THE NSBA REAL ESTATE, PROBATE & TRUST LAW SECTION PRESENTS

2019
ADVANCED ESTATE PLANNING INSTITUTE

JULY 11 - 13, 2019
ESTES PARK, COLORADO
THURSDAY JULY 11 6:00 pm - 8:30 pm
WELCOME RECEPTION
with Opening Remarks

FRIDAY JULY 12

7:00 am Continental Breakfast

7:30 am Coordinating Retirement Accounts with Estate Planning
Jesse D. Sitz, Esq.
Baird Holm LLP

8:30 am Protecting Attorney-Client Privilege in Estate Planning
Ramzi J. Hynek, Esq.
Rembolt Ludtke LLP

9:45 am One Hour Charity: The nuts and bolts of charitable planning for farmers
Paul Neiffer, CPA
CliftonLarsonAllen

10:45 am What changes are needed for farmers due to tax reform
Paul Neiffer, CPA
CliftonLarsonAllen

11:45 am Pick-up boxed lunch

12:00 pm Charitable Giving: Finding the Right Option for Your Farm/Ranch Clients
Damon T. Bahensky, Esq.
Parker, Grossart, Bahensky, Beucke, Bowman & Symington L.L.P.
Brandon D. Hamm, Esq.
Koley Jessen, P.C., L.L.O.
MODERATOR: Jim Gustafson
Director of Advancement and Gift Planning,
Nebraska Community Foundation

1:00 pm Adjourn

SATURDAY JULY 13

7:00 am Continental Breakfast

7:30 am Important Developments in Federal Income Tax
Professor Edward A. Morse, Esq.
Creighton University School of Law

8:30 am When You Can’t Trust a Fiduciary
Mark A. Kisker, Esq.
Senior Vice President & Trust Officer,
Pinnacle Bank
Marietta E. Luellen, Esq.
Vice President, Wealth Management,
First National Bank
Bradley A. Philson, Esq.
First Vice President & Senior Trust Officer,
Union Bank & Trust
MODERATOR: Matthew D. Baack, Esq.
Skalka & Baack Law Firm LLC

9:45 am Perils and Pitfalls of Multi-Party Representation
Walter N. Houghtaling, Esq.
McConnell Fleischner Houghtaling, LLC

10:45 am Review of Relevant Legislation From the Past Several Years
Brett E. Ebert, Esq.
Baylor Evnen, LLP

12:00 pm Update on Guardianships and Conservatorships
William J. Lindsay, Jr., Esq.
Gross & Welch, P.C., L.L.O.
Lisa M. Line, Esq.
Brodkey, Cuddigan, Peebles, Belmont & Line, LLP
Susan J. Spahn, Esq.
Fitzgerald, Schorr, Barmettler & Brennan, P.C., L.L.O.

1:00 pm Adjourn

ACCREDITATION

Colorado CLE
Accreditation Approved
12 CLE hours, including 2.4 hours ethics

Nebraska
MCLE #172313
10 CLE hours, including 2 hours ethics

Iowa
MCLE #316627
10 CLE hours, including 2 hours ethics

Kansas
MCLE #154118
12 CLE hours, including 2 hours ethics

Wyoming CLE
Accreditation Approved
10 CLE hours, including 2 hours ethics

ACCRREDITATION}

11:45 am Pick-up boxed lunch

12:00 pm Update on Guardianships and Conservatorships
William J. Lindsay, Jr., Esq.
Gross & Welch, P.C., L.L.O.
Lisa M. Line, Esq.
Brodkey, Cuddigan, Peebles, Belmont & Line, LLP
Susan J. Spahn, Esq.
Fitzgerald, Schorr, Barmettler & Brennan, P.C., L.L.O.

1:00 pm Adjourn

ACCREDITATION

Colorado CLE
Accreditation Approved
12 CLE hours, including 2.4 hours ethics

Nebraska
MCLE #172313
10 CLE hours, including 2 hours ethics

Iowa
MCLE #316627
10 CLE hours, including 2 hours ethics

Kansas
MCLE #154118
12 CLE hours, including 2 hours ethics

Wyoming CLE
Accreditation Approved
10 CLE hours, including 2 hours ethics

ACCRREDITATION}

11:45 am Pick-up boxed lunch

12:00 pm Update on Guardianships and Conservatorships
William J. Lindsay, Jr., Esq.
Gross & Welch, P.C., L.L.O.
Lisa M. Line, Esq.
Brodkey, Cuddigan, Peebles, Belmont & Line, LLP
Susan J. Spahn, Esq.
Fitzgerald, Schorr, Barmettler & Brennan, P.C., L.L.O.

1:00 pm Adjourn

ACCREDITATION

Colorado CLE
Accreditation Approved
12 CLE hours, including 2.4 hours ethics

Nebraska
MCLE #172313
10 CLE hours, including 2 hours ethics

Iowa
MCLE #316627
10 CLE hours, including 2 hours ethics

Kansas
MCLE #154118
12 CLE hours, including 2 hours ethics

Wyoming CLE
Accreditation Approved
10 CLE hours, including 2 hours ethics

ACCRREDITATION}

11:45 am Pick-up boxed lunch

12:00 pm Update on Guardianships and Conservatorships
William J. Lindsay, Jr., Esq.
Gross & Welch, P.C., L.L.O.
Lisa M. Line, Esq.
Brodkey, Cuddigan, Peebles, Belmont & Line, LLP
Susan J. Spahn, Esq.
Fitzgerald, Schorr, Barmettler & Brennan, P.C., L.L.O.

1:00 pm Adjourn

ACCREDITATION

Colorado CLE
Accreditation Approved
12 CLE hours, including 2.4 hours ethics

Nebraska
MCLE #172313
10 CLE hours, including 2 hours ethics

Iowa
MCLE #316627
10 CLE hours, including 2 hours ethics

Kansas
MCLE #154118
12 CLE hours, including 2 hours ethics

Wyoming CLE
Accreditation Approved
10 CLE hours, including 2 hours ethics

ACCRREDITATION}

11:45 am Pick-up boxed lunch

12:00 pm Update on Guardianships and Conservatorships
William J. Lindsay, Jr., Esq.
Gross & Welch, P.C., L.L.O.
Lisa M. Line, Esq.
Brodkey, Cuddigan, Peebles, Belmont & Line, LLP
Susan J. Spahn, Esq.
Fitzgerald, Schorr, Barmettler & Brennan, P.C., L.L.O.

1:00 pm Adjourn

ACCREDITATION

Colorado CLE
Accreditation Approved
12 CLE hours, including 2.4 hours ethics

Nebraska
MCLE #172313
10 CLE hours, including 2 hours ethics

Iowa
MCLE #316627
10 CLE hours, including 2 hours ethics

Kansas
MCLE #154118
12 CLE hours, including 2 hours ethics

Wyoming CLE
Accreditation Approved
10 CLE hours, including 2 hours ethics

ACCRREDITATION}

11:45 am Pick-up boxed lunch

12:00 pm Update on Guardianships and Conservatorships
William J. Lindsay, Jr., Esq.
Gross & Welch, P.C., L.L.O.
Lisa M. Line, Esq.
Brodkey, Cuddigan, Peebles, Belmont & Line, LLP
Susan J. Spahn, Esq.
Fitzgerald, Schorr, Barmettler & Brennan, P.C., L.L.O.

1:00 pm Adjourn

ACCREDITATION

Colorado CLE
Accreditation Approved
12 CLE hours, including 2.4 hours ethics

Nebraska
MCLE #172313
10 CLE hours, including 2 hours ethics

Iowa
MCLE #316627
10 CLE hours, including 2 hours ethics

Kansas
MCLE #154118
12 CLE hours, including 2 hours ethics

Wyoming CLE
Accreditation Approved
10 CLE hours, including 2 hours ethics

ACCRREDITATION}

11:45 am Pick-up boxed lunch

12:00 pm Update on Guardianships and Conservatorships
William J. Lindsay, Jr., Esq.
Gross & Welch, P.C., L.L.O.
Lisa M. Line, Esq.
Brodkey, Cuddigan, Peebles, Belmont & Line, LLP
Susan J. Spahn, Esq.
Fitzgerald, Schorr, Barmettler & Brennan, P.C., L.L.O.

1:00 pm Adjourn

ACCREDITATION

Colorado CLE
Accreditation Approved
12 CLE hours, including 2.4 hours ethics

Nebraska
MCLE #172313
10 CLE hours, including 2 hours ethics

Iowa
MCLE #316627
10 CLE hours, including 2 hours ethics

Kansas
MCLE #154118
12 CLE hours, including 2 hours ethics

Wyoming CLE
Accreditation Approved
10 CLE hours, including 2 hours ethics

ACCRREDITATION}

11:45 am Pick-up boxed lunch

12:00 pm Update on Guardianships and Conservatorships
William J. Lindsay, Jr., Esq.
Gross & Welch, P.C., L.L.O.
Lisa M. Line, Esq.
Brodkey, Cuddigan, Peebles, Belmont & Line, LLP
Susan J. Spahn, Esq.
Fitzgerald, Schorr, Barmettler & Brennan, P.C., L.L.O.

1:00 pm Adjourn

ACCREDITATION

Colorado CLE
Accreditation Approved
12 CLE hours, including 2.4 hours ethics

Nebraska
MCLE #172313
10 CLE hours, including 2 hours ethics

Iowa
MCLE #316627
10 CLE hours, including 2 hours ethics

Kansas
MCLE #154118
12 CLE hours, including 2 hours ethics

Wyoming CLE
Accreditation Approved
10 CLE hours, including 2 hours ethics

ACCRREDITATION}
**Matthew D. Baack, Esq.**  *Skalka & Baack Law Firm LLC*

Matt Baack’s practice focuses primarily on real estate transactions (including 1031 like-kind exchanges), business and corporate law, estate planning, and estate/probate administration. He enjoys working with clients to ensure that their wishes are fulfilled through effective business and estate planning. Mr. Baack has also spoken at seminars in the areas of estate planning, probate/estate administration and real estate. Mr. Baack received his Juris Doctor from the University of Nebraska College of Law, including a Certificate in Business Transactions.

**Damon “Dan” T. Bahensky, Esq.**  *Parker, Grossart, Bahensky, Beucke, Bowman & Symington, L.L.P.*

Dan Bahensky has been a partner in the law firm of Parker, Grossart, Bahensky, Beucke, Bowman & Symington, L.L.P. since 1980. His areas of practice include estate planning, probate, and real estate law. Mr. Bahensky received his Juris Doctor from the University of Nebraska College of Law.

**Brett E. Ebert, Esq.**  *Baylor Evnen, LLP*

Brett Ebert is a Partner of the firm’s Business & Commercial and Trusts & Estates practice groups. Her practice includes estate planning, estate administration, intellectual property, real estate law, entity formation, and planning for charitable giving.

Ms. Ebert is passionate about estate planning and the peace of mind that a well-thought-out estate plan can provide to clients. She has experience with a range of commercial matters, from simple real estate purchase agreements to complex mergers, acquisitions, and financing transactions.

Ms. Ebert has a long history at Baylor Evnen working as a runner during her undergraduate years, then subsequently as a Law Clerk while attending the University of Nebraska College of Law. Ms. Ebert was one of eight law students involved in the inaugural year of the Entrepreneurship Legal Clinic at the College of Law and is very involved in mentoring the professional growth of women.

**Jim Gustafson**  *Director of Advancement and Gift Planning, Nebraska Community Foundation*

Jim Gustafson helps people experience the joy of giving while making a difference to the people, places, and charitable organizations that are important to them. He works closely with professional advisors and their clients to help implement their charitable gift plans.

Currently, he oversees the Nebraska Community Foundation’s advancement and gift planning programs and projects initiated for the benefit of over 220 affiliated funds serving more than 250 communities in Nebraska. Jim has guided the growth of the Foundation’s expectancies to over $66 million.

Jim has been involved in various areas of financial and charitable estate planning for his entire career.

Jim consults, trains, and speaks on various topics from charitable gift planning, community development, and fund-raising. Jim has lead workshops attended by donors, professional advisors, community volunteers, and development professionals. He has been a speaker at the various community led workshops across Nebraska, National Philanthropic Planning Conference, Nebraska’s Give and Gain Conference, and various Nebraska Bar Association workshops.

He is the past-president of the Charitable Gift Planners of Nebraska and is the recipient of the J. Robert Sandberg Award in recognition of service to the gift planning profession.
Brandon D. Hamm, Esq.  Koley Jessen P.C., L.L.O.

Brandon Hamm is a Shareholder at the law firm of Koley Jessen in Omaha. He serves as the Chair of the Firm’s Estate, Succession and Tax Department and his practice areas include estate planning, estate and trust administration, business succession planning, and charitable giving. Brandon serves as a trusted advisor to affluent individuals, executives, and business owners, assisting them with the accumulation, management, protection and transfer of their wealth in a thoughtful and tax-efficient manner. Brandon received his Juris Doctor from Creighton University School of Law. He is also a Chartered Advisor in Philanthropy® (CAP®), The American College of Financial Services, and a Certified Exit Planner designation (CExP™), Business Enterprise Institute.

Walter N. Houghtaling, Esq.  McConnell Fleischner Houghtaling, LLC

Walter Houghtaling has dedicated his trial practice to the defense of licensed professionals, business entities and employers. Mr. Houghtaling is admitted to and has handled matters in the Supreme Court of the United States, the United States Court of Appeals for the Tenth Circuit, the United States District Court and Colorado’s state courts. A graduate of Norwich University and the University of Denver College of Law, his practice is focused on the representation of attorneys, insurance providers, corporate officers and directors, and business owners on tort, contract, and statutory claims including those brought under the Fair Debt Collection Practices Act and various labor statutes.

Mr. Houghtaling co-chaired the Colorado Bar Association’s Professional Liability Committee from 2005 to 2010 and has been active in the committee’s yearly “Preventing Legal Malpractice” presentations. A graduate of the National Institute of Trial Advocacy, he has served as an instructor for trial and discovery programs for the Institute and has lectured numerous times on professional malpractice, ethics, and employment topics.

Ramzi J. Hynek, Esq.  Rembolt Ludtke LLP

Ramzi Hynek is a partner at Rembolt Ludtke LLP. Her practice focuses on estate planning, succession planning, and developing family wealth transfer plans that minimize taxation while achieving each family’s unique needs and goals. She also represents individuals and corporate personal representatives and trustees in the administration of estates and trusts. Ms. Hynek received her Juris Doctor from the University of Nebraska College of Law.

Mark A. Kisker, Esq.  Senior Vice President & Trust Officer, Pinnacle Bank

Mark Kisker has been a trust compliance and trust administration officer since 1989. Mark is currently a Senior Vice President & Trust Officer with Pinnacle Bank. In 1981, Mark received a Bachelor of Science Degree in Agriculture from the University of Nebraska – Lincoln. In 1985, Mark received a Law Degree from the University of South Dakota School of Law.

William J. Lindsay, Jr., Esq.  Gross & Welch, P.C., L.L.O.

William Lindsay is a shareholder with Gross & Welch. His practice emphasis is in estate planning and probate, tax law, corporate and business, and real estate. Mr. Lindsay is an Adjunct Professor at Creighton University School of Law teaching Trusts and Estates. He received his Juris Doctor from Creighton University School of Law and his L.L.M. in Taxation from the University of Florida.
Lisa M. Line, Esq.  
*Brodkey, Cuddigan, Peebles, Belmont & Line, LLP*

Lisa Line represents clients in matters of social security, estate planning, probate, and related litigation. She is admitted to practice in Nebraska and the U.S. District Court District of Nebraska, having entered the legal profession in 1993.

Ms. Line has been active in several groups, including the college and legal organizations of Omicron Delta Epsilon and Phi Alpha Delta. She acted as Scholarship Coordinator for MENSA from 1996 to 1999.

Ms. Line is a graduate of the University of Nebraska, having earned her Bachelor’s in Economics as a member of Omicron Delta Epsilon. She obtained her Juris Doctor from the University of Nebraska College of Law.

Marietta E. Luellen, Esq.  
*Vice President, Wealth Management, First National Bank*

Marietta Luellen is the Vice President, Wealth Management for First National Bank.

Prior to joining First National Bank, Marietta spent 18 years as an attorney in private practice in Omaha, specializing in corporate, real estate, and trust and estate law. She earned her Bachelor of Arts from Colorado State University and her Juris Doctor degree from Pepperdine University. Ms. Luellen’s professional affiliations include the Nebraska State Bar Association and Omaha Bar Association, and she holds the CAP designation as a Chartered Advisor of Philanthropy.

Professor Edward A. Morse, Esq.  
*Creighton University School of Law*

Professor Edward Morse holds the McGrath North Mullin & Kratz Endowed Chair in Business Law at Creighton University School of Law. He is a frequent speaker at CLE programs, including the Great Plains Tax Institute and meetings of the American Bar Association.

Paul Neiffer, CPA, Partner  
*CliftonLarsonAllen*

Paul Neiffer is a certified public accountant and business advisor specializing in income taxation, accounting services, and succession planning for farmers and agribusiness processors. Mr. Neiffer is a partner with CliftonLarsonAllen (CLA) in Yakima, Washington, as well as a regular speaker at national conferences and contributor at agweb.com.

Mr. Neiffer regularly publishes timely content on CLA’s agribusiness blog, Farm CPA Today. He covers topics, including taxation, accounting, succession planning, new laws, major agribusiness events, and other issues that are unique to farmers and agribusiness processors.

Bradley A. Philson, Esq.  
*First Vice President & Senior Trust Officer, Union Bank & Trust*

Bradley Philson has been with Union Bank’s Trust Division since 1989. He has attained his Certified Trust and Financial Advisor (CTFA) designation and graduated from the ABA’s Graduate Trust School. Mr. Philson received his Juris Doctor from the University of Nebraska College of Law.
Jesse D. Sitz, Esq.  
*Baird Holm LLP*

Jesse Sitz represents clients with respect to general corporate matters, estate planning and probate matters, federal and state tax planning issues, and tax exempt matters. His practice highlights include:

- Representing parties involved in mergers, acquisitions, and reorganizations
- Representing fiduciaries in probate and trust administration
- Assisting clients in appealing federal and state tax assessments and penalties
- Representing business owners, farmers, and ranchers to develop and implement tax efficient business succession and multi-generational transition plans
- Representing developers and investors in transactions involving historic tax credits, low income housing tax credits, and new market tax credits

Mr. Sitz received his Juris Doctor, cum laude, from the University of Minnesota Law School.

Susan J. Spahn, Esq.  
*Fitzgerald, Schorr, Barmettler & Brennan, P.C., L.L.O.*

Susan Spahn was appointed by the Nebraska Supreme Court to serve on its Commission on Guardianships and Conservatorships, which also includes judges, clerk magistrates, law enforcement, and others with special knowledge of vulnerable adults. She also serves on the Commission’s Executive and Forms Committees. She is dedicated to making sure that the needs of vulnerable adults are met while also allowing them to maintain as much autonomy as possible.

She is a frequent speaker on estate and trust issues, with her presentations focusing on administration of estate and trusts and issues that arise in the litigation process.

Ms. Spahn received her JD from the University of Nebraska-Lincoln College of Law.
Coordinating Retirement Accounts with Estate Planning

Jesse D. Sitz, Esq.
Baird Holm LLP
2019 ADVANCED ESTATE PLANNING INSTITUTE

Coordinating Retirement Accounts
With Estate Planning

By

Jesse D. Sitz, Baird Holm LLP

1. Retirement Accounts.

As a preliminary matter, it is worth discussing what exactly it is we are talking about when we discuss “retirement accounts.” Retirement accounts include the following:

- Individual retirement accounts (“IRAs”);
- 401(k), 403(b), 451, and 457 plans;
- Pension plans (also known as defined benefit plans);
- SEP – IRAs;
- Simple IRAs;
- Keogh plans;
- ESOPs; and
- VEBAs.

For purposes of this outline, we will be touching only on corporate or self-employed pension, profit-sharing, or stock bonus plans that are “qualified” under IRC section 401(a), an IRA created under § 408A, or a tax-sheltered annuity under § 403. We will not be discussing life insurance, 529 plans, health savings accounts, or other “non-retirement” vehicles, although certain aspects of the discussion may be similar.¹

2. Why Estate Planners Care—or Should.

The complexity of taxation of retirement benefits has caused practitioners, including this one, to attempt to create rules-of-thumb to avoid the complexities. But knowledge of retirement assets provides distinct opportunities for estate planning practitioners for the following reasons:

- Reason 1—Retirement Assets Constitute a Large Amount of the Assets, Particularly of Wealthy Individuals. At the end of 2017, the total value of 401(k) and IRA accounts was $16.9 trillion.² This is a large number by any measure.

¹ We’ll only be focusing on federal tax implications, not state or local.
• **Reason 2—Retirement Plan Holdings are Disproportionately Held by the Top Quartile of Income Earners.** Ownership of retirement accounts is concentrated primarily among high-income earners. These high earners, who are also typically accumulators of wealth and seekers of estate planning advice, are more likely to seek to pass on retirement assets upon death, and they are less likely to spend those assets while they are alive.

• **Reason 3—Retirement Assets Can be Coordinated Effectively with Estate Plans.** Retirement assets implicate a number of considerations that are top-of-mind for estate planners. These include asset protection, charitable planning, asset titling issues, and tax planning.

For these reasons, estate and wealth planners will continue to encounter planning opportunities involving retirement assets.

3. **Retirements Accounts, RMDs, and IRD in a Nutshell.**

   A. **Retirement Accounts Not Intended to be Wealth Transfer Vehicles.**

   Congress provided tax-favored status to holders of retirement accounts to incentivize retirement savings, not to facilitate wealth transfer to younger generations. Accordingly, Congress enacted IRC § 401(a)(9). Section 401(a)(9) compels certain annual “minimum required distributions” (“MRDs” or “RMDs”) from most qualified retirement plans beginning at age 70 ½. The RMD regulations and rules drive much of the tax-centric planning (and a significant amount of triage upon the death of a participant as well), so we will discuss tax issues in some detail. Despite the general rule disfavoring deferral of retirement plan assets beyond the life of the participant, § 401(a)(9) does allow deferral to continue long after the death of the participant if the benefit is left to the right kind of beneficiary. The fact that retirement benefits are most often IRD assets also causes special tax planning considerations.

   There are also non-tax issues to be considered when incorporating retirement assets into an estate plan, such as creditor protection issues (or, these days, relative lack of creditor protection) of and Medicaid planning for inherited plan assets.

   B. **Overview—Income in Respect of Decedent “IRD”.

   Generally, retirement assets will trigger “income in respect of the decedent” or “IRD.” IRD includes items of income earned or accrued during life but not received until after death. According to IRC section 691 regulations and commentary over the years, IRD has four characteristics:

   5. The item of income would have been taxable to the decedent if the decedent had survived to receive the income;

---


4 One exception is a Roth plan.
The income right had not matured sufficiently to have been properly included in the
decedent's final income tax return;

The receipt must be of income and not a capital asset described in Sec. 1014(a); and

If the item of IRD is payable to someone other than the decedent's estate, the taxpayer
acceding to it must have acquired the property right solely because of the decedent's
death.\(^5\)

For example, if the beneficiary of a decedent's individual retirement account (IRA) receives
a lump sum distribution from the IRA, a portion of the lump sum distribution is IRD that is
includible in the gross income of the beneficiary for the tax year the distribution is received.\(^6\)
Certain transfers of retirement assets can trigger IRD.\(^7\) IRD could be triggered by a lifetime gift
of plan assets,\(^8\) transfers to trusts that are not “qualified beneficiaries,” and estates (which are not
considered qualified beneficiaries).\(^9\) IRD income can be deferred through the use of qualified
“stretch” planning (see below).

C. Overview—RMDs.

The main benefit of qualified plan assets is the participant’s ability to accumulate funds
inside the plan on a tax-deferred basis.\(^10\) The RMD rules dictate how long the deferral can go on,
as well as when it is available. Generally speaking, the longer a deferral can go on, the more it
benefits the plan participant or their beneficiaries. This is because the growth of the plan assets is
funded both with the participant’s money, but also with pre-tax dollars (e.g., the government’s
money). Appreciation in qualified plan assets thus occurs on both the participant’s “own share”
as well as on “Uncle Sam’s share.” This deferral benefit is even more meaningful if the participant
can take a deduction upon contribution to the plan at a higher tax rate than what will be in effect
upon distributions from the plan. Of course, if income tax rates \textit{increase} between the time of
contribution and the time of distribution, the deferral may be ineffective.\(^11\)

C. Plans Subject to RMD Rules.

The RMD rules are found in IRC § 401(a)(9) and corresponding Regulations and IRS
guidance and apply to “qualified retirement plans,” e.g., those qualified under IRC § 401(a). Rules
“similar to” the rules in § 401(a)(9) apply traditional IRAs, 403(b) plans, and 457 plans.\(^12\) Roth
IRAs are also subject to the RMD rules, but only after the death of the participant.

\(^5\) Audrey Young, J.D., LL.M, STRATEGIES FOR MINIMIZING THE IMPACT OF INCOME IN RESPECT OF A DECEDED
available at \url{https://www.thetaxadviser.com/issues/2015/apr/tax-clinic-06.html}
\(^7\) IRC § 691(a)(2).
\(^8\) An exception would be a charitable rollover under IRC Section 408(d)(8).
\(^9\) IRC § 401(a)(9).
\(^10\) The exception would be Roth plans, which are funded with after-tax dollars.
\(^12\) IRC §§ 408(a)(6); 403(b)(10); and 457(b)(5).
D. RMD Summary—Distributions During Life.

As a very brief summary, the RMD rules require a participant or the participant’s beneficiaries to take distributions from a plan subject to the RMD rules. These distributions begin at a date required in the RMD rules (usually 70 ½ or upon later retirement in some cases, or upon the death of the participant). The amount of the RMD that must be taken is calculated using the year-end account balance from the prior year and dividing it by a factor from an IRS table. The longer a participant lives, the lower the divisor.

EXAMPLE: Assume participant turns 73 in 2019; account is traditional IRA.

1. IRA balance on December 31 of the previous year. ……………………$1,000,000

2. Distribution period from the IRS table for age on your birthday ………………24.7 this year.

3. Line 1 divided by number entered on line 2. ……………………………$40,485.83
   This is the RMD for this year from this IRA.

Note: If participant was age 89, the RMD would be $83,333 because the distribution period would be 12 years.

Nothing in the RMD rules forecloses the participant’s ability to take a greater distribution than what the RMD rules provide; rather, the RMD rules to dictate the minimum distribution that must be taken.

E. RMD Distributions After Participant Death.15

Following the death of the participant, the RMD rules apply to the beneficiary. The post-death RMD rules allow a participant’s retirement benefit to be distributed gradually if certain requirements are satisfied. This is generally referred to as a “stretch.” The flexibility of RMDs following the death of the participant is severely limited by very technical rules:

- Not every beneficiary named on a beneficiary designation is considered a “designated beneficiary” for purposes of the stretch provisions. Only individuals and certain look-through trusts are considered “designated beneficiaries” for purposes of IRC § 401(a)(9). Estates are not qualified beneficiaries. If the beneficiary does not qualify as a “designated beneficiary” in the regulatory sense, a “stretch” payout may not be available. Generally, failure to satisfy the “designated beneficiary” requirements requires a pay-out over a maximum period of 5 years.

14 For an excellent summary of RMDs and their impact on estate planning, see Choate, Natalie, LIFE AND DEATH PLANNING FOR RETIREMENT BENEFITS, THE ESSENTIAL HANDBOOK FOR ESTATE PLANNERS, 7th Ed., Ataxplan Publications.
15 This discussion is limited to “individual account” plans and defined contribution plans (e.g., not pensions).
16 Reg. § 1.401(a)(9)-4, A-1.
In order to qualify as a “designated beneficiary,” a trust must satisfy the following requirements:

- The trust must be valid under state law or would be but for the fact there is no corpus.
- The trust is irrevocable or will, by its terms, become irrevocable upon the death of the participant.
- The beneficiaries of the trust who are beneficiaries with respect to the trust’s interest in the retirement account are identifiable from the trust instrument and must only be individuals.
- Certain documentation has been timely provided to the plan administrator.\(^{17}\)

These requirements pose a number of problematic questions where a trust beneficiary is involved. For example, will the presence of a non-individual beneficiary, such as a charity, cause a trust to be a disqualified beneficiary?\(^{18}\) Unexpected requirements can also arise in the context of marital trusts that are funded with retirement benefits. For example, if retirement assets are to be split between a credit shelter trust and a QTIP trust, a “fractional” formula may need to be used, rather than a “pecuniary” formula, or the beneficiary may face the possibility of acceleration of IRD.\(^{19}\)

- Different rules apply, depending on whether the decedent participant had begun taking distributions prior to his or her death versus if no distributions had been taken prior to death.

- Different rules apply based on whether the spouse is the “designated beneficiary” or not. Because of the complexity of the RMD rules, even seemingly straightforward situations can result in unexpected results. For example, if a decedent participant named a spouse as beneficiary, a different RMD table may apply depending on whether the spouse is more than 10 years younger than the decedent participant.

- A failure to take RMDs can trigger a 50% penalty.\(^{20}\) Unless a drafter is careful, there is a chance that a trust that is named as a designated beneficiary could fail to be characterized as such under the RMD rules, resulting in the imposition of this penalty or acceleration of distribution of the retirement assets. This is why the general rule is

\(^{17}\) Reg. § 1.401(a)(9)-4, A-6(b).

\(^{18}\) If the charity is a remainder beneficiary of the same trust to which the retirement assets will be transferred, the answer is “no.” PLRs 9846034 and 9820021; see Steven E. Trytten, “Tax and Investment Planning for the Individual: Roth IRAs and Other Retirement Assets,” 57 N.Y.U. Institute on Fed. Taxation § 24.03[3][a] (1999).


\(^{20}\) IRC § 4974.
to name individual as designated beneficiary, rather than a trust, absent compelling reasons.

The very technical nature of the RMD rules as applied in the context of wealth transfer planning can make retirement assets complicated to deal with, even in straightforward situations. In situations involving non-individual beneficiaries, the marital deduction, and other estate planning considerations, the RMD rules can be difficult to navigate, even for the most experienced estate planners.

F. Performing Tax Triage.

If a compelling reason does not exist for naming a trust as beneficiary, or if a better deferral result exists if the trust is not the beneficiary, the following are possible triage methods to fix a bad result:

- Subject to state law requirements and IRC § 2518, some plan administrators will allow qualified plan assets to be disclaimed from a trust (e.g., a trustee may disclaim plan assets from a trust that is not a “qualified beneficiary”) to a surviving spouse. Research must be done to determine whether this is a viable option.\(^{21}\)

- If a surviving spouse is named as designated beneficiary, the surviving spouse may disclaim the plan assets, resulting (depending on the beneficiary designation) on the plan assets passing to children or to a qualified trust.\(^{22}\)

- Plan assets can be disclaimed from an estate to another beneficiary under certain circumstances.\(^{23}\)

- Plan assets payable to an estate or trust may be able to be “assigned” to a charity, avoiding recognition of IRD by the estate or trust.\(^{24}\)

4. Beneficiaries—Trust or Individual. Is there Even a Choice?

Given the complexities of transfers of retirement benefits to non-individuals, why in the world would an estate planning attorney ever name anyone besides individuals as designated beneficiaries for retirement assets? There are many good non-tax reasons to name a non-individual beneficiary.

A. Creditor Protection.

---

\(^{21}\) See Rev. Rul. 2005-36 (receipt of RMD by a beneficiary does not foreclose disclaimer of all or part of the rest of the beneficiary’s interest in the decedent’s plan); PLR 9045050 (spouse trustee allowed to disclaim plan assets from the trust, with the result being that the spouse would receive the assets under the plan document, allowing spousal rollover of qualified assets).

\(^{22}\) Reg. § 1.409(a)(9)-4, A-4(a).

\(^{23}\) PLR 9437042.

\(^{24}\) PLR 200633009.
Previously, beneficiaries of inherited IRAs argued that their IRA assets were excluded from assets available to creditors under the federal bankruptcy laws. A Circuit split occurred, and the U.S. Supreme Court held that inherited IRA assets did not constitute “retirement assets” of the beneficiary of an inherited IRA under section §522(b)(3)(C) of the Bankruptcy Code. Because many state exemption statutes reference the Bankruptcy Code, there is significantly less protection for inherited IRA assets than existed before Clark.

Accordingly, if a participant desires to protect retirement assets from claims of creditors of a beneficiary, naming a spendthrift trust as designated beneficiary would be necessary to provide maximum creditor protection.

Presumably, a spendthrift trust holding retirement inherited IRA assets would also protect from divorce claimants.

B. Blended Families.

A participant may desire to hold retirement assets in trust following the participant’s death, perhaps because the participant believes that the surviving spouse is not capable of handling the asset, or perhaps the surviving spouse is the spouse from a second marriage, and the owner of an account has children or other beneficiaries to whom he or she would like to leave the remainder of the account, while the surviving spouse can enjoy the income from the IRA during her or his life. Given these facts, it may be appropriate to hold the retirement assets in a QTIP trust. Complexities exist in drafting the QTIP trust because, among other things, of the need to satisfy both the RMD rules and the marital deduction rules under IRC § 2056 that require all “income” to be distributed to the surviving spouse.

C. Special Needs Planning.

A parent or grandparent may desire to establish a third-party special needs trust for a descendant that qualifies, or is likely to qualify, for governmental assistance, such as Medicaid. Retirement assets that are transferred to a third-party special needs trust can be accumulated in the SNT, so long as the SNT remains a qualified beneficiary under the RMD rules. This may allow the beneficiary to continue to qualify for governmental benefits.


A. Naming the Correct Beneficiary.

26 https://www.actec.org/assets/1/6/50_STATE_INHERITED_IRA_CHART.pdf
27 For a robust discussion of leaving retirement benefits to a QTIP trust, see Choate, LIFE AND DEATH PLANNING FOR RETIREMENT BENEFITS, Ch. 3., and Donita M. Joseph, NAMING A QTIP TRUST AS THE BENEFICIARY OF AN IRA, available at http://www.cchwebsites.com/preview/36/369ce1d22cf8247c13bff0428abed604/content/client/369ce1d22cf8247c13bff0428abed604/uploads/news-releases/10192009165454281516.pdf
28 Reg. § 1.401(a)(9)-5; PLR 201116005.
One of the most basic practical considerations when doing estate planning with retirement assets is to ensure beneficiary designations are handled correctly. Of course, a beneficiary designation trumps any provision in a decedent’s Will or Trust. Nebraska law generally disinherits former spouses from receiving property following a divorce or annulment, including payable on death designations, bequests and devises in Wills, interests in certain trusts, pensions, retirement plans, transfer on death deeds, annuity policies, and profit-sharing plans, this general rule is severely limited in the context of retirement plans that are subject to ERISA or otherwise subject to federal law.

The U.S. Supreme Court held that for retirement plans subject to ERISA, federal law preempts state laws disinheriting spouses following a divorce. Accordingly, in most situations, a plan administrator may now ignore divorce decrees and pay out a survivor benefit in accordance with beneficiary designations in file or defaults provided in plan documents. This has been extended to the non-retirement context in the 8th Circuit in a case that held that a state law that overrode a beneficiary designation violated the “Contracts Clause” of the U.S. Constitution.

While in-depth discussions of federal preemption and the Contracts Clause are beyond the scope of this outline, these cases reinforce the importance of naming the correct beneficiaries when retirement assets are involved.

For retirement assets, the general rule of thumb nearly always favors naming beneficiaries in the following manner:

- **1st Preference—Spouses Individually.** Naming a surviving spouse individually as beneficiary generally provides the most planning options for estate planners where retirement plans are involved. A surviving spouse can often “roll over” retirement benefits to the surviving spouse’s own retirement plan, which results in several favorable outcomes. First, naming the spouse is by far the most common beneficiary designation, and the options are easily understood by plan administrators. Second, if the spouse is under the age of 70 1/2, no RMDs are required to be taken until the spouse reaches that age themselves. Third, even if the spouse has started taking benefits, rolled over benefits are allowed to be stretched over a longer period of time due to use of a Uniform Life Table under which the applicable distribution period is the joint life expectancy of the surviving spouse and a hypothetical beneficiary that is 10 years younger. Fourth, the surviving spouse can name a designated beneficiary of their plan that includes roll over benefits, RMDs will be based on the life expectancy of the designated beneficiary, rather than the decedent’s applicable distribution period.

- **2nd Preference—Other Individuals.** While roll overs are generally not available to individuals that are named as designated beneficiaries, individual beneficiaries

---

29 NEB. REV. STAT. § 30-2333(d).
32 Choute, Natalie, LIFE AND DEATH PLANNING FOR RETIREMENT BENEFITS, THE ESSENTIAL HANDBOOK FOR ESTATE PLANNERS at 3.2.01.
33 Id.
34 Id.
subject to RMDs are allowed to take RMDs based on the beneficiary’s life expectancy, rather than the decedent’s. Note: if a non-spouse beneficiary is named while a spouse is living, Federal law may require a spousal waiver for certain kinds of benefits.35

- **3rd Preference—Trusts.** Trusts are generally a less favorable option as a designated beneficiary. Where a surviving spouse is involved, a QTIP trust that is named as a designated beneficiary implicates a number of issues to be addressed in order to receive deferral beyond that allowed by the 5-year rule.36 Even then, the deferral available for a QTIP trust is generally less than what is available in a spousal rollover of IRA proceeds, and the QTIP trust itself should be named as the beneficiary.37 Where non-spouse individuals are involved in a “see-through” or “conduit” trust, the trust itself must be named as the beneficiary, and the applicable requirements must be satisfied to obtain deferral. Failure of the applicable designated beneficiary requirements for a trust may result in application of the 5-year rule.38

- **Least Favorable—Estates.** Estates are also generally subject to the 5-year rule if the participant dies before their required beginning date.39 Even if the participant’s RBD has passed, the single-life expectancy payout is the rule.40 Therefore, estates provide the least deferral opportunities.41

Charitable organizations are favorable beneficiaries for retirement assets in most situations as well, but they are not discussed in detail here.

**B. Minors as Beneficiaries.**

An exception to the general rule that it is beneficial to name individual beneficiaries is if the individuals are minors. Two issues can arise for minor beneficiaries. First, plan administrators may be unable to deal with minors, which could result in a requirement to distribute only to a court-appointed conservator. Second, plan benefits left to a minor would generally be payable upon the minor reaching age of majority. Accordingly, minor children should generally not be named as individual beneficiaries of retirement assets.

There are other options:

- Name a custodian under an UTMA account to hold the benefits;

- Name a trustee of a trust that qualifies as a “conduit trust;” and

---

35 See, e.g., IRC §§ 401(a)(11) and 417; ERISA § 205.
36 Choate at 3.3.02.
37 Id.
38 Reg. § 1.401(a)(9)-3.
39 IRC § 401(a)(9)(B)(ii). However, a plan can allow a designate beneficiary to choose between the 5-year rule and life expectancy payout method.
40 Reg. § 1.401(a)(9)-5.
41 Id.
• Name a trustee of an “accumulation trust.” 42

C. What if a Named Beneficiary Dies Before the Participant?

When a named beneficiary predeceases the participant, the secondary beneficiary will take. But what happens if there is no named secondary beneficiary named that is eligible to take? In that event the applicable Plan Document would apply to determine the disposition of the plan assets. For example, the Plan Document for our firm’s 401(k) plan provides:

If upon the death of the Participant there is, in the opinion of the Administrator, no designated Beneficiary for part or all of the Participant's Account, such amount shall be paid to his surviving Spouse or, if none, to his estate (such Spouse or estate shall be deemed to be the Beneficiary for purposes of the Plan). If a Beneficiary dies after benefits to such Beneficiary have commenced, but before they have been completed, and, in the opinion of the Administrator, no person has been designated to receive such remaining benefits, then such benefits shall be paid in a lump sum to the deceased Beneficiary's estate.

Another Plan Document states that until every primary beneficiary is deceased, no secondary beneficiary will take:

No contingent Beneficiary shall receive any benefit under the Plan if the Participant is survived by at least one primary Beneficiary. If one, but fewer than all of the primary Beneficiaries designated by the Participant survive the Participant, the percentage interest that otherwise would have been payable to the primary Beneficiary or Beneficiaries who predeceased the Participant shall be divided among the primary Beneficiaries who survive the Participant in the ratio determined by comparing the percentages specified by the Participant for those beneficiaries and adjusting the percentages accordingly. For example, if the Participant indicated percentages of 20% for Beneficiary A, 30% for Beneficiary B and 50% for Beneficiary C. If Beneficiary C predeceased the Participant, Beneficiaries A and B would share Beneficiary C’s 50% interest in a 2:3 ratio. Beneficiary A’s interest would increase to 40% and Beneficiary B’s interest would increase to 60%. The foregoing ratio principle shall be used to determine each such surviving contingent Beneficiary’s interest if one or more of such contingent Beneficiaries predeceases the Participant. 43

Therefore, to ensure assets pass to the correct beneficiaries in the correct amounts, a review of the applicable Plan Document is warranted.

---

43 https://www.sec.gov/Archives/edgar/data/1517650/000151765012000024/ex10_1-401k.pdf at Section 7.3.
6. **Conclusion.**

Estate planning with retirement benefits can be a complicated undertaking and warrants careful consideration. As more clients with significant retirement assets assess the best way to pass on wealth, including retirement assets, estate planning attorneys will need to be ever-more conscious of the special rules applicable to these assets.
Protecting Attorney-Client Privilege in Estate Planning

Ramzi J. Hynek, Esq.
Rembolt Ludtke LLP
You’ve Been Served: An Estate Planning Attorney’s Ethical Obligations When Responding to a Subpoena

Ramzi Hynek

An Aging Nation
Prevalence of Disability and Older Adults

For the First Time in U.S. History Older Adults Are Projected to Outnumber Children by 2035

Breaking Bad
EPISODE CLIP
Lizzie Borden took an axe,
She gave her mother forty whacks,
After she saw what she had done,
She gave her father forty-one.

You've Been Served: An Estate Planning Attorney's Ethical Obligations When Responding to a Subpoena

Ramzi Hynek
YOU’VE BEEN SERVED: AN ESTATE PLANNING ATTORNEY’S ETHICAL OBLIGATIONS WHEN RESPONDING TO A SUBPOENA

Outline Prepared by Ramzi Hynek, Rembolt Ludtke LLP

A Lawyer’s Duty of Confidentiality

- The Rule:
  - Nebraska Rules of Professional Conduct 1.6. Confidentiality of information. - See Appendix A
  - “A fundamental principle in the lawyer-client relationship is that, in the absence of the client’s informed consent, the lawyer must not reveal information relating to the representation. . . . This contributes to the trust that is the hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. The lawyer needs this information to refrain from wrongful conduct.” Rule 1.6, Comment [2].
  - “The principle of client-lawyer confidentiality is given effect by related bodies of law: the attorney-client privilege, the work product doctrine and the rule of confidentiality established in professional ethics. The attorney-client privilege and work-product doctrine apply in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to produce evidence concerning a client. The rule of client-lawyer confidentiality applies in situations other than those where evidence is sought from the lawyer through compulsion of law. The confidentiality rule, for example, applies not only to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source. A lawyer may not disclose such information except as authorized or required by the Rules of Professional Conduct or other law.” Rule 1.6, Comment [3].

- The Rule’s Application
  - Rule 1.6(b) permits, but does not require, a lawyer to disclose information relating to the representation of a client that a lawyer would otherwise be barred from disclosing under Rule 1.6(a).
  - However, a lawyer must obey a court order, subject to any right to move the court to withdraw or modify the order or to appeal the order. A lawyer facing a court order requiring the disclosure of client confidential information still is faced with complex, critical and fact-intensive questions on how to respond — e.g., what challenges should be considered, what specific information should be disclosed, and what
protective measures should be sought. In making those judgements the lawyer must balance obligations inherent in the lawyer’s dual role as an advocate for the client and an officer of the court. In doing so, the lawyer should disclose client information only to the extent the lawyer reasonably believes necessary to comply with the order. Rule 1.6(b)(4) enables – indeed calls upon- the lawyer to make these delicate judgments. ABA Formal Opinion 473.

Attorney-Client Privilege

• The Rule (of Evidence):
  - Neb. Rev. Stat. § 27-503 - Lawyer-client privilege; definitions; general rule of privilege; who may claim privilege; exception to the privilege. – See Appendix A
  - Similar to the duty of confidentiality found in Rule 1.6, the attorney-client privilege exists to encourage clients to make full disclosure to their attorneys. Unlike the duty of confidentiality, the attorney-client privilege is a rule of evidence and generally applies only in instances of compelled disclosure in the litigation context. The attorney-client privilege also uses a more restrictive definition of confidentiality. Can I Disclose That? Issues of Confidentiality in the Business Planning Context, Michelle M. Harner, 2008.
  - “The [attorney-client] privilege exists only to aid in the administration of justice, and when it is shown that the interests of the administration of justice can only be frustrated by the existence of the privilege, the trial judge may require that the communication be disclosed.” League v. Vanice, 374 N.W.2d 849, 856, 221 Neb. 34, 45 (Neb. 1985).
  - The Rule's Application
    - In Nebraska, pursuant to Neb. Rev. Stat. § 27-503(4)(b), the privilege can be invaded when parties claim from the same deceased testator. The purpose of this statute is to resolve the testator’s intent if such is at issue.
    - Lawyers would be well advised to seek a judicial order rather than otherwise seeking to resolve the issue. Doing so allows a balance to be found between the objecting parties and protecting the lawyer.
    - Who owns the privilege?
      - The privilege belongs to the client, not the attorney. However, the attorney has a professional obligation to advise the client of the existence of the privilege and to raise it on the client’s behalf in certain instances.
    - Does the privilege survive death?
- Who can assert or waive the privilege?
  - Either the client personally or the attorney, as the client’s agent, can assert the privilege.
  - “The privilege may be claimed by the client, his guardian or conservator, the personal representative of a deceased client, or the successor, trustee, or similar representative. . . The person who was the lawyer at the time of the communication may claim the privilege but only on behalf of the client. His authority to do so is presumed in the absence of evidence to the contrary.” Neb. Rev. Stat. § 27-503(3).

- For how long is the privilege waived?
  - Once a waiver of the attorney-client privilege is deemed to have occurred, for whatever reason, the privilege is generally treated as relinquished for all purposes and in all circumstances thereafter.

- Can a waiver of the attorney-client privilege be included in a Last Will and Testament?
  - Yes, below is sample language:
    - “I expressly consent that any attorney or attorneys consulted by me regarding the drafting or the terms of this document may testify as to any communication with me concerning this document or my intent herein, and concerning my affairs, and as to my mental capacity at such times, and as to any and all observations, facts or circumstances connected therewith. It is my intention to, and I hereby waive, any and all rights and objections which might be asserted against the testimony of such attorneys by reason of the provisions of any statute or the decisions of any court relating thereto.”

You’ve Been Served With a Subpoena. Now What?

- Notice to and consultation with client
  - Upon receipt of a demand for a copy of a client’s file, the lawyer must make attempts to notify the client.
  - Reasonable efforts might include:
    - Phone calls
    - Emails
    - Searching for contact information on the internet
    - Letter to the client’s last known address
  - See Rule 1.0 (h) for a definition of “reasonable.”
The attorney should carefully document the attempts made to contact the client.

- If the client is available for consultation:
  - The lawyer must consult the client as to how to respond.
    - This remains true for a current client as well as a former client.
      - Remember, a lawyer owes continuing duties to a former client not to reveal confidences learned in the course of the professional relationship. Rule 1.9(c)(2).
      - Rule 1.4 should guide this consultation. – See Appendix A
      - This consultation might include:
        - A discussion of the protections that Rule 1.6 might provide
        - Whether the attorney-client privilege (or the work product doctrine) might apply
        - A discussion as to the validity of the subpoena.
  - With the client’s consent, the attorney may disclose the information. See Rule 1.6(a).
  - If the client wishes to challenge the subpoena, then the attorney should pursue all reasonable challenges.
    - See discussion below regarding potential protective measures to defend against a subpoena.
  - What if the client and the lawyer disagree about how to respond—either to the initial demand or after disclosure is ordered – what are the lawyer’s obligations?
    - If the client is a current client and the requested work is within the scope of agreed representation, the attorney may seek to withdraw from representation.
    - If the work is outside of the scope of representation for a current client or it relates to a former client and the client desires to hire new counsel, the attorney must take reasonable steps to protect the client’s interests until the client secures new counsel.

- If the client is not available for consultation:
  - If the client is believed to be alive, but is either unable to be located or is incompetent, or if the client is deceased and the request is not in the context of a dispute between two parties who are claiming through the same deceased client:
    - The lawyer “should assert on behalf of the client all non-frivolous claims that . . . the information sought is protected against disclosure by the attorney-client privilege or other applicable law.” ABA Model Rule 1.6, Comment 15.
    - Many other state’s ethical advisory opinions have found that in the absence of informed consent from the client, the lawyer must reveal the information if ordered to do so by a court, but only after the lawyer has raised all non-frivolous objections.
If upon objection the attorney is ordered to produce certain records, then Rule 1.6(b)(4) would permit the lawyer to comply with the order.

If the client is deceased and the request for privileged information is relevant to an issue between parties who claim through the same deceased client:

- It may be still be prudent however, for the lawyer to:
  - Object on the basis of the attorney-client privilege and state that the attorney will disclose the information if there is a judicial determination that all privilege is waived. Likely, the requesting party will file a Motion to Compel asking the court to require the attorney to comply with the subpoena. At the hearing, the attorney may request an order declaring that the attorney-client privilege no longer exists.
  - Obtain a joint stipulation from all interested parties stipulating to the fact that the attorney-client privilege no longer exists.
- If disclosure is to be made, how extensive should it be?
  - The lawyer may produce documents and information “only to the extent the lawyer reasonably believes necessary.” Rule 1.6(b).
    - “Where practicable, the lawyer should first seek to persuade the client to take suitable action to obviate the need for disclosure. In any case, a disclosure adverse to the client’s interest should be no greater than the lawyer reasonably believes necessary to accomplish he purpose.” Rule 1.6, Comment [12].
- What, if any, protective measures might the lawyer seek?
  - “If the disclosure will be made in connection with a judicial proceeding, the disclosure should be made in a manner that limits access to the information to the tribunal or other persons having a need to know it and appropriate protective order or other arrangements should be sought by the lawyer to the fullest extent practicable.” Rule 1.6, Comment [12].
    - The attorney can file a motion for a protective order limiting the recipients of the documents from further distribution or a motion to quash. At the resulting hearing, the lawyer could also offer to submit the information to the court for an in camera inspection.
- After an order is entered requiring disclosure, is an appeal an option? Is it required?
  - If the court rules against all objections and the client is available, the lawyer must consult with the client about the possibility of appeal.
If the court rules against all objections and the client is unavailable, the lawyer is not required to file an appeal.

- “Requiring a lawyer to take an appeal when the client is unavailable places significant and undue burdens on the lawyer. An appeal costs money and takes time away from other clients. Taking an appeal on behalf of an unavailable client forces the lawyer to act without consultation and direction. While such clients need and deserve protection in response to an initial demand – to avoid improper and unjustified access to information and documents that the rules protect even after the client’s death – the balance changes once a court or other tribunal has rules on the lawyer’s initial objection. In the absence of instructions from the client to appeal, the ethics rules do not require a lawyer to shoulder further burdens. Accordingly, a lawyer is not ethically required to take an appeal on behalf of a client whom the lawyer cannot locate after due diligence.” ABA Formal Opinion 473.

- If a lawyer is uncertain about how to maintain compliance with his or her ethical obligations, can he or she seek outside counsel?
  - “A lawyer’s confidentiality obligations do not preclude a lawyer from securing confidential legal advice about the lawyer's personal responsibility to comply with [Nebraska’s Rules of Professional Conduct]. In most situations, disclosing information to secure such advice will be impliedly authorized for the lawyer to carry out the representation. Even when the disclosure is not impliedly authorized [Rule 1.6(b)(2)] permits such disclosures because of the importance of a lawyer’s compliance with the Rules of Professional Conduct.” Rule 1.6, Comment [7].
Appendix A


(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent the client from committing a crime or to prevent reasonably certain death or substantial bodily harm;

(2) to secure legal advice about the lawyer's compliance with these Rules;

(3) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

(4) to comply with other law or a court order.

(c) The relationship between a member of the Nebraska State Bar Association Committee on the Nebraska Lawyers Assistance Program or an employee of the Nebraska Lawyers Assistance Program and a lawyer who seeks or receives assistance through that committee or that program shall be the same as that of lawyer and client for the purposes of the application of Rule 1.6.
(1) As used in this rule:

(a) A client is a person, public officer, or corporation, association, or other organization or entity, either public or private, who is rendered professional legal services by a lawyer, or who consults a lawyer with a view to obtaining professional legal services from him;

(b) A lawyer is a person authorized, or reasonably believed by the client to be authorized, to practice law in any state or nation;

(c) A representative of the lawyer is one employed to assist the lawyer in the rendition of professional legal services; and

(d) A communication is confidential if not intended to be disclosed to third persons other than those to whom disclosure is in furtherance of the rendition of professional legal services to the client or those reasonably necessary for the transmission of the communication.

(2) A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client (a) between himself or his representative and his lawyer or his lawyer's representative, or (b) between his lawyer and the lawyer's representative, or (c) by him or his lawyer to a lawyer representing another in a matter of common interest, or (d) between representatives of the client or between the client and a representative of the client, or (e) between lawyers representing the client.

(3) The privilege may be claimed by the client, his guardian or conservator, the personal representative of a deceased client, or the successor, trustee, or similar representative of a corporation, association or other organization, whether or not in existence. The person who was the lawyer at the time of the communication may claim the privilege but only on behalf of the client. His authority to do so is presumed in the absence of evidence to the contrary.

(4) There is no privilege under this rule:

(a) If the services of the lawyer are sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or reasonably should have known to be a crime or fraud; or
(b) As to a communication relevant to an issue between parties who claim through the same deceased client, regardless of whether the claims are by testate or intestate succession or by inter vivos transaction; or

(c) As to a communication relevant to an issue of breach of duty by the lawyer to his client or by the client to his lawyer; or

(d) As to a communication relevant to an issue concerning an attested document to which the lawyer is an attesting witness; or

(e) As to a communication relevant to a matter of common interest between two or more clients if the communication was made by any of them to a lawyer retained or consulted in common, when offered in an action between any of the clients.
Nebraska Rules of Professional Conduct § 3-501.4. Communications.

(a) A lawyer shall:

(1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;

(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;

(3) keep the client reasonably informed about the status of the matter;

(4) promptly comply with reasonable requests for information; and

(5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.
NEBRASKA ETHICS ADVISORY OPINION FOR LAWYERS

No. 14-02

QUESTIONS PRESENTED

I. What must an attorney do, as a fiduciary to persons entitled to share in the estate of the deceased, to ensure that the cestui que (properly pronounced “ses-tee kay”, but lawyers popularly pronounce it “setty kay”) trust has the information necessary to enable it to protect its interests.

II. Is there an attorney-client privilege owed by the attorney that represented a decedent for estate planning purposes and now represents the personal representative of an estate, which would be violated by making a disclosure to the cestui que trust of the information the attorney believes it must know for the protection of its interests.

FACTS

An attorney began representing a client in October, 1999, for the purpose of making changes to her existing Will and Powers of Attorney. Her existing Will gave her Minnesota house to her living brother and sister, or to the survivor of them, and $1,000.00 to each of her nieces and nephews. The residuary was to pass 10% to her brother and 10% to her sister, with the remaining 80% passing to two named charitable beneficiaries, both of which had a connection with her longtime employer, a University that she was very fond of. She made it very clear that if she were predeceased by either her brother or her sister, the devises to each sibling were to lapse, and she did not intend to alternately benefit her nieces and nephews by a deceased sibling.

In the first Will drafted by this attorney, which was executed in April of 2000, the changes from the previous Will included that his client wanted to provide some income for her brother and sister before everything went to the charities, so she set up a testamentary credit shelter trust for federal estate tax purposes in the 2000 Will. Everything over and above the then applicable $600,000.00 credit shelter amount passed to four different charities, which were all connected to her employer, the University. The $600,000.00 credit shelter amount went into a family trust for the benefit of her brother and sister. The nieces and nephews were devised all of the client’s tangible personal property, to be shared by them, as well as $2,000.00 each. All devises to the nieces and nephews and the devise of the Minnesota home to the brother and sister would lapse, should any of the immediate family members predecease the client. The family trust in
the 2000 Will terminated with the death of the survivor of the brother and sister, and then all trust corpus passed to the four charities named in the Will. Nothing from the family trust was to be distributed to any of the eleven nieces and nephews. At the same time, the client executed new general and medical powers of attorney in favor of her brother and then sister, in that order, and the financial power of attorney was effective upon disability or incapacity.

In early 2005, the client again requested changes to her estate planning, and the major change in her new planning was to delete the credit shelter family trust. The client created and substituted an unfunded charitable remainder unitrust, which was done with the help of the Development and Planned Giving Department at the University, where she had been employed. Her attorney was involved in the process of the creation of her new Will and the charitable remainder unitrust. In August, 2005, the client signed the new Will and the charitable remainder unitrust. Her attorney was present and signed the Will as an attesting witness. He also was present for and witnessed the execution of the CRUT. The 2005 CRUT provided that if on the death of the client, the trustee of the CRUT received more than $100,000.00 from the client’s estate, and/or as the beneficiary of the client’s retirement accounts or qualified plans, the CRUT trust would upon funding be administered for the benefit of the brother and sister. If less than $100,000.00 were received, or both siblings were already dead, the trust would be distributed immediately to the client’s four designated charities, which remained unchanged from the 2000 Will. The brother and sister, or the survivor of them, were required to be paid 5% of the value of the trust assets each year. Upon the death of the surviving sibling, the CRUT would terminate, and all assets of the CRUT would be distributed to the four charities. The 2005 Will eliminated the $2,000.00 bequest to the nieces and nephews, and the tangible personal property was devised to the brother and sister, which were also devised the Minnesota home, or its sale value if sold prior to the client’s death. The entire residuary estate was devised to the trustee of the CRUT.

The revised 2005 Will and CRUT trust were the client’s last documents and comprised her estate plan when she died in August of 2013. The client had specifically asked for extra copies of the Will for her siblings, and the attorney was certain she gave copies of the 2005 Will to her brother and sister.

In September, 2006, the client had the attorney make changes to her Financial Power of Attorney. She changed her agent to her sister-in-law (by her brother), named her brother second, and her sister in Wisconsin was named third. The powers were effective immediately.
Her last Power of Attorney documents were prepared in November, 2009, after the client’s brother died. The attorney received a call from the sister-in-law to inform him that her husband (the client’s brother) had died. New Power of Attorney documents were prepared naming the sister-in-law as agent first, with the sister in Wisconsin as the alternate power of attorney.

Future communication with the client was limited. The attorney’s records reflect that they spoke in July and September, 2010. After the second call, at the client’s request, the attorney spoke to her sister on September 22, 2010, to explain to the sister how the Will and CRUT operated and how the sister was benefitted by the client’s planning. (The brother was already deceased).

In August, 2013, the sister-in-law advised the attorney that the client had passed away. He contacted the sister in Wisconsin, who was the named personal representative, and it was decided that the estate proceedings would be filed in Nebraska. He sent communication to the holder of the client’s retirement accounts, and received information regarding the date of death values. The sister (personal representative) provided him with papers she received from the annuity carrier, to get assistance in filling them out. When he received the claim forms, he saw the sister was the direct beneficiary of the annuity proceeds in the sum of $365,000.00. He was shocked. He had the sister request a copy of the carrier’s beneficiary records. The sister advised him that the beneficiary designation was made to her in 2010. After weeks passed and a couple of requests were made by the attorney, the sister sent a copy of it to the attorney. The beneficiary creation, or change, was signed on June 28, 2010, and was received by the carrier on July 1, 2010. The sister (personal representative) was designated as the primary beneficiary. No secondary or contingent beneficiary was named. The client did not sign the form’s signature page. It was signed by the sister-in-law, on behalf of the client, as the client’s power of attorney agent. The client had never mentioned the change to the attorney, or that she was considering making a beneficiary designation in favor of her sister, any other entity, or that she had made a beneficiary designation. The attorney had spoken with the client on July 13, 2010, within 15 days of the sister-in-law creating or changing the retirement account beneficiary designation in favor of the sister. Had the client discussed a change in designation with the attorney, he indicated he would have sent out a letter to the client pointing out that if she did this it would effectively disinherit the charitable beneficiaries she had always wanted before, for fourteen years, to receive the bulk of her estate.

As of the date of the letter requesting an advisory opinion, the attorney had not advised the CRUT that the sister was the named beneficiary of the retirement accounts or that the bulk of the client’s wealth is in her retirement assets.
The attorney set forth that there was nothing in the current or past Nebraska conservator or trustee power statutes that authorizes a conservator or a trustee to allow the client’s sister-in-law (power of attorney), to create or change a beneficiary designation. This conduct of the sister-in-law is the basis of the attorney’s question regarding what he, as attorney for the personal representative and as a fiduciary, must do or disclose to insure that the CRUT has the information to enable it to protect its own rights.

**APPLICABLE CASE LAW, RULES, AND COMMENTS**

I.

A. The administrator and his attorneys are officers of the court and both are fiduciaries in their relation to the heirs. An administrator is a trustee and property of the estate in his hands is trust property. He is both the personal representative of the deceased person and the trustee for the heirs and creditors. *In Re Rhea’s Estate*, 126 Neb. 571, 253 N.W.2d 876 (1934).

B. In *Johnson v. Richards*, 155 Neb. 552, 52 N.W.2d 737 (1952), appellants, decedent’s only heirs at law, had no knowledge of the date of hearing for the probate of the will of the deceased or of any date fixed for any hearing or proceedings in regard to the estate of the deceased until shortly before the filing of their petition in this case. A letter sent to them by the attorney that prepared the will and had been the attorney for the decedent for many years, was silent as to matters related to hearing dates. Appellants, upon receipt of the letter, mailed the attorney a request for information as to the date of the hearing on the probate of the will. The attorney did not answer the request, but remained silent and gave them no further information. The attorney was the principal beneficiary of the will and was named and designated as the executor. He prepared, executed, and filed the petition for the probate of the will. He knew the date of the hearing to be had thereon, but refrained from informing the appellants of the facts in reference thereto, and did not at any time advise them of the date of the hearing.

In its analysis, the Nebraska Supreme Court recognized that Richard was then executor, the attorney for the estate, and principal legatee and devisee of the deceased. There was a fiduciary relationship between him and the estate of the deceased, her heirs and beneficiaries, and all persons interested therein. The Court set forth that “[t]he personal representative of an estate and his attorney are officers of the court and both are fiduciaries in their relation to persons entitled to share in the estate of the deceased.” (Emphasis added).
The findings of the Court were that "[t]he status of [the attorney] as a trustee required him to make a full disclosure of all facts within his knowledge which were material for appellants to know for the protection of their interest, if they desired to contest the will of the deceased and acted timely after receipt of the information from the trustee.... It is the duty of a trustee to fully inform the cestui que trust of all facts relating to the subject-matter of the trust which come to the knowledge of the trustee and which are material for the cestui que trust to know for the protection of his interests."  *Id*.; *See Rettinger v. Pierpont*, 145 Neb. 161, 15 N.W.2d 393 (1944). The attorney was obligated, when he became the executor and was the attorney for the estate, "to advise appellants, at least, of the fact and the date of the probate of the will of the deceased, the time allowed for and the manner of taking an appeal to the district court from the decree of probate of the county court, that a new and complete trial in reference to the validity of the will of the deceased could be had in the district court, and that he had prepared the will and the facts concerning the making and execution thereof as he claimed them to be. He was also duty bound to correctly give any information he had concerning the will and the estate of the deceased on request of appellants. His default in these respects constituted a breach of his trust and a fraud on appellants."  *Id.*. "Every violation by a trustee of a duty required of it by law, whether willful and fraudulent, or done through negligence, or arising through mere oversight or forgetfulness, is a breach of trust."  *Id.*; *See Rettinger v. Pierpont*, 145 Neb. 161, 15 N.W.2d 393 (1944).

C. In *Nebraska State Bar Association v. Richards*, 165 Neb. 80, 84 N.W.2d 136 (1957), disciplinary proceedings were brought against attorney Richards, in part based upon the circumstances set forth above. The Supreme Court, in the disciplinary proceedings, set forth language from the *Johnson v. Richards* case above, that had application in relation to respondent's duties and responsibilities to the heirs at law of decedent as follows:

It is unnecessary in this case to consider what the duty of Richards was, if any, in reference to appellants before he volunteered to give partial information to them by his letter of October 27, 1950. But when he broke his silence he became obligated to truthfully and completely state the facts within the limits of his information and knowledge in regard to the subjects referred to by his letter and enclosure transmitted with it, and not to withhold or distort anything that would tend to cause appellants to remain inactive.

Though one may be under no duty to speak, if he undertakes to do so, he must tell the truth and not suppress facts within his knowledge or materially qualify them. Fraudulent representations may consist of half-truths.

3038
calculated to deceive, and a representation literally true is fraudulent if used to create an impression substantially false.

*Id.* See *Johnson v. Richards*, 155 Neb. 552, 52 N.W.2d 737 (1952).

The Supreme Court, through the disciplinary proceedings, made the finding that the status of the respondent required him to make a full disclosure of all facts within his knowledge which were material for the appellants to know for the protection of their interests. His failure to do so constituted a breach of his trust as an attorney. "It is apparent he was more concerned in making secure his rights under the will than he was of performing his duty as an attorney." *Id.*

D. In *State v. Douglas*, 217 Neb. 199, 349 N.W.2d 870 (1984), the dissenting opinion set forth various findings regarding fiduciaries and trustees charged with honesty and fidelity in the execution of their duties:

Although the general rule is that one party to a transaction has no duty to disclose material facts to the other, an exception to this rule is made when the parties are in a fiduciary relationship with each other. When a relationship of trust and confidence exists, the fiduciary has the duty to disclose to the beneficiary of that trust all material facts, and failure to do so constitutes fraud." *Midland National Bank, etc. v. Perranoski*, 299 N.W.2d 404, 413 (Minn. 1980); 37 C.J.S. Fraud §16d (1943).

It is the duty of the trustee to fully inform the cestui que a trust [beneficiary] of all facts relating to the subject matter of the trust which come to the knowledge of the trustee and which are material to the cestui que trust to know for the protection of his interests. *Johnson v. Richards*, 155 Neb. 552, 52 N.W.2d 737 (1952).

Where one has a duty to speak but deliberately remains silent, his silence is equivalent to a false representation. One standing in the relationship of a trustee to another owes to that other the duty of making a full disclosure of all matters appertaining to the trust, and neglect to do so, when the trustee knows or has good reason to believe that silence will result, is a fraudulent act. See *Anderson v. Anderson*, 620 S.W.2d 815 (Tex.Civ.App. 1981), *Kauffman v. McLaughlin*, 189 Okl. 194, 114 P.2d 929 (1941).

Suppression of a material fact, which a party is bound in good faith to disclose, is equivalent to a false representation.... Fraud may arise not only from misrepresentation but from concealment as well. For concealment to
constitute fraud, there must be suppression of facts which one party has a legal or equitable obligation to communicate to another. One who stands in a confidential or fiduciary relationship to another party must disclose material facts and must reveal enough information to prevent misleading the other party. See *Krueger v. Saint Joseph’s Hospital*, 305 N.W.2d 18 (N.D. 1981).

E. Rule 1.2(f) of the Nebraska Rules of Professional Conduct sets forth that “[a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

Comment 9 to Rule 1.2 provides that:

When the client’s course of action has already begun and is continuing, the lawyer's responsibility is especially delicate. The lawyer is required to avoid assisting the client, for example, by drafting or delivering documents that the lawyer knows are fraudulent or by suggesting how the wrongdoing might be concealed. A lawyer may not continue assisting a client in conduct that the lawyer originally supposed was legally proper but then discovers is criminal or fraudulent. The lawyer must, therefore, withdraw from the representation of the client in the matter. See Rule 1.16(a). In some cases, withdrawal alone might be insufficient. It may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm any opinion, document, affirmation, or the like. See Rule 4.1.

Comment 10 to Rule 1.2 provides that “[w]here the client is a fiduciary, the lawyer may be charged with special obligations in dealings with a beneficiary.”

F. Rule 1.7 of the Nebraska Rules of Professional Conduct provides that “(a) [e]xcept as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.” (Emphasis added).

Comment 4 to Rule 1.7 states “[i]f a conflict arises after representation has been undertaken, the lawyer ordinarily must withdraw from the representation, unless the lawyer has obtained the informed consent of the client under the conditions of paragraph
(b).” See Rule 1.16. Where more than one client is involved, whether the lawyer may continue to represent any of the clients is determined both by the lawyer’s ability to comply with duties owed to the former client and by the lawyer’s ability to represent adequately the remaining client or clients, given the lawyer’s duties to the former client. See Rule 1.9.

Comment 9 to Rule 1.7 addresses a lawyer’s responsibilities to former clients and other third persons and states “[i]n addition to conflicts with other current clients, a lawyer’s duties of loyalty and independence may be materially limited by responsibilities to former clients under Rule 1.9 or by the lawyer’s responsibilities to other persons, such as fiduciary duties arising from a lawyer’s service as a trustee, executor or corporate director.”

G. Rule 1.9 of the Nebraska Rules of Professional Conduct sets forth that “[a] lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person’s interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.”

Comment 1 to Rule 1.9 provides that “[a]fter termination of a client-lawyer relationship, a lawyer has certain continuing duties with respect to confidentiality and conflicts of interest and thus may not represent another client except in conformity with this Rule.”

II.

Neb. Rev. Stat. §27-503 addresses the lawyer-client privilege and states:

(3) The privilege may be claimed by the client, his guardian or conservator, the personal representative of a deceased client, or the successor, trustee, or similar representative of a corporation, association or other organization, whether or not in existence. The person who was the lawyer at the time of the communication may claim the privilege but only on behalf of the client. His authority to do so is presumed in the absence of evidence to the contrary.

(4) There is no privilege under this rule:

(b) As to a communication relevant to an issue between parties who claim through the same deceased client,
regardless of whether the claims are by testate or intestate succession or by inter vivos transaction; or

(d) As to a communication relevant to an issue concerning an attested document to which the lawyer is an attesting witness...

DISCUSSION AND CONCLUSION

I.

The attorney is in a position, as attorney for the personal representative of the estate, of a fiduciary to persons entitled to share in the estate of the deceased. As such, pursuant to the Supreme Court's findings in the case law set forth above, the Committee believes the attorney is required to make a full disclosure of all facts within his knowledge that are material for the CRUT to protect its interest, including any information that may be or has been requested by the beneficiary. The findings of the Supreme Court that require full disclosure of all facts within the attorney's knowledge that are material for beneficiaries to protect their interests would include, under the current circumstances, the information that the retirement accounts were subject to a beneficiary designation which was changed recently through the utilization of the power of attorney. The CRUT would be entitled to information as well regarding the facts concerning the making and execution of the Will of the decedent. Additionally, the case law further sets forth an obligation to advise the beneficiary of the legal, procedural steps that may be taken with respect to the decedent's Will, Power of Attorney and trust.

The attorney has advised that he is unaware of the sister-in-law's (POA's) position as to how the beneficiary change came about, nor is he aware of the sister's (personal representative's) involvement in the beneficiary change, if any. Depending upon those positions, the Committee believes that the attorney may be in a position if the sister wants to keep the money that he would be required to withdraw from the representation of the personal representative to avoid the potential for furtherance of conduct that the lawyer knows is fraudulent pursuant to Rule 1.2 of the Nebraska Rules of Professional Conduct. Furthermore, the potential for a conflict of interest between the representation of the personal representative and the attorney's former client, the decedent, may prompt the necessity of withdrawal as well pursuant to Rule 1.7 and Rule 1.9 of the Nebraska Rules of Professional Conduct.
II.

*Neb. Rev. Stat.* §27-503 specifically addresses the lawyer-client privilege in the situation at hand where there is communication relevant to an issue between parties who claim through the same deceased client, i.e. the CRUT and the sister, with regard to the beneficiary designation made by the deceased client which was then subsequently changed by the sister-in-law, POA. The statute provides that there would be no lawyer-client privilege.

Furthermore, the findings of the Nebraska Supreme Court set forth above do not appear to consider or have concern regarding any privilege issues when setting forth the requirement of full disclosure by the attorney fiduciary of all facts within his knowledge material for the beneficiary to know for the protection of its interest.

The attorney was also an attesting witness of the relevant documents, and 27-503(d) provides there is no lawyer-client privilege for communication related thereto.

The Committee believes that there would be no lawyer-client privilege prohibiting the attorney from providing the information to the CRUT or from potentially testifying as a material witness.
NEBRASKA ETHICS ADVISORY OPINION FOR LAWYERS

No. 11-05

A LAWYER WHO IS APPOINTED GUARDIAN AD LITEM FOR A MINOR IN A JUVENILE COURT CASE MAY NOT REVEAL INFORMATION RELATING TO HER REPRESENTATION OF THE MINOR TO A LEGISLATIVE COMMITTEE WITHOUT FIRST ASSERTING ALL NONFRIVOLOUS CLAIMS THAT THE INFORMATION REQUESTED IS PROTECTED AGAINST DISCLOSURE BY THE ATTORNEY-CLIENT PRIVILEGE.

QUESTION PRESENTED

WHAT ARE THE ETHICAL OBLIGATIONS OF A GUARDIAN AD LITEM WHO HAS BEEN ASKED TO PROVIDE INFORMATION TO THE NEBRASKA LEGISLATURE THAT SHE OBTAINED DURING THE PENDENCY OF A JUVENILE CASE THAT HAS BEEN CLOSED FOR MORE THAN ONE YEAR?

FACTS

An attorney was appointed by the Juvenile Court to serve as guardian ad litem for an infant in a case involving allegations of child neglect and abuse. The case was ultimately dismissed without trial. More than a year later, the attorney has been asked to provide information to a committee of the Nebraska Legislature that is investigating foster care and child welfare issues. The information sought by the committee was accumulated by the lawyer during her investigation of the case while serving as guardian ad litem. The child has not reached the age of majority.
§ 3-501.9. Duties to former clients.

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:


(2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

§ 3-501.6. Confidentiality of information.

A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:


(4) to comply with other law or a court order.

COMMENT

...[3] The principle of client-lawyer confidentiality is given effect by related bodies of law: the attorney-client privilege, the work product doctrine and the rule of confidentiality established in professional ethics. The attorney-client privilege and work-product doctrine apply in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to produce evidence concerning a client. The rule of client-lawyer confidentiality applies in situations other than those where evidence is sought from the lawyer through compulsion of law. The confidentiality rule, for example, applies not only to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source. A lawyer may not disclose such information except as authorized or required by the Rules of Professional Conduct or other law. See also Scope.
Paragraph (a) prohibits a lawyer from revealing information relating to the representation of a client. This prohibition also applies to disclosures by a lawyer that do not in themselves reveal protected information but could reasonably lead to the discovery of such information by a third person. A lawyer's use of a hypothetical to discuss issues relating to the representation is permissible so long as there is no reasonable likelihood that the listener will be able to ascertain the identity of the client or the situation involved.

... [11] A lawyer may be ordered to reveal information relating to the representation of a client by a court or by another tribunal or governmental entity claiming authority pursuant to other law to compel the disclosure. Absent informed consent of the client to do otherwise, the lawyer should assert on behalf of the client all nonfrivolous claims that the order is not authorized by other law or that the information sought is protected against disclosure by the attorney-client privilege or other applicable law. In the event of an adverse ruling, the lawyer must consult with the client about the possibility of appeal to the extent required by Rule 1.4. Unless review is sought, however, paragraph (b)(4) permits the lawyer to comply with the court's order.

§ 3-501.0. Terminology.

... (m) "Tribunal" denotes a court, an arbitrator in a binding arbitration proceeding or a legislative body, administrative agency or other body acting in an adjudicative capacity. A legislative body, administrative agency or other body acts in an adjudicative capacity when a neutral official, after the presentation of evidence or legal argument by a party or parties, will render a binding legal judgment directly affecting a party's interests in a particular matter.

§ 3-503.4. Fairness to opposing party and counsel.

A lawyer shall not:

... (c) knowingly disobey an obligation under the rules of a tribunal except for an open refusal based on an assertion that no valid obligation exists;

(a) When a client's capacity to make adequately considered decisions in connection with a representation is diminished, whether because of minority, mental impairment or for some other reason, the lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client. ...
(c) Information relating to the representation of a client with diminished capacity is protected by Rule 1.6. When taking protective action pursuant to paragraph (b), the lawyer is impliedly authorized under Rule 1.6(a) to reveal information about the client, but only to the extent reasonably necessary to protect the client's interests.


DISCUSSION

Attorneys appointed to serve as guardians ad litem in Juvenile Court proceedings involving allegations of neglect or abuse of children stand in loco parentis for the child, Neb. Rev. Stat. §43–272.01(2)(a), but they are also typically required to serve as counsel for themselves as well as the child. Neb. Rev. Stat. §43–272(3). Thus, the attorney’s status as guardian ad litem for an infant does not change the fact that she is subject to all of the applicable Rules of Professional Conduct.

The general rule is that an attorney may not disclose information relating to the representation of a former client. §3–501.9(c), Rules of the Nebraska Supreme Court. This rule’s protection of confidentiality incorporates the obligations of §3–501.6. Under that rule, confidentiality applies “not only to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source.” §3–501.6, Comment [3]. The rule prohibits “disclosures by a lawyer that do not in themselves reveal protected information but could reasonably lead to the discovery of such information by a third person.” §3–501.6, Comment [4]. A lawyer’s response to a request to provide information to a committee of the Legislature is therefore constrained by this privilege which applies broadly to all of the information that she gathered during her investigation of the juvenile court proceedings.

There are exceptions to this general rule. §3–501.6(c)(2) refers to other provisions in the rules that would “permit or require” disclosure. The exception that applies to this opinion is found in §3–501.6(b)(4), which allows disclosure if it is done “to comply with other law or court order.” The phrase “other law or court order” includes a Legislative inquiry. Comment [11] states: “A lawyer may be ordered to reveal information relating to the representation of a client by a court or by another tribunal or governmental entity claiming authority pursuant to other law to compel the disclosure.”
A “tribunal” includes a legislative body. §3–501(m). The Legislature’s rules give its committees the power “to require by subpoena or otherwise the attendance of such witnesses...and to take such testimony, as it deems advisable.” Rule 3, Section 1, Rules of the Nebraska Unicameral Legislature, 102 Legislature First Session, Jan. 12, 2011. This is enforced by the Legislature’s power to punish disobedience to its subpoena by contempt proceedings. Neb. Rev. Stat. §50–105. Thus, a committee of the Nebraska Legislature has the authority to compel a lawyer to disclose confidential information. And of course a lawyer is generally obligated to obey a tribunal’s subpoena. §3–503.4(c). These considerations lead to the conclusion that the exception in §3–501.6(b)(4) would apply to these facts, and the lawyer may reveal the confidential information to the legislative body.

However, the exception does not permit a lawyer to voluntarily make such a disclosure. §3–501.6(b) allows information to be revealed “to the extent the lawyer reasonably believes necessary...to comply with other law or a court order.” In other words, a lawyer may not disclose confidential information just because she believes it might be helpful to a Legislative committee’s investigation. Instead, the lawyer may only disclose the information when subpoenaed and compelled under oath to do so. Only then would a lawyer “reasonably believe” that disclosure is necessary, and not merely desirable.

Furthermore, the lawyer must resist a subpoena if there is a meritorious reason to do so. Comment [11] states: “Absent informed consent of the client to do otherwise, the lawyer should assert on behalf of the client all nonfrivolous claims that the order is not authorized by other law or that the information sought is protected against disclosure by the attorney-client privilege or other applicable law.” Other opinions of this committee concerning disclosures in litigated matters are consistent with the view that a lawyer must make reasonable attempts to protect the confidentiality of her client’s information. See Nebraska Ethics Advisory Opinion for Lawyers, Nos. 09–9 and 09–10, each of which ultimately concludes that a lawyer must obey a direct order issued by a court requiring disclosure. The fact that the tribunal seeking disclosure is the Legislature, instead of a court or opposing counsel in a lawsuit, does not alter the
latter's duty.

In the legislative arena, the lawyer's ability to resist a subpoena is limited. This is illustrated in District of Columbia Ethics Opinion No. 288(1999), in which the committee observed that there is no direct appeal from a legislative subpoena. That opinion concluded that a lawyer may disclose the requested information when the committee directly threatens contempt. Comment [11] to §3-501.6 states: "In the event of an adverse ruling, the lawyer must consult with the client about the possibility of appeal to the extent required by Rule 1.4. Unless review is sought, however, paragraph (b)(4) permits the lawyer to comply with the court's order." By the same reasoning, a lawyer is not obligated to endure a prosecution for contempt of the Legislature by refusing a direct demand to supply the requested information when it is enforced by the subpoena power.

CONCLUSION

Since the former client is a minor, she is not capable of giving informed consent to any disclosure. §3–501.14. The lawyer is therefore obligated to resist disclosure of confidential information to the Legislative committee by all nonfrivolous means until she concludes that disclosure is necessary in order to obey the direct requirements of a subpoena issued under penalty of contempt.
CI-925

April 27, 1983

SYLLABUS

A lawyer who is served with a summons from the IRS seeking the production of what may be confidential information has the ethical obligation to assert the attorney-client privilege wherever it may be relevant and to seek a judicial determination as to what, if any, information should be disclosed.

TEXT

A lawyer has been served with a summons by the IRS requiring that the lawyer appear before an IRS agent to give testimony and to bring any and all records pertaining to certain real estate transactions conducted on behalf of a particular client. While perfectly willing to cooperate with the IRS, the lawyer is concerned about a violation of the attorney-client privilege.

DR 4-101 provides that except in certain circumstances, a lawyer may not reveal confidences or secrets of a client "gained in a professional relationship that the client has requested be held inviolate or that the disclosure of which would be embarrassing or would be likely to be detrimental to the client." DR 4-101(C) provides that a lawyer may reveal:

"Confidences or secrets when permitted under Disciplinary Rules or required by law or court order."

Section 7602 of the Internal Revenue Code provides that the IRS is authorized to summon any person it may deem proper to appear before an agent of the service "to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry." Further, §7609 of the Code provides that a lawyer is a "third party record keeper" who, on receipt of a summons, "shall proceed to assemble the records requested, . . . and shall be prepared to produce the records pursuant to the summons on the day on which the records are to be examined." Internal Revenue Code §7609(I)(1). The Code does provide some protection for a third party record keeper who makes disclosure in §7609(I)(3) which provides that a third party record keeper making a disclosure of records in good faith reliance on an order of the court, shall not be liable to the customer/client for such disclosure.

In light of the provisions quoted above, the Committee would make the following suggestions regarding the problem proposed. The specific items named in the summons include a number of agreements, contracts, deeds, and applications for a mortgage and loan. Next, the IRS has asked for any and all records pertaining to the real estate transactions which culminated in those formal documents. Third, the IRS has asked for testimony as to those records at the hearing.

In Formal Opinion 172, the Committee was asked to examine a lawyer's obligation to produce documentation and to testify as to the lawyer's preparation of the client's income tax returns for particular years. In that opinion the Committee opined:

https://www.michbar.org/opinions/ethics/numbered_opinions/OpinionID=629

7/1/2019
"Upon being served with such a subpoena, it is the duty of a lawyer, after notifying or making a bona fide effort to notify the client, to appear before the agent, to respectfully assert the attorney client privilege, and to require a judicial ruling as to whether the privilege applies. A stated in Schwimmer v. United States (C.A. 8, 1956), 232 F2d 855, at 863:

The attorney has the duty, upon any attempt to require him to testify or produce documents within the confidence, to make assertion of the privilege, not merely for the benefit of the client, but also as a matter of professional responsibility in preventing the law from being violated.' From this point on, the lawyer will satisfy all ethical requirements if he conforms to the final rulings and judgment of the court. We emphasize the term 'final'; in some cases, the ruling of a district or other trial judge may not satisfy either the conscience of the testifying lawyer or the interest of the client concerning whose matters the lawyer may be directed to give testimony. In such a case, it may be incumbent upon the lawyer who is so directed to testify, to test the question by way of appeal as 'a matter of professional responsibility in preventing the law from being violated.' (See Schwimmer above)." (original emphasis) See also, Ci-389.

In Formal Opinion 172, this Committee also examined the specific types of information which have been provided. With respect to the client's original books of account, bills, receipts, cancelled checks, etc. which the client had provided to the lawyer for purposes of dealing with the case, the Committee opined that the court would order the lawyer to produce them. "Evidentiary papers do not become privileged by being put in the hands of counsel. Grant v. United States, 227 US 74, 57 LED 423." The Committee noted, however, that if the information sought by the IRS included letters from the client or memoranda drafted by the lawyer during the course of representation, then the papers would be privileged and should not be provided. Further, the Committee noted "the general rule that the privilege extends to information acquired from any source by the lawyer in the course of research and professional investigations, as distinguished from information coming to the lawyer incidentally and casually." It was emphasized that the court would need to be provided with specific information on which it could rule on this question.

With respect to the final formal documents drafted, including contracts, deeds and mortgage and loan applications, it is unlikely that any privilege would apply. By filing these items with the appropriate parties, any privilege as to information contained in them would have been effectively waived by the client. The materials used to generate those documents may, however, be privileged, as discussed.

Finally, there is the question of testimony regarding your dealing with your client. In Formal Opinion 172, the Committee opined:

"The proposed final question 'Was the finished return discussed with the taxpayer?' seems to require a disclosure as to what was said in the course of a professional consultation and it would seem that the court should hold it to be an improper question."

Should you be asked to discuss your consultations with your client with respect to the documents that have been summoned, the court should rule that that would be an improper intrusion into confidential communications.
In conclusion, the lawyer should appear before the IRS agent at the appointed time and present any materials as to which no claim of privilege may be asserted. This should be determined based on applicable law. As to any materials that the lawyer is unsure of, and testimony regarding dealings with the client, the attorney-client privilege should be asserted and then promptly seek a judicial determination as to the applicability of the privilege. This course of action is best suited to protect both the lawyer and the client's interests.
ALASKA BAR ASSOCIATION
ETHICS OPINION NO. 96-3

Disclosure Of Client Files

The Committee has been asked to define the extent of an attorney's duty to disclose client files pursuant to a subpoena in circumstances where the client has specifically declined the release of those materials, or where it is not possible to obtain the client's consent.

It is the Committee's view that an attorney may, in response to a valid subpoena, disclose non-privileged material without the client's consent. However, care should be taken to remove and/or redact confidential and privileged material or communications. This information should not be disclosed absent a specific court order.

ANALYSIS

Rule 1.6 of the Alaska Rules of Professional Conduct states:

(a) a lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation . . .

By design, Rule 1.6 imposes a duty on the lawyer which is much broader than the traditional attorney-client privilege. The broader obligation is derived from agency law governing obligations arising from fiduciary relationships. See Restatement (Second) of Agency § 396 (1957). It is also reflected in other aspects of the Model Code. See e.g., Rule 1.8(b).

The Comment to Rule 1.6 states, in part:

The attorney-client privilege applies in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to produce evidence concerning a client. The rule of client-lawyer confidentiality applies in situations other than those where evidence is sought from the lawyer through compulsion of law. The confidentiality rule applies not merely to matters communicated in confidence by the
client but also to all information relating to the representation, whatever its source. A lawyer may not disclose such information except as authorized or required by the rules of professional conduct or other law.

(Emphasis added).

This important distinction has been recognized by the Alaska courts. In Downie v. Super. Ct., 888 P.2d 1306 (Alaska Ct. App. 1995), a public defender refused to testify whether she had informed her client of a trial date on the basis that it would violate the attorney-client privilege. Downie conceded that the law was uniformly to the effect that the attorney-client privilege does not bar an attorney from testifying as to whether he or she informed a client of a court date, but she nonetheless contended that the scope of the attorney-client privilege must be re-evaluated in light of the adoption of the Alaska Rules of Professional Conduct and, in particular, Rule 1.6. The court of appeals rejected this interpretation. Because Downie was testifying pursuant to a grand jury subpoena, this was not a situation where the client-lawyer confidentiality contemplated by Rule 1.6 applied; i.e. it was a situation "where evidence is sought from the lawyer through compulsion of law." Accordingly, "in the final analysis . . . the lawyer's obligation to testify is governed by the attorney-client privilege as defined in that jurisdiction's law of evidence." Id. at pg. 1309.

Likewise, in the hypothetical presented to the committee, the attorney's files relating to his former representation have been subpoenaed.

DISCUSSION

In reaching its opinion in this case, the Committee believes it is important to emphasize several points:

1. This opinion does not address the situation of whether an attorney might be required to voluntarily disclose information if "necessary to avoid assisting a criminal or fraudulent act by the client." See Rule 3.3(a)(2). This is a far different scenario than that presented to the Committee, and no opinion is offered on the scope of an attorney's obligations in those circumstances, which may be problematic.

2. Nothing in this opinion should be construed as excusing an obligation on the part of the attorney to seek the client's consent to disclosure whenever that avenue is available. In the question presented to the
Committee, we have been asked to assume that consent was either declined or was impossible to obtain.

3. This opinion only deals with information and/or material which was not disclosed with the client's implied authorization during the attorney's representation of the client. For instance, in a matter in litigation, the Committee believes that pleadings filed in court or with an administrative body including, for instance, affidavits signed by the client, would be materials which the client "impliedly authorized" for disclosure. Once that material enters the public domain, we see no reason why it would be necessary for an attorney to obtain the client's consent to provide copies of those materials upon request to a third-party.¹

From the premises, the Committee believes an attorney is ethically obliged to follow these steps in responding to a request for client files:

A. If there is an informal request for information relating to representation of a client, the attorney may only reveal that information or materials, if any, which the client "impliedly authorized" the attorney to disclose "in order to carry out the representation ...".²

B. With respect to all other materials or information, the lawyer must try to obtain the client's consent. If that consent is not forthcoming, the attorney may not honor the informal request.

¹ This approach is consistent with an opinion already adopted by the Board of Governors which discusses the propriety of "shop talk" and providing courtesy copies of pleadings to other lawyers. See Alaska Bar Association Ethics Opinions 95-1.

² In the Committee's view, a practitioner would be well advised to nonetheless inform the client of the request as a courtesy, if nothing else. The Committee notes that in the Comment to Rule 1.6, the following are offered as examples of disclosures "impliedly authorized" by the client: "In litigation, for example, a lawyer may disclose information by admitting a fact that cannot properly be disputed, or in negotiation by making a disclosure that facilitates a satisfactory conclusion."

The Committee believes the former situation may be different from the latter. The client who authorizes a concession during a negotiation with a private party may have a reasonable expectation that the disclosure will not go beyond the parameters of that private dispute. On the other hand, a pleading filed in state court or with an administrative body, unless filed and/or maintained under seal, would not support a similar expectation. If there are doubts, the Committee believes the attorney should err on the side of non-disclosure.
C. If the attorney receives a validly issued subpoena, he is authorized under Rule 1.6 to disclose all non-privileged information and/or materials, but the attorney should take care to redact and/or remove privileged information and/or communications.

D. With respect to attorney-client materials and/or communications, that information should never be disclosed absent a specific court order.3

In summary, an attorney has a broad duty to prevent the disclosure of all information relating to representation of a client except those disclosures “impliedly authorized” by the client in order to carry out the representation. With respect to other information and materials in the attorney’s possession, non-privileged information and/or materials may be produced in response to a validly issued subpoena; materials and/or information otherwise within the scope of the attorney-client privilege should not be disclosed under any circumstances without the client’s consent unless there is a specific court order compelling the disclosure.

Approved by the Alaska Bar Association Ethics Committee on March 6, 1996.

Adopted by the Board of Governors on March 22, 1996.

---

3 Alaska R. Civ. P. 45 authorizes issuance of a subpoena duces tecum by the clerk of court. Technically, non-compliance with a subpoena is deemed a contempt of the court from which the subpoena issued. The Committee is uncomfortable in allowing attorneys to disclose confidential and privileged communications pursuant to a subpoena. We believe a lawyer has the duty to protect those materials and/or information at all time, unless consent is provided by the client. Absent that consent, an attorney should not disclose that information unless a judge has had an opportunity to evaluate the merits, and otherwise ordered the disclosure.
Ethics Opinion 14

EC 2-31, EC 2-32, DR 2-110(H)(2); Canon 4, EC 4-1, EC 4-4, EC 4-5, DR 4-101; EC 5-12, EC 5-15, EC 5-17, EC 5-18; EC 7-2—Duty Attorney Owes to Former Client Whom Attorney Represented in Connection With Civil Investigation by Government Regulatory Agency—Attorney’s File on Former Client Subpoenaed by Grand Jury

We have been asked several questions concerning, in general, the duties an attorney owes a former client whom the attorney represented individually in connection with a civil investigation by a government regulatory agency when the attorney’s files relating to the former client are subpoenaed by a grand jury. The former client was represented jointly with a corporate client that subsequently waived its attorney-client privileges. More specifically, we have been asked the following:

1. Whether and when an attorney who is served with a grand jury subpoena duces tecum to produce documents relating in whole or in part, or possibly relating in whole or in part, to a former client is required to notify that former client of the receipt of the subpoena.

2. Whether the attorney is required to provide the former client’s successor attorneys with a copy of the subpoena in question and whether he is required to do so when the attorney believes that only portions of the subpoena call for documents relating solely to his representation of the former client and that other portions of the subpoena relate either to his representation of the former client jointly with other clients, or relate solely to other, unrelated clients.

3. Whether the attorney should, prior to production of the documents in compliance with the subpoena, provide the former client’s successor attorneys with access to, or copies of, the documents under subpoena that relate either solely to the former client or jointly to the former client and other clients so that the successor attorneys can present to the court claims of privilege or other objections prior to production, or whether the attorney, as the recipient of the subpoena, is the only one entitled to determine, prior to production, which documents are privileged or arguably so.

4. Whether the attorney may assert a work-product privilege against his former client as to internal attorney work-product documents in his files relating either solely to the client or jointly to him and other clients produced during the lawyer-client relationship, particularly when such documents are requested by the former client to assist him in preparing for a grand jury investigation or other legal proceeding, or whether the attorney may do as he wishes with such documents. Also, we are asked whether the attorney has a duty to assert a work-product privilege on behalf of his former client when work-product documents relating to representation of him are subpoenaed, and whether the attorney may assert the privilege against his client as to those documents he does in fact disclose to third parties or proposes to disclose.

We note at the outset of this opinion that in one case that has come to our attention a trial court in another jurisdiction ruled upon the professional responsibilities of members of the D.C. Bar in circumstances similar to those presented in the questions posed to us. This trial court opinion diverges from ours in some respects. The existence of this out-of-state opinion, far from foreclosing us from setting forth in this opinion guidelines for the future conduct of members of the D.C. Bar, emphasizes the desirability of our doing so. The questions presented are important and
are not squarely answered by the terms of the Code of Professional Responsibility. In issuing the opinion, we do not mean to pass judgment on any actions inconsistent with this opinion that may have been taken by members of the bar before this opinion was published.

Section I

The Code of Professional Responsibility emphasizes that a lawyer should preserve the confidences and secrets of his clients. Canon 4; EC 4-1; DR 4-101; and that he should "not use information acquired in the course of representation to the disadvantage of the client," EC 4-5; DR 4-101(B)(2). Not only must the attorney preserve those client's "confidences" that are protected by the attorney-client privilege (which relates to communications from the client to the attorney) but also "secrets," which the Code says include "information gained in the professional relationship...the disclosure of which would be embarrassing or would be likely to be detrimental to the client." DR 4-101(A). Moreover, this ethical obligation to guard the confidences and secrets of a client, unlike the evidentiary attorney-client privilege, "exists without regard to the nature or source of information or the fact that others share the knowledge." EC 4-4.

EC 4-6 provides that "the obligation of a lawyer to preserve the confidences and secrets of his client continues after the termination of his employment." A lawyer's continuing obligation to a client whose representation he once undertook is underscored by those provisions of the Code that deal with the necessity of taking steps to avoid prejudicing a client as a result of termination of the representation. EC 2-31 provides generally that lawyers who undertake representation should complete the work involved and, more specifically, trial counsel for a convicted defendant should represent him through the appeal (unless new counsel is substituted). EC 2-32 provides further than when an attorney declines to proceed with a case on appeal he should endeavor "to minimize the possible adverse effect on the rights of his client," and DR 2-110(H)(2) provides: "In any event, a lawyer shall not withdraw from employment until he has taken reasonable steps to avoid foreseeable prejudice to the rights of his client. . . ."

EC 2-32 provides specifically that an attorney not continuing a client's representation should, inter alia, deliver to the client all papers and property to which the client is entitled, cooperate with counsel subsequently employed and otherwise attempt to minimize the possibility of harm. See also ABA Informal Opinion No. 724, Dec. 27, 1963.

A lawyer is excused from his ethical duty to preserve a client or former client's confidences and secrets when he is required to disclose them by law or court order. DR 4-101(C)(2). The question before us is how the attorney discharges his ethical responsibilities when documents come into his possession or are obtained or produced by the attorney during the course of his representation of a client and those documents are subsequently subpoenaed by a grand jury.

It is our opinion that, when documents are subpoenaed or an effort is otherwise made to compel their disclosure, it is the lawyer's ethical duty to a former client to assert on the former client's behalf every objection or claim of privilege available to him when to fail to do so might be prejudicial to the client. This rule is settled in the case of an existing attorney-client relationship. See Schwimmer v. United States, 232 F.2d 855, 863 (6th Cir.), cert. denied, 352 U.S. 833 (1956), for a statement of an attorney's duty to assert any applicable attorney-client privilege. Accord EC 4-4, which provides: "A lawyer owes an obligation to advise the client of the attorney-client privilege and timely to assert the privilege unless it is waived by the client." For reasons stated above, the rule should not be different in the case of an attorney-client relationship that has terminated.

We think, then, in answer to the first question posed, that in order to "minimize the possibility of harm" to a former client, EC 2-32, an attorney should promptly notify his former client when he receives a subpoena asking for documents that came into his possession during the course of the
representation of that former client or documents that affect or may affect that former client, irrespective of whether the attorney knows at the time of the receipt of the subpoena that he still has in his possession any specific documents arising during the attorney-client relationship. If there is any possibility whatever that the attorney has in his possession any subpoenaed document affecting the interest of his former client, which came into his possession from any source whatever during the course of that representation, he should immediately, upon receipt of the subpoena, notify the former client.

Section II

Our answer to the second question is that the lawyer need not provide the former client's successor attorneys with a copy of the subpoena but, if the lawyer believes that the disclosure of extraneous portions of the subpoena would risk prejudice to other clients, only with a copy of those portions of the subpoena that the lawyer believes relate to the former representation. In fulfillment of his obligation to his former client the lawyer is not obliged to risk unwarranted disclosures of confidences or secrets of other clients and indeed is ethically forbidden to do so.

Section III

Our answer to the third question is that the lawyer should provide to the former client or to the attorneys now representing the former client copies of or access to all documents called for by the subpoena that relate either solely to the former client or jointly to the former client and other clients so that the successor attorneys can determine or assist in determining as to which document claims of privilege should be made.

The attorney should zealously guard against the erroneous release, by production in court in response to the subpoena, of any documents that represent confidences or secrets obtained by the attorney in the course of his representation of the former client.

The attorney should resolve any disagreements with his former client as to the validity of any claims of privilege in favor of the client or should let the former client have an opportunity prior to production to assert any objection or claim of privilege that he, or successor attorneys acting on his behalf, think applicable. As a practical matter, this means that the attorney should provide the client, or his successor attorneys, prior to production, with access to or copies of the documents at issue so that they can properly frame and present to the court their objections or claims of privilege.

EC 5-12 is apposite here. That provision requires that, when co-counsel are unable to agree on a matter vital to the representation of their client, "their disagreement be submitted by them jointly to their client for his resolution, and the decision of the client shall control the action to be taken." We believe that this precept applies also to those situations involving a client's present and former counsel.

We recognize, as does the Code of Professional Responsibility, that lawyers may disagree on a matter vital to the representation of their client. We also note that "The bounds of the law in a given case are often difficult to ascertain." EC 7-2. In particular, attorneys can honestly differ among themselves over such issues as whether a grand jury subpoena is valid, or whether it calls for a particular document in question, whether a particular document is a privileged communication between the attorney and the client, or is otherwise privileged, or whether a particular document belongs to the client and contains self-incriminatory information that would form the basis for a claim of Fifth Amendment privilege.
Thus, where there are disagreements between present and former counsel as to the existence of any objections or privileges, with respect to subpoenaed documents that came into the possession of the former counsel from any source during the course of representing the client, the client should determine which attorney—his former attorney or his present attorney or both—should review the subpoena and documents at issue and present objections to the court, together with the documents in camera if requested by the court, prior to their production in compliance with the subpoena. The attorney should not disclose any document as to which the client, or his successor attorneys acting on his behalf, assert an objection or privilege but as to which he believes the objection invalid or the privilege unavailable. Rather, the attorney should first present the document to the court and inform the court of the disagreement. At the same time, the client or his new attorneys can also present to the court their arguments for nondisclosure. Having thus satisfied his ethical duties towards his former client, the attorney is then free to comply with whatever directive the trial court gives.1

Section IV

We turn now to the questions relating to documents in the attorney's files considered by the attorney or his former client to be the attorney's work product produced by him for the purpose of representing the client. Such work product may well be considered the property of the attorney, but we need not concern ourselves here with that issue. We believe that the attorney's ethical duty to preserve his client's confidences and secrets discussed above extends also to the attorney's work product produced during the course of the representation.2 Certainly, if the attorney, for any reason, has breached this responsibility and made such work product available to third parties, under no circumstances should he refuse to make it available also to the former client for whose benefit, or at least joint benefit, it was produced. Moreover, we believe that there is no requirement in law or in ethics that an attorney not disclose such work product to his former client in any event. Indeed, under his general duty to cooperate with a former client's new counsel discussed above, and to do all that he can to minimize the possibility of harm arising as the result of his withdrawal from representation of that client in succeeding or related litigation, we think that he should turn over to his former client, or the client's successor attorneys, that portion of his work product which is necessary to the adequate representation of the client.

As with any privilege existing either wholly or partially for the benefit of clients, it is our opinion that an attorney has an ethical duty to assert the work-product privilege whenever applicable when documents in the attorney's files are subpoenaed. Even though the attorney work-product privilege is technically considered the attorney's to assert in a court rather than the client's, the underlying purpose of the privilege is, at least partially, to protect and further the effective representation of clients. See Hickman v. Taylor, 329 U.S. 495, 514--15 (1947) (Jackson, J., concurring). Therefore, the attorney should not divulge such work product when to do so would work to the disadvantage of a client.

None of our answers is affected by the fact that the representation of the client in question was a joint representation, along with a corporate client that subsequently waived its attorney-client privilege. That waiver frees the lawyer to produce documents that relate solely to the corporate client so far as any claims to confidentiality by it are concerned, but it does not free him to disclose documents that relate in any way to the former individual client. In this regard, note that, when an attorney undertakes to represent a corporate officer in his individual capacity and also to represent

https://www.dcbar.org/bar-resources/legal-ethics/opinions/opinion014.cfm 7/1/2019
the corporation, documents obtained or produced during such joint representation frequently, if not invariably, intertwine the interests of the joint clients. Such joint representation is fraught with potential conflict and a lawyer should represent a corporate official in his individual capacity and also represent the corporation only if the lawyer is convinced that differing interests, or potentially differing interests, are not presented. EC 5-15; EC 5-17; and EC 5-18.

1. In the case of an existing attorney-client relationship, if an attorney disagrees with an existing client as to the validity of a particular objection or privilege, or whether failure to assert it entails potential prejudicial harm to the client, he should not prejudice his client or render the issue moot by himself producing the documents called for but rather should, prior to production, present the impasse to the appropriate court for adjudication, and give his client an opportunity to present his claims to that court also. See EC 7-7. By first allowing the client to assert whatever arguments against disclosure he thinks appropriate, the attorney best discharges his ethical duties to the client. The public interest is also protected since the court can review the documents at issue in camera and decide the validity of any claimed objections or privileges. (Of course the attorney may not suppress the fact that such documents are in his possession. EC 7-27.)

2. In this connection, see EC 4-6, providing that, when an attorney retires from practice, his work product should either be destroyed or delivered to another attorney and that the client's option as to method of disposition should be a dominant consideration.

January 1976
Pennsylvania Bar Association
Legal Ethics and Professional Responsibility Committee
FORMAL OPINION 2002-106
ORDER BY ARBITRATION PANEL OR OTHER TRIBUNAL
TO DISCLOSE CONFIDENTIAL CLIENT INFORMATION

The Pennsylvania Bar Association Legal Ethics and Professional Responsibility Committee has been requested to address the ethical obligations of a lawyer who is ordered to disclose confidential client information during an arbitration proceeding. The inquiry arose from the following facts:

Law Firm A and certain of its current shareholders are in a dispute with Lawyer B. Lawyer B was an employee and shareholder of Firm A. There is apparently some dispute as to whether Lawyer B's shareholder status was ever terminated and, if so, when. This Opinion assumes that Lawyer B is no longer a shareholder of Firm B. However, even if Lawyer B were a current shareholder, that would not alter the ultimate conclusion regarding the specific issues addressed in this Opinion, although it could create ethical issues for Lawyer B, Lawyer B's current firm, and Firm A, which are beyond the scope of this Opinion. Concurrent associations with two law firms could also give rise to issues regarding the lawyer's fulfillment of fiduciary obligations to the firms (see, generally, Philadelphia Bar Association Ethics Opinion 2001-5) and their respective clients, but that, too, is beyond the scope of this Opinion.

The parties agreed to submit their dispute to arbitration. The arbitration panel has directed Firm A to disclose certain information to lawyer B, which Firm A contends would include client confidences. Therefore, the issues are whether Firm A's disclosure of this allegedly confidential information to lawyer B in compliance with the order of the arbitration panel would be in violation of any Rules of Professional Conduct, and what additional ethical obligations arise from the disclosure order.

The lawyer's confidentiality obligation is set forth at RPC 1.6(a), which states that "a lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraphs (b) and (c)." The referenced exceptions to the lawyer's confidentiality obligation are not applicable here. RPC 1.6, which was modeled after the 1983 version of ABA Model Rule 1.6, contains no explicit provision authorizing disclosure of client confidences to comply with an order from a court, arbitration panel, or other legal authority. The current version of ABA Model Rule 1.6(b)(4), adopted in 2002, does contain an explicit exception authorizing disclosure of information relating to the representation of a client to the extent that a lawyer reasonably believes necessary to comply with a court order, or other law. (The PBA has endorsed this amendment to the Rule.)

Even in the absence of an explicit exception to RPC 1.6 authorizing disclosure of confidential information to comply with a court order or other law, the Comment to RPC 1.6
recognizes the existence of an additional, implicit exception to the lawyer’s general obligation to maintain client confidences: “The lawyer must comply with the final orders of a court or other tribunal of competent jurisdiction requiring the lawyer to give information about the client.” The quoted language from the Comment to RPC 1.6 is, again, identical to the language used in the Comment to the 1983 version of ABA Model Rule 1.6. Commentators have universally acknowledged that it would be impossible to require lawyers to defy court orders directing disclosure of privileged or confidential information. Hazard and Hodes, The Law of Lawyering, Section 9.24 (noting that an exception to the general confidentiality obligation for compliance with “other law,” including court orders “will be read back into Rule 1.6, one way or another, by courts, disciplinary authorities, and practicing lawyers”). “It is inconceivable that a legal system that has just ordered a lawyer to testify – after the expenditure of considerable judicial resources – would suddenly contradict itself and require instead that she refuse. The court order creates a ‘forced’ exception to confidentiality regardless of what the text of the rule provides” Id. at Section 9.25; accord ABA/BNA Lawyer’s Manual of Professional Practice, Section 55:1201; Pennsylvania Ethics Handbook, Section 3.6(f); Restatement of the Law Governing Lawyers (hereafter “Restatement”), Section 63.

The obligation to comply with the court orders to disclose privileged or confidential information applies even if the lawyer believes the order is “wrong.” cf. Balter v. Regan, 63 N.Y.2d 630, 468 N.E.2d 688, 479 N.Y.S.2d 506, cert. denied, 469 U.S. 934 (1984) (lawyer who defied court order based upon a good faith belief that the order raised a conflict of interest was nevertheless subject to conviction for criminal contempt because “however misguided and erroneous the court’s order may have been, petitioner was not free to disregard it and decide for himself the manner in which to proceed”).

In this case, the order in question was not issued by a judge, but rather by an arbitration panel. At first blush, this would seem to be a potentially meaningful difference. The court has plenary jurisdiction, including power to enforce its orders with contempt citations and other punitive sanctions, over all who appear or are summoned before it. On the other hand, except in the context of a court-annexed arbitration program, an arbitrator or arbitration panel’s authority is derived from the private, contractual agreement of the parties who have agreed to submit their dispute to arbitration. The clients of Firm A whose confidentiality interests are allegedly implicated by the disclosure order are not parties to the arbitration agreement between Firm A and Lawyer B. Unlike Firm A and Lawyer B, Firm A’s clients have not agreed to submit to the authority of the arbitration panel. This raises the question whether the confidentiality rights of non-parties should properly be subverted (assuming that would be the effect of compliance with the panel’s order), by virtue of the directive of an arbitration panel when the non-parties themselves have not submitted to the authority of the panel. Of course, the same concerns would apply if this dispute were pending in court rather than in a private arbitration proceeding, and the court ordered one of the lawyer litigants to disclose confidential information relating to a non-party client.

There is a strong public policy favoring arbitration and other forms of alternative dispute resolution. This policy recognizes that arbitration and other forms of ADR are generally faster and less expensive than litigation in court and that, by relieving some of the burden on the
limited resources of the judicial system, arbitration and other forms of ADR also assist in the speedy resolution of cases which remain in the judicial system. In many respects, private arbitration can be regarded as providing ancillary support to the judicial system. In the Pennsylvania Uniform Arbitration Act, 42 Pa. C.S.A. §§7301-7320, the legislature has affirmed the policy favoring arbitration in this Commonwealth by endowing arbitrators in proceedings subject to the Act with certain powers and authority comparable to that of a judicial officer, including the power to issue subpoenas. Thus, the legislature has explicitly authorized arbitration tribunals to compel non-parties to divulge evidence.

Of course, the order at issue here is directed to one of the parties to the proceedings, as opposed to a subpoena directed to a non-party witness. However, the provisions of the Pennsylvania Uniform Arbitration Act authorizing arbitrators to issue subpoenas is germane to the issue at hand because it illustrates that the policy favoring arbitration is strong and broad enough to authorize arbitrators to take actions which implicate the rights and interest of non-parties to the proceedings. As noted previously, the Comment to RPC 1.6 states that a lawyer “must comply with the final orders of a court or other tribunal of competent jurisdiction” requiring the lawyer to give information about a client. This strongly suggests that a lawyer can be required to divulge confidential information by a non-judicial “tribunal,” such as an arbitration panel acting pursuant to the statutory authority of the Pennsylvania Uniform Arbitration Act.\(^1\)

Finally, a conclusion that lawyers were ethically obligated to disobey orders from arbitration panels requiring disclosure of ostensibly confidential information would wreak havoc on the arbitration process, and undermine the role arbitration plays as an aid to the orderly administration of justice. If RPC 1.6 required a lawyer to defy an arbitrator’s order to disclose allegedly confidential information, the ultimate result could very well be an adverse ruling for that lawyer, or his or her client in the arbitration proceeding, with typically limited rights to appeal or seek judicial review. Such an adverse outcome, if attributable to the defiance of the arbitration panel’s disclosure order rather than to the underlying merit of the parties’ claims and defenses, would be inconsistent with the goals and purposes of arbitration, and could discourage litigants from choosing to resolve their disputes through arbitration rather than through the judicial system. In this case, the parties to the arbitration happen to be lawyers and law firms. However, parties to an arbitration, whether or not they happen to lawyers, could have their rights to a decision on the merits subverted if a lawyer – whether as advocate or litigant – was forced to ignore an arbitrator’s order to disclose information the lawyer considered to be confidential.

These considerations lead to the conclusion that a lawyer is not ethically obligated to disobey an arbitration panel’s order to disclose ostensibly confidential client information. However, pursuant to RPC 1.4, a lawyer who is subject to such an order must promptly advise

\(^1\) In the 2002 revisions to the ABA Model Rules of Professional Conduct, the definition of the term “tribunal” was modified to make clear that it includes arbitration panels. See ABA Model Rule 1.0(m)(“Tribunal’ denotes a court, an arbitrator in a binding arbitration proceeding. . . .”).
any clients whose confidences may be required to be disclosed, particularly if those clients are not themselves parties to the arbitration proceedings, so that the potentially affected clients may, if they choose to do so, independently pursue any remedies, judicial or otherwise, that may be available to them to prevent disclosure of the confidential information. cf. Restatement Section 63, comment b ("the lawyer should inform the client of an attempt to obtain the client's confidential information if it poses a significant risk to the material interests of the client and when circumstances reasonably permit opportunity to inform the client").

Section 63 of the Restatement also states that disclosure of confidential information should only be made "after the lawyer takes reasonably appropriate steps to assert that the information is privileged or otherwise protected against disclosure." This is also suggested by the reference in the Comment to RPC 1.6 quoted above regarding disclosure in compliance with a "final" order. There is little guidance in the case law or ethics treatises about the degree of effort that must be put forth to resist disclosure. Comment b to Restatement Section 63 suggests that the lawyer's duties in this regard should be determined based upon the general duty to provide competent representation. RPC 1.1. At a minimum, in this case, we would assume that the client confidentiality concerns either already have been or will be raised with the arbitration panel prior to disclosure.

Additionally, whenever a lawyer is ordered to divulge confidential information, whether by a court, arbitrator, or other tribunal, the lawyer should seek to minimize the scope and impact of the disclosure, by limiting the parties who have access to the information, and the purposes for which the information may be used. In this case, the arbitration panel's order at issue explicitly includes such protection. In its disclosure order, the arbitration panel notes that, since Lawyer B was a shareholder in Firm A at all times involved in the records discussed in the order, the confidentiality to which the firm's clients are entitled applies to Lawyer B and any need that he may have to review the records specified in the order. Even in the absence of such an explicit directive, Lawyer B would have continuing confidentiality obligations to former clients pursuant to RPC 1.6(d). Moreover, if, as Lawyer B apparently alleges, Lawyer B was still a shareholder of Firm A, then Lawyer B would have an ongoing confidentiality obligation to Firm A's clients under RPC 1.6.

Firm A also asserts that another firm with which Lawyer B and Lawyer's B's counsel in the arbitration proceeding are currently associated, Firm C, currently represents clients who are adverse to certain clients of Firm A, and that the information Firm A has been ordered to disclose to Lawyer B includes confidential information relating to the matters in which Firm C represents parties who are adverse to Firm A's clients. We understand that the existence of such conflicting representation may be disputed by Lawyer B. In any case, the existence or non-existence of such a conflict does not directly influence the conclusion that there is no ethical prohibition against complying with the directive of an arbitration tribunal regarding disclosure of confidential information, but that there is an obligation under RPC 1.4 to timely inform the clients whose confidentiality interests may be adversely affected by the order and to explain its implications. The determination as to whether and to what extent any additional measures should be implemented to avert prejudice to current clients of Firm A, beyond compliance with the
confidentiality provisions of the existing orders from the arbitration panel, lies within the province of the arbitration panel.

Finally, although not directly within the scope of the inquiry, it bears repeating that, if Lawyer B is, in fact, still associated in some fashion with Firm A, but is also associated with another firm which represents clients who are directly adverse to clients of Firm A, then that could raise conflict of interest issues for Lawyer B and for other lawyers associated with Firm A or with Lawyer B’s current firm, Firm C. The Committee has not been requested to provide an opinion on this issue and lacks a sufficiently clear understanding of Lawyer B’s asserted status with Firm A to do so in any event.

LEGAL ETHICS AND PROFESSIONAL RESPONSIBILITY COMMITTEE
DANIEL Q. HARRINGTON, Member
THOMAS G. WILKINSON JR., Co-Chair
KEVIN M. FRENCH, Co-Chair
JOANNE ROSS WILDER, Co-Vice Chair
AIMS C. CONEY, JR., Co-Vice Chair

CAVEAT: THE FOREGOING OPINION IS ADVISORY ONLY AND IS NOT BINDING ON THE DISCIPLINARY BOARD OF THE SUPREME COURT OF PENNSYLVANIA OR ANY COURT. IT CARRIES ONLY SUCH WEIGHT AS AN APPROPRIATE REVIEWING AUTHORITY MAY CHOOSE TO GIVE IT.
Rhode Island Supreme Court  
Ethics Advisory Panel Op. 2013-05  
Issued December 12, 2013

FACTS

The inquiring attorney’s client (Client) had signed a revocable living trust and other estate planning documents in 1993. The trust was amended several times and finally amended in its entirety in 2012. The original trust provided that all assets in the trust be left to Client’s daughter. Client bequested tangible personal property to Client’s daughter in a pourover will. The trust named Client’s daughter as successor trustee.

Client was divorced many years ago. In 2012, Client sought the inquiring attorney’s legal services to amend the trust to leave Client’s home to a female friend. The Client thereafter executed an amendment by the entirety which included a provision leaving Client’s home to a female friend. The inquiring attorney and a paralegal attended to the execution of the amended trust. The inquiring attorney states that he/she determined Client to be competent at the time of the execution.

Client died in 2013. Client’s assets pass to Client’s daughter under the terms of the trust with the exception of Client’s home which, under the terms of the trust, passes to Client’s female friend.

Client’s daughter has requested the inquiring attorney’s assistance in settling Client’s estate. The daughter is disturbed that Client’s home was left to Client’s female friend. The inquiring attorney along with another attorney in the inquiring attorney’s law firm, advised the daughter about the grounds for setting aside provisions of the trust. The daughter has retained another lawyer to represent her and the trust.

ISSUE PRESENTED

The inquiring attorney asks about his/her ethical obligations regarding communications with the successor attorney and with the trustee, as well as regarding testimony at trial or at a deposition.

OPINION

The inquiring attorney must assert both the obligation of confidentiality under Rule 1.6, and the attorney-client privilege, if he/she is called as a witness, or is contacted by successor counsel or the trustee. Should the inquiring attorney be ordered by a court
to disclose information relating to the representation of Client, disclosure would be permissible.

REASONING

Client’s daughter, who is both a beneficiary and the successor trustee under Client’s trust drafted by the inquiring attorney, challenges a provision of the trust which leaves Client’s home to Client’s female friend. The inquiring attorney would be a likely witness in a lawsuit challenging the trust, and under Rule 3.7 of the Rules of Professional Conduct, he/she is prohibited from serving as an advocate at the trial.

Rule 3.7 states as follows.

Rule 3.7. Lawyer as witness. - (a) A lawyer shall not act as advocate at a trial in which the lawyer is likely to be a necessary witness unless:
(1) the testimony relates to an uncontested issue;
(2) the testimony relates to the nature and value of legal services rendered in the case; or
(3) disqualification of the lawyer would work substantial hardship on the client.
(b) A lawyer may act as advocate in a trial in which another lawyer in the lawyer’s firm is likely to be called as a witness unless precluded from doing so by Rule 1.7 or Rule 1.9.

In addition to the inquiring attorney’s duty to refrain from serving as advocate in a challenge to the trust, the inquiring attorney has an obligation of confidentiality to Client. Rule 1.6 states:

Rule 1.6. Confidentiality of information. (a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraph (b).
(b) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:
(1) to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm;
(2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was
involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client;

(3) to secure legal advice about the lawyer's compliance with these Rules; or

(4) to comply with other law or a court order.

The inquiring attorney anticipates that he/she will receive telephone calls and letters from the successor attorney and from the daughter/trustee. The inquiring attorney also anticipates that he/she may be deposed and may be called as a witness at trial. The obligation of confidentiality continues after a client's death. Rhode Island Supreme Court Ethics Advisory Panel Op. 96-34 (1996); Geoffrey C. Hazard, Jr. and W. William Hodes, The Law of Lawyering, §1.6:101, at 130 (2nd ed. 1993).

The principle of confidentiality is given effect in two related bodies of law: the rule of confidentiality established in professional ethics, and the attorney-client privilege in the law of evidence. See Comment [1] to Rule 1.6. The scope and applicability of protection of information differs markedly between the privilege and the ethical duty of confidentiality. Annotated Model Rules of Professional Conduct, at 73 (3rd ed. 1996). Rule 1.6 protects from disclosure a broader range of information than would be protected under the attorney-client privilege. In re Ethics Advisory Opinion No. 92-1, 627 A.2d 317 (R.I. 1993). Regardless of whether the information requested of the inquiring attorney is protected under the attorney-client privilege, Rule 1.6 prevents the inquiring attorney from disclosing it if it relates to the representation of the client. Id.

The Panel therefore advises the inquiring attorney to assert the obligation of confidentiality under Rule 1.6, as well as the attorney-client privilege, if he/she is called as a witness or is contacted by successor counsel or the trustee. Should the inquiring attorney be ordered by a court to disclose information relating to the representation of Client, disclosure would be permissible. See Comment [6] to Rule 1.6. Even then, the inquiring attorney must seek to limit disclosure. See ABA Comm. on Ethics and Professional Responsibility, Formal Op. 94-385 (1994) (lawyer has professional responsibility to seek to limit subpoena or court order on any legitimate ground, such as attorney-client privilege, work product immunity, burden or relevance, to protect information to which obligations under Rule 1.6 apply.)
Can a lawyer who represented a testator refuse to honor a court order or subpoena to disclose, prior to the client's death, a Will or other testamentary document executed when the testator was competent on the basis that the document is protected against disclosure by the attorney-client privilege or confidentiality.

QUESTION

The Inquiring attorney asserts that it has become increasingly common for courts to appoint attorneys in a representative capacity to represent individuals suffering from dementia and/or Alzheimer's who are the subject of a dispute or litigation regarding management of the individual's funds and/or person. It is asserted that attorneys involved in elder-law practice, guardianships, conservatorships, and guardian-advocate items (GAL)/attorney-advocate items (ML) appointed by the court seek the "ward's" last Will and Testament by request, court order or subpoena from the lawyer or law firm which prepared and/or is in custody of the Will. The Will is sought prior to the death of the testator on the basis of alleged need for the appointed lawyer to engage in "estate planning" on behalf of the ward. The Inquiring attorney asks:

• Is the law firm and/or each attorney in the firm responsible for asserting the attorney-client privilege if a person other than the client request delivery of the last Will and Testament before the client's death?
  • Response: Yes, if requested in a judicial proceeding and there are non-frivolous claims that the Will is protected against disclosure by the attorney-client privilege or other applicable law, as required by Rules of Professional Conduct (RPC) 1.6(c)(2).

• Is the answer any different if a GAL, AAL or Conservator has been appointed over the client by a Court and requests the Will?
  • Response: This is an issue of substantive law beyond the scope of the Rules of Professional Conduct.

• Can the GAL waive the attorney-client privilege on behalf of the "ward"?
  • Response: This is an issue of substantive law beyond the scope of the Rules of Professional Conduct.

• Is the answer any different if a Court orders the law firm to turn over the Will on behalf of either (1) the GAL, (2) aAAL, and/or (3) the Conservator?
  • Response: The lawyer must comply with the court's order but only after the lawyer has raised all non-frivolous claims that the Will is protected against disclosure by the attorney-client privilege or other applicable law, as required by RPC 1.6(c)(2).

DISCUSSION

The Rules of Professional Conduct (RPC), Tennessee Supreme Court Rule (SCR) 8, nor the Rules of Disciplinary Enforcement, SCR 9, provide any basis, authority, or jurisdiction upon which the Board of Professional Responsibility (BPR) can opine or authorize lawyers to disregard or refuse to honor an order of a court or subpoena. A court order is given full affect unless and until a party obtains dissolution of the order through operation of the judicial system. In In Re Estate of Rinehart, 363 S.W.3d 186, 189 (Tn. Ct. App. 2011); Flatt & Mann v. Council of City of Memphis, 285 S.W.3d 856, 874 (Tenn. Ct. App. 2008). Ethics opinions of the BPR do not have the force of law and are not binding upon the courts of this state. State v. Jones, 726 S.W.2d 515, 519 (Tenn. 1987).

In addition, statute governs to whom a Will is to be produced before and after death.[1] TCA 32-2-112(1) provides that during the lifetime of the testator, the Will can only be delivered to the testator or someone authorized by the testator. Whether a Will or other testamentary document which was prepared and executed at a time when the testator was living and competent is subject to attack or change by someone other than the testator is an issue of substantive law to be determined by the court.

The principles of (1) attorney-client privilege and (2) confidentiality must be considered in responding to this inquiry. Tennessee Formal Ethics Opinion (TFEO) 2013-F-156 addressed differences between the two principles, as follows:
...Although interrelated and often considered essentially the same, the requirements for and exceptions to the (1) attorney-client privilege and (2) confidentiality are substantively different. The attorney-client privilege and its exceptions are governed by statute and common law. Confidentiality and its exceptions are governed by the Rules of Professional Conduct (RPC). Confidentiality is far broader than the attorney-client privilege. Differences between the two are addressed in RPC 1.6, cmt. (3).

The principle of client-lawyer confidentiality is given effect by related bodies of law: the attorney-client privilege, the work-product doctrine, and the rule of confidentiality established in professional ethics. The attorney-client privilege and work-product doctrine apply in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to produce evidence concerning a client. The rule of client-lawyer confidentiality applies in situations other than those where evidence is sought from the lawyer through compulsion of law. The confidentiality rule, for example, applies not only to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source. A lawyer may not disclose such information except as authorized or required by the Rules of Professional Conduct or other law. See also Scope.

Attorney-Client Privilege

By statute and common law, Tennessee recognizes an evidentiary attorney-client privilege by which an attorney may not disclose confidential communications between the client and their lawyer. See, Tennessee Code Annotated (TCA) 23-3-105(2); Bryan v. State, 848 S.W.2d 72, 79-80 (Tenn. Crim. App. 1992) (perm. app. denied).

...Thus, the purpose of the privilege is to shelter confidences a client shares with his or her attorney when seeking legal advice, in the interest of protecting a relationship that is a mainstay of our system of justice... Not only must the communication have occurred pursuant to the client-lawyer relationship, it must have been made with the intention of confidentiality...

Bryan, 848 S.W.2d at 79-80. The attorney-client privilege, however, is not absolute. Because of public policy and judicial administration concerns, several exceptions to the privilege have been fashioned. See, Hazlett v. Bryant, 192 Tenn. 251, 241 S.W.2d 121, 123 (Tenn. 1951); Bryan, 848 S.W.2d. at 80. The privilege can be waived expressly or by other circumstances. State v. Buford, 216 S. W. 3d. 323, 325-326 (Tenn. 2007); Smith Co. Educ. Assoc. v. Anderson, 676 S. W. 2d. 328, 333 (Tenn. 1984); Bryan, 848 S.W. 2d. at 80. "...[W]hether the privilege applies to any particular communication is necessarily question, topic or case specific." Bryan, 848 S.W. 2d. at 80. The privilege survives the death of the client. Estate of Queener v. Helton, 119 S.W.3d 682, 685 (Tenn. Ct. App. 2003) (perm. app. denied); Estate of Hamilton v. Morris, 67 S.W.3d 786, 791-92 (Tenn. Ct. App. 2001) (perm. app. denied); State v. Leonard, 2002 Tenn. Crim. App. LEXIS 737 at *21, 2002 WL 1857953, at *8 (Tenn. Crim. App., Aug. 28, 2002).

While the attorney-client privilege may be applicable to protect communications between the testator and their lawyer regarding estate planning or resulting documents from disclosure during the lifetime and after the death of the testator, an exception to the privilege may apply to permit the lawyer to make such disclosures to establish the testamentary intent of the testator.

Confidentiality

If a client or former client's Will or other testamentary document is sought in a judicial or other proceeding in which the lawyer may be required to produce information or document under compulsion of law, whether by order of the court, subpoena or otherwise, the lawyer is required to comply with and be governed by RPC 1.6(cX2),[7][8]. In the absence of informed consent of the client, the lawyer must reveal the information or document if ordered to do so by the tribunal, but only after the lawyer has raised all non-frivolous objections that the information sought is protected against disclosure by the attorney-client privilege or other applicable law. ABA Annotated Model Rules of Professional Conduct, (7th Ed. 2011), p. 96. The lawyer is obligated to disclose no more than the court requires. The rule requires the lawyer to resist disclosure if there are any non-frivolous claims that the information is protected from disclosure by the privilege. See, ABA Formal Op. 94-385 (1994); ABA Annotated Model Rules, p. 111. If no non-frivolous claims are available, the information or document can be revealed by the lawyer in a judicial proceeding without raising the issue with the tribunal. Whether the attorney-client privilege, an exception to or waiver(9) of the privilege are applicable is governed by substantive law, not the Rules of Professional Conduct and on which the BPR cannot opine.[10] By the terms of RPC 1.6(cX2), it is the court or the tribunal, not the BPR, which determines whether the requested information or document is protected from disclosure by the attorney-client privilege or other applicable law. If the court determines that the information or document is not protected from disclosure by the privilege, RPC 1.6(cX2) requires that the information or document be revealed by the lawyer unless the decision of the court is appealed.

Confidentiality

If a client or former client's Will or other testamentary document is sought outside a judicial or other proceeding in which a lawyer may be required to produce evidence, the disclosure is governed by the confidentiality rules of the Rules of Professional Conduct (RPC 1.67 and 1.9(cX11), respectively, rather than the attorney-client privilege. RPC 1.6(a)7 prohibits a lawyer from revealing any information, whatever or whoever its source, relating to the representation of a current client unless (1) the client has given informed consent, (2) the disclosure is impliedly authorized to carry out the representation, or (3) the disclosure falls within one of the exceptions permitted or required by the rule. Any disclosure permitted by an exception referenced in RPC 1.6(cX5) is limited to that which the lawyer reasonably believes necessary to accomplish the specified purpose. See, RPC 1.6, cmt (13); ABA Annotated Model Rules of Professional Conduct, (7th Ed. 2011), p. 112. RPC 1.8(b) prohibits a lawyer, in the absence of informed consent, from using information relating to the representation of a current client to the client's disadvantage.

RPC 1.9(c)(11) prohibits a lawyer from revealing information relating to representation of a former client or using such information to the former client's disadvantage unless (1) the former client gives informed consent, (2) the rules would permit with respect to a current client, or (3) the information has become generally known.[12] RPC 1.9(cX2) incorporates the bases on which RPC 1.6 permits disclosure for a current client. The duty of confidentiality continues after the client-lawyer relationship has been terminated, RPC 1.9(c), cmt. [3a][13] and RPC 1.6, cmt. [17], and survives the death of the client. ABA/BNA Lawyer's Manual on Professional Conduct, 55:106 (2006); ABA Annotated Model Rules, p. 103, [14]
Unless permitted or required by RPC 1.6(a) or 1.9(c)(11), a lawyer cannot voluntarily disclose information relating to the representation of the client or former client outside a judicial proceeding. "...A lawyer may not disclose such information except as authorized or required by the Rules of Professional Conduct or other law." RPC 1.6, cmt. [3]. Conversely, a lawyer may reveal such information if permitted or required by the rules.

Both RPC 1.6(a)(2) and 1.9(c)(11) permit a lawyer to reveal any information or document which the client or former client has given the lawyer informed consent[15] to reveal.[16] If the client or former client is deceased or incompetent, due to dementia, Alzheimer's or otherwise, they can no longer give informed consent. Ethics opinions of the states are inconsistent regarding whether individuals appointed by the court in various capacities can waive confidentiality on behalf of the client or former client. Neither RPC 1.6(a)(1), RPC 1.9(c)(11) nor the accompanying comments permit someone other than the client or former client to waive confidentiality on behalf of the client. South Carolina Ethics Op. 05-09 (2005). Aside from basis on which the client or former client's lawyer may disclose information relating to the representation, whether someone other than the client or former client can consent to such disclosure is governed by "other law" beyond the scope of this opinion. RPC 1.6(c)(3)(f)

RPC 1.6(a)(2) and, by incorporation, RPC 1.9(c)(11) permit lawyers to disclose information relating to the representation if impliedly authorized to carry out the representation.[17] The implication is defeated by the testator's instructions to the contrary.[17] In making the determination whether disclosure is impliedly authorized, the lawyer must exercise reasonable professional judgment. Philadelphia Ethics Op. 2007-6 (2007). The analysis is the same for each person who may request such information, although the answer for each will depend on the facts and circumstances of the particular situation and may differ depending on whom and why the request is made. Florida Bar Op. 10-3(2011); ABA Annotated Model Rules, p. 99. In making the determination a lawyer may consider the client's wishes or intent.[18] Doubts should be resolved in favor of not disclosing. Florida Bar Op. 10-3 (2011).

A lawyer is permitted to disclose information relating to the representation of a deceased former client, but only if the lawyer believes that the disclosure would further the client's interest and that the client would have consented to the disclosure. The ABA/BNA Lawyers' Manual on Professional Conduct, 55:506 (2006) [19] provides:

A lawyer may disclose information relating to the representation of a deceased client only if disclosure would further the client's interests, and only if the lawyer believes that the client would have consented.

Tennessee Advisory Ethics Opinion 2000-A-727, on the basis of the former Rules of Professional Responsibility, provided in part:

Assuming that waiver or court order do not apply, we are of the opinion that the attorney may reveal confidences and secrets if the attorney believes that the revelation is in the best interests of the client and that the client would consent to waiver of the attorney-client privilege.

If a lawyer believes that disclosure of the contents of the will would be in furtherance of the client's interest, and the client did not forbid the lawyer to make the disclosure, RPC 1.6(a)(2) permits the lawyer to furnish the will as being impliedly authorized to carry out the representation of the client. South Carolina Ethics Op. 05-09 (2005). See also, District of Columbia Op. 324 (2004). "A lawyer may be impliedly authorized to make appropriate disclosure of client confidential information that would promote the client's estate plan, forestall litigation, preserve assets, and further family understanding of the decedent's intention..." Philadelphia Ethics Op. 2007-6 (2007). The rule permits a lawyer to reveal such information even after the death of a client and even when no personal representative has been appointed. Id. North Carolina Ethics Op. 206 (1996) provides:

...It is assumed that a client impliedly authorizes the release of confidential information to the person designated as the personal representative of his estate after his death in order that the estate might be properly and thoroughly administered. Unless the disclosure of confidential information to the personal representative, or a third party at the personal representatives instruction, would be clearly contrary to the goals of the original representation or would be contrary to the express instruction given by the client to his lawyer prior to the client's death, the lawyer may reveal a client's confidential information to the personal representative of the client's estate and ... to third parties at the direction of the personal representative.

If the lawyer determines on the basis of the circumstances of the particular situation that disclosure was not impliedly authorized because contrary to the expressed instructions of the testator or contrary to the testator's intent, wishes or goals of the representation, the lawyer may not disclose the information or document, even to someone appointed by the court or designated by the personal representative. Other bases provided in the rules discussed herein may, however, permit or require disclosure of the information or document.

As discussed in Attorney-Client Privilege above, a lawyer is required to comply with RPC 1.6(c)(2) with respect to orders or subpoenas of the court.
RPC 1.9(c)(11) permits disclosure of information relating to the representation of a former client if the information has become "generally known." If the will or other testamentary document of a former client is part of the public record, the document is "generally known" and may be revealed or provided by the lawyer. RPC 1.9(c), cmt. [8a]:12

CONCLUSION

Specific responses to the inquiry are at pages 1-2 herein. Because other possible fact scenarios regarding disclosure of information relating to the representation of a client or former client are too numerous and varied to address individually, lawyers should be governed generally by the foregoing when such information is sought from the lawyer by someone other than the client or former client. Generally, the lawyer must comply with RPC 1.6 or 1.9(c)11 and shall not provide any information or document relating to the representation except with the informed consent of the current or former client, RPC 1.6(a)(1) and 1.9(c)(1); the disclosure was impliedly authorized, 1.6(a) (2) and 1.9(c)(2); the disclosure is required by order of the court specifically granting authority for such disclosure, RPC 1.6(c)(2) and 1.9(c)(2); the disclosure is required by other law, 1.6(c)(3) and 1.9(c)(2); the information or document is generally known, RPC 1.9(c)(3), as discussed herein, or as otherwise permitted or required by the rules.

This 13th day of June, 2014.

ETHICS COMMITTEE:

Susan McGannon
J. Russell Parkes
Francis Guess

APPROVED AND ADOPTED BY THE BOARD

[1] Tenn. Code Annotated (TCA) 32-1-112(b) provides that “the will shall, during the lifetime of the testator, be delivered only to the testator, or to some person authorized by the testator by an order in writing, duly proved by the oath of a subscribing witness. Any will that is deposited after the death of the testator shall be delivered only to a person named in the will as executor, to a next of kin of the testator, or to any other person so authorized by law or court order.” TCA 32-1-113(a) provides, in part, that “any person or corporation who has possession of or discovers a written instrument purporting to be the last will and testament of decedent shall mail or deliver that instrument to the personal representative named in the instrument as soon as the person or corporation has knowledge of the death...” (b) requires that in the absence of a personal representative, “then the person having possession of the original instrument shall mail or deliver it to the clerk.”

[2] Tennessee Code Annotated 23-3-105 provides:

No attorney, solicitor or counselor shall be permitted, in giving testimony against a client or a person who consulted the attorney, solicitor or counselor professionally, to disclose any communication made to the attorney, solicitor or counselor as such by such person, during the pendency of the suit, before or afterwards, to the person’s injury.

[3] The Supreme Court has long accorded privilege to certain communications between attorneys and their clients, while recognizing there are exceptions to this privilege. Hazlett v. Bryant, 192 Tenn. 251, 241 S.W.2d 121, 123 (1951). The United States Supreme Court in Swidler & Berlin v. U.S., 524 U.S. 399, 118 S.Ct. 2081, 141 L.Ed.2d 379 (1998) held that the attorney-client privileges survives the death of the client... 165 U.S. at 394, 17 S.Ct. 411, 41 L.Ed. 760 (1897), a case which has not been overruled in over one-hundred years, the United States Supreme Court set out what we believe is the applicable rule in the case at bar:

••• we are of the opinion that, in a suit between the devisees under a will, statements made by the deceased to counsel respecting the execution of the will, or other similar document, are not privileged. While such communications might be privileged if offered by third persons to establish claims against an estate they are not written within the reason of the rule requiring their exclusion, when the contest is between the heirs or next of kin.
165 U.S. at 406, 17 S.Ct. 411 (emphasis added)

Hamilton, 67 S.W. 3d at 791-92

[5] In this case, the claims presented are against the Estate, and the issue is not concerning the validity of the deceased's will or claimants thereunder. In this case, no will of the deceased has been admitted to probate, indeed the record indicates that only a draft of a proposed will was prepared by the attorney. Accordingly, the rationale for the exception by the Hamilton Court that this evidence would be admitted to help establish the intent of the maker of a will has no application to the facts of this case.

The Trial Court found the draft document was not a valid will and could not be treated as one, but that it could be treated as evidence of decedent's intentions. The evidence does not establish a basis for an exception to the privilege and the Court was in error to rely on the unexecuted document to establish deceased's intent.

119 S.W. 3d, at 686.

Queener, 119 S.W.3d at 686

[6] Both Hamilton and Queener quote with approval from 81 AmJur.2d Witnesses, § 389:

Where the client is dead and the controversy arises concerning the validity of the deceased client's will, or between the claimants thereunder, no privilege exists as to communications between the testator and his attorney concerning the drafting of a will. Thus, communications by a client to the attorney who drafted his will, concerning the will and transactions leading to its execution, generally are not, after the client's death, protected as privileged communications in a suit between the testator's heirs, devisees, or other parties who claim under him, although there is authority for the proposition that the privilege protecting a client's communications to the attorney who drew his will may be invoked against the claimants adverse to the interests of the client, his estate or his successors.

Hamilton, 67 S.W. 3d at 792; Queener, 119 S.W. 3d at 685.

[7] Rule of Professional Conduct (RPC) 1.6 provides:

(a) A lawyer shall not reveal information relating to the representation of a client unless:

(1) the client gives informed consent;

(2) the disclosure is impliedly authorized in order to carry out the representation; or

(3) the disclosure is permitted by paragraph (b) or required by paragraph (c).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent the client or another person from committing a crime, including a crime that is reasonably certain to result in substantial injury to the financial interest or property of another, unless disclosure is prohibited or restricted by RPC 3.3;

(2) to prevent the client from committing a fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services, unless disclosure is prohibited or restricted by RPC 3.3;

(3) to prevent, mitigate, or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a fraud in furtherance of which the client has used the lawyer's services, unless disclosure is prohibited or restricted by RPC 3.3;

(4) to secure legal advice about the lawyer's compliance with these rules; or

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client.

(c) A lawyer shall reveal information relating to the representation of a client to the extent the lawyer reasonably believes disclosure is necessary:

To prevent reasonably certain death or substantial bodily harm;
to comply with an order of a tribunal requiring disclosure, but only if ordered to do so by the tribunal after the lawyer has asserted on behalf of the client all non-frivolous claims that the information sought by the tribunal is protected against disclosure by the attorney-client privilege or other applicable law;

(3) to comply with RPC 3.3, 4.1, or other law.

[8] Comment [14b] to Rule of Professional Conduct (RPC) 1.6 provides:

[14b] A lawyer might be called as a witness to give testimony concerning a client or might be ordered to reveal information relating to the representation of a client by a court or by another tribunal or governmental entity claiming authority pursuant to other law to compel the disclosure. Absent informed consent of the client to do otherwise, the lawyer should assert on behalf of the client all nonfrivolous claims that the order is not authorized by other law or that the information sought is protected against disclosure by the attorney-client privilege or other applicable law. In the event of an adverse ruling, the lawyer must consult with the client about the possibility of appeal to the extent required by RPC 1.4. Unless review is sought, however, paragraph (c)(2) permits the lawyer to comply with the court's order.


...Although an issue of first impression in Tennessee, other jurisdictions have adopted the common law provision that the attorney-client privilege may be waived by the client, his guardian, or conservator, the personal representative of the deceased client, the successor, trustee, or similar representative of a corporation, association or other organization whether or not in existence (citation omitted) ... Those jurisdictions adopting this provision however, have done so in the limited circumstances involving recovery of real property and will contests. (citation omitted).

...Because the privilege exists to protect the client, it belongs only to the client and thus may not be asserted by a third party.

[10] The Rules of Professional Conduct. "... are not intended to govern or affect judicial application of either the attorney-client privilege or work-product privilege. ..." Rules of Professional Conduct, Scope (22).

[11] Rule of Professional Conduct (RPC) 1.9(c) provides:

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter reveal information relating to the representation or use such information to the disadvantage of the former client unless (1) the former client gives informed consent, confirmed in writing, or (2) these Rules would permit or require the lawyer to do so with respect to a client, or (3) the information has become generally known.

[12] Comment [Ba] to RPC 1.9 defines generally known as follows:

[Ba] Whether information is generally known depends on all circumstances relevant in obtaining the information. Information contained in books or records in public libraries, public-record depositories, such as government offices, or in publicly accessible electronic-data storage is generally known if the particular information is obtainable by public accessible indexes and similar methods of access. Information is not generally known when a person interested in knowing the information could obtain it only by means of special knowledge or substantial difficulty or expense. Special knowledge includes information about the whereabouts or identity of a person or other source from which the information can be acquired, if those facts are not themselves generally known. A lawyer may not, however, justify adverse use or disclosure of client information simply because the information has become known to third persons, if it is not otherwise generally known. Even if permitted to disclose information relating to a former client's representation, a lawyer should not do so unnecessarily.

[13] Comment [3a] to RPC 1.9 provides:

... The lawyer's duty of loyalty survives the termination of the former representation to the extent that it precludes the lawyer from acting to deprive the former client of the benefit of the lawyer's prior work on the former client's behalf.


[15] RPC 1.0(e) provides that "Informed consent" denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct."

[16] TCA 34-6-108 and 109(29) permit a client or former client to vest an attorney in fact with the power to reveal confidential legal information.

[17] RPC 1.6, cmt. [5] provides, "Except to the extent that the client's instructions or special circumstances limit authorization, a lawyer is impliedly authorized to make a disclosure about the client when appropriate in carrying out the representation..."


[20] RPC 1.6, cmt. (12) provides, in part, "...Whether such law supersedes RPC 1.6 is a question of law beyond the scope of these Rules... If... the other law supersedes this Rule and requires disclosure, paragraph (c)(3) requires the lawyer to make such disclosure as are necessary to comply with the law.

[21] TCA 34-1-104 requires that "the letters of conservatorship shall either: (1) Recite the specific powers to be exercised by the conservator and the specific powers retained by the person with a disability; or (2) Have attached to them the order or orders of the court specifying the powers to be exercised by the conservator and the powers retained by the person with a disability." Likewise, TCA 34-1-129 requires that "the letters conservatorship or guardianship shall either: (1) Recite the specific powers removed from the minor or person with a disability and transferred to the fiduciary; or (2) Have attached to them the order or orders of the court specifying the powers removed from the minor or person with a disability and transferred to the fiduciary..." TCA 34-2-105(3) requires that an order appointing a guardian "state any other authority or direction as the court determines is appropriate to properly care for the person and property of the minor. TCA 34-3-107(2) provides the court shall "enumerate the powers removed from the respondent and those to be vested in the conservator." The statute further specifically provides that "to the extent not specifically removed, the respondent shall retain and exercise all of the powers of a person with a disability." TCA 34-3-107(2)(F) provides that one of the powers which the court may vest in the conservator is "the power to give, receive, release, or authorize disclosure of confidential information."

[22] Depending on the differing circumstances or types of proceeding in which appointment of a GAL is deemed necessary, GALs may be appointed pursuant TCA 34-1-107, TCA 36-4-132, TCA 37-1-149 and Tenn. SCR 40 and 40A. The appointment of a GAL generally does not form an attorney-client relationship between the GAL and the ward. However, SCR 40(c)(1) provides that the GAL represents the child. If the appointment of a GAL forms an attorney-client relationship between the GAL and the ward, the Rules of Professional Conduct, including RPC 1.6 and 1.9(c), are applicable, and the disclosure of information relating the representation by the GAL would be governed as discussed herein.
Ethics Opinion 288

Compliance with Subpoena from Congressional Subcommittee to Produce Lawyer's Files Containing Client Confidences or Secrets

In response to a Congressional subcommittee's subpoena for a lawyer's files pertaining to the representation of a current or former client and containing confidences or secrets that the client does not wish to disclose, the lawyer has a professional responsibility to seek to quash or limit the subpoena on all available, legitimate grounds to protect confidential documents and client secrets. If, thereafter, the Congressional subcommittee overrules these objections, orders production of the documents and threatens to hold the lawyer in contempt absent compliance with the subpoena, then, in the absence of a judicial order forbidding the production, the lawyer is permitted, but not required, by the D.C. Rules of Professional Conduct to produce the subpoenaed documents. A directive of a Congressional subcommittee accompanied by a threat of fines and imprisonment pursuant to federal criminal law satisfies the standard of "required by law" as that phrase is used in D.C. Rule of Professional Conduct 1.6(d)(2)(A).

Applicable Rule

• Rule 1.6(d)(2)(A) (Confidentiality of Information)

Inquiry

The inquirer, a managing partner of a law firm in the District of Columbia, requests an opinion regarding the propriety of his compliance with a Congressional subcommittee subpoena duces tecum for the firm's files and records relating to its representation of a client. The inquirer seeks to know how far he and the firm must go to meet their obligations to protect the client's confidences under the D.C. Rules of Professional Conduct. Implicitly, he raises the question of whether a lawyer must stand in contempt of a subcommittee and face the prospect of a criminal conviction, imprisonment and fines in order to vindicate the client's interest in confidentiality.

The Congressional subcommittee issued a subpoena duces tecum requiring the firm to produce "all records that relate to the services, efforts, lobbying or other work undertaken or provided, or to be undertaken or provided" to one of the firm's clients. The subpoena also demanded all records relating to the fees the firm charged that client, "including but not limited to all records that relate to the nature, negotiation, agreement, billing, payment, structure, purpose or allocation of such fee."

The law firm and the client maintain that the subpoenaed documents contain client confidences and secrets. The law firm filed written objections to the request and advised the client of the subpoena. The subcommittee overruled the objections and demanded compliance with the subpoena. When threatened by the chairman with contempt of Congress and possible criminal prosecution and sanctions, the subpoenaed partner produced the documents, despite protests and a threat of suit by the client.

Even though this particular matter has been concluded, we address the ethical issues arising from these facts because of the disturbing increase in incidences of Congressional subpoenas being sent to lawyers in their professional capacity seeking information relating to the activities of their clients and legal services provided to them.
Relying on prior interpretations of the D.C. Rules of Professional Conduct and its predecessor, the Code of Professional Responsibility, in the analogous area of compliance with judicial and administrative subpoenas to lawyers for confidential client information, we conclude that a lawyer has an obligation to make all appropriate objections to the Congressional subpoena. We also suggest that the lawyer may be well advised to discuss with the client the opportunities and prospects of seeking a court order to prevent disclosure. Thereafter, if the subcommittee overrules the objections, orders the documents be produced and threatens to hold the lawyer in contempt for failure to comply, and if no judicial intervention is obtained by the client, then, we conclude, the lawyer may comply with the directive as if it were a court order to comply with a subpoena after all appeals have been exhausted.

Discussion

1. A Lawyer May Disclose Client Confidences or Secrets Against the Client's Will When Required by Law or Court Order

Under Rule 1.6(d)(2)(A) of the District of Columbia Rules of Professional Conduct ("Rules" or "Rule"), a lawyer may reveal a client confidence or secrets only when expressly permitted by these rules or when "required by law or court order." See Rule 1.6, Cmt. [10]. Client confidences are protected by state and federal law as set forth in the governing attorney-client privilege and the work-product doctrine as well as by the ethical constraints on lawyers imposed by the D.C. Rules on confidentiality. See Rule 1.6, Cmt. [5]. The rules and the comments reflect the critical importance that preserving client confidences and secrets has to the attorney-client relationship and to the ability of the client to receive effective legal advice and representation. Accordingly, the comments to the Rules recognize that the doctrines of privilege and confidentiality "apply in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to produce evidence concerning a client." Id. They also recognize that the rule applies to "all information gained in the course of the professional relationship that the client has requested be held inviolate, or the disclosure of which would be embarrassing or would... likely... be detrimental to the client..." See Rule 1.6, Cmt. [6].

Thus, the ethical obligation of the lawyer to take all necessary steps to protect client information is broader than the confines of the attorney-client privilege or the work product doctrine. As stated by a leading legal ethicist, "[e]xtending a reach that includes all of those protections—and encompassing much of what they omit—is the professional regulation requiring a lawyer to keep a vast array of client information confidential and not to use it against the interests of the client. We will call that obligation the principle of confidentiality." Wolfram, Modern Legal Ethics § 6.1.1, at 296 (Practitioner's ed. 1986). Echoing the language in our own commentary, Professor Wolfram states that this principle of confidentiality applies in all contexts, including legislative hearings. Id. § 6.3, at 255. We agree and believe that a lawyer's obligations to protect client confidences in the Congressional context are the same as those in the judicial or administrative context.

This Committee has repeatedly addressed the lawyer's obligations to maintain the client's confidences and secrets in judicial and administrative proceedings. See, e.g., D.C. Bar Ops. 214, 180, 124, 99 and 14. These opinions essentially hold that a lawyer has an ethical obligation to raise all available, legitimate objections to a judicial or administrative subpoena for protected information and, as reflected in Comment [26] to Rule 1.6, either to make "every reasonable effort" to appeal an order demanding compliance with a subpoena or at least to notify the client of the order and provide the client every opportunity to challenge it. On the other hand, our opinions and all of the other authorities we can identify bearing on the question suggest that a lawyer is not required to stand in contempt of a court order and risk criminal prosecution in order to protect the subpoenaed information.

For example, in D.C. Bar Opinion 83, we stated that a lawyer "is not obliged to run the risk of being held in contempt of court because of the client's desire that confidences and secrets not be disclosed." Similarly, in D.C. Bar Opinion 14, we stated that "the attorney is... free to comply with whatever directive the trial court gives." In D.C. Bar Opinion 214, we stated "we conclude that the law firm... may comply with a final judicial order enforcing an IRS summons without seeking appellate review of that order, but only after giving its client notice of the court's order and a reasonable opportunity to seek review independently of the firm."

The American Bar Association's Committee on Ethics and Professional Responsibility similarly has concluded that if a lawyer's efforts to seek to limit a subpoena to protect client confidences or secrets are "unsuccessful, either in the trial court or in the appellate court (in those jurisdictions where an interlocutory appeal on this issue is permitted), and she is specifically ordered by the court to turn over [the subpoenaed

https://www.dcbar.org/bar-resources/legal-ethics/opinions/opinion288.cfm
2. When a Congressional Subcommittee Directs Compliance with a Subpoena and Threatens to Hold a

Lawyer in Contempt for Noncompliance, Disclosure Is "Required by Law" as That Term Is Used in D.C.
Rule 1.6(d)(2)(A)

The Congressional subpoena does not, in itself, create the legal requirement that the lawyer disclose
confidential information or a client's secrets. Like a subpoena issued by a party in a judicial proceeding or a
grand jury subpoena, a Congressional subpoena is not self-executing. As with subpoenas in the judicial or
administrative process, objections can be raised, argued and resolved in the legislative process. Negotiations
with the committee chairman, members or staff may lead to modifications or even withdrawal of all or part
of a Congressional subpoena.

All of the authorities of which we are aware that have addressed this question uniformly suggest that a
lawyer has an obligation in the legislative process to raise all available, legitimate objections to a Congressional
subpoena for confidential client information. For example, the Restatement (Third) of the Law Governing
Lawyers, supra, asserts that the lawyer has an obligation in the legislative process to object on all legitimate
grounds to such a subpoena: "The scope of the protection afforded by the attorney-client privilege and the
work-product immunity may be debatable in various circumstances. Similar issues may arise ... in supplying
evidence to a legislative committee, grand jury, or administrative agency. ... A lawyer generally is required to
raise any reasonably tenable objection to another's attempt to obtain confidential client information ... , unless
disclosure would serve the client's interests. ... " Restatement (Third) of the Law Governing Lawyers:
Confidential Client Information § 115 (Proposed Final Draft No. 1, 1996) (emphasis added). Similarly, the
American Bar Association's Committee on Ethics and Professional Responsibility in its Formal Opinion 94-
385 (1994) suggests that the requirement to make "every reasonable effort" to quash or limit a subpoena
applies in the legislative arena. That opinion stated that "if a governmental agency, or any other entity or
person, subpoenas ... a lawyer's files and records relating to the lawyer's representation of a current or former
client, the lawyer has a professional responsibility to seek to limit the subpoena ... on any legitimate available
grounds so as to protect documents that are deemed to be confidential. ..."

In addition to making all appropriate objections to the Congressional body issuing the subpoena, a lawyer
would be well advised to discuss with the client the possibility of a judicial action by the client against the
lawyer to prevent compliance with the Congressional subpoena. While, as noted, courts generally not
enjoin members of Congress or their staffs from issuing or seeking to enforce a legislative subpoena, it is an
open question whether an action might lie against a third party such as a lawyer or a law firm to enjoin
compliance with a Congressional subpoena. See Eastland at 516 (Marshall, J., concurring) ("The Speech or
Debate Clause cannot be used to avoid a meaningful review of Constitutional objections to a subpoena simply
because the subpoena is served on a third party. Our prior cases arising under the Speech or Debate Clause
indicate that only a member of Congress or his aide may not be called upon to defend a subpoena against Constitutional objection, and not that the objection will not be heard at all.”). In United States v. AT&T, 567 F.2d 121 (D.C. Cir. 1977), the court upheld an action by the Department of Justice to enjoin AT&T from complying with a Congressional subpoena to provide telephone records that, according to the Executive Branch, implicated national security. See also Grabow, Congressional Investigations § 3.2[c] at 85 and n.31 (1988).

To prevent any possible appearance of collusion or other impropriety, it may well be prudent for the lawyer to suggest to the client that the client seeks separate counsel regarding such a possible course of action and to be advised of the prospects of such an option by counsel other than the subpoenaed lawyer.4

Once the process of objections, negotiations and a ruling by the Congressional subcommittee has been exhausted, and assuming the absence of any judicial intervention, the subcommittee may demand that certain enumerated documents be produced under pain of contempt. At that point, there is effectively no further recourse available to the subpoenaed lawyer. Based on our understanding of Congressional procedures, judicial precedents enforcing the criminal contempt of Congress' statutory provisions and analyses by recognized experts, we conclude that the point at which the lawyer becomes “required by law” to disclose any client confidences is the point at which the Congressional subcommittee specifically directs compliance with the subpoena and threatens to use its statutory authority, 2 U.S.C. § 192, providing criminal sanctions for contempt of Congress.

Current Congressional rules expressly permit any subcommittee of a House Committee to hold hearings and “to require by subpoena or otherwise, the attendance and testimony of such witnesses and the production of . . . documents as it considers necessary.” Rules of the House of Representatives, 106th Cong., 1st Sess., Rule XI, cl. 2(m)(1)(B) (“House Rules”) reprinted in 145 Cong. Rec. H6-10 (daily ed. Jan. 6, 1999). Compliance with a subpoena issued by a subcommittee may be enforced as authorized by the House. House Rule XI, cl. 2(m)(2) (B).

A contempt of Congress may be prosecuted, 5 following a referral from the House, by the U.S. Attorney pursuant to 2 U.S.C. § 192.6 Under this 6 statute, contempt may be prosecuted against any individual who willfully failed to comply with a subpoena issued pursuant to the authority of either House or any Committee of the House. Since a subcommittee subpoena is authorized by the Rules of the House, a contempt of Congress may lie against anyone who willfully failed to comply with a subcommittee subpoena. This interpretation is buttressed by the fact that the statute that authorizes certification from the Congress to the U.S. Attorney for prosecuting an alleged contempt to a grand jury specifically includes the willful failure to comply with a subcommittee subpoena. 2 U.S.C. § 194.

As the General Counsel to the Clerk of the House of Representatives noted, “In the Congressional context, the ruling by the Subcommittee chair that the privilege will not be accepted is the legal and functional equivalent [of] a legal requirement or a court order. Failure to answer at that point constitutes a criminal violation. Disclosure at that stage does not violate the Canons of Ethics nor the Bar Code of any jurisdiction.” Memorandum Opinion from Steven R. Ross, General Counsel of the Clerk of the House of Representatives to Congressman Stephen J. Solarz (Dec. 11, 1985) reprinted in 132 Cong. Rec. 3036, 3038 (1986). Similarly, in a memorandum from the American Law Division to the Office of the Clerk of the House in 1986, the conclusion was reached that where a committee issues a subpoena, “the contempt of Congress is complete when a committee rejects all claims of privilege and demands that a witness respond. The obligation of law attaches at that time.” 132 Cong. Rec. 3044, 3047 (1986). In connection with this same matter, New York University Law School ethics professor Stephen Gillers stated that with regard to privileged information “an order to answer a question, coming from a body with legal power to issue the order, imposes a legal duty that overrides the ethical duty.” Memorandum from Professor Gillers to Congressman Solarz (February 19, 1986) reprinted in 132 Cong. Rec. 3042, 3043 (1986).

At the heart of these conclusions is the recognition that a lawyer may face criminal conviction, imprisonment and fines for refusing at that point in the Congressional process to provide the demanded information. A violation of the contempt of Congress provisions of 2 U.S.C. § 192 carries with it the possibility of imprisonment of up to one year as well as a monetary fine. The Supreme Court has held that a contempt of Congress cannot be cured by the lawyer's later compliance with the subpoena. Jurney v. MacCracken, 294 U.S. 125, 148 (1935) (“where the offending act was of a nature to obstruct the legislative process, the fact that the obstruction has since been removed, or that its removal has become impossible, is without legal significance.”)
As noted, the Supreme Court has also held that when a witness refuses to answer a question in a mistaken, good faith belief that it would violate his rights to be compelled to answer, his mistake of law will be no defense at a trial on the criminal contempt charge. *Yellin v. United States*, 374 U.S. 109, 123 (1963).

Compounding the dilemma faced by the lawyer is the uncertainty of the applicability or force of the attorney-client privilege or work-product immunity in Congressional proceedings. While we have no doubt that the salutary purposes of the attorney-client privilege and work-product doctrine (as recognized by Congress itself in the Federal Rules of Evidence, the Federal Rules of Civil Procedure and the Federal Rules of Criminal Procedure) would be severely undermined if they were not fully applicable in Congressional proceedings, individual senators and representatives have repeatedly suggested that these privileges may not apply, or not apply with full force, in Congressional hearings. See, e.g., *Beard, Congress vs. The Attorney-Client Privilege: A Full and Frank Discussion*, 35 Am. Crim. L. Rev. 119 (1997); Rich, *The Attorney-Client Privilege in Congressional Investigations*, 88 Colum. L. Rev. 145 (1988). The matter has never been resolved definitively in the courts. An incorrect prediction of the law could result in the imprisonment of a lawyer who was held in contempt of Congress for refusing to produce documents on the ground of the attorney-client privilege.

The cited Supreme Court cases suggest that if a court upholds the view of a subcommittee—either that the attorney-client privilege or the work-product doctrine does not apply in Congressional proceedings or does not cover the subpoenaed documents—the lawyer will have no valid defense and could be ordered to serve a term of imprisonment. Since it is the unanimous ethical view that a lawyer need not stand in contempt, with the risk of imprisonment, to protect privileged confidential or secret information, it follows that the lawyer may comply with the directive of the subcommittee to produce the required documents without risking a citation for contempt of Congress.

The fact that a lawyer may deem himself or herself “required by law” to produce the documents at the point the subcommittee demands it does not mean that the lawyer must produce the documents at that time. It was noted at the time that the D.C. Rules of Professional Conduct were proposed that Rule 1.6(d)(2) and its commentary “do not advise a lawyer how far the lawyer must go in protecting client information.” Analysis of Comments submitted to the District of Columbia Court of Appeals in response to the Court’s order of September 1, 1988, Docket No. M-165-88, Proposed Rules of Professional Conduct and related comments, 21 (1989). In reviewing these comments at the request of Chief Judge Rogers, the former chairman of the D.C. Bar Model Rules of Professional Conduct Committee, Robert E. Jordan, III responded, “I suggest that judgments on these points be left to the lawyer who is ordered to disclose. It seems difficult to specify the proper course of action for such a lawyer given a myriad of factual circumstances which may exist.” Notwithstanding the authorization granted by Rule 1.6(d)(2)(A), the lawyer retains the discretion to risk being held in contempt and litigate the issue in the courts, based on the totality of the circumstances.

**Conclusion**

At the point that the lawyer has made and pressed every appropriate objection to the Congressional subpoena and has no avenues of appeal available, and in the absence of any judicial order to the contrary, a lawyer faced with a Congressional directive and a threat of contempt of Congress may deem himself or herself “required by law” to comply with the subpoena within the meaning of D.C. Rule 1.6(d)(2)(A). A lawyer has satisfied his or her professional obligation to maintain client confidences once all objections have been made and exhausted and is not required by the Rules to stand in contempt of Congress if the subcommittee overrules the objections.

February 1999

---

1. Throughout this opinion, we refer to actions by a Congressional subcommittee since these are the facts with which we are presented. However, the same reasoning and principles would apply to the appropriate response of a lawyer to subpoenas and directives of a Congressional committee, a House of Congress, or the full Congress.

2. The final version of the Restatement (Third) of the Law Governing Lawyers is expected to be published in late 1999 with no substantive changes to § 115.

3. While no appeal is available to the respondent, under current House Rules, a subcommittee needs a full committee vote to support a referral for a contempt prosecution. See House Rule XI, cl. 1(a)(2). If before the full committee votes to uphold the contempt, the lawyer discloses the subpoenaed documents, the full committee may, but need not necessarily, consider the matter moot.

4. The lengths to which the lawyer must go to protect the attorney-client privilege and confidentiality of the client raise the collateral issue of the lawyer’s entitlements to fees and expenses from the client for these efforts. While this may be a subject in the first instance for negotiations between the client and lawyer, we note that, as set forth in our prior Opinion 214, the lawyer has obligations to preserve the privilege and confidentiality of client information even if it is evident that the lawyer will not be compensated for those efforts by the client. As we stated in Opinion 214:

The ethical obligations of lawyers to protect the confidences and secrets of their clients is not a matter of contract between the lawyer and client; the obligation arises because “confidentiality is essential to the role of the lawyer in the administration of justice,” Opinion No. 180, and because, under Canon 1, every lawyer has a duty “to assist in maintaining the integrity and competence of the legal profession."

We interpret this to mean that if no agreement on fees and expenses is reached regarding the efforts to protect the confidential information, the lawyer must nevertheless take all ethically required steps to protect the privilege even if not compensated for the services by the client. Whether a suit in quantum meruit for the services rendered in such a situation may succeed under District of Columbia law is a subject on which we express no view.

5. Under current House Rules, after the relevant chairman has ruled against any objections or challenges to a subpoena, the relevant Committee or subcommittee may vote on whether to hold the party in contempt. If the initial contempt was voted by a subcommittee, then the contempt finding will reach the House floor only if the full Committee also votes the witness in contempt. See House Rule XI, cl. 1(a)(2). Under these Rules, if the House is in session, a vote of the full House is required to refer the matter to the U.S. Attorney for prosecution. However, when the House is not in session, the speaker may refer a finding of contempt by the full Committee to the appropriate U.S. attorney.


Every person who having been summoned as a witness by the authority of either House of Congress to give testimony or to produce papers upon any matter under inquiry before either House, or any joint committee established by a joint or concurrent resolution of the two Houses of Congress, or any committee of either House of Congress, willfully makes default, or who, having appeared, refuses to answer any question pertinent to the question under inquiry, shall be deemed guilty of a misdemeanor, punishable by a fine of not more than $1,000 nor less than $100 and imprisonment in a common jail for not less than one month nor more than twelve months.

In addition, theoretically, either chamber of Congress may exercise its “self-help” contempt power which involves a trial before the relevant body and confinement upon conviction for as long as the term of the current Congress. Such a confinement is subject to judicial challenge through a writ of habeas corpus. See Grabow, supra, § 3.4[a] at 87. This alternative procedure has not been utilized in modern times.
7. While far beyond the purview of this Committee and while recognizing the complexity of the issue, we believe it would be extremely beneficial to both clients and lawyers throughout the country for Congress to pass legislation clarifying the applicability of the attorney-client and perhaps other privileges in Congressional proceedings. Such legislation could also provide for procedures in which the privilege may be invoked, considered and resolved.
KENTUCKY BAR ASSOCIATION
Ethics Opinion KBA E-315
Issued: January 1987

This opinion was decided under the Code of Professional Responsibility, which was in effect from 1971 to 1990. Lawyers should consult the current version of the Rules of Professional Conduct and Comments, SCR 3.130 (available at http://www.kybar.org), before relying on this opinion.

Question: What is the proper response for an attorney who is subpoenaed by a prosecutor to give testimony or supply evidence regarding his or her client before a Grand Jury?

Answer: See discussion.

References: KY.R.Cr.P. 7.02; F.R.Cr.P. 17; U.S. v. Klubock, 639 F.Supp. 117 (D.Mass. 1986); ABA Resolution (Feb. 5-11, 1986); U.S. Attorneys’ Manual § 9-2.161(a); DR 4-101(C)(2); Proposed Kentucky Model Rule 1.6(b)(4).

OPINION

Several defense attorneys have contacted the Committee regarding the above question. The principal question posed by the attorneys is whether such subpoenas are proper, and whether they may properly appear and respond by asserting claims of privilege.

Such subpoenas presumably issue under the authority of Kentucky Rule of Criminal Procedure 17. Whether such a subpoena is appropriate in a given case is a question of law. In addition, the conduct of the prosecutor seeking such a subpoena is not properly before us, inasmuch as our “jurisdiction” is limited to questions relating to the propriety of the requestor’s own future conduct. As to limitations that might be placed on such subpoenas by the Courts or other rule-making authorities, see United States v. Klubock, 639 F.Supp. 117 (D.Mass. 1986); Resolution of the ABA House of Delegates (February 5-11, 1986). Cf: United States Attorneys Manual § 9-2.161(a).

The attorney-recipient of such a subpoena must respond by asserting any privilege (i.e., the attorney-client privilege) and may resolve doubts regarding the applicability of the privilege in favor of the client. The attorney should insist on a court order resolving any such issue, and may challenge the court order to the extent that good faith arguments can be advanced as to its invalidity, prior to providing testimony or documents. DR 4-101(C)(2); Proposed Kentucky Model Rule 1.6(b)(4).

The assertion of any privilege, or the presentation of any other objection to the subpoena, may presumably be made by a motion to quash. In the alternative, the attorney may assert the
privilege and demand a court order before appearing or at his or her appearance, prior to testifying or providing evidence.

Note to Reader

This ethics opinion has been formally adopted by the Board of Governors of the Kentucky Bar Association under the provisions of Kentucky Supreme Court Rule 3.530 (or its predecessor rule). The Rule provides that formal opinions are advisory only.
Privileged Communication Correspond with Client

92 N.J.L.J. 97
February 13, 1969

ADVISORY COMMITTEE ON PROFESSIONAL ETHICS

Appointed by the New Jersey Supreme Court

OPINION 145

Privileged Communication
Correspond with Client

A lawyer who represented a creditor of a bankrupt estate in which a distribution of the assets was made several years ago, had been asked by an attorney, who represented interests adverse to his client in the bankrupt estate, for copies of correspondence between him and his client in the bankruptcy matter. He wrote to his client informing him of the request and asking if he would consent to it. He also informed the client that the attorney intends to serve him (the client's attorney) with a subpoena duces tecum to produce the letters if he does not comply with the request. The inquirer poses the following questions which we quote verbatim:
In the event the client fails to respond to our letter, is it a breach of ethics to turn over copies of such correspondence without the issuance of a subpoena? May we treat the client's silence as consent? If the client directs us not to turn over copies of the letters, is it a breach of ethics to produce the letters under the subpoena and either to testify as to their contents or submit them for examination or copying? If directed by the presiding officer at a
deposition hearing to produce and turn over the letters, are we required under the Canons of Ethics to exhaust appellate procedures before complying? If the attorney, upon our refusal obtains an oral instruction or written order from the Referee in Bankruptcy or from a District Court Judge, requiring us to testify as above indicated or to submit the letters for inspection or copying, are we either permitted or obliged to comply or must we first exhaust appellate procedures?

The Canons of Professional Ethics, Canon 37 imposes a duty on a lawyer "to preserve his client's confidences, pointing out that "[t]his duty outlasts the lawyer's employment... ." The confidential relationship between attorney and client precludes an attorney from divulging information obtained from his client, during the relationship, without the client's consent. This lawyer-client privilege is an ancient one. It has been recognized in New Jersey as part of our common law and became part of our statutory law in 1960 (N.J.S. 2A:84A-20). The statute provides that, in general, communications between a lawyer and his client are privileged and a client has a right "(a) to refuse to disclose any such communications and (b) to prevent his lawyer from disclosing it, and (c) to prevent any other witness from disclosing such communication ...." The statute imposes a duty upon a lawyer to claim the privilege "unless otherwise instructed by the client or his representative." There are certain exceptions to the general rule set forth in the statute, none of which are applicable here.

The foregoing statute was considered in the case of Metalsalts Corp. v. Weiss, 76 N.J. Super. 291 (Ch. Div. 1982), where the attorney involved appeared for oral examination by deposition pursuant to pretrial discovery proceedings and refused to answer questions on the ground that he was bound by the attorney-client privilege and could not divulge communications had with his client without the latter's consent. Although the court found that the attorney had not been employed as a lawyer but as an officer of a corporate entity and therefore, the attorney-client privilege did not exist, the opinion stated (at page 296): It is a long established rule of the common law, embodied in New Jersey by statute, N.J.S. 2A:84A-20, that an attorney is not permitted and cannot be compelled to testify as to communications made to him in his professional character by his client, unless his client consents. The rule is based upon the grounds of public policy, and must be enforced by the courts, unless its enforcement is waived by the client...

In our N.J. Advisory Committee on Professional Ethics, Opinion 116, 90 N.J.L.J. 688 (1967), we said:
The late Chief Justice Vanderbilt in In re Selser, 15 N.J. 393 (1954), traced the history of privileged communication between attorney and client, recognizing that this privilege is part of our common law. The principle was enunciated to promote freedom of consultation between an attorney and his client.

To adequately protect a client's interests, an attorney should know all the relevant facts. If the client's confidences are not protected the client will have a tendency to withhold facts which may be detrimental to his cause. Thus these communications from attorney to client become privileged.

The conclusion which we have reached is that the attorney client privilege is an important right to be safeguarded.

Opinion 312 of the Community on Professional Ethics of the Association of the Bar, City of N.Y., concerned an attorney who had in his possession correspondence and documents received from a client. The question to be determined was whether the attorney, with professional propriety, could deliver the original documents to the authorities in another jurisdiction pursuant to their demand without the consent of his client. The Committee was of the opinion that before a lawyer disclosed such confidential information he should assert that it was received in confidence and then abide the determination of the tribunal to which the solution of the question was submitted by the statute.

In In re Selser, supra, the court said (at page 41)4):

Since the protection of the privileged communication is not for the attorney but rather for the client, not only may the client alone waive the privilege, ... but the attorney if called as a witness must assert the privilege where applicable, unless it has been waived by the client, Canons of Professional Ethics, 37; 58 Am. Jur. 259. The final determination of the existence of the privilege, however, rests with the court, and if it determines that the privilege does not exist then the attorney must testify as to the matters contained in the communication. State v. Tuscany, supra, 13 N.J. 418, 424 (1953).

In the light of the foregoing we are of the opinion that if the client fails to respond to the attorney's letter his silence cannot be construed as consent and it would be improper to turn over copies of the correspondence with or without a subpoena. Absent a court order, it would also, in our opinion, be a breach of ethics to produce the letters under the subpoena and either testify to their contents or submit them for examination or copying without the client's consent and particularly if the client directs the attorney not to turn over copies of the letters.

The lawyer-client privilege should be asserted by the attorney until overruled by a court with
jurisdiction to determine the issue. The necessity of taking appellate procedures involves a question of law which we should not attempt to decide. This must be determined by the attorney by a prudent and reasonable interpretation of the applicable law, bearing in mind that he must defend the privilege to the best of his ability. As stated in Canon 15 he owes "entire devotion to the interest of the client, warm zeal in the maintenance and defense of his rights and the exertion of his utmost learning and ability."

***
Final

RHODE ISLAND SUPREME COURT
ETHICS ADVISORY PANEL
Opinion No. 98-02, Request No. 737
Issued January 28, 1998

Facts:

The inquiring attorney has received a notice of deposition and a subpoena duces tecum that seeks information from him/her relating to the representation of a former client who is a party to a pending lawsuit. The inquiring attorney believes that the documents that are being sought are protected by the attorney-client privilege and by the work product doctrine. An attorney who is representing the inquiring attorney's former client in the pending action has advised the inquiring attorney that the client does not consent to disclosure of the information.

Issue Presented:

The inquiring attorney does not intend to produce the documents at the deposition and seeks the Panel's advice on this course of conduct.

Opinion:

The inquiring attorney has an obligation of confidentiality under Rule 1.6 of the Rules of Professional Conduct which does not permit him/her to disclose the information that is being sought. Pursuant to Rule 1.6, the inquiring attorney has a duty to invoke the attorney-client privilege and the work product doctrine with respect to documents and information which, in his/her professional judgment, are protected by the privilege or the doctrine. The inquiring attorney must comply with the final orders of a court requiring him/her to give information about the client.

Reasoning:

Rule 1.6(a) states:

Rule 1.6. Confidentiality of Information. -

(a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraph (b).

The information requested relates to the representation of the former client and therefore, pursuant to his/her obligation of confidentiality, the inquiring attorney may not disclose it without the client's consent. The official comments to Rule 1.6 further provide:
. . . . If a lawyer is called as a witness to give testimony concerning a client, absent waiver by the client, paragraph (a) requires a lawyer to invoke the privilege when it is applicable. The lawyer must comply with the final orders of a court or other tribunal of competent jurisdiction requiring the lawyer to give information about the client.

The Panel concludes that the inquiring attorney has an obligation to keep the information sought confidential, and to object to its disclosure in the appropriate motions and/or at the deposition on the grounds of the attorney-client privilege, the work product doctrine, and his/her ethical obligation of confidentiality. See ABA Comm. on Ethics and Professional Responsibility, Formal Op. 94-385 (1994) (lawyer has professional responsibility to seek to limit subpoena or court order on any legitimate ground, such as attorney-client privilege, work product immunity, burden or relevance, to protect information to which obligations under Rule 1.6 apply.) The inquiring attorney must comply, however, with the final orders of a court requiring him/her to produce the documents sought or to give information about the former client. See Comment to Rule 1.6.
One Hour Charity: The nuts and bolts of charitable planning for farmers

Paul Neiffer, CPA

CliftonLarsonAllen
Charlie Neiffer, Principal, CLA (CliftonLarsonAllen)
- Frequent national speaker on taxation, agricultural, ranch bill and estate tax topics
- Current chair of the AOPA National Agriculture Conference committee.
- Past President of ranch Financial Standards Council
- Author of the "FarmCPA" Top Producer column
- Primary source for nationally recognized blog "FarmCPAToday.com"
Agenda
• Non-Charitable Gifts of Commodities
• Use of a Charitable Remainder Trust to Defer Ordinary Income Sales
• Qualified Conservation Charitable Contributions
• Charitable Gifts of Raised Commodities

Non-Charitable Gifts of Commodities

Gifts of Commodities
Farmer unsold grain
• No income
• No SE tax
• Use prior year crop
• Gift tax return > $15,000

Donee
• Zero tax basis
• No SE tax
• Schedule D transaction
• Carryover holding period
• Keeps the proceeds
Commodity Gifts

• Post-gift costs of giving livestock E.1.
• Crop share landlords giving crop shares E.1.
  – Assignment of income
  – Gain at time of gift
• Example # 1: Child attains age 16 during year
• Example # 2: Tax applicable to college student age 20
• Example # 3: Increasing compensation to avoid the Kiddie Tax
• Example # 4: Using capital gain rates on a commodity gift

Use of a Charitable Remainder Trust to Defer Ordinary Income Sales

Charitable Remainder Trusts

• CRT = charitable trust A.1.
  – Use by all entity types
ANNUITY TRUST A.4.
• Fixed payout
• No additional funding
UNITRUST A.5.
• Payout is % of annual value
• Additional asset input allowed
CRT Flow of Funds

Donor → Asset → Term → Income → Charitable Remainder Trust → Remainer → After Term → Charity

(No Tax On Asset Sale)

CRT Computations

- Charitable deduction for LTCG property A.9.c.
  - 30% of AGI limits
- Factors A.9.d.
  - Amount or % of retained interest
  - Term of years or life expectancy
  - IRS published rates
  - Software

CRT for Farmers

- Funding a CRT with ordinary farm assets B.1.
- No income or SE tax to proprietor on inventory B.2.
  - Expenses allowable
  - CRT sells inventory tax-free
  - Distributions from CRT = ordinary income but not SE income
- Example 1: Concept
- Example 2: 10 year CRAT
- Example 3: No recapture of Sec. 1245
- Example 4: Section 179 recapture replaced by bonus
CRT Anti-Abuse Rules
1. 10% charitable remainder minimum \[D.1\].
2. 50% maximum payout \[D.2\].
3. 5% probability of exhaustion \[D.3\].
   - See Table
4. IRS provides sample trust provision \[E.2\].

CRT Design Issues
- Select highest of 3 AFRs to max. income payout \[F.1.c\].
  - Example 5: 3.2% AFR results in $799,350 to donor on $750,000 funding (10 year CRAT)
- Use fixed term CRAT \[F.2\].
- Analyze other client facts (Soc. Sec., MRDs, etc.) \[F.3\].
  - Example 6
- Effective tax rate for low-income recipients of SS \[F.3.c\].
  - Examples 7 and 8

CRT Illustrations
- 3.2% Sec. 7520 rate
- 10 year term, annual payout
- $750,000 funding
- Annual payout @ year end
- Payout amount, CRAT $79,935
- Charitable remainder 10.00%
Comparisons

<table>
<thead>
<tr>
<th>Taxpayer</th>
<th>Capital Gain</th>
<th>GRAT</th>
<th>CRT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$403,707</td>
<td>$183,871</td>
<td>$65,255</td>
</tr>
</tbody>
</table>

4.0% rate of return, instead of 2.5%

Comparisons

<table>
<thead>
<tr>
<th>Taxpayer</th>
<th>Capital Gain</th>
<th>GRAT</th>
<th>CRT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$536,247</td>
<td>$502,944</td>
<td>$617,911</td>
</tr>
</tbody>
</table>

Comments and Cautions

- Zero-basis ordinary property = no charitable deduction H.4.a.
- Benefit of spreading income H.4.c.
- Eliminating SE tax H.4.d.
- S corporation planning H.4.e.
- Tiering of distributions H.5.
- Need appraisal or valuation H.6.
- No active business interests: UBI tax H.6.c.
- No debt into CRT (H.6.e.2)
- No self-dealing, no sale to related party H.6.d.

CRT Compliance

- Form 5227, Split-Interest Trust Information Returns I.1.
  - Schedule K-1 (Form 1041) to beneficiary
  - Copy of CRT document 1st year
  - Calendar year I.2.
- Public inspection except K-1 and beneficiary information I.3.
Qualified Conservation Charitable Contributions

Qualified Conservation Easement

- Not subject to partial interest prohibition A.1.
  - Perpetuity—Example 1
- Qualified farmer or rancher: B.
  - 100% of AGI limit
  - 15 year carryover
  - Over 1/3 gross from farming B.2.
  - Property must remain available for ag production B.3.
- Includes incorporated farms (avoids 10% of income limit of C corp.) B.4.

Conservation Easements

- Farmer fails test in year of contribution C.1.
  - Bargain sale
- Nonfarmers: 50% of AGI and 15 year carryover D.1.
- 100% AGI limitation may waste tax benefits D.2.
  - Documentation D.
    - Qualified appraisals D.1.a.
    - Contemporaneous receipt D.1.a.
    - No right to substitute or move boundaries D.1.a.
    - Debt must be subordinated D.1.a.
- Estate value reduction due to restrictions in easement G.4.
Charitable Gifts of Commodities

- Tax savings A.2.
  - Income tax if use standard deduction A.2.a.
  - SE tax savings A.2.b.
- Inventory only; not landlord crop share B.1.
- Cash method farmer: Zero basis C.1.
- Two step process: C.2.
  - Donate via title transfer
  - Sale by charity
- Corporate gifts cannot be used to satisfy personal pledge E.2.

Charitable Contributions of Food Inventory

- Above-basis deductions F.2.
  - Gift to 501(c)(3) for care of ill, needy, infants F.2.a.
  - Written statement F.2.c.
  - Apparently wholesome food F.2.d.
- Limit on business income F.3
  - 15% of Schedule F
  - 15% of corporate income before charitable deduction
Food Inventory Deduction

- Deduction is lower of: F.5.
  - Basis plus ½ of what would have been ordinary income, or
  - Twice the tax basis

- Deemed basis for cash method grower = 25% FMV F.6.
  - Example 3
  - No appraisal required f.7.

Documentation

- Public storage G.2.
  - Warehouse receipt to charity
  - Payment upon sale directly to charity

- Home storage G.3.
  - Segregation
  - Charity arranges sale, receives payment

- Document production with FSA before donation G.5.
Charitable Contributions Related to Agriculture

Advanced Estate Planning Institute

Author and Presenter:

Paul Neiffer, CPA
CLA (CliftonLarsonAllen LLP)
This session is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the author is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought—From a Declaration of Principles jointly adopted by a Committee of the American Bar Association and a Committee of Publishers and Associations.

From Treasury Circular 230 Regulations:
Continuing education presentations provided to an audience solely for the purpose of enhancing practitioners’ professional knowledge on Federal tax matters are not considered written advice on a Federal tax matter [Reg. 10.37(a)(1)].

From the author:
The information contained herein is educational in nature. This material contains coverage of selected recent tax code changes, new regulations and other tax developments that by necessity of space and seminar timeframe are condensed, and may reflect only selected aspects of the development. The participant is cautioned not to rely on these summaries in lieu of a full review of the applicable statute, regulations and other authorities affecting any specific tax issue or transaction.
Table of Contents

Non-Charitable Gifts of Commodities.................................................................1

Use of a Charitable Remainder Trust to Defer Ordinary Income Sales ....................7

Qualified Conservation Charitable Contributions ..................................................30

Charitable Gifts of Raised Commodities .............................................................36
Non-Charitable Gifts of Commodities

A. Background.

1. Cash method farm proprietors have had several situations where gifts of farm commodities to family members are advantageous:

   a. Moving income to minor children to take advantage of their lower tax rates;

   b. Assisting with college costs for children of the taxpayer; and

   c. Supporting parents of the taxpayer.

2. The steep trust and estate income tax rates imposed on dependent children through age 23 limits the ability to shift unearned income in the form of gifts and subsequent sales of commodities to children of farm proprietors.

B. Tax consequences of commodity gifts of the farmer as donor.

1. There is no income recognition by a donor upon a gift of unsold inventory [Rev. Rul. 55-138; Rev. Rul. 55-531].

2. The assignment of income doctrine prevents a transfer of accrued income from one taxpayer to another. However, the courts, and subsequently the IRS, have held that a gift of unsold raised farm commodities represents a transfer of an asset (i.e., inventory) rather than an assignment of income [Estate of Farrier, 15 TC 277, 1950; SoRelle, 22 TC 459, 1954; Romine, 25 TC 859, 1956].

3. The farmer/donor sidesteps the income tax on commodities that are transferred by gift to another taxpayer. Further, the self-employment tax is also eliminated on the commodities, as excludable gross income is not considered in determining self-employment income [Reg. 1.1402(a)-2(a)].

4. Commodities that are the subject of a gift should have been raised or produced in a prior tax year, to avoid any expense adjustments for the donor.

   a. If current year crop is given, current year costs applicable to the commodity are not deductible by the donor [Rev. Ruls. 55-138 and 55-531].

   b. However, costs deducted on prior returns should not be disturbed by the IRS. Thus, a farmer reporting on a calendar year basis under the cash method is allowed full deductibility of expenses if a gift of raised commodity is not made until the tax year after harvest (i.e., the grain which is the subject of the gift was raised in a year prior to the gift, and all expenses were deducted in the prior year).

   c. The IRS notes that costs that apply to gifts of agricultural products may not be deducted as a farm business expense in the year of the gift or any later year (but by implication, costs deducted in a year prior to the gift will remain allowable) [IRS Publ. 225, Ch. 4].
5. Form 709, *U.S. Gift Tax Return*, is required if the value of the gift exceeds the $15,000 (2019 amount) annual exclusion per donee.
   a. Gifts in excess of the annual gift tax exclusion require Form 709. Gift-splitting is available for married donors.
   b. The gift of community property is deemed to be a gift of one-half from each spouse. If the gift does not exceed the combined annual gift tax exclusion for the year, Form 709 is not required (see instructions to Form 709 for treatment of gifts of community property).

   **C. Tax consequences of commodity gifts to donee.**
   1. The donor's tax basis in the commodity carries over to the donee [Sec. 1015(a)].
      a. In the case of raised commodities given in the year after harvest by a cash method producer, the donee receives the zero basis of the donor.
      b. Conversely, an accrual method farmer will have tax basis in raised commodities and there may be little income shifting accomplished from a gift.
   2. Assuming that the donee has not materially participated in the production of the commodity, the income from the sale of the commodity is classified as **unearned income**, and thus not subject to self-employment tax.
      a. Even though the raised farm commodity was inventory in the hands of the farmer-donor, the asset will typically not have inventory status in the hands of the donee, and thus represents a capital asset reportable on Schedule D at sale.
      b. Sec. 1221 defines a capital asset as **all property** other than items such as inventory and items held for resale, and Sec. 1231 productive assets used in a trade or business.
      c. Prior case law has established that an asset may be inventory in the hands of one taxpayer, but change its character in the hands of a second taxpayer, even if that taxpayer is related to the original holder of the inventory [*Greenspon*, 48 AFTR 979, CA-8, 1956; *Estate of Ferber*, 22 TC 261, 1954].
   3. The holding period of an asset in the hands of a donee refers back to the holding period of the donor [Sec. 1223(2)].
   4. **Commentary:** If the combined holding period of the donor and donee is more than a year after the harvest date, the donee has long-term capital gain upon sale.

   **D. Use of proceeds by the donee.**
   1. If the proceeds from the sale of the commodity by the donee revert back to the donor, **even by loan**, the IRS will assert that the donor has retained control over the funds and tax the commodity sale to the donor.
2. The Tax Court held that income was taxable to the parent, despite a purported transfer of farm property to children. The funds were not segregated in the hands of the children, but rather were retained by the parent [D. J. Fry, 4 TC 1045, 1945].

3. A parent was taxed on sales from a citrus grove owned by his four children, because the sales proceeds of the fruit were often retained by the parent and not reported by the children within their tax returns [Lawhon, 499 F2d 352, CA-5, 1974].

4. A farmer was found to be taxable on crops that were given to his children, where the sale proceeds from the crops were immediately lent from the children to the parents [G. J. Parkhill, 35 AFTR 2d 75-363, DC TX, 1974].

5. A farm proprietor who gave unsold soybeans to his wife was taxable on the income for SE tax purposes. The proceeds from this gift were deposited in a joint account where the husband maintained control over the funds [TAM 9210004].

6. Similarly, the IRS held that a proprietor's grain gift to his spouse was a tax avoidance transaction. There was no evidence that the donee/spouse had actual title to the grain, and the proceeds from sale were deposited into a joint account [TAM 9229002].

E. Other issues regarding gifts of commodities.

1. Commodity gifts of raised livestock.
   a. A donee who receives raised animals and takes responsibility for the care and feeding of these animals after the date of gift may face the risk of materially participating in the raising of the animals, and thus subject to self-employment tax.
   b. Several cases have allowed children to report the gain from the sale of cattle received as a gift, assuming the children evidenced a reasonable degree of control over the cattle and their sales proceeds. Physical segregation of the cattle at the time of gift is helpful, and any post-gift maintenance expenses for the animals should be paid by the donees [Harold Smith, TC Memo 1967-229; Harley Alexander, 41 AFTR 872, CA-5, 1952; Jones Livestock, TC Memo 1967-57; Adolf J. Urbanovsky, TC Memo 1965-276].

2. Crop share landlords.
   a. A crop share landlord receives commodities as the equivalent of rental income; the commodities do not have an inventory-asset status in the hands of the landlord.
   b. A gift or transfer by a landlord of a commodity received in a crop share arrangement is treated as an assignment of income disposition, causing full taxation to the donor/landlord at disposition [Rev. Rul. 63-66; Tatum, 22 AFTR 2d 5521, CA-5, 1968; Rev. Rul. 75-11].

3. A gift of zero basis culled dairy or breeding stock, as a Sec. 1231 asset, avoids the requirement of reducing current year costs of raising immature livestock.
F. Unearned income status of sale of commodities received as gifts.

1. Unearned income of a dependent child includes items such as interest, dividends and rents, as well as income recognized from the sale of raised grain received as a gift. This assumes that the commodities were transferred as a gift and not as compensation for services.

2. **Commentary:** The tax on the unearned income of a dependent child has a small inflation-indexed exemption [Sec. 1(g)(4), (j)(4)(D)]. For children who sell commodities received as a gift who are subject to the rules on unearned income:
   a. A dependent child is allowed a standard deduction that offsets the first $1,100 of unearned income (2019 amount).
   b. The next $1,100 of unearned income is subject to tax at the child’s single tax rate of 10%.
   c. The child’s unearned income in excess of $2,200 is taxed using the estate and trust income tax rate schedule.

G. Details for tax on unearned income of dependent child.

1. The tax reaches two groups who have attained age 18 (the Age Test) and whose earned income does not exceed half of their support (the Support Test) [Sec. 1(g)(2)(A)].

2. **Age Test.** The tax applies to a child who has attained age 18 before the close of the year and:
   a. Has not attained the age of 19 as of the close of the year (i.e., the child attained his or her 18th birthday during the year); **or**
   b. Is a full-time student at an educational organization during at least five months of the year who has not attained age 24 (i.e., a child who is a student who attained his or her 19th to 23rd birthday during the year).

3. **Support Test.** In addition, a child age 18-23 years old must have earned income that does not exceed one-half of the amount of the individual’s support for the year. In measuring support, amounts received as a scholarship by a student are not taken into account.

4. **Definition of support:**
   a. Support includes food, shelter, clothing, medical care, education and the like. Generally, the amount of support will be the amount of expense incurred in furnishing the item of support. If the item of support is in the form of property or lodging, the item is measured in terms of its fair market value [Reg. 1.152-1(a)(2)(i)].
   b. Support includes items such as a wedding for a child [Rev. Rul. 76-184] and the cost of education [Reg. 1.152-1(a)(2)(i)]. Student loan proceeds used to pay for education count as support from the child if the child is the obligor [McCaulley v. Comm., 56 TC 48, 1971].
c. Capital items provided to a child may represent support. An automobile purchased by the parent and owned by the parent but used by the child is not an item of support, other than out-of-pocket costs associated with the auto provided by the parent. However, an auto purchased and titled in the name of the child is an item of support of that child in an amount equal to its cost, whether provided by the parent or by the child [Rev. Rul. 77-282].

d. Only amounts actually expended during the year are considered in testing support [Rev. Rul. 58-404].

**Example 1  Child attains age 18 during the year**

**FACTS:**
- During the year, Sue attained her 18th birthday.
- Sue is subject to the tax on unearned income if her earned income is less than or equal to 50% of the cost of her support.
- Sue’s food, housing, transportation, and any educational costs are $16,000,

**RESULT:**
- Sue is subject to the unearned income tax if her earned income (W-2 or self-employment income) is $8,000 or less.

**Example 2  Tax applicable to college student age 20**

**FACTS:**
- Sam is a college student, age 20, with several scholarships.
- During the year, items expended for Sam’s support include room, board, tuition and other items that total $26,000.
- Sam has received scholarships of $6,000; Sam’s total support is $20,000.
- Sam’s W-2 income from employment at his university is $5,000.

**RESULT:**
- Sam is subject to the tax on unearned income, even though attaining age 20 this year.

**Example 3  Increasing compensation to avoid the Kiddie Tax**

**FACTS:**
- Assume the same facts as Example 2, except that Sam’s parents, who operate a farm proprietorship, pay wages to Sam in the amount of $6,000, which is a reasonable wage for the services.

**RESULT:**
- Sam’s total earned income is $11,000 ($5,000 Form W-2 from employment at his university and $6,000 Form W-2 from his parents for summer farm work).
- This total earned income of $11,000 is more than half of Sam’s $20,000 of support.
- Sam is not subject to the tax on unearned income.
5. **Commentary:** In the preceding example, an opportunity would arise to give unsold grain or other raised commodities to Sam, for sale within the same year. Sam could recognize the unearned income from the sale of his commodities without imposition of the higher income tax rates. These amounts would then be held and disbursed by Sam for items of support in the subsequent year. Note that the application of the tax on unearned income to those age 18 through 23 compares the child’s earned income to that individual’s items of support for the year, and ignores the amount of unearned income. It may be possible to recognize significant amounts of unearned income from commodity sales and yet have the child exempt from the higher estate and trust income tax rate due to earned income that exceeds half of those support expenditures for the year.

H. **Long-term capital gain opportunity.**

1. When a gift of commodities occurs, the holding period of the asset in the hands of the donee refers back to the holding period of the donor [Sec. 1223(2)].

2. Accordingly, a donee who exceeds the 12/24-month holding period requirement on the sale of commodities/breeding livestock is entitled to the preferential long-term capital gain rates.

3. **Commentary:** Even though the long-term capital gain rate of parents making a gift of commodities is often at the 15% (maybe 20%) rate and the estate and trust income tax rates apply, a significant tax advantage still exists. Not only are the ordinary tax rates of the parent avoided on the sale of the commodity, but the self-employment tax is also avoided (this assumes the child did not participate actively in raising the grain).

---

**Example 4   Using capital gain rates on a commodity gift**

**FACTS:**
- Phil, a farm proprietor, has a daughter who will need significant funds for higher education.
- At least a year in advance, Phil and his spouse give approximately $20,000 of unsold commodities to his daughter and file Form 709 to report gift-splitting (unless community property).
- The daughter holds the commodity in storage, titled in her name, and after a 12-month holding period from the date of harvest, she sells the commodity.

**RESULT:**
- The daughter reports the sale as a long-term capital gain on her tax return.
- Assuming that the estate and trust income tax rate schedule applies, some of the capital gain is taxed at 23.8% (unless she splits the sale into two tax years).
- Without this planning, the grain would have been taxable at an ordinary federal income tax rate in Phil’s 1040, and would have incurred additional self-employment tax.
I. **Summary: Commodity gifts to family members.**

1. Cash-method farm proprietors who intend to give raised commodities to another individual should recognize that the transaction must be accomplished in two distinct steps.
   
a. The donor gives unsold inventory, using prior year crop or commodity, and documents the transfer of the title/ownership in the commodity as transferred to the donee.
   
b. The donee independently and at a later date sells the commodity, recognizing income because of the zero basis in the commodity. The income is reported typically as a short-term capital gain (but see above regarding holding period).

2. The donee, as the owner of the sold commodity, must retain full ownership and control of the sale proceeds from the commodity. Loans and other circular arrangements that move the funds, or their economic benefit, back to the donor will be collapsed by the IRS and courts.

3. The application of the tax on unearned income makes **Sec. 529 plans** an attractive strategy for accumulating investments for higher education costs. Earnings and gains from Sec. 529 plans are not taxable, and funds can be withdrawn tax-free if expended for higher education costs.

4. Start giving commodities to the children at an early age. Unlike commodity wages, there is no reasonableness test.

5. Plan for commodity gifts in amounts that result in the tax on unearned income to be lower than the combined regular and self-employment tax of the parents.

**Use of a Charitable Remainder Trust to Defer Ordinary Income Sales**

A. **Background.**

1. A Charitable Remainder Trust (CRT) allows the tax-free sale of assets, with income paid to the donor during the donor's lifetime and the trust corpus paid to a named charity upon trust termination.

2. The CRT must be irrevocable, valid under state law, and organized as either a charitable remainder annuity trust or charitable remainder unitrust [Sec. 664].

3. Both the donor and the beneficiary must be a person, which may include corporations, partnerships and individuals (individual must be living to create the trust) [Secs. 664(d)(1)(A) and 664(d)(2)(A)]. More than one person may be a beneficiary.

4. An **annuity trust** provides for a payment each year to one or more persons of either a fixed amount or a percentage of the initial value of the trust.

5. A charitable remainder **unitrust** provides for payments to one or more persons computed as a percentage of an annual revaluation of the trust assets.
6. **Unitrust vs. annuity trust.**

   a. Both the annuity trust and the unitrust require minimum percentage distributions of 5% (fixed on the initial value of the annuity trust or on the annual market value of the unitrust) [Sec. 664(d)(1)(A) and (2)(A)].

   b. Both forms may have a fixed term not to exceed 20 years, or payments to continue for the life of the beneficiary(ies) [Sec. 664(d)(1)(A) and (2)(A)].

   c. The unitrust agreement may provide that distributions will not be made in excess of the trust’s accounting income [Sec. 664(d)(3)(A)]. That limitation may further provide for make-up distributions in later years [Sec. 664(d)(3)(B)].

   d. A unitrust may accept additional contributions in later years [Reg. 1.664-3(b)]; an annuity trust may not receive additional contributions after the initial funding [Reg. 1.664-2(b)].

7. **Commentary:** Use of pre-approved IRS sample documents eliminates any tax uncertainty, and saves legal fees in creating the trust. However, an attorney familiar with state law should still be used to finalize the drafting of the CRT document.

8. **Sequence and tax result of the charitable remainder trust.**

   a. **Step One:** The donor creates an irrevocable charitable remainder trust; the terms of the trust require an annual income stream back to the donor, but with the remainder value passing to a charitable organization at the death of the donor/beneficiary or after a specified term of years.

   b. **Step Two:** The donor transfers assets to the trust.

      1) If the asset is an appreciated long-term capital gain asset, a charitable income tax deduction for the market value of the asset is available, but reduced by the value of the retained income interest

      2) A capital gain asset for this purpose includes Sec. 1231 assets, except to the extent of Sec. 1245 and Sec. 1250 ordinary income recapture.

   c. **Step Three:** After receipt of the asset, the charitable trust typically sells the asset, but reports no taxable gain due to its charitable status.

   d. **Step Four:** The charitable trust invests the sale proceeds to provide a source of income to allow payment of the specified income interest to the donor.

   e. **Step Five:** Upon the termination of the trust (expiration of the term interest or death of the last beneficiary, as applicable), the property within the trust passes to the charity; the property is not part of the taxable estate of the donor and thus escapes any estate taxes.
9. Tax and planning strategies with charitable remainder trusts.

a. Charitable remainder trust donations are deductible for both regular tax and alternative tax purposes.

b. To achieve a charitable deduction, the asset contributed to the charitable remainder trust must be eligible for long-term capital gain status. Stock in a corporation or appreciated real estate would be typical examples. Ordinary income assets, such as inventory or depreciable equipment, do not produce a charitable deduction for the donor, other than to the extent of any basis in the asset.

c. The charitable income tax deduction of the donor is subject to a 30%-of-Adjusted Gross Income (AGI) annual limitation [Sec. 170(b)(1)(C)]. If a large charitable contribution exceeds this annual 30%-of-income limit, the excess is eligible for a five-year carryover.

   1) This 30%-of-income limitation has the advantage of spreading the charitable contribution into several tax years, and often allows the contribution to be used against the highest bracket income over several tax returns.

   2) 50% charitable contributions are considered before the allowance of the 30% contributions.

   3) Current year contributions are considered before using charitable contribution carryovers into the current year.

   4) Consequently, it is important to plan the utilization of the charitable contribution, to assure that it will be fully utilized within the six eligible tax return years (the year of donation plus five forward years). In some cases, it is necessary to fund the unitrust over a number of years to assure utilization of the contribution carryovers.

d. The amount of the charitable income tax deduction for capital assets is contingent upon three primary factors:

   1) The amount or percentage of the retained income interest (the higher the annual income back to the donor, the smaller the value of the charitable deduction for the remainder portion);

   2) The term of years or life expectancy of the retained income interest (the shorter the income interest or the shorter the life expectancies of the beneficiaries, the greater the charitable income tax deduction); and

   3) The IRS-published 120% annual mid-term AFR interest rate which must be selected from either the current month or two-month period prior to the charitable transfer (the greater the interest rate, the larger the charitable deduction). This rate is identified in Table 5 of the monthly publication of the AFR by the IRS.
4) **Commentary:** The IRS tables for term and remainder interests and life expectancies are issued in three IRS publications: Pubs. 1457, 1458, and 1459. Charitable planning software is now most often used to compute the results.

e. **Commentary:** If the donor desires to replace the value of the asset which has been given to charity, the income stream and tax savings from the charitable trust may be used by the donor to purchase life insurance to benefit the heirs of the donor. If this life insurance is acquired within an irrevocable life insurance trust, the death benefit proceeds are not reduced by estate taxes.

**B. Funding a charitable trust with ordinary income farm assets.**

1. The IRS approved a cash method farm proprietor’s transfer of crops and raised beef cattle to a charitable remainder unitrust [PLR 9413020].

2. Key income tax aspects of the private ruling:
   
a. The farm proprietor did not recognize any taxable income or any self-employment income upon the transfers of the farm inventory items to the unitrust.
   
b. The expenses that the farmer incurred in raising the cattle and crops prior to transfer to the unitrust remain as allowable farm deductions within his tax return.
   
c. The unitrust would not recognize any income on its subsequent sale of the farm inventory items, even if the sale occurred within a short period of time following the donation by the farmer, provided that the sale was not a prearranged transaction, and was independently enacted by the trustee of the unitrust.
   
d. The annual distributions from the unitrust to the farmer-donor would be ordinary income, but would not be self-employment income.

3. The facts in the ruling also noted that the farmer intended to contribute farm machinery to the unitrust at a later point in time.

4. **Commentary:** Because the transfers of assets in this ruling all represented ordinary income property (as opposed to capital gain property), no charitable deduction was expected for the farmer-donor [Sec. 170(e)(1)]. Rather, the objective of this strategy is to convert grain, livestock and machinery into cash at retirement without incurring the usual high income and social security tax costs (often nearly 50%). Income tax and cash flow is spread over a period of years.
Example 1  Sale vs. gift of grain

Jim is a 70 year old cash method farm proprietor with a substantial amount of unsold crop inventory on hand at the point of retirement. The following calculations illustrate the tax return and cash flow results to Jim if he sells the grain in a taxable transaction and invests the proceeds to provide retirement income, or alternatively contributes the grain to a charitable remainder unitrust, retaining a lifetime annual income for him and his spouse:

<table>
<thead>
<tr>
<th>Strategy #1: Sell grain and invest proceeds</th>
<th>Tax Return</th>
<th>Annual Cash Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale of grain</td>
<td>$ 200,000</td>
<td></td>
</tr>
<tr>
<td>Less federal, state and SS tax costs (50%)</td>
<td>(100,000)</td>
<td></td>
</tr>
<tr>
<td>Excess cash to invest</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>x Annual yield</td>
<td>4.00%</td>
<td></td>
</tr>
<tr>
<td>Annual income</td>
<td></td>
<td>$ 4,000</td>
</tr>
<tr>
<td>Remaining asset to heirs</td>
<td>$ 100,000</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Strategy #2: Contribute grain to CRT, with 5% retained income</th>
<th>Tax Return</th>
<th>Annual Cash Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale of grain by CRT</td>
<td>$ 200,000</td>
<td></td>
</tr>
<tr>
<td>Less tax costs</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Excess cash to invest</td>
<td>200,000</td>
<td></td>
</tr>
<tr>
<td>x Annual yield</td>
<td>5.00%</td>
<td>$ 10,000</td>
</tr>
<tr>
<td>Annual income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asset to heirs</td>
<td>$ -</td>
<td></td>
</tr>
</tbody>
</table>

5. Observations:

a. In the case of contributing the grain to the charitable remainder trust, there is no charitable deduction to the farmer, because the asset is ordinary income/zero basis.

b. The Net Investment Income Tax (NIIT) of 3.8% applies against the net investment income distributed from the CRT. IRS regulations provide that the trust's distributions are presumed to carry out the trust's NII first. See more information, below.

c. The danger with the CRT strategy making a lifetime payout involves the untimely early deaths of both beneficiaries; the extra annual income generated by the CRT would be interrupted. Strategies to eliminate this risk include:

1) Purchase of a life insurance policy to replace the asset lost to the heirs.

2) Addition of a second life (such as a spouse) as a successor income beneficiary, to assure that the income stream remains within the family for a longer period of time. Caution: The charitable remainder value must be projected to be at least 10%—see below.
3) Use of a fixed term CRAT which continues to make its payments to the estate or heirs of the grantor.

6. Caution: The property contributed to the CRT must not be committed. It must be free of a forward contract, not collateral on a debt obligation and not already sold under a deferred payment contract. The CRT must be allowed to sell the property without previous restriction. Due to self-dealing rules, the CRT must not sell the property to a related party, even in a public auction [Rev. Rul. 76-18].

Example 2 Use of a 10 year charitable remainder trust

Red, a 50-year old farmer, learns that health problems require him to exit from his cash method farm proprietorship business. When Red meets with his tax planner, he learns that selling his zero basis commodity inventory of $400,000 will trigger about $200,000 in federal and state income tax and self-employment tax (about 50% of the value of the crop). At the suggestion of his tax planner, Red forms a charitable remainder trust, transferring the unsold grain to this trust at a time when its market value is $400,000. The trust has a term of 10 years. If structured as a charitable remainder unitrust, the trust can pay an annual 20.6% amount to Red (20.6% of the fair market value of the trust, redetermined annually). If structured as a charitable remainder annuity trust, the trust can pay a fixed amount of almost $39,650 per year to Red for the 10-year period. In both cases, the percentage of the gift benefiting the charity is projected to be slightly in excess of 10%, ensuring that the trust qualifies under Sec. 664 as a charitable remainder trust. Because the trust is a fixed term, distributions will continue to Red’s beneficiary(ies) (presumably, his wife).

In either case, Red has replaced a present value tax cost of 50% for a present value charitable gift of about 10%. However, Red must still pay ordinary income tax on the payments received from the charitable trust. The efficiency of this arrangement lies in the possibility of lower federal and state income tax rates if this ordinary income is spread over 10 years, and that the SE tax is eliminated.

Caution: The payout optimization varies depending upon the Sec. 7520 rate published monthly by the IRS; the preceding illustrations are based on a 1.8% Sec. 7520 AFR.

C. Recapture of depreciation.

1. If Sec. 1245 property is disposed of and the amount realized exceeds the adjusted basis of the property, the gain is treated as ordinary income which “shall be recognized notwithstanding any other provision of this subtitle” [Sec. 1245(a)(1)].

   a. Depreciation recapture under Sec. 1245 does not apply to gifts, transfers at death, certain tax-free transfers, Secs. 1031 and 1033 exchanges, and specific other transfers [Sec. 1245(b)]. The donor does not recognize gain upon the gift of Sec. 1245 property to the CRT.

   b. The unrelated business income tax (UBIT) does not include gains and losses from the sale or exchange of assets or the disposition of property other than stock in trade or property held for customers [Sec. 512(b)(5)].
c. The nonrecognition provisions subtitle A (the income tax) are overridden by Sec. 1245 in a specific reference to various sections of the Internal Revenue Code, including Sec. 512(b)(5) [Reg. 1.1245-6(b)].

d. Property dispositions by an exempt organization are subject to Sec. 1245 recapture gain, but only to the extent depreciation was allowed or allowable in computing unrelated business taxable income (UBTI) or in computing taxable income for a period in which it was not tax-exempt [Reg. 1.1245-2(a)(8)].

e. **Commentary:** The donor is not subject to Sec. 1245 recapture gain upon the gift of Sec. 1245 property to the CRT. The CRT may not operate an unrelated trade or business (see H.6.c. below). An immediate sale of the property by the CRT will not trigger recapture gain to the CRT.

---

**Example 3  Recapture under Sec. 1245**

**FACTS:**
- Jason owns a dairy including modern milking facilities valued at $1 million, fully depreciated.
- Jason has arranged to sell the farm on an installment sale, including the dairy facilities, to a buyer who will continue to use the facilities in her dairy operation.
- In your tax planning meeting, you inform Jason that the $1 million Sec. 1245 gain is recognized in the year of sale, regardless of the amount of down payment.
- You also mention that Sec. 1245 real property exchanged under Sec. 1031 for non-1245 real property does not defer the gain.

**RESULT:**
- You present the CRT strategy to Jason, in effect creating a stream of payments that mimic the effect of an installment sale.
- Jason is not subject to tax on the gift of the property to the CRT.
- The CRT will not recognize gain on the immediate sale, because the CRT did not use the property in its UBIT activity.

**Commentary:** The sale arranged by Jason cannot be bound prior to the gift to the CRT. A binding commitment to sell will trigger gain to Jason based upon the assignment of income doctrine. See Rev. Rul. 78-197 and *Palmer v. Comm.*, 82 TC 684, 1974.

---

2. Regulations may provide for recapturing the benefit of Sec. 179 deductions with respect to property not used predominantly in a trade or business at any time [Sec. 179(d)(10)].

   a. Recapture applies if the property’s use in a trade or business terminates before the end of its recovery period [Reg. 1.179-1(e)(1)].

   b. If the taxpayer disposes of the property, the property is not treated as used in the taxpayer’s trade or business, and recapture applies [Reg. 1.179-1(e)(2)].
3. Upon a gift to a CRT, the property is no longer used in the taxpayer’s trade or business.
   a. The transfer of property before the expiration of its normal cost recovery period will trigger Sec. 179 recapture, even though recapture under Sec. 1245 does not apply [Reg. 1.179-1(e)].
   b. The amount recaptured is the difference between the Sec. 179 claimed and the amount of cost recovery which would have applied had Sec. 179 not been elected [Reg. 1.179-1(e)(1)].
   c. The amount of cost recovery which would have applied considers bonus depreciation which would have been claimed, unless the taxpayer elected out of bonus depreciation on that cost recovery period.

Example 4  Section 179 recapture upon contribution to CRT

FACTS:
• Jenn constructs a livestock feeding facility for $2.1 million in 2019, electing Sec. 179 for $1,000,000 of the cost.
• The remaining $1,100,000 is depreciable over 10 years. However, 100% bonus depreciation is claimed.
• Upon retirement from farming in 2023, she donates the feeding facility and underlying land to a CRT, to receive annuity payments.

RESULT:
• Sec. 1245 recapture does not apply because this is a gift.
• Because bonus depreciation would have been claimed on 100% of the cost had Sec. 179 not been elected, there is no Sec. 179 recapture.

4. Practice Tip: If Sec. 179 would not have been replaced with bonus depreciation and the year in which Sec. 179 was claimed is available to amend under the statute of limitations, an amended return may be filed to shift the Sec. 179 deduction to other qualifying assets purchased during that year. If available, this strategy will prevent Sec. 179 recapture from applying. See Topic 4B.

D. The anti-abuse barriers to using charitable remainder trusts.

1. The 10% charitable remainder minimum.
   a. The value of the charitable remainder in any transfer to a qualified charitable remainder annuity trust or a charitable remainder unitrust must be at least 10% of the net fair market value of the property as of the date of the contribution to the trust [Sec. 664(d)(1)(D) and (d)(2)(D)].
   b. The statute measures the necessary charitable remainder amount by reference to net present value at inception of the trust. Ultimately, when the trust reaches its conclusion at either the end of the term certain or the lifetime(s) of the donor/spouse, there may be significantly more or significantly less than the 10% target, but that is immaterial to the eligibility of the entity as a qualified charitable remainder trust.
2. The maximum annual payout percentage may not exceed 50% of the initial net fair market value of all property placed in the trust in the case of a CRAT and 50% of the net fair market value of the assets as annually revalued in the case of a CRUT [Sec. 664(d)(1)(A) and (d)(2)(A)].

3. Five percent probability-of-exhaustion rule.

   a. In 1977, the IRS indicated that no charitable deduction would be allowable at creation of a CRAT if there is a greater than 5% actuarial probability that the income beneficiary will survive the exhaustion of the corpus of the charitable trust [Rev. Rul. 77-374].

      1) The foundation for this position is the provision in estate and gift tax regulations holding that no deduction is allowable where a charitable transfer is subject to a condition “unless the possibility that the charitable transfer will not become effective is so remote as to be negligible” [Reg. 20.2055-2(b)(1); Reg. 25.2522(c)-3(b)(1)].

      2) Although the 5% probability-of-exhaustion rule is defined in terms of the estate and gift tax charitable deduction, the Sec. 170 income tax charitable deduction regulations contain similar language [Reg. 1.170A-1(e)].

   b. This 5% probability rule is not applicable to a CRUT that provides a payback limited to annual income, because under this formula the trust corpus is never invaded [PLR 7915038].

      1) However, the IRS approaches the application of the 5% rule to other unitrust paybacks on a case-by-case basis [GCM 37770, 11/30/78].

      2) With the enactment of the 10% charitable remainder minimum in 1997, as discussed above, this rather vague IRS 5% probability position is now considered by most practitioners to be eliminated in favor of the statutory 10% threshold.

   c. As a practical matter, most practitioners rely on their charitable planning software to test a CRAT’s eligibility under the 5% probability-of-exhaustion test. With today’s low interest rates, many CRATs based on the donor’s life expectancy will fail the 5% probability test, even though they pass the 10% charitable remainder threshold. However, fixed term CRATs, particularly those designed to provide only a short-term income tax deferral, face less likelihood of encountering the 5% probability problem.

<table>
<thead>
<tr>
<th>Charitable Remainder Annuity Trust (CRAT)</th>
<th>($100,000 corpus, 3.2% AFR, quarterly income payback)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Term</strong></td>
<td><strong>Fixed Payout</strong></td>
</tr>
<tr>
<td>5 yr.</td>
<td>$19,531</td>
</tr>
<tr>
<td>10 yr.</td>
<td>$10,533</td>
</tr>
<tr>
<td>15 yr.</td>
<td>$7,558</td>
</tr>
<tr>
<td>20 yr.</td>
<td>$6,809</td>
</tr>
<tr>
<td>Lifetime (age 64, 1 life)</td>
<td>$5,000</td>
</tr>
</tbody>
</table>
d. In view of today’s relatively low AFR interest rates, charitable remainder trusts that are structured for the lifetime of the donor may not qualify under the 10% test unless a lower payback percentage is selected. This is particularly true for annuity trusts (CRATs) with a fixed annual payback vs. unitrusts (CRUTs) with a declining annual payback, as illustrated by the following charts:

<table>
<thead>
<tr>
<th>Donor Age</th>
<th>Unitrust %:</th>
<th>6%</th>
<th>8%</th>
<th>10%</th>
</tr>
</thead>
<tbody>
<tr>
<td>70</td>
<td>46.79%</td>
<td>37.63%</td>
<td>30.78%</td>
<td></td>
</tr>
<tr>
<td>60</td>
<td>32.40%</td>
<td>23.76%</td>
<td>17.99%</td>
<td></td>
</tr>
<tr>
<td>50</td>
<td>21.15%</td>
<td>13.97%</td>
<td>9.73%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Donor Age</th>
<th>Fixed %:</th>
<th>6%</th>
<th>8%</th>
<th>10%</th>
</tr>
</thead>
<tbody>
<tr>
<td>70</td>
<td>34.88%*</td>
<td>13.18%*</td>
<td>0%*</td>
<td></td>
</tr>
<tr>
<td>60</td>
<td>11.31%*</td>
<td>0%*</td>
<td>0%*</td>
<td></td>
</tr>
<tr>
<td>50</td>
<td>0%*</td>
<td>0%*</td>
<td>0%*</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Donor Age</th>
<th>Unitrust %:</th>
<th>6%</th>
<th>8%</th>
<th>10%</th>
</tr>
</thead>
<tbody>
<tr>
<td>70 and 70</td>
<td>34.89%</td>
<td>25.13%</td>
<td>18.32%</td>
<td></td>
</tr>
<tr>
<td>65 and 65</td>
<td>27.67%</td>
<td>18.55%</td>
<td>12.65%</td>
<td></td>
</tr>
<tr>
<td>60 and 60</td>
<td>21.64%</td>
<td>13.46%</td>
<td>8.55%</td>
<td></td>
</tr>
</tbody>
</table>

* But 5% probability test of Rev. Rul. 77-374 failed.

e. **Commentary:** With a 3.2% interest rate, the minimum donor/beneficiary age is 65 with a 5% fixed distribution (the minimum allowed) in order to pass the 5% probability test. The CRUT is only likely to fail with lower age donor/beneficiaries or a larger percentage.

E. **IRS provides a sample trust provision that will be treated as a qualified contingency.**

1. Certain contingencies are permitted to qualify the trust as a CRT if, but for the qualified contingency, the trust fails the requirements [Sec. 664(f)].

2. A trust provision may be added to allow for early termination of the CRAT so as to prevent the trust from failing to qualify as a CRT [Rev. Proc. 2016-42].
3. **Commentary:** The use of a CRAT as a charitable giving tool has been limited in recent years due to low interest rates. For example, the Sec. 7520 interest rate for July 2016 prevented a 70-year-old donor from forming a single life CRAT to pay distributions over lifetime, due to the 5% probability of exhaustion test. A term of years sufficiently short in number would otherwise be required. The 3.2% rate for April 2019 reduces the disallowed age to 64.

4. The sample language provides for early termination of the trust by an immediate distribution of the trust assets to the charitable remainderman. This applies on the date immediately before the date on which any annuity payment would be made if that payment would result in the discounted value of the trust corpus to be less than 10% of the value of the initial corpus [Rev. Proc. 2016-42, Sec. 4.02].

5. As a result, the annuity payments to the donor terminate.

**F. Fixed term CRT design issues.**

1. Selecting the AFR.
   a. In calculating the charitable remainder (in order to test the required 10% charitable remainder minimum or the 5% probability-of-exhaustion rule), the current Sec. 7520 rate is a factor in the calculation.
   b. Table 5 of the monthly Applicable Federal Rate (AFR) release is the Sec. 7520 rate used for CRTs. It is used in computing the remainder interest.
   c. The taxpayer has the flexibility of selecting the Sec. 7520 rate for the month in which the valuation date falls or either of the two preceding months [Reg. 1.7520-2(a)].
   d. **Commentary:** Selecting the highest Sec. 7520 rate available will maximize the charitable remainder amount, providing the maximum income payout to the donor.

**Example 5 Selecting AFR for a fixed term CRAT**

Bea is considering the use of a 10-year CRAT, to be funded with an appreciated asset worth $750,000. The trust will pay income annually, and will be designed to meet the minimum 10% charitable remainder threshold. Bea’s tax advisor tests the AFR for the current and prior two months and determines that either the February or April rate should be selected:

<table>
<thead>
<tr>
<th>Month</th>
<th>AFR</th>
<th>10% Charitable Minimum</th>
</tr>
</thead>
<tbody>
<tr>
<td>February</td>
<td>3.2%</td>
<td>$79,935</td>
</tr>
<tr>
<td>March</td>
<td>3.2%</td>
<td>79,935</td>
</tr>
<tr>
<td>April</td>
<td>3.0%</td>
<td>79,125</td>
</tr>
</tbody>
</table>

e. **Commentary:** If the AFR decreased to 2.2%, the annual payout would decrease to $75,930.
2. Fixed term CRAT vs. CRUT.
   a. In the case of a CRAT or CRUT with a fixed term of years, the payments may be continued to the donor’s estate or heirs, in the event the donor(s) die before expiration of the income payout term [Rev. Rul. 74-39].
   b. A CRAT tends to minimize the income tax consequences of the CRT payout to the donor, as the payments are level.
   c. Conversely, under a short-term CRUT, the income payout in the first few years can be substantial, causing a higher income tax bracket consequence to the donor.

3. Client income tax variables.
   a. When a short-term CRAT or CRUT is being considered in order to provide income tax deferral on a large gain or other high income event, the tax advisor should carefully analyze other income factors affecting the client’s 1040.
   b. For most higher income clients, the attainment of age 70½ brings the inception of large minimum required distributions of IRAs and qualified retirement plan accounts [Sec. 401(a)(9)]. In this case, a short-term CRT might be designed to end prior to the beginning of the MRD payouts.

Example 6  CRT ending at MRD inception

Willis, age 61, a farm sole proprietor, is selling his farm assets and retiring. Willis is considering the use of a short-term CRT to accommodate the disposition of $500,000 of fully depreciated machinery and equipment to be sold at an auction. Recognizing that in about nine years Willis will attain age 70½ and be required to begin large minimum distributions from his retirement plan, his tax advisor designs a CRAT for a nine year term. Effectively, the $500,000 of equipment auction proceeds will be spread over the next nine years’ tax returns, filling the gap between Willis’ prior high income from operating the farm and future high income that will commence with retirement plan distributions.

c. Taxability of social security benefits.
   1) While most high income clients will automatically have 85% of their social security benefits brought into taxable income, other middle and lower income clients may be in the midst of an expensive phase-in range [Sec. 86].
   2) As a result of not being indexed, a greater number of taxpayers are subject to a greater amount of Social Security benefits being taxed.
3) The following chart is an approximation of the formula used to phase-in the taxation of social security benefits. Income for this purpose includes federal adjusted gross income increased by tax-exempt interest income and 50% of social security benefits:

<table>
<thead>
<tr>
<th>Taxable portion of S.S. benefits</th>
<th>Income</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>Joint</td>
<td>Single</td>
</tr>
<tr>
<td></td>
<td>Under $32,000</td>
<td>Under $25,000</td>
</tr>
<tr>
<td>50%</td>
<td>Over $32,000</td>
<td>Over $25,000</td>
</tr>
<tr>
<td>85%</td>
<td>Over $44,000</td>
<td>Over $34,000</td>
</tr>
</tbody>
</table>

**Example 7  Taxable social security – joint filers**

George and Mary, both over age 65, receive interest, rent and other retirement income of $26,000. Their social security benefits are $12,000. At this level, they are just beneath the phase-in of taxable social security benefits, and would incur about $300 of federal income tax for 2019. If they add an additional $10,000 of income each year, such as from CRT payouts, they must also add $5,000 of social security benefits to their tax return. This increases their tax to about $1,800. This increase represents a 14% rate on the $10,000 of added income, even though most of that income is taxed in the 10% tax bracket:

<table>
<thead>
<tr>
<th></th>
<th>Before</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental income</td>
<td>$ 26,000</td>
<td>$ 26,000</td>
</tr>
<tr>
<td>Additional income</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Taxable Social Security</td>
<td></td>
<td>5,000</td>
</tr>
<tr>
<td>Adjusted Gross Income</td>
<td>26,000</td>
<td>41,000</td>
</tr>
<tr>
<td>Standard deduction</td>
<td>(27,000)</td>
<td>(27,000)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>(1,000)</td>
<td>14,000</td>
</tr>
<tr>
<td>Income tax</td>
<td>$ -</td>
<td>$ 1,400</td>
</tr>
<tr>
<td>Additional tax</td>
<td></td>
<td>$ 1,400</td>
</tr>
<tr>
<td>Effective tax rate</td>
<td>14.00%</td>
<td></td>
</tr>
<tr>
<td>Stated marginal rate</td>
<td>10.00%</td>
<td></td>
</tr>
</tbody>
</table>
Example 8  Taxable social security – single filer

If the same numbers occur in a retired single taxpayer’s return, with only one personal exemption and the standard deduction is less, the effective tax rate is 25%, even though the taxpayer is in the 15% bracket:

<table>
<thead>
<tr>
<th></th>
<th>Before</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental income</td>
<td>$ 26,000</td>
<td>$ 26,000</td>
</tr>
<tr>
<td>Additional income</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>Taxable Social Security</td>
<td></td>
<td>3,500</td>
</tr>
<tr>
<td>Adjusted Gross Income</td>
<td>29,500</td>
<td>46,200</td>
</tr>
<tr>
<td>Standard deduction</td>
<td>(13,850)</td>
<td>(13,850)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>15,650</td>
<td>32,350</td>
</tr>
<tr>
<td>Income tax</td>
<td>$ 1,684</td>
<td>$ 3,688</td>
</tr>
<tr>
<td>Additional tax</td>
<td></td>
<td>$2,004</td>
</tr>
<tr>
<td>Effective tax rate</td>
<td></td>
<td>20.04%</td>
</tr>
<tr>
<td>Stated marginal rate</td>
<td></td>
<td>12.00%</td>
</tr>
</tbody>
</table>

G. CRT illustrations.

1. Annuity vs. unitrust – fixed term.

   a. Assume that a taxpayer intends to fund a 10-year CRT with a $750,000 asset in an attempt to spread the tax gain from the disposition of that asset over 10 future tax returns. If the objective is to design a CRAT or a CRUT that projects the requisite 10% minimum to the charitable remainder entities, the following would be the design parameters assuming a 3.2% Sec. 7520 rate and a 2.5% tax-free rate of return:

<table>
<thead>
<tr>
<th>10 Yr. CRT (annual payout, end of yr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CRAT</td>
</tr>
<tr>
<td>------</td>
</tr>
<tr>
<td>Value of gift</td>
</tr>
<tr>
<td>Section 7520 rate</td>
</tr>
<tr>
<td>Term</td>
</tr>
<tr>
<td>Payout amount</td>
</tr>
<tr>
<td>Charitable Remainder</td>
</tr>
</tbody>
</table>

   b. The payout amount ($79,935 in the case of the CRAT or 21.225% in the case of the CRUT) is determined using CRT software that provides an option to maximize the donor’s income and result in a charitable remainder percentage that meets or slightly exceeds 10%.
2. See Appendix 1 illustrating the earnings and payouts of the CRAT vs. the CRUT.

   a. This illustration assumes that the investments within the CRAT or CRUT have produced earnings over the 10-year term that are equal to the 3.2% Section 7520 rate.

   b. The balance in the CRTs at the end of the 10-year term, to be disbursed to the charitable remainder entity, is about 13.7% of the contribution amount (i.e., about $102,800, compared to the $750,000 beginning amount). This is approximately 10% of the present value of the amount contributed to the CRT.

   c. The results between the CRAT and the CRUT are the same in this illustration because the investment performance was assumed the same as the Sec. 7520 rate (3.2%).

   d. The actual amount that will transfer to the CRT will be more or less, depending upon actual investment performance of the CRT.

3. **Commentary:** If tax deferral is the objective of using the CRT, the CRAT will generally perform better than the CRUT, due to the level payout stream under the CRAT. This can be noted from the Appendix 1 illustration: a short-term CRUT results in very large payouts in the early years and declining payouts in later years. This payout stream may unduly increase taxes in the early years of the CRUT payouts.

H. **Outright sale vs. CRT illustrations.**

1. An illustration has been prepared to illustrate the after-tax cash flow to a client if zero-basis inventory is sold outright vs. disposed of in a deferred transaction through a 10-year CRAT or CRUT (Appendix 2). The Federal tax rate savings may be as high as 37% (ordinary) plus self-employment tax.

2. Earnings assumptions in illustrations.

   a. In Alternatives 1 and 2, the earnings inside the short-term CRT are assumed to occur at an average 2.5% rate. While the CRT can safely invest in the highest yielding taxable securities available, recognize that a short-term CRT must maintain a high degree of liquidity in order to pay out its large annual annuity or unitrust amounts. As a result, the investments will be a mix of short and mid-term investments. In the illustrations in this material, the assumed average non-taxable rate is 2.5%, selected to approximate the current mid-term AFR.

   b. For purposes of building an accumulation fund of the client’s after-tax net cash flow, a 2.5% rate has also been used. These funds presumably can be invested for a longer term horizon, and accordingly could be invested in long-term double-exempt bonds, again producing a yield of 2.5%.

3. The following is a summary of the accumulation fund that the client would have available after 10 years (see Appendix #2):
a. In this illustration, the taxpayer receives more if the CRAT alternative is chosen. This is because the investment rate of return used in the computations was less than the Sec. 7520 rate. As noted above at G.2.c., if the investment earnings accrued at the same rate as the Sec. 7520 rate, the CRAT and CRUT yield the same amounts to both the taxpayer and the charity.

b. The following summarizes the results if, instead of 2.5% after-tax and tax-exempt rates of return, a 4.0% rate is used in the computations (details not illustrated):

<table>
<thead>
<tr>
<th>Summary of Amounts after Ten Years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Summary of Amounts after Ten Years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Summary of Amounts after Ten Years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Summary of Amounts after Ten Years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Summary of Amounts after Ten Years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Summary of Amounts after Ten Years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

A higher rate of return than the Sec. 7520 rate favors the taxpayer (although, of course, the charity also benefits).

4. **Commentary:**

a. Contributions of capital gain property generally produce a charitable deduction to the donor, in this case approximately equal to the 10% remainder value targeted for charity at the end of the 10-year term of the trust. However, ordinary income property with zero basis produces no charitable deduction.

b. At the lower capital gain rates, incurring the tax on an outright sale leads to a greater after-tax accumulation than deferring under the CRAT or CRUT alternatives. Part of the reason for this outcome is that a large portion of capital gain is at a flat 15% rate, regardless of whether the capital gain is incurred in a single year or spread over 10 years through the CRT strategy.

1) If the outright sale of the property increases AGI over the threshold for the imposition of the 3.8% net investment tax under Sec. 1411, the use of a CRAT or CRUT may reduce or eliminate this effect if the AGI in years of distributions are under the modified AGI threshold levels for the 3.8% tax.

2) In addition, a large gain may be subject to the 20% capital gains rate.
c. An element in the favorable outcome for the ordinary income models is the lower tax rate when the CRT spreads the income over 10 tax returns vs. a single tax return for the outright sale. In the illustration, it is assumed that a single year sale with $750,000 of ordinary income occurs at the highest federal rate of 37%, whereas deferral over the 10-year term drops the marginal federal rate to 24%. If the marginal rate does not drop to 24%, the CRT savings are less.

d. When SE tax is involved, as in the case with the raised grain and livestock, the CRT alternative eliminates the SE tax, as the payout from the CRAT or CRUT is an annuity that is not subject to self-employment tax [PLR 9413020].

e. A CRT can be utilized by an S corporation with a built-in gains tax period that is close to expiration. If the assets are sold outright, all gain is subject to the tax, whereas by contributing the built-in gain assets to a CRAT or CRUT, the tax is imposed only for the remaining years in the BIG recognition period and eliminated thereafter. A CRUT will result in a lower accumulation of after-tax funds in this situation due to the larger payouts in the early years, until the BIG recognition period expires.

5. Income generated inside of a CRT is subject to two separate tiering rules.

a. First, income must be identified as investment income and non-investment income [Reg. 1.1411-3(d)]. The amount of net investment income within each class of income is considered the first distributed.

b. Second, income generated by the CRT is passed through from worst (ordinary income) to best (tax-free income). This income is accumulated into each respective tier and then reduced for any distributions until the first tier is eliminated and then drops into the second tier. But within each tier, from the first step, the NII portion is distributed first and the QBI portion (lower rate) is distributed last.

1) The ordinary income tier includes qualified dividends even though qualified dividends are taxed at long-term capital gain rates.

2) As a result, ordinary dividends will be distributed prior to short-term capital gains.
Example 9  Ordering method for CRT income distributions

Assume a CRT sells equipment for a $500,000 gain and invests these proceeds into taxable investments that generate a mix of interest, qualified dividend income and long-term capital gains. During the first year, the CRT has ordinary income from equipment sales of $500,000, interest income of $5,000, qualified dividends of $5,000 and capital gains of $20,000. A $50,000 distribution is made to the beneficiary during the year.

Investment income retains its character as subject to Net Investment Income Tax.

For purposes of regular tax calculations, the $50,000 distribution is allocated entirely to the ordinary income tier, leaving $460,000 of accumulated ordinary income ($500,000 Sec. 1245 gain plus $5,000 of interest income plus qualified dividends of $5,000 minus the $50,000 distribution). Capital gains are not distributed until the current and accumulated ordinary income is reduced to zero.

Although qualified dividends generate income taxed at the same rate as long-term capital gains, the qualified dividends are part of the ordinary income tier. The qualified dividends are the last items of income distributed from this tier, under the worst-in, first-out flow assumption.

In most cases, a farmer-created CRT with primarily ordinary income assets will have distributions that will be entirely ordinary income. The NIIT effect is computed separately, and may taint the ordinary distribution, even if the ordinary distribution is from trade or business gain.

Although a CRT may distribute QBI, and the ordinary tier will include QBI (except for the qualified dividends), the beneficiary of the CRT will be unlikely to benefit from the QBI deduction except to the extent tentative taxable income is less than the sum of the threshold plus the phase-out range. The beneficiary is unlikely to have W-2 wages expense or UBIA, unless active farming is continued and the contribution to the CRT was made from that active farm.

6. Cautions regarding transfer of appreciated assets to a CRT.
   a. If unmarketable assets are transferred to a CRT, the trust will fail to qualify for charitable status unless valuation of the property is completed by an independent trustee or determined by a qualified appraisal [Reg. 1.664-1(a)(7)(i)].
   b. A qualified appraisal meeting the standards for charitable contribution deductions is not necessary (unless a charitable deduction of greater than $5,000 is to be claimed) [Sec. 170(f)(11)(C)]. However, the bona fides of the CRT must be established. Contributions of unmarketable assets must be valued by an independent trustee or determined by a current qualified appraisal [Reg. 1.664-1(a)(7)].
      1) Unmarketable assets are assets other than cash, cash equivalents or other assets that can be readily sold or exchanged for cash or cash equivalents. Unmarketable assets include real property and closely-held stock [Reg. 1.664-1(a)(7)(ii)].
2) **Commentary:** This valuation requirement affects all contributions to all CRTs of unmarketable assets. Although the donor may have pre-arranged the sale of real property or grain, failure to obtain an independent trustee’s valuation risks immediate gain recognition, destroying the purpose of the CRT strategy.

3) Annual valuations by an independent trustee are also required of CRUTs because the distribution amount is based upon the annual valuation of the trust assets.

c. Beware of the possibility of unrelated business taxable income in a CRT, particularly if the CRT attempts to hold an ownership interest in an actively conducted business [PLR 9340043]. A CRT that has unrelated business taxable income becomes nonexempt and subject to taxation as a complex trust [Reg. 1.664-1(c)].

   1) Transfers to a CRT of interests in a subchapter K entity (generally, partnerships) may expose the CRT to unrelated business taxable income.

   2) Also, the transfer of debt-financed assets or the existence of debt within the business entity can trigger unrelated business taxable income.

d. The two-tiered self-dealing excise tax of Sec. 4941 can apply to a CRT that sells property to a disqualified person or otherwise transacts, leases or deals with the donor or a related party [Sec. 4947(a)].

I. **Compliance issues.**


   a. Form 1041 Schedule K-1 is attached to the Form 5227, to report each beneficiary’s share of trust income/distributions.

   b. A copy of the charitable trust document must be attached to the Form 5227 for the first year the return is required to be filed, accompanied by a written declaration signed by the trustee indicating that the trust instrument is a true and complete copy.

2. All CRTs must be on the calendar year. Form 5227 is due the following April 15. A six-month extension is available by filing Form 8868.

3. Pages 1 through 6 of the Form 5227 are available for public inspection but not page 7 (Schedule A) of Form 5227 or Schedule K-1, containing the beneficiary’s name and distribution information.
## Appendix 1

### Charitable Remainder Trust: Annuity

<table>
<thead>
<tr>
<th>Year</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance - Beginning of Year</td>
<td>$750,000</td>
<td>$694,065</td>
<td>$636,340</td>
<td>$576,768</td>
<td>$515,290</td>
<td>$451,844</td>
<td>$386,368</td>
<td>$318,797</td>
<td>$249,064</td>
<td>$177,099</td>
</tr>
<tr>
<td>Taxable earnings @ 3.20%</td>
<td>24,000</td>
<td>22,210</td>
<td>20,363</td>
<td>18,457</td>
<td>16,489</td>
<td>14,459</td>
<td>12,364</td>
<td>10,202</td>
<td>7,970</td>
<td>5,667</td>
</tr>
<tr>
<td>Balance - End of Year</td>
<td>$694,065</td>
<td>$636,340</td>
<td>$576,768</td>
<td>$515,290</td>
<td>$451,844</td>
<td>$386,368</td>
<td>$318,797</td>
<td>$249,064</td>
<td>$177,099</td>
<td>$102,831</td>
</tr>
</tbody>
</table>

### Charitable Remainder Trust: Unitrust

<table>
<thead>
<tr>
<th>Year</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance - Beginning of Year</td>
<td>$750,000</td>
<td>$614,812</td>
<td>$503,992</td>
<td>$413,148</td>
<td>$338,678</td>
<td>$277,632</td>
<td>$227,589</td>
<td>$186,566</td>
<td>$152,937</td>
<td>$125,370</td>
</tr>
<tr>
<td>Taxable earnings @ 3.20%</td>
<td>24,000</td>
<td>19,674</td>
<td>16,128</td>
<td>13,221</td>
<td>10,838</td>
<td>8,884</td>
<td>7,283</td>
<td>5,970</td>
<td>4,894</td>
<td>4,012</td>
</tr>
<tr>
<td>Pay out @ 21.225%</td>
<td>159,188</td>
<td>130,494</td>
<td>106,972</td>
<td>87,691</td>
<td>71,884</td>
<td>58,927</td>
<td>48,306</td>
<td>39,599</td>
<td>32,461</td>
<td>26,610</td>
</tr>
<tr>
<td>Balance - End of Year</td>
<td>$614,812</td>
<td>$503,992</td>
<td>$413,148</td>
<td>$338,678</td>
<td>$277,632</td>
<td>$227,589</td>
<td>$186,566</td>
<td>$152,937</td>
<td>$125,370</td>
<td>$102,772</td>
</tr>
</tbody>
</table>

Present value

- **Charitable Remainder Trust: Annuity**
  - $75,046

- **Charitable Remainder Trust: Unitrust**
  - $75,003
Appendix #2  Retiring Farmer (Unsold Grain/Raised Livestock)

Alternative 1  Outright Sale of Grain or Raised Livestock

Client: Jane & John Doe

<table>
<thead>
<tr>
<th>Rates</th>
<th>Peak</th>
<th>Spread</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term capital gain</td>
<td>20.0%</td>
<td>15.0%</td>
</tr>
<tr>
<td>Ordinary</td>
<td>37.0%</td>
<td>24.0%</td>
</tr>
<tr>
<td>State capital gain</td>
<td>9.0%</td>
<td>8.0%</td>
</tr>
<tr>
<td>State ordinary</td>
<td>9.0%</td>
<td>8.0%</td>
</tr>
<tr>
<td>Social Security</td>
<td>12.40%</td>
<td></td>
</tr>
<tr>
<td>Medicare</td>
<td>2.90%</td>
<td></td>
</tr>
<tr>
<td>High-income Medicare</td>
<td>0.90%</td>
<td></td>
</tr>
</tbody>
</table>

Sale Price  Grain/Livestock  $750,000
Less tax basis  -  
Gain  $750,000

Application of Tax Rates:

<table>
<thead>
<tr>
<th>Rates</th>
<th></th>
<th>29.0%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term capital gain</td>
<td>$750,000</td>
<td>46.0%</td>
</tr>
<tr>
<td>Ordinary</td>
<td>750,000</td>
<td>345,000</td>
</tr>
<tr>
<td>OASDI</td>
<td>132,900</td>
<td>12.40%</td>
</tr>
<tr>
<td>Medicare</td>
<td>750,000</td>
<td>2.90%</td>
</tr>
<tr>
<td>High income Medicare</td>
<td>500,000</td>
<td>0.90%</td>
</tr>
<tr>
<td>Total Tax</td>
<td>$387,730</td>
<td></td>
</tr>
</tbody>
</table>

Sales price  $750,000
Total tax  (387,730)
Net Proceeds After Tax  $362,270

Compounding Rate  2.5%

<table>
<thead>
<tr>
<th>Year</th>
<th>Beginning</th>
<th>Earnings</th>
<th>Ending</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$362,270</td>
<td>$9,057</td>
<td>$371,327</td>
</tr>
<tr>
<td>2</td>
<td>371,327</td>
<td>9,283</td>
<td>380,610</td>
</tr>
<tr>
<td>3</td>
<td>380,610</td>
<td>9,515</td>
<td>390,125</td>
</tr>
<tr>
<td>4</td>
<td>390,125</td>
<td>9,753</td>
<td>399,878</td>
</tr>
<tr>
<td>5</td>
<td>399,878</td>
<td>9,997</td>
<td>409,875</td>
</tr>
<tr>
<td>6</td>
<td>409,875</td>
<td>10,247</td>
<td>420,122</td>
</tr>
<tr>
<td>7</td>
<td>420,122</td>
<td>10,503</td>
<td>430,625</td>
</tr>
<tr>
<td>8</td>
<td>430,625</td>
<td>10,766</td>
<td>441,391</td>
</tr>
<tr>
<td>9</td>
<td>441,391</td>
<td>11,035</td>
<td>452,426</td>
</tr>
<tr>
<td>10</td>
<td>452,426</td>
<td>11,311</td>
<td>463,737</td>
</tr>
</tbody>
</table>
### Appendix #2  Retiring Farmer (Unsold Grain/Raised Livestock)

#### Alternative 2  Charitable Remainder Trust  Annuity

Client: Jane & John Doe

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
<th>Year 8</th>
<th>Year 9</th>
<th>Year 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>Charitable Deduction</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10% Remainder</td>
<td>$ -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ordinary Fed/state Rate</td>
<td>32%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Savings</td>
<td></td>
<td>$ -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less Tax:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital gains (inc. state)</td>
<td>23%</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>C.</td>
<td>Accumulation (Tax Savings + Net Annuity + % Growth)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Growth</td>
<td>2.50%</td>
<td>-</td>
<td>1,359</td>
<td>2,752</td>
<td>4,179</td>
<td>5,643</td>
<td>7,143</td>
<td>8,680</td>
<td>10,256</td>
<td>11,872</td>
<td>13,527</td>
</tr>
<tr>
<td>Accumulation</td>
<td>$ 54,356</td>
<td>$ 110,071</td>
<td>$ 167,179</td>
<td>$ 225,714</td>
<td>$ 285,713</td>
<td>$ 347,212</td>
<td>$ 410,248</td>
<td>$ 474,860</td>
<td>$ 541,088</td>
<td>$ 608,971</td>
<td></td>
</tr>
</tbody>
</table>

Charitable Remainder Trust: Annuity

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance - Beginning of Year</td>
<td>$ 750,000</td>
<td></td>
</tr>
<tr>
<td>Tax Free Earnings Rate</td>
<td>2.50%</td>
<td>18,750</td>
</tr>
<tr>
<td>Pay out (end of year)</td>
<td>79,935</td>
<td>79,935</td>
</tr>
<tr>
<td>Balance - End of Year</td>
<td>$ 688,815</td>
<td></td>
</tr>
</tbody>
</table>

Total Amount Accumulated by Client & Charity $ 673,491
### Appendix #2  Retiring Farmer (Unsold Grain/Raised Livestock)

#### Alternative 2  Charitable Remainder Trust  Unitrust

Client:  Jane & John Doe

#### A. Charitable Deduction

<p>| | | | | | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>10% Remainder</td>
<td>$</td>
<td>-</td>
<td>(no basis, no deduction)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ordinary Fed/state Rate</td>
<td>32%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Savings</td>
<td>$</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### B. C.R.T. Annuity Received

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
<th>Year 8</th>
<th>Year 9</th>
<th>Year 10</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$159,188</td>
<td>$129,380</td>
<td>$105,153</td>
<td>$85,463</td>
<td>$69,460</td>
<td>$56,454</td>
<td>$45,883</td>
<td>$37,291</td>
<td>$30,308</td>
<td>$24,633</td>
</tr>
<tr>
<td>Less Tax:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ordinary earnings</td>
<td>32%</td>
<td>50,940</td>
<td>41,402</td>
<td>33,649</td>
<td>27,348</td>
<td>22,227</td>
<td>18,065</td>
<td>14,683</td>
<td>11,933</td>
<td>9,699</td>
</tr>
<tr>
<td>Capital gains (inc. state)</td>
<td>22%</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Net Amount After Taxes</td>
<td></td>
<td>$108,248</td>
<td>$87,978</td>
<td>$71,504</td>
<td>$58,115</td>
<td>$47,233</td>
<td>$38,389</td>
<td>$31,200</td>
<td>$25,358</td>
<td>$20,609</td>
</tr>
</tbody>
</table>

#### C. Accumulation (Tax Savings + Net Annuity + % Growth)

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
<th>Year 8</th>
<th>Year 9</th>
<th>Year 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth</td>
<td></td>
<td>2.50%</td>
<td>2.706</td>
<td>4,973</td>
<td>6,885</td>
<td>8,510</td>
<td>9,904</td>
<td>11,111</td>
<td>12,169</td>
<td>13,107</td>
</tr>
</tbody>
</table>

Charitable Remainder Trust: Annuity

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
<th>Year 8</th>
<th>Year 9</th>
<th>Year 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance - Beginning of Year</td>
<td>$750,000</td>
<td>$609,562</td>
<td>$495,421</td>
<td>$402,654</td>
<td>$327,257</td>
<td>$265,978</td>
<td>$216,173</td>
<td>$175,694</td>
<td>$142,795</td>
<td>$116,057</td>
</tr>
<tr>
<td>Tax Free Earnings Rate</td>
<td>2.50%</td>
<td>18,750</td>
<td>15,239</td>
<td>12,386</td>
<td>10,066</td>
<td>8,181</td>
<td>6,464</td>
<td>5,404</td>
<td>4,392</td>
<td>3,570</td>
</tr>
<tr>
<td>Pay out (end of year)</td>
<td>21.225%</td>
<td>159,188</td>
<td>129,380</td>
<td>105,153</td>
<td>85,463</td>
<td>69,460</td>
<td>56,454</td>
<td>45,883</td>
<td>37,291</td>
<td>30,308</td>
</tr>
<tr>
<td>Balance - End of Year</td>
<td>$609,562</td>
<td>$495,421</td>
<td>$402,654</td>
<td>$327,257</td>
<td>$265,978</td>
<td>$216,173</td>
<td>$175,694</td>
<td>$142,795</td>
<td>$116,057</td>
<td>$94,325</td>
</tr>
</tbody>
</table>

Total Amount Accumulated by Client & Charity $683,024
Qualified Conservation Charitable Contributions

A. Background.

1. Qualified conservation contributions are not subject to the partial interest rule, which normally bars deductions for charitable contributions of partial interests in property [Sec. 170(f)(3)].

2. A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes, with a qualified real property interest defined as:
   a. The entire interest of the donor other than a qualified general interest;
   b. A remainder interest; or
   c. A restriction, granted in perpetuity, on the use that may be made of the real property [Sec. 170(h)].

3. This last provision applies to conservation easements, which is the most common application of qualified conservation contributions involving farmland.

Example 1 Qualified conservation contribution of farmland

Ed has 100 acres, bordering a river, that is marginal farmland and prone to flooding. Ed places the farm under a permanent easement in the Wetlands Reserve Program (WRP) administered by the Natural Resources Conservation Service. Under the terms of this permanent easement, Ed still owns the land and may use it recreationally or for hunting and can sell it. But the permanent easement prevents Ed or any future owner from ever tilling or farming the property. Because the creation of this permanent easement is a qualified conservation contribution, Ed is allowed to claim a charitable deduction based on the fair market value of the property prior to the easement compared to the fair market value of the property subject to the easement [Reg. 1.170A-14(h)(3)]. In the year of creation of the easement, Ed secures two appraisals. The appraisal of the property in unencumbered form as farmland values it at $300,000, and the appraisal of the property subject to the permanent conservation easement values the land at $200,000. Accordingly, Ed is entitled to claim a $100,000 charitable contribution.

4. Commentary: In addition to the WRP program, many states offer conservation easement programs, often under the auspices of the state’s fish and game division. Typically, a permanent easement is created to remove the land from farming status and add vegetation such as grasses and trees that enhance wildlife habitat.

5. Guidance on qualified conservation contributions [IRS Notice 2007-50].
   a. The determination of whether a taxpayer is a qualified farmer or rancher for a qualified conservation contribution is made at the partner or shareholder level (i.e., the individual return level) rather than the entity level.
b. Income from a bargain sale of a conservation easement to a charity does not represent farm gross income for purposes of determining farm status for this provision.

c. Income from the sale of timber is considered farming income for purposes of eligibility for farm status with respect to qualified conservation contributions.

d. Property that has been used in agricultural or livestock production must be subject to a restriction that it remain available for such use, but other property donated by a farmer does not need to meet this requirement.

B. **Enhanced qualified conservation contributions by farmers and ranchers.**

1. A qualified farmer or rancher is allowed to deduct a qualified conservation contribution up to 100% of the excess of the taxpayer’s contribution base (i.e., AGI) over the amount of all other allowable contributions. Excess qualified conservation contributions for individual taxpayers can be carried forward for up to 15 years, subject to the 100% of AGI limitation [Sec. 170(b)(1)(E)(iv)].

2. A qualified farmer or rancher is defined as a taxpayer whose gross income from farming is greater than one-half of the gross income of the taxpayer for the year. Gross income from farming for this purpose is the typical definition of income from raising agricultural or horticultural commodities, including livestock, but it also extends to the planting, raising or cutting of trees [Sec. 2032A(e)(5) via Sec. 170(b)(1)(E)(v)].

3. With respect to a qualified conservation contribution of agricultural property, the property interest must include a restriction that the property remains generally available for agricultural or livestock production. No specific requirement exists that such production actually occur, rather just that the property remains available for such purposes.

4. Corporate farmers and ranchers are also provided tax advantages for qualified conservation contributions.

   a. The deduction for a corporation, other than a publicly traded corporation, is allowed up to 100% of the excess of the taxable income of the corporation over the amount of all other allowable charitable contributions [Sec. 170(b)(2)].

   b. Excess qualified conservation contributions for corporate taxpayers can be carried forward up to 15 years, subject to the 100% of taxable income limitation.

   c. As with individual farmers, the corporate entity must have more than 50% of its gross income from farming for the year.

5. **Commentary:** This 100%-of-income limitation is much more important for corporate farmers and ranchers than the same limit for individual taxpayers. Corporate entities are normally subject to a charitable contribution limit of 10% of taxable income, with excess amounts only carried forward for five years. Realistically, the former 10% of income limit of the past has meant that a farm corporation donating a qualified conservation easement was unlikely to be able to utilize all of the charitable deduction. The new 100%-of-income limit and 15-year carryforward now makes qualified conservation easements attractive to corporate farm entities.
C. 50% vs. 100% income limit on farm property easement.

1. The Tax Court has held that a Maryland farm family was not entitled to the 100% annual income limit on an ag land conservation easement. In the year of the contribution they had recognized a large capital gain from a land sale, and did not meet the test of having over half of their gross income from raising and growing activities [Rutkoske v. Comm., 149 TC No. 6, 2017].

   a. The taxpayers claimed a charitable contribution of approximately $1.3 million for the diminished value of the land as a result of the conservation easement, claiming a 100% income offset as qualifying farmers.

   b. The taxpayers also reported a capital gain in the same year of approximately $1.7 million, primarily from partial consideration received for the conservation easement.

   c. The Tax Court found that the large capital gain was not qualifying farm income from raising or growing activities, and as a result the taxpayers were not entitled to use the easement contribution against 100% of income. The charitable deduction was limited to 50% of income.

2. **Commentary:** This Maryland family was clearly active in farming, but the large capital gain from the land sale took them out of the qualified farmer definition (i.e., more than 50% of gross income from a farming business) for the year of the conservation easement. An installment sale of the land could have provided a solution by reducing the capital gain for the year of the contribution to under half of farming gross income.

D. Opportunity for nonfarming landowners.

1. For all nonfarm taxpayers, a qualified conservation contribution deduction is allowed up to 50% of the taxpayer’s AGI contribution base, rather than the 30% of AGI limitation [Sec. 170(b)(1)(E)(i)].

2. Similar to the carryover rule for farmers and ranchers, any qualified conservation contribution in excess of this limit may be carried forward 15 years, rather than the former 5 year limitation [Sec. 170(b)(1)(E)(ii)].

3. **Commentary:** As a result, nonfarming landowners and retirees who do not meet the 50%-of-gross active farming definition also receive enhanced charitable deduction privileges from qualified conservation easements.

E. 100% versus 50% limitation.

1. The expanded 100%-of-income limitation on qualified conservation contributions by either individual or corporate active farmers does not contain any mechanism to allow the taxpayer to decline these increased limitations.

2. Any qualified conservation contribution subject to these higher percentage deduction limits is considered the last contribution of the taxpayer in terms of the order of carryovers. Accordingly, the normal contributions of the taxpayer by check that are deductible up to 60% of income are applied first, with any excess remaining subject to
the five-year carryover. Conservation easement contributions are considered secondly, and will qualify for 15-year carryover status.

3. **Commentary:** C corporations that meet the qualified farmer or rancher definition will benefit significantly from this new provision, as their qualified conservation contributions move from 10% of income to 100% of taxable income, with an expanded 15-year carryover for any excess. However, the 100%-of-AGI limit may be somewhat counterproductive for individuals, as it can force a portion of the charitable deduction to offset low bracket income and potentially waste other itemized deductions, personal exemptions and personal tax credits.

<table>
<thead>
<tr>
<th>Example 2 Applying the 100%-of-AGI ag limit on a qualified conservation contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lawrence, an individual taxpayer with over 50% active farming income from his S corporation, has current AGI of $100,000. He makes a qualified conservation contribution of property that, based on before and after appraisals, produces a charitable deduction of $160,000. Lawrence also makes other cash charitable contributions subject to the normal 60% of AGI limit of $10,000. Lawrence may claim $100,000 of contribution deductions in the current year. That consists of the $10,000 of cash charitable contributions subject to the 60% of AGI limit and, secondly, $90,000 of his $160,000 qualified conservation contribution (limited to 100% of AGI, after considering the 60% limit on cash contributions). Lawrence has a qualified conservation contribution carryover to the next tax year of $70,000 ($160,000 current conservation contribution less $90,000 utilized portion). However, as a result of claiming $100,000 of charitable contributions against his current AGI of $100,000, Lawrence has reduced his taxable income to a negative amount because of itemized deductions (or the standard deduction). Effectively, his itemized deductions are wasted because of the 100%-of-AGI charitable contribution deduction from the conservation easement. Also, a portion of the currently allowed conservation easement deduction was used against Lawrence’s taxable income in the lower 10% and 12% tax brackets.</td>
</tr>
</tbody>
</table>

4. **Commentary:** The wasted itemized deductions might be salvaged by farm income averaging elections during the subsequent three years.

**F. Documentation issues.**

1. Appraisal disputes.
   a. A taxpayer’s claimed charitable contribution amount for a donation of a qualified conservation easement with respect to farmland was reduced by the Tax Court, which determined the taxpayer had overstated the value of the easement [Esgar Corp. v. Comm., TC Memo 2012-35].
   b. The dispute centered around the fair market value of the property, which according to the court needed to be evaluated considering the property’s highest and best use. The court went on to note that “While highest and best use can be any realistic, objective potential use of the property, it is presumed to be the use to which the land is currently being put absent proof to the contrary.”
c. The taxpayers argued that the highest and best use of the property was for gravel mining, whereas the IRS argued that it was for agricultural purposes, as was currently occurring. The court agreed with the IRS that if the asserted highest and best use differs from the current use, the use must be reasonably probable and have real market value.

d. However, the court did not impose any accuracy-related penalties on the taxpayers, finding that they met the reasonable cause exception by relying on their tax advisor and accounting firm, by obtaining a core sampling report of the underlying gravel reserves, and by obtaining a qualified appraisal.

2. Deed satisfies contemporaneous receipt.

a. The Tax Court has ruled that a deed transferring a conservation easement satisfied the statutory provisions of Sec. 170(f)(8) as a contemporaneous written acknowledgement [Averyt v. Comm., TC Memo 2012-198].

b. Taxpayers had conveyed a wetlands conservation easement to a qualified charity of approximately 1,100 acres of land. The easement contribution was valued at approximately $5.5 million.

c. The IRS disallowed the deduction because the taxpayer failed to secure a receipt with the notation regarding no goods or services.

d. The court found that the conservation deed met the statutory requirements of Sec. 170(f)(8) because the deed was signed by a representative of the charity, provided a detailed description of the property and easement, and was contemporaneous with the contribution. Additionally, the deed stated that the easement was an unconditional gift, cited no consideration in exchange for it, and stipulated that the deed was the "entire agreement" between the parties.

e. **Preparation Tip:** Although the taxpayer prevailed in this case, be aware that the written contemporaneous acknowledgement rule with its no goods or services language applies to all contributions of $250 or more, including conservation easements supported by deeds and appraisals. A simple letter from the charity with the proper language would have saved the taxpayer a costly legal battle.

G. Other failures.

1. **Right to substitute property invalidates deduction.** The Ninth Circuit, affirming the Tax Court, denied a charitable contribution deduction for a conservation easement because the agreement permitted the donors to substitute other property subject to the conservation easement. This violated the requirement of a transfer in perpetuity [Belk v. Comm., 114 AFTR 2d 2014-6952, CA-4, 2014, affg. 140 TC 1, 2013].

a. The agreement between the taxpayer and the tax-exempt trust allowed the substitution of land owned by the taxpayer contiguous to the conservation area for an equal or lesser area of land within the conservation easement.
b. The court also rejected a savings clause in the easement agreement that attempted to invalidate any provision found to negate the charitable deduction. The court noted that savings clauses based on a “condition subsequent” are not to be enforced in determining the tax consequence of the original transaction.

2. Right to alter boundaries defeats conservation easement.

a. A taxpayer placed a conservation easement on a specific 22-acre parcel of land in North Carolina. However, the easement agreement allowed the taxpayer to make minor alterations to the boundary of the conservation area, up to 5% of the subject land and only if the adjustment occurred within five years. As a result, the court concluded that the easement was not an interest in an identifiable, specific parcel of real property, and the charitable deduction was disallowed [Balsam Mountain Investments, LLC v. Comm., TC Memo 2015-43].

b. Similarly, the Tax Court ruled that a limited partnership could not claim an $8.4 million charitable contribution with respect to 1,750 acres of ranch property placed in a conservation easement [Bosque Canyon Ranch, LP v. Comm., TC Memo 2015-130].

1) The agreement allowed modifications to the boundaries of various home site parcels excluded from the easement.

2) The taxpayer argued that the exterior boundaries of the easement could not be modified, and that the overall amount of property subject to the easement could not be decreased. However, the court found that there was a violation of the perpetuity requirement because the specific property protected by the easement could lose that protection if subsequent boundary modifications occurred with respect to the various home site parcels.

3. Mortgaged property.

a. The Tenth Circuit, affirming the Tax Court, disallowed a taxpayer’s charitable deduction of $500,000 for a conservation easement where the property was subject to a mortgage at the time of the donation. The taxpayer did not subordinate the debt to the conservation easement until two years later [Mitchell v. Comm., 115 AFTR 2d 2015-346, CA-10, 2015, aff’g. 138 TC 324, 2012].

b. The Ninth Circuit confirmed that a couple’s charitable contribution for a conservation easement was disallowed because a mortgage on the property was not subordinated at the time of the contribution. The easement contribution occurred in 2006, and the bank subordination was not completed until 2011 [Minnick v. Comm., 116 AFTR 2d 2015-5602, CA-9, 2015, aff’g. TC Memo 2012-345].

4. Faulty appraisal. A Maryland taxpayer claimed a conservation easement deduction of $5.5 million on farm property transferred to their county. However, the Tax Court found that they did not have a qualified appraisal and the charitable deduction was disallowed [Costello v. Comm., TC Memo 2015-87].
a. The court found that the appraisal was not qualified because it did not contain an accurate description of the property (the appraiser was unaware that the easement was a condition of the taxpayer's right to sell development rights) and the appraisal did not specify the date of the contribution.

b. Further, the Form 8283 appraisal summary did not contain the donee's signature and failed to disclose the consideration that the county had granted to the taxpayer by allowing the sale of the development rights.

H. Practice Tips:

1. Qualified conservation charitable easements have their greatest benefit when used by an individual with high taxable income and high net worth. A conservation easement can produce three forms of tax benefit:
   a. The income tax deduction from the qualified conservation charitable contribution;
   b. A reduction in the estate valuation of the property in the donor's eventual estate, potentially reducing the 40% federal estate tax; and
   c. A potential reduction in the local property tax valuation of the real estate.

2. Real estate that produces the greatest reduction in value is typically property that has development potential. This would include farmland adjacent to a city or highway that has development potential and is permanently restricted from any development. This also includes land that is suitable for residential real estate development that is restricted for perpetual use as farmland.

Charitable Gifts of Raised Commodities

A. Background.

1. Cash method farm proprietors have a unique opportunity to make pre-AGI charitable contributions of commodity inventory, which is readily marketable by the charitable recipient.

2. Cash method farm proprietors potentially achieve a number of advantages with the contribution of farm commodities to a charitable organization.

   a. Income tax savings result for standard deduction filers.
      1) The standard deduction has eliminated the tax advantage of charitable contributions for many farmers ($24,000 for joint filers for 2018).
      2) A charitable contribution of unsold inventory removes the income before recognition, and avoids the need to claim a charitable contribution as an itemized deduction.

   b. Self-employment (SE) tax decreases if unsold inventory is donated.
B. **Inventory vs. crop share rents.**

1. A charitable contribution of unsold raised commodities is only effective if it constitutes inventory of an active farm proprietor or partner.

2. A contribution of unsold crop-share rents by a farm landlord triggers taxation to the donor, as the assignment of income principle applies [Rev. Rul. 75-11; *Cullison*, 27 AFTR 2d 71-418, DC-AR, 1970; *Parmer*, 30 AFTR 2d 72-5689, CA-10, 1972].

C. **Mechanical requirements for a charitable contribution of raised commodities.**

1. The charitable donation of unsold raised commodities is best utilized by a cash method farmer. All of the costs incurred to raise the crop have been deducted as operating expenses.
   
   a. A farmer required to use the accrual method must capitalize all inventory costs and the costs of any other property [Sec. 263A(a)(1)(B)]. A charitable donation applies the inventory basis to a charitable deduction.
   
   b. An accrual basis farmer donating crops in which all of the costs were incurred in the year of harvest receives the same benefit as the cash method farmer. Unless the farmer is required to use the accrual method, costs of raising crops are deductible.
      
      1) Unsold crop on hand at the end of the year is recognized as income at fair market value.

      2) Gross income of an accrual method farmer includes the inventory value of products on hand and not sold at the end of the year [Reg. 1.61-4(b)(2)]. Until the end of the tax year, the crop has a zero tax basis, and all costs are treated as operating expenses.

2. The transaction must be segregated into two steps:

   a. Donate the commodity to the charity, with evidence that title to the commodity was transferred to the charity; and

   b. Sale of the commodity by the charity.

3. **Commentary:** It is not necessary to contribute crop raised in a prior year. Reg. 1.170A-1(c)(4) allows a farmer to currently deduct costs of producing inventory as business expenses, even if the inventory is contributed to charity (this is contrary to the rule for noncharitable family gifts).

D. **Charitable contribution deduction.**

1. When inventory is transferred to a charity, the donor's charitable deduction is the smaller of the property's fair market value or the adjusted tax basis of the property [Reg. 1.170A-4(b)(1)]. Accordingly, for raised inventory of a cash method farmer, no charitable contribution deduction is allowable because of the zero tax basis of the property.
2. If raised breeding livestock that qualifies for Sec. 1231 capital gain treatment is given to charity, a charitable deduction at fair market value applies, if the property is given to a charity for a use related to its exempt purpose or function (e.g., to a university agricultural school for breeding use at an experiment or training site). On the other hand, if the Sec. 1231 raised breeding animals are donated to a charity for a subsequent sale by the charity, the deduction is limited to the adjusted tax basis of the property (i.e., zero for raised livestock) [Sec. 170(e)(1)(B); Reg. 1.170A-4(b)(2)(ii)].

3. The written acknowledgment rules of Sec. 170(f)(8) and the requirement to use Form 8283 should not apply to most charitable contributions of commodities because no charitable contribution deduction is taken by the taxpayer.

   a. Sec. 170(f)(8) states: "No deduction shall be allowed . . . for any contribution of $250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment . . . ".

   b. The Form 8283 instructions indicate "You must file Form 8283 if the amount of your deduction for all noncash gifts is more than $500."

---

**Example 1  Illustration of charitable grain tax savings**

Don Jeere, a cash method farmer, normally reports Schedule F income of about $70,000 on his joint return. Sue, his spouse, has W-2 income of about $50,000. Don and Sue contribute about $5,000 annually to their church, but have not itemized deductions in many years because their only other significant Schedule A deduction is state income tax paid. Accordingly, Don and Sue contribute $5,000 of raised unsold grain to the church, as opposed to selling the grain and contributing cash.

As a consequence of not selling $5,000 of grain to fund their church contribution, Don and Sue reduce their federal income tax by $1,100 (22% federal income tax rate x $5,000), their state income tax by $400 (assume 8% state income tax rate x $5,000), and their self-employment tax by $706 (15.3% x $5,000 x 92.35%), for a total tax savings of $2,216.

---

**E. Corporate gifts of raised inventory.**

1. A cash method farming entity that has zero basis raised inventory is in a similar position to make contributions of unsold inventory to a charity in a tax-efficient manner.

   a. A partnership or S corporation would normally pass through any charitable deduction to its owners, but a contribution of zero basis inventory results in no deduction because of the zero basis. Effectively, there is no pass-through reporting to the owner.

   b. Similarly, a C corporation contributing zero basis cash method farm inventories would claim no deduction. This avoids any issue with the 10%-of-taxable-income charitable limitation that otherwise faces a C corporation.
2. Issue of possible personal benefit to a controlling C corporation shareholder.
   
a. A closely-held corporation arguably could lose the right to charitable treatment if the transfer is considered to have personal benefit to a controlling shareholder and is recharacterized as a constructive dividend to the shareholder. However, this issue was generally resolved in 1979, when the IRS determined that a charitable contribution by a closely-held corporation is treated as a constructive dividend only if property or economic benefit is received by the shareholders or their families as a result of the contribution [Rev. Rul. 79-9].

b. This ruling was based on a full Tax Court opinion that reached the same conclusion [Knott v. Comm., 67 TC 681, 1977].

c. A corporate contribution that satisfies a charitable pledge by a shareholder, or any member of the shareholder’s family, is considered a direct economic benefit and would produce a constructive dividend [PLR 8152094].

3. A 2006 Tax Court case imposed constructive dividend treatment on charitable contributions made by a closely-held corporation, with no reference in the court opinion to Rev. Rul. 79-9 or the Knott case. However, in the facts of this case, the closely-held corporation had claimed the charitable contributions as business expenses under various misleading categories, and it was only upon IRS examination that these charitable contributions became apparent [H.J. Builders, Inc. v. Comm., TC Memo 2006-278, 12/28/2006].

F. Contributions of food inventory.

1. Normally, the deduction for contributions to charity of ordinary income property, such as inventory, is limited to the basis of the property [Sec. 170(e)(1)].

2. However, there are special rules for categories of inventory that may allow a deduction in excess of the property’s basis. For food inventory donated by any trade or business, including C corporations, an enhanced contribution deduction is allowed, assuming these conditions are met [Sec. 170(e)(3)(C)]:

a. The donee must be a 501(c)(3) organization (other than a private foundation which is not an operating foundation) and it must use the property in its exempt purpose and the use must be solely for the care of the ill, needy or infants;

b. The property is not exchanged by the donee organization for money, property or services;

c. The donor receives a written statement from the exempt organization detailing that the property will be used to meet the requirements of this section;

d. In addition, the food must be “apparently wholesome food,” which means that it is intended for human consumption and meets all quality and labeling standards imposed by federal, state and local laws and regulations, even though it may not be readily marketable due to appearance, age, freshness, grade, size, surplus or other conditions; and
3. The deduction cannot exceed 15% of the taxpayer’s aggregate net income from all trades or businesses from which the contributions were made [Sec. 170(e)(3)(C)(ii) and (iii)].
   a. For C corporations, the food inventory contribution is applied first to reduce the 10% limitation to zero, before other charitable contributions are considered.
   b. If the contribution exceeds the 15% limit, then the excess contribution is carried forward for up to five years. However, the current year contributions are applied against the limitation before the carryovers and the carryovers are applied on a FIFO basis.

Example 2  Grocer gets enhanced donation

FACTS:
- Total Tofu, organized as an S corporation, had excess inventory of dried tofu chips.
- The chips met the “wholesome food” definition.
- The basis in the chips is $500 and the fair market value is $2,000.
- The unsold tofu chips are donated to a nearby food shelf, a Sec. 501(c)(3) charitable organization.

RESULT:
- Total Tofu gets a $1,000 charitable donation, using twice the basis.
- The deduction is the lower of the basis plus ½ ordinary income if the chips are sold at FMV ($500 + $750 = $1,250) or twice the basis (2 x $500 = $1,000).

VARIATION:
- The facts are the same except the basis is $500 and the fair market value is $750.
- In this case, the charitable donation deduction is $625, using the basis plus ½ the ordinary income if the chips are sold at FMV ($500 + $125 = $625) or twice the basis (2 x $500 = $1,000).

4. Fair market value definition [Sec. 170(e)(3)(C)(v)].
   a. The fair market value (FMV) of the food inventory contribution is not to be negatively adjusted in the case of food which cannot be sold by reason of internal standards of the taxpayer, lack of market or similar circumstances.
   b. FMV is determined by taking into account the price at which the same or substantially the same food items, both as to type and quality, are sold by the taxpayer at the time of the contribution. If the item has been discontinued, the price is the amount at which the taxpayer sold the item in the recent past.
   c. Commentary: This law change counters IRS assertions that FMV should be reduced because food products had reached their shelf life expiration [e.g., Lucky Stores, Inc. v. Comm., 105 TC 420, 1995; LAFA 20113801F].
5. The enhanced deduction is the lower of:
   a. The basis plus one-half of the ordinary income recognized if the inventory is sold at its fair market value; or
   b. Twice the basis of the inventory [Sec. 170(e)(3)(B)].

6. Deemed basis election for cash method growers.
   a. If a taxpayer does not account for inventories under Sec. 471 (full absorption costing) or under Sec. 263A (UNICAP rules), the taxpayer may elect to treat the basis of donated food inventory as equal to 25% of the FMV of the food inventory [Sec. 170(e)(3)(C)(iv)].
   b. The effect of this rule is to allow an electing taxpayer, generally a cash method farm producer with zero basis inventory, to claim a charitable donation of 50% of the FMV of donated food inventory, based upon the formula allowing twice the deemed basis (i.e., 2 x 25% of FMV = 50% of FMV).
   c. **Commentary:** The deemed basis provision is particularly advantageous for vegetable producers and other cash method farmers producing edible crops. In the past, they received no deduction for donated inventory because two times basis of zero was always the lower amount for charitable contribution purposes.

---

**Example 3**  *Cash basis grower-packer elects to use enhanced basis*

**FACTS:**
- Green Grower is owned by Barry as a single member LLC which is a disregarded entity.
- Green Grower is a cash basis grower-packer whose inventory includes bags of potatoes.
- Each bag has a FMV of $5 per bag and a tax basis of zero.
- Green Grower (i.e., Barry) donates 100 bags of potatoes to a local charity providing meals to the homeless.
- Barry elects to treat the basis of the bags of potatoes as being equal to 25% of FMV, which is $125 (25% x $5 x 100 bags).

**RESULT:**
- Barry is allowed a charitable donation of $250, two times the deemed basis (2 x 25% of the FMV). This is lower than $312.50, the basis plus ½ of the ordinary income if sold at FMV [basis of $125 + 187.50 (1/2 ordinary income = $500 - $125 basis)].

7. It is not necessary to secure a qualified appraisal; a special exemption applies for inventory [Sec. 170(f)(11)(A)(ii)(I)].
8. **Preparation Tip:** A client taking advantage of this deduction must secure a written statement from the charity stating that its use and disposition of the food inventory will be in accordance with its exempt purpose and solely for the care of the ill, needy, or infants, and that the inventory was not transferred by the charity in exchange for money, other property or services. The donor needs to establish the FMV of the crop or produce given to the charity for purposes of the enhanced deduction formula, but that can be done by reference to other sales of the same inventory.

G. **Summary re: charitable commodity gifts.**

1. The most crucial step to be followed is the transfer of the unsold commodity to the charity rather than conveying the proceeds after the sale.

2. For public storage.
   a. The commodity should be delivered to the elevator, with a storage receipt made out to the charity.
   b. The receipt should be delivered to the charity with a letter from the donor indicating the commodity belongs to the charity and the charity may sell the commodity as it sees fit.
   c. The buyer/grain elevator should refrain from issuing a check to the charity without specific instruction by the charity to sell the commodity.

3. For home storage.
   a. The commodity needs to be segregated and identified as belonging to the charity (e.g., create a bill of sale to transfer title to the charity).
   b. The charity needs to arrange for the sale of the commodity, together with incurring carrying costs, including insurance and disposal costs.
   c. Realistically, the charity will desire an immediate sale. The best market may be back to the farmer, who may be utilizing the commodity as livestock feed or for other purposes on the farm. If this is the case, the taxpayer should be advised of the inherent risks of IRS rejection of the charitable gift.

4. If the mechanical steps are not closely followed, the IRS will treat the transfer as if the grain was sold by the farmer, followed by a cash contribution to the charity.

5. **Caution:** Many grain producers annually certify or document their bushels of production to the Farm Service Agency, for purposes of enrolling that grain production in various ag subsidy programs. Farm producers who intend to make a charitable contribution of unsold raised commodities should be sure to accomplish their FSA certification prior to any donation of those commodities to charity.
What changes are needed for farmers due to tax reform

Paul Neiffer, CPA
CliftonLarsonAllen
What Changes are Needed for Farmers due to Tax Reform
Advanced Estate Planning Institute
July 12, 2019

Agenda
- Opportunity Zones and Farmers
- Should a Farmer Have a C Corporation
- Section 1031 Exchanges
- Farmer Loss Limits
- The 600 Pound Gorilla – Section 199A
Opportunity Zone Program
• Created by the Tax Cuts and Jobs Act of 2017
• Formed to generate economic activity and job creation in low-income communities
• Encourages investment of unrealized capital gain into these low-income community projects/businesses

Opportunity Zones - Benefits
• Capital Gain Deferral Period
  – Deferred until investment is sold, or
  – Dec. 31, 2026 whichever comes earlier
  – If investment is not sold before Dec. 31, 2026 any remaining deferred gain is recognized at that time

Opportunity Zones - Benefits
• Permanent Reduction of Deferred Gain
  – Investments held less than 5 years result in 100% deferred gain recognition
  – Investments held > 5 years, < than 7 years result in recognition of 90% of deferred gain
  – Investments held > 7 years results in 85% deferred gain recognition
Opportunity Zones – Benefits

- Permanent exclusion for investments held for at least 10 years
  - At sale of investment, election made to step up basis in investment to FMV
  - Election results in a permanent exclusion from income of any post-acquisition capital gain
  - Results in permanent benefit for depreciation deductions
  - Taxpayers can recognize losses by not making the permanent exclusion election

Opportunity Zones – Timing of Investment

- From date asset sold – 180 days to put into a QOZ Fund
- Funds do not need to go to a qualified intermediary
- The date the money is transferred to fund will be the start of the 10 year hold window

Opportunity Zone Timeline

- Year 0: $20MM Gain Invested into Opportunity Zone. $20MM Gain Deferral.
- Year 1:
- Year 2:
- Year 3:
- Year 4:
- Year 5:
- Year 6:
- Year 7:
- Year 8:
- Year 9:
- Year 10:
- Opp. Zone Fund exits structure with $30MM Buyout. $10MM in Capital Gains recognized and not taxable.
Opportunity Zones

- Does not have to be like-kind property
- Real or personal property
- Substantially all must be located in an OZ
- Close on replacement within 180 days of sale
- Only need to invest gain from sale
- Can invest in partnership interests and stock
- Gain recognized - earlier of sale or 12/31/26
- 10% basis step up for 5 year hold, 15% for 7 year hold
- Permanent exclusion on appreciation if held longer than 10 years

\[\text{§1031}\]

- Must be like-kind property
- Real property, no personal property
- No location requirement
- Replacement property must be identified within 45 days
- Close on replacement within 180 days of sale
- Must invest entire proceeds from sale
- Cannot invest in partnership int or stock
- Gain rec. – upon sale of replacement prop.
- No step up in basis
- No gain exclusion on appreciation

Comparison to §1031

Qualified Opportunity Zone Fund

- Fund can be any partnership or corporation that holds at least 90% of its assets in OZ property
- Must follow guidelines outlined by statute and the Treasury
- Requires self certification, no approval required by IRS
  - Complete a form and submit with Federal income tax return

What Kind of Gains Can be Invested

- Long Term and Short Term Capital Gains from sale of:
  - Real Estate
  - Business
  - Stock (private or publicly traded)
Investment Structure – Direct Investment

- Investor(s) 99% Capital Interest
- Opportunity Zone Fund 1% Capital Interest
- Managing Member (Developer)

Investment Structure – Indirect Investment

- Investor(s) Capital Interest
- Opportunity Zone Fund Capital Interest
- Special Purpose Entity Partnership Capital Interest
- Developer Capital Interest

What Can Opportunity Zones Invest In?

- Real Property
  - Original use must be with fund or must be substantially improved
  - Substantially Improved = At least 100% of adjusted basis in property
  - Farms can be purchased but must be operated

- Operating Businesses
  - Equity investments or stock purchase

- Equipment
Corporate Taxes

- Flat 21% rate
- Corporate AMT repealed
- May be an **actual 40% tax increase** for most ranchers who kept corporate taxable income under $50,000
- Bottom line – C corporations most helpful for tax-free fringe benefits
  - Or very long-term holding period

### Ranch C Corporation Tax Example

Ranch partnership with four equal C corporation owners.

- Partnership income of $200,000
- Under old law, the corporations each paid $7,500 or $30,000 of total taxes
- Under new law, each corporation pays $10,500 or $42,000 total, a 40% increase
Corporate-Provided Meals and Lodging

- Tax-free fringe benefit (Sec. 119)
- Owner benefit tax-free only if C corporation
- IRS examination attacks
- Ordinary and necessary expense for corporation (Sec. 162)
- Sec. 119 requirements
  - Meals (not groceries)
  - Condition of employment and convenience of employer
  - On business premises

Lodging

- Business premises (no ag cases)
- Includes utilities, furnishings, supplies consumed in home

Meals

- Provided on non-working days qualify
- Employee spouse and dependents also qualify
- Outside of working hours, need noncompensatory business reasons
  - On-call for emergencies
  - No eating facilities within vicinity
  - Meals w/o lodging during business hours okay
- Discrimination allowed
Key Ag Victories

<table>
<thead>
<tr>
<th>Wilhelm</th>
<th>Cattle ranch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Caratan</td>
<td>Even though urban lodging nearby</td>
</tr>
<tr>
<td>McDowell</td>
<td>Resided at ranch 8 months/year</td>
</tr>
<tr>
<td>Harrison</td>
<td>KS grain &amp; dairy: A roadmap</td>
</tr>
<tr>
<td>Grant/Johnson</td>
<td>Illinois; grain only</td>
</tr>
<tr>
<td>Moschmeyer</td>
<td>Residential improvements depreciable</td>
</tr>
<tr>
<td>PLR 9134003</td>
<td>Sec. 119 not a tax avoidance purpose</td>
</tr>
</tbody>
</table>

Adverse

<table>
<thead>
<tr>
<th>Dilts</th>
<th>S shareholder not an employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Four SD cases</td>
<td>Corporation was landlord</td>
</tr>
<tr>
<td>Peterson</td>
<td>Prior off-farm residency</td>
</tr>
</tbody>
</table>

Meals at 50%

- No 100% argument under Sec. 132 due to TCJA
  - Employee recreational, social functions remain 100% deductible
- All Sec. 119 meals nondeductible after 2025
Section 1031

- Real property only
  - Use federal definitions
- Personal property exchanges taxable
  - Replacement assets = full basis
  - Section 179 or bonus on replacement?
  - State conformity
- BIG tax implications upon electing S from C

Watch for Section 1245 Real Property

- Farms contain 1231 and 1245 real property
  - 1231 can be exchange into any real estate
  - 1245 real property must be into other 1245 real property
- 1245 real property includes tile, grain bins, hog barns, wells, underground mainlines, vines, trees, diary parlors, feedlots, etc.
Section 1031 Equipment Exchange Example

Rancher has old tractor worth $200,000. Trades it in on new tractor worth $500,000.

Old law – no gain, $300k cost basis (Section 179 or bonus)

New law – $200k gain, $500k tractor fully deducted over 5-7 years (large tax hit in year of sale)

Section 1031 Equipment Exchange Example – State Law

Rancher has old tractor worth $200,000. Trades it in on new tractor worth $500,000.

Old law – no gain, $300k cost basis depreciated over 7 years

New law – $200k gain, $500k tractor depreciated over 5-7 years (large tax hit in year of sale)
Business Interest Expense

- Disallowed: excess of 30% of business adjusted taxable income
  - Determined without interest expense, interest income, NOL, depreciation, amortization, depletion (EBIDTA)
  - EBIT is used beginning in 2022 (depreciation is deducted)
  - Determined at tax filer level (1065, 1120-S)
  - Excess carried forward
- **No disallowance** for businesses with average gross receipts ≤$25 million

Special Farmer Interest Provision

- If gross revenue over $25 million, then Rancher can elect to deduct 100% of business interest expense
  - Must use ADS for depreciation of 10 year + assets (longer lives)
  - Farm equipment still enjoy shorter life
  - Can't take bonus depreciation on 10 year or longer life assets
  - Likely only Feedlots will elect this before 2022
  - Business by business election

Loss Limit Provisions

- Maximum Business Loss in one year - $500,000
- Net Operating Loss: limited to 80% of pre-NOL taxable income
- Pre 2018 NOLs still allowed at 100% (FIFO)
- Repeal carrybacks for non-Ranchers
- Allows two-year carryback for farms
- However, carryback can only offset 80% of taxable income on both carrybacks and forwards
Loss Strategies

• Do not want NOL’s and if possible:
  – Elect out of bonus depreciation on class life basis
  – Elect out of deferred payment contracts
  – Capitalize fertilizer costs
  – Capitalize repair costs
  – Take Section 179 to optimize
• Must review state taxes too

Section 199A

• Most farmers got larger DPAD from cooperatives in 2017
  – Little or no DPAD in 2018 due to transition rules
  – 2019 should have more “DPAD” to farmers
• Have to have taxable income to get much benefit
  – Reduced for SE tax and health insurance deduction
  – Reduced for retirement plan contributions
• Many patrons got no deduction – “Grain Glitch Fix”
Structure Planning

- LLC and partnerships should consider preferred allocations versus guaranteed payments
- Rental agreements updated for leases to wholly owned C corporations
- Aggregation election options
- If over threshold, maximize wages (to owners?)

What We Still Don’t Know

- How to allocate Section 1245 gains
- Aggregation of real property rental income
- Negative 9% cooperative deduction add-back to QBI

Cooperative Examples

<table>
<thead>
<tr>
<th>Example</th>
<th>Low Income No Wages</th>
<th>Low Income with Wages</th>
<th>High Income No Wages</th>
<th>High Income with Wages</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>DPAD from co-op</td>
<td>$10,000</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>2</td>
<td>Schedule F</td>
<td>$200,000</td>
<td>$200,000</td>
<td>$200,000</td>
</tr>
<tr>
<td>3</td>
<td>Tentative taxable</td>
<td>&lt; $321,400</td>
<td>&gt; $321,400</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>QBI</td>
<td>$321,400</td>
<td>$321,400</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>QBI limited to</td>
<td>$421,400</td>
<td>&gt; $421,400</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Lesser of 2 or 3</td>
<td>(18,000)</td>
<td>(18,000)</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>QBI from operations</td>
<td>$40,000</td>
<td>$40,000</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Net QBI gain or loss</td>
<td>$50,000</td>
<td>$10,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Wages (if any)</td>
<td>Wages (if any)</td>
<td>Wages (if any)</td>
<td></td>
</tr>
</tbody>
</table>
Charitable Giving: Finding the Right Option for Your Farm/Ranch Clients

Damon T. Bahensky, Esq.
*Parker, Grossart, Bahensky, Beucke, Bowman & Symington, L.L.P.*

Brandon D. Hamm, Esq.
*Koley Jessen, P.C., L.L.O.*

Jim Gustafson  {Moderator}
*Director of Advancement and Gift Planning, Nebraska Community Foundation*
QUESTIONS

PROFESSIONAL ADVISORS COULD BE ASKING THEIR CLIENTS

As a professional advisor, are you asking your clients only fact-finding questions related to their assets? To clarify a client’s wishes, feeling and motivational questions can also help people determine how they would like their estate distributed. Below are some possible questions that might be helpful in working with your clients:

**Fact-finding questions:**

What charities have been important to you?
- Charities that served your family or friends
- Charities that you have supported financially
- Charities to which you have provided leadership

Who are the family members you have concerns for now and in the future?
- Concerns about their age when they will inherit
- Concerns about their financial situations
- Concerns about any special needs they may have

Do you have personal financial concerns?
- Concerns about retirement income
- Concerns about health care
- Concerns about having enough money to travel/leisure activities
- Concerns about taxes you and your estate will owe

**Feeling questions:**

What concerns do you have about the future of your charitable interests?
- Concerns about continuing their missions or expanding their services
- Concerns about people who need their services
- Concerns about continuing your annual charitable giving after your life is completed.

What are your personal concerns for yourself and your loved ones?
- Concerns about your personal care in the future
- Concerns about passing assets from your estate to your heirs
- Concerns about what you need to do to leave a legacy – a legacy you can really feel good about – a legacy that would be significant and meaningful to you.
Motivational questions:

- If you could change anything in the world, what would you like to change?
- If you were to make an estate gift to one or more of your favorite charities, what would you want it to accomplish?
- How much do you want to leave your heirs? Is there an upper limit? How much is enough? What do you owe your heirs?
- Would you rather give your heirs income or capital?
- Would you like to give less to taxes and more to your heirs and to your charitable interests?
- What do you want to accomplish with your money that is meaningful to you?
- What are the charities that have truly made an impact on your life?
- How has your community/hometown made an impact on your life?
- What charitable organizations would you want to be sure are here for future generations?
- What do you worry about? What keeps you awake at night?
- In times of struggle, what are you able to hold on to?
- What gift, charitable or otherwise, that you have given has provided you the greatest pleasure?
- What qualities have allowed you to get through tough times?
- Who were the people who most affected your personal values? What were the most important things you learned from them?
- What did you learn about charitable giving and community service from your parents, grandparents or other important people in your life?
- What does our Mission help accomplish that is important to your own personal legacy?
- Is your family involved in philanthropic decisions? Have you discussed with them the reasons for the choices you have made to this point?
- What would you hope to teach children, grandchildren, or other loved ones about giving, volunteering and community service?
- Do your children support the same causes you do? Why do you think they support the ones they do?
Questions and Answers about Conservation Easements

What is a conservation easement?
Essentially, a conservation easement is a legal agreement between a landowner and a non-profit conservation organization or government agency that forever prohibits specified land uses that are not compatible with conservation goals, while allowing those uses that are.

How do conservation easements affect property rights?
Every landowner holds certain rights related to the use of their land and its resources. Historically, the law has allowed some of these rights (such as mineral rights) to be transferred to other parties. A conservation easement transfers some development rights on a property to another entity, which is then prohibited from exercising those rights by the terms of the easement. The landowner still owns the land and retains all other rights not specifically prohibited by the conservation easement.

What land uses do conservation easements typically prohibit?
Every conservation easement is different depending on the conservation goals and each landowner’s circumstances, but most will prohibit excessive new development that results in the destruction of agricultural land, wildlife habitat, native plant communities or historic sites.

What land uses are typically allowed?
This list is driven by each landowner’s needs so it can vary, but the landowner usually retains the rights to live, farm, ranch, hunt, fish, and camp on the land, along with other activities that are consistent with conservation goals, which can even include some limited development.

Are there any criteria for lands that can be protected by easements?
The guidelines for conservation lands can vary with each organization or agency. The Nebraska Land Trust will accept conservation easements to preserve lands that: remain essentially in their natural state; are ecologically, historically or archeologically significant; serve as wildlife habitat; or are used for low-impact agriculture.

To learn more, please visit our website at www.nelandtrust.org; or call (402) 438-5263.
Does the entire property have to be included in an easement?
An owner may divide their property for the purposes of a conservation easement, restricting certain activities on a part of the land while reserving other portions of the land for some development, so long as that development does not adversely affect the conservation values of the easement land.

Do conservation easements restrict a landowner’s ability to sell or bequeath land?
Land protected by a conservation easement may be sold or transferred at any time, but the conservation easement is attached to the title so that any restrictions will apply to all future landowners.

Does a conservation easement grant public access to the land?
No. A landowner may choose to allow limited access for hunting, fishing, ecotourism, educational, or scientific purposes, but this is not required by the Nebraska Land Trust as a condition of accepting an easement.

What rights of access would the land trust have?
The Nebraska Land Trust is obligated to arrange an annual visit to the site by one of its representatives to assure compliance with the terms of the easement.

How is a conservation easement enforced?
When conservation easements are created, a baseline report is required to document current conditions. Among other things, these reports usually include detailed maps, a description of plants, animals, wetlands, woodlands, cropland, grasslands, existing development, and historic sites, along with photographic documentation of visual appearance. When annual monitoring visits are scheduled, this report will be compared to existing conditions. If a violation is identified, the landowner will be notified immediately in writing by the land trust and an attempt will be made to find an agreed upon solution that corrects the problem. If necessary, the Nebraska Land Trust can take legal action to fulfill its conservation easement obligations.

Are there tax breaks from the donation of a conservation easement?
Every situation is different, but the Internal Revenue Service will allow the value of a donated easement to be deducted from federal income tax according to its guidelines. Conservation easements can also lower the value of land in an estate which can lead to a savings on estate taxes. There can be significant costs associated with the creation of an easement, but landowners often offset these costs through tax savings.

Is a conservation easement right for me?
If you have land that meets conservation guidelines and you want to see the land protected forever, then your land may be a good prospect for a conservation easement. However, any landowner should always consult with their family as well as legal and financial advisors to see if an easement is right for them.
Home on the Range - Permanently

By: Joanna Pope, Nebraska NRCS Public Affairs Officer

Cowboys are known for being good storytellers. When you visit with Roy and Steve Breuklander, father and son ranchers in Cherry County, you are treated to several stories. Roy will share a story about how his grandparents homesteaded in Cherry County back in the 1880’s or about how he got his ranching operation started down along the Niobrara River. Steve will share stories about expanding the family’s ranching operation, or how his family started one of the first canoe outfitters in the Niobrara Valley.

The common thread in each of the stories they share is their love of the land, and the life they’ve carved out for themselves and their families along the Niobrara River.

It isn’t difficult to understand why the Breuklander family loves their land. Their ranch, which they’ve named “Sunny Brook Ranch” hugs the Niobrara River for over a mile, and then rises above the river valley into pine covered bluffs full of wildlife and beautiful views.

Anyone who has taken a float trip down the Niobrara River should appreciate Breuklander’s ranch and the pristine views their property offers. As development pressure along the Niobrara River continues to rise, so does the price of land. This has driven some local ranchers out of business, or has created a big incentive to sell their ranchland for development.

The Breuklander family was acutely aware of how the Niobrara River Valley was changing. Roy was looking to retire, and Steve wanted to purchase his dad’s property. This would provide Roy retirement income and help Steve expand his own ranching operation. But with the steep increase of land prices, Steve simply couldn’t afford to buy his dad’s ranch. The family had been offered above market value for bits and pieces of their ranch, but they didn’t want to see it broken up and developed, so they declined all offers.

The Breuklanders found a solution by working with their local Natural Resources Conservation Service (NRCS). The NRCS, through the 2008 Farm Bill, offers the Farm and Ranch Lands Protection Program. This program works with partner organization to help protect farm and ranchland threatened by development. The program provides matching funds to help purchase development rights to keep productive farm and ranchland in agriculture uses. NRCS partners – the Nebraska Environmental Trust

Through the Farm and Ranch Lands Protection Program, Roy (left) and Steve (right) Breuklander will be able to protect their Sunny Brook Ranch from development in the popular recreational area along the Niobrara River in Cherry County.
and the Nebraska Land Trust - provided up to 50 percent of the fair market value of the conservation easement, and NRCS provided the other 50 percent.

The easement allows owners to continue agricultural operations in perpetuity and the ranch remains the private property of the landowner. The primary purpose of a conservation easement is to protect land from certain development or uses while permitting existing uses. The land also remains on tax rolls.

This program was originally intended to assist with urban sprawl around densely populated urban areas, but in Nebraska, the program has been valuable in protecting historically significant, culturally unique and wild and scenic places from development.

The program worked well for the Breuklanders. It allowed the Breuklanders to keep their ranch intact. It provided money for Roy to retire, and the easement’s no-development condition lowered the value of the land, making it more affordable for Steve to buy.

To explain why the Breuklanders enrolled 1,124 acres into the Farm and Ranch Lands Protection Program, Steve shares another story.

On an elk hunting trip in Wyoming, Steve and his hunting guide came out into clearing. He was surrounded by one of the most majestic mountain views he had ever seen. Steve remarked to his guide that he’d love to put his cabin right here. His guide replied, “You and about 40,000 other people.” It was then Steve realized the benefit of wilderness preservation.

Steve said, “We can love a place to death. That experience showed me that if something special isn’t protected, we can destroy the things we love the most.”

The easement is good news for those who enjoy the wild and scenic views from the Niobrara River. The Breuklander ranch is highly visible from the well-traveled River Road, which crosses it for nearly 2.5 miles. The easement also includes 1.3 miles of river frontage just upstream from Rocky Ford, one of the most popular access points on the river.

The thing Steve Breuklander loves the most is ranching, and the Farm and Ranch Lands Protection Program allows Steve to continue doing what he loves. The easement does not restrict the Breuklanders from continuing to operate their ranch.

Callie Kreutner, soil conservationist with NRCS in Valentine, Neb., said that the Farm and Ranch Lands Protection Program fits well with some in the ranching community.

“This program is all about letting ranchers ranch. It’s about keeping land in sustainable production. The main restriction is that the property cannot be developed, but the land may still continue to be ranced has it always had,” Kreutner said.

What Steve Breuklander liked most about the Farm and Ranch Lands Protection Program was the flexibility.

“Our easement agreement contains several options for recreation like hiking, hunting, trail rides, as well as rangeland management options like brush management, prescribed fire and more. It lets me have options for the future while allowing me to continue ranching as I had before,” Steve said.

Steve plans to continue ranching and operating their canoe outfitting business, which offers the only alcohol-free campground on the river. Steve will also continue his deer and turkey hunting operation.

“The conservation easement has allowed my family to continue operating our land as we choose. We have been blessed with having a beautiful piece of God’s land to take care of for just a little while. I want to do all I can to protect it in the best way I know how,” Steve said.
Tangible Personal Property (TPP) Gifts

1. Is the TPP held as inventory by a dealer or as an asset in a collection by an investor?

   - Assets used in a trade or business are taxed as ordinary income and are deductible when gifted at cost basis.
   - Assets held in a collection for more than one year are taxed as long term gain property. When gifted the TPP is deductible at full fair market value and by-passes capital gain taxes.

2. What will the charity do with the TPP?

   - If the TPP is used in a manner related to the charity’s exempt purpose, for example, a gift of artwork to an art museum, the deductible amount is the full fair market value of the TPP up to 30% of the donor’s adjusted gross income in the year of the gift. With a five year carryover for any excess contribution.
   - If the TPP is not the type of property ordinarily used by the charity the value of the deduction is limited to the donor’s cost basis in the TPP. Since the deduction is for cost basis the amount of the deduction is limited to 50% of the donor’s adjusted gross income in the year of the gift. With a five year carryover for any excess contribution.

3. How is the value of the TPP substantiated for tax purposes?

   - If the full fair market value is over $5,000 an appraisal by an independent appraiser will be required to substantiate the value of the TPP.
Tax Analysis of a Gift of TPP put to an unrelated use by the charity:

1. Gift TPP to Charity then sold by the Charity:
   Sale Price of TPP $110,000
   Cost Basis (10,000)
   Capital Gain 100,000
   CG Tax Rate .15
   Capital Gains Tax Savings $ 15,000

   Charitable Deduction Value $ 10,000
   Ordinary Income Tax Rate ___ .35
   Tax Savings $ 3,500

   **Total Net Tax Savings** $ 18,500
   **Total Charitable Gift** $110,000

2. Sell TPP then gift the net proceeds to Charity:
   Sale price of TPP $110,000
   Cost Basis (10,000)
   Capital Gain 100,000
   CG Tax Rate ___ .15
   Capital Gains Tax Paid $ 15,000

   Gift of net Proceeds $ 95,000
   Ordinary Income Tax Rate ___ .35
   Tax Savings $ 33,250
   Capital Gains Tax Paid (15,000)

   **Total Net Tax Savings** $ 18,250
   **Total Charitable Gift** $ 95,000
Deferring Taxes Using a Charitable Remainder Trust

When considering retirement, many farmers and ranchers realize they face perhaps their largest income tax liability the year they retire because of the sale of the build-up in commodity inventories and sale of fully depreciated equipment. An option that can defer these taxes is a charitable remainder trust (CRT). A CRT is a tax-qualified trust. Any assets sold by a CRT are sold on a tax-free basis.

A CRT provides three benefits: 1) bypass of income taxes on the sale of the assets inside the CRT; 2) increased income from the tax-free sale of assets inside the trust and tax-free growth of the assets inside of the CRT; and 3) a future charitable gift.

Let’s break down how a CRT operates:

- Contribute grain/cattle/equipment to a CRT (the rancher/farmer may still be able to deduct the expenses of their operation).
- The CRT sells the grain/cattle/equipment tax-free.
- The CRT provides an income – either fixed or variable – to the rancher/farmer. The income can be for the life of the rancher/farmer and his/her spouse. Or, the income payments can be guaranteed to be paid for a fixed number of years (up to 20 years). This option is popular because if the rancher/farmer passes, the remaining income payments can continue to family members.
- Ordinary income tax is owed on the income payments from the CRT.
- At the end of the trust, the remaining asset will go to the community or a charity of the rancher’s/farmer’s choice.

Here is a real-life situation of how a rancher and his wife, who were retiring and wanted their children to inherit their ranch, used a CRT to make a tax-free sale of cattle. Since they were planning to lease the ranch, they wanted to sell the cattle. Their tax preparer informed them that due to cattle sales they were looking at incredible tax issues if they continued to sell their cattle. After exploring their options, they decided to establish a CRT. Prior to taking the next load of cattle to the sale barn, a CRT agreement was put into place. The CRT then delivered the cattle to the sale barn. The cattle were sold tax-free in the CRT’s name. As a result, the amount of income generated by the CRT was more than double the income that would have been generated from the net proceeds of an outright sale of the cattle. Plus, the couple are making a future charitable gift of the remainder of the CRT.

Table 1 shows a comparison of the outright sale of the cattle versus the tax-free sale by the CRT.

<table>
<thead>
<tr>
<th>Table 1</th>
<th>Charitable Remainder Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale of Cattle</td>
<td>$526,000</td>
</tr>
<tr>
<td>Less federal, state and self-employment taxes (57.14%)</td>
<td>($300,556)</td>
</tr>
<tr>
<td>Net cash to invest</td>
<td>$225,444</td>
</tr>
<tr>
<td>Annual yield</td>
<td>x 5%</td>
</tr>
<tr>
<td>Annual Income</td>
<td>$11,272</td>
</tr>
<tr>
<td>Net cash invested by CRT</td>
<td>$526,000</td>
</tr>
<tr>
<td>Annual payout by CRT</td>
<td>x 5%</td>
</tr>
<tr>
<td>Annual income</td>
<td>$26,300</td>
</tr>
</tbody>
</table>

A charitable remainder trust may be a way for you to defer taxes and make a future charitable gift, but it can be a little tricky to navigate.
Unlocking the Value of Ag Land with Charitable Remainder Trusts

This article attempts to further readers' awareness and understanding of the benefits of Charitable Remainder Trusts (CRTs). We'll start by looking at a case study of how a Nebraska couple with charitable inclinations used a CRT to unlock the appreciated value in their farmland.

In 2012, a married couple in their early 80s decided it was time to simplify their lives and take advantage of the increased value of the quarter section of farmland they owned and rented out in Clay County.

After evaluating the tax, income and charitable benefits, the couple decided to deed an undivided 50 percent interest in the land (80 acres) to a CRT. The couple and the CRT then jointly sold the land. The couple's charitable contribution deduction for the gift to the CRT offset a substantial portion of the capital gains deduction for the gift to the CRT.

The couple's charitable contribution and the CRT then jointly sold the land. They have named their adult children to make the grant recommendations from this fund. The Nebraska Community Foundation staff prepared a donor-advised fund agreement and will help the couple develop grant-making guidelines and principles to share with their children.

With the value of Nebraska's ag land at or near record levels, now is the time to explore the benefits of a CRT, if you are considering selling ag land but are hesitant because of capital gains taxes and the need for lifetime income. The following information describes some of the benefits and considerations for determining if a CRT is a good fit.

What is a CRT?

A CRT is a special tax-exempt, irrevocable trust arrangement written to comply with federal tax laws. The donor can transfer cash or assets (especially appreciated assets) to the trust and receive income for one or more lifetimes; or the donor may choose a term of years (not to exceed 20). For example, the income could be paid over the lifetimes of a husband and wife; then, the couple's children could be paid income for an additional 20-year term.

After the income beneficiaries' interests have ended, the charitable remainder beneficiary or beneficiaries will receive the remaining corpus of the trust. Note: IRC Section 664 lists the requirements a trust must meet in order to qualify as a CRT.

Overview of the Benefits of a CRT

The creation of a CRT typically provides the following benefits for the donor:

Avoid capital gains: No capital gains tax is due on the appreciation of the contributed property when the trustee sells and reinvests. The charitable contribution deduction is based on the fair market value of the property, not on the donor's basis in the property.

Increase income: The trustee can take appreciated, low-yield property, sell it and invest the proceeds in higher-yielding assets without paying capital gains taxes.

Provide an immediate charitable income tax deduction: The deduction is based on the present value of the remainder interest.

Types of CRTs

There are two basic types of CRTs: an annuity trust and a unitrust. The major difference between the two is how the payout to the income beneficiaries is determined. The annuity trust payout is a fixed annual dollar amount of not less than 5 percent of the initial value of the trust assets. The unitrust payout is a fixed percentage of not less than 5 percent of the beginning of the year value of the trust assets; as a result, the unitrust payout will vary from year to year.

Annuity Trust and Unitrust Considerations

- The payout rate may not exceed 50 percent of the initial value (annuity trust) or the annual value (unitrust).
- The present value of the charitable remainder must be at least 10 percent of the net fair market value of the
assets transferred to the trust on the date of the gift.

• When the donor names anyone other than himself/herself or a spouse as an income beneficiary, he/she is making a gift to that person with gift tax consequences.

• The value of a CRT is included in the donor’s estate. If the donor or donor’s spouse are the only income beneficiaries of a CRT, the estate will receive a corresponding charitable estate deduction or marital deduction for the value of the CRT. If there are other successor income beneficiaries, there may be a taxable transfer of the present value of the non-charitable beneficiaries’ income interest.

• The taxation to the beneficiary of the income payout depends upon the character of the income earned by the CRT. Distributions are taxed based on a “four-tier” system, in the following order:
  
  **First**, current and accumulated ordinary income;
  
  **Second**, capital gain (short-term gain is deemed distributed before long-term gain) determined on a cumulative net basis;
  
  **Third**, tax-exempt income; and
  
  **Fourth**, trust corpus.

• The trustee can be a commercial trustee, a charitable organization, an unrelated third person or the donor.

• A 1977 Revenue Ruling created the 5 Percent Probability Test for Annuity Trusts. Under this test, the trust is disqualified as a CRT if the chances are greater than 5 percent that the income beneficiaries will live long enough to exhaust the trust, leaving nothing for the charitable remainder.

• Unitrust Options:
  
  **Standard**: The unitrust payout amount will vary year to year as the value of the trust assets rises or falls.
  
  **Net income**: The trust agreement states that payment will be the lesser of the stated payout percentage or the net income earned.
  
  **Net income with makeup provisions**: Allows the trustee to make up prior years’ deficiencies in payouts to the extent current income of the trust exceeds the specified unitrust amount.
  
  **Flip**: Allows a net income trust to flip to a standard trust upon the occurrence of a specific triggering event, which must be outside the control of the trustee or any other person. Examples of triggering events are a beneficiary attaining a specific age, marriage, divorce, death, birth and sale of an unmarketable asset.

• Additional contributions may be made to the same unitrust. However, additional contributions cannot be made to the same annuity trust.

**Conclusion**

In my work with many generous people across Nebraska, I’ve found that in almost every case there is a planned giving tool that fulfills a donor’s charitable intentions, while maximizing tax benefits. CRTs are not widely understood by the general public. However, they may be very well-suited to people in Nebraska who hold much of their wealth in the appreciated value of their agricultural land. The people I have assisted in using a CRT held a strong attachment to their land and preferred making a gift to charitable causes close to their heart rather than paying significant taxes when it was time to sell. The flexibility of a CRT enables donors to choose from different options for lifetime income payments. For these reasons, I encourage readers to learn more about CRTs and how they may be right for a landowner.

**Editor’s Note**: This article is reprinted in part from The Nebraska Lawyer, May/June 2014. For more information, Gustafson can be reached at (402) 323-7341.
Benefits of Gifting Agricultural Commodities

Nebraska farmers and ranchers can save significant taxes by contributing commodities such as corn or cattle to their community foundation fund instead of making a cash contribution after selling the commodities.

When an agricultural producer transfers legal ownership of grain or livestock to a 501(c)(3) charitable organization such as Nebraska Community Foundation before the commodity is sold, the producer will not realize taxable income from a sale, thus minimizing taxes. The producer is still able to deduct the entire cost of the production of the commodity on Schedule F. Depending on the producer’s specific circumstances, savings may be realized on federal and state income tax and self-employment tax.

A producer should consult with his or her tax advisor to determine whether a contribution of commodities is appropriate to their tax situation.

The Nebraska Community Foundation can help you make a gift of commodities to benefit your local community foundation fund and get the desired tax treatment. Most importantly:

- You must provide written documentation to NCF and inform the grain elevator or sale barn of the transfer of title of the commodity.
- The Nebraska Community Foundation must be in control of the sale of the commodity.

See “Steps to Make a Charitable Gift of Grain” or “Steps to Make a Charitable Gift of Livestock” for the instructions on making a gift of commodities.

For assistance with a gift of commodities contact Les Long, NCF Controller at (402) 323-7346 or llong@nebcommfound.org.

This information is intended solely to inform you of a potential gift planning opportunity. The Nebraska Community Foundation is not a tax advisor. You may not rely on the information contained herein for the purpose of avoiding tax penalties and you should consult your tax advisor to determine whether the information presented here is appropriate to your tax situation.
Steps to Make a Charitable Gift of Grain

Following these specific steps will help ensure that you receive the intended tax benefits from a gift of grain. Failure to follow these steps may result in the IRS treating the transaction as a sale by the farmer resulting in a contribution of cash, rather than as a contribution of grain. As a donor, you should follow these steps to ensure that ownership of the gifted grain is transferred prior to sale and you receive recognition for your gift:

1. To advise us that a gift is about to be made, contact Les Long at (402) 323-7346 or llong@nebcommfound.org at Nebraska Community Foundation.

2. Complete the **Letter from the Producer Regarding a Gift of Grain** form notifying us that you are making a gift of grain. Indicate the quantity and type of grain being contributed and the affiliated fund (and related purpose) to which your contribution is directed. Send the letter to Nebraska Community Foundation, PO Box 83107, Lincoln, NE 68501-3107. You may also email the letter to llong@nebcommfound.org or fax it to (402) 323-7349.

3. Send a copy of the letter to the treasurer of the affiliated fund to which your gift is directed. NCF can provide the treasurer’s contact information.

4. When you deliver the gifted grain to the local elevator, tell the grain elevator to issue a storage receipt in the name of Nebraska Community Foundation. The storage receipt is the evidence that ownership of the grain was transferred from the farmer to NCF. Send the storage receipt to NCF at the address in Step 2.

5. Instruct the grain elevator that it must send the contract to sell the grain to the Nebraska Community Foundation for signature. The contract can be mailed to the address in Step 2 or faxed to the attention of Les Long at 402-323-7349. If the elevator does not use written contracts for grain sales, NCF will provide a completed **Instructions to Grain Elevator for Gift of Grain** form. Because NCF owns the grain following your gift, you may not instruct the elevator to sell it.

6. Remind the grain elevator to **issue the check** for the sale of the grain to Nebraska Community Foundation and send it to the address in Step 2.
Letter from the Producer Regarding a Gift of Grain

To:
Nebraska Community Foundation
PO Box 83107
Lincoln, NE  68501-3107
Fax 402-323-7349

I/We, _____________________________________, hereby gift _________ (# of bushels)
of ______________________________________________________(type of grain)
to Nebraska Community Foundation for the benefit of ______________________
Community Foundation Fund for the ________________ project / account.

☐ A check mark in this box verifies this grain does not have a lien against it; or if the grain does have
a lien against it, a lien waiver from the lender is attached.

____________________________________                                                    __________
Signature(s)             Date:

____________________________________
Printed name(s)

___________________________________
Mailing address

I will transport the gifted grain to the following facility on behalf of the Nebraska Community
Foundation:
  Name of grain elevator, feed lot or other facility __________________________
  Contact person __________________________
  Phone number __________________________

1. Send this letter to
   Nebraska Community Foundation
   P.O. Box 83107
   Lincoln, NE 68501-3107

2. Also send a copy to the treasurer of the affiliated fund to which your gift is directed.

   If you have questions, please contact:
   Les Long, Controller
   Nebraska Community Foundation
   402-323-7346

P.O. Box 83107 • Lincoln, Nebraska 68501-3107 • (402) 323-7330 • Fax (402) 323-7349
www.nebcommfound.org
Steps to Make a Charitable Gift of Livestock

Following these specific steps will help ensure that you receive the intended tax benefits from a gift of livestock. Failure to follow these steps may result in the IRS treating the transaction as a sale by the farmer/rancher resulting in a contribution of cash, rather than a contribution of livestock. As a donor, you should follow these steps to insure that ownership of the gifted livestock is transferred prior to sale and you receive recognition for your gift:

1. To advise us that a gift is about to be made, contact Les Long at (402) 323-7346 or llong@nebcommfound.org at the Nebraska Community Foundation

2. Complete the Letter from the Producer Regarding Gift of Livestock notifying us that you are making a gift of livestock. Indicate the quantity and type of livestock being contributed and the affiliated fund (and related purpose) to which your contribution is directed. Send the letter to Nebraska Community Foundation, PO Box 83107, Lincoln, NE 68501-3107. You may also email the letter to llong@nebcommfound.org or fax it to (402) 323-7349.

3. Send a copy of the letter to the treasurer of the affiliated fund to which your gift is directed. NCF can provide the treasurer’s contact information.

4. NCF will request that you deliver the livestock to market on our behalf and NCF will provide the sale barn with a completed Instructions to Sale Barn for Gifts of Livestock form.

5. Remind the sale barn to issue the check for the sale of the livestock to Nebraska Community Foundation and send it to the address in Step 2.
Letter from the Producer Regarding a Gift of Livestock

To:
Nebraska Community Foundation
PO Box 83107
Lincoln, NE 68501-3107
Fax 402-323-7349

I/We, _____________________________________, hereby gift _________ (# of head)
of ______________________________________________________(type of livestock)
to Nebraska Community Foundation for the benefit of _________________________________
Community Foundation Fund for the _______________________ project / account.

☐ A check mark in this box verifies this livestock does not have a lien against it; or if the livestock
does have a lien against it, a lien waiver from the lender is attached.

____________________________________ __________
Signature(s)      Date:

____________________________________
Printed name(s)

___________________________________
Mailing address

I will transport the gifted livestock to market at which time I understand you will direct that it be sold
on behalf of Nebraska Community Foundation.

1. Send this letter to
   Nebraska Community Foundation
   P.O. Box 83107
   Lincoln, NE 68501-3107

2. Also send a copy to the treasurer of the affiliated fund to which your gift is directed.

   If you have questions, please contact:
   Les Long, Controller
   Nebraska Community Foundation
   402-323-7346
Charitable IRA Rollover

In 2015 the Charitable IRA Rollover provision was reinstated and permanently extended into the future. This law allows an individual who is 70½ or older to gift up to $100,000 from his or her IRA directly to a qualified charity such as the Nebraska Community Foundation or for the benefit of an Affiliated Fund of NCF without having to recognize the IRA distribution in taxable income.

How it Works:

- The law allows those age 70½ and older to transfer up to $100,000 from an IRA to charity – tax-free. If married, each spouse can transfer up to $100,000 from his or her IRA.

- The gift must be made directly from the custodian of your IRA to the Nebraska Community Foundation for the benefit of your community’s or organization’s affiliated fund.

- Your tax-free rollover gift will be excluded from your gross income.

- Your gift can count toward your required minimum distribution.

- Gifts to life income plans, donor-advised funds, supporting organizations and most private foundations do not qualify.

We would be happy to discuss this charitable giving opportunity with you. Please contact Jim Gustafson, Director of Advancement and Gift Planning for the Nebraska Community Foundation at (402) 323-7341 or at jgustafson@nebcommfound.org.

To read more about the Charitable IRA Rollover visit www.nebcommfound.org.
This page intentionally left blank.