REPORT OF THE CHAIR

BY JUSTIN H. BROWN, ESQUIRE | PEPPER HAMILTON LLP

What a year it has been for our Section! As we prepare for our annual meeting and celebration of the year that was, I cannot help but look back upon all that we, as a Section, have accomplished this past year. Our members are the lifeblood of the Section, and this year, I am happy to report that our members have been busy building and shaping the Section for future growth and success. Here is a small sample of some of the things Section members have accomplished this year...

2019 Distinguished Pro Bono Service Award from the First Judicial District of Pennsylvania. In October, our Section was awarded the 2019 Distinguished Pro Bono Service Award from the First Judicial District of Pennsylvania for our pro bono work serving guardians of incapacitated individuals. With the help of our Elder Law and Guardianship Committee, members of our Section repeatedly offered their services to assist guardians needing help to complete annual guardianship reports in light of the new guardianship tracking system. Without the pro bono assistance of our Section members, many guardians would have been removed and would no longer be able to serve their loved ones. Special thanks to Scott Small, Heike Sullivan, Kathryn Cray, Bradley Newman, Neal Wiley, Lauren Ascher, Kelly Gastley, David Nagel, and Adrienne Hart who were specifically honored for their pro bono service and who will now be included in the Pro Bono Honor Roll of the First Judicial District of Pennsylvania.

Rules and Practice Committee. One of the most invaluable committees this year was the Rules and Practice Committee. Chaired by Neal Wiley, who was named a “Bar Star” by the Chancellor in November for his work as committee chair, the Rules and Practice Committee reviews all of the changes to the Pennsylvania Orphans’ Court Rules and other procedural rules that impact Orphans’ Court Practice and works closely with the Philadelphia Orphans’ Court to draft and revise Philadelphia’s Local Orphans’ Court Rules as necessary. If that was not enough, the Committee...
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Clockwise from top left: George C. McFarland, Jr.; Leslie Gillin Boehner, Esq.; Aaron H. Fox, Esq.; Clark D. Robertson, Esq.; Juliana Strong Karnavas, Eileen F. Carroll, Esq.

We invite you to call Leslie Gillin Boehner, Esq.
Chief Fiduciary Officer & General Counsel
610.977.0258

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RADNOR, PA
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RECENT TAXPAYER SUCCESS IN VALUING S-CORPORATION SHARES AND PARTNERSHIP INTERESTS FOR GIFT TAX PURPOSES

BY JOHN LATOURETTE, ESQUIRE, AND LISA L. NENTWIG, ESQUIRE | DILWORTH PAXSON, LLP

One of the methods used to value shares of a Subchapter S-corporation and interests in a partnership is the discounted cash flow (“DCF”) method. Using a DCF analysis, value is derived from future annual cash flows attributable to the enterprise and discounted to present value at a certain rate of return. The DCF methodology is based on an entity’s ability to generate free cash flow in the future which can be reinvested in the business or distributed to the entity’s owners.

The fair market value of such free cash flow is determined by what a hypothetical buyer is willing to pay for it. See Rev. Rul. 59-60, 1959-1 C.B. 237 (1959). A hypothetical buyer, in analyzing the value of future cash flow, would consider the tax consequences of such cash flow. A C-corporation buyer would have to account for the corporate level tax it would be required to pay on future income. Therefore, the possible purchase of an S-corporation or partnership by a C-corporation (and, therefore, the income taxes attributable to the C-corporation earnings), should be considered in the valuation. Another consideration is the income tax payable directly by the owners of the S-corporation and partnership.

When valuing shares of an S-corporation, for example, to adjust the valuation as if an S-corporation

REPORT OF THE CHAIR, CONTINUED

has taken on the monumental task of updating the Philadelphia Estate Planning Handbook (PEPH), a state-wide practice resource that provides forms, descriptions of procedures, and practice tips for practitioners in the areas of wills, trusts, estates, guardianships, non-profit corporations, and fiduciaries generally. This multi-year project, when completed, will produce one of the best state-wide Orphans’ Court and Register of Wills practice resources in the Commonwealth.

Young Lawyers Division. Thanks to our Young Lawyers Division Liaisons, Erica Russo and Alicia Berenson, for creating a new mentoring program which was kicked off this fall. Rather than a traditional one-on-one mentoring program, Erica and Alicia created mentoring groups of six to eight attorneys of varying ages, abilities, and expertise. These groups are designed to foster multi-generational participation that will set up our Section’s young lawyers for future growth and success.

Section Growth. This past year, we have made a concerted effort to attract young, new members to our Section. Our officers routinely met with young lawyers to introduce them to our Section, and our committee chairs have worked diligently to integrate these young lawyers into Section committees. Our Section members have visited local law schools to discuss career opportunities in the field of probate and trust law. The Section has offered all local law and graduate tax students showing an interest in probate and trust law with an opportunity to have a free membership to our Section. We have made our mentoring program available to any such law or graduate tax students and young lawyers who wish to participate.

I am so proud of our accomplishments this year. Without the tireless efforts of our officers, executive committee members, committee chairs, and committee members, none of the above could have been accomplished. Thank you to everyone for such a great year!
election had not been made, a two-step approach should be taken. First, the cash flow is reduced by the estimated corporate income taxes that would have been paid had an S election not been made (“tax affecting”). This is achieved by applying the C-corporation tax rate to the pre-tax income of the S-corporation. This reduces the value of the S-corporation to a C-corporation buyer. Once an S-corporation has been valued at its C-corporation equivalent value, the second step is to account for the continued tax benefit of the S-corporation election. One valuation model used to add back the value of an S-corporation is the S-corporation Economic Adjustment Model (“SEAM”). The SEAM model is based on the premise that because an S-corporation does not have to pay a corporate level income tax, the entity structure has an inherently increased value of equity because it is more advantageously taxed than a C-corporation. SEAM values the benefit of being an S-corporation and then adds that premium to the value of the S-corporation.

The Internal Revenue Service opposes tax-affecting cash flows used to value S-corporations and partnerships. Until recently, the United States Tax Court had supported that position. In Gross v. Commissioner, T.C. Memo 1999-254, aff’d. 272 F.3d 333 (6th Cir. 2001), cert. denied, 537 U.S. 827 (2002), the taxpayers gifted shares of an S-corporation to their children. In valuing the shares of the S-corporation the experts disagreed as to an allowable reduction in the corporation’s future income for hypothetical corporate income taxes. The Tax Court held that tax-affecting was inappropriate because the S-corporation did not pay corporate taxes, there was no evidence to suggest that the taxpayers would not continue as an S-corporation, and a 0% corporate tax rate was appropriate because the S-corporation had a practice of distributing all of its earnings to shareholders. The Tax Court’s ruling was later affirmed on appeal.

In Wall v. Commissioner, T.C. Memo 2001-75 (2001), Mr. Wall was the sole stockholder of Demco, Inc. (“Demco”), an S-corporation. He created 20 trusts for his children and gifted most of his non-voting common stock of Demco to the trusts and retained all of the voting stock. Both experts used an income and market approach to value the company. Both the IRS and the taxpayer’s tax experts used tax-affecting in their income approach analysis. The Court never directly addressed tax-affecting in its opinion. However, in a footnote, the Court noted that both experts’ income-based approaches probably understated Demco’s value because of the use of tax-affecting.

In Estate of Adams v. Commissioner, T.C. Memo 2002-80 (2002), Mr. Adams died owning 61.59% in WSA (an S-corporation). The sole issue before the Court was the fair market value of WSA on his date of death. The taxpayer’s expert used a 40% hypothetical corporate tax rate to reduce net cash flow. The Court rejected this approach outright citing Gross. It held “it is appropriate to use a zero corporate tax rate to estimate net cashflow when the stock being valued is stock of an S corporation.” Id. at 14.

In Dallas v. Commissioner, T.C. Memo 2006-212 (2006), Mr. Skeuse transferred 55% of the nonvoting stock of Dallas Group of America, Inc. (“DGA”), an S-corporation, to trusts established for the benefit of his sons in exchange for cash and promissory notes. The Court had to determine, for gift tax purposes, the value of the stock transferred and the value of the notes exchanged. Three experts were used (two for the taxpayer and one for the IRS). The taxpayer’s experts tax-affected the future earnings. The IRS expert did not tax-affect. The taxpayer argued that tax-affecting is appropriate because DGA could cease being an S-corporation at any time and in an actual transaction, a buyer and seller would both use tax-affecting to value DGA. The Court held that there was insufficient evidence on the record that either scenario would happen and therefore tax-affecting was not accepted.

In Estate of Gallagher v. Commissioner, 101 T.C. Memo 2011-148 (2011), Mrs. Gallagher died...
A LESSON IN MULTIGENERATIONAL PLANNING
BY ROBERT H. LOUIS, ESQUIRE | SAUL EWING ARNSTEIN & LEHR LLP

Although you might represent only the senior generation in a family, you should still consider the importance of multigenerational planning, planning that takes into account the needs and goals of several generations. Many lawyers prepare estate planning documents for several generations of a family – it is unrealistic to suppose that lawyers will tell their client’s children that they must have a different lawyer prepare their estate planning documents. But there are ethical constraints on what you can tell some family members of the plans others have made, unless there is consent given to do so. Preparing planning documents in these circumstances will be a balancing act, since different generations might have multiple ideas about what multi-generational success looks like. Whether you are only planning for the senior generation, or for younger family members as well, it is important to understand the importance of planning that seeks to combine the interests of two or more generations in a way that results in a successful family story. This type of planning includes not just wills and trusts but also shareholders agreements and partnership agreements. When lawyers advise clients on the basis of the client’s direct personal interest rather than thinking in a multigenerational way, the results may detrimental to the entire family.

And here is an example of that kind of thinking:

I was asked to serve as a mediator of a family business dispute by Jeffrey Savlov, a consultant of families in business from the viewpoint of a family therapist, based in Highland Park, New Jersey. We met with a father and son in a food distribution business that the father had inherited from his father. The father had worked in the business for 50 years and the son for 25 years. Both seemed devoted to the success of the business. The father had lost his wife in recent

VALUATION OF S CORPORATIONS, CONTINUED

owning 15% of PMG. The taxpayer’s expert tax-affect the earnings. The Tax Court disallowed tax-affecting because the taxpayer’s expert failed to give any reason for tax-affecting. The Court stated that without an explanation as to why the Court should allow tax-affecting, it was required to follow Gross.

In William A.V. Cecil, Sr., Donor, et al. v. Commissioner, Docket Nos. 14639-14, 14640-14, which is presently pending in the Tax Court, notably both the IRS and the taxpayer’s valuation experts tax-affecting the earnings of an S-corporation in their reports.

On August 19, 2019, for the first time, the Tax Court in Estate of Jones v. Commissioner of Internal Revenue, T.C. Memo 2019-101 (2019), approved tax-affecting S-corporation earnings and limited partnership earnings (at a 38% rate) in valuing those interests for gift tax purposes. The taxpayer’s expert then applied a 22% premium to the business value to reflect the benefit derived from the partnership’s and S-corporation’s relative tax-advantaged status. The Court stated that “(M)r. Reilly’s (taxpayer’s expert) tax-affecting may not be exact, but it is more complete and more convincing than Respondent’s zero tax rate.” Id. at 14. The Court, therefore, accepted tax-affecting without overruling Gross and the cases that followed Gross.

The key take-away from these cases is that tax-affecting the earnings to both reflect the possibility that a buyer could be a C-corporation and to reflect the income tax payable by the owners of the entity may be an acceptable valuation method, provided the taxpayer’s expert report properly develops the argument and a premium is added to the value to reflect the benefit of the tax-advantaged entity status. The IRS’s position of not permitting tax-affecting produces a dramatically higher valuation so the selection of the taxpayer’s valuation expert to prepare the analysis is very important.

continued on page 6
years and seemed much affected by this. He wanted to retire and move to Florida, but was unable to take the final step of turning the business over to his son. The son had worked diligently in the business and was prepared and eager to take over. In our meeting among the four of us, both father and son expressed the view that the other did not show sufficient respect for him. Interestingly, after expressing feelings of hurt and anger, when they left Mr. Savlov’s office, they hugged.

It appeared that the father and son were united in the goal of preserving and growing the business. The father wanted to retire and leave the business to the son. The son was eager to take over, but appreciated the years of work his father had put into the business. It was clear that their interests were largely in synch. Somehow, they had to get over the hurt feelings. After discussion with Mr. Savlov, I prepared a simple two-page agreement that accomplished their goals.

Unfortunately, the father took the agreement to his lawyer. The lawyer rejected the agreement, told the father to fire his son, and said he could find someone to take his place. In effect, the lawyer gave no credence to the idea of multigenerational planning, but considered only the father’s immediate personal interest. The result: the son left the business, which rapidly declined. The father died, and the business was sold for a fraction of its earlier value.

A more careful analysis of the father’s interests would have taken into account the history of the business, the long working relationship between the father and son, and the overarching desired of both parties to see the business prosper. Multigenerational planning departs from the standard process of will preparation, and it requires learning about the family’s history and goals, but the result can be a successful process over a long period of years that preserves family businesses and family wealth.
regulations differ from the proposed regulations insofar as:

1) They make clear that a SALT deduction that does not exceed the amount of the charitable gift does not reduce the federal income tax deduction. (Reg. § 1.170A-1(h)(3)(ii)(A);

2) They clarify that even if the SALT credit is provided by someone other than the donee of the gift, it is still provided “in consideration” for the gift. (Reg. § 1.170A-1(h)(3)(iii)); and

3) They provide that a 15% exception is applicable only if the taxpayer’s SALT credits received or expected to be received does not exceed 15% of the gift. (Reg. § 1.170A-1(h)(3)(vi))

LEGISLATIVE HAPPENINGS

Legislations Proposing to Return Estate Tax Applicable Exclusion to 2017 Levels for Financing Expenditures

Each of Rep. Tim Ryan (The Grants for Eliminating the Toxic Hazard of Lead in Our Towns (GET THE LEAD OUT) Act) and Sen. Martin Henrich (The Degrees, Not Debt Act of 2019) recently introduced legislation which would be financed by returning the estate tax applicable exclusion amount to its 2017 level (adjusted for inflation).

CASE

Estate Tax Lien Priority Over Partnership Terminating Distributions

The Sixth Circuit Court of Appeals recently held that an estate tax lien had priority as it relates to terminating distributions of two partnerships over any claim of the buyer. In Bennett v. Bascom, 2019 WL 4412477 (6th Cir. Sept. 16, 2019), the Court held that the government’s lien was superior to any claim of the buyer who purchased the assets of the partnerships in which the estate owned a 40 percent interest as the purchaser’s security interest was not perfected before the IRS filed its notice of lien.

PRIVATE LETTER RULINGS

GST Exemption Allocation: Substantial Compliance without Notice of Allocation

Despite the failure to attach a Notice of Allocation to a timely filed gift tax return, the IRS stated that a taxpayer who attempted to allocate GST exemption to a transfer to an indirect skip trust had substantially complied with the requirements for a valid allocation. In PLR 201936001 (Sept. 6, 2019), the IRS states that the information that was included on the gift tax return, coupled with the terms of the trust, demonstrated an intent to allocate such exemption and provided sufficient information to constitute substantial compliance.

IRA Roll Over: Allowed Despite IRA Being Initially Payable to Other Individual

The IRS recently found that a decedent’s IRA which was initially payable to a non-spouse but was retitled naming the surviving spouse as sole beneficiary in accordance with a state court order could be rolled over by the surviving spouse. In PLR 201935005 (Aug. 30, 2019), the IRS made such determination finding that since the surviving spouse was legally entitled to the proceeds and was the sole beneficiary, she was the individual for whom the account was maintained. Therefore, any distributions (other than any required minimum distribution) could be rolled over into her IRA.

The Probate and Trust Law Section has a hashtag:

#phillyprobatetrust

Please use the hashtag #phillyprobatetrust when posting on social media about news or events that might be interesting to section members!
FALL RULES AND PRACTICE UPDATE

BY NEAL G. WILEY, ESQUIRE | ALEXANDER & PELLI, LLC

The Orphans’ Court Judges wish to thank the members of the Probate Section who have volunteered their time, talent and skills to appear for hearings and render service to pro se guardians who have failed to file their inventory and/or annual reports for various reasons including but not limited to complications due to the implementation of the Guardianship Tracking System, the need for online access and reporting, the statewide inventory and report forms, and the in forma pauperis procedures.

The PA Supreme Court has approved the creation of a Governance Committee for the Guardianship Tracking System to represent the user community and “provide AOPC/IT with a uniform process for evaluating user enhancement requests in conjunction with necessary system upgrades and mandated software changes, such as those dictated by legislation and procedural rule changes.” Judge Paula Francisco Ott, Chair of the PA Supreme Court’s Advisory Council on Elder Justice in the Courts has extended an invitation to Orphans’ Court Administrative Judge Matthew D. Carrafiello and Maryanne Huha Finigan, Esquire, Senior Law Clerk to Judge Matthew D. Carrafiello to join the Governance Committee. They have both accepted.

The Supreme Court Rules Committee has proposed changing the name and citation format of the Pennsylvania Orphans’ Court Rules from the current “Pennsylvania Orphans’ Court Rules” cited as “Pa.O.C. Rule ___,” to “Pennsylvania Rules of Orphans’ Court Procedure,” cited as “Pa.R.O.C.P. ___.”

The AOPC is considering recommending to the Supreme Court that the Case Record Public Access Policy be amended so that counties can no longer permit filers to submit pleadings with confidential information in redacted/unredacted form, instead requiring them to file redacted pleadings and a separate Confidential Information Form. Locally, Philadelphia and Montgomery Counties currently permit redacted/unredacted filings.


Thanks as always to the Philadelphia Orphans’ Court judges and staff for their input.

JOIN A COMMITTEE

The Section’s committees depend on the steady flow of people, energy and ideas. Join one!

Contact the Section Chair:

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One South Broad Street
Philadelphia, PA 19107
267.321.7122
Scott.Small@wellsfargo.com
ANTI-CLAWBACK REGULATIONS
BY LANCE LACHEEN, ESQUIRE | KMS LAW OFFICES, LLC

Introduction

The 2017 Tax Cut and Jobs Act increased the lifetime gift/estate tax exclusion significantly to $11.4 million adjusted for inflation in 2019.¹ This increase is set to sunset, unless renewed, as of January 1, 2026, reducing the exclusion to $5 million CPI adjusted.² The 2017 Act directed the Treasury to prescribe regulations, necessary, to address the difference in the exclusion amount at the time of a gift, when current law is in effect, and the exclusion amount at the time of death.³ This is what is known, colloquially, as the “clawback” problem. A clawback problem occurs when the basic exclusion amount in effect at the time of the donor’s gifts, has decreased at the donor’s death.

In response, the Treasury and the IRS have proposed regulations ("the anti-clawback regulations") that foreclose the IRS clawback of transfer taxes on gifts/transfers made before 2026.⁴ The proposed regulations would allow the estate to use the exemption amount relied on at the time of the gifts to be used as a credit at the time of death as opposed to the then current credit amount. These regulations were proposed in 2018 and have not been promulgated to date.

II. Three possible problems presented to the IRS that after examination, the IRS concludes an issue does not exist

Treasury analyzed three situations in which it concluded that no potential problem exists as a result of the increased exemption. Treasury found that a problem existed only as to the fourth problem it examined; and that was the issue that the proposed regulations seek to resolve.⁵

III. The Claw Back Problem

The fourth situation that Treasury addresses is the clawback situation.⁶ Taxpayers are concerned that if they make gifts relying on the current high exemption amounts during lifetime and die after the exclusion sunsets, that their estates will owe tax on the excess amount of the gift over the then lower exemption. Essentially, the government would be “clawing back” a tax on large gifts that the taxpayer made expecting to pay no tax. To better illustrate the claw back that will occur without regulations let’s assume that taxpayer made a gift in 2019 of $11.18 million and dies after the current exemption sunsets in 2026 with no applicable deductions and a gross estate of $1 million:⁷

ESTATE TAX: DECEDED DIES AFTER SUNSET

<table>
<thead>
<tr>
<th>Makes no other gifts. Assume a rate of 40%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Estate</td>
</tr>
<tr>
<td>Less deductions</td>
</tr>
<tr>
<td>Taxable Estate</td>
</tr>
<tr>
<td>Plus: post 1976 taxable gifts</td>
</tr>
<tr>
<td>________________________________________</td>
</tr>
<tr>
<td>Total Transfers subject to tax</td>
</tr>
<tr>
<td>Tentative Tax on total transfers</td>
</tr>
<tr>
<td>Less: gift tax paid on gifts post 1976</td>
</tr>
<tr>
<td>Tentative tax on estate</td>
</tr>
<tr>
<td>________________________________________</td>
</tr>
<tr>
<td>Less credits for: where the problem happens</td>
</tr>
<tr>
<td>Unified credit</td>
</tr>
<tr>
<td>Total credits against tax</td>
</tr>
<tr>
<td>________________________________________</td>
</tr>
<tr>
<td>Estate Tax:</td>
</tr>
</tbody>
</table>

Taxpayer would pay essentially no tax on the gift in 2018. In 2026, when taxpayer dies, taxpayer’s estate calculates the total transfers made during life, then adds the gross estate to arrive at “total transfers subject to tax” ($12,165,000). Next, taxpayer’s estate calculates the tax on not only the gross estate, but on the total transfers made ($4,866,000 assuming a rate of 40%).

continued on page 10
The next step is where the claw back problem occurs. Taxpayer, on line 9 of Form 706, enters the unified credit amount available to the estate at the time of death. Since taxpayer died after the exemption was reduced, the unified credit is reduced to an inflation adjusted $2,117,800 instead of $4,417,800, which was the exemption when taxpayer made the gift. Since the tax is calculated on the total transfers made during lifetime and at death, the unified credit is not enough to shield the estate from tax, and subjects taxpayer’s estate to tax on the gift made in 2018. This is the claw back problem.

Assuming taxpayer died in 2025, taxpayer would owe less tax:

**Estate Tax: Decedent Dies Before Sunset in 2025**

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Estate</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Less deductions</td>
<td>$0</td>
</tr>
<tr>
<td>Taxable Estate</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Plus: post 1976 taxable gifts</td>
<td>$11,165,000</td>
</tr>
<tr>
<td><strong>Total Transfers subject to tax</strong></td>
<td>$12,165,000</td>
</tr>
<tr>
<td>Tentative Tax on total transfers</td>
<td>$4,866,000 (40% of $12,165,000)</td>
</tr>
<tr>
<td>Less: gift tax paid on gifts post 1976</td>
<td>($48,200)</td>
</tr>
<tr>
<td><strong>Tentative tax on estate</strong></td>
<td>$4,817,800</td>
</tr>
</tbody>
</table>

Less credits for: where the problem happens

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unified credit</td>
<td>$4,417,800</td>
</tr>
<tr>
<td>Total credits against tax</td>
<td>$4,417,800</td>
</tr>
</tbody>
</table>

**Estate Tax:** $400,000

In this scenario, taxpayer has used up his or her exemption amount when making the substantial $11.18 million gift in 2018 but can apply a larger unified credit of $4,417,800. Here, taxpayer owes $400,000 on the gross estate of $1 million but owes no tax on the gift made in 2018. Taxpayers owes less because taxpayer died in 2025, not 2026.

**IV. The Proposed Regulations Fix for Claw Back**

The proposed regulations provide a rule that allows the estate to compute its estate tax credit using the higher of the exemption amount at the time of death or the exemption applicable when the gifts were made during life. In determining the unified credit for estate tax purposes, the credit attributable to the basic exclusion amount (“BEA”) portion of the applicable exclusion amount (“AEA”) is (i) the credit attributable to the BEA at the date of death, or if larger, (ii) the sum of the amounts attributable to the BEA allowable in computing the gift tax payable on the decedent’s post-1976 gifts, whether or not included in the gross estate (but for any particular year, not exceeding the tentative tax on gifts during that year). The proposed regulations provide the following example:

If a decedent had made cumulative post-1976 taxable gifts of $9 million, all of which were sheltered from gift tax by a BEA of $10 million applicable on the dates of the gifts, and if the decedent died after 2025 when the BEA was $5 million, the credit to be applied in computing the estate tax is that based upon the $9 million of BEA that was used to compute gift tax payable. In this example, taxpayer’s estate would adjust the unified credit on line 9 of Form 706 to account for the $9 million gift made between 2018-2025. Since the tentative tax on $9 million exceeds the credit at the time of death, which is based on an inflation adjusted $5 million, the credit applied is based on an exemption of $9 million instead.

To further understand the proposed regulations approach, let’s assume taxpayer makes a gift of $11.18 million in 2018 during the period with a higher exemption, sheltering the gift from tax. Further, let’s assume continued on page 11
taxpayer dies in 2026 when the exemption amounts have gone back down to $5 million, and let’s assume an estate tax rate of 40%. Taxpayer made no additional gifts after 2018 before 2025 and has no applicable deductions. Taxpayer dies with a gross estate of $1 million and assume the proposed regulations have promulgated:

**Estate Tax: Decedent Dies After Sunset in 2026 with Proposed Regulations in Effect**

<table>
<thead>
<tr>
<th>Gross Estate</th>
<th>$1,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less deductions</td>
<td>$0</td>
</tr>
<tr>
<td>Taxable Estate</td>
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<tr>
<td>Unified credit</td>
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</tr>
</tbody>
</table>

The unified credit to be placed here in 2025 and in the absence of the proposed regulations would be $2,117,800. However, since taxpayer made a gift of $11.18M during the higher exemption period, and the unified credit used at that time exceeds unified credit at death, taxpayer can apply a credit used in computing gift tax on the $11.18M gift.

| Total credits against tax | $4,417,800 |
| Estate Tax: | $400,000 |

**Problems that the proposed regulations do not address**

**a. Inflation Adjustments**

Every year, the exemption amount is adjusted for inflation. The proposed regulations do not address a situation that could occur where a taxpayer loses the benefit of inflation adjustments if the exemption decreases back to $5 million.12

Presumably, inflation adjustments continue from 2018 up until the law expires in 2025. As a result, the exemption amount in 2025 is greater than the exemption amount in 2018. Possibly, inflation adjustments that taxpayer could have benefited from between 2018-2025 are lost after the exemption sunsets. Therefore, if clients want to take advantage of inflation they should make gifts when the exemption is at its highest point before sunset; 2025.

**b. Will a Donor’s gift come off the top of the larger exemption amount?**

The proposed regulations do not address whether gifts made during the period where the exemption amount is $10 million adjusted for inflation “come off the top” of the $10 million exemption.13 To illustrate, if a donor makes a $5 million gift between 2018-2025, and the donor dies when the exemption amount is reduced to $5 million, will the donor be treated as having used his or her $5 million exemption, or will the donor have an additional $5 million exemption to use towards his or her estate because the $5 million gift came off the top of the larger exemption amount in effect at the time of the gift? The Treasury could promulgate regulations that answer this question. In the meantime, it is safe to assume that gifts will not “come off the top” of the larger exemption amount. If taxpayers do not take advantage of the full exemption amount between 2018-2025, they lose the benefit.

**c. Portability**

The 2010 Tax Act introduced portability and the American Taxpayer Relief Act in 2012 made portability law.14 Portability allows the surviving spouse to inherit the deceased spouse’s unused exemption amount. A deceased spouse’s unused exemption amount (“DSUE”) is the lessor of (1) the applicable exclusion amount in the year of death or (2) the applicable

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continued on page 12
exclusion amount of the surviving spouse’s last deceased spouse over the combined amount of the deceased spouse’s taxable estate plus adjusted taxable gifts.\textsuperscript{15} Today, if an estate of a decedent elected portability to the decedent’s surviving spouse (who has not made any lifetime gifts that reduced the DSUE), a spouse would be able to port $11.4 million.

The proposed anti-clawback regulations do not address how a possible sunset of the current exclusion amounts will affect portability. The issue arises if the first spouse dies before the 2026 sunset, when the exclusion amount was an inflation adjusted $10 million and the second spouse dies after the exclusion amount is back to an inflation adjusted $5 million. In this situation, will the DSUE be from the first deceased spouse remain at the higher $10 million, or will it be adjusted to the exclusion amount when the second spouse dies, $5 million?\textsuperscript{16}

The IRC defines the DSUE as the lesser of (1) the applicable exclusion amount in the year of death or (2) the applicable exclusion amount of the surviving spouse’s last deceased spouse over the combined amount of the deceased spouse’s taxable estate plus adjusted taxable gifts.\textsuperscript{16} When the statute refers to “basic exclusion amount” in Section 2010(c)(4), it is unclear whether this is the exclusion amount at the prior deceased spouse’s death or at the death of the spouse who utilized portability. Regulation Section 20.2010-2(c)(1) is clear that it is the exclusion amount of the deceased spouse and not the surviving spouse that limits DSUE.\textsuperscript{17}

The regulations define the DSUE amount as the lesser of two amounts, one of which is the exclusion amount in effect in the year of the death of the decedent, but unlike the statutory language, the regulations discuss the decedent and the surviving spouse, so the regulation makes clear that the DSUE is the exclusion amount for the first spouse to die at his or her death.\textsuperscript{18} Regulatory provisions with regard to portability are viewed expansively and are very taxpayer friendly.\textsuperscript{19} Although nothing in the proposed anti-clawback regulations seem to change the result in the current portability regulations, there remains an ambiguity in the statute. The American Society of CPA’s submitted a letter to the IRS dated February 15, 2019 asking the IRS to clarify how the anti-clawback regulations will affect the portability issue and whether the DSUE will be based on the amount of the exclusion when the first spouse dies or when the surviving spouse dies.\textsuperscript{20}

\textbf{VI. Conclusion}

The Treasury’s proposed regulations adequately solve a typical claw back problem. The proposed regulations do not address whether a taxpayer will lose the benefit of inflation or whether a taxpayer’s gifts will be “off the top” of the larger exemption amounts at the time of the gift or portability.

Not addressing portability is problematic. If the first spouse dies before the 2026 sunset, when the exclusion amount was an inflation adjusted $11 million and the second spouse dies after the exclusion amount is back to an inflation adjusted $5 million, will the DSUE be from the first deceased spouse remain at the higher $11 million, or will it be adjusted to the exclusion amount when the second spouse dies, $5 million? This question raises uncertainty.

It is vital that the government give taxpayers confidence to make decisions, especially when our tax laws change so frequently. Throughout our tax history, the exemption amounts have never decreased. It is possible the law will not sunset in 2026 as this paper assumes. If the law sunsets in 2026, tax law will find itself in unchartered waters. These proposed regulations are an attempt to mitigate the consequences. If we cannot be sure of anything else, it is certainly an interesting time to be representing clients in the Trusts and Estates field.
Section 11061 of the Tax Cut and Jobs Act of 2017 amended IRC § 2010(c)(3).

Id.

Section 11061 of the Tax Cut and Jobs Act of 2017 added IRC § 2001(g)(2).

Proposed Reg. §20.2010-1(c)(2).

Id.

Section 11061 of the Tax Cut and Jobs Act of 2017 added IRC § 2001(g)(2).

For simplification, I will assume a rate of 40% tax on the first dollar over the allowable exemption instead of using the rate tables that have progressive rates for the first $1 million of taxable gifts/estate. When making gifts, a taxpayer can take advantage of an annual exclusion. The annual exclusion is an amount that a taxpayer can gift any individual free of tax within a given tax year. A taxpayer can gift up to this amount tax free to an unlimited number of donees. Currently, the annual exclusion is $15,000 and continues to be adjusted for inflation.

The unified credit amount can be found in the instructions to Form 706. IRC § 2505(a)(1) requires the determination of a credit equal to the credit in IRC § 2010(c). IRC § 2505(a) requires that the total credit allowable be subtracted from the net tentative gift tax.


Id.

Id.


Akers, Supra at 10.

IRC § 2032A. IRC § 2010(c)(4).

RC § 2010(c)(4).

Id.

Akers, Supra at 11.

20.2010-2(c)(1), see also, Akers, Supra at 10.

Akers, Supra at 11.

Id.
The PEPC invites the Philadelphia Bar Association Probate and Trust Law Section to join our Council for membership and programming

October Luncheon Program
Tuesday, October 22, 2019
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: “Sustainable Investing”
Speaker: Casey Jojic, UBS

November Luncheon Program
Tuesday, November 19, 2019
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: “Unwinding an Unworkable Transaction with a Workable Policy – Dealing with ILITs, Split Dollar Agreements and Closely-Held Business or Business Owner Owning a Policy”
Speaker: Todd Steinberg, Loeb & Loeb LLP

Holiday Celebration
Wednesday, December 4, 2019
5:30 p.m. – 7:30 p.m.
JG Domestic
2929 Arch Street, Philadelphia, PA

For more information on joining the Philadelphia Estate Planning Council or to register for any upcoming programs, please visit www.philaepc.org.
On July 17, 2019, the Uniform Law Commission (ULC) approved the Uniform Electronic Wills Act. Since 2000, the Uniform Electronic Transactions Act (UETA) and a similar federal law, E-SIGN, have provided that a transaction is not invalid solely because the terms of the contract are in an electronic format. But UETA and E-SIGN both contain a specific exception for wills, which must still be executed on paper in most states. However, a society that banks online, shops online, and communicates online also expects to find legal services online, and a body of law that prevents the execution of an electronic will is increasingly viewed as anachronistic.

The Act aims to bridge that gap, allowing a testator to execute a will electronically, while retaining adapted versions of the traditional wills act formalities of writing, signature and attestation. Under the Act, the electronic will must be signed in the physical presence of the requisite number of witnesses (normally, two), or, in the states that opt to allow it, in their “virtual” presence. Additionally, the Act requires that a will must exist in the electronic equivalent of text if it is electronically signed, thus precluding audio and video wills, unless transcribed prior to the testator’s signature.

The ULC’s Electronic Wills Committee believes that the harmless error doctrine, which gives the judiciary latitude to uphold wills in the face of deficient execution procedures, is of increased importance in an age of self-helpers. Thus, Section 6 of the Act adopts the harmless error doctrine even though at present it is in effect in only 11 states. The Act provides that electronic wills, like traditional ones, can be revoked effectively with a revocatory act or a subsequent will or codicil. Although it may prove harder to unambiguously revoke an electronic will by physical act (because, in part, there can be an infinite number of identical originals), courts will ultimately be responsible for determining the intent.

The direct impact of electronic wills on the legal profession will take time to unfold, both in the states that do and the states that do not adopt the Act’s model language. In some ways, the statutory recognition of electronic wills merely continues the digital commoditization of basic estate planning documents that began when the first online provider offered testators an opportunity to draft their own wills without direct attorney supervision. But, it is also clear that the use of electronic wills, both by practicing attorneys and online providers, will likely be a bigger catalyst to the changing legal marketplace than any single advancement in recent memory.
ETHICS COLUMN
BY TIMOTHY J. HOLMAN, ESQUIRE | SMITH KANE HOLMAN, LLC

What ethical considerations arise when you are approached to represent Co-Executors, one of whom previously served as Decedent’s Agent under Power of Attorney?

Before agreeing to represent two or more individuals (or one or more individuals and a corporate fiduciary) as co-executors, you must ensure that your potential clients’ interests are aligned and consider the resulting ethical implications if their interests diverge. Can you zealously represent those clients consistent with your ethical obligations? In this column, I will explore one common and recurring ethical dilemma – representing two or more co-executors when one served as Agent under a Power of Attorney for the Decedent.

When an attorney represents co-fiduciaries, some amount of disagreement may inevitably occur between them. This implicates Pennsylvania Rule of Professional Conduct 1.7(a), which provides that a lawyer shall not represent a client if there is a concurrent conflict of interest, i.e., if the representation of one client will be directly adverse to another client, or if there is a significant risk that the representation of one client will be materially limited by the attorney’s responsibilities to another client, a former client or third person, or by the personal interest of the lawyer.

Notwithstanding the existence of a concurrent conflict of interest, a lawyer may still represent a client if: a) the lawyer reasonably believes that she will be able to provide competent and diligent representation to each affected client; b) the representation is not prohibited by law; c) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and d) each affected client gives informed consent. Pa. R.P.C. 1.7(b).

Consider the following all too common hypothetical: H and W, husband and wife, lived with H’s father, F, for 5 years before his death. During those five years, H served as F’s Agent under Power of Attorney. F’s other child (and fifty percent remainder beneficiary), C, lives far away. During the last 5 years of F’s life, H and W spent more than one hundred thousand dollars of F’s money on food, clothes, travel and entertainment for themselves, and never kept receipts or invoices of their expenditures of F’s money. Upon F’s death, F’s Will named H to serve as co-executor of his estate with Bank. Bank and H ask Lawyer to represent them in administering the estate. Can Lawyer properly represent them both, and what ethical issues and conflicts does the dual representation present?

When clients like H and Bank walk in your door, you must ask them relevant questions to fully understand whether they have conflicts of interest and the degree of those conflicts. Among the first questions every estate administration counsel should ask potential executor clients is whether anyone served as Agent under a Power of Attorney for Decedent, because the Agent’s actions may have materially impacted (typically by reducing) the opening value of the Estate. After learning that H served as F’s Agent, Lawyer should inform H that he could be required to file an Account as Agent. Then Lawyer should ask, “If asked to file an Agent’s Account, will you be able to create such an Account and do you have documentary support to show that all of the transactions you entered into as Agent were for the benefit of the Principal?” By asking these questions, and insisting on obtaining truthful answers, you can gather the necessary information to evaluate

1 Special thanks to Daniel R. Boose, Esquire for his assistance in preparing this column.
whether the conflict of interest between your clients is tolerable or intolerable.

Under the facts set forth in our hypothetical, Lawyer cannot properly or ethically represent both Bank and H because Bank, as co-executor, has a fiduciary duty to compel H to file an Agent’s Account, and then to seek an appropriate surcharge against H as former Agent for F. Lawyer cannot represent both Bank and H zealously, because Bank and H have completely divergent interests: Bank should seek to surcharge H, and H will (typically) wish to defend the surcharge action by attempting to justify H’s expenditures of F’s assets. Lawyer cannot advise both Bank and H without violating Pa. R.P.C. 1.7(a)(1), which states that a lawyer shall not represent a client if the representation involves a concurrent conflict of interest.

Notably, the ACTEC Commentary on Model Rule of Professional Conduct 1.7 states that “a lawyer may represent co-fiduciaries whose interests do not conflict to an impermissible degree. A lawyer who represents co-fiduciaries may also represent one or both of them as beneficiaries so long as no disabling conflict arises.” ACTEC Commentary on MRPC 1.2, p. 102 (5th ed. 2016). The ACTEC Commentary also states, “[t]he lawyer also must bear this concern in mind as the representation progresses: What was once a tolerable conflict at the outset may develop into one that precludes the lawyer from continuing to represent one or more of the clients.” ACTEC Commentary on MRPC 1.7, p. 103 (5th Ed. 2016).

Under our hypothetical, when Bank and H asked Lawyer to jointly represent them despite H’s dubious history as Agent under Power of Attorney, the conflict was not tolerable at the outset, and it was foreseeable that the conflict would grow worse with time.

Even if Bank and H do not yet appreciate that an “actual conflict” exists (perhaps Bank does not yet know enough about the underlying facts to conclude that H acted improperly) the “potential conflict” between them prevents Lawyer from representing them simultaneously as Co-Executors. Indeed, “[t]he test of whether an attorney has conflicting interests so as to preclude his representation of a party is not actuality of conflict, but possibility that a conflict may arise.” Middleberg v. Middleberg, 427 Pa. 114, 223 A.2d 889 (1967).

Is Lawyer’s conflict waivable, you may ask? No – Lawyer cannot provide competent and diligent representation to both Bank and H under our hypothetical, because the representation will properly involve the assertion by Bank of a surcharge claim against H in his capacity as Agent, which violates Pa. R.P.C. 1.7(b).

What ethical considerations arise when you are approached to represent a sole Executor who formerly served as Decedent’s Agent?

What if H is the sole executor, however? Could Lawyer represent H in both his capacity as Executor and former Agent? With regard to such “dual capacity representation,” whether Executor/former Agent or Executor/Beneficiary, ACTEC’s Commentary to Model Rule of Professional Conduct 1.7 states, “[s]o long as there is no risk that the decisions being or to be made by the client as a fiduciary would be compromised by the client’s personal interest, such a “dual capacity representation” poses no ethical problem …. [A] lawyer asked to undertake such a dual capacity representation should explain to the client the nature of the fiduciary role and insist that the client execute an informed waiver of any right to have the lawyer advocate for the client’s personal interest in a way that is inconsistent with the client’s fiduciary duty. If the client is not willing to do this, the lawyer should decline to undertake the dual capacity representation. If such a dual capacity representation has been undertaken and no such waiver has been obtained, and such a conflict arises, the lawyer should withdraw from representing the client in both capacities.” ACTEC Commentaries on the Model Rules of Professional Conduct, p. 107 (5th Ed. 2016).
Before Lawyer agrees to represent H in both capacities, she should ask the necessary questions and perhaps review relevant financial documents to understand whether H can justify his conduct as Agent, and to understand the nature of H’s service as Agent. If Lawyer were to represent H in both his capacity as Executor and Agent, Lawyer should inform the other estate beneficiary, C, of the dual representation. Under our hypothetical, upon learning from H that H will be unable to provide required evidentiary support for H’s large expenditures of F’s funds while serving as Agent, Lawyer should advise H to obtain independent counsel to represent him as Agent. H’s duty to maximize the value of the Estate and/or to make the Estate whole conflicts with H’s personal interest to avoid surcharge. Lawyer would be wise to advise H to resign as Executor if it appears that H’s personal interests in avoiding surcharge for his misconduct as Agent give rise to an intolerable conflict with his fiduciary duties as Executor.

In the above hypotheticals, it is important to remember that a critical step in meeting your ethical obligations is to ask your potential clients questions about their previous fiduciary roles for the Decedent so that you can properly evaluate the nature and extent of any conflict of interest.

The Court then turned to the agent’s Dead Man’s Rule argument. The Court summarized the Rule, stating that “when one party to a transaction or thing is dead and his interest has passed to a party of record, the person with the adverse interest is incompetent to testify as to any matter offering before death.” The estate of the decedent holds the interest. His personal representative is the person of record to assert the protection of the Dead Man’s Rule.” Here, the
Court noted that the agent was being sued in her capacity as agent (not as executor), and the decedent’s estate was not a party. Therefore, she could not assert the Dead Man’s Rule. The Court likened the action to disputes over the recovery of proceeds of life insurance on a decedent’s life, which “would not in any way be a benefit or a detriment to the estate of [the decedent]. Consequently, persons claiming insurance proceeds against designated beneficiaries or, by the same logic, retirement accounts are not witnesses adverse to any rights of the deceased so as to render them incompetent to testify.”

Even if the Dead Man’s Rule could apply, the Court concluded that the agent did not specify “which witnesses are being referred to and what their violative testimony was anticipated to be.”

The agent also argued that the one-year statute of limitations had run to present a claim against the decedent’s estate. The Court noted, again, that this was not a claim against the decedent’s estate; it was against the agent. Furthermore, the Court stated that the statute of limitations against an estate was not one year – the statute of limitations for personal injury claims is two years, and the statute of limitations for breach of contract is four years, and that “does not change when the matter is brought in the Orphans’ Court.” The Court did note that if the statute of limitations on a claim against a decedent would expire within one year of the decedent’s death, then pursuant to 20 Pa. C.S. §3383 the statute is extended to one year after the death of the decedent.

Finally, the agent argued that the Court lacked subject matter jurisdiction because the IRA was governed by ERISA. The Court stated that this fact was not in the record (either in the petition or the preliminary objections), and could not be considered. Even if it could be considered, the Court concluded that it still had jurisdiction to review the actions of the agent under 20 Pa. C.S. §§ 711(12), (17) & (22) and 5610.

Accordingly, the Court dismissed the preliminary objections.
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