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The Administration's Fiscal Year 2025 Revenue Proposals

By Samuel A. Donaldson

On March 11, 2024, the Treasury Department released its General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals. The 248-page document reviews the tax reform proposals set forth in the President's Fiscal Year 2025 Budget. According to Treasury, the proposed reforms "would raise revenues, expand tax credits for workers and families, and improve tax administration and compliance."

The chances of any of these proposals becoming law in the short term are, to say the least, slim. In an election year, no one has incentive to push through significant tax reforms. Further, with a Republican majority in the House and Democratic control of the Senate, any tax legislation would very likely need to be watered down to have any chance of passage. As a result, everyone recognizes that the Budget proposals are little more than a wish list of reforms the President and his supporters would like to see.

Readers of a certain age might recall the *Schoolhouse Rock!* tune, "I'm Just a Bill," wherein proposed Congressional legislation in anthropomorphized form explains in song the tortuous process by which it hopes to become enacted.

The proposals set forth in the Budget would be lucky to one day be "just a bill." Nonetheless, a look at the proposals can give planners an idea of possible tax reform in the coming years, and it is never too early to think through the ramifications should the proposals be enacted. Accordingly, this summary will highlight the proposals of greatest interest to estate planners and their clients.

Taxing High-Income Taxpayers

The Budget proposes **increasing the top marginal tax rate on ordinary income to 39.6%**, applying to taxable income over $400,000 for unmarried taxpayers, $425,000 for heads of household, $450,000 for married couples filing jointly, and $225,000 for married couples filing separately. For taxpayers with taxable incomes over $1 million, the **preferential rate for long-term capital gains and qualified dividends would disappear**, leaving such items to be taxed as ordinary income.

The Budget also proposes that **gifts and bequests would be income taxable**, even in the case of transfers to a defective grantor trust, though the first $5 million in aggregate gains would be excluded. Transfers to charity would not give rise to recognized gain, and the rule would likewise not apply to gifts of tangible personal property (except collectibles). If this rule is adopted, all property received by gift, bequest, devise, or inheritance would have a basis in the hands of the recipient equal to the property's fair market value at the time of the gift, bequest, devise, or inheritance. In addition, the Budget proposes a **deemed sale of property held in trust, a partnership, or some other non-corporate entity** if it has not been the subject of a recognition event within the past 90 years.

Interestingly, the Budget proposes a **25 percent minimum tax on total income for taxpayers with net wealth of more than $100 million**. This is the "wealth tax" that Democrats have introduced from time to time and which may well be the real subject of *Moore v. United States*, a case currently before the United States Supreme Court, as explained in the December 2023 edition of the REPORTER.

Estate and Gift Tax Reform

The Budget contains a mixed bag of recommendations for modifying the federal wealth transfer tax regime. Planners would likely welcome the proposal to **increase the special use valuation cap.** Under current law, the maximum reduction in value for certain real property used in a family-owned business is limited to $750,000, adjusted for post-1997 inflation (for 2024, the maximum reduction in value is $1,390,000). The proposal would increase this limit to $14 million, effective upon enactment.

But the Budget also proposes that most **trusts administered in the United States would have to make annual reports** to the IRS that would include identifying information about grantors and trustees, as well as information about the nature and estimated value of the trust's assets. The reporting rule would not apply to trusts with no more than $300,000 in net assets as of the last day of the taxable year, provided

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the trust does not have more than $10,000 in gross income for the year.

The Budget also calls for the **effective repeal of “as finally determined for Federal transfer tax purposes” defined value formula clauses**. Many donors today use defined value formula clauses to prevent an unwanted taxable gift that could arise from a valuation error. For example, the owner of $50 million in closely-held stock with an applicable exclusion amount of $13.61 million might give “shares having a value of $13.61 million as finally determined for Federal transfer tax purposes” to a child, with “all remaining shares” passing to a charity. If the IRS successfully challenges the valuation used to compute the number of shares transferred to the child, the IRS collects no gift tax, as the formula clause provides that any excess passes instead to the charity (qualifying for the unlimited charitable deduction). The Budget proposes that any gift or bequest using a defined value formula clause be treated as transferring the entire amount reported on the gift or estate tax return. In the example above, that would mean the donor would be deemed to have given all $50 million of the stock to the child. Under this proposal, two defined value formula clauses would remain effective: (1) when the value is to be determined by something other than action by the IRS, like an appraisal to be obtained within a short period following the transfer; and (2) defined value formula clauses used to define the gift to a marital trust or credit shelter trust.

The Budget also would impose a **minimum value for the remainder interest in a charitable lead annuity trust** to be at least 10 percent of the value of the property used to fund the trust, effectively requiring that the creation of a charitable lead trust will result in a taxable gift. Under current law, the value of the remainder interest in a charitable lead trust can be “zeroed-out.”

Finally, the Budget purports to “simplify” the gift tax annual exclusion by **replacing *Crummey* powers with a revamped annual exclusion amount.** Specifically, the Budget proposes to eliminate the “present interest” requirement to qualify for the annual exclusion and instead cap the maximum annual exclusion to $50,000 per donor. This limit would be in addition to the current $18,000 per donee limitation. Thus, for example, if a donor subject to this new regime made gifts of $18,000 cash to each of three donees, the donor would be making taxable gifts of $4,000, the amount by which the total gifts of $54,000 exceeds $50,000. Did we mention that the odds of this or any proposal being enacted are slim to none, with the needle leaning heavily toward “none?”

Grantor Trusts

The Budget takes dead aim at grantor trusts, providing first that **remainder interests in grantor retained annuity trusts have a minimum present value** at least equal to the greater of 25 percent of the assets transferred to the trustor or $500,000 (but not more than the value of the assets transferred), with **no reduction in the annuity** during the trust term. Further, a GRAT would have a **10-year minimum term**, with a maximum term of the grantor’s life plus ten years.

Furthermore, the Budget proposes to **tax transactions between grantors and defective grantor trusts**. As if that’s not enough of a nightmare, the Budget proposes that the **grantor’s payment of a defective grantor trust’s income tax would be a gift** to the trust as of December 31 of the year in which the tax is paid unless the grantor is reimbursed by the trust within the same year.

Provisions for Workers and Families

Unsurprisingly, the Budget calls for extending the **enhanced child tax credit** from 2021, when the refundable credit was $3,600 for each child under age 6 and $3,000 for children ages 6 – 17. The Budget seeks to make the credit fully refundable, regardless of a taxpayer’s earned income. The Budget also wants to make permanent the **exclusion from gross income**

for forgiven student debt, which is scheduled to expire at the end of 2025. Finally, the Budget proposes a **credit for first-time home buyers and home sellers** for 2024 and 2025. The credit for first-time buyers would be 10 percent of the home's purchase price, up to a maximum credit of $10,000, with phaseouts once a buyer's adjusted gross income exceeds $100,000. The credit would be taken over two years, half in the year of purchase and the rest in the next year. The credit for sellers would be similar: a credit equal to 10 percent of the home's sale price, up to a maximum credit of $10,000, with phaseouts once a buyer's adjusted gross income exceeds $100,000. The entire credit would be taken in the year of sale.

Closing Loopholes

The Budget again calls for **taxing carried interests as ordinary income.** Venture capital firms and other investment entities have long taken advantage of two partnership tax chestnuts to achieve favorable treatment for compensation paid to managers. The first is the preferential tax treatment given to profits interests as opposed to capital interests. A manager receiving a capital interest in a partnership as compensation for services has gross income upon receipt. But the recipient of a profits interest only has the right to a share of future profits, and thus has no value upon receipt. But when the interest is later sold, any gain qualifies as capital gain because the profits interest is still a capital asset. The second chestnut provides that limited partners do not pay self-employment tax on their distributive shares of partnership profits. Thus, the holder of a limited profits interest can convert compensation (which would be ordinary income subject to self-employment taxes) into capital gains (taxed at preferential rates and not subject to self-employment taxes). The Budget calls for treating the distributive shares of profits interest holders with taxable incomes over $400,000 both as ordinary income and as income from self-employment. This proposed reform is nothing new, having been a staple of the budgets of Democratic presidents throughout this century.

The Budget would also **cap the deferral for like-kind exchanges of real property to $500,000** in any one year, starting in 2025. Also starting in 2025 would be a new rule requiring **complete recapture of real property depreciation**. Under section 1250, a taxpayer selling depreciable real property at a gain must recapture as ordinary income only that portion of depreciation in excess of what would be allowed under the straight-line method. The rule is practically a dinosaur, however, because the straight-line method has been the only available depreciation method since 1986. Because no one can use accelerated depreciation methods with respect to real property, recapture of depreciation in this context rarely occurs. But under the proposed Budget, all depreciation deductions would be subject to recapture, not just the portion in excess of what is allowed under the straight-line method.

Finally, the Budget would make explicit that **distributions from a private foundation to a donor advised fund would not count** as qualifying distributions unless the donor advised fund in turn makes a distribution by the end of the next succeeding taxable year. The Budget points out, fairly, that using a donor advised fund to hold private foundation monies subverts the purpose of the minimum distribution requirement.

Probate Report

- **Fiancee Commits Undue Influence**

In *Tyson v. Harbin*, __ So.3d __ (Ala. 2024) (2024 Westlaw 503711), the testator divorced the father of her two sons and became engaged to her fiancee, he proposed to her in a hospital while she was recovering from a stroke. Several months later, they sat down together to discuss their wills, filling out forms prepared by the testator's attorney. The testator's will named her fiancee as personal representative and devised most of her estate to him, with relatively little, including some of her cremation ashes, passing to her sons. After the testator's death, the sons contested the will, claiming that she lacked testamentary capacity and was subject to the fiancee's undue influence. A jury decided in favor of the sons, and the fiancee moved for a judgment as a matter of law. On appeal, the fiancee contended that the sons failed to produce substantial evidence of undue influence.

The appellate court first examined whether there was enough evidence for the jury to conclude that the fiancee was the dominant and controlling party in his relationship with the testator. The evidence demonstrated that the testator was financially dependent on the fiancee and lived in his house; that she was scared to talk with her ex-husband because the fiancee would get mad; that, despite previously being a "rambunctious woman," her behavior changed significantly after her stroke, rendering her submissive. The appellate court found that the jury could reasonably determine that the fiancee was the dominant and controlling party.

The appellate court then considered whether the sons produced sufficient evidence for the jury to "meet the undue-activity element" of an undue influence claim. Noting that such evidence could be circumstantial and be demonstrated in a "variety of ways," the appellate court focused on several pieces of evidence: the couple worked on their wills together; the fiancee spoke with the drafting attorney despite denying having done so; and despite the testator's focus on her boys — whom she described on social media as "her world" — she effectively disinherited them in favor of the fiancee. The appellate court upheld the jury verdict.

Editors' Comment: The opinion cited precedent for the proposition that "the jury had the right to consider the relationship of the parties to see if an unnatural disposition had been made by the testator." Based on the evidence, the jury could reasonably determine that a confidential relationship existed, with the fiancee being the dominant and controlling party, and that he engaged in undue activity in procuring the will. Courts examining undue influence typically compare the proposed will with previous estate planning patterns. In this case, the testator's omission of the sons who were "her world" in favor of her fiancee seemed to fit within that paradigm. And, at least from a historical perspective, a testator might be deemed to be less committed to a fiancee than a spouse, especially if the marriage has continued for a while.

- **Oral Testimony about Contract to Make a Will Allowed**

In *Castellotti v. Free*, 203 N.Y.S.3d 274 (App. Div. 2024), the decedent's son testified over objection about an oral agreement for his sister to transfer half of their mother's assets after distribution of her estate, after the brother's divorce. The sister sought to bar testimony concerning the brother's communications with their mother regarding her will, which the sister contended violated the state's deadman's statute, as well as other relevant testimony from the brother and others. The brother's communications with the decedent focused on their mother's apparent intent to transfer half of her estate to him after his divorce. The court concluded that the deadman's statute barred the brother's conversations with their mother because he was interested in her will. However, the deadman's statute did not bar testimony from third parties about conversations with the deceased mother because they had no interest in her estate. Moreover, the brother's testimony about his communications with his sister was allowed because such testimony did "not constitute extrinsic evidence in derogation of the will and [did] not call into question whether or not the will reflected decedent's intentions."

Editors' Comment: The opinion observed that, while extrinsic evidence is not admissible to challenge an unambiguous will, the issue at stake in this case was whether the brother and sister had an agreement to transfer half of the estate from the sister to the brother after his divorce.

Although the trend is for jurisdictions to disfavor the deadman's statute, its essential purpose is to prevent self-serving testimony from someone who can benefit from communications with a decedent, who of course cannot refute any allegations. The *Castellotti* court seemed to recognize the line between the deadman's statute barring testimony about communications by an interested witness with the decedent versus testimony by non-interested persons and testimony by an interested person with someone other than the decedent.

Although states with statutes similar to Uniform Probate Code section 2-514 may require written proof in certain situations involving contracts regarding a will, that section applies to agreements with a testator, whereas the focus of *Castellotti* focused on a purported agreement between beneficiaries. That situation is more related to UPC section 3-912, involving an agreement among successors to an estate.

Although the opinion dealt with an evidentiary issue, and there is no discussion or proof in the opinion that any agreement between the brother and his sister and/or mother was an attempt to circumvent having his assets subjected to equitable distribution in his divorce, there is precedent that equitable factors, such as the clean hands doctrine, may preclude the enforcement of such an agreement.

- **Nonprobate Transfer Avoids Omitted Spouse's Share but Not Pickup Truck**

In *Estate of Reis*, not reported in N.W. Reporter (Minn. App. 2024) (2024 Westlaw 912625), the testator and his wife had been in a long-term relationship since 2009, but did not marry until late 2020. Earlier that year, the testator was told that he had only months to live. He asked his sister to help him find an attorney to update his will because he wanted to name her as personal representative and ensure that their mother was taken care of financially. His sister recommended the drafting attorney, who met with him several times throughout 2020. The testator executed his will about a month before his marriage. About two months before the marriage, the testator named his wife as the beneficiary of his retirement account, worth approximately $90,000. After the marriage, he added his wife to the title of his Volkswagen Jetta. He died a few days later.

The wife filed for probate in Minnesota and sought to have the court appoint the testator's sister as personal representative. The testator apparently believed that he was a resident of North Dakota, which he told his drafting attorney. Although the sister therefore objected to the proceedings in Minnesota, the Minnesota court commenced probate.

The wife sought her omitted spouse's share because the testator executed his will before they married. She also claimed that she should have received his pickup truck because the homestead statute entitled a surviving spouse to one automobile from the estate. The trial court agreed with the sister that the wife was not entitled to an omitted spouse's share because the testator's transfer of his retirement account overrode that statute and that the wife was not entitled to the pickup truck — which the personal representative sold with a camper for $120,000 — because she received the Jetta.

On appeal, the wife contended that the trial court failed to satisfy both conditions for the avoidance of an omitted spouse's share: the testator must make a nonprobate transfer to the surviving spouse and must indicate his intent for the nonprobate transfer to be in lieu of the statutory omitted spouse's share. The wife argued that the trial court failed to properly find intent because it determined that the testator provided for the wife outside the will but he also expected that she would receive additional property if they married. The appellate court reasoned that these two findings were not inconsistent — the testator could have intended for the nonprobate transfer to be in lieu of the omitted spouse's share and yet expect that, upon marriage, the wife would be entitled to additional assets such as the pickup truck and the elective share, which the wife did not claim.

The appellate court placed great weight on the testimony of the attorney, who discussed the omitted spouse's share on several occasions with the testator and explained the homestead share and the elective share to him as well. The attorney and the sister testified that the testator clearly intended to ensure that his mother was taken care of financially. Consequently, the appellate court held that the testator intended for the nonprobate transfer of the retirement account to be in lieu of the omitted spouse's share.

However, the appellate court agreed with the wife that she was entitled to the pickup truck, despite her survivorship interest in the Jetta. The appellate court parsed the applicable statute, which states that the wife is entitled to up to $15,000 in personal effects and one automobile. Because the personal representative had sold the personal property chosen by the wife, she received $15,000 instead. But the statute provides that the surviving spouse also got one automobile, regardless of value, from the estate. The wife became the sole owner of the Jetta when the testator died, so it did not pass through his estate. The homestead statute entitled the surviving spouse to an automobile from the estate, so the Jetta did not satisfy that statutory entitlement. Moreover, the intent of the testator was irrelevant for the homestead entitlement. Even if he meant the transfer of the Jetta to be in lieu of the homestead allowance, she was entitled to an automobile. Because the homestead allowance was in addition to whatever the surviving spouse receives under a will, she would have been entitled to the pickup truck even if he had willed her an automobile. Thus, the appellate court reversed and remanded as to the pickup truck.

Editors' Comment: In parsing the language of the homestead allowance statute to buttress its reasoning, the appellate court looked to case law, which discussed "selecting" exempt property under the homestead allowance.

The opinion did not discuss what appears to be a critical feature of the omitted spouse's statute, which allows a court to infer a testator's intent to make a nonprobate transfer in lieu of the omitted spouse's merely from the size of that transfer, without additional evidence of intent. Of course, in *Reis*, the appellate court had evidence of his intent, from the attorney's testimony.

- **Trustee Has Duty to Distribute, Not Occupy**

In *Kersey v. Abraham*, __ So.3d __ (Fla. App. 2024) (2024 Westlaw 57468), the settlor created a trust that became irrevocable upon her death. The trust contained property including the settlor's residence and a guest house, which was being rented by her niece. The trust provided that, upon the settlor's death, the trustee was to distribute two-thirds of the real property to the settlor's daughter and one-third to her son. All the rest of the trust property, including any income, was to be equally divided between the daughter and the son. Upon the settlor's death, the daughter became the trustee and the personal representative of the settlor's estate. Rather than distribute the property upon the settlor's death, the daughter instead moved into the residence without paying rent. She wanted to buy out the son's interest, but they could not agree on a price — the son wanted even more than his own appraiser had valued the property.

The son sued to receive his share of the value of the real property, including the rents, and to remove the daughter as trustee. They entered into a settlement agreement providing that she would be replaced as trustee by an attorney. However, the attorney trustee declined to distribute the real estate because he favored selling it, given that the beneficiaries were “at loggerheads.” He was named as a nominal party in the lawsuit. The trial court ruled that the daughter breached her fiduciary duty by failing to pay rent during her occupancy and awarded the son his share of the fair market rental. The daughter’s payments were to be offset against her share of the trust property “to the extent possible.”

The daughter argued that, even though the title to the real estate was still nominally in the name of the trust, she and the son were effectively tenants in common, so that she therefore did not owe any rent. Observing that an irrevocable trust is a distinct entity capable of owning property, the appellate court rejected her argument. However, the appellate court reduced the amount of damages based on the calculation of rent. The daughter continued to occupy the property without paying rent once the attorney trustee took over. Thus, because the damages were based on her breach of fiduciary duty, she owed rent only for the time she occupied the property while she was trustee.

Editors’ Comment: The appellate court agreed with the daughter’s argument that her rent payments should not be split equally with her brother, based on the trust’s residuary clause dividing income and any assets other than the real estate in equal shares. Rather, she contended that she owed her brother only for one-third of the rent damages. The appellate court considered the interest in the real estate to be akin to a specific devise and, based on the settlor’s intent, maintained the daughter’s two-thirds interest in the real estate, thereby requiring her to pay only for the brother’s one-third interest in the rent.

- **Feuding Sibling Co-Trustees Removed**

In *Trust of Betty J. Lamprecht*, 2 N.W.3d 181 (Neb. 2024), a husband and wife created separate trusts. The husband died first, and the trusts were consolidated after the wife’s death. Their daughter and one of their sons served as co-trustees. They, along with their brother, were the beneficiaries. The opinion described the trust as “land rich and cash poor.”

The two sons asserted that the daughter failed to distribute the land from the trust. The daughter argued that the trust had debts to pay, that her two brothers refused to agree to actions necessary to create liquidity to pay the trust’s debts, and that part of the debts were paid using assets that should have been distributed to the daughter.

The son and daughter co-trustees filed cross-motions to remove the other as trustee. The nontrustee son was an interested party. During the hearing on the cross-motions, the son resigned as trustee. The trial court accepted the son’s resignation and removed the daughter as trustee. The trial court found that the co-trustees’ conduct, including cross-allegations of misconduct and dereliction of duty, resulted in extraordinary expense to the trust. Concluding that the co-trustees had breached their fiduciary duty, the trial court stated that “radical actions” were necessary. The trial court also awarded attorney’s fees to the nontrustee son, to be paid by the co-trustees personally.

On appeal, the daughter argued that the trial court erred in finding that she breached her fiduciary duties, by removing her as co-trustee, by failing to find that the two sons’ claims were barred by unclean hands, and awarding attorney’s fees to the nontrustee son. The trustee son also appealed, contending that the lower court erred in finding that he breached his fiduciary duties and awarding attorney’s fees to the nontrustee son, in an amount yet to be determined.

The appellate court skipped over the issue of whether the sibling co-trustees breached their fiduciary duties, finding it moot in light of the resignation of the son and the removal of the daughter. According to the appellate court, the removal of both was justified without the need to examine any breach of fiduciary duty because the state version of the trust code authorized a co-trustee's removal when the co-trustees fail to cooperate or when all qualified beneficiaries seek removal and it is in their best interests. Because the issue of a trustee's removal is in equity, the appellate court reviewed the matter de novo. The hostile relations between the co-trustee siblings served as a sufficient justification in itself to remove the co-trustees.

The appellate court refused to rule on the attorney's fee issue because it was not final, pending the determination of the amount, and was not yet appealable.

Editors' Comment: One reason that clients choose their children as co-trustees is to avoid giving one child too much control. Yet *Lamprecht* demonstrates the other side of that choice: feuding siblings may not be able to cooperate and therefore act in the best interests of the beneficiaries, or for that matter not be able to act at all.

The state statutory version of the trustee removal provisions were based on Uniform Trust Code section 706, which provides specific methods for removing a trustee and is more generous in allowing removal than some courts might have been with a statute. UTC section 706 states:

> (a) The settlor, a cotrustee, or a beneficiary may request the court to remove a trustee, or a trustee may be removed by the court on its own initiative.
>
> (b) The court may remove a trustee if:
>
> > (1) the trustee has committed a serious breach of trust;
> >
> > (2) lack of cooperation among cotrustees substantially impairs the administration of the trust;
> >
> > (3) because of unfitness, unwillingness, or persistent failure of the trustee to administer the trust effectively, the court determines that removal of the trustee best serves the interests of the beneficiaries; or
> >
> > (4) there has been a substantial change of circumstances or removal is requested by all of the qualified beneficiaries, the court finds that removal of the trustee best serves the interests of all of the beneficiaries and is not inconsistent with a material purpose of the trust, and a suitable cotrustee or successor trustee is available.
>
> (c) Pending a final decision on a request to remove a trustee, or in lieu of or in addition to removing a trustee, the court may order such appropriate relief under Section 1001(b) as may be necessary to protect the trust property or the interests of the beneficiaries.

For example, without a statute, a court may have been more reluctant to remove a trustee merely because the trustee did not get along with some or all of the beneficiaries. The policy underlying that reluctance was to honor the intention of the settlor, who chose the trustee. UTC section 706 allows qualified beneficiaries — as defined by UTC section 103(13) — to seek removal by unanimous agreement, but their power is tempered by the language that the removal must be in the best interest of the beneficiaries and not inconsistent with a material purpose of the trust. One could argue that, although the statutory language seems more generous in granting the court's authority, the "best interests" and "not inconsistent" required findings by the court practically mirror the common law reluctance based on the settlor's expressed preference in naming the trustee.

The *Lamprecht* court's focus on the statutory provision allowing removal because co-trustees cannot agree, which inhibits positive actions on behalf of the trust may have been technically incorrect, given that the son trustee resigned during the hearing, but that would be an over-technical application of the language. If the son had not resigned, the court clearly had reason to remove both because of their inability to act in concert.

- **Attorneys' Fees Disgorged Despite Apparently Well-Intentioned Trustee**

In *Matter of Ellen C. Stark Charitable Trust*, 203 N.Y.S.3d 425 (App. Div. 2024), the settlor's testamentary trust provided for income to be paid to two charitable beneficiaries. At the time of the trust's creation, both were qualified as tax-exempt under section 501(c)(3). The trust provided that, if either of the charities lost its section 501(c)(3) status, all of the income would then be paid to the remaining qualified beneficiary.

One of the charitable beneficiaries lost its tax-exempt status in 2011, but continued to receive distributions from the trust until 2014. The trustee then contacted the state attorney general's office to propose bringing a petition to reform the trust to change the requirements of the charitable beneficiaries from maintaining tax-exempt status to merely maintaining a charitable purpose. The trustee contended that the settlor "'surely . . . did not intend such a harsh result' as the disqualification of a beneficiary for losing its section 501(c)(3) status due to . . . mere 'shoddy bookkeeping.'" The trustee asserted that both charitable beneficiaries were amenable to the proposed reformation, but the attorney general's office did not consent because the trust terms were clear and the alleged shoddy bookkeeping was not trivial. Eventually, the trustee brought an action to reform the trust, but the non-tax-exempt beneficiary ceased operations.

The attorney general objected to the payment of counsel fees because several years of documentation were missing, most of the legal work was unnecessarily dedicated to reforming the trust, and the fees were excessive. The Surrogate directed the trustee to repay most of the legal fees.

The appellate court noted that a trustee is entitled to reasonable attorneys' fees in administering the trust. However, counsel fees that do not benefit an estate or trust should not be paid from the estate or trust. The appellate court figured that the Surrogate did not act unreasonably in limiting the payment of counsel fees from the trust. Although the trustee contended that the settlor's section 501(c)(3) requirements for the beneficiaries were consonant with her intentions for the trust to also qualify as tax-exempt, the appellate court reasoned that the plain language of the trust provided a purpose that was "just as likely" and "perfectly legitimate": ensuring that the beneficiaries honored their obligations as charities. Finding that the will's language was clear and unambiguous, the appellate court concluded that the proposed reformation was unnecessary. The appellate court held that, once the charity lost its tax-exempt status, the remaining qualified charity was entitled to all the distributions.

Observing that a trustee must be impartial while being loyal to all trust beneficiaries, the appellate court determined that the trust acted to the detriment of the qualified beneficiary by seeking to reform the trust, which was contrary to the express terms of the trust.

Editors' Comment: The ruling created a conundrum that can arise if a court refuses payment of a trustee's legal fees: did trust counsel agree to take a haircut if the court reduced the payment from the trust or is the trustee personally liable to counsel for the disallowed fees.

One might consider the result rather harsh. The opinion noted that, based on the plain language of the trust, it was "just as likely" that the settlor's purpose was consistent with the trustee's position as not. Yet the appellate court seemed to refuse to admit that the trustee could have been acting appropriately in taking the "just as likely" position in pursuing accomplishment of the settlor's purpose. Moreover, the other charity apparently did not object to the trustee's proposal; rather, it was the attorney general's office that did. Query whether such involvement by the attorney general's office was even necessary when the other charity was viable and able to take its own position. Perhaps the result may have been different if the charity that lost its tax-exempt status had not eventually ceased operations.

At least the trustee was not saddled with a constructive fraud claim. Constructive fraud can arise if a beneficiary relies on the trustee acting in good faith. For example, if a trust provides that income is payable to a surviving spouse until that spouse remarries, and the trustee continues to make income payments to a surviving spouse who remarries, the trustee can be liable to the other beneficiaries who were entitled to rely on the trustee checking in a prudent manner on the surviving spouse's marital status. The trustee could have to pay the other beneficiaries the amount of the payments improperly made to the surviving spouse. Although the trustee would be entitled to claw back the improper payments from the surviving spouse, the success of that adventure would depend on the ability of the surviving spouse to make the repayment. However, in *Stark Charitable Trust*, at least the nonqualified charity reimbursed the trust for distributions made after it lost its section 501(c)(3) status.

- **Action Against Trustee Does Not Trigger No-Contest Clause**

In *Spurlock v. Wyoming Trust Company* 542 P.3d 1071 (Wyo. 2024), the settlor's trust benefitted his three children. One son had the right to purchase trust real estate at a discount on the settlor's death. That son, and his wife, exercised the option to purchase and closed on the property. Upon entering the property, they discovered that pipes had cracked and ruptured, causing approximately $80,000 in damages. Initially, they sued a brother, contending that he had turned off the heat, which caused the pipes to freeze. The brother alleged that the trustee was responsible for protecting the property. Eventually, the son and his wife voluntarily dismissed the suit against the brother and instead sued the trustee and its officers, seeking damages and the removal of the trustee. Because the trust contained a no-contest clause, the complaint specifically provided that the suit should not be construed as an action against the trust.

The no-contest clause provided that

> The SETTLOR desires that this trust, the trust estate and the trust administrators and beneficiaries shall not be involved in time consuming and costly litigation concerning the function of this trust and disbursement of the assets. Furthermore, the SETTLOR has taken great care to designate through the provisions of this trust how he wants the trust estate distributed. Therefore, if a beneficiary or representative of a beneficiary or if anyone claiming a beneficial interest in the trust estate or any part thereof should legally challenge or should in any way attempt to impair the function and operation of this trust, its provisions or asset distributions, then all asset distributions to said challenging beneficiary or to the beneficiary upon whose benefit said challenge is raised shall be retained in trust and distributed to the remaining beneficiaries named herein as if said challenging beneficiary or the beneficiary to be benefitted by said challenge and his or her issue had predeceased the distribution of the trust estate.

The trust specifically provided for methods to remove the trustee: by the settlor or, upon the death or incapacity of the settlor, by a majority of the settlor's then-living children.

Contending that the son's action was impairing the operation of the trust and that he had attempted to remove the trustee in a manner not authorized by the trust, the trustee sought to enforce the no-contest provision. The son countered that he was not challenging the trust, but rather was bringing an action against the trustee, which was not prohibited by the no-contest language. Moreover, the son contended that the trust provisions for removal were not exclusive, so that he was allowed to rely on the statutory provisions for causes to remove the trustee. The lower court found for the trustee and enforced the no-contest clause against the son.

Recognizing the general construction rule that the intent of a settlor can be gleaned from the entire trust, the appellate court rejected the trustee's argument that the no-contest clause was intended to preclude any litigation involving the trust. The trust expressly cited two situations in which litigation was possible — one paragraph provided that the trustee could be liable for fraud and gross negligence and another paragraph allowed a trustee removed for incapacity to dispute the removal in court, both of which necessitated litigation. The appellate court cited rulings from other jurisdictions holding that a suit to remove a trustee for cause does not trigger a no-contest provision. "These holdings are based in part on the policy that a trustee cannot hide behind a no-contest clause and commit breaches of fiduciary duty with impunity."

Nor did the appellate court agree that the son's actions impaired the administration of the trust. In bringing the action directly against the trustee, he was merely seeking damages from the trustee, which did not inhibit the trustee's ability — or duty — to continue the administration of the trust. Nor did the son challenge the validity of the trust.

The appellate court also reasoned that the trust's provisions regarding removal of the trustee were not exclusive. Consequently, the son was entitled to rely on the applicable statute for causes to remove a trustee without violating the settlor's intent.

Concluding that the son's action did not impair the administration of the trust or improperly seek removal of the trustee, the appellate court reversed and remanded.

Editors' Comment: Although no such indication of improper motive by the trustee was involved in *Spurlock*, a trustee committing undue influence, whether to seek inclusion as a beneficiary or merely an ability to receive a significant fee as trustee, would likely attempt to influence the settlor to include as strict a no-contest clause as possible, including any attempt to remove the trustee or question its actions. That could have a chilling effect on a beneficiary seeking to seek a ruling that the trustee breached its duty. The concern expressed in *Spurlock*, although pointed to a different issue, would have application to the trustee who unduly influences to gain protection: the court should not allow a trustee to "commit breaches of fiduciary duty with impunity.

Tax Report

- **Tax Court Lacks Jurisdiction to Consider Late Petition Seeking Review of Denied Innocent Spouse Relief Request**

In *Frutiger v. Comm'r*, 162 T.C. No. 5 (Mar. 11, 2024), the Tax Court held that it has no jurisdiction to hear a claim for innocent spouse relief because the petitioner filed a late petition. The court confirmed that the 90-day filing deadline for innocent spouse relief petitions set forth in section 6015(e)(1)(A) is jurisdictional, even though earlier precedent reaching that conclusion had been called into question by a 2022 holding of the Supreme Court.

The case involved a husband who had requested innocent spouse relief in connection with a joint return filed for 2018. The I.R.S. issued a notice of determination denying the request in June 2021. The husband mailed a petition to the Tax Court seeking review 92 days after the date of the determination, and the Tax Court received the petition four days after that (96 days after the date of the determination). The IRS moved to dismiss the petition for lack of jurisdiction.

Section 6015(e)(1)(A) states in relevant part that an individual:

> may petition the Tax Court (and the Tax Court shall have jurisdiction) to determine the appropriate relief available to the individual under this section if such petition is filed . . . at any time after the date the Secretary mails . . . notice of the Secretary's final determination of relief available to the individual, . . . and . . . not later than the close of the 90th day after [such] date .

Given the husband in this case filed a petition after the close of the 90th day after the date the IRS mailed its notice of determination, the question is whether the Tax Court has the power to consider the husband's petition. This, in turn, depends on whether the 90-day deadline set forth in the Code is a "jurisdictional rule" (in which case the Tax Court does not have power to consider the husband's petition) or merely a "claim-processing rule" (in which case the Tax Court has the discretion to consider a late-filed petition on equitable grounds).

In *Pollock v. Comm'r*, 132 T.C. 1 (2009), the Tax Court concluded that the 90-day deadline in section 6015(e)(1)(A) is a jurisdictional rule, both because the statute expressly uses the word "jurisdiction" and because an earlier case, *Boyd v. Comm'r*, 124 T.C. 296 (2005), held that similar language in section 6330(d)(1) relating to petitions challenging correction determinations was a jurisdictional rule. But in 2022, the Supreme Court in *Boechler, P.C. v. Comm'r*, 596 U.S. 199 (2022), held that the time limit in section 6330(d)(1) is but "an ordinary, nonjurisdictional deadline subject to equitable tolling." *Id.* at 211. This effectively overruled the *Boyd* decision. Given that *Pollock* rested in part on *Boyd,* the court here observed that "*Pollock* no longer rests on a sure foundation; that foundation was eroded by *Boechler*."

Acknowledging the need to "revisit our holding *Pollock*," the court then went about determining whether Congress "clearly states" that the 90-day filing deadline in section 6015(e)(1)(A) is jurisdictional. After quoting the statute, the court concludes the deadline "reads as a prerequisite to the Tax Court's jurisdiction." The husband—and the Center for Taxpayer Rights, through an amicus brief—argued that the parenthetical in the statute related to the Tax Court's jurisdiction "can be interpreted to modify many parts of the provision and not specifically the filing deadline." But the court rejected the argument, noting that while section 6330(d)(1) contained an ambiguous reference to jurisdiction in "such matter" that could be subject to multiple interpretations, there is no similar ambiguous language in section 6015(e)(1)(A):

> Specifically, section 5016(e)(1)(A) is a provision that solely sets forth deadlines. Reduced to its essential terms, it provides that "an individual may petition the Tax Court (and the Tax Court shall have jurisdiction) if such petition is filed" by a specified deadline.

The court also found it probative that the *Boechler* Court even observed that section 6015(e)(1)(A) more clearly links the jurisdictional grant to the filing deadline than did section 6330(d)(1).

The amicus brief argued that the deadline in section 6015(e)(1)(A) is not jurisdictional because it is part of a statutory scheme that grants equitable relief. In effect, it asserted that because relief for innocent spouses is grounded in equity, any deadlines in the statute should not be considered jurisdictional. The Tax Court rejected this argument, finding that while some portions of innocent spouse relief contain equitable components, equity is not a sole grounds for relief. "The partial equitable nature of section 6015 is not enough to overcome the clear statutory text." In the end, then, the court determined that because the filing deadline is a jurisdictional rule, it had no jurisdiction to hear the husband's case.

- **Federal Tax Liens Attach to Property Owned by an Invalid QPRT**

In *Sohn v. United States*, ___ F. Supp. 3d ___ (N.D. Cal. Mar. 18, 2024) (2024 Westlaw 1182879), a federal district court held that a federal tax lien on residential property once owned by a qualified personal residence trust (QPRT) was valid because nominal title to the property was held by the grantors rather than by the trust at the time the lien arose. The court also implied that even if the trust held title to the property at that time, the result would be the same because the trust was not a valid QPRT because the trust agreement did not comply with regulatory requirements prohibiting transfer back to the grantors.

In March of 1996, Jeffrey and Olivia, a married couple, purchased a home in Saratoga, California. Shortly thereafter, they transferred their home to a QPRT, retaining the right to occupy the residence for a term generally ending upon the earlier of: (1) the death of either grantor; (2) the expiration of 25 years; or (3) the date the trust ceases to be a QPRT.

In February of 1998, for reasons not disclosed in the case, Jeffrey and Olivia conveyed the property from the trust to themselves as joint tenants with rights of survivorship. They then reconveyed the house to the trust two months later. Then, in April of 2004, they again transferred title back to themselves individually. They retained individual ownership of the house at all relevant times thereafter.

In 2014, the I.R.S. placed federal tax liens on Jeffrey's property related to some $4.5 million in unpaid penalties and interest attributable to the years 1997 through 2004. These liens were recorded in 2016. But now Olivia and other family members have brought this quiet title action seeking a determination that the liens do not encumber the Saratoga residence. The IRS counterclaimed, arguing that the trust is not a QPRT and that it has the power to foreclose its liens on the residence.

In arguing the trust is not a QPRT, the IRS pointed to regulations requiring that the governing instrument of a QPRT must prohibit the trust from conveying the residence during the term of the trust to the grantor, the grantor's spouse, or an entity controlled by the grantor. Treas. Reg. § 25.2702-5(c)(9). That regulation was promulgated in December 1997, nearly two years after the trust at issue in this case was created and funded. In finalizing the regulation, Treasury said it would apply retroactively, but that noncompliant trusts formed before the date of finalization would have 90 days to begin a trust modification to incorporate the new rule. The trust in this case was never modified to reflect the anti-buyback rule in the regulation. What's more, said the IRS, the grantors conveyed the property to themselves in 1998, after the effective date of the regulation. Accordingly, it claimed the trust was no longer a QPRT.

The court agreed, granting summary judgment to the United States on the issue. "Because the Trust Agreement not only fails to prohibit buy-backs, as required by section 25.27025(c)(9) clause (sic), but also contains a buy-back provision specifically prohibited by that provision, the [trust] does not meet 'all' the requirements under the paragraph. Therefore, it does not qualify as a QPRT."

The court also held the IRS could foreclose its federal tax liens on the residence. When the liens arose and were recorded, recall, title to the house was in the names of Jeffrey and Olivia. Though the house would be community property, California law allows the tax liens of one spouse to attach to the entire community property. The plaintiffs contended that, because the trust was irrevocable, the trust was still the actual owner of the home. Apparently their thinking is that Jeffrey and Olivia could not convey property from an irrevocable trust and any attempt to do so would be ineffective. But the court didn't buy it, observing that while the trust purports to be irrevocable, they had the power to terminate the trust by ceasing to reside in the trust property or by buying the house from the trust. Either event would cause the trust to dissolve by its own terms. As the court concluded:

> Given that the terms of the [trust agreement] made the trust terminable under certain circumstances, including when it ceased to be a QPRT, plaintiffs cannot overcome the presumption under California law that when legal title to the [house] was subsequently transferred from the trust to [Jeffrey and Olivia], that transfer validly transferred full beneficial title in the property . . . as their community property. Under California law, that community estate is liable for the debt of [Jeffrey].

Thus, the government could foreclose on the liens.

Editors' Comment: Because of historically low interest rates for much of the past 15 years, few estate planners have recommended QPRTs to their clients. As interest rates increase, however, the QPRT becomes more attractive. This case serves as a reminder both that QPRT instruments must affirmatively restrict transfers back to the grantor, the grantor's spouse, or an entity controlled by the grantor and that a QPRT can offer some creditor protection. If the house had been held by a valid QPRT when the federal tax liens arose, the court noted that Jeffrey's federal tax liens would not attach to the property.

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