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4Q 2023

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Being a trustee can be costly.

Richard and Joan Mueller created a living trust in 2004. Their two daughters, Amy and Katherine, were equal residual beneficiaries. Amy and then Katherine were named successor trustees upon the deaths of their parents. The trust also provided for a $10,000 distribution to Julie, Richard's daughter from an earlier marriage. The trust included a no-contest clause, but by its terms it did not apply to subsequent amendments.

The trust was first amended in 2005. Joan died in 2017, and Richard was diagnosed with terminal cancer two months later. A second amendment was then made to the trust naming Amy and Katherine as co-trustees.

In early 2018, Amy moved into the family home to take care of her father. In April 2018, she e-mailed a copy of a handwritten letter to the family attorney, Gabriel Lenhart, asking for a third amendment to the trust. This amendment named Richard's brother, Thomas, as successor trustee instead of the daughters. It provided for $10,000 for each of Thomas' daughters. A life estate in the family home was granted to Amy, and she would be required to personally cover maintenance costs for the home. The residuary would be divided equally among Amy, Katherine, and their stepsister, Julie.

Although the amendment was not entirely in accord with the letter of instructions, Richard purportedly executed the third amendment about an hour after it was received. A week later, a second version of the third amendment was sent. In this version, Julie again received $10,000 rather than one-third of the residuary. Consistent with the letter of instruction, a $100,000 account would be established to cover maintenance expenses while Amy was in the home.

Richard died in August 2018. After his death, Thomas took over as successor trustee, as required by the third amendment. Katherine filed a lawsuit to declare the third amendment invalid as improperly executed and a product of undue influence. She also demanded an accounting of the trust.

At trial in June 2020, substantial issues arose about the execution of the third amendment by the attorney. Counsel for both Katherine and Thomas asked that the proceedings be suspended. A week later, Amy filed a petition asking that the third amendment be disregarded.

She testified that the first version of the amendment did not reflect Richard's testamentary wishes, and although the second version did reflect those wishes, it was not validly executed. She asked that a private fiduciary be appointed as successor trustee, rather than Thomas. The court granted her wishes.

In his accounting for the trust, Thomas noted that he had spent over $200,000 of the trust's assets in defending it against Katherine's lawsuits. Her next petition was that Thomas should reimburse the trust for those expenses, because they were not authorized by the specific language of the trust.

That petition was granted. Not only were the expenses not authorized by the trust, but Thomas had breached his fiduciary duty by not acting neutrally in the dispute over the third amendment. What's more, he had a conflict of interest, as he was effectively advocating for the inheritance for his own daughters.

The Court of Appeals affirmed the lower court ruling.

—Zahnleuter v. Mueller, 305 Cal. Rptr. 3d 474 (Cal. Ct. App. 2023)

COMMENT: The Court also awarded costs to Katherine. All in all, it was an expensive lesson about being the trustee for a family trust.

Hoarder loses a will

As Patricia Lynch-Carbaugh aged, she had trouble keeping her household. She was estranged from her two sons. Patricia had a will executed by attorney Donna Wilson in 2018, and enrolled in a "maintenance program" that allowed for updating her estate planning documents at no additional cost. Patricia updated those plans three times, the last time being in July 2020. She paid for the maintenance program through August 2021, but Patricia died in March 2021.

That final update to the will included a specific disinheritance of the sons "for reasons personal to [Lynch-Carbaugh] and known to them." After Patricia died, her executor was unable to locate the final will in the mess that her house had become. There was evidence of rodent infestation, and documents littered all over the home. The disarray was documented with photographic evidence. The executor produced a copy of the last will for probate.

The sons objected that there is a presumption that, when a will cannot be located, it has been revoked by the testator through destruction. True, ruled the court, but the presumption may be overcome by clear and convincing evidence. Here, the condition of the house provided an explanation for the failure to locate the document. Given her subscription to the maintenance program, it was unlikely that Patricia would have revoked her will without consulting the attorney she had prepaid for services. There was no such consultation, nor any other indication from others that Patricia had entertained second thoughts about the July 2020 draft of the will.

—Glynn v. Kenney, 884 S.E.2d 259 (Va. Ct. App. 2023)

COMMENT: The sons were evidently hoping that if the will were tossed, they would inherit Patricia's estate by intestacy. But the court observed that "the explicit exclusions of her sons in her will indicated a clear desire that her estate not pass by intestacy; indeed, her lawyer testified that she was consistent that she wanted charities to inherit her estate." Taken as a whole, the evidence overcame the presumption, and the sons lost.

Substantial compliance sufficient for a beneficiary change

On September 5, 2016, Teresa James informed her husband of 13 years, Dr. James Rocconi, that she was leaving him. She filed for divorce three days later. Accordingly, on September 9, Dr. Rocconi changed his will to disinherit Teresa in favor of his three adult children. On October 17, 2016, Dr. Rocconi called Allianz Insurance Company to determine what, if any, insurance policies he had with them, and to remove Teresa if she was a beneficiary of any of them, because she had left him. The call was recorded, so we know that he told the representative, "She could have told me that the Pope left the church and was getting married, and I wouldn't have been more shocked."

The representative sent a change-of-beneficiary form via fax, which Dr. Rocconi filled out by hand and returned via fax the same day, removing Teresa as beneficiary. Apparently, the insurance company did not record the change, but instead sent a letter to Dr. Rocconi stating that the form was incomplete without his signature. However, no evidence of such a letter was found among his papers.

After Dr. Rocconi's death, the insurance company notified Teresa about the $300,000 death benefit. The children and the estate's executor intervened, claiming that Dr. Rocconi had substantially complied with the requirements for changing the beneficiary. The lower court agreed, the Court of Appeals reversed, and the Supreme Court of Arkansas reversed again, reinstating the lower court's decision. "Under Arkansas law, only substantial compliance with the insurance policy's change-of-beneficiary procedures is required." The completion of the faxed form, buttressed by the testimony of Rocconi's lawyer and the recording of his conversations with the insurance company, are sufficient to meet that test.

Saving the DSUE

The amount exempt from the federal estate tax became portable for married couples in 2010, but apparently many executors remain unfamiliar with the rule. To claim the Deceased Spouse's Unused Exemption (DSUE), a federal estate tax must be filed. In cases where the estate was small enough that a federal estate tax return was not required, the IRS has routinely allowed for an extension of time to file a late return to make the election. No reason is needed to explain the oversight. However, larger estates are out of luck.

—Private letter ruling 202343027

—Private letter ruling 202343033

COMMENT: The amount exempt from federal estate and gift tax is scheduled to be cut in half in 2026. So far, all previous legislative reductions in the exempt amount have been rescinded before the deadline, but this time could be different. If the exempt amount really is reduced this time, having the DSUE for a surviving spouse will be very important, so we may expect a flurry of private letter ruling requests in 2024 and 2025.

Special assets require special handling

"This case is a quintessential example of the pitfalls of holding nontraditional, non-publicly traded assets in an IRA. Failure to follow the labyrinth of rules surrounding these assets can mean forfeiting their tax-advantaged status."

That's the concluding observation from Tax Court Judge Copeland about a tax controversy that began eight years ago. Actor James Caan had two IRAs, one of which held a partnership interest in a hedge fund. The partnership interest was not publicly traded. As such, the IRA custodian was required to report the year-end value of the interest to the IRS every year, or the custodian would face substantial penalties. Accordingly, the IRA custodial agreement stipulated that Mr. Caan would report to the custodian the value of the partnership interest every year.

No such report was sent to the custodian for 2014. The case does not make clear who dropped the ball that year, because reports had been sent in earlier years. The custodian made several attempts throughout 2015 to get the necessary figures, sending letters to the hedge fund as well as to Mr. Caan's financial advisors, to no avail. When all the correspondence went unanswered, the custodian resigned, and sent a notice that the hedge fund interest was being returned to Mr. Caan, in accordance with the custodial agreement. Further, the value of the interest, some $1.5 million, would be reported to the IRS as a distribution to Caan from the IRA.

Still, there was no response from the financial advisors, until they received Form 1099-R. The distribution was reported on Caan's 2015 income tax return, but was characterized as nontaxable because it was rolled over into an IRA. That was not true at the time of the filing. The interest was liquidated about a year after the distribution, and the proceeds were then deposited in an IRA.

The IRS noticed that the attempted rollover happened long after the 60-day window for rollovers had expired, and issued a notice of deficiency for the taxable distribution. The deficiency notice was sent in April 2018, and in July 2018 Mr. Caan asked for a private letter ruling waiving the 60-day limit. Such a ruling was denied, and the case went to the Tax Court.

Mr. Caan's advisors claimed that they had never received the letters from the IRA custodian, but the Tax Court was not persuaded. The custodian had kept meticulous records, and the story held together very well.

As it happens, violating the 60-day rule was not the most important problem here. When property (as opposed to cash) is distributed from an IRA, only that exact same property is eligible to be rolled tax-deferred into a successor IRA [IRC ¤408(d)(3)(A)(i)]. Even if the IRS had issued a waiver of the 60-day rule, the distribution would have been taxable because the character of the property changed when hedge fund interest was liquidated, ending the rollover privilege.

—Estate of James E. Caan et al. v. Commissioner; No. 14783-18; 161 T.C. No. 6

COMMENT: Mr. Caan died during the pendency of this litigation, and it was continued by his estate. The only good news for the estate was that the IRS agreed to withdraw the accuracy-related penalty of $155,000.

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