Personal Legal Fees of Fiduciaries

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paid in connection with the redacted descriptions.

Summary and Conclusion

As shown by the cases cited above, Pennsylvania courts are generally opposed to fiduciaries paying legal fees from estates when those fees are incurred in litigation with the beneficiaries of the estate that the fiduciary has been charged with administering.

When representing a fiduciary, a responsible attorney should at the very least keep time records that separate the tasks necessary for the ongoing administration of the estate, such as accounting for ongoing receipts and disbursements and preparing annual tax returns, from the tasks related to the litigation, and the fiduciary should be made aware that the costs of litigation are not necessarily payable by the estate. Ideally, the costs of litigation should be billed to the fiduciary and not the estate, with a request to the court for reimbursement for the fiduciary only when the litigation has been successfully completed.

When representing beneficiaries in litigation with fiduciaries, two steps should be considered:

- In the early stages of litigation (such as when threatening to file a petition to compel an account), it has become the practice of the author to write a letter to counsel for the fiduciary to make sure that they are aware of some the cases cited above, so that the fiduciary (and counsel) will know that they cannot assume that the costs of litigation will be borne by the estate and that they may be risking their own funds.
- If during litigation it appears that the fiduciary is spending funds of the estate on legal fees in opposition to the beneficiaries (such as an account being filed that shows additional legal fees being paid while the fiduciary is resisting the filing of the account), it may be appropriate to ask the presiding judge for a court order to limit the ability of the fiduciary to continue to pay counsel fees from the estate.

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New Federal Legislation Threatens Current Estate Planning Practices

By Rebecca Sallen, Esq.

Two pieces of legislation recently introduced by Senate Democrats promise to shake up the estate planning industry. First, the For the 99.5 Percent Act (99.5% Act), written by Senators Sanders and Whitehouse, seeks to dramatically change estate planning by drastically reducing the federal estate and gift tax credits, increasing tax rates on estates, gifts and generation-skipping transfers (GSTs) and including certain trust assets in a decedent's estate. Second, the Sensible Taxation and Equity Promotion (STEP) Act written by Senators Booker, Sanders, Van Hollen, Warren and Whitehouse would eliminate stepped-up basis at death and would treat most asset transfers, including those that occur at death, as taxable events. The effects of these two acts would eliminate trusted estate planning strategies and require estate planners and administrators to carefully review their clients' plans.

Rebecca Sallen

Key Components

The 99.5% Act would reduce the federal exemption from $11.7 million to $3.5 million and increase taxes on estates. The new estate tax rates would be tiered and assess 40% on estates valued between $3.5 and $10 million, 50% on estates valued between $10 and $50 million, 55% on estates valued between $50 million and $1 billion and 65% on estates valued in excess of $1 billion. Additionally, the annual gift tax exemption limit would be lowered from $15,000 to $10,000 and be subject to a cap of $20,000 per donor, per year. This limit would apply to 1) transfers to a trust, 2) transfers of any pass-through entity, 3) transfers of interests subject to prohibitions on sale and 4) any other transfer that cannot immediately be liquidated by the donee. One effect of the annual cap on gift tax exemption would be that it essen-

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tially eliminates trusts with Crummey provisions for transfers of these assets.

The STEP Act would impose a tax on the transfer of assets with a net gain regardless of whether the transfer occurred during a person's lifetime or at death. The act allows the first million dollars of gain to be excluded from the transfer tax. However, lifetime transfers to a trust or a non-spouse would only have a $100,000 exemption, a dramatic departure from the current $11.7 million. Transfers to trusts that are not included in the grantor's estate (including Intentionally Defective Grantor Trusts (IDGT), as discussed in more detail below) would be subject to this tax. However, under the same rationale, lifetime transfers to revocable trusts would not be subject to the tax. The $500,000 exemption for personal residences would still apply, and assets held in retirement accounts would be exempt from capital gains tax, as well as charitable gifts.

The theory of the STEP Act is to close an income tax loophole by imposing a "transfer tax" on unrealized capital gains when heirs inherit appreciated assets on which the original owner never paid income taxes. However, there would be unintended concerns that drafters may not have considered. The process of estate administration is a tedious one and many times important documents cannot be found. If a decedent had the asset for a long period of time, if may be impossible to locate the basis information. There are additional concerns that this would impose a double taxation since the current version of the STEP Act would assess a tax at the time of death, even if the assets were not liquidated and no gain was realized and again once the asset is sold.

Additionally, all non-grantor trusts would have to report gain on appreciated assets every 21 years and any established trusts would automatically report their gain in 2026.

The proposed legislation, if enacted, would be a stark departure from where we are now. Below are only some examples of how new legislation may render ineffective many relied-upon estate planning strategies.

Effect on Estate Planning Tools

STEP UP IN BASIS

Currently, the IRS allows inherited assets to reset their basis at the decedent's death, so that heirs avoid paying capital gains tax on unrealized capital gains. For example, a child may quickly sell the family home upon a parent's death and no capital gains would be owed. The STEP Act would fundamentally change this since all previously untaxed gains over $1 million would now be subject to tax in the year of death.

IDGTs

IDGTs have been a historically popular estate planning tool. This technique is often used to benefit a grantor's spouse and descendants by allowing a client to transfer assets out of his/her estate while retaining the grantor's basis and having the trust income taxed at the grantor level. Within an IDGT, under current law transfers between the trust and the grantor are respected for gift and estate tax purposes but disregarded for income tax purposes. If enacted, there would be little appeal to use IDGTs as an estate planning tool because a transfer or sale to the IDGT would become a taxable event under the STEP Act. Further, the 99.5% Act specifically provides that any asset in an IDGT would be included in the grantor's estate for federal estate tax purposes. The 99.5% Act also deems any distributions from the IDGT to beneficiaries during the grantor's lifetime as taxable gifts. Importantly, this provision would be effective as of the date of enactment and may also be applicable to IDGTs that were created prior to that date when additional contributions are made to the trust. These changes would totally reverse the reasons for creating the IDGT.

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GRATs

Grantor-Retained Annuity Trusts (GRATs) allow a grantor to contribute assets with appreciation potential to a fixed-term, irrevocable trust. The grantor retains the right to receive an annuity stream over the trust's term, after which the assets are distributed to the non-charitable beneficiaries. The two primary benefits of utilizing this type of trust is that 1) a GRAT freezes the value of the property at a moment in time, allowing for a beneficiary to receive the benefits of the trust and any subsequent appreciation of the trust assets without gift or estate tax, and 2) the annuity can be valued to approximate the transferred asset value (zeroed-out), thereby virtually eliminating a taxable gift upon the trust funding. The 99.5% Act would make GRATs less effective in transferring wealth due to the new restrictions that would impose limitations on terms and restrictions on the value of remainder interests that would generate gifts upon funding. The new minimum term would be 10 years, instead of only the two-year term required now, and there would be a maximum term of the annuitant's life expectancy, plus 10 years. This would prevent short-term, rolling GRATs. In addition, the remainder interest may not be less than the greater of 25% of the fair market value of the trust assets or $500,000.

GENERATION-SKIPPING TRANSFER TAXES

Another technique that would no longer be as effective is a trust that continues for multiple generations. Dynasty trusts are able to successfully leverage transfer tax exemptions because the trust assets are not included in anyone's estate as succeeding generations become beneficiaries of the trust. However, the 99.5% Act would require an irrevocable trust to terminate for estate tax purposes after 50 years. This would be an extra estate tax in addition to the transfer tax applicable under the STEP Act.

ACTION ITEMS

While this legislation is pending, the retroactive provisions in the acts would eliminate the ability to do proactive planning as they would apply taxes to any gifts or inheritances after Dec. 31, 2020. Estate planning practitioners would be wise to begin thinking about how their practice may be affected by upcoming tax proposals. In addition, attorneys may want to:

- Discuss impacts of possible legislation with clients;
- Evaluate benefits of accelerating the funding of GRATs and other Grantor Trusts;
- Potentially accelerate IDGT sales;
- Be organized to use the lifetime exclusion prior to enactment; be wary of Deceased Spouse Unused Exemption (DSUE) ordering rules;
- Be prepared to pay gift tax at 40% prior to enactment;
- Consider recommending estate tax be paid for 2020 and 2021 deaths at 40% rather than higher future rates.

CONCLUSION

The proposed pieces of legislation represent an aggressive stance and the terms will likely be negotiated. Additionally, it is likely that lawmakers will be focused on pandemic relief this year, which may buy wealthy families more time for estate planning and asset transfers. However, attorneys should not wait for the terms of legislation to be finalized. The government will need a way to pay for the relief as the U.S. is expected to lose almost $42 billion on tax revenue this year alone, according to the Joint Committee on Taxation. The new proposed legislation, if passed, would surely put more money into the government. Accordingly, there may be real benefit to clients by implementing certain wealth transfer planning techniques while they are still available.

Rebecca Sallen of Sallen Law LLC is active in the Main Line suburbs and Greater Philadelphia area since 2011. Her practice focuses on trust and estate planning and estate administration. Rebecca is a board member of the Montgomery Bar Association, Vice-Chair of the Probate and Tax Section, and a regular lecturer and educator on estate planning topics.

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