Trust and Estate Planning Update
2019

by James E. Bache
(Not to be considered legal advice)

I. The Trump Tax Act (The Tax Cuts and Jobs Act (TC JA)) increased the basic exclusion amount through 2026. This year the basic exclusion amount is $11,400,000. The amount is indexed for inflation and thus will increase through 2026, when it sunsets and we return to the pre-Act amounts as indexed for inflation through that date. The pre-Act amount indexed for inflation will be around $7,380,000 in 2026, assuming a 3% inflation rate. The estate tax rate is 40%. A deceased spouse's unused exclusion (DSUE) can be "ported" to the surviving spouse by election on a timely filed Form 706 Estate Tax Return. If decedent's estate does not meet the filing requirement ($11.4 Million), then taxpayer favorable rules for completing the Return apply.

Gift tax annual exclusion, also indexed for inflation, remains at $15,000.

II. Planning Implications of the High Exclusion World:

A. For married clients having a combined estate valued well under the likely 2026 basic exclusion amount, a traditional maximum funding formula A/B Trust is not only not needed, but likely will result in increasing the total taxes paid, as the B Trust will not receive a second step up in basis upon the death of the surviving spouse. For these clients, their existing A/B Trust should be amended by restatement so as to do away with both the B Trust and the need for a split upon the death of the first to die.

B. For clients in a second marriage having estates valued well under the likely 2026 basic exclusion amount who wish to control the ultimate distribution of their own estate, it is likely best to use an A/C Trust rather than an A/B Trust. The C Trust (a QTIP Marital Trust) need only give the surviving spouse income for life and its principal will receive a second step up in basis upon the death of the surviving spouse, thus escaping capital gains taxation on the appreciation occurring after the death of the first spouse to die. The C Trust, like the B Trust, also offers protection from the creditors of the surviving spouse. If the client wants the income interest to end uppon remarriage, then you are stuck with a B Trust, since a C (QTIP) Trust must give all income to the surviving spouse for life.

C. For clients who are near or may have estates in the future valued near the likely 2026 basic exclusion amount who do not require control over the ultimate distribution of their own estate, I recommend using a trust that funds a Survivor's Trust (an A Trust) with all of the assets, but allows the surviving spouse to disclaim the deceased's assets, or a portion thereof, which will then pass to a B Trust. This would allow them to trim off non-appreciating assets if available which could be placed in the B Trust without risk of generating future capital gains. Electing to so fund the B Trust will then allow the use of the basic exclusion amount of the first spouse to die to shelter some of the combined estate from estate taxation, thus minimizing the possibility of an estate tax occurring due to an inadvertent loss of the DSUE. If all of the assets are appreciating assets, then a Clayton QTIP Election could be made as to a part or all of the B Trust, which portion would then become a C Trust.

D. For clients whose combined estates exceed their combined available basic exclusion amounts, an A/B or A/B/C Trust may offer tax savings as the appreciation on the assets in the B

Trust, while being subject to the 20+ percent capital gains tax, will escape the 40% federal estate tax. If instead, all property passes to the surviving spouse or to a C Trust and the deceased's unused exemption is ported to the surviving spouse, because the DSUE amount is static, the appreciation in excess thereof will be taxed at the 40% estate tax rate. These clients may be candidates for a Clayton QTIPable "bypass trust" which will provide the flexibility to defer the decision whether to fund the B Trust to the time of the first death.

E. Obviously, if the estate tax is no longer a genuine concern for the bulk of the clients, then planners will need to refocus on the clients' needs for the trust's control over time of the benefit of the assets held in trust, avoidance of probate, and asset protection. Planners may add value to basic trusts by encouraging distribution to asset protection sub-trusts for the ultimate beneficiaries. Note, asset protection sub-trusts for children or grandchildren will likely pose the possibility of generational skips subject to the GST tax, so you will want to include appropriate language regarding the segregation of GST exempt assets from non-GST exempt assets and the establishment of otherwise identical sub-trusts, one being exempt and the other not. The GST tax exemption mirrors the estate tax exemption. Exemption is automatically allocated to GST Trusts, unless you opt out by filing a timely 706 Estate Tax Return.

F. **Note, the following comments are not tried and tested –they are only my thoughts on things that might work.** Many clients with funded B Trusts or other irrevocable trusts may need to take steps to minimize the capital gains consequences of the B Trust. During the survivor's life, consider a purchase for cash or a promissory note. Such is an exchange and thus will have immediate income tax consequences. If the purchase is at the "basis" value and FMV is higher, then there may be a gift component to the transaction. To avoid the gift component you might first transfer the assets of the B Trust to an entity with fractional interests and then purchase the fractional interests in steps over time at their discounted FMV. Consider amending or modifying the B trust. Modifications might be accomplished through judicial reformation, family agreement, use of the trust protector provisions of the trust, or decanting the trust. All of these actions should only be accomplished with either the consent of all beneficiaries or approval of a court so your Trustee client does not get sued for failing to comply with the Trust's terms.

Modifications may be done to obtain a step up in basis, minimize income taxes or estate taxes, qualify a beneficiary for government benefits, change the trustee, adjust or remove a power of appointment, move the trust to a new jurisdiction, change the governing law, or add or remove a trust protector. Because irrevocable trusts are irrevocable, changes involving the addition or removal of beneficiaries or changes to the distributive terms may not be safely accomplished. If a trust is no longer economical or practical and changes are desired and they cannot be accomplished through one of the above processes, then the planner should consider how to terminate the trust.

G. Standalone trusts as beneficiaries of IRAs and other retirement funds are being marketed as asset protection devices and will allow the life expectancy of the trust beneficiary to be the measuring life for the calculation of the required minimum distribution. If trust with multiple beneficiaries are going to receive funds from IRAs and other retirement accounts, then make sure

you include a conduit provision so that the life expectancy of contingent remainder beneficiaries do not need to be considered when determining the life expectancy of the trust, which is the life expectancy of the oldest beneficiary. Also, make sure the trust otherwise qualifies as a "see-through" trust: namely: 1) it is irrevocable at the time benefits are to be paid to it, 2) it only has individuals as beneficiaries, 3) all beneficiaries are ascertainable and 4) by September 30 of the year following the Plan owner's death the beneficiaries names and dates of birth are provided to the Plan Administrator..

III. Current events and other planning suggestions:

A. The commoditization of legal services continues at a rapid rate, causing planners to consider life under a time of declining revenues. Case in point, AZ has passed a bill allowing for electronic Wills. Effective June 30, 2019. This might allow Internet providers like Legal Zoom who already have an Internet presence and the digital know-how to take over the market for Wills in Arizona.

B. More importantly, House Bill 2054 changes who may witness a will in Arizona. Previously, ARS §14-2505 did away with the common-law rule that a beneficiary or other interested party could not be a witness. For any will executed on or after October 1, 2019 unless the will is made self proved, a person may not act as a witness to the will if that person is a devisee under that will or is related by blood or marriage or adoption to a devisee under that will.

C. The Secure Act seems destined to become law. It would extend to age 72 the date upon which you must begin to take retirement distributions.

D. A drafting suggestion. When your trust states that it can be amended by the settlors by an instrument in writing signed by them and delivered to the trustee, consider adding the word "only" to the statement. Otherwise, under the Restatement Third, without the word "only", the method of amendment is not the exclusive method and thus the trust may be amended even verbally. Note, however, Arizona rejected the Restatement Third's approach to this when it adopted the Arizona Trust Code. The Code states that when a written trust states it can be amended by a writing signed by the settlors and it is not stated as the exclusive method, then the trust can only be amended by certain writings, one of which is by a later Will which either refers to the trust or disposes of property which would otherwise be disposed of by the trust. See, ARS 14-10602.

E. Note, there are new proposed Rules of Probate Procedure.

F. Tom Petty left two adult daughters and a second wife who are duking it out over who controls his Trust Estate. Apparently his Trust named his second wife as Trustee, then included language giving his daughter's "equal participation" in the decisions regarding the handling of his trust estate and his catalog of music. Also, the Trust called for the catalog to be held by a yet to be formed entity called Petty Unlimited, LLC, but wife transferred it to another entity. The lesson, define nonstandard terms when drafting documents so as to avoid the need for court interpretation.

G. Michael Jackson's Estate Tax Return reported the value of his likeness and image at $2105. That's not a typo. The estate is valuing Jackson's likeness at less than your used car. The IRS values it at $434 million. The estate reported the value of the entire estate as being $7 **million**. The IRS says the estate and lifetime taxable gifts have a value of $1.178 **billion**. The IRS wants $731 million in additional tax and penalties. Jackson held a 50% interest in a joint music publishing venture called Sony/ATV Music Publishing, the largest music publishing company in the world. It owns millions of songs and contains the Beatles songs purchased by Jackson. The estate valued the interest at a measly $2.2 million. The IRS says it's worth $527.5 million. Reportedly the Jackson estate has made since his death over $700 million on deals involving his likeness, including the Cirque du Soliel show based on him and his songs. A three week trial before the Tax Court was held two years ago and they are still filing post trial motions, the latest was this last April when the Jackson estate requested the court strike the testimony/opinion of the IRS valuation expert because it's not based on reality. Now, even though the estate has done well after Michael's death, the issue is what was the word of his likeness on the date of his death. The state argues the value jumped post death as a result of his death. That jump in the value is not part of his taxable estate.

H. Aretha Franklin died without a Will, or so they thought. Now three handwritten instruments consisting of 16 pages have been located and presented to the probate court.

I. The TCJA also lowered the effective combined income tax rate on C Corps and their dividends from 48% to 38.6%. That is a C corporation rate of 21% and a 20% rate on its dividends. To provide similar relief to pass-through entities, Section 199 A lowered the top rate on qualified business income, pass-through entities to an effective rate of 29.6% by allowing a deduction equal to 20% of the qualified business income. If you have questions speak with the CPA.

J. The IRS recently issued guidance confirming there will not be a "clawback" of the current gift tax rates when they are lowered upon the sun-setting of the TCJA in 2026.

IV. Arizona Cases Decided in 2018:

1. *In Re Estate of Corrigan*, 1 CA-CV 2017-0482. Memorandum Decision. Notable only because it involved a rebuke of the arguments made by Peter Williams and Emilie Halliday to the extent that the Court of Appeals awarded fees against Peter, Emilie, and their client, jointly and severally, pursuant to ARS § 14-11004 (B). The Court of Appeals found the claims were brought without substantial justification and the attorneys were engaged in unreasonable conduct in bringing said claims. The above statute doesn't authorize an award against the attorneys, just against the party who acted unreasonably. It is a fee shifting statute, shifting the fees incurred by a Trustee from the Trust to the opposing party. The prevailing party also cited to ARS § 12-349 and the Court mentioned paragraph F; and ARS§ 14-1105 and the Court mentioned paragraph A. The latter statute includes authority to make awards against attorneys and it applies to trusts as well as the estates. The former statute of course addresses "civil" actions and allows awards if the claim lacks substantial justification (defined as being "groundless and not made in good faith").

2. *In Re Estate of Keller*, 2CA-CV 2018-0083. Another Memorandum Decision. This case is of interest to PI and collections attorneys. It involved a claim against the estate which claim was filed with the court. The claim was found not to have been properly and timely presented because the evidence failed to show receipt by the PR or PR's attorney, even though claimant claimed a copy had been mailed to said attorney. This highlights the need to read and follow statutes. The creditors claim statute states a claim must be presented and presentment occurs upon receipt by the PR. Practice suggestion: send creditors claims by certified mail return receipt requested. Filing with the court is not presentment.

Back in the late 80s I had this same issue arise and we filed on behalf of the PR a motion seeking the court's confirmation of the disallowance of the claim. In that case, there was a mailer on the notice of claim filed with the court, but we never received the copy. The court determined that the mailer was insufficient as it was the burden of the claimant to establish presentment and they could not contradict the affidavit of my staff, who opened the mail daily, that the Notice was never received. Note, even if you make this mistake, if there is insurance coverage, the claim can still be brought to the extent of and against the insurance, but not against the decedent's estate.

3. *Kistler v. Kistler*, 1 CA-CV 17-0010. Memorandum Decision. Affirmed a lower court's later interpretation of a Settlement Agreement that had been read into the record upon the conclusion of a mediation. Practice note-always require subsequent written agreement/order so all of the ifs, ands, ors, and buts can be fully addressed and have the mediation judge retain jurisdiction to resolve any disputes which arise in connection with the preparation of and execution of the written agreement/order.

4. *Black v. Mitsvotai*, 2CA-CV 2017-0207. Memorandum Decision. Court of Appeals affirmed due to Pro per Appellant's failure to follow the briefing requirements of ARCAP Rule 13 (a)(7) and failure to do so constituted a waiver of his argument. Note, it seems there were a number of cases reaching the appellate court that were Pro per and they were often dismissed for failure to follow the briefing requirements.

5. *In Re Estate of McConnell*, 1CA-CV 17-0554. Memorandum Decision. Affirmed lower court's finding that no probate was necessary because estate could be collected by Small Estate Affidavit and that Petitioner seeking appointment as PR was unqualified due to his incarceration.

6. Chalker v. Chalker, 430 P.2d 375 (App. Div 1, 2018). Addressed the statute which requires claims in probate to be paid with interest at the legal rate (or contracted for rate) for the period commencing 60 days after the time for original presentation of the claim has expired.

7. *In Re Evitt*, 429 P.3d 1146 (App.Div 1, 2018). Another claim, barred by running of claim statute. Involved whether claim was a pre–death claim, which must be asserted within 4 month creditor's claim period, or a post death claim. Decedent agreed in divorce settlement to maintain life insurance. He didn't. Claimant, the former spouse, couldn't bring claim before death because the obligation wasn't breached until death. Nonetheless, court found it was a pre-death claim because the claim occurred when the decedent failed to maintain a life insurance policy per the agreement.

8. *In Re Estate of Riley*, 2 CA-CV2017-0090. Memorandum Decision. Has an interesting analysis of ER 1.9 (a) which states, "a lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent." The Court of Appeals upheld the lower court's decision not to disqualify, finding there was no abuse of discretion. The disqualification Motion came late in the litigation and Movant showed no harm occurred as a result of counsel's noncompliance with the rule.

9. *In Re Estate of Brisbon*, 1CA-CV 16-0711. Memorandum Decision. The appointment of a PR appointed without proper notice to interested parties is not void ab initio, merely voidable.

10. *In Re The state of Ross*, 2 CA-CV 2017-0154. Memorandum Decision. Pro per. Again, failure to comply with appellate briefing procedure constitutes waiver of appellant's argument.

11. *In Re Estate of Bradley*, 420 P. 3d 216, (App.Div.1, 2018). The court resolved an open question, namely, whether a notary who notarizes the Will can be deemed a witness to the Will when there is only one other witness so as to comply with Arizona's two witness requirement. The answer is, yes.

12. *In Re Richard Fell*, 1 CA-CV-17-0675. Memorandum Decision. Odd case involving Pro per in lower court. Of no import.

13. *In Re Streaker*,1CA-CV 17-0188 Memorandum Decision. This case involved poor drafting and a need for court interpretation. Lower court's interpretation was affirmed. Interesting because the Court of Appeals struck, due to failure to comply with the briefing prerequisites, the Appellant's first draft of an opening brief prepared and filed by an attorney, but allowed a second draft to be filed. At the conclusion, after affirming the lower court decision, instead of awarding fees for unreasonable conduct or an unjustified position, the Court of Appeals fined appellant's attorney $500, personally.

14. *In re Estate of Sibley*, 1CA-CV 17-0369. Interesting case on "precatory" words that are dispositive instead of just being wishful thinking. Also addressed the Arizona statute authorizing decanting. For some reason, as a preparatory matter, the court felt a need to eviscerate the one year bar provided for in ARS §14-10604(A)(1), which prevents challenges to the validity of a trust that is revocable at the time of death. In my opinion, every planner believed the purpose of the statute was to facilitate the administration of a trust revocable at death but which becomes irrevocable upon death of the settlor by requiring those who would contest the validity of the trust document or who have competing documents to bring their case forward within one year after decedent's death. That was this case. Instead, the Court of Appeals found the bar of the statute did not apply because the statute only applies to revocable trusts and this trust became irrevocable upon the settlor's death. I think the court's opinion on this point was dicta and thus will not stand as precedent on the interpretation and application of the statute.

15. *In re Estate of Ode*, 1 CA-CV 2018-0057. Memorandum Decision. This case involved the disposition of payments after death by the United States to victims of state-sponsored terrorism pursuant to a statute that was passed well after the death of a husband and wife. The husband who was the victim died in 1995. His wife died in 2012. The statute, passed thereafter, stated that the compensation went to the deceased victim's estate. In this case, when the husband died his estate passed to his wife. When she died, her estate went to a trust the distribution of which was to charities. The decedent's nephews, who were given during life all items associated with the victimization, challenged the disposition saying that the gift served to transfer the compensation. Court held that you cannot make a lifetime gift of something you don't have. Since the federal statute stated the compensation passed to the victim's estate upon his death, it then passed to his wife pursuant to his Will and then passed upon wife's death to the charity.

16. *In re Loesch*. This case involved a question of whether the person was a vulnerable adult. That is an individualized question of fact. Court of Appeals found the lower court erred as there was insufficient evidence to establish the person was a vulnerable adult.

Note: of the above cases, most were Memorandum Decisions. They are not precedent and cannot generally be cited for such purpose, but now, per AZ Rules of Supreme Court 111(c), they can be used for persuasive value, provided they were decided after 1/1/2015; no other opinion adequately addresses the issue before the court; and the citation is not to a depublished opinion or portion of a depublished opinion.

V. Final Thoughts:

1. **Ethics Matter**. Since January 1, 2016 you have been ethically required to have a succession plan. See the Bar's website for forms and details.

2. QCDs (Qualified charitable distributions) are now permanent. You can give up to $100,000 from your IRA to a 501(c)(3) charity **directly** without having to declare the income, but you don't get a charitable deduction. This can be used as a good planning tool for those receiving RMDs who don't want the resulting increase to their taxable income and who are making regular charitable contributions. They can direct the RMD, or a portion thereof, to be distributed directly to the charity, effectively redirecting the taxable income to the charity, and do so in lieu of their regular charitable contribution.

14-10604 Limitation on actions contesting validity or revocable trust; distribution of trust property

14-10604. Limitation on actions contesting validity or revocable trust; distribution of trust property

A. A person may commence a judicial proceeding to contest the validity of a trust that was revocable at the settlor's death within the earlier of:

1. One year after the settlor's death.

2. Four months after the trustee sent the person a copy of the trust instrument and a notice informing the person of the trust's existence, of the trustee's name and address and of the time allowed for commencing a proceeding.

B. On the death of the settlor of a trust that was revocable at the settlor's death, the trustee may proceed to distribute the trust property in accordance with the terms of the trust. The trustee is not subject to liability for doing so unless either:

1. The trustee has actual knowledge of a pending judicial proceeding contesting the validity of the trust.

2. A potential contestant has notified the trustee in writing of a possible judicial proceeding to contest the trust and a judicial proceeding is commenced within sixty days after the contestant sent the notification.

C. A beneficiary of a trust that is determined to have been invalid is liable to return any distribution received except to the extent that the beneficiary is a bona fide purchaser for value without notice.

14-2505 Witnesses; requirements; definition

This section is likely affected by New Legislation. Although the new codification has not yet been released, the likely impact of the new legislation is reflected below.

Codified Section:

14-2505. Witnesses; requirements

A. A person who is generally competent to be a witness may act as a witness to a will.

B. The signing of a will by an interested witness does not invalidate the will or any provision of it.

As Affected by Hb2054

Effective Date: 6/30/2019

A. A person who is generally competent to be a witness may act as a witness to a will.

~~B. The signing of a will by an interested witness does not invalidate the will or any provision of it.~~

B. For any will executed on or after October 1, 2019, unless the will is made self-proved as prescribed in section 14-2504 or 14-2519, a person may not act as a witness to a will if that person is a devisee under that will or is related by blood, marriage or adoption to a devisee under that will.

C. For the purposes of this section, "devisee" means a person who is designated in the will to receive a devise or who is a beneficiary of a trust that is designated in the will to receive a devise.

Affected by Hb2054