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Tax News & Comment

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IRS Matters

Recent Developments

National Taxpayer Advocate Nina Olson released her annual report urging Congress to simplify the Code and lessen the burden on taxpayers who cannot meet their tax obligations. The report noted that "[i]f tax compliance were an industry, it would be one of the largest in the United States," since businesses and individuals spend 7.6 billion hours annually in compliance, at an annual cost of $193 billion, which equals 14 percent of tax revenues collected.

Two examples of complexity cited were the AMT and the legion of Code provisions governing savings for education and retirement. The report concluded that levy and seizure are less

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From The Courts

2008 Valuation Cases of Note

The Tax Court approved "tiered" discounts in *Ashford v. Com'r.*, T.C. Memo, 2008-128. A family limited partnership owned a 50% general partnership interest in another partnership which owned Minnesota farmland. The 50% interest was noncontrolling, since neither 50% general partner could act unilaterally. Although the IRS argued that valuation discounts below the top tier or "parent" entity were not appropriate, the court allowed both lack of control and lack of marketability discounts at both levels. Combined discounts were 30% for the general partnership interest and 35% for the limited partnership interest.

In *Bergquist v. Com'r.*, 131 T.C.

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From Washington

Senate Approves President's Stimulus Plan

Tax Analysis

Stating that the nation is mired in "an economic crisis as deep and dire as any since the days of the Great Depression," President Obama introduced $838 billion legislation that provides more than $350 billion in tax cuts, and spending in areas such as health care, education, energy and highway projects. The Senate vote of 61-36 included three northeast Republicans. The House and Senate will now reconcile the bill.

The bill also funds unemployment compensation, health care, and food stamps. House Ways and Means had earlier approved $500 in rebates for many workers, and $1,000 for millions of

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Use of Disclaimers in Pre and Post-Mortem Estate Planning

Estate Planning

I. Introduction

Disclaimers can be extremely useful in estate planning. A person who disclaims property is treated as never having received the property for gift, estate or income tax purposes. This is significant, since the actual receipt of the same property followed by a gratuitous transfer would result in a taxable gift. Although Wills frequently contain express language advising a beneficiary of a right to disclaim, such language is gratuitous, since a beneficiary may always disclaim.

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Modifying or "Decanting" Irrevocable Trusts

I. Introduction

Despite the best efforts of drafters to contemplate unforeseen circumstances, situations arise where dispositive trust provisions may not reflect the present circumstances of beneficiaries. If the trust is revocable, and the grantor is alive, the grantor may revoke or amend the trust. However, trusts are often made irrevocable for tax or asset protection purposes. In those cases, revoking the trust, while not impossible, may be extremely difficult, especially if minor beneficiaries are involved.

Under the Uniform Trust Code, a noncharitable irrevocable trust may be

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February Comment

General Power of Appointment Can Neutralize Estate Tax

Estate Planning

A general power of appointment is power of appointment that is exercisable in favor of the donee, the donee's creditors, or the creditors of the donee's estate. Under IRC § 2042, the value of property over which the donee possesses a general power of appointment at death is included in the donee's estate.

In situations where spouses have vastly unequal estates, the prudent use of a general power of appointment can avoid wasting the $3.5 million applicable exclusion amount, and in so doing, save more than $1.5 million in estate taxes.

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FROM WASHINGTON, CONT.

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couples, many of whose earnings are so low they pay no federal income tax. The first of these credits would be distributed in 2009 based on filed 2007 tax returns. The measure, which Republicans criticized, survived Senate negotiations, albeit with a lower income phaseout threshold.

Republicans had criticized the bill as providing too many long-term spending programs unlikely to provide jobs or increase consumer spending. Three northeast Republicans, Susan Collins (Maine), Arlen Specter (Pa), and Olympia Snowe (NH), joined 58 Senate Democrats — enough to withstand a Republican filibuster — in agreeing to trim $100 billion from the original bill. $40 billion of that would have reached state governments.

The "Make Work Pay" payroll tax holiday proposed by Mr. Obama was also trimmed in the final Senate version, as was an expansion of the child tax credit for the working poor. Senate Republicans were successful in adding measures (i) providing all homebuyers with tax credits of up to $15,000; (ii) providing small tax credits for new car purchases; and (iii) allowing corporations to carry back current losses against earlier years' profits.

* * *

Given the state of the economy, few now believe that the President will seek to accelerate into 2009 the 36 percent and 39.6 percent income tax rates that are scheduled to return after 2010. Mr. Obama is also said to favor retaining the 15 percent capital gains rate — at least for now. However, higher income individuals may pay more employment taxes in 2009, as Mr. Obama has called for a "payroll surtax" of up to four percent on compensation in excess of $250,000.

President Obama has expressed support for other tax legislation that would provide relief to lower and middle income taxpayers, including (i) a 10 percent mortgage interest credit for nonitemizers; (ii) an expansion of the earned income credit; (iii) an increase in education credits; (iv) an increase in the child credit; and (v) a tax break that would effectively eliminate federal income tax for retirees who income is less than $50,000 per year. *One unanswered question under Mr. Obama's planned tax relief for retirees is whether capital gains and required minimum distributions from retirement accounts would affect the $50,000 threshold. Another question is whether partial relief would be available for those whose income is above $50,000.*

Given the record federal budget deficit, elimination of the AMT appears remote. Mr. Obama appears to support a permanent annual inflation-adjusted "patch". The current legislation contains a $64 billion AMT "patch" for 2009. *If the 36 percent and 39.6 percent income tax rates return in 2011, fewer higher-income taxpayers will be subject to the AMT because of their higher regular tax liability.*

Under EGTRRA, the estate tax applicable exclusion amount reached $3.5 million on January 1, 2009, with a maximum tax rate of 45 percent. President Obama favors retaining this exclusion amount, as well as the 45 percent rate, permanently. According to Mr. Obama, this proposal would result in only 0.3 percent of estates being subject to the estate tax, and would reduce by 84 percent the number of taxable estates compared to 2000. Despite the reduced incidence of estate tax, Mr. Obama has expressed no support for eliminating the step up in basis for property acquired from an estate, which was an unpopular component of the earlier legislation which eliminated the estate tax for the year 2010.

President Obama favors providing assistance to homeowners faced with foreclosure. He has proposed lenders temporarily delaying foreclosures for 90 days. Mr. Obama also sup-

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GENERAL POWERS OF APPOINTMENT, CONT.

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To illustrate, assume one spouse has an estate worth $7 million, and the other spouse has an estate worth only $0.05 million. If poorer spouse dies first, virtually the entire applicable exclusion amount of the poorer spouse will be wasted. Upon the death of richer spouse, that spouse's estate may be subject to significant estate taxes, since only $3.5 can currently be shielded from estate tax.

The traditional solution to this problem has been to "equalize" estates before the death of either spouse. If richer spouse were to transfer $3.5 million to poorer spouse either by outright gift or by lifetime QTIP trust under IRC §2523(f), the estate tax problem would be solved, since regardless of which spouse died first, the applicable exclusion amount would be sufficient to avoid the imposition of estate taxes. However, richer spouse may be reluctant or unwilling to make such a large lifetime transfer to poorer spouse. Thus, exposure to a large estate tax liability could be eventuate.

Another solution involves the use of a testamentary general power of appointment. Employing this technique, richer spouse grants to poorer spouse a testamentary general power of appointment over so much of richer spouse's estate as is equal to poorer spouse's unused applicable exclusion amount. In the example, richer spouse would grant to poorer spouse a testamentary general power of appointment equal to $3.45 million (*i.e.*, $3.5 million applicable exclusion amount less $0.05 million estate of poorer spouse). The testamentary general power of appointment would be conferred upon poorer spouse by virtue of a revocable testamentary trust executed by richer spouse during his lifetime. Being revocable in nature, the power could be revoked by richer spouse at any time before the death of poorer spouse.

Note that if richer spouse were to die first, the problem requiring the use of the general power of appointment will not arise: Richer spouse could simply leave to poorer spouse an amount equal to $3.5 million — either outright or in a QTIP trust. Richer spouse would still have available his own $3.5 million exemption, and upon the eventual death of poorer spouse, that spouse's estate will have been augmented so that it can utilize that spouse's own $3.5 million exemption.

However, if poorer spouse dies first, the general power of appointment conferred upon her will result in her estate being increased by an amount equal to the difference between the applicable exclusion amount and her estate, so that the poorer spouse's entire $3.5 million exemption amount would be utilized. The general power of appointment exercised by poorer spouse at death could even fund a credit shelter trust which would benefit richer spouse during his lifetime.

By utilizing this technique, the estates of both spouses have been equalized, and richer spouse has not been required to part with dominion or control over any assets until the death of poorer spouse. Moreover, even at the death of poorer spouse, at which time richer spouse will be divested of dominion and control by reason of the testamentary exercise of the power of appointment by poorer spouse, richer spouse may still continue to benefit from the assets, since those assets could fund a credit shelter trust benefiting richer spouse during his lifetime.

[Note: Although the credit shelter trust may be drafted to liberally provide distributions to richer spouse during his lifetime, it may not go so far as to give richer spouse an unrestricted right to appoint trust assets to himself or others (*i.e.*, an general power of appointment), as this could cause the trust assets to be included in the estate of richer spouse upon his death by virtue of IRC § 2036.]

If properly structured, this technique would thus achieve the following favorable tax results:

¶ No taxable event would occur during the lifetime of either spouse, since the *inter vivos* revocable trust granting the testamentary general power of appointment is not a completed gift, since it is revocable;

¶ At poorer spouse's death, richer spouse makes a completed gift to poorer spouse (qualifying for the unlimited marital deduction) of that portion of richer spouse's property which is subject to the general power of appointment;

¶ The extent of richer spouse's property that is subject to the general power of appointment is included in the poorer spouse's gross estate;

¶ Poorer spouse is treated as the transferor of all assets which fund the credit shelter trust, established for the benefit of richer spouse during his lifetime;

¶ Richer spouse (i) may be named both the beneficiary and trustee of the credit shelter trust, provided the power to make distributions to himself is limited by an ascertainable standard and (ii) may even possess a special power of appointment over the trust property, without the property being included in his estate at his death;

¶ The credit shelter trust may be exempt from generation skipping tax through allocation of poorer spouse's GST exemption; and

¶ Assets transferred to the credit shelter trust will be asset protected, despite the fact that richer spouse will continue to benefit from the trust.

The IRS, in four published rulings, has

RECENT IRS DEVELOPMENTS, CONT.

(Continued from page 1)

effective in collection than offers in compromise and partial-payment alternatives. The report recommended implementation of a "screen[ing]" process to protect low income Social Security recipients from automated tax levies. An estimated 25 percent of taxpayers subject to automatic levies had incomes below the poverty level. IR-2009-003

IRC § 529(b) provides that a qualified tuition program will not be treated as a qualified section 529 program unless such program may not directly or indirectly direct the investment of program contributions. Notice 2001-55 had provided that a program which permits a change in investment strategy once per year will not violate this requirement. In response to the financial crisis, Treasury has announced that for the calendar year 2009, a program that permits a change in investment strategy twice per year will not violate the investment restriction. Notice 2009-1.

The IRS announced the opening on January 16th of an expanded IRS e-file program for 2008 federal returns. New features will allow expanded access to electronic filing, which will result in faster refunds. IRS Commissioner Doug Shulman stated that electronic filing was the preferred method to file accurate returns and receive prompt refunds, which could occur in as few as ten days. IR-2009-5.

IRC § 6694(a) imposes a return preparer penalty for a return or claim for refund reflecting an understatement of liability due to an "unreasonable position" if the tax preparer knew (or reasonably should have known) of the position. No penalty is imposed if there is reasonable cause for the understatement and the preparer acted in good faith.

Notice 2009-5 states that interim guidance provided by Notice 2008-13, which reflected the 2007 Tax Act, generally held tax preparers to a more stringent standard under IRC § 6694(a) than the "substantial authority" standard imposed by the 2008 Tax Act. Accordingly, when preparing returns for the 2008 tax year, preparers may comply with **either** Notice 2008-13, or with the less stringent standard imposed by the 2008 Tax Act. (However, tax shelter and reportable transactions must comply with the more stringent Notice 2008-13.)

The 2008 Tax Act provided that a position would be treated as unreasonable unless (i) there was "substantial authority" for the position or (ii) the position was properly disclosed and had a reasonable basis. Notice 2009-5 states that until further

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FROM THE COURTS, CONT.

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No. 2, a group of anesthesiologists gifted stock in their professional service corporation to a newly formed tax-exempt professional service corporation. Four months later, they transferred their individual practices to the tax-exempt when a planned consolidation with other medical practice groups was completed. The doctors claimed substantial income tax charitable deductions. The court held that since consolidation was "imminent" when the gifts were made, they were required to be valued under an asset-based, rather than a going concern, valuation approach. The court accepted the minority interest discount of 35% and the lack of marketability discount of 45% proposed by the IRS. Finding bad faith, the Tax Court also upheld the imposition of penalties.

In *Holman v. Com'r.*, 130 T.C. 12, gifts of limited partnership interests were made a few days after the partnership was formed. Although the Tax Court rejected the "indirect gift" and step transaction arguments, it held that the transfer restrictions in the partnership agreement should be ignored for valuation purposes under IRC § 2703. Under IRC § 2703, a restriction on transfer is disregarded unless "it is not a device to transfer property to the family for less than adequate consideration." The court theorized that given the large minority and marketability discounts available in valuing the gifts, any limited partner wishing to assign a limited partnership interest would "strike a deal" with the remaining limited partners "at some price between the discounted value of the unit and the dollar value of the units' proportional share of the partnership's NAV." The decision has been criticized as ignoring the willing buyer-willing seller precedents set forth in *Morrissey* and *Simplot.*

In Estate of *Mirowski v. Com'r.,* T.C. Memo 2008-74, the decedent, two weeks before her death, funded a Maryland LLC with 90% of her assets and made gifts of 48% of the noncontrolling limited partnership interests to her three daughter's trusts. The decedent, Mrs. Mirowski, retained a 52% majority interest as general partner. Despite the proximity to her death of both the funding of the LLC and her subsequent gifts of limited partnership interests, the Tax Court held that IRC §§ 2036 and 2038 did not operate to bring the asset back into Mrs. Mirowski's estate since her illness was treatable and her death was unexpected. Among the "legitimate and significant" nontax purposes of creating the LLC were (i) the joint management of family assets and (ii) the objective of having the children and grandchildren sharing equally in family assets.

An important positive factor in the case was that the decedent had retained enough assets to live on following her her transfers to the trusts. A gift tax liability of $11.8 million would have been paid for by a combination of retained assets. The LLC was found to be a "valid functioning business operation" whose responsibilities included managing patents invented by the deceased husband. Another factor which militated against the application of IRC §§ 2036 and 2038 was the fact that Mrs. Mirowski did not have authority to decide the timing and amount of distributions. Maryland law also imposed upon Mrs. Mirowski a fiduciary duty to the other LLC members.

In *Gross v. Com'r,* T.C. Memo, 2008-221, the decedent filed a certificate of limited partnership with New York on July 15, 1998. Transfers of marketable securities were made to a partnership account over the next few months. On December 15, 1998, the decedent and her two daughters signed a partnership agreement, and the decedent made gifts of limited partnership interests to each daughter. A 35% discount was applied in valuing the gifts.

The IRS argued that indirect gifts of marketable securities had been made since the partnership was not formed until the agreement was signed on December 15, 1998. Rejecting the IRS arguments and finding for the taxpayer, the Tax Court held that (i) the filing of a Certificate of Limited Partnership is conclusive evidence of the formation of a partnership under New York law; and (ii) New York law permits formation of a general partnership where limited partnership formation requirements fail, if

DISCLAIMERS IN ESTATE PLANNING, CONT.

(Continued from page 1)

For a disclaimer to achieve the intended federal tax result, it must constitute a *qualified* disclaimer under IRC §2518. If the disclaimer is not a qualified disclaimer, the disclaimant is treated as having received the property and then having made a taxable gift. Treas. Regs. §25.2518-1(b). Under the EPTL, as well as under most states' laws, the person disclaiming is treated as if he had predeceased the donor, or died before the date on which the transfer creating the interest was made. Neither New York nor Florida is among the ten states which have adopted the Uniform Disclaimer of Property Interests Act (UDPIA).

II. <u>Qualified Disclaimer Requirements</u>

For a disclaimer to be qualified under IRC § 2518, the disclaimer must be (i) **irrevocable and unqualified**; (ii) **in writing,** identify the property disclaimed and be signed by the disclaimant or by his legal representative; (iii) **delivered** to either the transferor or his attorney, the holder of legal title, or the person in possession; (iv) **made within 9 months** of the date of transfer or, if later, within 9 months of the date when the disclaimant attains the age of 21; (v) made at a time when the **disclaimant had not accepted the interest disclaimed or enjoyed any of its benefits**; and (vi) be **valid under state law**, such that it passes to either the spouse of the decedent or to a person other than the disclaimant without any direction on the part of the person making the disclaimer. Under EPTL § 2-1.11(f) the right to disclaim may be waived if in writing.

With respect to (i), PLR 200234017 ruled that a surviving spouse who had been granted a general power of appointment had not made a qualified disclaimer of that power by making a QTIP election on the estate tax return, since the estate tax return did not evidence an irrevocable and unqualified refusal to accept the general power of appointment.

With respect to (iii), copies of the disclaimer must be filed with the surrogates court having jurisdiction of the estate. If the disclaimer concerns nontestamentary property, the disclaimer must be sent via certified mail to the trustee or other person holding legal title to, or who is in possession of, the disclaimed property.

With respect to (iv), it is possible that a disclaimer might be effective under the EPTL, but not under the Internal Revenue Code. For example, under EPTL §2-1.11(a)(2) and (b)(2), the time for making a valid disclaimer may be extended until "the date of the event by which the beneficiary is ascertained," which may be more than 9 months of the date of the transfer. In such a case, the disclaimer would be effective under New York law but would result in a taxable gift for purposes of federal tax law.

With respect to (v), consideration received in exchange for making a disclaimer would constitute a prohibited acceptance of benefits under EPTL §2-1.11(f).

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DISCLAIMERS IN ESTATE PLANNING, CONT.

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With respect to (vi), EPTL §2-1.11(g) provides that a beneficiary may accept one disposition and renounce another, and may renounce a disposition in whole or in part. One must be careful to disclaim all interests, since the disclaimant may also have a right to receive the property by reason of being an heir at law, a residuary legatee or by other means. In this case, if disclaimant does not effectively disclaim all of these rights, the disclaimer will not be a qualified disclaimer with respect to the portion of the disclaimed property which the disclaimant continues to have the right to receive. IRC §2518-2(e)(3).

IRC § 2518(c) provides for what is termed a "transfer disclaimer." The statute provides that a written transfer which meets requirements similar to IRC § 2518(b)(2) (timing and delivery) and IRC § 2518(b)(3) (no acceptance) and which is to a person who would have received the property had the transferor made a qualified disclaimer, will be *treated* as a qualified disclaimer for purposes of IRC §2518. The usefulness of IRC § 2518(c) becomes apparent in cases where federal tax law would permit a disclaimer, yet state law would not.

To illustrate, in *Estate of Lee*, 589 N.Y.S.2d 753 (Surr. Ct. 1992), the residuary beneficiary signed a disclaimer within 9 months, but the attorney neglected to file it with the Surrogates Court. The beneficiary sought permission to file the late renunciation with the court, but was concerned that the failure to file within 9 months would result in a nonqualified disclaimer for federal tax purposes. The Surrogates Court accepted the late filing and opined (perhaps gratuitously, since the IRS is not bound by the decision of the Surrogates Court) that the transfer met the requirements of IRC § 2518(c). [Note that in the converse situation, eleven states, but not New York or Florida, provide that if a disclaimer is valid under IRC § 2518, then it is valid under state law.]

III. Uses of Qualified Disclaimers

A. Charitable Deductions

Treas. Reg. § 20.2055-2(c) provides that a charitable deduction is available for property which passes directly to a charity by virtue of a qualified disclaimer. If the disclaimed property passes to a private foundation of which the disclaimant is an officer, he should resign, or at a minimum not have any power to direct the disposition of the disclaimed property. The testator may wish to give family members discretion to disclaim property to a charity, but yet may not wish to name the charity as a residuary legatee. In this case, without specific language, the disclaimed property would not pass to the charity. To solve this problem, the will could provide that if the beneficiary disclaims certain property, the property would pass to a specified charity.

B. Marital Disclaimers

Many wills contain "formula" clauses which allocate to the credit shelter trust — or give outright — the maximum amount of money or property that can pass to beneficiaries (other than the surviving spouse) without the imposition of federal estate tax. With the applicable exclusion amount now $3.5 million, situations will arise where the surviving spouse may be disinherited if the beneficiaries of the credit shelter trust do not renounce part of their interest under such a formula clause. If such an interest is disclaimed and it passes to the surviving spouse, it will qualify for the marital deduction. Another use of the disclaimer in a similar situation is where either the surviving spouse or a trustee renounces a power of appointment so that the trust will qualify as a QTIP trust.

A surviving spouse who is granted a general power of appointment over property intended to qualify for the marital deduction under IRC § 2056(b)(5) may disclaim the general power, thereby enabling the executor to make a partial QTIP election. This ability to alter the amount of the marital deduction allows the executor to finely tune the credit shelter amount. If both spouses die within 9 months of one another, a qualifying disclaimer by the estate of the surviving spouse can effect an equalization of estates, thereby reducing or avoiding estate tax.

Consider the effect of qualified disclaimer executed within nine months by a surviving spouse of her lifetime right to income from a credit shelter trust providing for an outright distribution to the children upon her death. If, within nine months of her spouse's death, the surviving spouse decides that she does not need distributions during her life from the credit shelter trust, she disclaims, she will treated as if she predeceased her husband. If the will of the predeceasing spouse provides for an outright distribution of the estate to the children if wife does not survive, then the disclaimer will have the effect of enabling the children to receive the property that would have funded the credit shelter trust at the death of the first spouse.

Assume the surviving spouse paid no consideration for certain property held jointly with her predeceasing spouse. If she dies within 9 months and her estate disclaims, then the property would pass through the predeceasing spouse's probate estate. In that case, a full basis step up would become available. If the property would then pass to the surviving spouse under the will of the predeceasing spouse, this planning technique becomes invaluable, as it creates a stepped up basis for assets which would not otherwise receive such a step up if the disclaimer were not made.

A qualifying disclaimer executed by the surviving spouse may also enable the predeceasing spouse to fully utilize the applicable exclusion amount. For example, assume the will of the predeceasing spouse left the entire estate of $10 million to the surviving spouse (and nothing to the children). Although the marital deduction would eliminate any estate tax liability on the estate of the first spouse to die, the eventual estate of the surviving spouse would likely have an estate tax problem. By disclaiming $3.5 million, the surviving spouse would create a taxable estate in the predeceasing spouse, which could then utilize the full applicable exclusion amount of $3.5 million. The taxable estate of the surviving spouse would be reduced to $6.5 million.

To refine this example, the will of the first spouse to die could provide that if the surviving spouse disclaims, the disclaimed amount would pass to a family trust of which the surviving spouse has a lifetime income interest. The will could further provide that if the spouse were also to disclaim her interest in the family trust, the disclaimed property would pass as if she had predeceased.

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DISCLAIMERS IN ESTATE PLANNING, CONT.

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C. General Powers of Appointment

The grantor may wish to ensure that the named trustee will be liberal in making distributions to his children. By giving the child beneficiary the unrestricted right to remove the trustee, this objection can be achieved. However, if the child has the ability to remove the trustee, and the trust grants the trustee the power to make distributions to the child that are not subject to an ascertainable standard, this may cause problems, since the IRS may impute to the child a general power of appointment. If the IRS were successful in this regard, the entire trust might be included in the child's taxable estate. To avoid this result, the child could disclaim the power to remove the trustee. This might, of course, not accord with the child's nontax wishes.

If a surviving spouse is given a "five and five" power over a credit shelter or family trust, 5 percent of the value of the trust will be included in her estate under IRC §2041. However, if the surviving spouse disclaims within 9 months, nothing will be included in her estate.

D. Eliminating a Trust

At times, all beneficiaries may agree that it would be better if no trust existed. If all current income trust beneficiaries, which might include the surviving spouse and children, disclaim, the trust may be eliminated. In such a case, the property might pass to the surviving spouse and the children outright. Note that if minor children are income beneficiaries, their disclaimers could require the consent of guardians *ad litem*.

E. Medicaid, Creditor & Bankruptcy

Under New York law, if one disclaims, and by reason of such disclaimer that person retains Medicaid eligibility, such disclaimer may be treated as an uncompensated transfer of assets equal to the value of any interest disclaimed. This could impair Medicaid eligibility.

In some states, if a disclaimer defeats the encumbrance or lien of a creditor, it may be alleged that the disclaimer constitutes a fraudulent transfer. Not so in New York and California, where a disclaimer may be used to defeat the claim of a creditor. In Florida, the result in contra: A disclaimer cannot prevent a creditor from reaching the disclaimed property.

Will a qualified disclaimer defeat a claim of the IRS? No. Prior to a Supreme Court ruling, there had been a split in the circuits. The 2nd Circuit in *United States v. Camparato*, 22 F3d. 455, *cert. denied*, 115 S.Ct. 481 (1994) held that a federal tax lien attached to the "right to inherit" property, and that a subsequent disclaimer did not affect the federal tax lien under IRC §6321. The Supreme Court, in *Drye v. United States,* 528 U.S. 49 (1999), adopted the view of the Second Circuit, and held that the federal tax lien attached to the property when created, and that any subsequent attempt to defeat the tax lien by disclaimer would not eliminate the lien.

Bankruptcy courts have generally reached the same result as in *Drye*. The disclaimer of a bequest within 180 days of the filing of a bankruptcy petition has in most bankruptcy courts been held to be a transfer which the trustee in bankruptcy can avoid. Many courts have held that even pre-petition disclaimers constitute a fraudulent transfer which the bankruptcy trustee can avoid. If the *Drye* rationale were applied to bankruptcy cases, it would appear that pre-petition bankruptcy disclaimers would, in general, constitute transfers which the bankruptcy trustee could seek to avoid. However, at least one court, *Grassmueck, Inc., v. Nistler* (In re Nistler), 259 B.R. 723 (Bankr. D. Or. 2001) held that *Drye* relied on language in IRC §6321, and should be limited to tax liens.

IV. Frequently Litigated Issues

A. Acceptance of Benefits

The acceptance of benefits will preclude a disclaimer under state law. EPTL §2-11(b)(2) provides that "a person accepts an interest in property if he voluntarily transfers or encumbers, or contracts to transfer or encumber all or part of such interest, or accepts delivery or payment of, or exercises control as beneficial owner over all or part thereof . . . "

Similarly, a qualified disclaimer for purposes of IRC §2518 will not result if the disclaimant has accepted the interest or any of its benefits prior to making the disclaimer. Treas. Regs. §25.2518-2(d)(1) states that acts "indicative" of acceptance include (i) using the property or interest in the property; (ii) accepting dividends, interest, or rents from the property; or (iii) directing others to act with respect to the property or interest in the property. However, merely taking title to property without accepting any benefits associated therewith does not constitute acceptance. Treas. Regs. §25.2518-2(d)(1). Nor will a disclaimant be considered to have accepted benefits merely because under local law title to property vests immediately in the disclaimant upon the death of the decedent. Treas. Regs. §25.2518-2(d)(1).

The acceptance of benefits of one interest in the property will not, alone, constitute an acceptance of any other separate interests created by the transferor and held by the disclaimant in the same property. Treas. Regs. §25.2518-2(d)(1). Thus, TAM 8619002 ruled that surviving spouse who accepted $1.75x in benefits from a joint brokerage account effectively disclaimed the remainder since she had not accepted the benefits of the disclaimed portion which did not include the $1.75x in benefits which she had accepted.

The disclaimant's continued use of property already owned is also not, without more, a bar to a qualifying disclaimer. Thus, a joint tenant who continues to reside in jointly held property will not be considered to have accepted the benefit of the property merely because she continued to reside in the property prior to effecting the disclaimer. Treas. Regs. §25.2518-2(d)(1); PLR 9733008.

The existence of an exercised general power of appointment in a will before the death of the testator is not an acceptance of benefits. Treas. Regs. §25.2518-2(d)(1). However, if the powerholder dies having exercised the power, acceptance of benefits has occurred. TAM 8142008.

The receipt of consideration in exchange for exercising a disclaimer constitutes an acceptance of benefits. However, the mere possibility that a benefit will accrue to the disclaimant in the future is insufficient to constitute an acceptance. Treas. Regs. §25.2518-2(d)(1); TAM 8701001. Actions taken in a fiduciary capacity by a disclaimant to preserve the disclaimed property will not constitute an acceptance of benefits. Treas. Regs. §25.2518-2(d)(2).

B. Separate & Severable Interests

A disclaimant may make a qualified disclaimer with respect to all or an undivided portion of a separate interest in property, even if the disclaimant has another interest in the same property. Thus, one

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DISCLAIMERS IN ESTATE PLANNING, CONT.

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could disclaim an income interest while retaining an interest in principal. PLR 200029048. So too, the right to remove a trustee was an interest separate from the right to receive principal or a lifetime special power of appointment. PLR 9329025. PLR 200127007 ruled that the benefit conferred by the waiver of the right of recovery under IRC §2207A would constitute a qualified disclaimer.

A disclaimant makes a qualified disclaimer with respect to disclaimed property if the disclaimer relates to severable property. Treas. Regs. §25.2518-3(a)(1)(ii). Thus, (i) the disclaimer of a fractional interest in a residuary bequest was a qualified disclaimer (PLR 8326033); (ii) a disclaimer may be made of severable oil, gas and mineral rights (PLR 8326110); and (iii) a disclaimer of the portion of real estate needed to fund the obligation of the residuary estate to pay legacies, debts, funeral and administrative expenses is a severable interest. PLR 8130127.

C. Interest Passing Without Direction

To constitute a qualified disclaimer under federal tax law, the property must pass to someone other than the disclaimant without any direction on the part of the disclaimant. An important exception to this rule exists where the disclaimant is the surviving spouse: In that case the disclaimed interest may pass to the surviving spouse even if she is the disclaimant. Treas. Reg. §25.2518-2(e); EPTL §2-1.11(e).

For disclaimants (other than a surviving spouse) who are residuary legatees or heirs at law, the disclaimant must therefore be especially careful not only to disclaim the interest in the property itself, but also to disclaim the residuary interest. If not, the disclaimer will not be effective with respect to that portion of the interest which the disclaimant has the right to receive. §25.2518-2(e)(3). To illustrate, in PLR 8824003, a joint tenant (who was not a surviving spouse) was entitled to one-half of the residuary estate. The joint tenant disclaimed his interest in the joint tenancy, but did not disclaim his residuary interest. The result was that only half of the disclaimed interest qualified under IRC §2518. The half that passed to the disclaimant as a residuary legatee did not qualify.

The disclaimant may not have the power, either alone or in conjunction with another, to determine who will receive the disclaimed property, unless the power is subject to an ascertainable standard. However, with respect to a surviving spouse, the rule is more lax: *Estate of Lassiter*, 80 T.C.M. (CCH) 541 (2000) held that Treas. Reg. §25.2518-2(e)(2) does not prohibit a surviving spouse from retaining a power to direct the beneficial enjoyment of the disclaimed property, even if the power is not limited by an ascertainable standard, provided the surviving spouse will ultimately be subject to estate or gift tax with respect to the disclaimed property.

An impermissible power of direction exists if the disclaimant has a power of appointment over a trust receiving the disclaimed property, or if the disclaimant is a fiduciary with respect to the disclaimed property. §25.2518-2(e)(3). However, merely precatory language which is not binding under state law as to who shall receive the disclaimed property will not constitute a prohibited "direction". PLR 9509003.

E. Disclaimer of Fiduciary Powers

Limits on the power of a fiduciary to disclaim may have profound tax implications. PLR 8409024 stated that the trustees could disclaim administrative powers the exercise of which did not "enlarge or shift any of the beneficial interests in the trust." However, the trustees could not disclaim dispositive fiduciary powers which directly affected the beneficial interest involved. This rule limits the trustee's power to qualify a trust for a QTIP election.

F. Infants, Minors & Incompetents

In some states, representatives of minors, infants, or incompetents may disclaim without court approval. However, EPTL §2-1.11(c), while permitting renunciation on behalf of an infant, incompetent or minor, provides that such renunciation must be "authorized" by the court having jurisdiction of the estate of the minor, infant or incompetent. In *Estate of Azie*, 694 N.Y.S.2d 912 (Sur. Ct. 1999), two minor children were beneficiaries of a $1 million life insurance policy of their deceased father. The mother, who was the guardian, proposed to disclaim $50,000 of each child. The proposed disclaimer would fund a marital trust and would save $40,000 in estate taxes. The Surrogate, disapproving of the proposed disclaimer, stated that the disclaimer must be advantageous to the children, and not merely to the parent.

I. Timeliness of Disclaimer

Vexing tax issues may arise where a disclaimer would be valid under the EPTL but not under the Internal Revenue Code. EPTL §2-1.11-(b)(2) provides that a renunciation must be filed with the Surrogates court within 9 months after the effective date of the disposition, but that this time may be extended for "reasonable cause." Further, EPTL §2-1.11(a)(2)(C) provides that the effective date of the disposition of a future interest "shall be the date on which it becomes an estate in possession." Since under IRC §2518, a renunciation must be made within 9 months, the grant of an extension by the Surrogates court of the time in which to file a renunciation might result in a valid disclaimer for New York purposes, but not for purposes of federal tax law. Similarly, while the time for making a renunciation of a future interest court may be extended under EPTL §2-1.11(a)(2)(C), such an extension would be ineffective for purposes of IRC §2518.

J. Jointly Owned Property

The rules for disclaiming jointly owned property can generally be divided into two categories: (i) joint bank, brokerage and other investment accounts where the transferor may unilaterally regain his contributions; and (ii) all other jointly held interests. With respect to (i), the surviving co-tenant may disclaim within 9 months of the transferor's death, but only to the extent that the survivor did not furnish consideration.

With respect to (ii), for all other interests held jointly with right of survivorship or as tenants by the entirety, a qualified disclaimer of the interest to which the disclaimant succeeds upon creation must be made no later than 9 months after the creation. A qualified disclaimer of an interest to which the disclaimant succeeds upon the death of another (*i.e.*, a survivorship interest) must be made no later than 9 months after the death of the first tenant. This is true (i) regardless of the portion of the property contributed by the disclaimant; (ii) regardless of the portion of the property included in the decedent's gross estate under IRC §2040; and (iii) regardless of whether the property is unilaterally severable under local law.

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DECANTING IRREVOCABLE TRUSTS, CONT.

(Continued from page 1)

modified with court approval "upon the consent of all beneficiaries if the court concludes that modification is not inconsistent with a material purpose of the trust." The settlor, a beneficiary, or a trustee may initiate an action to modify an irrevocable trust. However, the court may approve the modification only if all of the beneficiaries have consented and the interests of all beneficiaries who have not consented will be adequately protected.

Where trust modification under the UTC or under common law is either not possible — or even where it is possible, but unattractive — modification under a "decanting" statute may be preferable. New York was the first state to enact a "decanting" statute, which effectively permits the trustee acting alone to amend the terms of an irrevocable trust. The most important prerequisite to utilizing New York's decanting statute, found in EPTL §10-6.6(b), is that the original trust must contain language granting the trustee **absolute discretion** with respect to making trust distributions to beneficiaries. If the original trust only grants the trustee discretion to make distributions in accordance with an ascertainable standard (*i.e.*, for the beneficiary's health, education, maintenance or support), or even if the trustee is given absolute discretion to make distributions, but only for the beneficiary's comfort, then EPTL §10-6.6(b) cannot apply, and the original trust cannot be decanted or distributed into a new trust.

Another limitation of EPTL §10-6.6(b) is that the fixed income right of any beneficiary cannot be reduced by reason of the decanting. This limitation has been construed as being applicable only to a named beneficiary identified in the trust instrument as having a right to income for a fixed period of time. One purpose of this requirement is to ensure that the marital deduction for estate and gift tax purposes is preserved, since the surviving spouse must have a right to all of the income during her life from the trust to ensure the availability of the deduction.

The procedure for invoking EPTL §10-6.6(b) is straightforward: First, the trustee must sign a notarized document which effectuates the decanting. Second, the document must be filed with the court having jurisdiction over the trust. Third, the trustee must serve a copy of the acknowledged instrument upon "all persons interested in the trust." All persons interested in the trust are essentially those who would be required to be served in a judicial accounting. *See* EPTL §10-6.6(b). While court approval is not required, the trustee may seek court approval if he is unsure as to whether the decanting statute applies, or if he is concerned with potential exposure from claims made by recalcitrant or litigious beneficiaries.

[Under the decanting statutes of Delaware and Alaska, the trustee of the original trust need only have authority to invade trust principal. Absolute discretion is not required. DEL. CODE ANN. title 12 § 3528; ALASKA STAT. § 10-6.6(b)(1). If a trust sitused in New York does not grant the trustee absolute discretion to make distributions, it might be possible to change the governing law of the trust instrument to avail the trustee of the more favorable Delaware statute. Under the Delaware statute, if the statutory prerequisites are met, a trustee may decant trust property in favor of a new trust without court approval and even without notice to or consent of beneficiaries. However, a written instrument signed and acknowledged by the trustee must be filed with the records of the trust.]

II. Circumstances Favoring Decanting

A trustee might seek to utilize EPTL §10-6.6 to accomplish any of the following objectives: (i) to extend the termination date of the trust; (ii) to add or modify spendthrift provisions; (iii) to create a supplemental needs trust for a beneficiary who is or has become disabled; (iv) to consolidate multiple trusts; (v) to modify trustee provisions; (vi) to change trust situs; (vii) to correct drafting errors; (viii) to modify trust provisions to reflect new law; (ix) to reduce state income tax imposed on trust assets; (x) to vary investment strategies for beneficiaries; or (xi) to create marital and non-marital trusts.

For example, an irrevocable trust might provide for a mandatory distribution of principal at age 25, with final principal distributions at age 30. However, such mandatory distributions might be inadvisable if the beneficiary has creditor problems, or is profligate or immature. In *In re Rockefeller*, NYLJ Aug. 24, 1999 (Surr. Ct. N.Y. Cty.), the Surrogate allowed trust assets to be decanted into a new trust which contained a spendthrift provision.

The beneficiary may have become subject to a disability after the trust had been drafted. To become (or maintain) eligibility for public assistance, it might be necessary for the trust assets to be distributed to a supplemental needs trust. The Nassau Surrogate, in *In Re Hazan*, NYLJ Apr. 11, 2000 authorized the trustee of a discretionary trust to distribute assets to a supplemental needs trust whose term had been extended, to enable the beneficiary to continue to be eligible for public assistance.

If more than one trust has been created for a beneficiary, overall liquidity may be enhanced by transferring the assets of one trust into another trust. So too, combining multiple trusts into a single trust may greatly reduce administrative expenses. In *In Re Vetlesen*, NYLJ June 29, 1999 (Surr. Ct. N.Y. Cty.), the court authorized the trustee to appoint trust assets to a testamentary trust with identical provisions to reduce administrative expenses.

EPTL §10-6.6(b) is particularly well suited to address problems where it may be desirable to appoint new trustees. *In re Klingenstein*, NYLJ, Apr. 20, 2000 (Surr. Ct. Westchester Cty.) authorized the decanting of assets into multiple trusts which granted the beneficiary of each trust the power to remove the trustee. The creation of new trusts in *Klingenstein* also allowed the removal of the impractical limitation requiring any trustee acting as sole trustee to appoint a corporate co-Trustee, and allowed for the elimination of successor Trustee appointments. The decanting statute could also be utilized to modify trustee compensation.

EPTL §10-6.6(b) may also be utilized to change the situs of a trust for privacy reasons. The grantor of a trust may

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DECANTING IRREVOCABLE TRUSTS, CONT.

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not want child beneficiaries to become aware of the trust. To preserve secrecy, the trustee might wish to change the situs of the trust to Delaware, which limits the trustee's duty to disclose. If trust property is also located out of New York, changing the situs of the trust might also facilitate trust administration.

Drafting errors or changes in the tax law may also be occasions for seeking to distribute trust assets into a new trust. The Surrogate in *In re Ould Irrevocable Trust*, NYLJ Nov. 28, 2002 (Surr. Ct. N.Y. Cty.) authorized the transfer of trust assets into a new trust where the retention of certain powers by the insured in the original trust may have resulted in estate tax inclusion.

Tax considerations may provide another compelling reason for decanting trust assets. Under NY Tax Law §603(b)(3)(D), even if the trust is sitused in New York, if there is (i) no trustee domiciled in New York, (ii) no New York source income, and (iii) no real or tangible property located in New York, then accumulated income and capital gains will not be subject to New York income tax. Accordingly, if a trust sitused in New York holds considerable assets outside of New York, decanting those assets into a trust in another jurisdiction might avoid New York income tax on capital gains and accumulated income sourced outside of New York.

If a single trust contains many beneficiaries, one investment strategy might not satisfy the differing objectives and needs of each beneficiary. Splitting the trust into individual trusts for each beneficiary might enable the trustees to manage each trust in accordance with the differing objectives of each beneficiary. The Surrogate in *In Re Estate of Scheuer*, NYLJ July 10, 2000 (Surr. Ct. N.Y. Cty.) authorized the trustees of the original trust to appoint trust assets into ten new trusts to accomplish this objective.

Federal tax considerations may also warrant consideration of EPTL §10-6.6(b). For example, the statute could be used to create GST Exempt and GST Non-Exempt trusts. Investment strategy for the GST Exempt trust — which would not be subject to GST tax — could be aggressive, while investment strategy for the GST Non-Exempt trust could be used to make distributions to children who are exempt from the GST tax. For example, these distributions could be made for tuition or medical care. [PLR 200629021 ruled that dividing a GST exempt trust into three equal trusts to facilitate investment strategies for different beneficiaries would not taint GST exempt status.]

Dividing a trust into marital deduction and nonmarital deduction trusts may also yield both tax and nontax benefits. Assets decanted into the marital deduction trust, which would ultimately be included in the estate of the spouse, could be invested in conservative securities and could be used for distributions of principal to the spouse. To the extent the marital trust is depleted, the amount of assets ultimately included in the spouse's gross estate would be reduced. Assets in the nonmarital trust, which would not be subject to estate tax in the estate of the spouse, could be in invested in growth assets for future beneficiaries.

III. Tax Consequences of Decanting

A. Transfer Tax Consequences

A GST Exempt Trust is not subject to Generation Skipping Transfer Tax. Treas. Reg. §26.2601-1(b)(v)(B) states that the extension of an Exempt Trust in favor of another trust will not trigger GST tax. However, actual additions or deemed additions to a GST Exempt Trust would cause it to lose its exempt status. Therefore, care must be taken when utilizing EPTL §10-6.6(b) not to make an actual or deemed addition to the trust which would cause a GST Exempt Trust to lose its exempt status. If GST implications resulting from distributions to a new trust under EPTL §10-6.6(b) are unclear, a private letter ruling from the IRS should be obtained in advance.

The IRS could argue that decanting causes a taxable gift by the beneficiary to the trust. If the beneficiary is entitled to receive trust distributions at a certain age, and by reason of decanting, the assets are held in trust for a longer period, the IRS could make the argument that the right of the beneficiary to receive trust assets at a certain age is equivalent to a general power of appointment. If the beneficiary fails to object to the decanting, the beneficiary has, in effect, released a general power of appointment, which would result in a taxable gift. The problem with this argument is that since the beneficiary likely does not have the right to object to the decanting, the beneficiary possesses no general power of appointment over trust assets. The beneficiary cannot release a power he does not possess.

However, if the beneficiary could forestall an attempt by the trustee to decant, then the gift argument gains credibility. To weaken the argument that a taxable gift has occurred, the beneficiary could be given a limited power over trust assets in the new trust. The retention of a limited power of appointment generally should prevent the release from being a taxable gift. Treas. Reg. §25.2511-2(b).

B. Income Tax Consequences

Decanting should result in no adverse income tax consequences. For gain or loss to occur, there must be either a sale or exchange of property, or the property received must be materially different from the property surrendered. Treas. Reg. §1.1001-1(a). The Supreme Court in *Cottege Savings Ass'n v. Com'r.*, 499 U.S. 554 (1991) seemed to read out the word "materially" from the term "materially different" in holding that an exchange of similar mortgages triggered a taxable event. Nevertheless, the IRS has stated in recent rulings that a distribution in further trust will not trigger income tax provided the distribution is permitted either by the trust instrument or by local law.

If encumbered property is distributed pursuant a decanting statute, a potential income tax problem could arise under *Crane v. Com'r.*, 331 U.S. 1 (1947), since that case held that the amount realized includes relief from liability. However, IRC §643(e) provides that distributions from a trust generally do not produce taxable gain. Therefore, substantial authority would appear to exist for the reporting position that decanting produces no realized even if liabilities exceed basis. In view of the preparer penalties under IRC §6694, practitioners might consider disclosing the position on the return.

The decanting statutes of all states provide that the ability to decant trust assets into a new trust is the default rule, but that the default rule may be overridden by the trust instrument. Therefore, the grantor may wish to include in newly drafted trust instruments a provision which specifically addresses his wishes with respect to future trust decanting. The grantor may wish to limit the trustee's future ability to modify the trust or may wish to give the trustee *carte blanche* to decant. In either case, specific reference to the grantor's wishes should be included in the trust instrument.

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RECENT IRS DEVELOPMENTS, CONT.

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guidance is issued, "substantial authority" for purposes of IRC § 6694(a) has the same meaning as in Treas. Reg. §1.6662-4(d)(2) of the accuracy-related penalty regulations.

Treas. Reg. §1.6662-4(d)(2) provides that substantial authority for a position exists if "the weight of authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment. . . Only the following are authority for purposes of determining whether there is substantial authority for the tax treatment of an item: applicable provisions of the Internal Revenue Code and other statutory provisions; proposed, temporary and final regulations construing such statutes; revenue rulings and revenue procedures; tax treaties and regulations thereunder . . . court cases; [and] congressional intent as reflected in committee reports. . . Conclusions reached in treatises, legal periodicals, legal opinions or opinions rendered by tax professionals are not authority. . ."

In PLR 200901020, the IRS expanded the definition of real property for purposes of IRC §1031 to include Residential Development Rights (RDRs). Although "[n]ot all interests defined as real property interests for state law purposes are of like kind for purposes of §1031," the ruling states the IRS generally looks to state law in determining which rights constitute real property interests. Under state law, RDRs constitute an interest in real estate. Since the RDRs would be held "in perpetuity and are directly related to the taxpayer's interest, use and enjoyment of the underlying land," the ruling concluded they were of like kind to a fee interest in real estate.

In PLR 200901004, the taxpayer, in the business of transporting Processed Mineral, proposed to exchange an Old Facility for New Facility, to be constructed by an LLC owned by Domestic Sub. Domestic Sub would continue to use Old Facility, and the taxpayer would begin using New Facility, in their respective trades or businesses. Old Facility and New Facility consist of both tangible and intangible properties. The ruling concluded that since Old Facility and New Facility were "essentially the same type of property," the relinquished property was essentially of like kind to the replacement property. However, even though no cash is received in the exchange, it is still possible that some of the realized gain must still be recognized, since the exchange is of multiple properties. Under Treas. Reg. §1.1031(j)-1, which governs multiple property exchanges, the exchange must be bifurcated.

If the fair market values of the tangible properties (and therefore the intangible properties) being exchanged are equal, then no gain recognition will occur. However, if the fair market values of the tangible properties are unequal, then some of the realized gain, either with respect to the tangible property received in the exchange (if the fair market value of the tangible property received in the exchange exceeds the fair market value of the tangible property relinquished in the exchange) or with respect to the intangible property received in the exchange (if the fair market value of the intangible property received in the exchange exceeds the fair market value of the intangible property relinquished in the exchange) will have to be recognized. Note that even though some gain will be recognized in this situation, the corresponding loss — and there will always be a corresponding loss which mirrors the gain — will not be recognized because realized losses are not recognized in a like kind exchange (IRC § 1031(c).

In PLR 200901023, the taxpayer established a Trust to "manage, conserve and distribute" her deceased husband's art works. The works would be made available for exhibition in public galleries and museums throughout the world, but principally in Country B and in the United States. Items not on public exhibition would be available for viewing by arrangement with the trustees. The trustees were authorized to sell items within the collection to provide funding for future activities as an addition to the original endowment funding. The ruling sought clarification as to whether the gift or bequest to the Trust would qualify for a gift tax deduction under IRC §2522, or for an estate tax deduction under IRC §2055.

The ruling first noted that the estate tax deduction is not limited to transfers for use within the United States, and then cited Rev. Rul. 66-178, which found that an organization created to "foster and develop the arts by sponsoring an annual public exhibition at which art works of promising but unknown artists" were displayed was exempt from income tax under IRC § 501(c)(3). The ruling concluded that "[l]ike the organization described in Rev. Rul. 66-178, Trust is created to foster and develop the arts by sponsoring public exhibitions of art work." Accordingly, the ruling concluded that gifts to the Trust qualify for the gift tax charitable deduction, and bequests to the Trust qualify for the estate tax charitable deduction.

In PLR 200901008, Buyer 1 purchased a 50-year estate for years in Property (the "Lead Interest") and Buyer 2 purchased a remainder interest in the Property. Buyer 2 intends to hold the remainder interest as a long-term investment. The ruling stated that no income, gain or loss will be recognized to Buyer 2 either at the time of purchase or when the remainder interests vests in possession. The holding period for the remainder interest of Buyer 2 commences on the day

FROM WASHINGTON, CONT.

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ports granting bankruptcy judges the power to modify the terms of mortgages. *Until legislation is passed, lenders with securitized investors are contractually bound to commence foreclosure proceedings.*

Mr. Obama appears to favor lowering the corporate tax rate, which is the second highest in the industrialized world. However, Mr. Obama has long been an advocate of closing tax loopholes which favor large corporations. Although the President had discussed a $3,000 refundable credit for 2009 and 2010 for each full time employee added to the workforce by an existing business, this proposal seems to have been abandoned as unworkable in practice. However, the President does favor extending the IRC § 179 expensing limitation of $250,000 through 2009. Legislation has been introduced in Congress which would cap deductible executive compensation at 25 times the salary of the lowest-paid employee of the business.

Permanent extension of the research and development (R&D) tax credit, which both Democrats and Republicans have in the past advocated, but had never accomplished due to its cost, may actually occur in 2009 under the Obama administration. President Obama has stated that the country's future prosperity depends upon innovation. So too, the development of alternative energy is a top priority of Mr. Obama. Expect to see tax incentives for producers of wind, solar, biomass and other alternative energy sources — especially those which create "green" jobs. *Although in the past Mr. Obama has been lukewarm toward nuclear energy, given its recent rehabilitation as a "green" energy source, administration might decide to streamline the regulatory process for new reactors.*

Although President Obama spoke frequently — and eloquently — about health care reform and the importance of providing adequate health care to all Americans, economic realities may result in that ideal being held in abeyance. Senator Baucus (D. Mont.), chairman of Senate Finance, has proposed a "health insurance exchange," which would serve as a marketplace for consumers to compare and purchase plans.

To increase tax revenues, President Obama has expressed support for the codification of the economic substance doctrine, which states that the tax benefits of a transaction will not be permitted if the transaction does not have economic substance. Although courts have invoked the doctrine, codification could result in penalties being imposed for transactions lacking economic substance. Mr. Obama also favors taxing "carried interest" — which is the share of profits investment fund managers receive as compensation for investment services — at ordinary income rates. Currently, compensation for these services is taxed as long-term capital gains at 15

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