The Will & The Way

NORTH CAROLINA BAR ASSOCIATION

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The Chair's Comments

Hardin

By Jessica M. Hardin

Each year, the depth and breadth of the section's activities astonish me. Dedicated section members, committee chairs, council members and NCBA staff work tirelessly to provide resources and support to estate planners across the state. This year – with a public health crisis and an election that left our clients scrambling to plan for future tax law changes – would have been an understandable time to scale back. After all, even routine tasks just seemed harder and took longer.

But our section's unbelievable volunteers didn't scale back. They plowed through our important work, albeit with (way too many) Zoom meetings and (regrettably) without cocktail receptions and networking events. This dedication resulted in some incredible products:

Live and on-demand CLEs. The Fiduciary Litigation Committee sponsored a standalone webinar in the fall, and the CLE committee held our biennial Advanced Estate Planning and Fiduciary Law Survey in May. The survey course premiered as a full-day live webcast covering sophisticated estate planning topics. Each of those topics (as well as the fiduciary litigation pro-gram) remains available as separate, On-Demand programs through the NCBA website. The CLE Committee also lined up a terrific CLE program to accompany our annual meeting in July. Na-tional speakers and some of our section's own

Continued on page 2

Born Out of Wedlock & Inheritance: Here Are the Rules – Can We Please Change Them?

By Lee Laskody

When we saw the DNA results, all the air left the room. Our client was not the biological daughter of the decedent. The man she knew as her father, who had treated her as a daughter for over 50 years, who told everyone that he was her father – was not. Oh my. We are experienced lawyers, and used to telling our clients bad news, but this was different. My co-counsel, Tom Sparks, made the call. Our client was understandably crushed, her understanding of her place in the world shattered.

Our client was born out of wedlock; the man she understood to be her father had died intestate, and with some significant property. She reasonably expected she would get a share of the estate. The problem is that the North Carolina intestate laws regarding children born out of wedlock and their putative fathers are restrictive, inflexible, and not what most people would expect.

When it comes to fathers and children born out of wedlock, the paths to inheritance can be found in the intestate succession statute, N.C.G.S. Section 29-19, and in the legitimation statutes, N.C.G.S. Sections 49-10 through 49-12. This article will review these statutes, argue that the statutory scheme is unfair, and suggest several ways that the laws could be improved to allow for more equitable results, while maintaining efficient estate administration.

Legitimating the Child

If the father marries the mother any time after the birth of the child, the child is legitimated pursuant to N.C.G.S. Section 49-12. Legitimation confers rights and responsibilities, as if the child had originally been born in lawful wedlock. Of course, for the purposes of this article, the key point is that it confers inheritance rights.

Instead of marriage, the father can institute a legitimation proceeding. This is a special proceeding that requires the father to file a verified petition. If the mother was unmarried at the time of conception through the birth, then the father may proceed under N.C.G.S. Section 49-10. The mother must be named as a party and served proper notice. If the mother is, or was married, at any

Continued on page 3

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The Chair's Comments, continued from the front page

experts will present during the afternoon of July 22 and the morning of July 23. Thanks to Kim Kirk, BJ Kilgore, Kerri Mast and committee members for these great programs.

Timely and informative newsletters. Editors Heidi Royal and Sara Page Waugh, and the many contributing authors, published regular issues of The Will and the Way. These newsletters kept our section connected to each other and in touch with important state and federal developments.

Increased commitment to diversity, equity and inclusion. Our newly formed Diversity, Equity and Inclusion Committee, led by Paula Kohut and Candace Wehr, continues to explore ways to improve diversity, equity and inclusion within our section and practice area as well as to demonstrate our commitment to these important issues.

Proposed legislation. The legislature's 2021-2022 long session doesn't slow down for a pandemic, and our Legislative Committee didn't either. Six legislative proposals that originated in the Legislative Committee are included in bills currently under consideration by the General Assembly. Those proposals include (1) partial incorporation of the Uniform Directed Trusts Act; (2) clarification of the trust exclusion from the Rule Against Perpetuities; (3) application of living probate procedures to trusts; (4) court approval of single transactions without appointment of guardian; (5) amendments to procedural rules for estate and trust proceedings; and (6) an update to the North Carolina Uniform Powers of Appointment Act. These proposals are the result of many hours of research, analysis and drafting, and all of us owe a debt to Kemp Mosley, Judy Linville and the many Legislative Committee members who worked so hard on them.

Event-filled annual meeting. While COVID uncertainty kept us from Kiawah again this year, Linda Johnson, Holly Norvell and Tanya Oesterreich have planned annual meeting events that you don't want to miss. Look for opportunities on July 22 and July 23 to interact with our sponsors, "see" old friends and make some new connections.

These are just some of the remarkable achievements from an unprecedented year. So many of you dedicated time and expertise to the section's work, and I so appreciate all those contributions. It has been my privilege to serve as your chair this year. I look forward to continuing our work together (with fewer Zooms and more cocktails).

Interested in writing for The Will & The Way?

Please email article suggestions to hroyal@hroyallaw.com and sarapagewaugh@mvalaw.com.

time from conception through birth, the father must proceed under N.C.G.S. Section 49-12.1, requiring that the spouse must also be a party and receive service. The evidentiary standard is different for the two situations: if unmarried, it is the greater weight of the evidence, while if married, it is clear and convincing evidence to overcome the presumption that the child is legitimate from the marriage.

Acknowledging the Child

Alternatively, the father may acknowledge himself as the father of the child in an affidavit filed with the clerk of superior court during his lifetime and the lifetime of the child pursuant to N.C.G.S. Section 29-19(b)(2). While this fairly simple procedure does not legitimize the child, it does create a path to inheritance.

If a mother is unmarried at the time of conception through the birth, then no father will be listed on the birth certificate, unless both the mother and father execute an affidavit regarding parentage pursuant to N.C.G.S. Section 130A-101(f). The statute notes, however, that "[t]he execution and filing of this affidavit with the registrar does not affect rights of inheritance unless the affidavit is also filed with the clerk of court in accordance with N.C.G.S. Section 29-19(b)(2)." One can only guess how many unmarried fathers assume that signing such an affidavit and being listed on the birth certificate is sufficient for inheritance.

Paternity Suit

The mother, the father, or the child may file a paternity suit to establish paternity of a child born out of wedlock pursuant to N.C.G.S. Sections 49-14 through 49-16. If the court finds paternity, then the child may inherit from the father pursuant to N.C.G.S. Section 29-19(b)(1). Under N.C.G.S. Section 49-14(d), if the child is more than three years old, or if the action is brought after the death of the father, evidence from a "blood or genetic marker test" is required to establish paternity. Paternity actions must be commenced before the child's 18th birthday.

Criminal Proceeding for Non-Support

If the father of a child born out of wedlock fails to support that child, he is guilty of a class 2 misdemeanor and may be prosecuted pursuant to N.C.G.S. Sections 49-1 et seq. As in a paternity suit, if the court finds paternity, then the child may inherit from the father under N.C.G.S. Section 29-19(b)(1).

Father Died Within One Year After Birth of Child

N.C.G.S. Section 29-19(b)(3) allows for inheritance by and through "[a] person who died prior to or within one year after the birth of the child and who can be established to have been the father of the child by DNA testing." This provision is an exception, in that it appears to allow someone to present evidence directly to the clerk of court in the event of the father dying before the child turned one year and one day old. All the other paths to inheritance rely on a separate legal proceeding (legitimation, paternity suit, non-support prosecution) or past documented action (acknowledgement).

The Bottom Line: In or Out?

The only statutory paths to inheritance for children born out of wedlock are those described above. If the child was legitimated, then it is simple: they have all the rights of a child born in wedlock. For those not legitimated, it is more complicated, as N.C.G.S. Section 29-19 is very particular, contains deadlines, and has been strictly interpreted and applied by the North Carolina appellate courts. Further, potential heirs who are minors have options not available to adult children.

It is significant that minor children have the potential to bring a paternity suit against the father's estate, in addition to the right to present DNA evidence to the probate court, if the father died within one year of birth of the child. Adult children, however, are stuck with their status as of the time of death of the father. They have no right to bring a paternity suit against the father's estate. In fact, they lost that right upon turning 18, which may have been many years ago.

Six Month Notice Deadline

If a child has not been legitimated, but is claiming inheritance through N.C.G.S. Section 29-19 (paternity suit, non-support prosecution, acknowledgement, died within one year), then that potential heir must give written notice of the basis of the claim to the personal representative of the estate within six months after the first publication of the general notice to creditors under N.C.G.S. Section 29-19(b). This is important, as failure to give such notice will extinguish the claim.

Adult Children Locked Out of Court?

The part of this statute that seems especially harsh is its treatment of adult children born out of wedlock. They are stuck with their inheritance status as of the date of death of their father. Their status depends upon either their father or mother having taken specific legal actions before the death of the father. In theory, a child has the right to bring a paternity action before they turn 18. However, the reality of this occurring is unlikely; minors are under a legal disability and cannot bring a legal action without the assistance of a guardian. There are also the practical problems of a minor having the knowledge to understand their legal situation, having the emotional maturity to sue their father, and having the logistical support to do so.

The Rest of the Story

This brings me back to our middle-aged client who discovered her father was not her father. The decedent was never married, but admitted to fathering children with several women and acting as their father. Our client understood herself to have four half-sisters from him. Three of her supposed sisters had opened an estate for their father and stated that they were the only heirs. They refused to list our client as an heir.

Our client did not qualify as an heir under the current statutes. We suspected that the three sisters did not qualify either. We filed a complaint on behalf of our client asking the superior court to find a particular part of the statutory scheme unconstitutional. Although the inheritance statutes for children born out of wedlock had been upheld through multiple constitutional challenges, we devised a novel challenge. We believed that granting a child the right to bring a paternity suit, but then extinguishing that right upon reaching majority, violated the NC and Federal constitutions. The statute granted children a legal right that the child has no capacity to assert and removed that right once they gained the capacity. For every right, there must be access to the courts to assert that right.

We knew that in the event that we would prevail, we needed proof of paternity. We contacted the attorney for the estate and requested assistance in getting DNA of the decedent for testing. The administrator agreed, and our client and her presumed three sisters submitted DNA for testing. That is when everyone learned that our client was not related to the decedent, and the other three were his daughters. Our client was devastated, and with a heavy heart we withdrew all of our filings. But that was not to be the end of our involvement in this case. In fact, it was just beginning.

When we filed our client's complaint, we served it on everyone we thought may be an heir. That meant serving all the brothers, sisters, nieces, and nephews of the decedent. Some weeks after we had closed our file, we started getting calls from these people wanting to know what was happening with the estate. When they found out that our client had withdrawn her claim, they asked us to represent them. So it came to pass that we represented 16 potential heirs in a contested action to determine the proper heirs of the estate. In our initial search of public records, we could find no evidence that any of the biological daughters fulfilled the statutory requirements for inheritance. Their answers to our discovery confirmed that they had no legal basis for inheritance. Eventually, upon a motion for summary judgment in the superior court, our clients were declared to be the lawful heirs of the decedent.

Unfair Results for More People

In our case, the daughters of the decedent had unquestionable DNA proof that they were his biological children. Yet, under the current scheme, they had no path to inherit. They had no opportunity to present their evidence, as it did not fit into any part of the law. Without a doubt it was the correct legal outcome. Yet, it just seems wrong.

Demographic data reveals that this is likely to become an increasing source of legal inequity. In the United States, births outside of marriage have increased from around 28 percent in 1990 to 40 percent in 2019. Child Trends, *Births to Unmarried Women*; Centers for Disease Control and Prevention, *Births: Final Data for 2019*. North Carolina is in line with the national statistics, with 48,599 births to unmarried mothers in 2018, comprising 40.85 percent of all births. *2018 North Carolina Vital Statistics*, Volume 1.

As is frequently observed, our laws and legal procedures often lag behind societal and technological changes. This statutory scheme seems to be heavily influenced by outdated judgments about people born out of marriage, and therefore their legal rights. The constitutional analysis contained in the North Carolina and Federal appellate decisions basically weighs the rights of people born out of wedlock against the need to efficiently identify heirs and administer estates. In my opinion, these appellate courts have given undue weight to the efficient administration side of the equation. In addition, I believe it is often a false dichotomy, as we can use technology and procedures already in place to achieve both equitable results and efficient procedure. In any case, we should think of passing constitutional muster as a floor, not a badge for an exemplary law.

Possible Improvements to the Statutes

There are ways to change the statutory scheme to create both more equitable results, and to maintain efficient estate administration. Here are three suggestions for modest changes to improve the current situation. The first suggestion would likely produce the most equitable outcomes, without adding any more burdens to the court system: allow the hospital affidavit of parentage to qualify as an acknowledgement under N.C.G.S Section 29-19(b). These affidavits are already being processed and recorded with the State as a matter of course. The second suggestion is to expand N.C.G.S. Section 29-19(b)(3), allowing DNA test results to be presented to the clerk to show paternity, regardless of the time of the father's death and the age of the child. In other words, allow any putative child who has DNA evidence of paternity to be able to present such evidence to the clerk. In the rare case where someone has DNA proof of the paternity of the decedent, I assume an uncontested motion or brief hearing before the clerk would settle the issue. Finally, the third suggestion is to allow putative adult children to bring a paternity action against the estate of the putative father. This would truly allow fair access to the courts but would also add potentially significant litigation to an estate case. However, since estates can already be the context for litigation such as caveats, why continue to ignore the unfair inheritance situation of 40 percent of our future potential heirs?

Lee Laskody is an attorney with Laskody Law Office, PC in Carrboro, North Carolina. His practice is focused on estate litigation including spousal elective shares.

When Two Become One . . . Or Not
The Tax Code's Treatment of Transactions Involving Married Couples

By Sara Page H. Waugh

When referring to their spouse, individuals often speak of their "better half" as though, once married, the spouses ceased being two distinct people and instead morphed into a single person. It seems that the Internal Revenue Code has also adopted this notion, allowing for certain transactions between spouses to be disregarded, as though only a single taxpayer is involved. However, the Internal Revenue Code has not wholly adopted this romantic ideal of spousal unity, imposing tax on other transactions between spouses. Rather than going down a philosophical and historical rabbit hole about the nature of marriage and why the union of marriage creates some quasi-unity of tax attributes, this article instead will describe several common situations in which transactions between married couples are disregarded under certain provisions of the Internal Revenue Code but have tax consequences under others.

Note: For purposes of this Article and for ease of the reader's comprehension, the author will assume a cisgender male and cisgender female couple. Also, each spouse is assumed to be a United States citizen.

Income Tax

Transfers Between Spouses During Lifetime

It is commonly known that, if desired, married couples can file joint income tax returns. Such an election tends to suggest that transactions between such couples would be disregarded for income tax purposes and would be "netted out" on their joint returns. As a result of Section 1041 of the Internal Revenue Code of 1986, as amended, (the "Code") this result is partially achieved.

Pursuant to Section 1041(a) of the Code, no gain or loss is recognized on the transfer of property, by sale or otherwise, from an individual to his or her spouse. Furthermore, pursuant to Section 1041(b) of the Code, even in the event of sale transactions or transactions that otherwise would typically result in an adjusted basis, property transferred between two spouses retains the same basis as though such property were transferred by gift.

As an example, assume that Husband sells Blackacre (basis of $50, fair market value of $100) to Wife for $100 cash. There would be no gain on this sale, and Wife would receive Blackacre with a basis of $50 despite her cost being $100.

However, what would be the result if Wife purchased Blackacre not for cash but instead for a promissory note?

Section 1041 of the Code would still apply to provide that no gain is recognized on any principal payments under the note. However, any interest payments would be taxable under the generally applicable rule of Section 61 of the Code. The Tax Court has ruled several times, most notably in **Gibbs v. Commissioner, T.C. Memo. 1997-196, 2672**, in the context of divorce that "interest [the taxpayer is] paid . . . and the gain [the taxpayer] might have realized upon the transfer . . . are two distinct items that give rise to separate Federal income tax consequences. The latter item might be subject to section 1041; the former is not." Although the case law centers around transfers in the event of divorce (also governed by Section 1041 of the Code), the Tax Court has made clear that the gain exclusion permitted under Section 1041 does not apply more broadly to exempt any element of a transfer between spouses (or divorcing spouses) from tax. In the absence of a specific exclusion, such interest payments would be subject to the generally applicable rule of Section 61(a) of the Code that "except as otherwise provided . . . gross income means all income from whatever source derived."

As stated in its first line, Section 61(a) applies to all income unless another section of the Code provides for an exception. Therefore, other common transactions between spouses would be subject to income tax. Employment compensation paid from one spouse to another is taxable as income to the employee spouse. Also, guaranty payments made by one spouse to another spouse will be treated as taxable income to the receiving spouse. Many of these taxable transactions are not between each spouse, individually, but rather an entity that is disregarded for income tax purposes with respect to such spouse, such as grantor trusts and single member LLCs. Because these entities are disregarded for income tax purposes, the tax effect of transactions between such entities are the same as if such transactions were engaged in directly between the spouses.

In transactions in which the paying spouse is permitted an income tax deduction for such payments, it is very possible that the taxable income received by the receiving spouse will be offset or netted against the deduction available to the paying spouse on a joint income tax return. However, given the limitations on deductions for personal expenses, many of the transactions that result in taxable income to one spouse will not afford the paying spouse a commensurate deduction.

As such, when structuring transactions between spouses, practitioners should take care to avoid falling into the trap that "transfers between spouses are not subject to income tax" and realize that Section 1041 is limited to excluding gain or loss from recognition.

Transfers Between Spouses After Death

Similar to the ability of married couples to file joint income tax returns, the ability of a surviving spouse under Section 402(c)(9) of the Code to rollover a retirement account inherited from her predeceased spouse into a retirement account in her own name is one of the most well-known instances in which spouses are treated as the same taxpayer under the Code. Despite the simplicity and commonality of this approach, spousal rollovers can provide significant income tax benefits, especially with the enactment of the Secure Act and limitation of the "stretch" period for inherited retirement accounts thereunder.

Transfer Tax

Unlike Section 1041 which automatically disregards transactions between spouses, in order for spouses to be treated as a single taxpayer for transfer tax purposes, an affirmative election often must be made.

Marital Deduction

Section 2523 of the Code provides that, for gift tax purposes, a deduction (known as the "gift tax marital deduction") shall be allowed for a gift of property from one spouse to the other, which deduction shall be in the amount of the value of the gift. If such gift transfer is made to the spouse individually, no election or reporting is required. However, the Code expands the deduction beyond gifts directly to the individual spouse but also to certain trusts for the benefit of such spouse. Section 2523(e) permits a deduction for gratuitous transfers to a trust of which the spouse is the sole current beneficiary, is entitled to receive annual income payments for life, and is permitted to appoint assets to himself or his estate (commonly known as a "Power of Appointment Trust"). Furthermore, Section 2523(f) permits a deduction for gratuitous transfers to a trust of which the spouse is the sole current beneficiary and has a qualifying income interest for life (commonly known as a "QTIP Trust"). Unlike a transfer directly to a spouse or to a Power of Appointment Trust in which no affirmative election must be made for such transfer to qualify for the gift tax marital deduction, in order for a QTIP Trust to qualify for the gift tax marital deduction, an election must be made on a Form 709 gift tax return, even if no other gift transactions are being reported, no gift tax will be due, and none of the transferring spouse's gift tax exclusion will be used in such transfer.

Similarly, at death, Section 2506 provides that, for a estate tax purposes, a deduction (known as the "estate tax marital deduction") shall be allowed for bequests to a surviving spouse, which deduction shall be in the amount of the value of the bequest. Similar to the gift tax marital deduction, no reporting is required for bequests to the surviving spouse individually or to a Power of Appointment Trust (defined under Section 2506(b)(5)) created at the predeceasing spouse's death and, pursuant to Section 2506(b)(7), an election must be made on a Form 706 estate tax return for bequests to a QTIP Trust created at the predeceasing spouse's death, even if no estate tax return would otherwise be required to be filed.

Transactions with Third Parties During Lifetime: Gift-Splitting

Under Section 2513(a) of the Code, a gift made by one spouse to a third party can be treated as being made equally by both spouses – commonly known as "gift-splitting." Much like married filing jointly income tax status, gift-splitting allows a couple to combine their tax attributes and apply them to the assets of a single spouse. A "moneyed" spouse is able to make gifts of an amount not only of her applicable exclusion amount but also of the applicable exclusion amount of her less moneyed spouse. Without having to actually to cede control of her assets, gift-splitting allows a moneyed spouse to truly embody the phrase: "what's mine is yours and what's yours is mine," i.e., (for purposes of this gift tax return), my money is your money, and your applicable exclusion amount is my applicable exclusion amount.

In any given year, gift-splitting is commonly used to double the amount of annual exclusion gifts that can be made to an irrevocable trust. For many couples with disparate income levels, irrevocable life insurance trusts are a tried and true method to ensure that, if the high earning spouse were to pass away prematurely, sufficient assets would be available to care for any surviving descendants. Assuming that the appropriate "Crummey" withdrawal provisions are in place, taking advantage of gift-splitting would allow twice as much to be contributed for premium payments to qualify for the annual exclusion and avoid gift tax.

It should be noted, if not intuitively obvious, that transfers eligible for gift-splitting must be made to a third party and not to the other spouse. Although conceptually it is often easier to think of transfers being subject to gift-splitting as coming from "the couple" as a single distinct entity, section 2513(a) actually provides that such transfers are deemed to be made "one-half by [the taxpayer] and one-half by [the taxpayer's] spouse." Because one cannot make a gift to oneself, there is always a question as to whether a couple can elect to split gifts to an irrevocable trust of which one spouse is a beneficiary. Treasury Regulation 25.2513-1(b)(4) provides that if a taxpayer makes a transfer in part to her spouse and in part to third parties, gift-splitting is effective with respect to third parties only to the extent that the interest being transferred to the third parties is ascertainable and severable from the interest being transferred to the spouse. Therefore, in determining whether gift-splitting is available to trusts of which the spouse is a discretionary beneficiary, it must be determined if the interest to the other beneficiaries is ascertainable and severable from the interest of the spouse. Then, the values of the separate interests must be calculated in order to determine how much of the gift is eligible for gift-splitting and how much is a gift to the spouse. Because the spouse is likely not the sole beneficiary, it is unlikely that the portion attributable to the spouse's interest will be eligible for the gift tax marital deduction, and, thus, an additional portion of the transferring spouse's separate applicable exclusion amount must be used unless the interest transferred is less than the annual exclusion. This result typically leads practitioners to add the requirement that the spouse's interest be "de minimus" as well as ascertainable and severable in order to avoid using a portion of the grantor's applicable exclusion amount for the portion of the gift attributable to the spouse.

As will be discussed in further detail below, the generation-skipping transfer (GST) tax is often treated differently than the gift and estate tax which can, usually (under current law), be safely discussed in tandem. The treatment of spouses' GST exemptions in gift-splitting is no different. Treasury Regulation Section 26.2652-1(a)(4) provides that a consenting spouse is deemed to be the transferor for GST tax purposes of one-half of the entire value of the property transferred, regardless of whether the consenting spouse's interest in the property reduces the value of the gift subject to gift-splitting.

As an example, assume that the taxpayer transfers $100,000 to a trust of which the spouse is a beneficiary, the taxpayer and her spouse consent to split gifts, and no annual exclusions are available. The interest of the spouse is determined to be $10,000. The spouse will use $45,000 of his gift tax exclusion amount (one-half of the $90,000 that is eligible for gift-splitting) but will use $50,000 of his GST tax exemption because he is deemed to be a transferor of one-half of the total property transferred, regardless of his $10,000 interest that reduces the portion of the property eligible for gift-splitting.

As we are currently in a period of flux with respect to the applicable exclusion amount, with the increased exclusion amount set to sunset on January 1, 2026 (if not reduced earlier), it is worth noting that the elective feature of gift-splitting grants taxpayers some flexibility in their tax planning. Ultra-high net worth individuals can elect to gift-split and transfer over $23 million to their descendants, transfer tax free. On the other hand, couples who are either unwilling or unable to transfer the full increased exclusion amount can decline the gift-splitting election and still take advantage of one spouse's increased "bonus" exclusion while preserving the other spouse's "base" exclusion. For example, one spouse could transfer $11 million to a trust for the other spouse and/or descendants using her entire increased applicable exclusion amount. If the other spouse makes no gifts before the applicable exclusion amount is decreased, the couple will have retained use of his "base" exclusion of approximately $6 million (assuming an unaltered 2026 sunset), which can be used for additional lifetime gifts or to shelter assets from tax upon the spouses' deaths.

As alluded to above, an affirmative election must be made in order for spouses to gift-split. This election must be made on a Form 709 gift tax return even if a gift tax return would not otherwise be required to be filed because all gifts made in a given year were below the annual exclusion or to spousal or charitable beneficiaries. Furthermore, it should be noted that, if gift-splitting is elected, all gifts (other than gifts between the spouses, which, as discussed above, are not eligible for gift-splitting) must be split.

Transactions with Third Parties After Death: Portability

Much like Section 2513(a) allows a moneyed spouse to "use" her less moneyed spouse's exclusion to make lifetime gifts, Section 2010(c)(5) allows a moneyed spouse to use her predeceasing less moneyed spouse's unused applicable exclusion amount. This concept, known as "portability," allows the executor of the estate of the predeceasing spouse to elect to transfer or "port" the predeceasing spouse's unused applicable exclusion amount (the "deceased spousal unused exclusion amount" or "DSUE") to the surviving spouse. When the surviving spouse makes gifts during her lifetime or upon the surviving spouse's death, this DSUE amount will be combined with the then applicable exclusion amount in order to determine the surviving spouse's applicable exclusion amount. If, for example, the less moneyed spouse dies with $2 million in assets and an applicable exclusion amount of $11 million, $9 million of applicable exclusion amount will be made available or "ported" to the surviving spouse. Assuming a then applicable exclusion amount of $11 million, the surviving spouse then would have the ability to transfer $20 million gift or estate tax free: $11 million attributable to her applicable exclusion amount and $9 million in DSUE.

Portability is also applicable if the predeceasing spouse dies with assets in excess of the applicable exclusion amount but, as a result of available deductions, not all of the predeceasing spouse's applicable exclusion amount must be used to avoid the imposition of estate tax at the predeceasing spouse's death. If, for example, the predeceasing spouse dies with an applicable exclusion amount of $11 million, assets equal to $15 million, and $5 million passes to the surviving spouse, qualifying for the marital deduction, and $10 million passes to charitable organizations, qualifying for the charitable deduction, the DSUE would be the full $11 million applicable exclusion amount.

It should be noted that, unlike the surviving spouse's applicable exclusion amount, which can increase or decrease based on inflation adjustments or sunset provisions, under current law, the DSUE amount would remain unchanged from the DSUE calculated as of the date of the predeceasing spouse's death. Furthermore, as alluded to above, much like gift-splitting, an affirmative election must be made in order to transfer a predeceasing spouse's DSUE to the surviving spouse. This election must be made on a Form 706 estate tax return filed for the predeceasing spouse's estate even if an estate tax return would not otherwise be required to be filed because the predeceasing spouse's assets were not in excess of the applicable exclusion amount.

GST Exemption

Gift-splitting and portability are quite commonly used, prompting many practitioners to state that the exemption amount is, for example, "$11,700,000 for a single person and $23,400,000 for a married couple." However, much like the generalizations made about Section 1041 with respect to transfers between spouses, practitioners should be careful not to apply this statement to all transfer taxes.

Section 2010(c)(5) (portability) does not apply to the GST tax. Pursuant to Section 2631(c), the GST exemption amount is equal to the basic exclusion amount under Section 2010(c). However, Chapter 13 of the Code, addressing the GST tax, does not specifically incorporate references to Section 2010(c)(5). Without the application of these provisions to the GST tax, there is no "GST portability" at a spouse's death. The following example illustrates this lack of parity between the applicable exclusion amount when applied to estate tax as opposed to the GST tax.

Example: A predeceasing spouse dies with $2 million in assets, an applicable exclusion of $11 million, and a GST exemption of $11 million. The executor of the predeceasing spouse's estate makes a portability election on a timely filed Form 706. At a time when the surviving spouse's applicable exclusion amount is $11 million and her GST exemption is $11 million, the surviving spouse makes a $20 million gift to trusts for the benefit of the surviving spouse's grandchildren. This transfer is not subject to any gift tax as a result of the surviving spouse's $11 million applicable exclusion amount and $9 million DSUE – for a total of $20 million. However, $9 million of this transfer is subject to GST tax as only the surviving spouse's $11 million GST exemption is available to shield a portion of the transfer from GST tax.

Therefore, unlike a predeceasing spouse's applicable exclusion amount for estate tax purposes, the predeceasing spouse's GST exemption must be used during his lifetime or at his death or it will be lost.

Conclusion

For many couples with consolidated assets, it is often hard to determine what belongs to one spouse and what belongs to another. In the course of daily living, assets that "belong" to one spouse are used by the other spouse and vice versa. These practical realities along with the Code's disregard of certain transactions between spouses can create the inaccurate impression that spouses are treated a single unit for all purposes under the Code and that all tax attributes and benefits flow freely between them. Practitioners should take care to avoid this trap and treat their married clients as two distinct taxpayers, unless specifically permitted under the Code. As much as we may like to believe in the ideal that marriage is the union of two souls into one, unfortunately this idealism does not extend to all areas of the Code.

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Selecting the Right Philanthropic Vehicle: How to Leverage Designated Funds & Field of Interest Funds

By Kindl Detar & Whitney Feld

While philanthropic giving through Donor Advised Funds (DAFs) has proliferated in recent years, there are other lesser-known vehicles that can be used for charitable giving. This Article examines the benefits of Designated Funds and Field of Interest Funds, including practical considerations and case studies, to help you assist your clients in selecting the right vehicle(s) to meet their philanthropic objectives for both lifetime and planned giving.

How are these Funds different from Donor Advised Funds?

As a threshold matter, both Designated Funds and Field of Interest Funds must fail the Donor Advised Fund test as articulated in the Pension Protection Act of 2006 (PPA). Section 4966(d)(2)(A) of the Internal Revenue Code (the "Code") defines a "donor advised fund" as "a fund or account which is separately identified by reference to contributions of a donor or donors, (ii) which is owned and controlled by a sponsoring organization, and (iii) with respect to which a donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reasons of the donor's status as a donor." All three prongs of the definition must be met for a fund to be classified as a DAF. As detailed below, the definition excludes both Designated Funds and Field of Interest Funds.

What is a Designated Fund?

Designated Funds are established by donors wishing to support a specific charitable organization, typically for a period of years or in perpetuity. A Designated Fund may be opened during the donor's life to support their current charitable giving, or as part of the donor's overall estate planning to be used at their death to sustain their philanthropic legacy. For example, a hypothetical donor named Roy Williams, with a long history of support for the University of North Carolina at Chapel Hill, might create the Roy Williams Designated Fund for UNC–Chapel Hill. Note that in Section 4966(d)(2)(B) of the Code, the IRS specifically excludes from the definition of a DAF any fund which "makes distributions only to a single identified organization or governmental entity" (emphasis added). Therefore, Designated Funds typically meet this exception even if the donor has advisory privileges over timing of grants or investments. However, an advisor should pay close attention to how the fund is administered so it is not at risk of being reclassified as a DAF. For instance, where multiple charitable beneficiaries are designated in the fund agreement and the advisor has discretion to choose among the beneficiaries in recommending distributions, the fund would likely meet the definition of a DAF as articulated by the PPA and thus fail to qualify as a Designated Fund as this term is used in this article.

Establishing a Designated Fund is a straightforward process that typically requires only a single fund agreement. If created during the donor's life, an initial charitable contribution can be made with a wide variety of assets. Each lifetime contribution should qualify for an immediate public charity income tax deduction, and donors may add to the fund at any time. Additionally, unlike DAFs and private foundations, Designated Funds are one of several philanthropic vehicles that eligible donors may use to make a qualified charitable distribution (QCD) from an Individual Retirement Account (IRA) (sometimes referred to as an IRA charitable rollover). For planned giving, donors can fund Designated Funds from a variety of sources including wills, retirement assets, life insurance and charitable remainder trusts. Most sponsoring organizations provide an array of investment options that allow the fund to grow tax-free and, for endowed Designated Funds, provide continued support to the designated organization in perpetuity.

For some clients, the opportunity to leverage the structure and support of a sponsoring organization in creating a Designated Fund may be appealing as they are able to, for example, access economies of scales with investments and create a centralized giving plan that includes a Designated Fund alongside other charitable distributions and funds. In addition, where the client has a longer-term horizon for the gift, there can be comfort in partnering with an established sponsoring organization to ensure that distributions are made timely and that, should the organization cease to exist, the donor's charitable intent can still be achieved.

What is a Field of Interest Fund?

Field of Interest Funds benefit organizations that fall within a specific charitable field or category rather than a particular charitable organization. Donors may describe the Field of Interest Funds broadly or narrowly. For example, the fund could benefit the environment and emphasize air quality. Additionally, it may benefit an entire geographic area, such as Charlotte-Mecklenburg or a smaller community, such as the Town of Matthews.

Much like Designated Funds, Field of Interest Funds are useful for lifetime and, more frequently, planned gifts. The fund can be opened with a single fund agreement and contributions during life should qualify for an immediate public charity income tax deduction. They are also eligible for qualified charitable distributions from an IRA.

Again, for planned gifts, a variety of sources may be used to fund a Field of Interest Fund.

A distinguishing feature of Field of Interest Funds is that the advisory privileges are typically given to the sponsoring organization when the fund is created. As a result, Field of Interest Funds typically fail the third prong of the DAF test, which states "with respect to which a donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reasons of the donor's status as a donor." However, the donor may be able to recommend that a committee, often with subject matter expertise, be appointed (perhaps by the sponsoring organization) to assist in overseeing grantmaking within the established field, so long as the sponsoring organization retains advisory privileges for the grantmaking.

It is worth briefly mentioning that Field of Interest Funds constitute the backbone of the community foundation movement and pre-date DAFs, which were not established until the 1930s. Frederick Harris Goff, founder of The Cleveland Foundation, the first community foundation, was concerned about how often provisions for the charitable uses of trust income became obsolete or counterproductive, a phenomenon he observed in his work as an attorney. He established The Cleveland Foundation in 1914 to pool the charitable resources of Clevelanders from all walks of life, both living and deceased, into a single permanent trust administered for the betterment of the community. Ultimately, many other communities followed suit with donors setting up unrestricted or broad Field of Interest Funds, primarily through bequests, entrusting future leaders to evaluate changing community needs and make grants accordingly. Currently, there are more than 800 community foundations across the United States, including Foundation For The Carolinas (FFTC), with each serving a unique geographic region. Field of Interest Funds continue to play a crucial role in empowering community foundations to respond to evolving needs and provide civic leadership within their communities. The COVID-19 pandemic starkly illustrated the importance of flexible funds that enable a timely response to critical and unexpected community needs.

Considerations for Designated & Field of Interest Funds for Planned Giving

The benefits of Designated Funds and Field of Interest Funds as part of an overall strategy to meet a client's philanthropic goals are perhaps best illustrated in the context of planned giving. While planned giving is a broad category and is not limited to charitable gifts taking effect at a donor's death, for purposes of this Article, references to planned giving refer to gifts that take effect at a donor's death.

Designated Funds for Planned Giving

Although a donor may support numerous organizations during their life, in naming a beneficiary of a Designated Fund as part of a planned gift, donors typically select an organization that has been of great importance during their lifetime (e.g., an organization where the donor served on the board and/or made annual grants, an alma mater, or house of worship). Thus, the decision to select an organization as the beneficiary of a Designated Fund is frequently the result of a longstanding and close relationship between the donor and the organization. Accordingly, one benefit of a Designated Fund for planned giving is the opportunity to create a legacy of support for an organization beyond the client's life. One client, for example, noted that he took comfort in knowing that an organization he has long supported will receive annual grants from a fund bearing his name for generations to come, even after he is gone.

While the beneficiary of a Designated Fund is defined, a donor may tailor the distributions to the organization to reflect the client's charitable goals. Some clients elect to create an endowment for the organization, providing perpetual, predictable support for generations to come. Particularly where there is a history of support, in establishing an endowed fund, clients may target a principal amount that would, assuming a normal rate of return and distribution, "endow" their lifetime giving in perpetuity. For example, assuming a spendable rate of 5 percent, an endowment created with $100,000 would typically support a perpetual, annual grant of $5,000 to the designated beneficiary, securing the client's legacy of support. Other clients favor a shorter horizon and may elect to specify a cadence for payments – for example, a term of years – over which the balance of the Designated Fund shall be distributed to the named beneficiary. While an endowed fund typically disburses annual grants in line with the sponsoring organization's calculated spendable rate, for a non-endowed fund, the donor has flexibility as to the timing and amount of grants to the designated organization.

In addition to the ability to determine the time horizon and amount for distributions, a donor may also indicate the designated uses of the grant funds disbursed from the broad to the specific. For example, a donor may wish to provide unrestricted funds for the organization to use as it deems best, or to specify that the funds are intended to support specific programming. For grants other than unrestricted grants, the donor should consult with the organization in advance to ensure that the latter understands the client's wishes and will be able to honor them when the gift is realized.

In implementing a donor's charitable intent, a planned gift donor may name advisors for a Designated Fund or, in the case of a sponsoring organization, such as FFTC, may list the sponsoring organization as the advisor. For clients considering planned gifts, the ability to name the sponsoring organization as the advisor can be particularly attractive where there are no family members or other trusted advisors to name. Donor intent is of paramount importance to the community foundation sector and the sector spends significant time properly documenting the same, particularly where the community foundation is named as an advisor.

While a specific named charitable beneficiary is the hallmark of a Designated Fund, the donor should consider a contingent philanthropic plan should the designated beneficiary cease to exist or to be a qualified charitable organization (e.g., the organization could close its doors or its charitable purpose could be rendered moot such as in the case of a disease being cured). The possibility of such a change increases over time and thus, contingency planning is particularly important for gifts with a longer time horizon. In creating a Designated Fund, the donor can articulate her or his wishes in such a contingent scenario, either allocating the funds in question to other beneficiaries or authorizing the advisor to select an alternate beneficiary whose mission is closely aligned to that of the original organization.

Even in cases where the donor has not documented a contingency plan, a community foundation (such as FFTC) is aided by policies addressing this issue, as well as its variance power. The variance power typically authorizes the community foundation's board of directors to modify any condition or restriction on the distribution of funds if, in its judgment, such restriction or condition becomes unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the area served by the foundation or with the requirements of the Code. See, e.g., Treas. Reg. §1.170A-9(f)(11)(v)(B)(1). While this power is rarely invoked and always carefully considered, it ultimately serves to guarantee that a client's charitable intent will not be frustrated by an external change, thus providing peace of mind regarding future charitable impact.

The ability to provide a legacy of support to a specific beneficiary through a Designated Fund can be a welcome tool for a donor with a long-standing and close relationship to an organization. Conversely, as detailed below, a Field of Interest Fund can prove a helpful option for clients whose charitable beneficiaries may be less prescribed.

Field of Interest Funds for Planned Giving

Given the unique structure of a Field of Interest Fund, this philanthropic tool is perhaps most beneficial in the planned giving context. Before addressing the distinctive features of these funds, it is worth noting that, as with a Designated Fund, a Field of Interest Fund may be endowed or non-endowed, as directed by the client.

When a Field of Interest Fund is created, the donor identifies a specific area of charitable focus, as broadly or narrowly as the donor desires, and entrusts advisors to exercise discretion in awarding future grants *within that identified area*. Because there is no specified beneficiary, the role of the advisor is key. In selecting an advisor, clients typically look to the sponsoring organization and *may* recommend a committee of advisors to assist the sponsoring organization with grantmaking. Advisors on the Field of Interest Fund should have both experience with grantmaking and expertise in the selected subject matter. Particularly where the donor has strong ties to a particular place and desires to support that community or region, the local knowledge and connectivity offered by a community foundation may be a welcome resource, as each community foundation represents a specific geographic region. For example, a donor wanting to support broad charitable purposes in Cabarrus County might contribute to the Cabarrus County Community Foundation's endowment, supporting annual grantmaking within that geographic region, as led by Foundation staff and a board of local civic leaders.

This ability to select a general area of interest and leverage the advisors' expertise can be compelling for the donor who does not have specific organizations they wish to support or who lacks significant experience with grantmaking but is nonetheless passionate about the future impact of their gift. Even clients with a lengthy history of giving and existing relationships with nonprofits may find a Field of Interest Fund valuable given the forward-looking nature of planned giving. Planned giving frequently asks clients to predict their future charitable goals – how would I use these funds in 25 or 50 years? – a task that can be daunting given the changing needs within our communities. A Field of Interest Fund helps assuage this concern about an unknown, evolving future by entrusting future grantmaking to the advisors. Here, it is important to note that in addition to the experience and expertise that the advisors provide, they offer another benefit that is uniquely welcome for planned gifts clients – future relevance. That is, in awarding grants from the Field of Interest Fund, the advisor is able to evaluate the greatest *current* needs and opportunities within the client's specific focus area. In 2020, for example, a Field of Interest Fund focused on early childhood literacy might well have awarded grants to increase access to remote learning. Certainly, no donor 50 years, or even five years ago, could have predicted the necessity of remote learning. However, in 2020, this grant would have been an important and timely way to support early childhood literacy. The discretion inherent in a Field of Interest Fund allows grantmaking to meet the needs of the day, even as those needs evolve.

Thus, a Field of Interest Fund can be a helpful planned giving tool for a variety of clients, including those who may not have a strong connection to a specific nonprofit, but are generally passionate about a specific area of community need; those who desire a longer-term impact and are mindful of ever-evolving needs; and, as we increasingly see in our work, those who wish to give a portion of a planned gift to a Field of Interest Fund in an effort to diversify their giving and future charitable impact. For these clients, there is a desire to both provide for the organizations they know and love well, perhaps via a Designated Fund, *and* a recognition that there will be future needs and opportunities that we cannot predict. The opportunity to incorporate a Field of Interest Fund as part of a planned giving strategy can provide peace of mind regarding future, relevant impact. For example, the same donor might create a Designated Fund to benefit the local homeless shelter, and also a Field of Interest Fund to support ongoing community efforts to address affordable housing.

Indeed, in addition to creating a standalone Field of Interest Fund that reflects a client's specific, perhaps narrow charitable focus, a donor may consider contributing to an existing Field of Interest Fund, pooling the client's funds with other like-minded community members for greater impact. Many community foundations have such funds that reflect broad community areas of need. FFTC, for example, offers eight Community Impact Funds that support broad, vital causes in our community: Health & Human Services, Education & Youth Development, Arts & Culture, Environment & Wildlife, Animal Welfare, Evolving Needs & Opportunities, Our Region and Your FFTC. In awarding grants from each of these endowed funds, FFTC leverages the respective experience and expertise of our grantmaking team and volunteer community leaders. For the donor who wishes to support broad community causes, the opportunity to be a part of a larger initiative, as with the Community Impact Funds, can be compelling.

As discussed, Field of Interest Funds can be an important tool to address evolving community needs and may also offer a way to contribute to a broader fund supported by the community. While the benefits of using Designated Funds and Field of Interest Funds for planned giving are more widely known, they are also helpful tools for practitioners seeking to fulfill their clients' charitable objectives during life.

Considerations in Using Designated & Field of Interest Funds for Lifetime Giving

Recent legislation enhanced the benefits of using Designated Funds and Field of Interest Funds, either as standalone charitable vehicles, or in concert with other charitable planning tools, such as DAFs, for lifetime giving. This section will address several pieces of relevant legislation with a more comprehensive discussion, including excess business holdings considerations, provided at the end of this Section.

Tax Cuts and Jobs Act of 2017

The Tax Cuts and Jobs Act (TCJA) of 2017 was the largest overhaul of the tax code in three decades, with most provisions set to remain in place through 2025. In addition to a number of revisions to earlier tax law, the standard deduction was significantly raised. The Tax Foundation estimates the percentage of itemizing taxpayers dropped from 31.1 percent pre-TCJA, to just 13.7 percent in 2019.

As a result of these changes, taxpayers adjusted their strategies for post-TCJA giving, which include using DAFs to bunch their donations (discussed in Doug Benson and Whitney Feld, *Selecting the Right Philanthropic Vehicle: Private Foundations vs. Donor Advised Funds*, The Will & The Way, Vol. 40, No. 1) and using IRAs to make QCDs (effectively tax-free distributions from an IRA to qualified charities). QCDs count toward an IRA owner's required minimum distribution (RMD) and are particularly advantageous for clients claiming the standard deduction. As detailed below, while the advantages of using QCDs are many, QCDs cannot be made to DAFs, Private Non-Operating Foundations, Supporting Organizations, or split-interest giving vehicles (e.g., charitable remainder trusts, charitable lead trusts and pooled income funds). For clients wishing to use QCDs for multi-year philanthropic planning, Designated Funds and Field of Interest Funds can be beneficial planning vehicles.

After the passage of the Setting Every Community Up for Retirement Enhancement Act (the SECURE Act), individuals who own IRAs are now required to take RMDs each year beginning at age 72 (an increase from age 70½). RMDs are treated as taxable income and, as the name implies, must be taken regardless of whether the funds are needed. In some instances, the income from the RMD may push the taxpayer into a higher income tax bracket or trigger phaseouts which limit tax deductions and may even trigger higher taxes on social security income (i.e., the Medicare high-income surcharge). Even though the SECURE Act raised the RMD age from 70½ to 72 years old, individuals may still take QCDs from their IRAs at age 70½. The maximum amount that can be transferred from a traditional IRA to a qualified charity each year as a QCD is $100,000 per individual. In this regard, for couples, each spouse with an IRA may make QCDs of up to $100,000 per year, enabling potential combined QCDs of $200,000. Although this applies to a limited age group, there are thousands of Baby Boomers reaching this age daily. Furthermore, as indicated by a study conducted by The Philanthropy Roundtable, this demographic is very philanthropic with 77 percent of households donating to charity.

The benefits of QCDs are significant for qualified individuals. As noted above, QCDs do not constitute taxable income, but still satisfy RMDs. During the 18-month window between 70½ and 72, clients who make QCDs can provide support to charities while simultaneously reducing the remaining amount in their IRA (while preserving other assets), thus resulting in reduced future RMDs and taxes. As noted, while QCDs may not be made to DAFs or private foundations, they may be made directly to most public charities, as well as to community foundations and other organizations to support Designated Funds and Field of Interest Funds, as well other funds such as Scholarship Funds. Thus, Designated Funds and Field of Interest Funds may provide an attractive alternative for clients who wish to provide strategic support over a period of years rather than in one lump sum.

As an illustration of the impact of QCDs, an individual who elects to make a QCD of $100,000 to charity and is in the 22% marginal tax federal income bracket, can save $22,000 in federal income taxes. To expand, if the same donor contributed the $100,000 QCD into a Designated Fund for the benefit of their local food bank, they could make $10,000 grants annually for the next 10 years, in effect prefunding their giving. In addition, the assets in the Designated Fund could be invested and potentially grow tax-free during this time. Alternatively, the donor could make a $100,000 QCD into a Field of Interest Fund to benefit Animal Welfare with the sponsoring organization overseeing the distributions to non-profits within that focus area. If the sponsoring organization is a community foundation, the Field of Interest Fund provides the community foundation with discretionary grantmaking resources and the donor can benefit from their subject matter expertise.

Coronavirus Aid, Relief, and Economic Security Act of 2020

Under the Coronavirus Aid, Relief and Economic Security Act (the CARES Act), donors who itemize their deductions may deduct cash contributions to public charities up to 100 percent of their Adjusted Gross Income (AGI) in 2020 and 2021. This represents an increase from the 60 percent AGI limit that ordinarily applies to cash gifts made to public charities. Excess contributions can be carried forward for up to five additional years. While the benefits of the CARES Act are set to expire at the end of the year, they are significant enough to warrant discussion. Similar to QCDs and other recent enhanced charitable provisions, this increased 100 percent AGI limit does not apply to cash gifts made to DAFs, Private Non-Operating Foundations, Supporting Organizations, or split-interest giving vehicles, but may be made to Designated Funds and Field of Interest Funds. The enhanced AGI limit also does not apply to charitable contributions carried forward from a prior tax year.

The CARES Act does not change the AGI limit for charitable gifts of non-cash assets or for gifts to DAFs. If a donor wishes to make charitable gifts exceeding the respective AGI limits, they might consider "stacking" charitable gifts of cash and non-cash assets and leveraging Designated Funds and Field of Interest Funds to fully meet their tax and charitable goals.

Excess Business Holdings

The rules related to excess business holdings, enumerated in Section 4943 of the Code, can also make Designated Funds and Field of Interest Funds attractive planning tools for charitably minded clients. Congress enacted the excess business holdings rules to limit the ability of individuals to retain control of business enterprises after transferring ownership to a private foundation. For purposes of the taxes under Section 4943, DAFs and supporting organizations are treated as private foundations.

Generally, under Section 4943, the combined holdings of a private foundation and its disqualified persons are limited to 20 percent of the voting stock in a business enterprise that is a corporation, partnership, joint venture, or other unincorporated enterprise. In the case of a partnership or joint venture, voting stock is replaced by a beneficial interest in the profits of the partnership or joint venture.

A private foundation that has excess business holdings may become liable for an excise tax based on the amount of the excess holdings. Typically, an initial tax of 10 percent of the value of the excess holdings is imposed on the foundation. The tax is imposed on the last day of each year that ends during the taxable period. The initial tax may be abated if the foundation can show that the excess holdings were due to reasonable cause and not to willful neglect, and that the excess holdings were disposed of within the correction period. Note, the correction period begins on the first day that the foundation has excess business holdings and ends 90 days after a notice of deficiency for the additional tax is mailed.

After the initial tax has been imposed, an excise tax of 200 percent of the excess holdings will be imposed on the foundation if it has not disposed of the remaining excess business holdings by the end of the taxable period. However, the additional tax will not be assessed, or, if assessed, will be abated, if the excess business holdings are reduced to zero during the "correction period."

There are several exceptions to the excess business holdings rule; however, a detailed discussion of these exceptions falls outside the scope of this article. That said, it is important to highlight a few exceptions. Under Section 4943(d)(3)(B), a business enterprise does not include a trade or business at least 95 percent of the gross income of which is derived from passive sources. In addition, under Section 4943(c)(2)(C), there is a de minimis exception for a private foundation (or DAF) holding no more than 2 percent of the voting stock and not more than 2 percent of the value of all outstanding shares. Perhaps most importantly in the area of charitable gifts, Section 4943(c)(6) provides five years to dispose of holdings in a business enterprise acquired by gift or bequest that would otherwise be considered excess business holdings. There is also the potential to seek an extension of five additional years under Section 4943(c)(7) for unusually large gifts and bequests if certain requirements are met.

In light of the draconian penalties noted above, it is important that clients take care before transferring holdings in a closely held business to a private foundation or DAF; however, most public charities are exempt from the excess business holdings rules. Because Designated Funds and Field of Interest funds are not considered DAFs, they are not subject to the excess business holdings rules and can be important vehicles for gifts of closely held business interests.

While there are many tax considerations that make Designated Funds and Field of Interest Funds attractive for lifetime and charitable planning, clients are often motivated to give for other reasons. In fact, studies have shown that individuals are inclined to give back to make an impact and that often leads to personal satisfaction, known in philanthropy as the "warm glow" effect. Therefore, even without the tax benefits, your clients may wish to explore these giving vehicles to help them fully achieve their philanthropic goals. In particular, for clients contemplating gifting a portion of their estate to a Field of Interest Fund, it can be rewarding to establish a relationship with the sponsoring organization during life. This provides an opportunity to better understand the sponsoring organization's approach to grantmaking and perhaps create a deeper relationship with key staff that may provide peace of mind.

Designated Funds and Field of Interest Funds can offer unique benefits for both lifetime and planned giving. The following case studies are provided to help illustrate these benefits.

Case Studies

Case Study 1: Phil Anthropist is 45 years old, unmarried and has no children. He comes to your office to update his estate plan. He has limited experience with charitable giving beyond an annual gift of $10,000 to his church. Phil has net worth in excess of $3M and is interested in making a larger gift which might have a lasting impact in his community. Phil shares that he is passionate about the environment, and in particular, sustainable farming practices. Additionally, he mentions that his mom passed away from breast cancer three years ago.

In this case, Phil might consider establishing several funds. First, Phil might consider a Designated Fund for the benefit of his church given his consistent lifetime support. Note, this gift could provide general support or name a specific program (e.g., the choir, community outreach, beautification, etc.). If Phil sought to endow his annual support in perpetuity, the fund would need to be approximately $200,000.

Given that Phil's estate is in excess of $3M and he has no children, Phil may wish to make additional charitable gifts. For instance, Phil may want to consider creating a Field of Interest Fund named for his mother to support finding a cure for breast cancer. Assuming this gift is endowed or has a longer time horizon for distribution, Phil could explore additional causes to receive funding in the event breast cancer is cured. Finally, given Phil's passion for sustainable farming practices, but lack of experience making charitable grants, Phil may wish to work with his local community foundation to contribute to an existing Field of Interest Fund. In this way, he can leverage local expertise and maximize the impact of his contribution.

Case Study 2: Meghan and Harry come to your office to discuss several philanthropic objectives. They recently turned 71 years old, have three adult children ranging in age from 34 to 40 years old, and five grandchildren. All of their children live in North Carolina and have a close relationship with their parents. Meghan is very involved with her alma mater, their synagogue, and the local school district. Harry is passionate about animal welfare and sits on the board of the local Humane Society. As lifelong residents of Cleveland County, they also care about local development initiatives. As a result, they opened a DAF with FFTC twenty years ago, affiliating their fund with Cleveland County Community Foundation. The DAF now has assets that exceed $250,000. Meghan and Harry have two objectives.

First, they hope to inspire their children to give to causes that align with the children's personal philanthropic interests. Second, they want to continue their legacy of support for the causes near and dear to their hearts.

In this case, Meghan and Harry might consider naming their children as successor advisors to their existing DAF. Furthermore, to encourage the children to give to interests important to them, Meghan and Harry may want to consider seed funding modest DAFs for each of their children.

Additionally, because Meghan and Harry are both older than 70½, they may want to explore whether they can leverage a QCD to create separate Designated Funds for specific organizations (e.g., their synagogue or the Humane Society). Each Designated Fund could be structured as a non-endowed fund during their lifetime, and then, as a planning tool, be converted to endowed funds at the death of the survivor to continue their legacy of support. Additionally, they could use a QCD to contribute to an existing regional Field of Interest Fund focused on Cleveland County. By utilizing the QCDs, they are essentially pre-funding endowments for organizations about which they care deeply, eliminating the need to use estate gifts to provide support for these organizations and protecting the corpus of the DAF, which provides greater funds for their children to award and thus maximizes the couple's comprehensive charitable legacy.

Conclusion

In helping your clients fulfill their philanthropic objectives, there are a variety of charitable vehicles to consider. Designated Funds and Field of Interest Funds, while perhaps less well known, present unique and important opportunities for charitable planning, both during lifetime, and particularly for planned gifts.

Disclaimer: The information provided in this Article is general and educational in nature. It is not intended to be, and should not be construed as, legal or tax advice. Foundation For The Carolinas does not provide legal or tax advice. Laws of a specific state or laws relevant to a particular situation may affect the applicability, accuracy, or completeness of this information. Please consult an attorney or tax advisor regarding your specific circumstances.

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Recent Developments Through April 30, 2021

Authorship and editing are provided by Stephen A. Brown, Chadwick I. McCullen, Stephanie R. Poston and Tyler F. Chriscoe of the Trusts and Estates Team of Young Moore and Henderson, P.A.

Administrative Developments

Service Updates Publication 590-B With Questionable Interpretation of SECURE Act 10-Year Rule

On April 6, 2021, the Service issued an updated Publication 590-B, *Distributions from Individual Retirement Arrangements (IRAs)* for use in preparing 2020 returns. Pages 11-12 provide instructions for determining required minimum distributions for beneficiaries of an IRA. Significantly, the Publication implements an interpretation of the 10-year rule that is contrary to most commentators' interpretation of the law. The Publication provides that the designated beneficiary of an IRA subject to the 10-year rule must take required minimum distributions during each year of the 10-year period. The beneficiary may not delay distributions to the final year of the 10-year period. The required minimum distributions are calculated using the beneficiary's life expectancy. As a result, the Publication treats an inherited IRA subject to the 10-year as a form of mini-stretch IRA. The Publication also appears to suggest that the 10-year rule applies to designated beneficiaries, other than eligible designated beneficiaries, of a decedent's IRA where the decedent died after his or her required beginning date.

Service Addresses Trust Modification and Declaratory Judgment

In **PLR 202108001 (February 26, 2021)**, the decedent was the beneficiary of a grandfathered GST exempt trust. An attorney prepared a will for the decedent intending to exercise a special power of appointment over the trust to appoint the assets into further trust for the decedent's children. Due to various scrivener's errors, the exercise of the power of appointment did not clearly identify the trust and failed to clearly identify that the children's trust would vest within the rule against perpetuities. The Court determined that the exercise of the power of appointment was intended to apply to the trust and that the perpetuities period referenced was intended to vest the trust within the rule against perpetuities. The Service ruled that the modification and judgment did not cause the assets to be included in the decedent's estate and did not cause the trust to lose its grandfathered GST status. The Service ruled similarly in **PLR 20216003 (July 13, 2020)**.

Service Rules S Corporation Reorganization Will Not Trigger Gain or Loss

In **PLR 202108010 (February 26, 2021)**, the Service ruled that an S corporation reorganization would not trigger gain or loss. The S corporation was comprised of voting and nonvoting stock, all of which was owned by three shareholders or their respective children, either outright or in trust. The parties had disagreements about how to operate and manage the business. The parties proposed to form a controlled corporation, which would have voting and nonvoting stock. A portion of the S corporation's assets would be distributed to the controlled corporation in exchange for the stock. The S corporation would then create a second controlled corporation with the same capital structure. The result would be three separate companies each containing one-third of the S corporation's assets. Thereafter, one shareholder would exchange all of his stock in the S corporation for stock in the first corporation, the second shareholder would do the same for stock in the second corporation, and third shareholder would retain the original S Corporation. The Service evaluated the transaction and issued the ruling pursuant to Rev. Proc. 2017-52, as amplified by Rev. Proc. 2018-53, and found that the S Corporation reorganization would not trigger gain or loss.

Service Grants Extension to Elect Out of GST Exemption Allocation

In **PLR 202107002 (February 19, 2021)**, the Service granted relief pursuant to Treas. Reg. Section 301.9100-01 and permitted an extension of time to elect out of automatic allocation of GST exemption. The taxpayer and spouse created an irrevocable trust for the benefit of their issue. The trust had GST potential. The taxpayer later established a GRAT and funded it with limited partnership units. The remainder interest in the GRAT passed to the irrevocable trust. The estate tax inclusion period closed following the distribution to the irrevocable trust. The irrevocable trust was created primarily for the benefit of taxpayer's children and the attorney advising taxpayer failed to advise the taxpayer of the automatic allocation rules and the need to elect out of the automatic allocation. The Service granted a 120-day extension to elect out of GST exemption allocation. The Service granted similar relief to allocate GST exemption in **PLR 20216006 (August 26, 2020)**.

Service Grants Extension of Time to Make Portability and QTIP Elections

In **PLR 202107003 (February 19, 2021)**, the Service granted relief pursuant to Treas. Reg. Section 301.9100-001 and permitted an estate an extension of time to file an estate tax return for the purpose of electing portability. The Service granted similar relief to make a portability election in **PLR 202115001 (April 16, 2021)**, **PLR 202108007 (February 26, 2021)**, **PLR 202116005 (Apirl 23, 2021)** and **PLR**

202046006 (November 13, 2020). The Service granted similar relief for a late QTIP election in **PLR 202115002 (April 16, 2021)**.

Service Rules on Division of Marital Trust

In **PLR 202116001 (April 23, 2021)**, the Service ruled that a division of a QTIP trust into two trusts and a subsequent judicial termination of one of the resulting trusts did not result in a gift by the spouse beneficiary upon division of the original trust but did result in a gift upon termination of the spouse's qualified income interest in the terminated trust.

Service Announces Online Filing of Tax Authorizations

In **IR-2021-20 (January 25, 2021)**, the Service announced that Form 2848, Power of Attorney and Declaration of Representative, and Form 8821, Tax Information Authorization, may be submitted online. In addition, the forms may be both signed and submitted through a tax professional's secure account. More information is available at irs.gov.

Service Rules Gain on Like-Kind Exchange may be Deferred

In **PLR 202053007 (December 31, 2020)**, the Service ruled that a corporation could defer gain in a Section 1031 exchange. The taxpayer was an S corporation and was a "related person" to two limited liability companies. The taxpayer entered into a deferred exchange agreement with a qualified intermediary and relinquished property in the exchange to an unrelated person. The taxpayer then acquired replacement property from the related companies. The first company entered into a deferred exchange agreement with the qualified intermediary showing the property relinquished to the taxpayer. The company then acquired replacement properties from unrelated persons. The second, related company also entered a deferred exchange agreement and reported the relinquished property to the taxpayer. However, it acquired replacement property from another related company. The third company then repeated the process and acquired replacement property from a fourth related company. The fourth company also reported a like-kind exchange but acquired property from an unrelated taxpayer. The taxpayer asserted there was no cashing out by the taxpayer or any related persons as a result of the transactions. The Service ruled that the transactions qualified for the deferral of gain under Section 1031 of the Code.

Service Announces Required Electronic Filing for Form 1024-A

In **Rev. Proc. 2021-8 (January 5, 2021)**, the Service announced that all Form 1024-A, *Application for Recognition of Exemption under Section 501(c)(4) of the Internal Revenue Code,* must be completed and submitted electronically with the exception of submissions eligible for 90-day transition relief as provided in the procedure.

Proposed Regulation Authorizes User Fee for Request of Estate Tax Closing Letter

In **REG-114615-16 (December 31, 2020)**, the Service proposed charging a user fee for requesting an estate tax closing letter. The Service cited the significant number of requests for the closing letter and the continued preference for the closing letter over obtaining an account transcript. Accordingly, the Service proposed a user fee of $67 for the request and indicated that procedures would be issued for requesting the letter and paying the fee.

Service Addresses Gift Tax Implications of Private Foundation Dissolution

In **ILM 202045011 (November 6, 2020**), the Service concluded that the dissolution of a private foundation and transfer of the foundation's assets to an account over which the taxpayer had no ownership or control is a release of dominion and control constituting a completed gift by the taxpayer for gift tax purposes. Upon the foundation's dissolution, the taxpayer at issue was the primary beneficiary of the foundation, but the taxpayer directed the foundation to transfer the assets to another account. The Service concluded that the assets are treated as having been transferred first to taxpayer and then to the other account, constituting a completed gift by the taxpayer. The taxpayer was not designated as an account owner of the second account and had no signatory authority over the account. Furthermore, the Service concluded that the transfer of the foundation's assets to another account could not be treated as a qualified disclaimer under Section 2518 of the Code because the taxpayer directed the transfer to the account.

Service Announces Guidance to Partnerships and S Corporations on SALT Deduction Limit

In **Notice 2020-75**, the Service announced its intent to issue proposed regulations to clarify that Specified Income Tax Payments are deductible by partnership and S corporations in computing non-separately stated income or loss. The Service defined "Specified Income Tax Payments" as "any amount paid by a partnership or an S corporation to a State, a political subdivision of a State, or the District of Columbia (Domestic Jurisdiction) to satisfy its liability for income taxes imposed by the Domestic Jurisdiction on the partnership or S corporation." Specified Income Tax Payments are not an item of deduction that a partner or S corporation shareholder may take into account separately under Sections 702 or 1336 of the Code, and they are not taken into account for SALT deduction limitations to an individual partner or shareholder. The proposed regulations apply to Specified Income Tax Payments made on or after November 9, 2020, and those made in a taxable year of the partnership or S corporation ending after December 31, 2017, and made before November 9, 2020, if the payment is in satisfaction of liability for income tax imposed on the partnership or S corporation pursuant to a law enacted before November 9, 2020.

Service Issues Preliminary Draft of Final Regulations on Statutory Limitations for Like-Kind Exchanges

In **T.D. 9935 (November 23, 2020)**, the Service issued regulations to provide guidance regarding statutory changes to Section 1031 of the Code. The Treasury Regulations amend Section 1031 to include a definition of real property to implement the limitation of Section 1031 treatment to like-kind exchanges of real property. "Real property" is defined as "land and improvements to land, unsevered natural products of land, and water and air space superjacent to land" with further definitions of those terms in subparagraphs. The regulations also address personal property that is incidental to real property acquired in a like-kind exchange that generally results in gain recognition under Section 1031(b). The Treasury Regulations consider personal property to be incidental to real property acquired in an exchange if (1) the personal property is typically transferred together with the real property in standard commercial transactions and (2) the aggregate fair market value of the property transferred with the real property does not exceed 15 percent of the aggregate fair market value of the replacement real property or properties received in the exchange.

Service Addresses Transfer of Interest in CRAT to Private Foundation

In **PLR 202047005 (November 20, 2020)**, the Service issued six rulings regarding a taxpayer and his spouse's transfer of their interest in a charitable remainder annuity trust (CRAT) to a private foundation. Taxpayer and Spouse created a CRAT of which Taxpayer was the Trustee, Taxpayer and Spouse were the annuity beneficiaries, and a charitable organization ("Foundation") was the remainder beneficiary. Taxpayer and Spouse are substantial contributors to the Foundation. Taxpayer and Spouse wanted to assign their undivided annuity interest in the Trust to the Foundation to result in a merger of the annuity and remainder interests. Thereafter, Taxpayer and Spouse would seek a court order terminating the Trust. Regarding this transaction, the Service made the following rulings:

> *Ruling 1.* Pursuant to Section 170(e)(1)(B)(ii) of the Code, Taxpayer's and Spouse's income tax charitable contribution deduction will be reduced by the total amount of gain that would have been realized if the property had been sold at fair market value. The gain would be equal to their entire interest transferred because their basis in the annuity interest is zero, so no income tax contribution deduction will be allowed for the assignment of the annuity interest. Likewise, because their basis is zero, the charitable contribution deduction for appreciated property to the private foundation will be zero.
>
> *Ruling 2.* When Taxpayer and Spouse transfer their undivided annuity interest in the Trust to the Foundation, neither will retain any interest in the Trust. In addition, neither Taxpayer nor Spouse will make a transfer of trust property for private purposes at the time of the intended transfer or at any time prior. Therefore, Taxpayer and Spouse will be entitled to a gift tax charitable contribution deduction in the amount of the present value of the annuity interest transferred to the Foundation as of the date of the transfer.
>
> *Ruling 3.* Because Taxpayer and Spouse will irrevocably release the right to designate charitable beneficiaries of the Trust, the Foundation will be irrevocably designated as the charitable remainderman of the Trust. Taxpayer and Spouse's assignment to the Foundation of their annuity interest in the Trust and termination of the Trust will result in a merger of the annuity and remainder interests, giving the Foundation a fee interest in the assets of the Trust. Thus, Taxpayer and Spouse will be entitled to a gift tax charitable deduction under Section 2522(a) of the Code for the fair market value of the remainder interest transferred to the Foundation calculated as provided in Treas. Reg. Section 1.664-2(c).
>
> *Ruling 4.* No gain or loss will be recognized by Taxpayer or Spouse under Section 1001 of the Code because they will receive no money or property from the assignment of their undivided annuity interest in the Trust. In addition, because Taxpayer and Spouse will not retain any reversionary interest in the annuity interest upon the assignment, they will avoid income taxation with respect to any future income attributable to the annuity interest assigned to the Foundation.
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> *Ruling 5.* Taxpayer's and Spouse's assignment to the Foundation of their annuity interest in the Trust does not give rise to an act of self-dealing under Section 4941(d)(1) of the Code.
>
> *Ruling 6.* Taxpayer and Spouse's assignment will not subject the Trust or the Foundation to a termination tax under Section 507(a) of the Code because the assignment is not a transfer as described in Section 507(b)(2) of the Code.

Federal Court Cases

Tax Court Upholds Tax on Early Distribution from IRA

In **Catania v. Comm., T.C. Memo 2021-33 (March 15, 2021)**, the Tax Court upheld an additional tax on the taxpayer's withdrawal from an IRA prior to reaching age 59 ½. The taxpayer participated in a 401(k) plan with his employer, retired at age 55, and rolled the 401(k) to an IRA. Thereafter, the taxpayer withdrew funds from the IRA and reported the distribution on his income tax return. The taxpayer did not report or pay an additional tax under Section 72(t) of the Code. The Service issued a notice of deficiency and assessed the 10% additional tax. The taxpayer claimed that the exception under Section 72(t)(2)(A)(v) of the Code applied which provided for an exception for distributions made to an employee after separation from service after attaining age 55. The Court rejected the taxpayer's argument citing Section 72(t)(3)(A) of the Code which made the separation from service exception inapplicable to IRAs.

District Court Finds Denial of Passport Due to Tax Debt Constitutional

In **Jones v. Mnuchin, 1:19-CV-000222 (S.D. Ga. March 8, 2021)**, the Court granted the Treasury Department summary judgment on the plaintiff's claim that Section 7345 of the Code was unconstitutional. The plaintiff had $404,928.24 in tax liabilities from tax years 2000, 2002, 2005, 2006, 2008 and 2009. The plaintiff sought to renew his passport but was denied under Section 7345 which permits the Treasury Department to deny passport services to individuals with seriously delinquent tax liabilities. The plaintiff claimed that the denial of the passport infringed on his right to international travel guaranteed by the First, Fifth, Ninth and Fourteenth Amendments to the U.S. Constitution as well as the Privileges and Immunities Clause. The Court found that the Ninth Amendment contains no individual freedoms standing alone and that neither the Fourteenth Amendment nor the Privileges and Immunities Clause apply to federal action. The Court also found that the First Amendment did not contain any right to international travel. The Court then evaluated the plaintiff's claim under the Fifth Amendment. The Court found that the Fifth Amendment does encompass a right to travel, but there is a distinction between domestic and international travel under the Fifth Amendment. The right to travel internationally does not invoke a fundamental right and therefore neither strict nor intermediate scrutiny applied. As a consequence, the Court found that Section 7345 of the Code passed the rational basis test and was constitutional. The case has been appealed by the plaintiff.

Fifth Circuit Upholds Summons Against Law Firm

In **Taylor Lohmeyer Law Firm P.L.L.C. v. United States, 957 F.3d 505 (5th Circuit April 24, 2020)**, the Fifth Circuit affirmed the lower court's order to enforce a summons by the IRS against a law firm (the "Firm") regarding the Firm's offshore tax planning for clients. The IRS served a "John Doe" summons on the Firm seeking documents for any taxpayers who, at any time from 1995 through 2017, used the Firm to "acquire, establish, maintain, operate, or control (1) any foreign financial account or other asset, (2) any foreign corporation, company, trust, foundation or other legal entity, or (3) any foreign or domestic financial account or other asset in the name of such foreign entity." The Firm responded to the summons with the blanket claim that all documents responsive were protected by the attorney-client privilege. It was believed that the Firm had established foreign accounts and entities for certain clients and had the clients assign income to those accounts and entities to avoid U.S. income tax. The Court, in applying federal privilege law, noted that the attorney-client privilege must generally be specifically asserted with respect to particular documents, which the Firm failed to do in this case. Instead, the Firm merely asserted the blanket claim as to all documents and failed to produce a privilege log. The Court further noted that client identities and fee arrangements are generally not protected as privileged. Therefore, the Court affirmed the lower court's order to enforce the summons.

Court Finds Statutory Cap on Non-Willful FBAR Penalties

In **U.S. v. Kaufman, 127 A.F.T.R.2d 2021-502 (D. Conn. January 11, 2021)**, the taxpayer challenged the assessment of civil penalties for his non-willful failure to file FBARs for 2008, 2009 and 2010. The taxpayer was a U.S. citizen but resided in Israel and had multiple foreign accounts in Israel during the applicable tax years. The taxpayer did not file FBARs for the subject years until 2012. The government assessed $144,244.00 in penalties for the taxpayer's non-willful failure to file the FBARs. The taxpayer challenged the assessment. The government claimed that 31 U.S.C Section 5321 permitted a $10,000 penalty per account for each tax year. The taxpayer challenged the assessment, claiming that the statute provided a cap of $10,000 per form in each tax year. The Court reviewed the statutory language for both willful and non-willful violations and concluded that the penalties for a non-willful violation authorized by statute applied on a per form rather than a per account basis. The Ninth Circuit Court of Appeals reached the same result on similar facts regarding a different taxpayer. **U.S. v. Boyd, 991 F.3d. 1077 (9th Cir. March 24, 2021)** (reversing district court and finding a statutory cap of $10,000 civil penalty per FBAR form for each tax year).

Tax Court Denies Conservation Easement Deduction for Failure to Satisfy Perpetuity Requirement

In **Glade Creek Partners, LLC v. Comm., T.C. Memo 2020-148 (November 2, 2020)**, the Tax Court denied a taxpayer's deduction for contribution of a conservation easement due to the easement's failure to protect the conservation purpose in perpetuity. Specifically, the court found that the easement's extinguishment clause did not give the charitable organization a proportionate share of the proceeds from a potential extinguishment. The clause did not grant the charity its proportionate share of any post-easement improvements to the property. This ruling follows a line of cases reaching the same result with respect to other taxpayers. The Tax Court reached the same result in **Sells, et. al. v. Comm., T.C. Memo 2021-12 (January 28, 2021)** (extinguishment clause in conservation easement violated the in perpetuity requirement) and **Soddy Creek Preserve LLC, et. al. v. Comm., No. 22271-17 (T.C. February 9, 2021)**.

Tax Court Values Contribution of Façade Easement

In **Kissling v. Comm., T.C. Memo 2020-153 (November 12, 2020)**, the Tax Court addressed a taxpayer's charitable contribution deduction for façade easements on three commercial buildings. The taxpayer purchased the buildings in a historic district. The buildings were subject to the local city's building code and rules regarding historic preservation, including the jurisdiction of a preservation board and department tasked with enforcement of those standards. The taxpayer claimed a charitable contribution deduction for the façade easements in 2004 and carried forward the unused deduction to 2005 and 2006. On audit, the Service denied the deduction for all three years on the basis that the easement subjected the buildings to no more restrictions than they were subject to under local law and therefore had no value. The Service later assessed a gross-valuation-misstatement penalty.

The Tax Court found that the only dispute was about the proper value of the easement. In a detailed opinion, the Court evaluated the taxpayer's three valuation expert opinions and the Service's expert opinion. The Court rejected the Service's attempt to use a comparable sales approach and found that the income capitalization approach was the proper method to value the property under the "before and after" approach. The Court found problems with two of the taxpayer's experts, giving them either no weight or limited weight.

The primary issue in the case was whether the easements had an effect on the property. The Court distinguished other cases denying deductions for façade easements on residential property finding that, under the income capitalization method, the easement could increase costs even if the property were subject to preservation regulations under local law. The Court found that in this specific circumstance, the easement added a level of cost that did not exist with local regulation at the time the donation was made. The Court then evaluated the specific nature of those increased costs and valued the easement.

Tax Court Finds Petitioners' Conservation Easement Valuation Was Reasonable

In **Rajagopalan et ux. v. Commissioner, T.C. Memo. 2020-159 (November 19, 2020)**, the Tax Court held the taxpayer's claimed conservation easement deductions were reasonable. In 2005 and 2006, a North Carolina LLC (SS Mountain) assembled and then divided a tract of land into two parts: one for the development of homes and one with a conservation easement. In November 2006, SS

Mountain contributed a conservation easement over 89 acres to the North American Land Trust (NALT). On its Form 1065 for 2006, SS Mountain reported a noncash charitable contribution of $4,879,000 for the contribution and attached a qualified appraisal of the conservation easement. It also issued Schedules K-1 to its partners, including Kumar and Sapp. On Form 1040 for 2006, the Kumars and Sapps claimed a flow-through noncash charitable contribution of more than $190,000 and more than $2.1 million respectively for the donation of the conservation easement to the NALT, both attaching qualified appraisals to their returns. The Commissioner issued notices of deficiency to the Sapps and the Kumars, asserting deficiencies and penalties under Section 6662(a) of the Code. On petition by the Sapps and Kumars, one of the issues before the Tax Court was the value of the conservation easement.

The value of a conservation easement donated under Section 170 of the Code is its fair market value at the time of the donation. When there is no substantial record of sales of property with comparable easements, the fair market value is determined using the "before-and-after test," which is "the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property after the granting of the restriction." The petitioners' expert used both the sales-comparison and income methods to determine a before value of $4.15 million and an after value of $1.25 million, making the conservation easement's fair market value $2.9 million. The Commissioner's expert used only the sales-comparison method to reach a before value of $1.28 million and an after value of $560,000, making the fair market value $720,000.

In its own before-and-after valuation, the Court divided the property into the 12 lots that were to be developed after placement of the conservation easement and the other 25 lots that became conserved land. Considering recent transactional history of the 12 lots, bank loans secured by the lots, and county tax records, the Court found it more likely than not that the 12 lots had a fair market value of $8 million as of the easement date. Given the lack of similar hard data for the 25 lots, the Court held it was reasonable to consider each lot worth at least $750,000 as well because the views and sizes were about the same as the 12 lots. Thus, the Court valued the 25 lots at $18.75 million, making the before value of the SS Mountain property $26.75 million. The Court held that the after value of the 12 lots remained $8 million because factors that would increase the property value and factors that would decrease the property value canceled each other out. The Court assumed the Commissioner's after value of $560,000 for the land encumbered by the easement to be correct.

Given the after value calculated by the Court and the petitioners' assertion that the easement's fair market value was $4,879,000, the before value of the conserved land would have to be at least $5,439,000 for the deduction to be sustained. This would mean each of the 25 lots was worth only $217,560, which the Court found unreasonable based on the lots' similarities to the 12 lots worth $750,000. The Court further noted that the $5,439,000 before value would be unreasonably low in light of rapidly increasing prices per acre in 2004 and 2005. Therefore, the Court held that the amounts claimed by the Kumars and Sapps were reasonable.

Fourth Circuit Affirms Denial of Charitable Deduction

In **Lawrence P. Mann et ux v. United States, 984 F.3d 317 (4th Cir. January 6, 2021)**, the Fourth Circuit affirmed the lower court's denial of a charitable deduction for the donation of a house. The taxpayer couple purchased a tract of land and agreed to donate the house located thereon, but not the underlying land, to a local charitable organization, and took a charitable deduction in the amount of the appraised value of the house as if the house were moved intact to another lot. The charitable organization disassembled part of the house, salvaged useful components, and left part of the remainder of the house for demolition. The IRS denied the deduction on the grounds that the taxpayers did not convey their entire interest in the house as required by Section 170(f)(3) of the Code and further failed to provide a qualified appraisal of what they actually donated. The appraisal was calculated as if the house would remain intact and did not account for which components of the house would be removed by the charitable organization, which components would be destroyed during the deconstruction, nor which would remain on site for demolition. The lower court noted that the proper method of calculating the tax deduction would have been based on the resale value of the specific materials and contents that the organization actually removed from the house in order to resell them. Since the taxpayers failed to donate their entire interest in the property as required by Section 170(f)(3) of the Code and because the appraisals were not qualified appraisals that properly substantiated the claimed deductions, the Court affirmed the denial of the charitable deduction.

Tax Court Values Ground Leases, Membership Interests and Charitable Contribution Deduction

In **Estate of Warne v. Comm., T.C. Memo 2021-17 (February 18, 2021)**, the Tax Court valued interests in certain ground leases and membership interests, as well as membership interests devised to charitable organizations for federal estate and gift tax purposes. Miriam Warne made gifts of certain fractional interests in certain closely-held limited liability companies to family members in 2012. The LLCs' primary assets consisted of valuable ground leases. Warne retained a majority interest in the LLCs following the gifts, and the operating agreements for the LLCs provided that the majority interest owner had substantial rights to control the entity, including the power to dissolve the LLC. Mrs. Warne died in 2014, and her estate filed a late gift return reporting the 2012 gifts in 2015. The estate also filed a federal estate tax return reporting the majority interests in the LLCs. The gift tax return valued the underlying ground leases held by the LLCs and included a separate valuation for the fractional membership interest gifts that applied lack of marketability and lack of control discounts. The estate tax return updated the valuation of the underlying ground leases and applied a discount for lack of control for the majority interest owned by the decedent in the LLCs. Finally, the decedent's estate conveyed 100% of her interest in one LLC to two charitable organizations, one receiving 25% of the interest and the other receiving 75% of the interest. The estate claimed a charitable deduction on the estate tax return equal to 100% of the interest included in the decedent's estate that was devised to the charitable organizations.

The Service issued notices of deficiency for the 2012 gift tax return and the estate tax return. Specifically, the Service increased the fair market value of the LLCs on the basis of the Service's valuation of the ground leases and more modest discounts for lack of control and marketability. The Service also reduced the amount of the charitable deduction for the LLC interests devised to the charitable organizations claiming that a minority interest discount applied to the interests received by the charitable organizations. The estate filed a petition challenging the deficiencies.

Ground Leases. The Tax Court reviewed the testimony of valuation experts for the estate and for the Service and found problems with the expert opinions. The court found that the yield capitalization method was the appropriate valuation method but found that the estate's appraiser improperly considered risk when calculating the fee simple value of the property. The court found that adjusting value for risk in the fee simple value of the land and then applying a discount rate that also factored in the risk double-counted the risk. However, the court found that the estate's discount rate was more sound and adopted it.

Valuation Discounts. The court noted that the parties stipulated that valuation discounts were appropriate for the majority interests in the LLCs and therefore the issue before the court was the amount of the discounts, not whether discounts applied. The court found that the potential litigation risk if the majority owner exercised the rights granted under the operating agreement was speculative and should not be given any meaningful weight. The court found that a lack of control discount should be at the low end of the potential range of discounts and applied a 4% discount. The court also evaluated the range of potential discounts for lack of marketability and found that the Service's expert did not provide any supporting evidence for its "visceral reduction" in the amount of the discount. Instead, the court adopted a 5% discount based on the low end of the range of discounts for lack of marketability provided by the estate's expert.

Charitable Contribution Deduction. The parties stipulated the amount of the charitable deductions if the court found that discounts applied to the membership interests passing to the charities. Accordingly, the court solely addressed whether the membership interests passing to the charities were subject to valuation discounts. Citing Ahmanson Foundation v. U.S., the court found that the valuation for the charitable contribution deduction was based on the amount received by the charity and not the amount included in the decedent's gross estate. Although the decedent's estate valued 100% of the LLC interests for inclusion in the estate and 100% of that interest passed to the charities, the interests received by the charities were not the same as that held by the decedent. The charities were receiving a 25% interest and 75% interest in the LLC and therefore valuation discounts were appropriate for purposes of calculating the charitable deduction.

Tax Court Denies Charitable Deduction of Interests in Oil and Gas Fields

In **Pankratz v. Commissioner, T.C. Memo. 2021-26 (March 3, 2021)**, the Tax Court denied a charitable deduction for a donation of interests in oil and gas fields. The taxpayer owned over a dozen businesses and farms. The taxpayer donated his interests in oil and gas fields and claimed a $2 million deduction. However, he failed to include any appraisal with his return and instead calculated the deduction based on the purchase price and what he thought the appreciation to be. Section 170(f)(11)(C) of the Code provides that for contributions over $5,000, the taxpayer must obtain a qualified appraisal and attach a summary to the return. Further, Section 170(f)(11)(D) of the Code provides that when a taxpayer claims a deduction of more than $500,000, the taxpayer must attach the actual qualified appraisal to the return. The taxpayer argued that the charitable deduction should not have been denied because Section 170(f)(11)(A)(ii)(II) of the Code provides that a deduction cannot be denied for failure to comply with subparagraph (B), (C), or (D) "if it is shown that the failure to meet such requirements is due to reasonable cause and not to willful neglect." The taxpayer argued that since he never read the return and had relied on his financial adviser to complete the return, there was reasonable cause to excuse the appraisal requirement. According to the Court, whether a taxpayer had reasonable cause is a fact-intensive inquiry that requires a case-by-case examination of all the facts and circumstances. The Court stated that the taxpayer's adviser was not a competent tax adviser because he was not a CPA, not an attorney, not a full-time return preparer, and he had no professional license of any kind. Instead, the adviser was merely an employee who provided financial-related support to the taxpayer. Furthermore, according to the Court, if the taxpayer had reviewed Form 8283, he could have seen that an appraisal is generally required. Therefore, the taxpayer lacked reasonable cause for not including the appraisals, and the Court denied the charitable deduction of the oil and gas interests.

State Court Cases

North Carolina Court of Appeals Affirms Summary Judgment on Will Interpretation

In **Taylor v. Vaughan, 849 S.E.2d 576 (Unpublished) (N.C. App. November 17, 2020)**, the Court affirmed summary judgment on the interpretation of a will and codicil. Lloyd Taylor ("Testator") died testate in May 2017, and his will and a codicil were admitted to probate. The Testator was survived by his son, James Gregory Taylor ("Plaintiff"), and his daughter, Vicki Taylor Vaughan ("Defendant"). The Testator named Plaintiff and Defendant as co-executors of his estate. At the time of his death, Testator held a Ground Lease Agreement with a tenant called Crown Castle for the real property known as "Union Chapel Farm," where the Testator received monthly lease payments. The lease provided that if during the lease term, the Testator sold all or part of the property being leased, then the property would remain subject to the lease, and that the lease was binding on the heirs, personal representatives, successors and assigns.

The Testator's will contained the following provision:

> All of the residue of my estate I will, devise and bequeath unto my beloved wife, JOSEPHINE H. TAYLOR, to her absolutely. Should she predecease me, then and in this event I will, devise and bequeath all other property owned by me in shares unto my two surviving children, James Gregory Taylor and Vicki Taylor Vaughan.

The codicil to the will contained the following provisions:

> ITEM I
>
> The residue of monies and securities at Wells Fargo Bank will be equally divided between James Gregory Taylor and Vicki

Taylor Vaughan. The residue of money and CDs at First South Bank will also be equally divided between James Gregory Taylor and Vicki Taylor Vaughan.

ITEM II

The monthly lease payment from Crown Castle and deposited in checking account at First South Bank shall be equally divided between James Gregory Taylor and Vicki Taylor Vaughan.

ITEM III

To James Gregory Taylor, I give, devise and bequeath the following real estate:

2. Tract #3 "Union Chapel Farm" described in deed from W. Rayvon Taylor and Hope H. Taylor to Lloyd R. Taylor and Josephine H. Taylor and recorded in Book 762, page 682.

The Plaintiff filed a declaratory judgment action seeking to declare him the sole owner of the lease and that he was entitled to all rental payments under the lease. The Defendant filed an answer and counterclaim asking the court to order that the lease was now owned 50% by Plaintiff and 50% by Defendant per Item II of the codicil. The lower court granted Defendant's motion for summary judgment and the Plaintiff appealed.

Plaintiff argued on appeal that the Testator gave the real property encumbered by the lease to the Plaintiff, so the rent, accrued from the date of death forward, belonged to the owner of the real property. Plaintiff argued that the language of Item II of the codicil referred only to monthly lease payments prior to Testator's death that were already deposited and not to future lease payments. Defendant argued that the Testator specifically gave the monthly lease payments, including future payments, in equal shares to Plaintiff and Defendant. The Court agreed with Defendant and concluded that the lower court did not err in denying Plaintiff's motion for summary judgment and entering summary judgment in favor of Defendant. The Court said that since Item I of the codicil disposed of all the residue of monies, securities, and CDs in both Wells Fargo Bank and First South Bank, if the Court read Item II to refer only to lease payments already accrued and deposited, then it would render Item II superfluous. Therefore, Testator had the clear intent to divide all future lease payments for Union Chapel Farm equally between the Plaintiff and Defendant.

North Carolina Court of Appeals Affirms Summary Judgment on Testamentary Capacity and Reverses Summary Judgment on Undue Influence

In **In re Sabol, 852 S.E.2d 733 (Unpublished) (N.C. App. December 31, 2020)**, the Court affirmed the trial court's order of summary judgment on the issue of testamentary capacity but reversed the trial court's order on the issue of undue influence and remanded the case to the trial court.

Decedent was married to Peggy Sabol, now deceased, and had three children of the marriage: Shelia, Stuart, and Graham. In 2004, the decedent and Peggy executed wills, leaving all property to each other, and in equal shares to all three children if the spouse predeceased. After Peggy died in 2013, decedent executed a new will, giving his son Stuart $10, and the remainder in equal shares to Graham and Shelia. Under the 2013 will, if Graham predeceased, then Graham's share was to go to Shelia, and if Shelia predeceased, then Shelia's share was to go to an organization called Genesis II Church of Health and Healing. Graham and Shelia later had a falling out with each other over a restaurant of which they were co-owners.

In 2015, the decedent executed a new will. Under the terms of the 2015 will, $10 was to go to Stuart, $1 was to go to Graham, and the remainder was to go to Shelia. If Shelia predeceased, then all property was to go to Genesis II Church of Health and Healing. The 2015 will was signed at decedent's residence and Shelia was in a different room of the residence during the will signing. The attorney conducting the will signing asked decedent if he had a prior will and the decedent answered no. Approximately one month later, decedent died at age 94, and the autopsy showed decedent had advanced prostate cancer, heart disease (including clogged arteries, advanced stenosis, enlarged heart, and that he had a heart attack approximately two months before his death), bronchitis, gastritis, vascular disease, gallstones, arthritis, and possible scoliosis in his spine.

A caveat was filed to the 2015 will, arguing lack of testamentary capacity and undue influence. The trial court granted propounder's motion for summary judgment. Caveators appealed, arguing that genuine issue of material fact existed regarding testamentary capacity at the time of signing the 2015 will and regarding undue influence to procure the 2015 will.

Regarding the issue of testamentary capacity, the Court of Appeals noted that there is a presumption that every individual has the capacity to make a will. The caveators must prove by greater weight of the evidence that the testator lacked testamentary capacity, and it is not sufficient to present only general evidence of deteriorating physical health and mental confusion. Instead, the caveator must present specific evidence relating to the testator's understanding of his property, to whom he wished to give it, and the effect of his act in making a will at the time the will was made.

The caveators presented no evidence that at or near the time the decedent executed the 2015 will he was mentally unequipped to do so. Caveators provide no evidence that decedent did not know the effect his act would have on his estate, other than the ambiguous statement by decedent that he did not have any other wills. The attorney who conducted the will signing testified that the decedent understood what he was doing. Furthermore, the decedent sent notes to the caveator and to his granddaughter in late 2015 that were thoughtful and coherent. Therefore, summary judgment was proper on the issue of testamentary capacity.

Regarding the issue of undue influence, however, summary judgment was not proper. In order to state a prima facie case on the issue of undue influence, a caveator must prove the existence of four factors: (1) a person who is subject to influence; (2) an opportunity to exert influence; (3) a disposition to exert influence; and (4) a result indicating undue influence. Pursuant to **In re Will of Andrews**, **299 N.C. 52**, **261 S.E.2d 198 (1980)**, there are seven factors which are relevant to determining undue influence: (1) old age and physical and mental weakness of the testator; (2) that the person signing the paper is in the home of the beneficiary and subject to the beneficiary's constant association and supervision; (3) that others have little or no opportunity to see the testator; (4) that the will is different from and revokes a prior will; (5) that it is made in favor of one with whom there are no ties of blood; (6) that it disinherits the natural objects of the testator's bounty; (7) that the beneficiary has procured its execution.

The decedent was 94 years old and suffered from bad health. The decedent's daughter Shelia visited him every day and he relied on Shelia to pay bills, check the mail, and take him to medical appointments. The alternative beneficiary under the 2015 will was an organization, Genesis II Church of Health and Healing. Therefore, in consideration of the seven factors laid out in Andrews, the Court of Appeals reversed the trial court's order of summary judgment on the issue of undue influence and remanded to the trial court.

North Carolina Court of Appeals Denies Equitable Adoption Claim Against Estate

In **Shearin v. Brown, 854 S.E.2d 443 (N.C. App. February 2, 2021)**, the Court affirmed the trial court's order dismissing a petition seeking to be declared the sole heir of an intestate estate. Petitioner argued that she was the sole heir to the intestate estate of the Decedent because her father, who was now deceased, was equitably adopted by the Decedent. Decedent had only one child, Timothy, with his then-wife. While Timothy was a minor, the Decedent divorced Timothy's mother and Timothy was legally adopted by her new spouse and went to live in Virginia. After Timothy was 18 years old, he moved back to North Carolina and reconnected with the Decedent. Timothy and the Decedent made their father-son relationship known in the community by, for example, the Decedent paying for Timothy's wedding and the Decedent being identified as Timothy's father in the wedding announcement in the local paper. Petitioner was Timothy's only child, and the Petitioner's birth announcement identified the Decedent as her grandfather. When Timothy died in a work-related accident, survived by the Decedent, the Decedent was listed as Timothy's father on the death certificate. When Decedent died, the Petitioner filed a petition to ascertain heirs, for declaratory judgment, and to revoke the letters of administration on the grounds that she was sole heir under North Carolina's intestacy statutes by virtue of the Decedent's equitable adoption of her father. When the trial court entered an order dismissing the petition, the Petitioner appealed to the Court of Appeals.

On appeal, the North Carolina Court of Appeals acknowledged that the only time the North Carolina Supreme Court has applied the doctrine of equitable adoption was in **Lankford v. Wright**, 347 N.C. 115, 489 S.E.2d 604 (1997). The Supreme Court in Lankford recognized that the doctrine of equitable adoption is available "to protect the interest of a person who was supposed to have been adopted as a child but whose adoptive parents failed to undertake the legal steps necessary to formally accomplish the adoption." The Supreme Court in **Lankford** noted that the doctrine is limited to facts comparable to those presented in that case and that the "doctrine is invoked for the sole benefit of the foster child." The Court of Appeals concluded that the facts presented were materially different from the facts in **Lankford**. Unlike in **Lankford**, no minor was taken in and raised by foster parents. Instead, Timothy was over the age of 18 when he reconnected with the Decedent. The Supreme Court in **Lankford** said that equitable adoption is "to protect the interest of a person who was supposed to have been adopted as a child." Furthermore, the Petitioner here is not the adoptee in the purported equitable adoption and the Supreme Court in **Lankford** said that the doctrine is for the sole benefit of the foster child. Therefore, the Court of Appeals affirmed the trial court's order against the Petitioner.

North Carolina Court of Appeals Denies Elective Share

In **Crosland v. Patrick, 855 S.E.2d 303 (Unpublished) (N.C. App. March 16, 2021)**, the Court superseded and replaced its prior opinion filed on September 15, 2020, and held that the surviving spouse's petition for elective share was barred by the statute of limitations. John Crosland Jr. died testate on August 2, 2015. His surviving spouse, Judith Crosland, filed a petition for elective share. The executor of the estate filed a notice of transfer to superior court to determine all issues regarding the elective share petition as well as a declaratory judgment that the premarital agreement signed on February 3, 1978, was valid and enforceable. The surviving spouse testified that the agreement was presented to her on the night before the wedding and argued that the agreement was invalid because it was signed under duress and that her husband had not adequately disclosed his financial assets to her. Furthermore, the surviving spouse argued that her husband had "revoked" the agreement during his lifetime by evidencing his intent to waive it. Both parties moved for summary judgment in the lower courts and the lower court granted the estate's motion for summary judgment.

On appeal, the Court upheld summary judgment because the statute of limitations for a contract and fraud claim is three years pursuant to N.C.G.S. Section 1-52(1), (9) and the premarital agreement was signed thirty-seven years prior to the petition for elective share. Therefore, the surviving spouse's claim that the agreement was unenforceable on the above grounds was time-barred. It should be noted that the premarital agreement was not governed by the Uniform Premarital Agreement Act, N.C.G.S. Section 52B-1-11, which became effective July 1, 1987, and applies to premarital agreements executed on or after that date, so the tolling provision in N.C.G.S. Section 52B-9 was inapplicable. Furthermore, regarding the argument that her husband had "revoked" the agreement during his lifetime, the Court responded that one spouse may not unilaterally cancel a valid marital contract and therefore, this argument is of no legal significance.

North Carolina Court of Appeals Finds Trial Court Improperly Granted Partial Summary Judgment When Genuine Issues of Fact Existed as to Mental Capacity and Undue Influence

In **Woody v. Vickrey, __S.E.2d __, 2021 WL 1257112 (April 6, 2021)**, the North Carolina Court of Appeals vacated the trial court's interlocutory orders (i) granting a declaratory judgment regarding a revocable trust, (ii) granting partial summary judgment regarding cancellation and rescission, quiet title, and conversion claims, and (iii) issuing a permanent injunction.

In 2008, Julius Woody created a revocable trust, named his long-time friend Randy Vickrey as trustee of the Trust, and transferred certain real and personal property into the Trust. In 2017, friends and family became concerned about Woody's mental and physical wellbeing after Carrie Vickrey, Donald Ayscue, and Shannon Gaines ("Appellants") moved to and began living on Woody's property. Shortly thereafter, Woody's living conditions changed: cameras and sensors were installed around his home, curtains remained closed, he became isolated, and his personal property went missing. Within one month, Woody had executed multiple legal documents, including a revocation of the Trust, all of which benefitted one or more Appellants. In light of these actions and to protect the Trust, Randy Vickrey executed a certificate of trust affirming his status as Trustee of the Trust and transferred two parcels of land held by the Trust to himself.

Woody and Gaines brought suit against Randy seeking to quiet title to the real property. Randy brought counterclaims seeking declaratory judgment confirming his status as Trustee and sole beneficiary of Woody's Trust and to quiet title to remove a 2017 deed executed by Woody. He also brought third-party claims against Carrie Vickrey and Donald Ayscue for cancellation or rescission of the multiple legal documents executed by Woody in 2017 due to duress, undue influence, and lack of capacity; quiet title; punitive damages; injunctive relief; conversion; and civil conspiracy.

Pursuant to court order, a board-certified forensic psychiatrist performed a mental examination on Woody and rendered his opinion with a "reasonable degree of medical certainty" that Woody lacked competence to execute the 2017 legal instruments "in a knowing, voluntary, and intelligent manner." Appellants presented contradictory evidence in the form of witness testimony of people who observed Woody first-hand, including the attorney present when the 2017 legal instruments were executed.

Based on the psychiatrist's opinion, the trial court concluded Woody lacked capacity to execute the 2017 legal instruments and entered orders (i) granting declaratory judgment designating Randy as the Trustee and sole beneficiary of Woody's Trust; (ii) granting summary judgment in favor of Randy on the claims for quiet title and conversion; (iii) granting summary judgment in favor of Randy on his third-party claim for cancellation and rescission of the 2017 legal instruments; and (iv) denying summary judgment on his third-party claim for conspiracy. Appellants filed interlocutory appeal.

As an initial matter, the Court held that, while Appellants were not entitled to interlocutory review based on inconsistent verdicts, they were entitled to interlocutory review as the orders effectively deprived them of their substantial right to a jury trial. The Court found that genuine issues of fact existed regarding whether Woody was mentally competent and whether he was unduly influenced and as such, Appellants had a constitutional and statutory right for these critical preliminary factual matters to be submitted to a jury.

In determining that genuine issues of fact existed, the Court found that the trial court applied an incorrect legal standard ("knowingly, voluntarily, and intelligently") in determining Woody's testamentary and contractual capacity and improperly adopted the expert opinion as the issue of mental capacity was a question of fact for a jury. The Court also relied on North Carolina Supreme Court precedent that once a *prima facie* case of undue influence has been presented by a party, "the case must be submitted to the jury for its decision." Thus, the Court found that the trial court's determination of undue influence and lack of capacity as a matter of law was improper. As the petition for declaratory judgment and claims for quiet title and rescission and cancellation of instruments relied on the material factual issues of undue influence and lack of capacity, the trial court's grant of summary judgment as to these claims was likewise improper.

The Court also found that it was improper for the trial court to issue a permanent injunction because it "determine[d] the final rights of the parties" before the "final trial of the action."

Finally, the Court found that summary judgment was not appropriate on the claim of conversion as a genuine issue of material fact existed as to who had exercised ownership and control over the property alleged to have been converted.

North Carolina Supreme Court Issues 30-Day Suspension for District Court Judge Who Improperly Served as Executor

In **In re Brooks, _ S.E.2d _, 2021-NCSC-36, 2021 WL 1439527 (April 16, 2021)**, the North Carolina Supreme Court reviewed the recommendation of the Judicial Standards Commission for censure of a judge who improperly served as executor for non-relatives' estates, collected substantial fees for such services, and failed to properly report such extra-judicial income. The Court adopted the Commission's conclusions of law as appropriately supported by the stipulated facts, but then went beyond the recommended censure and held that a one-month suspension was the appropriate sanction.

In doing so, the Court noted that not only did the judge fail to properly report the extra-judicial income, the activity which created such income (i.e., serving as executor of a non-family member's estate) was explicitly prohibited by the Code of Judicial Conduct. In addition, the estates were settled in the judge's own judicial district with the judge seeking and receiving significant commissions (nearly $90,000 total) for his services as executor, thereby creating the appearance of a lack of judicial independence. The Court held that the judge's conduct was a willful violation that was prejudicial to the administration of justice and brought the judicial office into disrepute which, after weighing the severity of the conduct with the mitigating factors, warranted more than a censure.