PHILADELPHIA BAR ASSOCIATION

# Probate and Trust Law Section Newsletter

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IN THIS ISSUE



## REPORT OF THE CHAIR

BY ROSS E. BRUCH ESQUIRE | BROWN BROTHERS HARRIMAN & CO.

It has been a very busy first half of the year for the Probate and Trust Law Section's subcommittees. As many of you know, the Section is made up of ten different committees and also benefits from the work of four liaisons that work closely with other groups within the Bar Association. Without the hard work of the committee chairs, liaisons, and members of each group who volunteer their time, the Section simply would not function. While it would take too long to report on all of their activities, here are a few highlights of the last quarter:

- In June, the Education Committee, chaired by Amy Quigg and Devin Fox, held a hybrid Section Quarterly CLE, titled *Health Care Decision-Making: Addressing Life and Death from Legal and Practical Perspectives*. In addition to offering useful insight from both legal and medical perspectives, this CLE is notable because it is the first Quarterly CLE to include an in-person option in nearly three and a half years. The topic for the next Quarterly CLE (October) is will contests and it will also have an in-person option.
- Also in June, the Diversity Committee, chaired by Chloe Mullen-Wilson, working together with the SeniorLAW Center and the Section's Community Service Liaison Valerie Snow, held a well-attended document planning clinic for Philadelphia senior citizens who received wills, health care directives, and financial powers of attorney. Earlier in the year the Diversity Committee also hosted a CLE on intersectionality and its importance to the legal profession.
- In April, the Elder Law and Guardianship Committee, chaired by Bess Collier and Linda Hee, hosted a CLE that was focused on eligibility rules for Medicaid long-term care benefits. The panelists also addressed issues surrounding

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### NEWSLETTER ARTICLES

Would you like to see something in future issues of the Probate and Trust Law Section Newsletter? Then, why don't you write it? If you are interested, please contact the editor:

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## REPORT OF THE CHAIR, CONTINUED

Medicaid that have arisen coming out of the pandemic.

- The Section's Young Lawyers' Division Liaisons, Melissa Siravo Hensinger and Ryan Ahrens, have organized associate peer groups with the goal of joining trust and estate associates with similar years of experience - a revival of an important program that has been underutilized in recent years. Additionally, Melissa and Ryan worked with Business Planning Committee Chairs, Alicia Berenson and Dan Levine, to help organize a joint mixer in June with members of the Tax Section and the Young Lawyers Division.

- The Tax Committee, chaired by George Deeney and Elizabeth Roberts, recently hosted a CLE providing an overview of Spousal Lifetime Access Trusts and their role in estate planning for married couples.

Again, the events listed above are just a part of the efforts the Section's committees have already put in in 2023, including the excellent research and reporting in which these and many other committees have engaged to ensure sections members stay informed and up to date on the latest developments in our field. If you've missed any of these events and weren't aware they occurred, please subscribe to the Probate and Trust Law calendar on the Bar Association's website. The second half of the year promises to be just as busy as the first half and if you're not already, now is as a great time to become more active with the Section.

## JOIN A COMMITTEE

The Section's committees depend on the steady flow of people, energy and ideas.

Join one!

Contact the section chair:

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# QPRTS ARE BACK, BUT SHOULD THEY BE?

BY ALICIA BERENSON, ESQUIRE | BALLARD SPAHR LLP.

In this inflationary environment, federal interest rates in the last year have been higher than we have seen since 2007. An increased IRC §7520 rate makes certain estate planning tools such as a Grantor Retained Annuity Trust (GRAT) less appealing. On the flip side, high IRC §7520 rates are bringing back some estate planning tools for clients with taxable estates, such as the Qualified Personal Residence Trust (QPRT), that have been out of favor for the last decade of low interest rates. This article will give a quick background about QPRT planning and then detail some of the common issues that practitioners should be wary of when counseling clients with respect to QPRTs.

**QPRT BASICS**

A QPRT is a trust to which the grantor transfers her personal residence but retains the right to live in the residence for a period of years (the "Trust Term"). At the end of the QPRT's Trust Term, the residence is distributed to remainder beneficiaries (either individuals or a continuing trust). One gift tax benefit is the grantor's retention of the right to reside in the residence reduces the current value of the gift of the residence to the QPRT for gift tax purposes. Another gift tax benefit is that all post-transfer appreciation in the residence is removed from the estate of the grantor, thereby avoiding tax. Thus, if the grantor survives the term of the QPRT, the grantor can transfer a valuable residence at a deep discount. Because the value of the grantor's retained interest increases as the IRC §7520 rate increases, practitioners are beginning to more frequently recommend QPRT planning to their clients.

The simple example below shows how this higher interest rate environment makes QPRT planning more favorable from a tax savings perspective. Two years ago in July 2021, the IRC §7520 rate was 1.2%. The July 2023 IRC rate is 4.6%. If a 70-year-old grantor transferred her $1 million residence into a QPRT in July 2021, and she retained a 10-year right to use and occupy the residence, that transfer would result in a taxable gift of about $650,000 (the grantor's retained interest is approximately $350,000). If the same transfer of the $1.0 million home to the QPRT occurred in July 2023 when the IRC §7520 rate is 4.6%, the taxable gift would be about $470,000 (the grantor's retained interest is approximately $530,000). Thus, there is approximately $200,000 of additional tax savings now over an identical QPRT instituted only two years ago.

In order to qualify as a QPRT, the trust must meet the requirements set forth in Treasury Regulation 25.2702-5(c) which are set forth below.

1. The Trust must hold no other assets other than an interest in one personal residence and certain related assets (such as proceeds from a sale). In addition, the personal residence is to be used only by grantor, grantor's spouse, and the grantor's dependents as a residence.

2. The Trust must distribute income to the grantor at least annually and no distributions of principal can be made from the trust to anyone other than the grantor.

3. The governing instrument must prohibit prepayment of the grantor's interest.

4. The governing instrument must provide that a trust ceases to be a QPRT if the residence ceases to be used

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or held for use as a personal residence of the grantor (with further specific rules for when the property is sold or damaged/destroyed).

5. The governing instrument must provide that, within 30 days after the date on which the trust has ceased to be a QPRT, the assets of the trust must be distributed outright to the grantor or the assets of the trust must convert to a GRAT for the benefit of the grantor for the remaining term of the trust.

6. The governing instrument must prohibit the trust from selling or transferring the residence, directly or indirectly, to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse.[1]

### POTENTIAL PITFALLS WITH QPRTS

As shown in the above example, in this higher interest rate environment, a QPRT can seem like a perfect tax saving option for our clients. However, there are some issues that can arise during the term of the QPRT and after its termination that an estate planner should be aware of in order to have an open and fulsome discussion with clients about the pros and cons of utilizing a QPRT.

Potential issues could arise during the term of the QPRT if the grantor contemplates making improvements to the residence or selling the residence. While the grantor has the right to occupy the residence during the term of the QPRT, she is only responsible for regular maintenance and repairs to the residence. If the grantor makes any capital improvements to the residence (e.g., adding an addition or renovating a kitchen or bathroom), the money she spends would be considered additional gifts and must be reported as such on gift tax returns. Accordingly, estate planners must make sure their clients understand the gift tax implications before they make any improvements to the residence during the term of the QPRT. In addition, if the trustee of the QPRT (which is often the grantor during the Trust Term) determines to sell the residence during the fixed Trust Term, Treasury Regulation 25.2702-5(c) requires that in order to preserve the QPRT, the sale proceeds must be invested into a new residence within two years. If the trustee of the QPRT does not purchase a new residence, the QPRT must be converted to a qualified annuity trust within 30 days of the sale. If neither of these two scenarios occur, the assets of the trust must be distributed back to the grantor resulting in the grantor losing the wealth transfer benefits.

The most common problems with QPRTs often arise after the Trust Term has ended. Three common issues are: (1) a holdover Grantor; (2) maintenance of the residence; and (3) Generation-Skipping Transfer (GST) tax.

While the grantor might have been impressed with the tax savings a QPRT can provide, when the Trust Term ends and the residence is required to be transferred to the remainder beneficiaries, the grantor may have some reservations about "losing" her home. If the grantor wants to continue to reside in the residence without causing estate tax inclusion issues, she can rent the residence from the remainder beneficiaries. In this case, it is recommended that the grantor and the remainder beneficiaries execute a lease agreement and the grantor pay fair market value for renting the residence as determined by an independent appraiser. While the payment of rent to the remainder beneficiaries does have gift/estate tax benefits, some clients balk at the idea that they must pay rent on a residence that they view as theirs. Thus, estate planners should be sure to clearly say

1 Reg. § 25.2702-5(c).

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## QPRTS, CONTINUED

what happens at the termination of a QPRT, so clients do not feel surprised when they have to pay rent when the QPRT terminates. In addition, estate planners must make sure they follow up with clients at the end of the QPRT term to help with the transfer to the remainder beneficiaries (e.g., drafting and executing a deed) and any follow up documents needed like a lease agreement.

While the grantor may have been happy to transfer her residence to the QPRT at a discounted rate, the remainder beneficiaries might not be ready to take on the financial and management responsibility of the residence at the termination of the QPRT term. Before the end of the QPRT term, it is important to determine who will be responsible for paying the bills, continuing the appropriate insurance, making improvements, and collecting the rent if the grantor or a third party is renting the residence. Also, if there is not adequate rent to cover the expenses of the home, the remainder beneficiaries must determine who will be responsible for paying these maintenance costs. Depending on the needs and goals of the remainder beneficiaries, a good option can be for the remainder beneficiaries to contribute their interests to an LLC or execute a tenants in common agreement to define the rights and obligations related to the residence.

At the termination of a QPRT, there is the potential imposition of unwanted GST tax. Specifically, the estate tax inclusion period (ETIP) rule applies to gifts to QPRTs. Accordingly, the grantor cannot allocate GST exemption to the QPRT when it is created and instead must wait until the termination of the Trust Term.[2] Because at the termination of the Trust Term, the grantor no longer has a retained interest, there is no discount to the GST tax. In addition, the residence in the QPRT may have appreciated greatly from its fair market value at the time of funding, resulting in the grantor needing to allocate additional GST exemption (or paying GST tax). With careful drafting, it is possible to avoid potential GST tax consequences by ensuring that the remainder beneficiaries of a QPRT are all non-skip persons. However, tax issues could arise if, for example, the remainder beneficiaries are the grantor's descendants, per stirpes, and a child dies before termination, or if the remainder beneficiary is a GST Trust.

The QPRT can be a very effective estate planning tool that can lead to significant gift and estate tax savings. However, it is important that practitioners think beyond the gift tax savings and consider whether it is an appropriate estate planning tool to use for the specific client and the specific property. It is also important to think through tax consequences beyond the gift/estate tax savings (e.g., GST Tax, loss of step up in basis, realty transfer tax) to ensure that a QPRT really is providing an overall tax benefit to the client. Finally, it is important to talk through all of the steps of the QPRT, including what happens when the QPRT ends, to ensure that the client is really ready to hand-off the property.

2 Internal Revenue Code § 2642(f).

# PROBATE AND TRUST LAW SECTION AND THE YOUNG LAWYERS DIVISION

BY MELISSA HENSINGER, ESQUIRE | HECKSCHER, TEILLON, TERRILL & SAGER, P.C. AND RYAN J. AHRENS, ESQUIRE | DECHERT LLP

It is an exciting time to be a young lawyer in the Probate and Trust Law section! Interest in trust and estate law among law school students and newly admitted lawyers appears to be growing, and the leadership of this section is committed to taking advantage of this opportunity.

We have the honor to serve as liaisons between the Probate and Trust Law Section and the Young Lawyers Division (YLD). As liaisons, our principal goals are to engage current young trust and estate lawyers to increase their participation in this section and the YLD, as well as to work with the YLD as it increases awareness about the legal field with youths in Philadelphia, including awareness about trusts and estates.

In this article, we briefly share some updates on YLD activities we have been involved with in the last year as well as a trust and estate associate peer group program we are starting with the assistance of the Probate and Trust Law section.

**Trust and Estate Young Lawyer Peer Groups**

Most young trust and estate lawyers have older colleagues who speak fondly of their "study groups" (or peer groups) that they joined as young lawyers. Some of these groups still meet today, years or even decades later, having provided and still providing invaluable camaraderie, legal insights and networking opportunities.

Over the last few years, the formation of these groups stalled. This development, coupled with the isolating effects of the pandemic, led to a period during which few young trust and estate lawyers formed meaningful professional relationships with lawyers outside of their firms. As any successful lawyer knows, some of the most important realizations or breakthroughs originate from a discussion with a lawyer outside of one's organization. It is possible or even likely that another lawyer's unique perspective and/or training led to a different (and perhaps better) understanding of a legal issue, and it is a disservice to a young lawyer and his or her clients not to explore that.

In 2022, a group of Cozen O'Connor lawyers consisting of senior counsel Matthew Kames and associates Amy Corenswet and Natalie Goldberg took it upon themselves to form a new peer group. This group, now made up of nine lawyers (including one of the co-authors, Ryan Ahrens) from seven firms, met for the first time in the summer of 2022. Since its inaugural meeting, this group has convened several more times at lunches (each hosted by a different member's firm), happy hours and bar association events.

Topics of discussion have ranged from the strictly legal – like an analysis of a New Yorker article about the Getty family trusts or the Supreme Court of Pennsylvania's decision in *Trust Under Deed of Garrison* – to the personal – how we chose this field, upcoming vacations and challenges we face as young lawyers. The fiduciary litigators in the group teach the non-litigators the ins and outs of the Orphans' Court (there is much to learn), and the non-litigators mostly try not to talk endlessly about taxes.

This group's unquestionable success in forging new professional relationships and the many other young trust and estate lawyers without a similar group inspired the authors, in conjunction with the encouragement of the Probate and Trust Law section's leadership team, to create more of them. This spring, the authors distributed a questionnaire to as many young trust and estate lawyers as we could locate to gauge interest in new peer groups.

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# YOUNG LAWYERS DIVISION, CONTINUED

In total, we received 30 interested responses ranging from lawyers who graduated law school in 2011 to current law school students graduating in 2024. Over 20 firms/companies are represented in the responses. Acknowledging that some of the most helpful conversations are those with lawyers with similar experience, we formed four new peer groups based primarily on law school graduation year and preference for location of in-person meetings. After three years full of Zoom or Teams meetings, we have encouraged the groups to meet in person as much as possible. The existing peer group formed in 2022 has found in-person meetings to be especially beneficial in getting to know each other, and, in fact, has not yet met virtually.

Invitations to the members of the four new peer groups were distributed in the last week of June, and we are determined to assist these groups in whatever way they need. To formally kick things off, we are planning a late summer or early fall happy hour with all group members invited, including the members of the group formed last year.

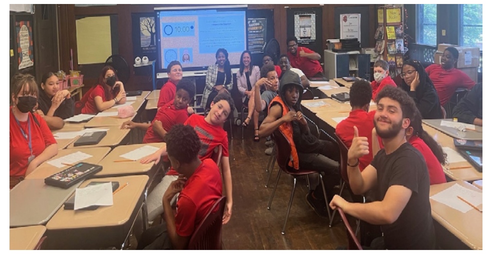
We look forward to sharing updates as these groups progress.

**YLD Developments**

At the beginning of May, the YLD put on a series of events for Law Week. The Law Week programs are held as part of National Law Day on May 1st and are aimed at helping Philadelphia residents and students learn about the legal system. The programs this year included Legal Advice Live, Lawyer in the Classroom and the Goldilocks Trial.

For Legal Advice Live, volunteer attorneys answered legal questions at the Free Library. This program gives Philadelphia residents an opportunity to speak to a lawyer in person regarding their legal problems to either help resolve them or point them in the direction of someone that may be able help them.

Lawyer in the Classroom had 20 volunteer attorneys go into elementary and middle school classroom within the School District of Philadelphia.



Students had the opportunity to learn about the legal system, the path to becoming a lawyer and the day-to-day aspects of being a lawyer. Students also had the opportunity to ask all their burning questions. There were lots of questions ranging from how much money lawyers make to the most interesting case the lawyer was involved in to very specific questions regarding what do you in the event that you think your client is lying to you.

The YLD brought back the Goldilocks Trial for the first time post-COVID. In this program, volunteer lawyers along with judges in the Court of Common Pleas act out the trial of a well-known fairytale and then elementary aged students get to act as the jurors and deliver a verdict. It provides students a first-hand opportunity to experience the legal system in a fun way. Given that it was the first year holding the program in several years, we decided to keep with the program's namesake and put on the trial of the Commonwealth of *Pennsylvania v. Gold E. Locks.* Judge Roberts presided over the trial and students had to decide

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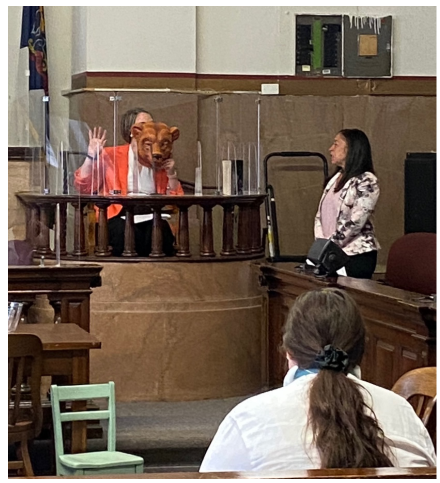
## YOUNG LAWYERS DIVISION, CONTINUED

whether Gold E. Locks was guilty of having bad manners, entering a house uninvited, eating another person's food without permission, breaking another person's bed and messing up a made bed.

Before the trial, students met with President Judge Fox, Chancellor Marc Zucker and Chancellor-Elect Jen Coatsworth to learn more about the legal system and City Hall (many students were interested in knowing whether there were any ghosts in City Hall). The students took their jobs as jurors very seriously and were very interested to hear from the prosecution, Defense, Mama Bear, Papa Bear (played by co-author, Melissa Hensinger), Baby Bear and Gold E. Locks herself. Many of the students were split on their verdicts and there were several hung juries! After the trial, students had the opportunity to ask Judge Roberts and the volunteers lawyers more questions. Overall, it was a very fun event for everyone involved!



Thank you to all those that volunteered for Law Week! We would not be able to put on these programs without your help.

The YLD is currently working on planning the YLD-Affinity Bar Quizzo scheduled for July 21, a mid-year community service project and YLD After Dark for Bench Bar in September. We hope to see you at some of the upcoming events!

# TAX UPDATE

BY GEORGE C. DEENEY, ESQUIRE | GILBOY & GILBOY LLP

**GUIDANCE FROM THE IRS**

**Internal Revenue Service Issues Proposed Regulations to address Section 1035 Exchanges of Interests in Life Insurance Contracts**

The IRS has issued proposed regulations that address transferring interests certain life insurance contracts under Section 101 of the Internal Revenue Code. The proposed regulations would modify the final regulations and address the information reporting requirements under Section 6050Y of the Code.

The proposed regulations would make it so there would be no transfer for value and no reportable sale under the Code when a life insurance policy is exchanged for another similar contract under Section 1035. As a result, there would be no limitation on the death benefit exclusion under Section 101(a)(2). The proposed regulations also address transfers of life insurance contracts between C corporations in a tax-free reorganization when there is an acquisition of life insurance contracts owned by a target corporation.

The current final regulations mandate a policyholder effectuating a 1035 exchange has a substantial family, business or financial relationship with the insured individual in order to avoid a reportable sale under the Code.

**Internal Revenue Service Release Spending Plan for Funds Allocated to it in Inflation Reduction Act**

In IR-2023-72, the Internal Revenue Service issued its strategic operating plan in which it outlined how it intends to spend the $80 billion it will receive as a result of the Inflation Reduction Act between now and fiscal year 2031. The IRA allocated $4.8 billion to business systems modernization, $3.2 billion to taxpayer service, $35.3 billion to operations support and $47.4 billion to enforcement. The IRS cannot change the allocation without approval from Congress.

**Internal Revenue Service Releases HSA Inflation Adjusted Limits for 2024**

The Internal Revenue Service has issued the inflation adjusted limits for Health Savings Accounts effective in 2024. In Rev. Proc. 2023-23, the limits are noted as follows:

**Out of Pocket**

| | |
|---|---|
| Self - $8,050 (increased from $7,500)<br>Family - $16,100 (increased from $15,000) | Contribution (and additional $1,000 permitted from individuals 55 and older) |
| Self - 4,150 (increased from $3,850)<br>Family - $8,300 (increased from $7,750) | Deductible (HDHP) |
| Self - $1,600 (increased from $1,500)<br>Family - $3,200 (increased from $3,000) | |

# NAVIGATING INTRA-FAMILY TRANSACTIONS AND THEIR ESTATE AND GIFT TAX IMPLICATIONS: LESSONS FROM *ESTATE OF MACELHENNY V. COMMISSIONER*

BY JONAH SHO LEVINSON, ESQUIRE | WHITE AND WILLIAMS LLP

**Introduction and Factual Summary**

In *Estate of MacElhenny v. Commissioner* (decided March 15, 2023), the United States Tax Court considered the deductibility of debts of a California estate—including whether the debts were bona fide, given family involvement in several complex transactions related to the debts. The Tax Court also examined gift tax deficiencies assessed by the IRS for the family recipients of discounted real estate.

Though *Est. of MacElhenny* involves a set of facts that is quite complex, consisting of two multi-step transactions, the issues discussed and decided by the Tax Court are relatively straightforward. The Tax Court considers these transactions in light of the gift tax and estate tax deficiencies in the decedent's estate. In summary, two broad issues are discussed by the Tax Court: (1) whether the estate can deduct the value of two consent judgments entered against the decedent, and (2) whether the decedent's children received taxable gifts by purchasing property from the decedent.

Bernard J. MacElhenny, Jr. (the "Decedent"), a California resident, passed away in 2015, leaving behind two children, Michael P. MacElhenny ("Son") and Catherine MacElhenny Dann ("Daughter"). Son and Daughter acted as representatives for Decedent under a Power of Attorney beginning in 2004, and ultimately served as co-executors of the estate and co-Trustees of Decedent's trust, the MacElhenny 1999 Trust. Son and Daughter were the primary beneficiaries of Decedent's estate.

Decedent and Son were involved in the real estate industry. They co-managed Arizona properties until 2010, when Decedent wanted to take back control—at this time, Son stepped back from the business. Around the same time, Decedent's health began to decline. In 2012, Son and Daughter stepped in to assist Decedent, with Son handling business affairs and Daughter tending to health-related matters. Due to inadequate property management and incomplete records, Son faced many challenges in managing the business. In facing such challenges, he discovered the existence of several short-term debts, two of which are at issue in this matter. One of these issues relates to a debt owed to Union Bank, and the other issue involves a debt owed to Westamerica Bank. These transactions are described in some detail below, but importantly, they each culminated in a consent judgment against the estate—the former judgment was in favor of both Son and Daughter, and the latter judgment was in favor of Son alone.

In 2016, when Son and Daughter filed Form 706, United States Gift (and Generation-Skipping Transfer) Tax Return, in their capacity as co-executors of Decedent's estate, they claimed deductions of $3,638,083 and $1,007,320 for the Union Bank and Westamerica Bank consent judgments respectively. The IRS disallowed these deductions, determining that the claims were not bona fide.

Additionally, Decedent's 1999 Trust transferred a 50% interest in a California property (the "El Mercado property") to each of Son and Daughter in 2011. The purchase agreement included the assumptions of existing mortgages and a credit against the purchase price based on payments on account of the Union Bank judgment. On Decedent's 2011 Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, the IRS increased the

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estate's adjusted taxable gifts by $3,497,609.

**Transactions**

As noted above, the transactions in question are fairly complex and accordingly, they tend to complicate the relatively simple holdings of the Tax Court. The primary features of each transaction are enumerated here, however, to provide useful context in interpreting the court's holding and reasoning, as well as the set of fact patterns to which such holding applies.

**Union Bank Debt**

1. Decedent and his business partner formed New Healdsburg Venture, LP (the "Partnership"), with his business partner's wholly owned entity as the general partner, and Decedent and his wholly owned entity as limited partners. Decedent contributed a vacant parcel in California to the Partnership. The Partnership borrowed $11.3 million from Tamalpais Bank (later acquired by Union Bank) guaranteed by Decedent and his business partner, and later defaulted and filed for bankruptcy, leading to a lawsuit.

2. Son and Union Bank negotiated a settlement, the terms of which required Son to pay the bank $2,650,000 in his personal capacity, with a clause assigning the remainder of the judgment and the bank's interest in the pledged properties to Son and Daughter in exchange for such payment (Daughter also promised to pay Son for her half of the purchase of the judgment through a separate agreement between them). Union Bank, however, refused to warrant or represent that the state court would enter the assigned judgment, as it would have preferred to release the claim against Decedent for an agreed monetary sum.

3. The state court entered an order substituting Son and Daughter as plaintiffs in the lawsuit and, shortly after, it entered the judgment in their favor at $6,000,000 with ten (10) percent statutory annual interest against Decedent.

**Westamerica Bank Debt**

1. Decedent's wholly owned entity borrowed $1,365,000 from Sonoma Valley Bank, which eventually increased to $1,800,000, and Decedent personally borrowed an additional $1,500,000 from Sonoma Valley Bank. Both loans in question were later acquired by Westamerica Bank.

2. Decedent and his wholly owned entity defaulted on the loans, leading to a lawsuit against Decedent by Westamerica Bank.

3. The parties settled the matter by stipulating a judgment of $1,460,104, requiring the sale of one of Decedent's properties, and monthly payments thereafter. The settlement agreement also permitted Son to purchase the judgment.

4. After selling the property and realizing that Decedent could not pay the balance of the judgment, Son purchased the judgment pursuant to the settlement agreement.

5. Son and Westamerica Bank agreed to allow Son to purchase the judgment for $432,000. In doing so, Westamerica Bank asked Son whether the judgment should be entered for a higher amount, even though the purchase price itself was $432,000. Son and Westamerica Bank eventually agreed that the stated price should be $865,517. Accordingly, a state court judgment was entered, which provided Son with the agreed-

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upon judgment of $865,517 (accruing ten (10) percent annual interest). Note that Son had not taken any action to collect on this judgment.

**The El Mercado Property**

1. The El Mercado property was owned by the MacElhenny 1999 Trust, which provided that the property would pass to Son and Daughter upon the death of Decedent.

2. On October 26, 2012, the Trust transferred a fifty (50) percent interest in the El Mercado property to each of Son and Daughter, its co-Trustees, for a stated price of $4,750,000. The purchase agreement executed by the parties provided that Son and Daughter assumed the existing mortgage on the property ($1,614,391) and received a credit for the remainder ($3,135,609), which was comprised of their payment to acquire the Union Bank judgment ($2,650,000) and an "offset" against the Union Bank judgment ($485,609).

3. Son and Daughter formed El Mercado (Delaware), LLC (the "LLC"), of which they were equal owners, and contributed the El Mercado property to it.

4. The LLC borrowed $4,750,000 from UBS Real Estate Securities, Inc., in exchange for a security interest in the El Mercado property. The LLC then used the funds to pay off the mortgage on the property and repay Son's partner the $2,650,000 used to purchase the Union Bank judgment.

Son and Daughter later stipulated that the El Mercado property was worth $6,200,000 and encumbered by a $1,614,392 mortgage at the time of the sale of the property.

**Discussion**

The Tax Court's decision addresses two discrete issues: (1) the deductibility of the value of the two consent judgments entered against Decedent, given that the judgments were owned by family members, and (2) whether Decedent's children received taxable gifts by purchasing the El Mercado property at less than fair market value, and, if so, the amount of such gifts. Each issue is discussed in turn below. Unless otherwise noted, all statutory references set forth refer to the Internal Revenue Code (i.e., Title 26 of the U.S. Code) or its corresponding Treasury Regulations.

**Deducibility of Judgments Owned by Family Members**

For federal estate tax purposes, claims against an estate are deductible, provided that when they are founded on a promise or agreement, they were contracted bona fide and for an adequate and full consideration in money or money's worth. Section 2053(a), (c)(1)(A).

The regulations to Section 2053, (specifically Sections 20.2053-4 and 20.2053-1), set forth the requirements for deductibility for a claim arising from contract or tort. A deductible contract (or tort) claim must meet the following requirements: (1) it must represent a personal obligation of the decedent existing at the time of death; (2) it must be enforceable against the decedent's estate; and (3) it must have been actually paid by the estate or be ascertainable with reasonable certainty and will be paid. These requirements serve as a useful checklist to determine whether a claim is bona fide.

The regulations specifically disallow deductions to the extent that a claim is "founded on a transfer that is essentially donative in character (a mere cloak for a gift or bequest)." Treas. Reg. Section 20.2053-1(b)(2)(i). This rule reflects the longstanding tax law precedent for valuing the substance of a transaction over

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its mere form. Accordingly, a red flag is raised in transactions involving intra-family agreements—such agreements are subject to heightened scrutiny due to the increased potential for abuse of the tax laws. Section 20.2053-1(b)(2)(ii) of the regulations provide factors for analyzing whether a transaction involving an intra-family agreement is bona fide. In relevant part, for such a transaction to be bona fide, it must occur in the ordinary course of business, be negotiated at arm's length, and be free from donative intent.

Because the transactions in the *MacElhenny* case all involve intra-family agreements, the court properly begins its analysis with the above regulations to determine whether the claims were bona fide, rather than substantive gifts or testamentary dispositions. The Tax Court determined that the petitioners did not satisfy their burden of proving that the debts were Decedent's personal obligations at his death, because the children satisfied the debts before Decedent had died. The Tax Court reasoned that once Son and Daughter settled the bank debts on behalf of Decedent, he was no longer personally obligated to pay them.

Moreover, the fact that the bank judgments were assigned to Son and Daughter did not change the determination concerning Decedent's personal obligations—the assignments of the claims were not made in the ordinary course of business and were not negotiated at arm's length. With respect to the Union Bank debt, the bank preferred to release the claim for a sum of money, and despite ultimately agreeing to the assignment to the children, refused to warrant that the state court would enter the judgment. As for the Westamerica Bank debt, after the purchase price was decided upon, the bank asked Son whether it should enter the judgment for the payment amount, or for a higher amount (which had no effect on Westamerica Bank one way or the other). The court considered the fact that neither bank required an assignment of the debt to the children and would have preferred to simply release any remaining claims. Due to the assignment clauses in the agreements, Son was on both sides of the two transactions—his multiple interests and powers as Decedent's representative were essentially used to transfer the debts from the bank to Son and Daughter, which they could also use to offset the purchase price of the estate assets. They then attempted to deduct such claim. But the estate never actually paid the amounts to discharge the debts—rather, Son and Daughter paid the amounts to obtain the judgments, and because they were on both sides of the transaction, there was no reasonable certainty that they would attempt to ever collect the amounts from the estate. Therefore, the court disallowed the deductions, as they did not meet the requirements for deductibility set forth in Treas. Reg. Section 20.2053-1(d)(4)(i).

**The Purchase of the El Mercado Property**

When property is transferred, it is valued at the date of the transfer, and if it is transferred for "less than an adequate and full consideration in money or money's worth," then the excess of the property value over the consideration is a taxable gift.

In this case, the stated consideration from the children for the El Mercado property included the mortgage discharge of $1,614,391, the $2,650,000 paid to Union Bank to settle the Decedent's personal liability, and a $485,609 offset against the Union Bank judgment (totaling $4,750,000). Son and Daughter, however, stipulated that each fifty (50) percent interest was worth $3,100,000 at the time of the transfer (with a total property value of $6,200,000, rather than the $4,750,000 they had initially claimed). Accordingly, the value of the El Mercado property exceeded the consideration by $1,450,000, or $725,000 per fifty (50) percent

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share. These amounts are taxable as gifts to each of the children.

However, the Union Bank offset of $485,609, founded on the state court judgment, was not found to be a bona fide liability due to the rules establishing heightened scrutiny in such transactions involving family. The court accepted the other two claims of consideration—the mortgage was bona fide and therefore enforceable, and the $2,650,000 payment to the bank was a negotiated arm's length settlement. This result reduced the consideration value by $485,609, resulting in a larger disparity of $1,935,609 between the purchase price and the fair market value. Accordingly, the court properly found that each of Son and Daughter received a taxable gift of roughly $967,805.

**Conclusion**

*Est. of MacElhenny* provides a few important estate planning considerations for estate planners and representatives, though none of them are necessarily novel.

First, with respect to deductibility of bona fide claims from a gross estate, it is of no consequence how simple or complex the form of a given transaction related to the debt is—if the transaction does not comply with Section 2053 and its corresponding Treasury Regulations in substance, then the deduction will be disallowed. When members of the same family are involved in a transaction, then the transaction will be subject to the heightened scrutiny rules set forth in Treasury Regulation Section 20.2053-1(b)(2)(ii). Moreover, use of an uncontested court decree to substantiate a debt of the decedent will be respected only in those cases where the facts satisfy the rules stated in the Supreme Court's seminal 1967 Bosch opinion. Estate planners and representative should ensure that the above requirements are met, to determine whether a claim is bona fide.

Second, transferors of property should expect to incur gift tax liability if they receive the property for less than adequate and full consideration in money or money's worth. Whether property is transferred for adequate and full consideration in money or money's worth may, as here, require an analysis of whether the property transfer was made in the ordinary course of business, per Treasury Regulation Section 25.2512-8.

Since *Est. of MacElhenny* is a United States Tax Court decision that considers estate tax deductions, the holdings are, at the least, suggestive as to Pennsylvania estates. Consequently, the rules and discussions in the opinion regarding deductibility of claims against the estate should be considered when structuring a Pennsylvania estate plan or filing tax returns.

The dichotomy between the convoluted nature of the *Est. of MacElhenny* facts and the simple applicability of the tax laws despite the factual complexity is a wonderful exhibit of the IRS's prioritization of transaction substance over form. The requirements for a transaction to be "in the ordinary course of business" should not be disregarded, as doing so can result in unanticipated tax liability. Moreover, property transfers should be examined and structured carefully to account for potential gift tax consequences. Even more careful attention must be afforded to such transactions when multiple members of the same family are involved—in these cases, estate planners and representatives should take care to ensure that the transaction can survive the heightened scrutiny standards discussed above.

*PRACTICE POINT*

# HANDLING BENEFICIARY DESIGNATED ASSETS IN A POST-PENSION, PRO-401(K) WORLD

BY KATHERINE F. THACKRAY, ESQUIRE | ALEXANDER & PELLI, LLC

I recently saw a snazzy infographic designed to advise young people about the best order of operations for investing for retirement, cleverly likening saving for retirement to the Please Excuse My Dear Aunt Sally ("PEMDAS") rules taught in elementary school math.[1] First, the chart advised, contribute to a 401(k), up to an employer's match, if any. Next, try to fill up a Roth or Traditional IRA, up to the annual limits. Then, if possible, go back to the 401(k) and max it out for the year. Finally, after considering a few other types of accounts (HSA, SEP IRA if applicable), throw whatever you have left into a plain old brokerage account, because "it is important to invest versus just saving."[2] Follow these easy steps, just like the "PEMDAS," and it should be financial smooth-sailing into your golden years.

This eye-catching chart accords with the traditional investing advice many folks growing up in a post-pension, pro-401(k) era have been given about how to save their hard-earned dollars for the future. And one hopes it is successful; my peers and I have our retirement funds substantially tied to the markets in a way that differs from the generations before us, and we are investing significantly in these designated investment vehicles over savings accounts and those plain old brokerage accounts.

On a personal level, I'll trust the experts, stay the course, and hope for a stable future for myself and my family. But as an estate planning attorney, I can't help but to think about how only the traditional brokerage account, i.e., the chart's investment vehicle of last resort, is likely to pass under the provisions I write so carefully into the Wills I prepare. The preferred investment vehicles – 401(k), IRA, and the like – will pass in accordance with beneficiary designation forms, something I may have little control over and that my clients likely filled out with the slew of onboarding paperwork on their first day on the job. Based on the conventional wisdom, these assets are likely to make up bulk of my client's estates, making the designations on the accounts, filled out however haphazardly, potentially more important than the fancy legal documents I've been hired to prepare.

The increasing popularity of beneficiary-designated assets such as 401(k)s and IRAs creates cause for estate planning attorneys to reflect upon, and perhaps even revamp, their usual practices for advising clients about their beneficiary designations. In chatting with folks in the field, it has become apparent to me that the ways in which attorneys handle this aspect of estate planning run the gamut. Some attorneys insist upon a hands-on approach, working directly with clients' investment advisors to ensure that the beneficiary designations

1 Robert Farrington, *The Best Order of Operations For Saving For Retirement, THE COLLEGE INVESTOR* (April 2, 2023), https://thecollegeinvestor.com/1493/order-operations-funding-retirement/. As a refresher for the English majors among us, "Please Excuse My Dear Aunt Sally," or "PEMDAS" refers to "parenthesis, exponents, multiplication/division, addition/subtraction," or, the order in which you should solve a mathematical equation.

2 *Id.* I note that Farrington recommends, in a final step, considering your options and eligibility for Social Security benefits.

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## BENEFICIARY DESIGNATED ASSETS, CONTINUED

align with their carefully crafted wills and trusts. Others choose to play quarterback, sending their clients out with specific instructions or customized beneficiary designation riders. Others may include a cautionary note or memorandum in a final wrap-up letter, advising clients that they have a responsibility to keep their designations up to date and offering to address any questions.

The many ways in which attorneys approach this somewhat grey area of estate planning begs the question: How involved should estate planning attorneys be when it comes to beneficiary designations, and what happens if they aren't involved enough?

Let's tackle the hands-on approach. With this approach, an attorney will liaise directly with investment advisors and providers to ensure that a client's beneficiary designations are consistent with the client's estate planning, or, if not, that such departure is intentional. This approach seems like it would be a best practice, but it also envisions a universe where clients have a real, existing relationship with their advisors and providers. However, in this world of online banking, automated answering services and giant call centers, this may be easier said than done. While clients with significant wealth and large portfolios are likely to have a designated point person who can help make any needed adjustments, clients of more modest means or who work with big conglomerate providers may be directed to make the change via an online portal or customer service call center, making direct lawyer-to-advisor communication difficult if not impossible.

The quarterback approach takes these administrative hurdles into account. An attorney will explain to the client how their planning intersects with their beneficiary designations, confirming that the client understands the importance of this financial hygiene and the implications of a botched designation. The attorney then sends the client to their provider armed with this information, giving them the "homework" of reporting back with confirmation that the designations have been updated. One might even send a sample rider or proposed language along with the client, so that they can explain to the customer service representative exactly what they need. They'll review any necessary paperwork if asked, and request updated copies of the designations for their file. This solution is certainly more practical than the hands-on approach, and ideally educates the client while making sure the designations are in order. However, it also leaves dangerous room for instructions to be lost in translation or, even worse, never put into place at all.

Finally, some attorneys may fall into more passive role with respect to beneficiary designations. These attorneys will be sure to put clients on notice, via spoken communications and/or in writing, that beneficiary designations are important, that they should be in line with the client's wishes, and to let their attorney know if they have any questions. Attorneys who take this approach may believe that beneficiary designations are outside of their scope as preparers of Wills and Trusts; instead, they are the turf of financial planners, whose role is to strategize and coordinate the plan. These attorneys may also be working with clients who are more cost-sensitive and unwilling to pay for the extra billable time required to prepare beneficiary designation riders or make calls to a retirement plan provider. Of course, the risks to this approach are obvious, and it creates ample opportunities for client inaction or confusion; on the other hand, some may consider this approach a necessary solution for clients with extremely simple planning and limited resources.

While this list of approaches is not exhaustive, it is illustrative of the different strategies attorneys use to help clients handle their beneficiary designations. Regardless of how this process is handled, however, estate planning attorneys must consider how a client's beneficiary designations

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fit into their overall estate plan, or else risk a drafting error that could result in malpractice. Consider *Julia v. Cerato*, an unpublished Superior Court case from Monroe County in which the scrivener of a will failed obtain an up-to-date client questionnaire, and was consequently not aware of an annuity and IRA with designations naming beneficiaries taxed at the 15% Pennsylvania inheritance tax rate.[3] The death tax clause under the will provided that all death taxes, regardless of the source, were to be paid from the residuary estate.[4] This resulted in a $27,469.91 inheritance tax liability attributable to assets which did not pass under the will, and which did not pass to the named beneficiaries under the will (four of the six of whom where charitable beneficiaries exempt from inheritance tax entirely).[5] Here, a failure to consider beneficiary designations as part of the overall estate plan created a domino effect, culminating in the estate's overpayment of inheritance taxes to the detriment of the will's beneficiaries, which, the Superior Court held, "directly damages the estate and will sustain a legal malpractice action."[6]

*Julia v. Cerato* speaks to the importance of a holistic approach to estate planning; without a full picture of the client's assets, including and especially the beneficiary designations, an attorney is unable to develop a comprehensive plan that adequately addresses the client's needs. Had the attorney in *Julia* adopted a hands-on or even "quarterback" approach to beneficiary designations as a matter of practice, one wonders whether this issue could have been caught and corrected instead of resulting in an eventual malpractice claim.

Because of my job, I've been (mostly) mindful about keeping my beneficiary designations up to date after big life events. But the truth is that most of our clients, even those who diligently hire us for their estate planning, do not have beneficiary designations on the brain. It is important to remember this sometimes trivial-seeming aspect of planning and to recognize that, for many clients, these beneficiary-designated assets will be their most significant. For as long as the conventional wisdom trends toward heavy investing in beneficiary-designated assets (and even if it veers away), we must thoughtfully approach these designations with our clients in a way that serves their best interests, and keep their implications in mind as one more piece of the estate planning puzzle.

3 2015 Pa. Super. Unpub. LEXIS 3295.

4 *Id.* at *2.

5 *Id.* at *2, *13.

6 *Id.* at *12-13.

# CHANGES TO PHILADELPHIA ORPHANS' COURT RULES

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

The Rules and Practice Committee of the Philadelphia Bar Association is pleased to announce that three changes to the local rules of the Philadelphia Orphans' Court were approved by the Board of Judges of Philadelphia on February 17, 2023. The changes were published in the Pennsylvania Bulletin at 53 Pa.B. 1169 on March 4, 2023, and went into effect thirty days later, on April 3, 2023.

The changes, which consist of one completely new rule, one rule replacing an old rule, and one modification to an existing rule, are summarized below. The full text of the new rules can be reviewed in the Pennsylvania Bulletin.

**New Rule 3.5A: "Procedure for Determination when No Response is Filed to a Petition under Pa.R.O.C.P. 3.5(a) or 3.5(b)**

This is an entirely new rule, though it was based loosely on provisions found in the pre-2016 revision of the Philadelphia local Orphans' Court Rules. The purpose of the new rule is to smooth the petitioner's path to relief when no response is filed by a respondent. Before the adoption of this rule, the practice varied between judges.

Depending on the circumstances, a petitioner may proceed either under Pa.R.O.C.P. 3.5(a) by requesting a citation from the court and serving it on the respondent, or by serving a petition with notice on the respondent under Pa.R.O.C.P. 3.5(b). In either case, the respondent must respond by a deadline set by the rules, applicable statute, or order of the court.

Under the new Rule 3.5A, if the respondent does not file a responsive pleading within the applicable timeframe, the petitioner may file a "Praecipe for a Decree or Order" (as appropriate), which includes a proposed decree or order, an explanation of the procedural posture, and details about how the underlying citation or petition was served. The praecipe itself must be served on the respondents, and a certificate of service filed.

Upon receipt of the praecipe and service documents, the court can grant the relief requested or order further proceedings. If the court grants the relief requested, the petitioner must serve the decree on the respondent according to the provisions of Pa.R.O.C.P. 4.3, which includes service by mail, and file a certification of service.

At that point, the respondent has a further 20 days in which to object to the relief, though in doing so they must explain why they did not timely file their objection.

**New Rule 5.50A: "Settlement of Small Estates by Petition"**

Until 2020, the principal rule governing petitions to settle small estates in Philadelphia under 20 Pa.C.S. § 3102 was Philadelphia Local Rule 5.16A. However, a new state rule, Pa.R.O.C.P. 5.50, abrogated the need for a detailed local rule by supplying comprehensive statewide requirements when it became effective on October 1, 2020.

New local rule 5.50A replaces local rule 5.16A, and enumerates the requirements from the old rule that are not present in the statewide rule. It also brings the numbering of the local and statewide rules into accord.

**Revision to Rule 14.2A: "Petition for Adjudication of Incapacity and Appointment of a Guardian of the Person or Estate of an Incapacitated Person**

Philadelphia Local Rule 14.2A and its predecessors have long contained a requirement that the Office of Attorney General be served with guardianship petitions when the alleged incapacitated person has no known next of kin. Acting on information from that office that this was unnecessary (and in fact a nuisance), this requirement has been deleted.

# CONSIDERATIONS FOR REPRESENTING FAMILIES WITH MULTISTATE ESTATE PLANNING ISSUES

BY CAITLIN AKINS, ESQUIRE | GADSDEN, SCHNEIDER & WOODWARD LLP

In today's trusts and estates practice, we see fact patterns involving multi-state estate planning with regularity: young families relocating to be closer to relatives, retirees spending more time in warmer climates, empty nesters moving to care for aging parents, or even simply clients with vacation properties in other states. As such, practitioners should be mindful of the various issues that can arise when representing clients with interests that cross state lines. The following outlines relevant considerations and potential tools for addressing these issues.

As a preliminary reminder, when representing clients with assets or interests outside of Pennsylvania (or whichever jurisdiction in which you are admitted to practice), keep in mind Rule 5.5 of the Model Rules of Professional Conduct, which prohibits the unauthorized practice of law. This rule is particularly salient when working with clients domiciled in another state where you are not admitted. Take care to stay within the exception to unauthorized practice found in paragraph (c)(4) of Rule 5.5, allowing a lawyer to provide legal services in a foreign jurisdiction on a temporary basis that, "arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice." Pennsylvania Rules of Professional Conduct Rule 1.1 also requires attorneys to provide competent representation for clients. When in doubt about which side of these rules a particular representation might fall, err on the side of consulting with local counsel in the relevant foreign jurisdiction to provide detailed or nuanced legal advice specific to that jurisdiction.

**Property Located in Other States**

Likely the most common multi-state scenario estate planners will encounter is a client with a vacation property or second home in a foreign jurisdiction. The property owner's death can trigger both probate and death tax consequences, depending on the state. In client intake meetings or discussions, attorneys should take particular note of real property held in popular vacation destinations like New York, most of New England, Hawaii, or Maryland (among other states), all of which assess state-level inheritance or estate tax. Even a beach house down the shore in New Jersey can incur inheritance tax when the property is not specifically devised to or held in joint tenancy with a decedent's spouse or lineal descendants.

An estate with real property or other property physically located in a foreign jurisdiction (such as tangible personal property) will require ancillary probate proceedings, which can be time consuming and costly. Typically, though, advanced estate planning can eliminate the need to undergo ancillary probate by removing the relevant property from the foreign jurisdiction or from the decedent's probate estate. This could be as simple as transferring the title of the property into the client's revocable trust during his or her lifetime or creating a joint tenancy (although beware ancillary probate requirements arising again if the property is not sold before the death of the last surviving joint tenant).

Those methods should be sufficient to avoid ancillary probate, but additional planning is required to also bypass death taxes in a foreign jurisdiction that assesses estate or inheritance tax on non-residents' property located within the foreign jurisdiction. When appropriate marital deduction planning is in place, the marital deduction can usually defer state death tax until the surviving spouse's death. For situations where clients want to plan ahead or there is no surviving spouse,

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there are various other options available.

Placing the property in an LLC is a good strategy for a client who wants to retain ownership and use of the property. The LLC wrapper is typically sufficient to transform real or tangible property to intangible property that is beyond the foreign jurisdiction's taxation power. With rising interest rates, a QPRT may also make economic sense for some clients who want to continue using their property, although note that a QPRT that distributes a home outright to beneficiaries at the end of the initial term only recreates the ancillary probate and state death tax issues for the beneficiaries.

Clients willing to part immediately with their out-of-state property can consider selling or gifting it outright or in trust. State death tax applicability and calculations can be quite nuanced and the economic benefits are fact-specific, so in these situations it is important to counsel clients carefully, for example, on the economic tradeoff of avoiding extra state death tax vs. foregoing a step-up in basis at death in gifting scenarios.

**Planning Ahead of or After a Move to a New State**

For clients moving to or out of Pennsylvania, there are many other items for practitioners to keep in mind. For one, clients with second homes may plan to someday make a vacation home their primary residence. Be prepared to discuss the issues involved in changing domicile with your client, which will range from the practicalities and indicia of establishing a new domicile to the estate and income tax benefits that may be at play. After changing domicile, real property a client retains in Pennsylvania will still be governed by Pennsylvania law (and subject to Pennsylvania inheritance tax, per Section 2116(b)(2) of the Inheritance and Estate Tax Act of 1991) unless the client takes some of the steps outlined above.

Clients moving from another state also may bring along existing documents drafted in a foreign jurisdiction. One situation warranting new documents relatively soon after a move is a domicile change, since executing estate planning documents in the client's new state is one factor (among many others that evidences the intention to formally switch domicile. However, under the full faith and credit clause of the Constitution, documents properly executed in one state should be acceptable in all other states so a client's relocation does not automatically trigger the need for a new estate plan.

The careful practitioner should still review whether the construction or content of a client's out-of-state documents might cause holdups in the probate process, difficulties interpreting a health care agent's power, or even unforeseen testamentary outcomes based on differences in state law. For example, states vary in treatment of the presumption of opting in or out of joint tenancies and anatomical gifts, whether pretermitted heirs must be identified explicitly, the effect of marriage or divorce on a will's validity, the availability of statutory trust decanting, or the operation of ademption or anti-lapse statutes. Importantly, clients moving from states that do not assess inheritance tax may not have estate plans equipped to maximize the Pennsylvania inheritance tax marital deduction. Therefore, even if a client arrives in Pennsylvania with relatively recent estate planning documents that are valid and effective here, there can be good reasons to consider additional Pennsylvania-specific updates.

**Community Property**

Another important issue that can arise when representing clients who have moved across state lines is whether the clients have ever lived in a community property state. A married couple's community property, in

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## DIVERSITY COMMITTEE UPDATE

BY CHLOE MULLEN-WILSON, ESQUIRE | TIMONEY KNOX LLP

The Diversity Committee of the Philadelphia Bar Association's Probate Section held a pro bono documents clinic on Thursday, June 15th, in partnership with the Pro Bono Coordinator of the Probate Section, Valerie Snow. Hosted at the Center City office of Stradley Ronon Stevens & Young, attorney and law student volunteers assisted clients of SeniorLAW Center by drafting powers of attorney, health care directives and simple wills. A dozen clients left the clinic with completed estate plans in hand, which would not have been possible without the volunteers who dedicated their morning to public service.

Join the Diversity Committee at its next program, a CLE presented by Howard Law professor, Keeva Terry, which will take place on Wednesday, August 30th at 12 p.m. via webcast. Professor Terry will present on her 2021 paper entitled "Black Assets Matter" and will discuss the racial wealth gap in America, factors that produced and continue to perpetuate that wealth gap, and strategies for how we can eliminate the wealth gap to level the playing field for all Americans to have access to economic mobility.

If you have thoughts for the Diversity Committee, or there is additional programming that you would like to see, please send all inquiries to the Chair of the Committee, Chloe Mullen-Wilson, at CMullen-Wilson@timoneyknox.com

## MULTISTATE ESTATE PLANNING ISSUES, CONTINUED

combination with a joint revocable trust, can get a full step up in basis at the first death. This is a valuable benefit that should not be unwound automatically simply because a couple relocates. Community property retains its character even when clients move to a separate property state like Pennsylvania until and unless the owners take action. A transmutation agreement would be sufficient to change the property's characterization, as would retitling the community property as joint property, which is something that could even happen unintentionally if clients are not advised ahead of time.

Therefore, practitioners should carefully explain to clients the mechanics and consequences of changing the community property characterization. Preserving a full step up in basis after the first death can be particularly valuable if the surviving spouse will likely sell the property during his or her lifetime. If clients opt to continue holding their community property in a joint trust that was created in a foreign jurisdiction, consider amending it to ensure the portion of the joint trust included in the estate of the first spouse to die qualifies for the Pennsylvania inheritance tax marital deduction.

Whether on the state or even federal level, it is impossible to predict which laws will eventually be applicable to any client or their estate. However, estate planners have many tools to help reduce complications and unforeseen problems arising from clients' interstate moves or out-of-state property ownership.

# CASE SUMMARY FROM THE ORPHANS' COURT LITIGATION COMMITTEE[1]

## *In Re: Estate of Susan Kittler, Deceased*

BY BRADLEY D. TEREBELO, ESQUIRE | HECKSCHER, TEILLON, TERRILL & SAGER, P.C.[2]

As technology has advanced, and the COVID-19 pandemic made in person meetings difficult, if not impossible, the question of what it means to "sign" a will in Pennsylvania – well settled for decades – has become less certain. For example, does testator's digital signature affixed to a document constitute the necessary requirements in Pennsylvania that a will be "in writing and shall be signed by the testator at the end thereof…" as required by 20 Pa. C.S. §2502? This issue was examined by the Court of Common Pleas of Lancaster County, Orphans' Court Division, in *In re: Estate of Susan Kittler, Deceased*, 1 Fid. Rep. 4th 53 (O.C. Lanc. 2022).

During the pandemic, Susan Kittler was in a nursing home where visitors were prohibited, as was the case in many nursing homes. In the fall of 2020, Susan had suffered a fall and had been diagnosed with cancer. Susan's sons met with an attorney concerning Susan's estate planning, and the attorney was able to get in touch with Susan, who expressed that she wanted to create a will. Susan and her attorney had detailed conversations about Susan's estate planning goals, and the attorney prepared a draft will in accordance with Susan's wishes. The attorney secured the services of a notary, who was able to act as a remote notary as permitted by Pennsylvania law.

The attorney oversaw a virtual video conference, with two witnesses present at the attorney's office, Susan at the nursing home and the notary at her residence. The notary used "DocVerify," an online software vendor that met the Pennsylvania requirements for virtual notarization.

To use DocVerify, Susan had to go through an independent verification process to verify her identity, and she had to provide an electronic signature, which could be added to the document being signed. At the conference, Susan presented her state-issued identification.

At the conference, Susan did not physically sign the will. Instead, her digital signature was added using the DocVerify software. "On the line for [Susan's] signature is a red box that contains the number 587B93E4B8EA at the top of the box in red and 'Signed on 2020/11/24 10:59:15-8:00' in black at the bottom of the box. Inside the box is the script name (not a font generated by a computer) appearing to be the signature of Susan L. Kittler."

Susan subsequently died. The issue was whether Susan's electronic "signature" affixed to the purported will was sufficient to execute it.

1 The Orphans' Court Litigation and Dispute Resolution Committee will provide summaries of recent litigation cases in each quarterly newsletter.

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# CASE SUMMARY, CONTINUED

Before turning to whether Susan had signed the document, the Court first addressed that the notary certificate did not include the language "'that the notarial act was performed by means of communication technology'" as required by 57 Pa. C.S. §306.1(c) for virtual notarization. Although not addressed by the Court, presumably this would disqualify the will from being a self-proving will because the notary certificate was deficient. See 20 Pa. C.S. §3132.1(b).

The Court then addressed whether the electronic signature rose to the level of signing the will as required by 20 Pa. C.S. §2502. The Court concluded that the electronic signature added to the document "is an image which is sometimes referred to as a 'digital signature' that was placed upon the document electronically through the DocVerify software. The Decedent never put ink to the copy of the Purported Will offered for probate. The Court will not exceed its authority by expanding the statutory requirement that a will must be signed at the end to encompass the placement of an image towards the end of the documents in lieu of the testator's manual signature on the document."

The Court also cited Pennsylvania's Electronic Transaction Act ("PETA"), which provides for when electronic signatures can be used on documents. The Court cited to 73 P.S. §2260.104(b)(1), which provided that PETA does not apply to "[a] law governing the creation and execution of wills, codicils or testamentary trusts." Accordingly, the Court held that "PETA is not a solution to the current quandary" and that PETA did not "alter the fundamental requirement in Pennsylvania that a will be executed by an ink signature or mark at its conclusion. Until the legislature directs another course, a digital signature remains unacceptable as a method for will execution in Pennsylvania."

The Court also noted that the attorney could have simply sent the will to Susan for her to sign at the nursing home. As long as she physically signed it, it would have been a valid will, and witnesses and a notary could have observed the signing virtually (although to make the will self-proving, the notary would have had to "affix[] the appropriate certification" – discussed above).

Accordingly, the Court refused to direct the Register to admit the purported will to probate (although it noted that the beneficiaries under the intestate laws and under the purported will were the same).[3] *Kittler* has been appealed to the Superior Court. The appeal is pending.

3 *But see In re: Estate of Joyce A. Walktman, Deceased,* Docket No. 21-21-0045 (O.C. Cumb., May 17, 2021), in which the Cumberland County Register of Wills admitted an electronically-signed, witnessed and notarized will to probate.