 12, 2015, but they apply to sales and other dispositions of interests in CRTs occurring on or after January 16, 2014, except for sales or dispositions occurring under to a binding commitment entered into before January 16, 2014.

However, the fact that a sale or disposition occurred, or a binding commitment to complete a sale or disposition was entered into, before January 16, 2014, does not preclude the IRS from applying legal arguments available to the IRS before issuance of these final regulations in order to contest the claimed tax treatment of such a transaction.

80 Fed. Reg. 48249 (Aug. 12, 2015)

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*In England, a scheme is not a pejorative; but the Brits don't pronounce the "c"—so what do they know.

**Evasion is more serious than avoidance. Avoidance can be achieved by taking advantage of tax-saving methods specified in the Code. Sometimes it is achieved by a loophole (something that Congress didn't think of—but kosher until the loophole is closed by legislation, regulation, revenue ruling). Tax evasion, on the other hand, can end you up in a federal gated community.

P. FIVE PROBLEM AREAS—WATCH YOUR STEP

Multiple grantor CRTS. IRS privately ruled that a CRUT with more than one donor is not a qualified trust. *Letter Ruling 9547004.* Responding to requests that the ruling be withdrawn and that IRS affirmatively announce that multiple grantor CRTs are OK, the author of that ruling said IRS holds to its position—except the letter ruling wouldn't apply when spouses are the grantors. See also *Letter Ruling 200203034.* Also, the IRS in its safe-harbor charitable remainder unitrust and annuity trust revenue procedures state that it is OK to have multiple grantors if they are spouses. See Rev. Proc. 2003-53 through Rev. Proc. 2003-60 and Rev. Proc. 2005-52 through Rev. Proc. 2005-59.

Funding CRTS with undivided property interests. Spouses wanted to fund CRUTs with an undivided interest in a shopping center, keeping an undivided interest for themselves in *Letter Ruling 9114025.* But IRS—I understand—warned the spouses that common ownership of the center with the trusts would be deemed self-dealing. So the couple transferred their interests to a limited partnership and funded the CRUTs with part of the partnership interest. The partnership arrangement apparently "cleansed" the relationship to IRS's satisfaction and IRS ruled that the CRUTs qualified.

Funding CRTS with mortgaged property. IRS disqualified a CRUT because it was funded with mortgaged property and the donor remained personally liable on the mortgage. IRS reasoned that a CRT must function exclusively as one from its creation. But a trust isn't deemed "created," said IRS, as long as the donor is treated as an owner of the trust under the grantor trust rules. *Letter Ruling 9015049*. Another donor funded a CRUT with mortgaged property but wasn't personally liable on the mortgage. IRS ignored the issue of whether the nonrecourse mortgaged property disqualified the trust and didn't rule whether the trust qualified. Before 1990 many donors funded CRTs with mortgaged property without a peep from the IRS.

Funding CRTS with tangible personal property. IRS privately ruled that no *income* tax charitable deduction was allowable when a CRT was funded with a violin—tangible personal property—because the donor retained an income interest in the property. But when the trust sells the asset, a deduction would be available—although limited to the remainder value element of the basis because of the "unrelated" use wrinkle. *Letter Ruling 9452026.* Will there be a *gift* tax charitable deduction for the value of the charitable remainder when the property is transferred to the trust? Donor didn't ask, so IRS didn't rule.

CRAT "5% probability test." A CRAT doesn't qualify for a charitable deduction (and by implication isn't a qualified trust) unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If there's more than a 5% probability that the noncharitable income beneficiary will survive the exhaustion of the trust assets, that probability isn't negligible. *Rev. Rul. 77-374,* 1977-2 CB 329. The Tax Court upheld the "5% probability test" in *Moor,* 43 TCM 1530 (1982). However, the court also held that the test is satisfied as long as the trust's annual earnings can be reasonably anticipated to exceed the required annual payout to the beneficiary. Suppose a donor creates an inter vivos two-life CRAT that pays the donor for life, then his sister for life and it passes the 5% probability test. So the donor is entitled to an income tax charitable deduction. But because of a new interest assumption every month for computing the value of the charitable deduction, it's not certain that the trust will pass the 5% probability test on the donor's death. That puts a shadow over the estate tax charitable deduction. **Caution.** It’s possible to pass the 10% minimum remainder interest requirement (below) by a mile, but nevertheless flunk the 5% probability test.

Q. REMINDER—CRUTS AND CRATS MUST MEET 10% MINIMUM REMAINDER INTEREST (10% MRI) AND 50% MAXIMUM ANNUAL PAYOUT (50% MAP) REQUIREMENTS

Consequences of noncompliance. Failure to meet either of the requirements means loss of otherwise allowable income, gift and estate tax charitable deductions. Also, the trusts won't be CRATs or CRUTs. Thus sales of appreciated property by those trusts will be taxable to the donors or the trusts. Sales of appreciated property by qualified CRATs and CRUTs are generally not taxed to the trusts and are taxed to the beneficiaries only to the extent deemed distributed under tier two of the four-tier taxation rules. Correcting a mucked-up trust won't always be possible, and some questions remain unanswered. Marital deductions are also lost.

Valuing CRAT and CRUT remainder interests. The value is to be "determined under section 7520." That section provides for valuing both charitable and noncharitable split-interest trusts and other arrangements. Those interests are determined under tables prescribed by the Treasury using an interest rate (rounded to the nearest 2/10ths of one percent) equal to 120% of the Federal mid-term rate in effect under IRC §1274(d)(1) for the month in which the valuation date falls. The rate so determined is the applicable Federal rate (AFR). IRC §7520 goes on to provide that if an income, estate or gift tax charitable contribution [deduction], is allowed for any part of the property, the taxpayer—instead of valuing the interest for the month of the creation of the interest—may elect to use the AFR for either of the two preceding months.

Can the 10% MRI requirement be met by using the AFR for either of the two months preceding the month the CRAT or CRUT is created? Or must the valuation be made using the AFR for the month the trust is created? IRC §7520 says you can use either of the two preceding months for computing any income, estate or gift tax charitable deduction. It doesn't say you can use either of those two months for determining whether the 10% MRI requirement is met. Yet IRC §664(d)(1)(D) and IRC §664(d)(2)(D) say the values for meeting the 10% MRI requirement shall be "determined under section 7520" and those Code sections don’t carve out the "either-of-the-two-preceding months" election. *Another yet:* IRC §664(d)(2)(D) provides: "with respect to each contribution of property to the trust, the value (determined under section 7520) of such remainder interest in such property is at least 10% of the net fair market value of such property as <u>of the date such property is contributed to the trust.</u>" [emphasis supplied]

A splendid argument can be made that for purposes of meeting the 10% MRI requirement, the remainder can be valued using the AFR for either of the two preceding months or the month of the transfer. But do you want to have to make that argument to the IRS—or to a court?

Short deadline for reforming or amending to satisfy the 10% MRI requirement. A "proceeding" must be commenced within the period required in IRC §2055(e)(3)(C)(iii). That section provides that a proceeding must begin within 90 days after the filing date (including extensions) of the estate tax return. IRC §2055(e)(3)(C)(iii)(I). If no estate tax return is required (the estate isn't large enough to require the filing of a return, or the trust is created during the donor's lifetime), reformation must begin within 90 days after the due date (including extensions) for the trust's first income tax return. IRC §2055 (e)(3)(C)(iii)(II). Does a "proceeding" mean a court reformation exclusively or can the trustee correct by "amendment or otherwise" without going to court? The statute isn't clear.

Consequence of declaring a trust void *ab initio*. No deduction will be allowed for any transfer to the trust and any transactions entered into by the trust before being declared void will be treated as entered into by the donor. IRC §2055(e)(3)(J).

R. REFORMING DEFECTIVE SPLIT-INTEREST GIFTS

1. Many faulty split-interest charitable gifts can be reformed to obtain tax benefits. But for some faulty governing instruments, a judicial reformation proceeding must be begun by a close deadline (and for some, the deadline may already have passed). If an arrangement is tax-defective, determine which deadline for reformation applies. Even if the deadline for reformation is not close, reform the trust as soon as possible to keep potential interest costs down.

2. **Charitable remainder trust: intention-to-comply rule.** The trust smells like a unitrust or annuity trust (it pays a fixed percentage of fair market value or pays specified dollar amounts), but is defective because it has incorrect or missing governing instrument provisions. This trust can be reformed to obtain tax benefits.

   No deadline is imposed for reforming these trusts, but do so as soon as possible in case IRS maintains that the trust does not pay specified dollar amounts or a fixed percentage of fair market value. In that case, you must meet the 90-day rule (see below).

   Caution. The Committee reports state that a trust does **not** evidence an attempt to comply with TRA '69 "if governing instrument provides for powers of invasion for a noncharitable beneficiary of any sort."

3. **Charitable remainder trust: no-intention-to-comply rule.** The draftsperson never heard of TRA '69 (trust does not pay beneficiary a fixed percentage of fair market value or specified dollar amounts), but the trust does meet the pre-TRA '69 requirements. The trust pays income to the beneficiary, with remainder to charity. This would have been a qualified trust had TRA '69 not been enacted; it can be reformed to qualify for tax benefits, but there is a deadline. Reformation must begin within 90 days after the filing date (including extensions) of the estate tax return. If no estate tax return is required (estate is not large enough to require filing of return, or the trust is created during the donor's lifetime), reformation must begin within 90 days after the due date (with extensions) for the trust's first income tax return. Under a special rule, a trust meeting the requirements of pre-TRA '69 law is exempt from the 90-day rule if the trust is in a will executed before January 1, 1979, or is in an inter vivos trust created

before that date.

4. A scrivener's error.

When all else fails, a scrivener's (drafter's) error—if IRS and a state court are convinced that the lawyer is the culprit—may be a way to save an otherwise non-reformable charitable remainder trust. See *Letter Rulings 200002029, 199923013, 9833008, 9833010*, and *9804036.*

S. DRAFTING CHARITABLE REMAINDER TRUSTS — CHECKLIST 23

1. Understand the meaning of every provision.

2. Spousal right of election: IRS has withdrawn Rev. Proc. 2005-24. It provided that unless its requirements were met, inter vivos charitable remainder unitrusts and annuity trusts will be disqualified — retroactively to the date of creation — if a spousal right of election now exists under state law, exists in the future, exists if the grantor (donor) of a CRUT or CRAT moves, marries or remarries. IRS may issue a new revenue procedure on this topic. So keep an eye out for it. And if possible, as a precaution, get a waiver from a current spouse now.

3. Double check that the trust contains all the required governing instrument provisions.

4. A specimen — no matter how good — is lousy if it doesn't cover or isn't amended to cover the client's situation.

5. Yesterday's form — no matter how good — is terrible if it doesn't take today's changes in the law into account.

6. Charitable remainder trusts must, of course, comply with the federal tax laws. But state laws must also be taken into account.

7. The trust should reflect how the funding assets are owned—separate property, joint property, tenancy by the entirety, tenancy in common, community property. Ascertain the holding period and cost basis of each asset. That information is essential in determining the charitable deduction and how payments are taxable to the recipients (beneficiaries).

8. Confirm that no mortgages are on property used to fund a CRT. Funding a trust with mortgaged property will disqualify it.

9. Has the trust been drawn to avoid gift taxes (when possible) on an income beneficiary's life interest?

10. Confirm that the spouses are U.S. citizens. If they aren't, take the special rules that apply to alien spouses into account. (There's a difference between an alien spouse and an alienated spouse. The latter may well be a U.S. citizen.)

11. IRS in 2003 issued specimen charitable remainder annuity trusts that are excellent. See Rev. Proc. 2003-53 through Rev. Proc. 2003-60 and in 2005 issued excellent specimen charitable remainder unitrusts. See Rev. Proc. 2005-52 through Rev. Proc. 2005-59. Of course, one size doesn't fit all. IRS recognized that with ample annotations to many of the provisions and furnished alternate provisions. Use the IRS specimens as your guide. But make sure to read the annotations and in many cases you'll want to mix and match and make your own modifications.

12. No matter how skillfully the trust is drawn, make sure that CRUTs and CRATs pass the 5% minimum payout requirement, the maximum 50% payout requirement, the 10% minimum remainder interest requirement and for CRATs, the 5% probability test of Rev. Rul. 77-374.

13. Make sure the trust has an appropriate trustee — e.g., an independent trustee for hard-to-value assets in a unitrust (or provide for a qualified appraiser) and for a sprinkling CRUT or CRAT.

14. Make sure the payments are made and are timely lest you run afoul of the rule that requires that a CRT not only meet the Code's requirements, but also be administered according to its terms. In *Atkinson,* 309 F.3d 1290 (CA-11, 2002) the U.S. Court of Appeals for the Eleventh Circuit held that an inter vivos charitable remainder annuity trust's failure to make payments resulted in complete loss of the estate tax charitable deduction (there were four survivor beneficiaries). And that was so even though substantial sums would go to

charity. The loss of the charitable deduction cost the estate $2,654,976. U.S. Supreme Court denied cert., 540 U.S. 946 (2003).

15. The trust should meet state law investment requirements — e.g., prudent investor rules. See: *Americans for the Arts, The Poetry Foundation, and Lilly Endowment, Inc. v. Ruth Lilly Charitable Remainder Annuity Trust #1 National City Bank of Indiana, Trustee, and Ruth Lilly Charitable Remainder Annuity Trust #2, National City Bank of Indiana, Trustee,* 855 N.E. 2d 592 (Ct. App. Ind. 2006). See also: *Fifth Third Bank and Elizabeth Gamble Reagan v. Firstar Bank, N.A. Ohio App.1 Dist., 2006.* See also: *Estate of Rowe*, N.Y. App. Div. (3rd Dept), 712 NYS2d 662 involving a charitable lead trust.

16. Check whether there is a tax strategy patent on a plan involving the contemplated CRT. Effective 9/16/11, tax strategy patents are no longer issued.

17. Don't fund the trust with Sub S Corp stock. Doing so will kill the S election.

18. Check if there are any SEC restrictions on transferring securities to the CRT.

19. If life-insurance-wealth-replacement is part of the plan, make sure that the insurance is obtained before signing and funding the charitable remainder trust.

20. Is a right retained to substitute public charities for named private foundation remainder organizations? Doing so can avoid self-dealing concerns on terminating a CRT and dividing the assets between the income beneficiary and the charitable remainder organization. The client can also get a larger charitable deduction on a contribution of the remaining life interest to a public charity remainder organization.

21. Add additional items to this checklist to cover things that should have been covered by this checklist.

22. Any CRT income that is considered UBTI will be taxed at 100 percent.

23. Finally, trust no one. If your mother tells you that she loves you — check it out.

II. CHARITABLE GIFT ANNUITIES

A. IN THE VERY BEGINNING

1. **Donative intent.** Read no further if you believe that a donor will create a gift annuity solely because of the tax and financial benefits. But if the donor believes in the charity's cause, then a gift annuity might be the appropriate way to make a gift. If the donor does not need income for himself or herself and does not wish to provide income for another individual, an outright gift is generally the most appropriate.

2. **What is a gift annuity?** Very generally, a gift annuity is a contract whereby a donor irrevocably transfers money or property to a qualified organization in return for its promise to pay the donor, another individual or both, fixed and guaranteed payments for life. The value of the consideration paid by the donor to the charity exceeds the actuarial value of the payments made by the charity to the annuitant. Payments may begin immediately under an immediate

charitable gift annuity ("CGA") or may be deferred until a future time – more than one (1) year from the gift ("deferred payment gift annuity" or "DPGA") or at such time as chosen by the annuitant ("flexible deferred payment gift annuity" or "Flex-DPGA"). In essence, the transfer is part charitable gift and part purchase of an annuity.

The transferred assets become a part of the charity's general assets and the annuity payments are backed by all of the charity's assets – not just the transferred property. This is an important distinction between gift annuities and other planned giving methods such as charitable remainder trusts ("CRT"s) or pooled income funds where the obligation to make payments is limited to the assets in a particular trust or segregated fund.

3. **Why a gift annuity? – A donor's perspective.** Of all planned giving arrangements, gift annuities are probably the simplest and most commonly used. A typical gift annuity agreement is fairly short and easy to understand, making even novice donors comfortable with the arrangement. Under a gift annuity agreement, the donor or other annuitant receives a guaranteed income stream for life. Upon the death of the annuitant, any remaining property (the "residuum") is applied by the charity for the charity's general use unless a specific purpose is called for in the agreement.

The donor, as an itemizer, is entitled to a current income tax charitable deduction and, in cases involving gifts of appreciated property, reduced capital gains taxation. Unlike other types of planned gifts, gift annuities can be funded with difficult assets and are not subject to the private foundation self-dealing rules or penalties for unrelated business taxable income ("UBTI"). Furthermore, an inter vivos gift annuity can provide favorable taxation of life-income payments, reduce capital gains taxation on changing investments and in most cases, the capital gain can be reported ratably over the life expectancy period, and enable a donor to have the joy of giving (not possible with a bequest).

4. **Why a gift annuity? – A charity's-eye view.** From the charity's perspective, gift annuities are attractive because, unlike with other planned gifts, such as charitable remainder trusts, or bequests, the charity often gets immediate use of the gifted assets.

The charity may spend a portion of the gifted assets, so long as it meets all reserve requirements imposed by the state(s) in which the charity may be registered, or may hold the gifted assets in reserve until the death of the annuitant or, in the case of gift annuities for the benefit of more than one annuitant, the death of the surviving annuitant. Furthermore, gift annuities are also a relatively low-cost gift plan, thereby permitting the charity to market these gifts to a wide pool of potential donors.

5. **Considerations.** In determining whether a gift annuity is appropriate, consider: 1. the donor's wishes, 2. the needs and health of beneficiaries, 3. the marital status and citizenship of spouses, 4. the type of property to be contributed — securities, real estate, tangible personal property, marketability, Subchapter S stock, 5. how the property is owned — separate, joint, tenants by the entirety, tenants in common, community property, 6. the cost-basis and holding period of property, 7. the fair market value of property, 8. whether the property is subject to any mortgages, 9. any prior negotiations or contracts for sale, options,10.in the cases of stock, whether corporation is about to liquidate, merge, or make an initial public offering, 11. whether the sponsoring charity is a public charity or a private foundation, 12. for sizable gift, information about donor's (and spouse's) overall estate and financial plan, and 13. state law requirements of both the charity's state and the state in which the donor is domiciled.

B. MECHANICS: Creation, state regulation, taxation of payments.

1. **Creation.** Gift annuities are creatures of contract and are governed by a written agreement between the donor and the issuing charity. These agreements are typically fairly short and easy to understand.

   a. **Requirements.** The agreement itself should contain several basic provisions: the identity, age and date of birth of the donor(s) and the issuing charity, the identity of the annuitant(s) and the type and fair market value of the transferred property. The agreement should specify the amount of the annual annuity payment and the timing/manner in which such payment will be made (whether annually, semi-annually, quarterly or monthly at either the beginning or end of the period). Other important provisions include a statement as to whether the property remaining upon the termination of the annuity (the "residuum") should be used for a specific purpose or the charity's general purposes, a payment correction provision and a governing law clause. Many states also require specific disclosure statements and other provisions, so it is *crucial* to check state law before executing a gift annuity agreement. Of course, the agreement should be signed by both the donor and the charity, although some states do accept agreements without the donor's signature, provided that the donor has signed an application form. **Note:** The annuity may need to meet the requirements not only in the charity's state but also the law of the state of the donor's domicile. Some states also require that the law of the donor's state be the governing law in the agreement.

   b. **Annuitant(s).** The individual(s) to whom payments are to be made is (are) referred to as the "annuitant(s)". A gift annuity agreement may be for the life of a single annuitant (a "single life gift annuity"), for the life of one annuitant followed by a successor annuitant ("two lives in succession gift annuity") or for the benefit of two annuitants during both of their lifetimes, with payments to the survivor after the death of one of the annuitants (a "joint and survivor gift annuity"). An annuity may not be for a term of years. Code §§ 501(m) and 514(c)(5).

c. **Forms of agreement.** As noted above, the gift annuity agreement may specify that annuity payments are to begin immediately with a CGA or are to be deferred until a later date with a DPGA. DPGAs may either specify a commencement date which must be more than one (1) year after the date of the gift or, with a Flex-DPGA, permit the annuitant to choose the date on which annuity payments will begin. Whatever the type, a gift annuity agreement may be for the life of a single annuitant (a "single life gift annuity"), for the life of one annuitant followed by a successor annuitant ("two lives in succession gift annuity") or for the benefit of two annuitants during both of their lifetimes, with payments to the survivor after the death of one of the annuitants (a "joint and survivor gift annuity"). These various types of agreements are discussed in more detail below.

2. **State regulation.** A number of states regulate charitable gift annuities by requiring charities issuing gift annuities to be licensed and/or to file annual reports. In addition, some states specify minimum reserves and allowable investments. Furthermore, as noted above, certain states also require specific disclosure language in gift annuity agreement. The American Council on Gift Annuities ("ACGA") provides detailed, state-by-state information regarding the applicability of licensing, reporting and disclosure requirements. This information can be accessed at www.acga-web.org.

Note: The Philanthropy Protection Act of 1995 (P.L. 104-62) exempts collective investment funds that are maintained by charities and contain assets of irrevocable charitable remainder unitrusts, charitable remainder annuity trusts, charitable lead trusts and charitable gift annuities from registration with the Securities and Exchange Commission. It does, however, require certain disclosures to donors that may be useful in determining whether to make a gift. And the Act doesn't provide complete exemptions for charities maintaining collective funds that include the assets of revocable charitable remainder trusts.

3. **Federal Appeals Court in egregious case holds that gift annuities are securities**

· Philanthropy Protection Act inapplicable
· Marketing of legitimate gift annuities now under microscope
· Obvious lesson — don't pay commissions
· Other lessons — crucial to emphasize the charitable gift, avoid terms such as yields and returns; don't compare with stocks, bonds and CDs

"Not only did Robert Dillie promise his investors 'a gift for your lifetime and beyond,' he pledged 'preservation of the American way of life,' 'preservation of your assets,' and 'preservation of the American family.' Unless Dillie meant to refer to the way of life perfected by the Boston

swindler Charles Ponzi and his family, we can safely say that Dillie's claims were a bit overstated." So begins U.S. Circuit Court of Appeals Judge Sidney R. Thomas's opinion affirming the district court's holding that the Dillie-controlled Mid-America Foundation's gift annuity contracts were investment contracts under federal securities law.

The facts. Mid-America Foundation from 1996 until 2001 sold charitable gift annuities through financial planners, insurance agents, and others. They all received commissions.

The Foundation's marketing literature assured investors that they would receive a lifetime stream of income, with the money remaining at their death directed to a charity designated by the investor. The promotion was initially an enormous success for Dillie; the return for the investors was not. The Foundation raised $55 million from the sale of more than 400 charitable gift annuities. The business model was simply a Ponzi scheme in which, rather than investing the investors' funds, the Foundation used their funds to make annuity payments to earlier annuitants, commission payments to facilitators, and payments to Dillie and others for personal expenses (including Dillie's gambling expenses). Although it collected millions in investments, the Foundation quickly became insolvent. With a few minor exceptions, no charitable contributions were ever made, and the scheme collapsed in 2001.

Shortly after the collapse, the Securities and Exchange Commission filed a civil complaint against Dillie. He was subsequently indicted, ultimately pled guilty to wire fraud and money laundering, and was sentenced to 121 months in prison.

Observation. Madoff got 150 years for his $55 billion swindle; Dillie got 121 months for his $55 million scheme. You do the arithmetic.

The narrow effect of the circuit court's decision. The sales people are required to return their commissions to the receiver who was appointed to recover any remaining funds to make some payments to the defrauded and hapless donors.

The broad effect of the court's decision is that all annuity programs are now under the microscope. The circuit court didn't base its decision on the Philanthropy Protection Act's prohibition of paying commissions, but took pains to show that the annuities were promoted as investments.
Charitable organizations and their advisers should review gift annuity marketing materials in light of this case. Here's how the court described some of the Foundation's marketing materials:

> Our review of the record in this case demonstrates that the Foundation marketed its gift annuities as investments, and not merely as vehicles for

philanthropy. One promotional brochure entitled "Maximizer Gift Annuity: A Gift that Offers Lifetime Income . . . and Beyond" states, under the heading "Attractive Returns," that "[y]our annuity payment is determined by your age and the amount you deposit. The older you are, the more you'll receive." The brochure goes on to list the "current average net-yield" rates. Elsewhere, under a heading titled "A Gift that Gives to the Donors," the brochure states:

> To get this same return through the stock market, [the hypothetical investor] would have had to find investments that pay dividends of 19.3%! (Even the most profitable companies rarely pay dividends of more than 5%.) The rate of return on a Mid-America Foundation "Gift Annuity" is hard to beat!

The brochure also includes a chart comparing the benefits of a $200,000 commercial annuity with a $200,000 charitable gift annuity, indicating the superiority of the charitable gift annuity in such categories as annuity rate, annual income, income tax savings, federal estate tax savings, and "partial bypass capital gains." Although the brochure also notes that the investor will "make a difference" through the purchase of the gift annuity, the brochure as a whole emphasizes the income generation and tax savings aspect of the charitable gift annuity. Indeed, a bullet point summary of the advantages of the Foundation's charitable gift annuities states: "High Rates; Tax Free Income; Capital Gains Tax Savings; Current Tax Savings; Estate Tax Free; Safe; Secure; Simple; Flexible; PAYS YOU NOW!!! HELPS YOU MAKE A DIFFERENCE LATER."

Another brochure entitled "The Charitable Gift Annuity: Preserving Your Family Legacy . . . Now and For Generations to Come" places emphasis on the opportunity for the investor to designate family members as secondary annuitants under the scheme, noting that "[y]ou can easily include your spouse, children, or grandchildren to receive these lifetime benefits." This brochure also emphasizes the stability and security of charitable gift annuities, noting that "[a] gift annuity is one of the OLDEST and SAFEST financial instruments available." On the whole, this brochure pitches charitable gift annuities to an investor whose main concern is to provide a steady stream of income to dependents after he or she is gone. The brochure's emphasis is on the long-term income production potential of the charitable gift annuity. The fact that some purchasers may have been attracted to the gift annuities in part by the Foundation's promise to donate funds remaining after the annuitants' life to a designated charity does not alter the outcome. See Forman, 421 U.S. at 853 n.17 (suggesting that existence of collateral non-investment motive does not shield transaction from securities laws). In sum, when the promotional materials are examined, the investment component of the annuity is evident.

The court of appeals holds. ". . . [W]e affirm the judgment of the district court. The charitable gift annuities sold by Defendants on behalf of the Foundation were investment contracts, and hence securities for purposes of federal and state securities laws. Defendants were not exempt from registration as securities brokers under the terms of the Philanthropy Act. Because the charitable gift annuities were securities, the district court had personal jurisdiction over the non-resident Defendants."

Warfield v. Alaniz, 569 F.3d 1015 (9th Cir. 2009)

Guidance from the American Council on Gift Annuities: "Two important points may be derived by charities and gift planners from this case. First, in case there was still any doubt in anyone's mind, charities should not offer or pay commissions to anyone (employees or independent third parties like financial planners) for solicitation of gift annuities. Second, CGA marketing materials should emphasize the philanthropic, rather than the investment, objectives of this gift vehicle. Of course, it's OK to talk about payments to the annuitant, and to express those payments as a percentage of the amount transferred to the charity. But we should avoid referring to those percentages as 'yields' or 'returns', or comparing CGAs to investments like stocks, bonds and certificates of deposit."

ACGA Online, 9/3/09

4. **Annuity payments.**

a. **Payments measured by one life.** Annuity payments under a gift annuity agreement must be measured by the lifetime of one or more individuals. See Code §501(m)(5) which defines the term "charitable gift annuity" as an annuity "if (A) a portion of the amount paid in connection with the issuance of the annuity is allowable as a deduction under section 170 or 2055, and (B) the annuity is described in section 514(c)(5)(determined as if any amount paid in cash in connection with such issuance were property). Code §514(c)(5)(B) specifically requires that the annuity be payable over the life of one individual or the lives of two individuals in being at the time the annuity was issued. Gift annuities may not be created for a term of years.

b. **Payment amount.** The amount of the annual payment—which can also be paid in monthly, quarterly or semi-annual installments—is fixed at the outset and never varies. As with a commercial annuity: (1) the older the annuitant at the annuity starting date, the larger the annual payments; (2) when there are two annuitants, the annual payments are smaller than if there is one annuitant; and (3) a portion of each annuity payment is excludable from gross income for the period of the annuitant's life expectancy. The excludable (tax-free) amount is established at the annuity starting date.

c. **The annuity payout rates.** Annuity payment rates are decided by the charity. Most charities calculate the annuity payments based on the recommended rates published by the ACGA. For the rates currently recommended by ACGA for both immediate and deferred payment gift annuities, go to its website: www.acga-web.org. Any state law requirements must be met. The rates, whether determined independently by the charity, or by following the ACGA's published rates, are the same for males and females and are based on the following factors: a) number and age of the annuitant(s); b) expenses; c) estimated annual return; and d) assumed residuum (the amount remaining for the charity after the death of all of the annuitants). The ACGA's recommended rates are based upon an assumed residuum of 50% of the property initially transferred.

Note: A 1995 lawsuit charged that charities issuing gift annuities were conspiring to fix rates in violation of federal antitrust and securities law. **The Charitable Gift Annuity Antitrust Relief Act of 1995 (P.L. 104-63)** was enacted so as to specifically permit two or more charities to use or agree to use the same annuity rate for the purpose of issuing charitable gift annuities (subject to each state's right to enact statutes electing not to have their antitrust laws preempted by the Act). **The Philanthropy Protection Act of 1995 (P.L. 104-62)** and **The Charitable Donation Antitrust Immunity Act of 1997 (P.L. 105-26)** were also enacted in the wake of the lawsuit.

5. **Comparison with annuity trusts. Gift annuities differ from charitable remainder annuity trusts in several respects.** An annuity trust's payments are made only as long as the trust has sufficient assets while payments under a gift annuity agreement are backed by all of the charity's assets. Further, the capital gain implications, the way rates are set, and the taxation of the annual payments also differ. Among other differences, the self-dealing and jeopardy investment prohibitions don't apply to CGA's mortgaged property and S corp stock can be used to fund a CGA–but even though allowed it may not be wise. **Note:** If a donor contributes assets to charity in return for annual income based on the earnings on the donated assets, the arrangement is treated as a trust—not an annuity—and donor will be fully taxed on the trust's income. *Letter Ruling 8223014.*

C. INCOME TAX RULES

1. **Income tax considerations for the donor.** A donor considering a gift annuity, whether an immediate CGA, a DPGA or a Flex-DPGA, should be advised of the following income tax considerations:

   a. **Income tax charitable deduction.** The donor is entitled to an immediate income, gift and/or estate tax charitable deduction for the charitable contribution, calculated as the difference between the amount of money transferred (or the fair market value of long-term securities or real estate transferred) and the present value of the annuity. Reg. §1.170A-1(d), 20.2055-2(f) and 25.2522(c)-3(d).The present value of the annuity is based upon the life expectancy(ies) of the annuitant(s), the frequency of payments and timing of payments and the 7520 rate in effect at the time the gift annuity is entered into. The tables used to value the income interest in a charitable remainder annuity trust are also used to calculate the actuarial value of charitable gift annuities (investment in the contract); the tables are in IRS Publication 1457. The income tax charitable deduction is subject to the usual limitations on deductibility of charitable gifts.

b. **Caveat:** If there is a requirement that charity reinsure its obligation to pay the annuity, the deduction will be based on the difference between the amount transferred and the (current) cost of commercial annuity policy. Arguably, the favorable "ratably" rule (discussed below) won't apply even if the donor is a beneficiary. *Letter Ruling 8322068.*

2. Capital gains tax implications.

a. **Bargain sale.** The transfer of appreciated property in exchange for a gift annuity is deemed to be a bargain sale under Reg. §1.1011-2(a)(4). As a result, the donor may recognize capital gain upon entering into a gift annuity agreement. Generally speaking, any gain recognized on the transfer is taxable to the donor at the time of transfer either as long-term or short-term capital gain (depending on the kind of property transferred and the donor's holding period). However, in certain situations, the capital gain may be reported ratably over the lifetime of the annuitant(s). In computing the amount of the gain, the cost basis of the transferred property must be allocated between the gift portion and the actuarial value of the gift annuity. The amount of gain is the difference between the value of the CGA and the cost basis allocated to the value of the gift annuity. Reg. §1.1011-2(a)(4), -2 (c) Example 8.

b. **The "ratably" rule.** The gain determined under the bargain sale rules is reportable by the donor-annuitant ratably over her life expectancy if: (1) the annuity is nonassignable; and (2) the donor is the sole annuitant or is one of the annuitants in a two-life annuity. Reg. §1.1011-2(a)(4). If the donor-annuitant dies before all of the gain has been reported, the remaining gain is buried with her—and is not reportable. When the donor is the first annuitant in a two-life annuity funded with her separate property, the gain is reported ratably over her life expectancy and not the joint life expectancy of the two annuitants. For annuities funded with joint or community property, the capital gain is reported ratably over the joint life expectancy of the two annuitants.

Pointer: For annuities for spouses, convert separate property to joint property <u>before</u> funding. That should not be subject to the gift tax because of the unlimited gift tax marital deduction for gifts to U.S. citizen spouses. For non-U.S. citizen spouses, the annual gift tax exclusion of $147,000 (in 2015) could offset the gift. And the gain will then be reportable ratably over two lives (instead of one life).

Note: The instructions to Form 1099-R tell charities to report taxable and nontaxable amounts—*as well as any capital gain.* The instructions say: "If cash or capital gain property is donated in exchange for a CGA, report distributions from the annuity on Form 1099-R." "Report in box 3 any amount taxable as capital gain. Report in box 1 the total amount distributed during the year. Report in box 2a the taxable amount. Advise the annuity recipient of any amount subject to the 28% rate gain for collectibles and any unrecaptured section 1250 gain. Report in box 5 any nontaxable amount. Enter F in box 7 the Code F. See Regulations §1.1011-2(c), Example 8."

3. **Income taxation of annuity payments to the annuitant.** Since the value of the consideration paid by the donor exceeds the present value of the annuity payments under the agreement, a portion of each annuity payment is treated as a return of principal and is excludable (tax-free) for the period of the annuitant's life expectancy under Code §72. The percentage (called the "exclusion ratio") is determined when the annuity is created and remains constant. Reg. §1.72-4 *et seq*.

   a. **Computation of the exclusion ratio.** The exclusion ratio is computed by dividing the investment in the contract (the actuarial value of the gift annuity – i.e., non-charitable portion of the amount transferred to the charity) by the "expected return" (annual annuity multiplied by the annuitant's life expectancy). Reg. §§1.72-4 and 1.72-5(a). The actuarial value of the annuity and the expected return are computed using the Treasury tables under Reg. §1.72-9. The exclusion ratio multiplied by the annual payment gives the amount excludable. The difference between the payment and the excludable amount is taxable.

   b. **"Exclusion ratio" wrinkle—the way it was.** Under prior law, the ratio was based on the annuitant's life expectancy. The annuitant continued to exclude a portion of each payment even if he or she outlived the life expectancy, thus recovering more than all the "investment in the contract." If the annuitant died before his or her life expectancy expired, no deduction or exclusion was allowed for the unrecovered investment in the contract.

   c. **Effective for annuities with "starting dates" after 1986,** an annuitant who outlives his or her life expectancy may not exclude a portion of each payment. Code §72(b)(3). But the hapless annuitant who predeceases his or her life expectancy gets a deduction for the unrecovered investment on his or her last income tax return. This deduction is not subject to the 2%

miscellaneous itemized deduction rule. Code §72(b)(3).

Alert: Often overlooked, Code §72(b)(3)(C) states that for purposes of Code §172 (dealing with net operating loss deductions), a deduction allowed under §72(b)(3) will be deemed attributable to a trade or business of the taxpayer. Thus, it appears that any part of the unrecovered investment in the contract not deductible on the final income tax return should qualify to be carried back to the 2 years preceding the year of the loss. Code §172(b)(1)(A).

Note: Unless the agreement provides for payments to be made at the beginning of the (annual, semi-annual, quarterly, monthly) period, the "starting date" is generally the date that the agreement is signed and money or assets are transferred to the charity. Code §72(c)(4). So annuities purchased in 1986 might not be subject to the changed rule even though they made first payments in 1987. Admittedly, this will be rare but it is good to know about because rare cases could come up and you could be a hero.

D. GIFT TAX ISSUES

1. **Overview.** The creation of a gift annuity involves one or more gifts: first, the gift to the charity and second, in the case of an annuity created for another individual, a taxable gift to that annuitant. If the donor is the only annuitant, there are no gift tax consequences apart from the charitable gift.

2. **Gift to charity eligible for the gift tax charitable deduction.** The gift to the charity first qualifies for the gift tax annual exclusion ($14,000 in 2015). The balance of the gift to charity qualifies for the unlimited gift tax charitable deduction.

Note: The provision exempting charitable gifts from reporting requirements does not apply to gift annuities or other split-interest gifts, so be *certain* to file a gift tax return if the charitable gift exceeds the applicable annual exclusion amount. Code §6019(a)(3).

3. **Taxable gift to annuitant.** If the donor creates a gift annuity for the benefit of another individual, he or she will have made a taxable gift to the annuitant. With a CGA (requiring immediate payments), the gift to the annuitant constitutes a present interest and will qualify for the gift tax annual exclusion. Code §2503(c), *Letter Rulings 8721023* and *8637084*. Depending upon the relationship of the annuitant to the donor, one or more options may be available to mitigate any tax due on the gift.

   a. **Right of revocation.** In a one-life gift annuity providing for an annuity to another, some commentators advocate retaining a right to revoke the non-donor annuitant's interest so as to avoid making completed gift. While this sounds simple enough, there are a few issues to consider:

i. **Gift tax issues.** The retention of the right to revoke the annuitant's annuity interest, exercisable by the donor either during the donor's lifetime or at death, will cause the gift of the annuity interest to be an *incomplete* gift for gift tax purposes. Reg § 25.2511-2(c). Accordingly, the donor will not be required to report the value of the annuitant's annuity interest as a taxable gift at the time the charitable gift annuity is created. Rather, the donor will be deemed to have made a taxable gift to the annuitant in each year that the donor does not exercise his right of revocation. The receipt of the annuity payment by the annuitant will operate to "free" the property from the exercise of the donor's reserved power and will constitute a gift of the payment during the calendar year. Reg. §25.2511-2(f). Accordingly, the receipt of the annuity payment by the annuitant in each year will be deemed a present interest gift and will qualify for the gift tax annual exclusion. The donor must, however, report the value of the annuity interest to the extent that it exceeds the annual exclusion amount. No gift tax will be payable if the gift is offset by the donor's $5.43 million unified gift and estate tax exemption.

   If the donor's right of revocation is only a testamentary right, it is arguable that the donor may have made a completed gift at the outset to the annuitant of the right to receive annuity payments measured by the donor's lifetime. While there is no authority on this point, watch your step.

ii. **Estate tax issues.** The retention of the right to revoke the annuitant's annuity interest may cause a portion of the amount transferred for the charitable gift annuity to be included in the donor's gross estate. The determination of the estate tax implications of the reserved right of revocation depends upon the order of death and whether the donor exercised or did not exercise the right of revocation.

   If the donor predeceases the annuitant and *does not* exercise the right of revocation, the present value of the annuitant's future annuity payments (calculated from the donor's date of death through the annuitant's assumed life expectancy) will be includable in the donor's gross estate. Code §2038. If the donor predeceases the annuitant and *does* exercise the right of revocation, nothing would be includable in the donor's gross estate. If the annuitant predeceases the donor, no portion of the gift annuity would be includable in either the donor's or the annuitant's gross estate.

iii. **Income tax issues.** Ordinarily, the annuitant must include the value of the annuity payments received in his or her gross income and the donor will not be subject to tax on the annuity payments. Code §72(a). However, it appears that where the donor retains the right to revoke the annuitant's interest, there is the possibility that the annuity payments *would* be taxable to the donor. The concern is that the Service might apply the grantor trust rules, specifically Code §674, to charitable gift annuities. Under Code §674, a grantor will be taxable on income earned by a trust over which the grantor has retained the right to control the beneficial enjoyment of the trust. A power to terminate a beneficiary's

interest is a power that causes the grantor of a trust to be treated as the "owner" of the trust for income tax purposes.

iv. **Issue for the charity.** If you are representing the charity, be aware that, particularly in the case of a one-life gift annuity for the benefit of another individual, the donor's retention of a right of revocation might cause the gift annuity to run afoul of Code §§ 514(c)(5)(b)(requiring that the annuity be payable over the lifetime of one or more individuals) and 501(m). The IRS has not ruled on this issue but watch your step.

b. **Gift tax marital deduction.** Gift annuities for the benefit of a U.S. citizen spouse automatically qualify for the unlimited gift tax marital deduction. Gift annuities for the benefit of a non-U.S. citizen spouse may qualify for the $147,000 annual exclusion for gifts to non-U.S. citizen spouses or the $14,000 gift tax annual exclusion (for gifts made in 2015).

c. **Gift tax annual exclusion.** To the extent that a donor of an immediate CGA makes a taxable gift, the annuitant's interest will qualify for the gift tax annual exclusion.

4. **Specific examples of gift tax implications of gift annuities.**

a. **One-life annuity for donor.** The value of the charitable gift element of a gift annuity is deemed a present interest. However, the donor must report the gift on a federal gift tax return if it exceeds the annual gift tax exclusion. The donor then takes an offsetting gift tax charitable deduction. Code §2522(a).

b. **One-life gift annuity for annuitant other than donor.** A donor who creates a CGA calling for payments to another (*e.g.,* a spouse or sibling) makes two gifts: one to the annuitant (the actuarial value of the annuity) and one to the charity (the gift element). The charity's gift is a present interest gift and is reportable if it exceeds the annual gift tax exclusion. The balance is then deductible as a charitable gift—resulting in a wash.

i. **Annuitant's interest when annuitant is not the donor's spouse**. The gift to the annuitant qualifies for the annual gift tax exclusion. If it exceeds the amount of the exclusion and the "tentative" tax on the gift is not offset by the $5,430,000 unified gift and estate gift tax exemption (as of January 1, 2015), gift tax will be due.

ii. **Annuitant's interest when annuitant is the donor's U.S. citizen spouse.** One-life gift annuities when a U.S. citizen spouse is the annuitant automatically qualify for the unlimited gift tax QTIP marital deduction. You have to "elect out" if you don't want it. The election not to take the marital deduction is made by attaching a statement to the return for the first taxable year for which the election is to be effective. The statement must: (1) contain the name, address and TIN of the electing taxpayer; (2) identify the election; (3) indicate the section of the Internal Revenue Code under which the election is made; (4) specify the period for which the election is being made and the items to which it applies; and (5) provide any information requested in applicable forms and instructions.

If donor's spouse is a non-U.S. citizen, the gift can qualify for the $147,000 (in 2015) per-year gift tax exclusion. But it would have to meet the "present interest" requirement of the annual gift tax exclusion.

c. **Two-life gift annuity funded with donor's separate property when donor is first annuitant.** A donor who uses her own separate property to create a CGA that pays an annuity to her for life and then to a survivor annuitant makes two gifts: one to the charity (which is reportable if it exceeds the annual exclusion, and then deductible—resulting in a wash), and one to the survivor annuitant (right to receive annuity payments if she survives the donor). No annual gift tax exclusion for the gift to the survivor beneficiary because the gift is a future interest. Code §2503(b). For the same reason, there's no gift tax marital deduction. Code §2523(b); Reg. §25.2523(b)-1(c). A non-U.S. citizen spouse's future interest in a CGA does not qualify for $147,000 (in 2015) annual gift tax marital exclusion because it's a future interest. It would be preferable to create separate annuity for non-U.S. citizen spouse.

Pointer: The donor can avoid making a gift to the survivor annuitant by providing in the CGA agreement that the donor retains the right to revoke the survivor's life interest. Should the donor exercise that right, the payments won't terminate on the death of the survivor of the donor and the second beneficiary, but on the donor's death. The donor need not actually exercise the right; merely retaining the right avoids the donor's making a completed taxable gift to the survivor annuitant. Unlike charitable remainder trusts, a gift annuity donor can revoke during life, by will or both. Reg. §25.2511-2(c).

d. **Two-life gift annuity funded with joint property or tenancy in common property when donors are annuitants but not spouses.** The actuarially older annuitant makes a gift to the actuarially younger annuitant of the difference in their survivorship interests. To avoid adverse gift tax implications, each annuitant should reserve the right to revoke the other annuitant's interest. If that right were exercised, the charity would only have to pay half of the payments to the survivor annuitant for his or her life. The gift to the charity—the gift element—is a present interest gift and is reportable if it exceeds the annual gift tax exclusion. The balance is then deductible as a charitable gift—again, resulting in a wash.

e. **Two-life gift annuity funded with joint property, tenancy in common property or community property when donors are spouses and the annuitants and payments are made to them jointly and then to the survivor.** U.S. citizen-spouses' interests qualify for QTIP marital deductions. Alternatively, each spouse can—in the gift annuity agreement—reserve the power to revoke the survivor's interest in the payments from his or her half share of the joint or community property. Joint and survivor annuities automatically qualify for the unlimited gift tax QTIP marital deduction. You have to "elect out" if you don't want it. The election not to take the marital deduction is made by attaching a statement to the return for the first taxable year for which the election is to be effective. The statement must: (1) contain the name, address and TIN of the electing taxpayer; (2) identify the election; (3) indicate the section of the Internal Revenue Code under which the election is made; (4) specify the period for which the election is being made and the items to which it applies; and (5) provide any information requested in applicable forms and instructions.

Caution. It's not clear that the automatic QTIP marital deduction applies to gift annuities that make *consecutive* payments—first to one spouse and then to the survivor for life—as opposed to paying the spouses *jointly* for life and then to the survivor for life. Presumably a timely QTIP election could be made. But to be safe, the donors should reserve the right to terminate the surviving spouse's annuity. Unlike charitable remainder unitrusts, annuity trusts and pooled income fund gifts where the right to revoke can only be by will, the gift annuity donor can keep the right to revoke during life, by will, or both. It is also unclear whether joint and survivor gift annuity can qualify for the $147,000 (in 2015) per-year gift tax exclusion for non-U.S. citizen spouses (discussed above).

E. ESTATE TAX CONSIDERATIONS

1. **Overview.** The donor of either an inter vivos gift annuity or a testamentary gift annuity should also consider potential estate tax inclusion issues. Whether an inter vivos gift annuity is includable in a donor's gross estate depends upon the number of annuitants, the relationship of the annuitants to the donor and whether the donor, at the time of his or her death, retained the right to revoke any annuitant's interest to receive payments.

2. **Specific examples of estate tax treatment of gift annuities.**

a. **Donor is the sole annuitant of an inter vivos CGA.** For a single life annuity making payments to a donor-annuitant, no amount is included in his or her gross estate.

b. **CGA for annuitant(s) other than donor.** For an annuity providing payments to an annuitant or annuitants other than the donor, no amount is included in the donor's gross estate.

c. **Two-life inter vivos CGA funded with donor's separate property with payments to donor for life and then to a survivor annuitant for life.**

i. If the survivor annuitant does not survive the donor, no amount is includable in the donor's gross estate.

ii. If the survivor annuitant does survive the donor, includable in the donor's gross estate is the value of an annuity paying the same amount to the survivor annuitant (at the survivor's age at the donor's death) as the donor received during his life: i.e., what it would cost to purchase a comparable annuity from a commercial insurance company. Code §2039(b).

iii. **Survivor annuitant is donor's U.S. citizen spouse.** The gift to the survivor qualifies for the estate tax marital deduction for a U.S. citizen spouse to the extent it is includable in the donor's gross estate. Reg. §20.2056(b)-1(g), Example 3.

iv. **Survivor annuitant is donor's non-U.S. citizen spouse.** Property bequeathed in a garden-variety qualified terminable interest property (QTIP) or general power of appointment trust to a noncitizen surviving spouse isn't eligible for the estate tax marital deduction. To get the deduction the property must pass through a qualified domestic trust (QDOT). Code §2056(b).

Any estate tax attributable to the survivor's annuity is allowed as an income tax deduction to the survivor annuitant—if the survivor itemizes deductions on her income tax return—and is claimed over the survivor's life expectancy. Code §691(c).

3. **Tax issues associated with testamentary CGAs.**

a. **Capital gains tax issues.** No gain should be incurred by an estate on the difference between the donor's cost basis in appreciated property used to obtain the annuity and the property's fair market value. *Reason:* the property is no longer appreciated; the estate has a stepped-up basis. However, if the estate funds the annuity with property that has appreciated after the estate tax valuation date, gain (computed under the bargain sales rules) will be incurred. In that case, the "ratably" rule wouldn't apply. IRS hasn't ruled on any of this. But be warned.

b. **Estate tax issues.** An estate tax charitable deduction is allowable for the difference between the amount transferred to the charity and the actuarial value of the CGA (computed the same way as an inter vivos CGA).

   i. For transfers to a U.S. citizen spouses, see above.

   ii. For transfers to non-U.S. citizen spouses, see above.

Caution. An estate tax charitable deduction for a CGA will not be allowed, however, if a will does not properly define the amount of the annuity to be paid. IRS will disallow a deduction if the annuity is unascertainable. See *Letter Ruling 8045010*.

F. THE DEFERRED PAYMENT GIFT ANNUITY

1. **Brief description.** In a DPGA transaction, a donor transfers money or property to a charitable organization in exchange for its promise to pay an annuity to the donor, another or both, to begin more than one year from the date of the transfer. The donor is able to make a gift now and get an income tax charitable deduction when he or she is in a high tax bracket, deferring payment until those years when the donor may need the income more (*e.g.*, after retirement) and may be in a lower income tax bracket.

2. **Charitable contribution.** The charitable contribution is the amount of money, or fair market value of long-term securities or long-term real estate transferred, minus the actuarial value of the deferred annuity.

3. **Setting the payments.** The payments under a DPGA agreement are determined by taking the amount transferred to the charity and compounding annually at the interest rate, determined by an actuary, for the period until the annuity begins. That figure is then multiplied by the rate of return currently offered to donors who are now the age the donor will be at the "starting anniversary" date—the anniversary of the date of purchase (gift) that coincides with (or next precedes, if none coincides with) the due date of the first annuity payment. The ACGA recommends interest rates and provides procedures for determining the payments under a DPGA. This information can be found at www.acga-web.org.

4. **Taxation of annual payments.** The amount of each payment that will be excludable, or tax-free, will depend on the rules in effect when the payments start. A reasonable rule would be that the "expected return" (which is needed to compute the exclusion ratio and hence the excludable amount) is to be computed at the time payments begin, using the life expectancy tables then in effect.

5. **Capital gains tax implications.** Treasury regulations and *Rev. Rul. 72-438,* 1972-2 CB 38, are silent on the gain implications of deferred payment gift annuities funded with appreciated property. An unpublished private letter ruling holds that the rules applicable to immediate CGAs apply to DPGAs. Thus, the gain will be determined under the bargain sale rules and will be reportable ratably over the annuitant's life expectancy if: (1) the annuity is nonassignable; and (2) the donor is the sole annuitant in a one-life annuity or is one of the annuitants in a two-life annuity. The private letter ruling holds that the gain will not be reportable until payments begin, and then will be reported ratably over the life expectancy (determined as of the "starting anniversary" date). This is logical because in no event can the capital gain be greater than the return on the contract for the year.

6. **Other tax rules—the estate tax marital deduction.** The deduction should be allowed for joint and survivor and two-life consecutive gift annuities where the spouse(s) kept the right to revoke and the deferral period extends beyond the death of the first spouse. The deduction should also be allowed for testamentary one-life CGAs. Those deductions appear to be allowable even though the payments for the surviving spouse don't begin at death (but at some future date) because there is no requirement in Code §2056 or the regulations that payments to a surviving spouse begin immediately upon the death of the first spouse. There should be no question, however, that an estate tax marital deduction is allowed for DPGAs which are already paying income at the death of the first spouse because the payments to the surviving spouse are immediate. The marital deduction is not allowed if the executor, under a power, directs the creation of the annuity rather than the decedent's doing so. Reg. §20.2056(b)-1(f).

7. **Tax implications in surviving spouse's estate.** As with "immediate" payment charitable gift annuities, there's no tax to the surviving spouse's estate. The value of a "survivor annuity" for which a marital deduction was previously allowed is includable in the surviving spouse's gross estate. Reg. §20.2044-1(a). The amount included in the surviving spouse's gross estate is "the value of the entire interest in which the decedent had a qualifying income interest for life, determined at the decedent's date of death. . . ." Reg. §20.2044-1(b). The value of a survivorship annuity at the date of the surviving annuitant's death is zero. Thus, nothing is included in his or her estate.

8. **Specific example of gift tax issues.**

   a. **One-life DPGA for donor.** The value of the charitable gift element of a DPGA is deemed a present interest. However, the donor must report the gift on a federal gift tax return if it exceeds the annual gift tax exclusion. The donor then takes an offsetting gift tax charitable deduction.

b. **One-life DPGA for annuitant other than donor.** A donor who creates a DPGA with payments to another (*e.g.*, a spouse or sibling) makes two gifts: one to the annuitant (the actuarial value of the annuity) and one to the charity (the gift element). The charity's gift is a present interest gift and is reportable if it exceeds the annual gift tax exclusion. It is then deductible—resulting in a wash.

i. **Annuitant's interest when annuitant is not the spouse.** It is not clear whether the gift to the annuitant qualifies for the annual gift tax exclusion. If the tax on the gift is not offset by $5,430,000 unified gift and estate tax exemption (as of January 1, 2015), tax will be due.

ii. **Annuitant's interest when annuitant is the spouse.** The gift tax marital deduction is not available for one-life DPGAs created for a spouse because the spouse has no immediate right to income. If a donor during his or her life wishes to provide a one-life DPGA for the donor's spouse, he or she should consider making an outright gift to the spouse. That qualifies for the unlimited gift tax marital deduction. The spouse may then use the gift to establish a one-life DPGA for himself or herself. The income tax charitable deduction is then taken by the spouses on their joint income tax return. This end run gives them income tax benefits and wipes out gift tax concerns.

c. **Two-life DPGA funded with donor's separate property when the donor is the first annuitant.** A donor who uses his or her own property to create a DPGA that pays an annuity to the donor for life and then to a survivor annuitant makes two gifts: one to the charity (which is reportable if it exceeds the annual gift tax exclusion, and then deductible—resulting in a wash), and one to the survivor annuitant (the right to receive annuity payments if he or she survives the donor). The gift to the survivor annuitant is a future interest, and thus doesn't qualify for the annual gift tax exclusion. For the same reason, it doesn't qualify for a gift tax marital deduction.

Pointer: The donor can avoid making a gift to the survivor annuitant by retaining the right to revoke the survivor's life interest. Should the donor exercise that right, the payments won't terminate on the death of the survivor of the donor and the second beneficiary, but on the donor's death. The donor need not actually exercise the right; merely retaining the right avoids making a completed taxable gift to the survivor annuitant. Unlike charitable remainder trusts, a DPGA donor can retain the right to revoke during life, by will, or both.

d. **Two-life DPGA funded with joint property when donors are annuitants but not spouses.** The actuarially older annuitant makes a gift to the actuarially younger annuitant of the difference in their survivorship interests. To avoid adverse gift tax implications, each annuitant should reserve the right to revoke the other annuitant's interest. If that right were exercised, the charity would only have to pay half of the payments to the survivor annuitant for his or her life. The gift to the charity—the gift element—is a present interest gift and is reportable if it exceeds the annual gift tax exclusion. It is then deductible—resulting in a wash.

e. **Two-life DPGA funded with joint or community property when donors are spouses and the annuitants and payments are made to them jointly and then to the survivor.** The gift tax marital deduction is not available for joint and survivor DPGAs created for a spouse because the spouse has no immediate right to income. To avoid adverse gift tax implications, each annuitant should reserve the right to revoke the other annuitant's interest. If that right were exercised, the charity would only have to pay half of the payments to the survivor annuitant for his or her life. The gift to the charity—the gift element—is a present interest gift and is reportable if it exceeds the annual gift tax exclusion. It is then deductible—resulting in a wash.

f. **A Hybrid deferred annuity.** Harold plans to get a deferred CGA for himself and his wife, Enid. Payments will go to them jointly, then to the survivor for life. *The twist:* If either spouse dies before the starting date, the survivor can start receiving reduced annuity payments sooner.

IRS rules. . . Harold will be entitled to an income tax charitable deduction. In *Rev. Rul. 73-1*, 1973-1 CB 117, IRS disallowed the charitable deduction where a donor had the option to revoke the annuity and get all his money back at any time before the starting date. But the proposed arrangement in this instance doesn't make the charitable gift revocable; it simply gives the annuitants a different payment option. *Letter Ruling 9017071.*

. . . and doesn't rule. IRS wouldn't rule on the value of the annuity or the amount of the charitable deduction. Nor would it rule on how the acceleration provision might affect the annuity's value or the potential debt-financed income (Code §514(c)(5)) consequences to the issuing organization. *Note:* Code §501(m) could also be a concern.

Comment. This arrangement would be an excellent alternative for donors who want to make a charitable gift that provides retirement income, but fear being locked into an ironclad payment schedule. Now that computer software for calculating deductions is widely available, it should be possible to design a time acceleration/rate reduction schedule that results in equal actuarial values in each instance. That would help nail down the amount of the charitable deduction, the gift tax marital deduction and compliance with Code §514 (c)(5)(A)—which, among other things requires that the gift portion be at least 10% of the amount transferred for an annuity.

How about the other requirements of Code §§514(c)(5) and 501(m)?

Under Code § 514(c)(5), the term "acquisition indebtedness" does not include an obligation to pay an annuity which:

i. Is the sole consideration (other than certain mortgages to which Code §514(c)(2)(B) applies) issued in exchange for property if, at the time of the exchange, the value of the annuity is less than 90% of the value of the property received in the exchange (the gift is more than 10%). **Caution:**
low charitable mid-term federal rates for split interest gifts (7520 rates) may result in failing the "more-than-10%-gift portion" test for CGAs.

ii. Is payable over the life of one individual in being at the time the annuity was issued, or over the lives of two individuals in being at such time, and

iii. Is payable under a contract which –

a. does not guarantee a minimum amount of payments or specify a maximum amount of payments, and

b. does not provide for any adjustment of the amount of the annuity payments by reference to the income received from the transferred property or any other property.

(They're also important because charities can be taxed as insurance companies (or lose their exemptions) unless their annuities comply. Code §501(m)(3)(E) and 501(m)(5).) Harold and Enid's annuity is payable over the lives of individuals, and the agreement doesn't guarantee a minimum or maximum amount of payments. Even though the amount received might vary, it won't depend on the income earned by the property they've transferred—or on any other property.

Comment: Only a brave and daring soul would do this without a letter ruling.

G. PLANNING CONSIDERATIONS

1. **Testamentary gift annuity funded with an IRA.** Until fairly recently, it was uncertain whether an IRA could be used to fund a CGA. Conservative scholars and estate planning practitioners, such as Christopher Hoyt of the University of Missouri (Kansas City) School of Law, discouraged making a bequest from an IRA to acquire a CGA because there was absolutely no legal precedent about the tax consequences. In *Letter Ruling 200230018*, the IRS ruled favorably on funding a CGA at death with an IRA, but left some issues open.

a. **Situation.** Abel will enter into a gift annuity agreement with Charity under which he agrees to make a testamentary gift of his IRA to Charity, and Charity agrees to pay Barbara (Abel's sister) an annuity on Abel's death. To facilitate the transfer, Abel will complete a beneficiary designation form that will provide that upon his death, the entire assets of his IRA will be transferred to Charity. The annuity, to be paid quarterly, will be based on the amount transferred to Charity, the percentage rate then recommended by the American Council on Gift Annuities (ACGA isn't identified in the letter ruling), and Barbara's age at Abel's death. The annuity will be irrevocable and nonassignable (except to Charity for no consideration), and can't be commuted. Further, the annuity is to be paid from Charity's "general fund." (More about the "general fund" point later.)

b. **IRS rules—issue #1.** Charity's tax-exempt status won't be adversely affected by receiving Abel's IRA in exchange for Barbara's annuity, nor will Charity recognize taxable income on receiving the IRA.

IRS's rationale. Code §501(m)(1) provides that a charity is exempt from tax only if no substantial part of its activities consist of providing commercial-type insurance. Code §501(m)(3)(E) provides that "commercial-type insurance" doesn't include a "CGA." Code §501(m)(5) provides that "to be a CGA, a portion of the amount paid in connection with the issuance of the annuity must be allowable as a deduction under Code §170 or §2055, and the annuity must be described in Code §514(c)(5)." Moving right along to Code §514(c)(5), an "acquisition indebtedness" doesn't include an obligation to pay an annuity which: (1) is the sole consideration issued in exchange for property if, at the time of the exchange, the value of the annuity is less than 90% of the value of the property received in the exchange (the gift is more than 10%); (2) is payable over the life of one individual, or over the lives of two individuals; (3) is payable under a contract that doesn't guarantee a minimum amount of payments, or specify a maximum amount of payments; and (4) doesn't provide for any adjustment of the amount of the annuity payments by reference to the income received from the transferred property or any other property. In this case, IRS rules that the annuity to be issued by Charity will meet the foregoing requirements.

Comment. The ACGA has been around since 1927 and all hope it will live forever. This is a testamentary arrangement, however, so a cautious draftsperson should provide for an alternative disposition if there are no rates recommended by the ACGA at the IRA owner's death. Also, it may be possible that the "90% test" is met now, but won't be met at death because the applicable mid-term federal rate for computing the gift portion of the annuity changes every month. Also, a future Congress may change the 90% requirement. So, back to our cautious drafter: he or she should provide for those contingencies.

c. IRS doesn't rule—issue #2. IRS was asked to rule that, for purposes of determining the character of the annuity payments received by Barbara (the taxable and non-taxable portions), the "investment in the contract" would be equal to the IRA proceeds transferred to the Charity for the annuity less the estate tax charitable contribution deduction.

IRS declined to rule, stating that in order to rule on that issue, it would have to assume that Barbara will survive Abel. That assumption would involve a hypothetical situation because both Barbara and Abel are living. Accordingly, pursuant to section 8.02 of Rev. Proc. 2001-4, 2001-1 IRB. 121, IRS declined to rule.

Comment. Presumably, the investment in the contract will be zero, unless the IRA was partially funded with after-tax dollars. Thus the IRA payments received by Barbara will be taxable as ordinary income. (That would also be the case if she were to receive payments directly from the IRA with no intervening CGA.)

d. IRS rules—issue #3. The IRA's value at Abel's death will be included in his gross estate. *Reason:* He has the right to designate the IRA beneficiaries and receive payments during his lifetime. Also, the IRA is funded with his contributions.

e. IRS rules—issue #4. Abel's estate may claim an estate tax charitable deduction for the IRA's value (the amount includable in his gross estate) less the value of the annuity to be paid to Barbara.

IRS's rationale. *Rev. Rul. 80-281*, 1980-2 CB 282, dealt with a donor who purchased an annuity that was payable from a charity's general funds for the donor's lifetime. The ruling concluded that because the annuity was payable out of the charity's general funds, rather than the transferred funds, the donor hadn't retained any interest in the transferred funds. Accordingly, the provisions of Code §2522(c) (providing gift tax rules similar to the estate tax rules of Code §2055(e)(2)) are inapplicable (those are the charitable remainder unitrust, annuity trust and pooled income fund requirements). IRS thus ruled that a gift tax charitable deduction was allowable for the amount by which the value of the property transferred by the donor exceeded the present value of the annuity.

In the present letter ruling, IRS noted that the annuity will be payable from the Charity's general funds. Thus Abel's estate will be entitled to an estate tax charitable deduction for the value of the IRA at his death, less the present value (determined as of his date of death) of the annuity payable to Barbara. The present value of the annuity will be determined under Code §7520 and Reg. §20.2031-7.

Caution. In this letter ruling and in *Rev. Rul. 80-281*, IRS makes the point that a charitable deduction won't be allowed if the annuity is payable out of the assets transferred to the charity rather than out of its general funds. In a state such as New York, gift annuities aren't payable out of a charity's general funds. The charity must maintain a special reserve fund for gift annuities. Apparently, IRS means that the charity shouldn't be obligated to make the payments out of a donor's gift or reinvestments of the gift. If that were the case, to get income, gift and estate tax charitable deductions, the arrangement would have to be a charitable remainder unitrust, annuity trust, or pooled income fund trust.

f. **IRS rules—issue #5.** On Abel's death, the IRA proceeds won't be included in his estate's gross income.

IRS rationale. Based on the information submitted and the representations made, if Charity is named as the designated beneficiary of Abel's IRA, the proceeds distributed to Charity from his IRA will be items of "income in respect of a decedent" to Charity under Code §691(a)(1)(B) when distributed to it. The character of the IRD in the hands of the Charity will be considered to have the character that it would have had in Abel's hands if he had lived and received those amounts. *Note.* Because Charity is tax-exempt and the Code §501(m) and §514 requirements are met (see ruling issue #1, above), Charity won't be taxable on the IRD.

The usual IRS warning. This ruling is directed only to the taxpayer requesting it. Code §6110(k)(3) provides that it may not be used or cited as precedent.

But here's another IRS warning. "The rulings are based on information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination." *Letter Ruling 200230018*.

g. **Unanswered questions.** Hopefully the next ruling will address these issues:

i. **No taxable income to beneficiary when IRA is distributed to charity or when annuity is issued?** The ruling held that the estate has no taxable income when the IRA is transferred to the charity to acquire an annuity. We all would feel better if there were also a statement that the beneficiary of the annuity did not have any income either at the time of the distribution or at the time the annuity contract became a fixed right.

ii. **How much taxable income to annuitant with each payment?** The IRS did not present a formula to us determine how much of each payment that the annuitant will receive is taxable or tax-free. Assume all of it would be taxable because the IRA has a tax basis of zero dollars (unless the IRA held non-deductible contributions).

iii. **What rules apply to pass-through income tax deductions to annuitant?** By way of background, if an estate is subject to estate tax, the recipient of inherited IRA distributions is entitled to claim an income tax deduction with each distribution for the attributable estate tax. Sec. 691(c). The IRS did not explain how that deduction would flow through (if at all) when an IRA is used to purchase a CGA.

Many of us will be hesitant to recommend using IRAs for charitable gift annuities until these and other questions are answered. Still, this ruling is encouraging because it tells us some of the tax consequences.

2. **Gift annuity funded with remainder interest in personal residence.** A donor can combine two deferred charitable gifts in one transaction: (1) a remainder interest in his or her personal residence (donor retains a life estate); and (2) a lifetime annuity payable to the donor from the charity's general assets. To the extent the value of the remainder interest exceeds the value of the lifetime annuity on the date of transfer, the donor has made a charitable gift. Income and gift tax charitable deductions are allowable, but donor recognizes gain on the transaction, determined under Code §1011(b) and Reg. §1.1011-2. *Letter Rulings 8120089, 8305075* and *8806042*. Check state law on whether charity can issue gift annuity in exchange for real property. Also, charity must decide whether it wants to start paying annuity now though it won't receive property until later.

3. **Gift annuity funded with mortgaged property.**

   a. **Overview:** Gift annuities, unlike charitable remainder trusts, may be funded with mortgaged or other debt-encumbered property but there can be tax concerns.

   b. **Debt-financed income.** If a charity accepts mortgaged property for a gift annuity, it will have taxable debt-financed income unless the mortgage was placed on the property more than five years before the inter vivos transfer for the annuity, and the donor owned the property more than five years before the transfer. In that case, the mortgage is not considered an acquisition indebtedness during the ten years following the transfer. If the property is transferred by a donor's will, the "five-year before the transfer" requirement does not apply. Code §514(c)(2).

   c. **Exception.** Even if the charity receives unmortgaged property for a gift annuity, it will be deemed to have received debt-financed income—and/or may find itself being taxed as an insurance company under Code §501(m)—unless these tests are met:

i. The value of the annuity is less than 90% of the value of the property received (the gift part is more than 10%);

ii. The annuity is payable over the life of one or two individuals living when the annuity is created;

iii. The annuity does not guarantee a minimum or maximum amount of total payments; and

iv. The annuity does not provide for adjustment of payments by reference to the income received from the transferred or other property. Code §514(c)(5).

d. **Gift implications when annuity funded with mortgaged property.** Add the amount of the mortgage to the actuarial value of the annuity in determining the gain implications. The gain attributable to the indebtedness cannot be reported ratably over the donor-annuitant's life expectancy.

e. **Gift annuities may be a problem solver for gifts of mortgaged property and tangible personal property.** Under current IRS interpretations, unitrusts, annuity trusts and pooled funds can't be created with mortgaged property. But CGAs can be funded with mortgaged property (keep the bargain sale rule and consequences to the charity in mind). No income tax charitable deduction is allowable for transfers of tangible personal property to unitrusts, annuity trusts and pooled income funds (a limited deduction, however, may be allowable when the trust disposes of the tangible personal property). But that property can produce an income tax charitable deduction when transferred for a gift annuity. Keep in mind: (1) the related/unrelated issue for valuing the charitable contribution; (2) Is this a good deal for the charity? If it keeps the property, it will have to pay the annuity from other funds; if the charity sells the property, the proceeds may be less than the valuation placed on the property for determining the annuity payments; make sure state law permits issuance of an annuity for tangible personal property.

4. **Gift annuity funded with S corporation stock.** CGAs, unlike CRTs, may be funded with S corp stock because charities are eligible S corporation shareholders. However, Code §170(e)(1) requires that the charitable income tax deduction be reduced to reflect assets such as unrealized receivables, appreciated inventory and depreciation recapture, which would produce ordinary income upon sale. As to the charity, Code §512(e)(1) treats all income attributable to the S corp as UBTI and gain on the sale of the stock is also treated as UBTI.

5. **Self-dealing and excess business holdings issues.** Gift annuities may also be a problem solver if you run into self-dealing and excess business holding

problems for charitable remainder unitrusts and annuity trusts.

6. **Reinsurance of gift annuities.** In Letter Ruling 200847014, the IRS ruled that a donor was entitled to income and gift tax charitable deductions even though the charity had the right to but was not required to reinsure his gift annuity with a commercial insurance company. The insurance company – not the charity – paid commissions to the brokers. The rulings were contingent on the charity receiving favorable rulings from the Exempt Organizations Division on other issues (which it did, as you will see in Letter Ruling 200852037 (below). The annuity purchased by the charity had an option – for an additional premium – to have part of the premium paid by the charity returned to it if the annuitant dies before the payout equals the premium paid by the charity.

The IRS ruled that the donor is entitled to an income tax charitable deduction for his payment to the charity minus the present value of the gift annuity determined under Reg. §1.170A-1(d). Note that the tests of Code §§ 501(m) and 514(c)(5) were met and thus the charity's gift annuity program did not constitute commercial-type insurance and income from the program was not unrelated business taxable income.
Note: In Letter Ruling 8322068 (dealing with an escalating annuity amount), the charity was required to reinsure the annuity. The IRS ruled that the charitable contribution was the difference between the amount transferred to the charity and the premiums paid by the charity to the insurance company.

Query: How will the contribution deduction be determined today if a charity is required to reinsure an annuity? If it is not required to reinsure but always does so? Suppose the IRS interprets a reinsurance program to mean that charity is deemed to not "regularly issue" gift annuities? If the non-assignability and other tests are met will the donor nevertheless be precluded from spreading the gain ratably over his or her life expectancy?

H. CHARITABLE GIFT ANNUITY DRAFTING CHECKLIST

1. Understand the meaning of every provision in the annuity agreement.

2. A specimen—no matter how good—is lousy if it doesn't cover or isn't amended to cover the client's situation.

3. Yesterday's form—no matter how good—is terrible if it doesn't take today's changes in the law into account.

4. Double check that the gift annuity agreement contains all the provisions required by state law. The ACGA website has excellent state-specific resources (www.acga-web.org).

5. If the annuity is for the donor's life alone or if it is a two-life annuity and the donor is one of the annuitants, the capital gain when funded with appreciated property can be spread over the donor's life expectancy if the annuity is non-assignable. Make sure the annuity agreement states: This is non-assignable. Or, the agreement can state that the annuity is non-assignable except that is may be assigned to the charity that issues the annuity.

6. A non-assignable two-life annuity funded with a donor's separate property providing payments first to the donor and then to a survivor results in the capital gain being spread ratably over the donor's life expectancy whereas a two-life one-annuity funded with joint, tenancy in common or community property has the capital gain spread ratably over the two-life expectancy. Consider changing ownership of the property to co-ownership before funding the annuity and the fund with the co-owned property. That way the gain will be reportable ratably over the two-life expectancy. Be mindful of the gift-tax implications—generally not a concern if the conversion to co-ownership involves spouses who are citizens.
7. Make sure that the gift annuity agreement reflects how the property is owned. Otherwise, bad gift tax things can happen to good people.

8. Has the annuity agreement been drawn to avoid gift taxes (when possible) on the survivor annuitant's interest?

9. Confirm that both spouses are U.S. citizens. If they aren't, take the special rules that apply to transfers to non-U.S. citizen spouses into account. (There's a difference between a non-U.S. citizen spouse and an alienated spouse. The latter may well be a U.S. citizen.)

10. No matter how skillfully the annuity agreement is drawn, make sure that the gift portion is more than 10% and that the three other requirements of Code §514(c)(5) and 501(m) are met. If not, the charity will be taxed on debt-financed income, as an insurance company and in extreme cases can lose its tax exemption. Not a good thing.

11. Make sure the payments are made and are timely. A rule governing charitable remainder trusts requires that a CRT not only meet the Code's requirements, but also be administered according to its terms. In *Atkinson*, 309 F.3d 1290 (CA-11, 2002) the U.S. Court of Appeals for the Eleventh Circuit held that an inter vivos charitable remainder annuity trust's failure resulted in complete loss of the estate tax charitable deduction (there were four survivor beneficiaries). And that's so even though substantial sums would go to charity. The loss of the charitable deduction cost the estate $2,654,976. U.S. Supreme Court denied cert., 540 U.S. 946 (2003).

12. Unlike CRTs, gift annuities can be funded with S corp stock without losing the S election. BUT, there can be adverse tax implications for the charity. If you are representing the charity, consider these issues carefully.

13. Check if there are any SEC restrictions on transferring securities.

14. If life-insurance-wealth-replacement is part of the plan, make sure that the insurance is obtained before signing and funding the gift annuity agreement. In *Smallegan v. Kooistra*, the decedent signed and funded her CRUT before obtaining a life-insurance-wealth-replacement policy that was to be part of her estate plan. The decedent was subsequently denied insurance and died without the anticipated insurance in place. The son sued the attorney who drafted the CRUT to recover the value of the insurance he should have received as his inheritance. It is surprising that the decedent's attorney had the decedent sign and fund her CRUT before the insurance was nailed down. The Michigan Court denied the son's claims, but the laws of other states may have resulted in a different outcome. So be sure to have the insurance in place before signing and funding a gift annuity agreement or any other planned gift if wealth-replacement insurance is part of the estate plan. *Smallegan v. Kooistra,* 2007 WL 840123 (Mich. App. 2007).

15. One of the elements taken into account in determining the amount deemed contributed for the income tax deduction is the section 7520 rate for the month of the gift or either of the two prior months at the donor's election. The higher the section 7520 rate, the greater is the contribution deduction. But the excludable amount of each payment is greater with the lowest section 7520 rate. Another but: the capital gain is smallest with the highest section 7520 rate. So weigh all of this in determining which section 7520 rate to select. Many gift annuity donors take the standard deductions so the size of the deduction should not be a factor. Or an itemizer may have hit the deductibility ceiling and is making full use of the carryover.

16. Finally, trust no one. This checklist can't possibly cover everything, so if your mother tells you she loves you—check it out.

III. GIFTS OF REMAINDERS IN PERSONAL RESIDENCES AND FARMS

Alert. Gifts of remainders in personal residences and farms are especially attractive now because of the extremely low section 7520 rates. The donor receives an income tax deduction for the actuarial value of the remainder interest passing to the charity. The section 7520 rate at the time of the gift is used to calculate the value of the reminder interest. The lower the section 7520 rate, the greater is the value of the remainder interest and the greater is the donor's income tax charitable deduction.

A. BASICS — BRIEF DESCRIPTION

Donor can obtain income and estate tax benefits by making a charitable gift of a personal residence (need not be a principal residence) or farm even though he or she retains the right to life enjoyment. A life estate may be retained for one or more lives. Or an estate may be retained for a term of years.

Remainder interest must be in a personal residence or farm. Does not include furnishings or other tangible personal property. However, property that qualifies as a fixture under local law can be included in value. See *Letter Ruling 8529014* (heating and air conditioning system). **Gift can't be in trust.** *Estate of Cassidy,* 49 TCM 580 (1985); *Rev. Rul. 76-357,* 1976-2 CB 285.

Charitable deduction. For the income tax charitable deduction, depreciation (computed on the straight-line method) and depletion must be taken into account to determine the value of the remainder interest. Those values are discounted at an interest rate that depends on the federal rate (IRC §7520) in effect in the month of the transfer or either of the two prior months. For gift and estate tax purposes, depreciation (or depletion) need not be taken into account in valuing the remainder.

Capital gain. Capital gain is generally not taxable on a transfer of appreciated property to charity. Gain is, however, taxable to a donor who donates property subject to an indebtedness, whether or not charity assumes the debt. IRC §1011(b); Reg. §1.1011-2(a)(3). See also *Guest,* 77 TC 9 (1981). If a donor bargain-sells a remainder interest in an appreciated personal residence or farm to charity, donor will have gain determined under IRC §1011(b) and Reg. §1.1011-2.

B. GIFT TAX RULES

The charitable remainder qualifies for the unlimited charitable deduction. **Caution.** If a life estate is retained for an individual other than the donor, there can be gift tax implications. Those implications are beyond the scope of this outline. To highlight some (but not all issues) a QTIP marital deduction is available for an American spouse. For an alien spouse, there is the $147,000 gift tax annual exclusion and for non spouses, the $14,000 annual exclusion for present interests in 2015 (indexed annually for inflation). If an individual has a survivorship interest, generally gift tax concerns can be avoided on the donors retaining the right to revoke the survivor’s interest.

C. ESTATE TAX RULES—INCLUDING MARITAL DEDUCTION RULES

Gift of remainder interest with life estate reserved for donor's life. The fair market value of the personal residence or farm at the donor's death (or the alternate valuation date) is includable in his or her gross estate when donor retains a life estate in the property. IRC §2036. The estate then deducts as a charitable contribution the amount included in the gross estate—resulting in a wash. IRC §2055(e)(2); Reg. §20.2055-2(e)(2)(ii), (iii).

The estate tax implication for survivorship interests are beyond the scope of this outline. Suffice it to say that the charity's remainder interest isn't subject to the estate tax. And the survivor's interest for a citizen spouse can qualify for the QTIP marital deduction.

D. PLANNING CONSIDERATIONS

Charitable gift of proceeds from sale of farm or residence.

IRS's position.

No deduction is allowed for a gift of a remainder interest in a residence or farm when donor's will directs that the property be sold and all or part of the sales proceeds be distributed to charity. *Rev. Rul. 76-543,* 1976-2 CB 287; *Rev. Rul. 76-544*, 1976-2 CB 288.

IRS allows a deduction, however, if the second beneficiary's interest terminates (he or she dies) before the due date of donor's estate tax return, so that the remainder interest passes directly to charity and is deductible under a special exception in IRC §2055(e)(3). *TAM 7812005.*

IRS will also allow a deduction if state law permits the charitable remainder organization to take the farm or residence itself, despite the terms of donor's will. *TAM 8141037.*

IRS has allowed a deduction on these facts: Donor gave his personal residence to charity, retaining a life estate, and directed that on his death the charity sell the residence and add its proceeds to a trust Donor had previously established for charity's benefit. Here, said IRS, the charity's remainder interest is in the residence itself, not just the proceeds of a future sale. *TAM 7835010.*

Previously, no deduction where remainder interest (or proceeds therefrom) in a personal residence is split between charity and noncharity. *Letter Ruling 8341009.* But see 4., below.

U.S. Tax Court allowed deduction even though the interest received by charity was not a remainder interest in a personal residence, but rather a remainder interest in the proceeds from the sale of the residence. *Blackford,* 77 TC 1246 (1981). IRS acquiesces in the result of *Blackford,* but disagrees with the Tax Court's reasoning. IRB 1983-42, 5. IRS intends to continue challenging *Blackford*-type bequests when local law doesn't allow for equitable conversion of remainder interests. *Rev. Rul. 83-158*, 1983-2 CB 159.

Gift of remainder interest coupled with gift of undivided interest in property. Donor can give a charity a remainder interest and an undivided interest in the same property. For example, donor can deed his personal residence or farm to charity, reserving the right for life to use the property during the summer months as a vacation home. Donor will be entitled to a charitable deduction for: the remainder interest; and the undivided portion of his life interest in the property. *Rev. Rul. 76-473,* 1976-2 CB 306.

Gift of remainder interest split between charity and individual.

Background. Donor's will gave his personal residence to Ann for life. On her death, the residence was to vest in a charity and an individual as tenants in common. The IRS ruled that the donor's estate wasn't entitled to an estate tax charitable deduction for the value of the charity's one-half interest in the remainder. To qualify, citing IRC §2055, the charity must receive the entire remainder interest. *Rev. Rul. 76-544,* 1976-2 CB 288.

Another donor willed his sister a life estate in his personal residence. On her death, the remainder interest would pass under his will's residuary clause, which devised 90% of the residue to charity and 10% to individuals. In *Letter Ruling 8341009,* IRS denied an estate tax charitable deduction, citing *Rev. Rul. 76-544.*

But in 1987 the IRS muddied the waters. Alphonse conveyed the remainder in his home to a charity and Sarah as tenants in common. Sarah has a 90% interest; the remaining 10% goes to the charity. Alphonse filed a gift tax return, but subtracted the charity's undivided 10% interest from the value of his gift to Sarah.

IRS rules. Alphonse may deduct the charity's 10% interest as a charitable contribution. *Rev. Rul. 87-37*, 1987-1 CB 295.

A house divided is less than the sum of its parts. The amount of the charitable deduction must be reduced, said IRS, *"to reflect appropriate valuation discount for the cotenancy arrangement. See Estate of Fawcett, 64 T.C. 889, 900 (1975), acq., 1978-2 CB 2."*

Comment. This ruling deals only with the *gift tax* charitable deduction. The reasoning should apply for income tax purposes, but what's deductible for gift tax purposes isn't always deductible for income tax purposes.

IRS's copious citations to IRC §170 in this ruling don't assure parity for income tax deductions—the gift tax statute itself is cross-referenced to §170. Note that if an income tax charitable deduction is allowable, the amount must be discounted twice: once for cotenancy and once for depreciation on the structures. For gift tax purposes, though, depreciation is not taken into account.

How much discount for cotenancy? The *Fawcett* case cited by IRS doesn't offer much guidance beyond telling why a discount may be appropriate. Under the facts of that case, a decedent's executor sought a 25% discount on the estate tax value of his half interest in a ranch. The court said:

"Although we believe that such a factor should be considered to reflect the possible legal and other problems that would arise when such an interest is sold, we believe in this instance its importance is overstated.

"The subject ranch was owned by a family unit, not total strangers; consequently, we believe that neither the likelihood nor the magnitude of such problems would be great."

Unfortunately, the court didn't say how much of a discount would be applied under the facts at hand; it simply arrived at a valuation "after a careful review of the entire record." Still, it indicated the two factors to be considered in determining the amount

of a discount: the likelihood and the magnitude of "problems" resulting from the cotenancy.

A more recent case shed more light on the subject of cotenancy discounts (while not involving a charitable gift). An estate wanted a discount for federal estate tax valuation purposes where the decedent held a half-interest in a farm (the other half-interest was divided among eight heirs of the decedent's sister). The estate's expert testified that local appraisers often discount fractional interests in real property by 20%—25%. Citing the difficulty of finding an arm's-length buyer for a fractional interest in property—and the considerable expense that might be encountered in any attempt to partition the land under local (Illinois) law—the Tax Court found a 12.5% discount appropriate. *Estate of Youle,* 56 TCM 1594 (1989).

Charitable gift of life interest after gift of remainder interest.

A donor who has given a remainder interest in his residence or farm to charity, reserving a life estate for himself, should be entitled to an income tax charitable deduction if he later contributes his remaining life interest to the charitable remainder organization, thereby accelerating the charitable remainder. The amount deduction should be for the then value of the remaining life interest.

Caution. If the property in which the partial interest exists was divided to create an interest that would avoid the "less than the entire interest" rule, no deduction is allowable. It is a fact question whether a donor created a partial interest for reasons other than avoidance of IRC §170(f)(3)(A). If a donor, for example, can show that she retained a life interest to provide for her security and that her security is now otherwise assured (or she is no longer concerned about it), she should be entitled to a charitable deduction of the current value of her remaining life interest. See, *e.g.*, *Rev. Rul. 76-523*, 1976-2 CB 54.

Reforming defective remainder interest in personal residence of farm. TRA '84 instructed Treasury to issue regulations. However, Treasury has closed its regulation project. IR 86-167.

***Letter Ruling 9329017*—some interesting points.** A donor who contributes a remainder interest in a mortgaged farm (or personal residence) makes a gift to the extent of the remainder interest in the *equity* in the property. Donor is deemed to make a gift to the extent of the remainder interest in principal payments on the mortgage and to the extent of the remainder interest in any improvement that constitutes real property under applicable local law. Finally, a donor who gives a remainder interest in a mortgaged farm (or personal residence) is deemed to have sold a portion of the property to the charitable remainder organization and must take the full value of the mortgage into account as an amount realized in determining gain or loss (not loss for a personal residence) under Regs. §§1.170A-4(c)(2)(ii) and 1.1011-2. See the formula in Reg. §1.1011-2.

Property improvements by life tenant and foundation—not self-dealing. Husband (now deceased) contributed his house to Private Foundation, retaining a life interest for himself and Wife. Wife, as the life tenant, has continuously used the property as her principal residence for many years. Wife, who is over 90 years old, is a disqualified person under IRC §4946.

Wife and Private Foundation want to make much-needed improvements—replacement of the driveway, central air conditioning, and water heater—each paying a proportional share of the costs.

IRS rules. Wife's and Private Foundation's payments of a proportional share of the costs of the improvements (equal to the present value of each party's interest in the improvements at the time of the payments) won't be an act of self-dealing under IRC §4941. If Private Foundation were to pay the entire cost of the improvements, IRS noted, it could be argued that the value of the life tenant's property interest would be increased and that Private Foundation would be making a prohibited direct or indirect transfer to the life tenant. On the other hand, if Wife, as the life tenant, were to pay the total costs, the payment would constitute a gift to Private Foundation equal to Private Foundation's remainder interest in the improvements.

IRS emphasizes that the proposed improvements are necessary to maintain the property's condition (a valuable Foundation asset) and that the life tenant is over

90 years old; thus, any benefits that Wife (a disqualified person) receives would be incidental. *Rev. Rul. 73-407*, 1973-2 CB 383; Reg. §53.4941(d)-2(f)(4), Ex. 1 and 4. *Letter Ruling 200149040.*

IV. LATEST DEVELOPMENTS

A. NIM-CRUT—Early-Termination "Clarification" PATH '15 "SEC. 344. CLARIFICATION OF VALUATION RULE FOR EARLY TERMINATION OF CERTAIN CHARITABLE REMAINDER UNITRUSTS.

"(a) IN GENERAL.— [IRC] Section 664(e) is amended—

"(1) by adding at the end the following: 'In the case of the early termination of a trust which is a charitable remainder unitrust by reason of subsection (d)(3), the valuation of interests in such trust for purposes of this section shall be made under rules similar to the rules of the preceding sentence.', and

"(2) by striking 'FOR PURPOSES OF CHARITABLE CONTRIBUTION' in the heading thereof and inserting 'OF INTERESTS'.

"(b) EFFECTIVE DATE.—The amendment made by this section shall apply to terminations of trusts occurring after the date of the enactment of this Act."

Translation: The "clarification" provides that the value of a beneficiary's life (or term) interest on the early termination of a NIM-CRUT or NI-CRUT is to be determined the same way as if the trust were a STAN-CRUT.

The Code amendment and the Joint Committee's explanation don't tell why this "clarification" is important to some trust beneficiaries who want to terminate their trusts before the end of the specified term.

Why are some trusts terminated early?

·Terminated early when a donor gives his remaining life interest to the charitable remainder organization. Letter rulings on this termination method (except for one earlier outlier) haven't required a special way of valuing the donor's life interest in a NIM-CRUT or NI-CRUT when valuing the donor's charitable contribution for the then value of his life interest. Letter Rulings 200124010 and 200140027.

·Terminated early by dividing the trust assets between the life beneficiary and the charitable remainder organization based on the value of their then respective interests. IRS letter rulings hold that the value of the assets to be received by a NIM-CRUT life beneficiary is lower than the value he would receive had the CRT been a STAN-CRUT. This is the case when the IRC §7520 rate is lower than the percentage payout provided in the NIM-CRUT (same rule would apply to a NI-CRUT). Letter Rulings 200725044 and 201325018.

The Code amendment on its face eliminates the low valuation issue. One doesn't always know who is behind a law's modification, repeal or enactment. **No big guess here.** The motivating forces are some life beneficiaries of existing large NIM-CRUTs who wish to terminate their CRTs now by dividing the trust assets with the charitable remainder organization. But they don't want their life interests to be low valued as provided in earlier letter rulings.

Caution. A prudent buyer wouldn't buy a life interest in a NIM-CRUT or NI-CRUT paying the STAN-CRUT valuation amount if he would receive only the value as determined by the IRS in letter rulings when the IRC §7520 rate is lower the unitrust payout amount provided in the CRT. Generally, the charity will benefit by having the trust continue if no or little payments have been paid and will be paid to the life-income beneficiary.

So should a charitable remainder organization agree to terminate a NIM-CRUT or NI-CRUT when the life beneficiary will receive assets equal to a STAN-CRUT valuation? Attorneys General in some states must agree to an early termination. Despite the Code's "clarification" of the valuation rules, a state's AG could object to an early termination to protect the charity. And the charity's board, officers and employees might not (should not?) approve an early termination (based on a STAN-CRUT instead of a NIM-CRUT valuation) because of the potential adverse financial consequences to the charity.
In the film *Casava,* Captain Louis Renault shuts down Rick's Place and Tax Shelter: I'm shocked, shocked to find that 'self-dealing' is going on here."

Effective: Terminations of trusts starting December 19, 2015. ***Query.*** If this is a "clarification" rather than a new rule, why is it effective prospectively and not retroactively?

Parthian shot. A charitable remainder trust of any kind—CRAT, STAN-CRUT, NIM-CRUT, NI-CRUT, FLIP-CRUT—can also be terminated early when the life beneficiary and the charitable remainder organization sell their respective life interests to a third party. The NI-CRUT, NIM-CRUT issue hasn't been raised in this situation. But the IRS hasn't been concerned about valuing the respective interests, but rather about shutting down plans designed to avoid or minimize capital gains on the sale of the life beneficiary's interest to a third party. Reg. §1.6111-4.

B. CHARITABLE REMAINDER ANNUITY TRUSTS

- **Early termination qualified contingency provision as alternative to "five percent probability of exhaustion" test of Rev. Rul. 77-374 (for CRATs created on or after 8/8/16)**
- **Caution: Despite IRS's good intentions, it could be a non-blessing in**

disguise—a trap for the unwary

Background. A charitable remainder annuity trust must meet two tests:

Test 1—Actuarial Value Test. The charitable remainder must be at least 10 percent, computed using the tables prescribed for split-interest charitable gifts; **and**

Test 2—Five Percent Probability of Exhaustion Test. Even if there's an actuarially determined minimum remainder interest value satisfying Test 1, charitable deductions (income, gift and estate) aren't allowable unless the probability that the charitable transfer will not become effective is so remote as to be negligible. If there's more than a five percent probability that the noncharitable income beneficiary (or beneficiaries) will survive the exhaustion of the trust assets, that probability isn't so remote as to be negligible. *Rev. Rul. 77-374,* 1977-2 CB 329.

With historically low section 7520 rates (1.4 percent this month), it's possible to easily pass the 10 percent minimum remainder interest *Test 1*, but flunk the five percent probability of exhaustion *Test 2.*

New alternative to *Test 2*—the early termination qualified contingency provision for CRATs created on or after August 8, 2016. The IRS will treat the sample provision in Rev. Proc. 2016-42 (below) as a qualified contingency within the meaning of IRC §664(f). (Stay tuned for a discussion of other qualified contingencies starting on page 8). Inclusion of the IRS's sample provision (below) in the CRAT won't cause it to fail to qualify as a CRAT under IRC §664. Any CRAT containing the sample provision won't be subject to the five percent probability of exhaustion test in Rev. Rul. 77-374.

IRS tells why the five percent probability of exhaustion test is easily flunked:

Low interest rates in recent years have greatly limited use of a CRAT as an effective charitable-giving vehicle. For example, in May of 2016, the *section 7520* rate was 1.8 percent. At this interest rate, the sole life beneficiary of a CRAT that provides for the payment of the minimum allowable annuity (equal to 5 percent of the initial FMV of the trust assets) must be at least 72 years old at the creation of the trust for the trust to satisfy the probability of exhaustion test. The *section 7520* rate has not exceeded the minimum 5 percent annuity payout rate since December of 2007, which has necessitated testing for the probability of exhaustion for every CRAT created since that time.

Section 664(f)(1) provides in general that, if a trust would, but for a qualified contingency, meet the requirements of *section 664(d)(1)(A)* (relating to CRATs) or *section 664(d)(2)(A)* (relating to charitable remainder unitrusts), the trust is treated as meeting these requirements. *Section 664(f)(2)* provides that, for purposes of determining the amount of any charitable contribution (or the actuarial value of any interest), a qualified contingency is not taken into account. *Section 664(f)(3)* defines a qualified contingency for purposes of *section 664(f)* as any provision of a trust which provides that, upon the happening of a contingency, the payments described in *section 664(d)(1)(A)* or *(d)(2)(A)* (as the case may be) will terminate not later than these payments otherwise would terminate under the trust.

To get the protection of the early termination qualified contingency rules: The governing instrument **must have the precise language (below) of the sample provision of Rev. Proc. 2016-42**. [My emphasis supplied.] A CRAT that has a "substantive provision similar but not identical to that provided in the Rev. Proc. will not necessarily be disqualified, but neither will such a provision be assured of treatment as a qualified contingency under section 664(f).

Comment. By comparison, the *Simon Says* game is child's play.

Two ways now available to pass the probability of exhaustion test:

Way one. The five percent probability of exhaustion test of Rev. Rul. 77-374.

Way two. The early termination qualified contingency provision of Rev. Proc. 2016-42.

The IRS's safe-harbor provision can cause the early termination of the CRAT, followed by an immediate distribution of the remaining trust assets to the charitable remainder beneficiary.
The IRS explains:

Specifically, this provision provides for early termination of the trust (and thus the end of the ability to make any more annuity payments) on the date immediately before the date on which any annuity payment would be made, if the payment of that annuity amount would result in the value of the trust corpus, when multiplied by a specified discount factor, being less than 10 percent of the value of the initial trust corpus.

The sample provision is designed to ensure that the benefit from the creation of the CRAT will be available only where there is a significant benefit to charity. *See* Staff of the Joint Comm. on Taxation, 105th Cong., General Explanation of Tax Legislation Enacted in the 105th Congress, JCS-23-97 at 289-290 (1997). This provision also is designed to ensure that the charitable remainder beneficiary will receive an amount that accords with the charitable deduction allowed to the donor on creation of the trust. *See* H.R. Rep. No. 91-413, pt. 1, at 59 (1969), *1969-3 C.B. 200, 238,* and S. Rep. No. 91-552, 88 and 90 (1969), *1969-3 C.B. 423, 480-81.* Finally, this provision is designed to expose the charitable remainderman to some, but not all, of the investment performance risk of the CRAT assets.

IRS's Sample Provision for Inter vivos CRATs.

The first day of the annuity period shall be the date <u>the</u> <u>property</u> <u>is</u> <u>transferred</u> <u>to</u> <u>the</u> <u>trust</u> and the last day of the annuity period shall be the date of <u>the</u> <u>Recipient's</u> <u>death</u> or, if earlier, the date of the contingent termination. The date of the contingent termination is the date immediately preceding the payment date of any annuity payment if, after making that payment, the value of the trust corpus, when multiplied by the specified discount factor, would be less than 10 percent of the value of the initial trust corpus. The specified discount factor is equal to $[1 / (1 + i)^t]$, where *t* is the time from inception of the trust to the date of the annuity payment, expressed in years and fractions of a year, and *I* is the interest rate determined by the Internal Revenue Service for purposes of *section 7520 of the Internal Revenue Code* of 1986, as amended (*section 7250* rate), that was used to determine the value of the charitable remainder at the inception of the trust. The *section 7520* rate used to determine the value of the charitable remainder at the inception of the trust is the *section 7520* rate in effect for [insert the month and year], which is [insert the applicable *section 7520* rate]."

In a testamentary CRAT.

The phrase "the property is transferred to the trust" (the first underlined phrase) in this sample language must be replaced with "of my death."

If the *inter vivos* or testamentary CRAT is created using the sample form provided in *Rev. Proc. 2003-53, 2003-2 C.B. 230,* or *Rev. Proc. 2003-57, 2003-2 C.B. 257,* respectively, the insertion of this sample provision in place of the second sentence of paragraph 2 of that sample *inter vivos* form, or in place of the second sentence of paragraph 1 of the sample testamentary form, respectively, will satisfy the requirements of a qualified contingency as described in section 6.03 of each revenue procedure.

If the CRAT annuity is payable consecutively for two measuring lives. The phrase "the Recipient's death" (the second underlined phrase) in the sample provision must be replaced with "the death of the survivor of the Initial Recipient and the Successor Recipient(s)". See *Rev. Proc. 2003-55, 2003-2 C.B. 242,* and *Rev. Proc. 2003-59, 2003-2 C.B. 268.* If the CRAT annuity instead is payable concurrently and consecutively for two measuring lives, the second underlined phrase in the sample provision must be replaced with "the Survivor Recipient's death". See *Rev. Proc. 2003-56, 2003-2 C.B. 249,* and *Rev. Proc. 2003-60, 2003-2 C.B. 274.*

Comment. These sample provisions scare the living daylights out of me. And as we shall see, even if you hit the sample language right on the nose, this is a treacherous way to qualify a CRAT.

RS's example. On January 1, Year 1, Donor transfers property valued at $1,000,000 to Trust, an *inter vivos* trust providing for an annuity payment of $50,000 (5 percent of the value of the initial trust corpus) on December 31 of each year to S for S's life followed by the distribution of trust assets to Charity. Trust includes the precise language of the sample provision in *section 5* of this revenue procedure providing for an early termination contingency and specifies the *section 7520* rate in effect for January, Year 1, which is 3 percent. But for the early termination provision, Trust meets all of the requirements of *section 664(d)(1)*. In accordance with this revenue procedure, the IRS will treat the early termination contingency as a qualified contingency under *section 664(f)*. Therefore, the early termination provision does not cause Trust to fail to qualify as a CRAT under *section 664*. In addition, Trust qualifies as a CRAT regardless of whether it passes the probability of exhaustion test on January 1, Year 1.

Each year, prior to payment of the annuity to S, the trustee performs the calculations required to determine if Trust will terminate early in accordance with the terms of the qualified contingency. In each year from Year 1 through Year 17, the trustee determines that the value of the trust corpus, minus the $50,000 annual payment, and then multiplied by the specified discount factor, is greater than 10 percent of the initial trust corpus. The value of the trust corpus as of December 30 in Year 18 is $210,000. Only in Year 18 does the value of the trust corpus as of December 30, when reduced by the annuity payment and multiplied by the specified discount factor, fall below 10 percent of the value of the initial trust corpus. The calculations required to determine if Trust will terminate early in Year 18 are as follows:

1. $1,000,000 x 10 percent = $100,000
2. ($210,000 - 50,000) x $[1 / (1 + .03)^{18}]$
   $160,000 x $(1/1.03)^{18}$
   $160,000 x 0.970874^{18}
   $160,000 x 0.587397 = $ 93,984.

Because the value of the trust corpus ($210,000), when reduced by the annuity payment ($50,000) and then multiplied by the specified discount factor (0.587397), is less than 10 percent of the value of the initial trust corpus ($100,000), Trust terminates on December 30, Year 18, and the principal and income remaining in Trust (including the annuity payment for Year 18 that otherwise would have been payable to S) then must be distributed to Charity.

Effect on Other Documents. *Rev. Rul. 70-452* and *Rev. Rul. 77-374* are modified to provide an exception for CRATs that conform to this revenue procedure.

Rev. Proc. 2003-53, Rev. Proc. 2003-55, Rev. Proc. 2003-56, Rev. Proc. 2003-57, *Rev. Proc. 2003-59* and *Rev. Proc. 2003-60* are amplified.

Effective date. CRATs created on or after August 8, 2016.

Drafting information. The principal author of this revenue procedure is Donna Douglas of the Office of Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this revenue procedure, contact Donna Douglas at (202) 317-6859.

Rev. Proc. 2016-42; 2016-34 IRB 269, Release Date: August 8, 2016

Nationally recognized charitable and estate planning lawyer Lawrence Katzenstein of St. Louis alerts us to the potential danger of this early termination qualified contingency provision.

Here's how the formula works. The trust ends not when the trust has declined to 10 percent of its original value, but when the remaining trust assets *as discounted* are less than 10 percent of the trust's original value.

In the IRS example (above), the trust still has 21 percent of its original value before the next payment, and 16 percent of its original value after the next payment. But because that remaining value is discounted, it falls to 9.3984 percent of the trust's original value. **So remember the downside of using the Rev. Proc. language: the beneficiary's annuity may end unexpectedly because of a downturn in the market just when the beneficiary really needs the income.**

More advice from Larry Katzenstein:

I doubt the Revenue Procedure's contingent termination technique will be used very often. CRATs are often created by donors of relatively modest means who want the security of fixed income. But if the donor knows that the trust may end prematurely, even though it still has substantial assets remaining, that may dampen the donor's enthusiasm for the technique. Remember that the test is not that the trust ends when it has declined to 10 percent of the original value. Rather, the test is that the trust must end when the amount remaining in the trust after the next payment as discounted from date of gift to test date has declined to more than 10 percent of the original value. In the example in the Service's own Rev. Proc. the trust must end even though it still holds $210,000 of the original $1,000,000 which funded the trust. How many donors will want to take this risk?

Also, the technique will require extra diligence on the part of the trustee, who will have to determine before each payment is made whether the trust can continue or must terminate.

Larry Katzenstein cautions:

Remember: even if you use the qualified contingency method to satisfy the five percent exhaustion test, you still have to pass the 10 percent remainder test. Since the purpose of the Rev. Proc.—and the formula used—is to insure that the charity will receive a remainder equal actuarially to 10 percent of the original trust amount, why can't the qualified contingency method also be used to qualify a trust that passes the five percent test but doesn't satisfy the 10 percent remainder test? (That can easily happen if the §7520 rate is higher than the annuity payout rate but the beneficiary is very young or there are multiple beneficiaries.) The reason is that the 10 percent remainder test is statutory and can't be changed just by IRS action. It is only because the five percent exhaustion test is regulatory that a revenue procedure can be used to modify it.

This is an especially technical Rev. Proc. so this final technical point raised by Larry is in order.

The Rev. Proc. states incorrectly that "If the §7520 rate at creation of the trust is equal to or greater than the percentage used to determine the annuity payment, then exhaustion will never occur under this test." That will always be true for a trust paying annually at the end of each year. But a trust paying more frequently than annually as is usually the case can flunk the exhaustion test even if the 7520 rate at creation of the trust is equal to the percentage used to determine the annuity payment. That is because more frequent payments increase the effective rate of the annuity. For example, the probability of exhaustion is 7.844 percent for a CRAT for a 60-year-old measuring life paying a 10 percent annuity quarterly at the end of each quarter even though the applicable 7520 rate is also 10 percent.

Larry Katzenstein programs and produces the widely used planned giving and other estate planning calculations in his Tiger Tables.

Larry has developed software that will, at the creation of the CRAT, generate a table showing the amount at every future payment date that the trust must exceed in order not to terminate. All the trustee will have to do is consult the table before every payment date if the trust has declined significantly.

With Larry's cautions in mind, is the early termination qualified contingency provision helpful for a donor who craves a CRAT but until now couldn't have one because the CRAT would flunk the five percent probability of exhaustion test of Rev. Rul. 77-374?

The first question to ask. If there were no five percent probability of exhaustion test, would a CRAT be the most desirable life-income plan?

For an individual who wants fixed payments, arguably yes. But remember a CRAT can run dry. A charitable gift annuity is often a better choice.

And for younger beneficiaries, a charitable remainder unitrust (CRUT) provides a potential hedge against inflation (but no hedge against deflation). CRUTs offer flexibility—STAN-CRUTs, NIM-CRUTs, NI-CRUTs and FLIP-CRUTS.

Take away. I'd tell a client who has her heart set on a CRAT not to create one if it flunks the five percent probability of exhaustion test of Rev. Rul. 77-374. The early termination qualified contingent alternative of Rev. Proc. 2016-42 is too harsh as Larry Katzenstein points out. A CGA or a CRUT would be a better choice.

Some tax thoughts—

Belt, suspenders, velcro and hands-holding- up- pants provision: The CRAT provides: This trust on its creation satisfies the five percent probability of exhaustion test of Rev. Rul. 77-374. But, if it doesn't, then the language of Rev. Proc. 2016-42 (CRAT has that language) shall govern the termination date rather than the date of my death.

Why would this super-duper-fail-safe provision even be considered?

Suppose a mistake is made in determining that the five percent probability of exhaustion was met? That's no excuse at the IRS.

Another suppose. Donor's CRAT is drafted and funded on or after the August 8, 2016 effective date of the early termination qualified contingency rule of Rev. Proc. 2016-42. Turns out that it flunks the five percent probability of exhaustion test of Rev. Rul. 77-374 on its creation **and** doesn't have the early termination qualified contingency language of Rev. Proc. 2016-42.

Is all lost? The lawyer who drafted the CRAT should immediately notify his malpractice insurance carrier; then a trip to the courthouse to reform the CRAT based on scrivener's error to insert early termination qualified contingency language. That could save the day—and the CRAT.

If all else fails. See *Moor,* 43 TCM 1530 (1982).

Final words. I salute the IRS and Treasury for its early termination qualified contingency alternative. It addresses the difficulty of a CRAT's meeting the five percent probability of exhaustion test of Rev. Rul. 77-374.

But, I wouldn't advise a client (for reasons stated in this article) to create a CRAT if qualification depended on reciting and following the early termination qualified-contingency provision of Rev. Proc. 2016-42.

V. TCJA– P.L. 115-97 AFFECT ON CHARITABLE GIVING

A. THE GOOD

· **Virtually all the rules governing outright and split-interest charitable gifts remain unchanged.** The House Ways and Means Committee seriously considered many proposals that would have drastically reduced the tax incentives for many types of appreciated property gifts.

· **The "Pease" provision placing a limit for high-income taxpayers on the charitable and some other itemized deductions is repealed.**

· **Cash gifts to "public" charities.** The adjusted gross income ceiling on deductibility is increased from 50 percent to 60 percent starting in 2018 with a 60 percent of AGI five-year carryover for any "excess."

Fly in the ointment.* The American Institute of Certified Public Accountants recommends that Congress provide a technical correction for IRC §170(b)(1)(G)(iii) as changed by the Tax Cuts and Jobs Act of 2017 (TCJA) §11023 for the 60 percent of adjusted gross income (AGI) charitable deduction limitation to function as intended.

We recommend that Congress replace the statutory provision with the language below:

Notwithstanding subparagraphs (A)-(F), a taxpayer may deduct a cash contribution to an organization described in subparagraph A up to 10 percent of their adjusted gross income in addition to any amount allowed in the current year (or under a

*Dead flies cause the ointment of the apothecary to send forth a stinking savour.

Ecclesiastes 10:1—King James Version

in excess of the 10 percent described in the preceding sentence shall be treated as a carryover paid in each of the 5 succeeding years in order of time.

The current statutory language in the TCJA reduces the allowed charitable deduction if assets other than cash are donated. This reduction results in a total percentage of 50 percent, rather than 60 percent of AGI. This reduction is the result even if one dollar of non-cash assets is donated (such as securities).

This change would confirm Congress's intent to allow for the increased 60 percent of AGI limitation, assuming the additional amount is in cash (for example, 30 percent appreciated securities and 30 percent cash). Currently under the TCJA, the taxpayer can only receive the increased 60 percent of AGI limitation if the entire donation is in cash.

· **Unlimited charitable and unlimited marital deductions continue to be allowed for gift and estate taxes.** See the increased exemptions (and expiration date) for those taxes.

· **Indirect benefit for charitable gifts: nonrecognition of gain for like-kind IRC §1031 exchanges is limited to real property not held primarily for sale.** *Effective for exchanges completed after December 31, 2017.*

Pointer. Appreciated property used to fund a charitable remainder trust avoids capital gain on the transfer to the CRT. And when that property is sold and reinvested in other assets, the gain is taxable only to the extent it is paid out to the beneficiaries under category two of the four-category taxation provision governing CRTs.

C Corporations: Charitable contributions continue to be deductible up to 10 percent of the corporation's taxable income for the year with a five-year 10 percent of taxable income for any "excess." Taxable income is determined without regard to: **(1)** the charitable deduction; **(2)** any net operating loss carryback to the taxable year; **(3)** deductions for dividends received; **(4)** deductions for dividends paid on certain preferred stock of public utilities; and **(5)** any capital loss carryback to the taxable year.

Tax rates before 2018
Corporate taxable income was subject to tax under a four-step graduated rate structure. The top corporate tax rate was 35 percent on taxable income over $10 million. The corporate taxable income brackets and tax rates were:

Taxable Income	**Tax rate percent)**
Not over $50,000	15
Over $50,000 but not over $75,000	25
Over $75,000 but not over $10,000,000	34
Over $10,000,000	35

Starting 2018 the corporate tax rate is 21 percent—effective for taxable years beginning after 2017. No expiration date—this is "permanent."

Am I missing something? Will income formerly taxed at the 15 percent rate now be taxed at 21 percent?

B. CHANGES INDIRECTLY NEGATIVELY AFFECTING CHARITABLE GIVING

· **Doubling the standard deduction—indirect negative change—reduces the percentage of taxpayers who itemize from 30 percent to 5 to 10 percent.** This will reduce tax incentives for charitable gifts.

The standard deduction for nonitemizers is increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other individuals. The standard deduction is indexed for inflation using the C-CPI-U for taxable years beginning after December 31, 2018. An additional standard deduction is allowable for the elderly and the blind. $1,300 for each category; $1,600 for an unmarried individual who is not a surviving spouse .

· **Income tax rates for individuals are reduced—another *indirect* negative.** The top rate is 37 percent, down from 39.6 percent. But the reduced tax rates are—seems to me—unlikely to significantly reduce the tax incentives for charitable gifts made by itemizers.

· **Contributions for preferred seating at college and university sports events no longer deductible—effective 2018.** This is bad for taxpayers who want to sit on the 50-yard line and get a charitable deduction. But not bad if you believe that this benefit favored a limited group for a limited purpose.

VI. PRIMER ON UNCHANGED AND ONGOING CHARITABLE DEDUCTION RULES

Virtually all the rules governing outright and split-interest charitable gifts remain unchanged. The House Ways and Means Committee seriously considered many proposals that would have drastically reduced the tax benefits for many appreciated property gifts.

Valuation of charitable contributions. For the income tax charitable deduction, the value of property contributed to charity may be limited to the fair market value (FMV) of the property, the donor's tax basis in the property, or sometimes a different amount. For all gifts, the deductible amount is subject to the percentage limits discussed below.

Cash charitable contributions. Deductible in the amount contributed.

Long-term (held more than one year) capital gain property (securities, real property). Deductible at fair market value.

Appreciated tangible personal property (e.g., artworks). Deductible at fair market value if the use by the recipient charitable organization is related to its tax-exempt purpose.

Deduction limited to basis (assuming lower than FMV). IRC §170(e) limits the deductible value of the contribution of appreciated property to the donor's tax basis in the property. This limitation of the property's deductible value to basis generally applies, for example, for: **(1)** contributions of inventory or other ordinary income or short-term capital gain property; **(2)** contributions of tangible personal property (artworks) if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose; and **(3)** contributions to or for the use of a private foundation (other than certain private operating foundations).

For contributions of "qualified appreciated stock" to private foundations. The above-described rule limiting the value of property contributed to or for the use of a private nonoperating foundation to the taxpayer's basis in the property doesn't apply; subject to certain limits (below) to contributions of qualified appreciated stock to a nonoperating private foundation. If tests are met, those gifts may be deducted at fair market value.

Qualified appreciated stock is stock that is capital gain property and for which (as of the date of the contribution) market quotations are readily available on an established securities market. A contribution of qualified appreciated stock (when increased by the aggregate amount of all prior such contributions by the donor of stock in the corporation) generally doesn't include a contribution of stock to the extent the amount of the stock contributed exceeds 10 percent in value of all of the outstanding stock of the corporation.

Contributions of property with a fair market value that is less than the donor's tax basis, generally are deductible at the lower fair market value of the property.
Enhanced deduction for some contributions of inventory and other property by C corporations. Although most property contributions are valued at fair market value or the donor's basis in the property, some statutorily described contributions of appreciated inventory and other property qualify for an enhanced deduction valuation exceeding the donor's tax basis, but which is less than the property's fair market value.

As discussed earlier, a taxpayer's deduction for contributions of inventory property generally is limited to the taxpayer's basis (typically, cost) in the inventory, or if less, the fair market value of the property. But for some contributions of inventory, C corporations (but not other taxpayers) may claim an enhanced deduction equal to the

lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.

To be eligible for the enhanced deduction value, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in IRC §501(c)(3) (except for private nonoperating foundations), and the donee must **(1)** use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, **(2)** not transfer the property in exchange for money, other property, or services, and **(3)** provide the taxpayer a written statement that the donee's use of the property will be consistent with those requirements. Contributions to organizations that aren't described in IRC §501(c)(3), such as governmental entities, don't qualify for this enhanced deduction.

To qualify for the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

A taxpayer engaged in a trade or business, whether or not a C corporation, is eligible to claim the enhanced deduction for certain donations of food inventory.

Rules for other types of contributions. Special rules limit the deductible value (and impose enhanced reporting obligations on donors) of charitable contributions of certain types of property, including vehicles, intellectual property, and clothing and household items.

Vehicle donations. The amount of deduction for contributions of vehicles (generally including automobiles, boats, and airplanes for which the claimed value exceeds $500 and excluding inventory property) depends on the use of the vehicle by the donee organization. If the donee organization sells the vehicle without any significant intervening use or material improvement of the vehicle by the organization, the deduction may not exceed the gross proceeds received from the sale. In other situations, a fair market value deduction may be allowed.

Clothing and household items. Charitable contributions of clothing and household items generally are subject to the charitable deduction rules applicable to tangible personal property. If the contributed property is appreciated property in the hands of the taxpayer, and is not used to further the donee's exempt purpose, the deduction is limited to basis. In most situations, however, clothing and household items have a fair market value that is less than the taxpayer's basis in the property. Because property with a fair market value less than basis generally is deductible at the property's lower FMV, taxpayers generally may deduct only the FMV of most contributions of clothing or household items, regardless of whether the property is used for exempt or unrelated purposes by the donee organization. Plus, a special rule generally provides that no deduction is allowed for a charitable contribution of clothing or a household item unless the item is in good used or better condition. The Treasury is authorized to deny by regulation a deduction for any contribution of clothing or a household item that has minimal monetary value, such as used socks and used undergarments. Notwithstanding the general rule, a charitable contribution of clothing or household items not in good used or better condition with a claimed value of more than $500 may be deducted if the taxpayer includes with the taxpayer's return a qualified appraisal of the property.

Household items include furniture, furnishings, electronics, appliances, linens, and other similar items. Food, paintings, antiques, and other objects of art, jewelry and gems, and certain collections are excluded from the special rules described in the preceding paragraph.

Use of a vehicle when volunteering for a charity. Unreimbursed out-of-pocket expenditures made while providing donated services to a charitable organization—such as out-of-pocket transportation expenses necessarily incurred in performing donated services—may qualify as a charitable contribution. No charitable deduction is allowed for traveling expenses (including expenses for meals and lodging) while away from home, whether paid directly or by reimbursement, *with a significant element of personal pleasure, recreation, or vacation in that travel.*

The amount treated as a charitable contribution where a taxpayer operates a vehicle in providing donated services to a charity: the taxpayer either may track and deduct actual out-of-pocket expenditures or, in the case of a passenger automobile, may use the charitable standard mileage rate at 14 cents per mile.

The taxpayer may also deduct (under either computation method), any parking fees and tolls incurred in rendering the services, but may not deduct any amount (regardless of the computation method used) for general repair or maintenance expenses, depreciation, insurance, and registration fees. Regardless of the computation method used, the taxpayer must keep reliable written records of expenses incurred.

For example, where a taxpayer uses the charitable standard mileage rate to determine a deduction, the IRS has stated that the taxpayer generally must maintain records of miles driven, time, place, and purpose of the mileage. If the charitable standard mileage rate is not used to determine the deduction, the taxpayer generally must maintain reliable written records of actual expenses incurred.

Patents and other intellectual property. A donor's initial deduction for a patent gift is limited to the lesser of the taxpayer's basis in the patent or its fair market value.

In addition, the taxpayer generally is permitted to deduct, as a charitable contribution, some additional amounts in the year of contribution or in subsequent taxable years based on a specified percentage of the qualified donee income received or accrued by the charitable donee with respect to the contributed intellectual property. For this purpose, qualified donee income includes net income received or accrued by the donee that properly is allocable to the intellectual property itself (as opposed to the activity in which the intellectual property is used).

BASIC AND LONG-STANDING TAX RULES ON CHARITABLE CONTRIBUTIONS

Percentage limits on charitable deductions—individual-taxpayers. Charitable contributions are limited to a specified percentage of the individual's contribution base (the taxpayer's adjusted gross income (AGI) for a taxable year, disregarding any net operating loss carryback to the year under IRC §172). From now on, I'll call it the AGI (not the contribution base) ceiling.

Generally, higher percentage limits apply to contributions of cash and ordinary income property than to contributions of long term (held more than one year) capital gain (appreciated) property. Also, more favorable limits generally apply to contributions to public charities (and some operating private foundations) than to contributions to nonoperating foundations.

Cash and short term capital gain property (held one year or less) or property having a fair market value equal to its basis. The deduction for those gifts to public charities and certain governmental units may not exceed 50 percent of the taxpayer's AGI.

Cash gift ceiling increased to 60 percent of AGI starting in 2018—with a five-year 60 percent of AGI carryover for "excess" gifts. Applies for gifts to public charities, private operating foundations and "passthrough" (conduit) foundations.

Contributions of appreciated capital gain property to public charities and other organizations described in IRC §170(b)(1)(A) generally are deductible up to 30 percent of the taxpayer's AGI (after taking into account contributions other than contributions of capital gain property).

An individual may elect, however, to bring all these contributions of appreciated capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of appreciated capital gain property to nonoperating private foundations are deductible up to the lesser of 20 percent of the taxpayer's AGI or the excess of (i) 30 percent of the AGI over (ii) the amount of contributions subject to the 30 percent limitation.

Finally, contributions for the use of (not to) the donee charity have less favorable percentage limits. Contributions of capital gain property for the use of public charities and other organizations described in IRC §170(b)(1)(A) also are limited to 20 percent of the taxpayer's AGI. Property contributed for the use of an organization generally has been interpreted to mean property contributed in trust for the organization. Charitable contributions of income interests (where deductible) also generally are treated as contributions for the use of the donee organization.

Carryforwards of excess contributions. Gifts exceeding the percentage limit generally may be carried forward for up to five years. Generally, contributions carried over from a prior year are taken into account after contributions for the current year that are subject to the same percentage limit. Excess contributions made for the use of (rather than to) an organization generally may not be carried forward.

Qualified conservation contributions are still deductible. That's a transfer of a qualified real property interest to a qualified organization exclusively for conservation purposes.

A qualified real property interest is: (1) the donor's entire interest other than a qualified mineral interest; **(2)** a remainder interest; or **(3)** a restriction, granted in perpetuity, on the use that may be made of the real property (generally, a conservation easement).

Qualified organizations include: governmental units, public charities meeting public support tests, and supporting organizations.

Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; **(2)** the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; **(3)** the preservation of open space (including farmland and forest land) where the preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or under a clearly delineated Federal, State, or local governmental conservation policy; and **(4)** the preservation of an historically important land area or a certified historic structure.

Preferential percentage limits and carryover rules apply for qualified conservation contributions. Generally, the 30-percent AGI limitation on contributions of capital gain property by individuals doesn't apply to qualified conservation contributions. Instead, individuals may deduct the FMV of any qualified conservation contribution to an organization described in IRC §170(b)(1)(A) (generally, public charities) to the extent of the excess of 50 percent of AGI over the amount of all other allowable charitable contributions. These contributions aren't taken into account in determining the amount of other allowable charitable contributions. **Individuals are allowed to carry forward any qualified conservation contributions that exceed the 50 percent limitation for up to 15 years.** That's not a typo.

For an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer's AGI over the amount of all other allowable charitable contributions. Again, that's not a typo.

For a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under IRC §170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.

A qualified farmer or rancher is a taxpayer whose gross income from the trade or business of farming (within the meaning of IRC §2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

The Valuation and Substantiation Requirements Are Not Changed.

VII. COOL CHARITABLE GIVING MOVES IN THE NEW TAX CLIMATE

The direct transfer to charities from IRAs by individuals 70½ or older. These gifts were taxwise for nonitemizers even before passage of TCJA'17. Not being taxed on otherwise taxable withdrawals from IRAs is the equivalent of a charitable deduction. Now that many more taxpayers will be taking the standard deduction, making direct transfers from IRAs to charities is a smart tax strategy for additional donors. And, direct IRA transfers from IRAs can also be advantageous for taxpayers who itemize.

Maltum in parvo (in a nutshell). An individual age 70½ or older can make direct charitable gifts annually of up to $100,000 from an IRA, to public charities (other than donor advised funds and supporting organizations) and not have to report the IRA distributions as taxable income on his federal income tax return. Most private foundations are ineligible donees, but private-operating and passthrough (conduit) foundations are. There is no charitable deduction for the IRA distributions. However, not paying tax on otherwise taxable income is the equivalent of a charitable deduction. Tax-free distributions are for outright (direct) gifts only—not life-income gifts.

Traditional and Roth IRAs only. Distributions from traditional and Roth IRAs are the only ones that are tax free. Distributions from employer-sponsored retirement plans, including SIMPLE IRAs and simplified employee pensions (SEPs) aren't qualified charitable distributions; nor are distributions from Keoghs, 403(b) plans, 401(k) plans, profit sharing and other plans.

Doing a two step to qualify: (1) Roll over a non-qualified pension plan into a qualified IRA. That's generally tax free (make sure that's so). (2) The qualified IRA then makes the distributions directly to the charity.

Pointer on donor-advised funds of community foundations. As noted, IRA distributions to those funds don't qualify. But IRA distributions to a community foundation's endowment and field-of-interest funds do qualify—as long as the donor has no advisory rights.

Distributions from a qualified IRA must be made <u>directly</u> by the IRA's administrator or trustee to a qualified charity. A payment to the donor who one honko-second later gives it to the charity doesn't qualify (a honko-second is the shortest measure of time—the time that elapses between a traffic signal turning green and the driver of the car behind honking his horn).

The entire distribution must be paid to the charity with no quid pro quo. The exclusion applies only if a charitable deduction for the *entire* distribution would have been allowable (determined without regard to the generally applicable percentage limitations). Thus if the donor receives (or is entitled to receive) a chicken dinner in connection with the transfer to the charity from the IRA, the exclusion isn't available for *any* part of the IRA distribution.

Caveat on year-end charitable distributions. A donor who by U.S. mail sends checks and securities to a charity this year that are received by the charity next year has made a charitable gift this year. Will a distribution mailed by the IRA trustee/custodian to the charity this year, but received by it next year, qualify for tax-free treatment? Unless clarified by the IRS, make sure that the charity actually receives the distribution this year.

Death-time distributions to charity from IRAs—reminder. Current and continuing laws allow tax-free distributions to charities at death for both outright and charitable remainder gifts. Income in respect of a decedent (IRD) isn't taxable to charities and CRTs. When a CRT beneficiary receives payments, he or she will be taxable on the IRD. Less than one-tenth of one percent of estates are subject to the estate tax. If those estates have income in respect of a decedent, the IRA beneficiaries are entitled to itemized deductions on their income tax returns spread over their life expectancies for estate taxes attributable to their bequests. This should be considered when deciding whether to create a testamentary charitable remainder trust funded with an IRA. But this isn't an issue for over 99.9 percent of estates. Also, outright bequests of IRAs to charity avoid tax on the IRD. So give appreciated stock outright to family members who will get a stepped-up basis, and give the IRA and other IRD "items" to charity. The charity being tax exempt doesn't pay tax on the IRD. Other IRD items include: salary and wages earned before death but paid after death; accounts receivable; unpaid royalties; commissions and partnership income earned before death but paid after death; unpaid royalties;

payments under installment obligations paid after death; and interest or dividends earned before death but paid after death.

For death-time transfers from IRAs, there isn't a ceiling or limitation on the types of charitable donees. Thus distributions to all private foundations and public charities (including supporting organizations and donor advised funds) qualify. **To avoid IRD concerns, the gift must be properly structured.**

Advantages of IRA/Charitable Distributions:

- A gigantic additional pool of funds is available for charitable gifts.
- The over nine tenths of taxpayers who take the standard deduction—and thus can't deduct their charitable gifts—can get the equivalent of a deduction by making gifts directly from their IRAs to qualified charities. Not being taxed on income is the equivalent of a deduction.
- Itemizers who bump into the adjusted gross income ceilings on charitable-gift deductibility can use distributions from IRAs to make additional gifts. Because they won't be taxed on the distributions, they have the equivalent of additional charitable deductions.
- The carryover can be saved. Deductible gifts made in a current year are taken into account before deducting a carryover from earlier years. Making a gift from an IRA (as opposed to making a gift with other funds or assets) means that a carryover can be used in the current year.
- As adjusted gross income increases, the following benefits can be reduced or eliminated: social security; contributions to Roth IRAs; and passive activity losses and credits,
- If a donor's state income tax law doesn't allow charitable deductions (e.g., Connecticut): Making the gift from the donor's IRA to the charity can be the equivalent of a state income tax charitable deduction.

Caution. State laws differ, so check out all the ramifications in your state. For example, in some states IRA distributions directly to the IRA owners aren't subject to state income tax. A distribution from the IRA to charity thus won't save state income taxes and the donor could lose a state income tax charitable deduction that might—depending on state law—be available for a gift from the donor to the charity. Of course, consider both the federal and state tax rules. *You may have heard this before:* Do the arithmetic under various scenarios.

Reminder. It won't be a Qualified Charitable Distribution (QCD) if the IRA donor gets a chicken dinner or any other benefit. So don't fowl up an IRA distribution with a quid pro crow.

For donors not to be taxed on the IRA transfers, the donee-charity must properly acknowledge the gift from the donor's IRA. And this is **NOT** the usual receipt for gifts of other contributions to charities.

Specimen Receipt for a Gift Received from a Donor's IRA

Charity's Name and Address, Date sent to donor, Name and address of donor

Dear [donor's name]:

Thank you very much for your $ gift to [name of charity] from your Individual Retirement Account (IRA), received on [date]. This acknowledges that we received your gift directly from [Name of IRA Administrator] and that it is your intention for all or a portion of your gift to qualify as a qualified charitable distribution from your IRA under the Internal Revenue Code. Note that you may exclude the qualified gift amount from your gross income, but if you do so you may not also claim the gift amount as a charitable deduction on your 2018 tax return.

This confirms that [name of charity] is qualified under IRC §170(b)(1)(A) and that your gift was not transferred to either a donor advised fund or a supporting organization.

No goods or services were provided in consideration of this gift.

Thank you again for your gift.

Sincerely,
s/

Title Date

Retain this letter for your tax records for 2018.

As always, consult your own advisers.

Charitable Remainder Trusts: Tax Benefits <u>Now</u> for Gifts at Death
Now is a good time for charitably minded individuals to consider inter vivos charitable remainder trusts, gift annuities and gifts of life estates in personal residences and farms instead of waiting to make significant charitable gifts in their wills.

Why? Under the new tax law less than one-tenth of one percent of estates are subject to the estate tax. Thus hardly any estates get estate-tax savings for charitable bequests.

A charitable remainder trust created during lifetime gives an itemizer an income tax charitable deduction now—for the value of the remainder interest—for property that pays him (and/or another) life income before the charity gets the trust assets. The donor gets a charitable deduction now for gifts going to charity at death.

The life income can be: **(1)** favorably taxed; and **(2)** capital gains on the sale and reinvestment of appreciated assets used to fund the trust can be avoided, reduced or spread over the years.

VIII. IRA TO FUND LIFE-INCOME CHARITABLE GIFTS—PROPOSED LEGISLATION

Ask Congress to enact the Legacy IRA Act of 2019 (S. 1257). It enables middle-class individuals to continue to receive retirement income for life and provide for a charitable gift at death.

The Legacy IRA would authorize tax-free IRA rollovers for gifts that benefit charities and provide taxable retirement income—charitable life-income plans—for the donors. At the donor's death, the assets in the plan are owned outright by the qualified charity. Charitable deductions aren't allowable for amounts transferred to the life-income plans (charitable remainder trusts and charitable gift annuities). The Joint Committee on Taxation has scored this bill at only $106 million over 10 years.

The Legacy IRA Act (H.R. 1337) was introduced on March 2, 2017 by Kevin Cramer (R-ND) and Ways and Means cosponsors Earl Blumenauer (D-OR), Patrick Tiberi (R-OH), Eric Paulson (R-MN), Kristi Noem (R-SD), Randy Hultgren (R-IL), David Reichert (R-WA) and Mike Kelley (R-PA)..

An identical bill in the 114th Congress (H.R. 5171) and the 115th Congress (H.R. 1337) were in the House of Representatives were introduced.

Current law: Individuals age 70½ or older can make direct (outright) gifts from an IRA of up to $100,000 per year to public charities (other than donor advised funds and supporting organizations) and to private operating and passthrough (conduit) foundations without having to report the IRA distributions as taxable income on their federal income tax returns. A charitable deduction isn't allowable.

First enacted in 2006, this law was made permanent by the PATH Act of 2015. Direct IRA rollovers have helped American charities feed the hungry; and provide education, medical services, housing assistance, and myriad other services that Americans need.

Legacy IRA: the details:

Qualified charities under The Legacy IRA. The same donees authorized for direct outright IRA transfers to charities.

Annual ceiling on transfers from a donor's IRA for a life-income plan under The Legacy IRA: $400,000, for individuals 65 or older. For individuals 70½ or older, the combined ceiling for direct and life-income transfers from their IRAs is $400,000, with a $100,000 cap for direct transfers.

No loss to the government on Required Minimum Distributions under The Legacy IRA. The types of life-income plans assure that the annual taxable payments will generally be equal to (or greater than) what individuals must have received under the required minimum distribution rules had they kept the funds in their IRAs instead of rolling them over for charitable life-income plans.

Minimal revenue cost to the government of The Legacy IRA. Under the authorized life-income plans, the IRA owners will be taxable on income received at ordinary income tax rates. Because the payouts are 5 percent or more, there generally will be more income paid from the charitable life-income plans than under the normal minimum required distribution rules. The only authorized income beneficiaries of the life-income plans are the individual IRA owner, his or her spouse or both of them. At death, the assets in the plan go directly to the named qualified charity or charities and not to family members.

Why wouldn't IRA owners just give outright to charity (direct gifts) from their IRAs as provided under the now permanent law? Many IRA owners want to make charitable gifts, but also need retirement income. The life-income IRA rollover is a way for donors of average resources to combine charitable gifts with retirement income. Many charities have donors "standing by" to make life-income charitable gifts from their IRAs.

The Legacy IRA is a Middle-Class Charitable IRA Rollover. It allows average Americans (who meet the minimum age requirement) not just wealthy taxpayers to benefit charities.

Four-year trial for Life-Income Charitable IRAs. The provision wouldn't be permanent but be for a four-year trial period. That provides adequate time to determine the provision's efficacy.

X. OUTRIGHT AND CLAT CHARITABLE GIFTS BY PRISONERS
The lighter (heavier?) side of the law

Over a quarter a century ago, I received this letter from the librarian at the Federal Correctional Institution in El Reno, Oklahoma.

Federal Bureau of Prisons — *El Reno, OK 73036*
Federal Correctional Institutions — Brenda Bradley, Librarian

Taxwise Giving November 12, 1990
13 Arcadia Road
Old Greenwich, CT 06870

RE: LAW BOOK DONATION PROJECT

Dear Sir or Madam:

Our law library here at the Federal Correctional Institution is in desperate need of assistance. We operate on a small quarterly budget of $1500.00 and this allows us to buy only those law books mandated by the courts. However, there are many areas of the law that inmates need access to. For example, we have inmates who are going through divorces, fighting to keep visitation rights to their children and/or trying to convince the courts not to allow adoption proceedings. There are many areas of the law for which we do not have reference books and for this reason I am seeking your assistance.

I am specifically asking your company to donate one copy of each of the following titles:

Charitable Lead Trusts: Explanation, Specimen Agreements, Forms
Outright Charitable Gifts: Explanation, Substantiating, Forms

These books will be available for use by the inmates, but will remain in the law library and will not be sold or exchanged. All donations will be acknowledged on official prison stationary (sic) for IRS purposes. Please include an invoice reflecting current retail prices.

Enclosed you will find two government mailing labels that will allow you to ship your donation free of charge. Should you need more labels or have any questions about our programs, please call me at (405) 262-4875 ext. 268, between the hours of 1-5 p.m., Monday thru Thursday.

Thank you for considering us,

Brenda Bradley, Librarian

My response:

December 20, 1990

Dear Ms. Bradley:

This is in response to your letter (copy enclosed) asking for a donation of one copy of each of the following titles: Charitable Lead Trusts -- Explanation, Specimen Agreements, Forms; and Outright Charitable Gifts -- Explanation, Substantiating, Forms.

Although I am flattered that you believe my books to be helpful, I wonder whether inmates in a federal penitentiary would need books explaining the tax implications of charitable contributions. Would you be using the volumes in one of the so-called white collar correctional institutions?

Your letter states: "All donations will be acknowledged on official prison stationary for IRS purposes. Please include an invoice reflecting current retail prices."

The Internal Revenue Code limits the charitable deduction for gifts of inventory (e.g., textbooks by a publisher) to the property's cost basis (not the retail price). IRC Sec. 170(e)(1)(A); Reg. Sec. 1.170A-4(a)(1).

A special rule allows corporations meeting certain tests to get enhanced deductions for gifts of inventory – used by a charity for the ill, needy or minors – for the property's basis, plus half of the appreciation or twice the property's basis, whichever is lower. IRC Sec. 170(e)(3); Reg. Sec. 1.170-A-4A.

Your letter suggesting that the donor include an invoice reflecting current retail prices could mislead some donors into claiming larger charitable deductions than the law allows. I know that you wouldn't want your donors ending up in your correctional institutions.

Enclosed is a copy of my booklet, "A Matter of Life and Death -- a common sense guide to living wills and healthcare decisions." Perhaps that booklet would be useful to your inmates. I'd be happy to donate multiple copies of that booklet and wouldn't plan on claiming a charitable deduction.

Also, I'd be happy to donate the volumes that you requested if on reflection you believe they will serve a purpose in your library.

I look forward to hearing from you.

Sincerely,
Conrad Teitell

Not receiving an answer, I wrote the same letter to the librarian on every April 15th for several years. I finally gave up on getting an answer.

As the cliché goes. You can't make this stuff up.

One more thing. Note the librarian wrote "official prison stationary." I guess the third word in the quotation is spelled that way because the prisoners weren't going anywhere.

XI. SOCRATES ON THE NEW TAX LAW

Static and dynamic score predictors alike ignore the estimated yearly $500 billion cost of the Tax Gap's lost government revenue ($500 billion here, $500 billion there and pretty soon you're talking about real money—Everett Dirksen's analysis adjusted for inflation).

The tax gap isn't a clothing store for CPAs. It is the gulf between taxes legally owed and taxes actually collected on time. The gap is widened by illegal tax schemes and nonpayment of taxes resulting from understating income. Or income may not be reported at all—the so-called underground economy.

The tax gap also results from the overstating of deductions. Take Harold's Delicatessen, as an example. Harold reported $175,000 of income for the year. On audit, the IRS agent was satisfied that he had reported every penny of income, but the agent questioned the $90,000 travel expense deduction for trips to Europe by Harold and his wife. Harold explained, "We deliver!"

Closing the Tax Gap isn't helped by the Congress's reducing the IRS's budget.

Parthian shot. The unexamined return is not worth filing.