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Probate and Estate Planning Section

Michigan Probate and Estate Planning Journal

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Joint Financial Accounts: Legal Analysis and Litigation Tips

By Michael J. McClory

Author's note: The views expressed in this article do not necessarily reflect those of the Wayne County Probate Court.

I. Introduction

It is not uncommon for a probate practitioner to become embroiled in a dispute over title to a decedent's joint financial account. A surviving joint account holder, typically either a relative or close friend of the decedent, may contact you for assistance in resisting the claim of another individual that the account should be declared an estate asset. While serving as counsel for a personal representative, you may encounter a situation where it appears that an account was made joint for convenience only and should be determined to belong to the decedent's estate. Whatever the interest of your client, a clear understanding of Michigan's law concerning joint financial accounts will allow you to make a realistic and informed evaluation of the strengths and weaknesses of each side's position and to make tactical decisions to maximize the potential for achieving a satisfactory outcome.

This article will present an analysis of the law concerning joint financial accounts in Michigan. Although the emphasis is on bank accounts, the statutes regarding funds held for deposit in credit unions and savings and loan associations will also be discussed. Suggestions for successfully prosecuting or defending a claim involving joint accounts, as well as sample forms to memorialize a joint owner's statement of intent regarding the creation of a multiple party account, are also included.

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News and Comments

By Fredric A. Sytsma

Have We Found a Magic Pill? Because of a dearth of more traditional news, and having nothing else that I particularly want to comment on, I am departing from my usual format to highlight a single fairly recent development, in an effort to generate some discussion of an interesting topic. In midsummer, as I'm writing this, television news, newspapers, and news magazines are all breathlessly

reporting research that could lead to the development of a new "fat pill," derived from the protein leptin, which apparently melts away fat on some roly-poly laboratory mice and reduces their cholesterol levels--all without exercise. The possibilities are admittedly fascinating, even to a dedicated workout fanatic like me.

Almost as fascinating to me (as an estate planner) is a concept known as the Tax Basis Revocable Trust (TBRT, pronounced t-ber?), which promises, with no particular risk or effort, to achieve a very desirable tax result for my clients. Could this be another magic pill?

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Readers' Questions on Estate Planning and Estate Settlement

By Kenneth E. Konop

QUESTION

Is a transfer and declaration of trust ownership in revocable form, if delivered to counsel for recording at a later date or even after death, effective upon execution and delivery to transfer present and future acquired property to a trust, for purposes of probate avoidance and estate splitting for federal transfer tax purposes if signed by the husband and the wife transferring all of their property in equal shares to their respective trusts as tenants in common?

ANSWER

The use of a joint tenancy declaration of trust or a declaration of ownership by two trusts as tenants in common is a useful form of ownership and should achieve the result you desire. The use of this form of ownership as a part of an estate plan has been the subject of two outlines.

Susan S. Westerman in her outline entitled, "Using Joint Trusts in the Estate Plan: Problems and Possibilities" and John H. Martin in his outline entitled, "Solutions for Common Will Drafting Problems" include forms and a discussion of this form of owning property. These outlines are contained in the material prepared by the authors for The Institute of Continuing Legal Education and the Probate and Estate Planning Section of the State Bar of Michigan's "33d Annual Probate and Estate Planning Seminar" in 1993. The material may still be available for purchase from ICLE at (313) 764-0533.

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Legislative Developments

By Richard C. Lowe

HB 4023--Review of Certain Guardianships (*Representatives Profit and Wallace*)

House Bill 4023 requires an informal review of a guardianship within five years if the term of the guardianship exceeds five years.

It has been assigned to the House Judiciary and Civil Rights Committee.

HB 4024--Notification of Change of Location of Ward (*Representatives Profit and Wallace*)

House Bill 4024 requires the guardian to notify the court within 14 days of a change in the ward's place of residence.

It has been assigned to the House Judiciary and Civil Rights Committee.

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Recent Decisions in Michigan Probate, Trust, and Estate Planning Law

By Hon. Phillip E. Harter

Child Custody Act--Guardians--Standing

In re Alexander Michael Ramon, Minor, 208 Mich App 610 (1995) Father had acknowledged paternity of his daughter, who was born out of wedlock. A judgment was entered in 1991 declaring him to be father; ordering support; awarding him visitation rights; and granting the care, custody, and control of the child to mother. Mother died September 14, 1993. The probate court appointed grandparents as the child's temporary guardians on September 23, 1993. Father moved for a change of custody on September 29, 1993. Grandparents responded to father's petition in probate court on October 12, 1993, and also petitioned the circuit court for sole custody on that date. The probate court issued an Order for Temporary Court Structured Guardianship Plan on November 3, 1993. Father contested grandparents' circuit court action on the basis that they lacked standing to file a petition for custody. The circuit court found that the probate court's Order for Temporary Court Structured Guardianship Plan was a de facto "limited guardianship placement plan" and that father had substantially complied with the plan. Therefore, the circuit court determined that grandparents lacked standing under MCL 722.26b(2); MSA 25.312(6b)(2) to contest custody and granted custody to father. Grandparents appealed.

The Court of Appeals reversed. It held that a limited guardianship is strictly a

creature of statute and that the probate court's order could not be a statutory limited guardianship because of the way it was created. Nor could it be considered to be the equivalent of a statutory limited guardianship. The court observed that a limited guardianship is based on mutual agreement, trust, and cooperation between the limited guardian and the custodial parent(s). Those factors were not present in this case. The case was remanded to the circuit court for a custodial hearing pursuant to the Child Custody Act.

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Digest of Michigan Probate Opinions

By Hon. George E. Benko

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Ambiguities; Personal Representative; In re Estate of Arthur Wesley MacArthur, Deceased; Judge Bruce A. Newman, Genesee County. The court had interpreted a will from its plain language as the purpose of interpretation is to ascertain the expressed intention of the testator. When the intent of the testator can be derived from the plain terms of the will, no ambiguities shall be presumed to exist. MCLA: 555.55; 555.58; 700.552; 700.553; 700.554; MSA: 26.79(5); 26.79(8); 27.5552; 27.5553; 27.5554; 18 NW 537 (1884); 136 NW 590 (1912); 147 NW 556 (1914); 229 NW 465 (1930); 77 NW2d 384 (1956); 84 NW2d 441 (1957); 156 NW2d 631 (1967); 275 NW2d 262 (1979); 445 NW2d 218 (1989); 53 Mich 10 (1884); 170 Mich 617 (1912); 180 Mich 583 (1914); 249 Mich 474 (1930); 346 Mich 106 (1956); 349 Mich 136 (1957); 405 Mich 702 (1979); 9 Mich App 245 (1967); 179 Mich App 216 (1989)

95-10

Burden of Proof; Testamentary Disposition; In the Matter of Estate of John W. Moorhead, Deceased; Judge Richard J. Liedel, Otsego County. The burden of proving that a later testamentary disposition is not valid and does not supersede a prior one is on the party claiming its invalidity, where there has been compliance with all the requisites to make a valid disposition. MCLA: 700.121; 700.124; 154 Mich App 350 (1986); 25 Mich. Civ Jur. Wills, Sec. 3

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Probate and Estate Planning Section

From the Chairperson's Desk

By Raymond H. Dresser, Jr.

Published in the Fall 1995 issue of Michigan Probate and Estate Planning Journal

It is a great privilege to have the opportunity to serve as chairperson of one of the leading and largest sections of the State Bar of Michigan. I served for a number of years as a member of the Board of Commissioners and an officer of the State Bar of Michigan dealing with the entire Bar. It is a new type of challenge to chair a section whose responsibilities pertain to practitioners within a given field of law. Before becoming a Council member of the Section, I was the commissioner liaison from the Board of Commissioners. I was immediately impressed by the dedication and the quality of lawyers who participated in the Council activities. The attendance at the meetings is exceptional, and the dialogue is equal to any seminar that one might attend. It is not an intimidating environment for the new kid on the block, who is always welcome at the meetings.

Michael W. Irish was one of my close acquaintances on the Council. I was fortunate in that I had met Mike and his wife, Ann, through other associations. Mike was not only an outstanding and well-respected practitioner, he was a gentleman (a term which seems to have escaped modern day vocabularies). After Mike's untimely death early this year, it was with sincere humility that I took over his role as chair-elect and now chair of the Council.

The other new officers for the coming year are chairperson-elect John H. Martin, vice-chairperson Patricia Gormely Prince, secretary Brian V. Howe, and treasurer Richard C. Lowe. Congratulations and bountiful thanks go to retiring chairperson John D. Mabley, continuing a long line of outstanding leaders, and fellow Council members Honorable George E. Benko and Catherine A. Jacobs. I welcome as new Council members Douglas A. Mielock, Michael J. McClory, Mary Ann Zito, and Honorable John N. Kirkendall. Reelected to their second three-year terms are Michael O. Love and Honorable Gerald J. Supina.

There are major tasks facing the Council and the Section for the coming year. There are also areas in the probate and trust law field to which I would particularly like to have our energies and attentions directed.

1. *Estate Settlement Act.* The Council and the Section initially did a study in 1988 regarding the structure of the Revised Probate Code. After careful analysis, it became apparent that in the best interests of the public and the lawyers who serve the public, a complete revision of the Code was in order along the lines of the Uniform Probate Code but keeping those parts of our existing law which had already been duly massaged and were serving their

purpose. In 1995 the draft of the new Estate Settlement Act was completed and ready for comment. John H. Martin acted as reporter and has done an outstanding job. The legislative enactment group, consisting of Robin D. Ferriby (chair), Catherine A. Jacobs, Richard C. Lowe, and Honorable Gerald J. Supina (probate judge as liaison), has commenced the enormous task of introducing this bill to the lawyers, judges, the legislature, and the public.

The top priority of the Council and Section for 1995-1996 is to expose the Estate Settlement Act to as many people as possible and have the Act passed into law. The effective date of the legislation will extend beyond the year in order to fully educate everyone about the provisions of the Act and be ready for its implementation.

2. *Michigan and federal estate and gift tax and related tax legislation.* The Section was instrumental in the repeal of the Michigan Inheritance Tax law and the implementation of the Michigan Estate Tax law, which essentially is a pickup tax the same as Florida's. Finally, we can now say that our death taxes are the same as Florida's, which don't cost you anything. We were also instrumental in the passage of the phaseout of the Michigan Intangibles Tax in 1998. These tax changes helped make the State of Michigan more user friendly and encourage the public to continue to be residents of Michigan and utilize the facilities and services of our state rather than running off to the Sun Belt for tax reasons.

There are now a number of tasks that the Council and the Section can undertake in the federal estate and gift tax area. Several of the proposals would have immense impact in the estate planning area. I want to see the Council and the Section taking an active part in giving input and supporting the federal legislation which reduces death taxes and provides for long-range planning and retirement. Some changes that are most often mentioned are (a) modifying the present laws relating to deductible IRAs by permitting deductible IRA contributions of up to \$2,000 for each spouse; (b) allowing a deduction equal to 50 percent of net capital gain for the taxable year (rather than have a maximum 28 percent rate it would be half of the taxpayer's effective rate); (c) indexing the gift and estate tax (the present unified credit of \$192,800 would be increased to \$248,300 over a three-year period beginning in 1996; this would effectively provide an exemption then of \$750,000); (d) enacting the American Family-Owned Business Act introduced in the Senate with a similar provision in the House, providing for a \$1.5 million exemption for small businesses and farms and a 50 percent exemption for amounts in excess of \$1.5 million (this would be in addition to the present law, excluding up to \$600,000 personal and business assets).

3. *Michael W. Irish Award.* This will be the first year that the newly established Michael W. Irish Award will be granted. The initial standing committee will be chaired by Fred Sytsma with the assistance of Brian Howe and three immediate past chairpersons of the Section. Mike's widow, Ann, will also act ex officio. The award will go to a lawyer for significant professional or community contributions.
4. *Expanded Practice Committee.* This relatively new committee consists of Dirk C. Hoffius (chair), John E. Bos, Kenneth E. Konop, and John A. Scott. There are so many inroads being made in the historical territory of the law practice and particularly in the probate and trust law area, we need to look for ways to expand our services. In the good old days, lawyers dealt with legal issues, and others dealt with business, investment and financial advice. We need to explore these other possibilities. Likewise, there are guardianships and trusts, because of the economics of size, that are not being provided with services.

5. *Ethics and Unauthorized Practice of Law Committee.* These two committees have been combined in one under the chair of Mary Ann Zito. Working in cooperation with the State Bar of Michigan, the problems that are faced usually cross over between the two areas and are therefore being combined under one committee with a continued strong emphasis and watchdog mentality.
6. *Environmental Committee.* Environmental issues continue to mushroom in the probate and trust law area. This year we will be addressing the needs of practitioners and fiduciaries and addressing the environmental problems they may encounter. John A. Scott will be chairing this important committee.
7. *Meetings and seminars.* The annual highlight of continuing legal education, the annual Probate Seminar, will again be held at the Grand Traverse Resort in Traverse City and in Dearborn with Patricia Gormely Prince as chairperson. The annual meeting will be held in Grand Rapids, and the program for that meeting will be under the direction of the Grand Rapids Council members, M. Gayle Robinson (chair), John D. Flynn, and Dirk C. Hoffius. Several other seminars will be held in conjunction with ICLE. The Advanced Estate Planning seminar is scheduled for Troy on November 10, 1995. Timely subjects are featured by national and state experts.

As always, all members are welcome at our Council meetings. We enjoy your input, and we draw our committee and Council members from those participating at these meetings.

I look forward to working with all of you in the forthcoming year.

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Probate and Estate Planning Section

Estate Planning Trends and Techniques

by William E. Fisher

Published in the Fall 1995 issue of Michigan Probate and Estate Planning Journal

Divorce Settlements--Watch Out for Chapter 14

Divorce is a fairly common phenomenon in present day society. It is no longer unusual for clients of my law firm to become involved in divorce proceedings. As wealthy clients, frequently with closely held business interests and complicated financial structures, become involved in divorce proceedings, many practitioners who might once have never been involved with divorce are now being asked to provide a range of services to clients, especially services pertaining to tax and property management issues. Not infrequently I will be called upon not only to provide such services to other members of my law firm who now specialize in "family law" but also to assist the high priced, top gun divorce lawyer who is representing a client in the primary divorce proceeding.

Divorce proceedings, even those that are deemed friendly, most often arrive at financial settlements after hard negotiations and bargaining. While broad tax considerations are on the minds of the parties and their advisers during the negotiations, underlying economic considerations are frequently given greater weight. Unfortunately, what often happens is that after the parties have negotiated a settlement and designated a structure to implement the settlement, certain esoteric parts of the tax law can result in some very significant and unintended consequences.

A hypothetical case can illustrate the potential problem. Assume a situation in which both the husband and wife have previously been married to other persons and have children from their prior marriages. The husband and wife are now involved in divorce proceedings. The parties did execute a prenuptial agreement, but there are questions whether the terms of the prenuptial agreement can be fully enforced in the divorce proceedings. Assume that the wife is the wealthier of the two parties, with assets of approximately \$10,000,000, and that the husband has assets of only \$500,000. Finally, assume that the marriage has lasted for at least 10 years.

A fairly common property settlement in this type of case would involve the following elements. The wealthier spouse would transfer a certain amount of assets outright to the less wealthy spouse (the property settlement component). The wealthier spouse would also agree to make some sort of periodic payments

to the less wealthy spouse for the remainder of that spouse's life (the alimony component).

Assume in our hypothetical case that the divorce was friendly and that the husband and wife, at a meeting without their lawyers present, reached an agreement on a financial settlement. The wife will transfer \$500,000 in cash to the husband, and she, or her estate, will agree to pay the husband \$7,500 per month until his death. Because the wife's wealth is great in relation to the required payments that she must make, it seems that there should be few problems in implementing the settlement agreement. The wife will simply pay the \$500,000 to her husband when the marital settlement agreement is executed. During her life the wife will make the monthly alimony payments to the husband, and the wife will agree to include a provision in her will or revocable trust agreement that will require her estate or trust to continue the monthly payments to the husband for the remainder of his life after the wife's death. If the wife fails to include such a provision in her documents, the marital settlement agreement will give the husband a legally enforceable claim against the wife's estate.

At this point complications occur, usually because the less wealthy spouse's attorney begins thinking about malpractice claims. If the alimony payments are to be made to the husband by the wife during her lifetime and by direction in the will or a revocable trust of the wife or as a claim against the wife's estate after the wife's death, the payments to the husband would stand in line with the claims of other creditors. If for whatever reason, the wife should experience a significant financial decline during her life or at the time of her death, the payments to the husband could be in jeopardy.

A further problem with payments by a spouse's estate or trust is that the children of the wealthier spouse will often play a role as fiduciaries of that spouse's estate or trust. One of the most distasteful aspects of the divorce may involve the shattered relationship between one of the spouses and the children of the other spouse. The thought of dealing with the children of the other spouse is something the less wealthy spouse wants to avoid.

Accordingly, the attorney for the husband could be expected to make the following proposal. The wife should create and fund an alimony trust. More specifically the wife will create an irrevocable trust and will transfer a certain amount of assets to that trust. The monthly alimony payments to the less wealthy spouse will be made from the particular trust. In the event that the assets of the trust are insufficient to meet the required payments, the wife and her estate would still retain personal liability. If the wife has no problem with creditors at the time of the transfer, the trust should be immune from the claims of her future creditors.

The use of the alimony trust has several advantages. Not only does it isolate funds from the claims of future creditors of the wife, but it also protects against changing consumption patterns of the wife, or even the targeting of the wife's funds by a new husband. In addition, if proper trustees are selected, the husband will not have to deal with any members of the wife's family.

Assume in our hypothetical case that the marital settlement agreement, signed by the husband and wife three weeks before the judgment of divorce is entered, provides as follows. The wife will create an irrevocable trust for the husband's benefit, and the wife will fund the trust with \$1,500,000 in cash. Each month the trust will pay to the husband the sum of \$7,500, and these payments will be made for the remainder of the husband's life. At the time of the husband's death, the assets will pass to the wife's descendants. Because the husband, who is only 54 years old, is concerned that the trust could run out of money, the trust and the marital settlement agreement contain a provision that if the trust principal falls below \$1,200,000 for two consecutive calendar quarters, the wife must transfer

additional property to the trust to bring the principal balance of the trust up to \$1,500,000. The wife and her estate also retain a personal liability with respect to the alimony payments. The trustee of the trust will be a bank on which the husband and wife agreed. The wife will retain no power to remove or replace the corporate trustee.

This appears to be a garden variety transaction, and the traditional analysis of the transfer tax consequences of this settlement would probably be as follows. Assuming that under IRC §7520 the applicable federal rate in effect on the date of the transfer to the trust is 7.2 percent and that the husband was 54 years old, the present value of the husband's right to receive the monthly (annuity) payments would be \$977,814. The remainder interest in the trust that would pass to the wife's descendants would be \$522,186.

Because the divorce occurred three weeks after the marital settlement was executed, the timing requirements of §2516 are met. Therefore the portion of the transfer representing the husband's annuity interest will be deemed to be for full and adequate consideration. Thus no gift will have been made with respect to the husband's interest in the trust. Because the trust would not qualify for a marital deduction, this is important for the wife.

The remainder interest in the trust, \$522,186, would be a taxable gift at the time of transfer. Assuming that the wife has not used any of her unified credit, she can use a portion of her unified credit to offset the gift to the remainder beneficiaries.

Because §2516 of the Code specifically deals with a property transfer incident to a divorce, it would be very easy to stop the analysis at this point. However, the attorney representing the wife remembers from a seminar that she has attended that there is a Chapter 14 to the Internal Revenue Code, which deals in part with the valuation of gifts in trusts in which certain family members have retained interests. She wonders is there any way the provisions of Chapter 14 and, more specifically, § 2702, dealing with retained interests, could apply to the proposed settlement agreement?

A quick look at the statute indicates there may be a problem. The transfer is in trust for the benefit of the transferor's family (the wife's descendants' remainder interest), and there is a retained interest by a member of the transferor's family (the interest of the husband in the annuity payments). See IRC §2702(a)(1) and §2701(e)(2). However, doesn't §2516 indicate that the portion of the transfer for the husband is to be for full and adequate consideration and therefore not a gift? Because §2516, which is an exception to the general gift tax rules, applies, the wife should be home free. The only gift that the wife will have to worry about is the gift of the remainder interest to the daughter. Beware, however. The IRS doesn't agree with that analysis.

If we run a search on "2702" and the word "divorce" on LEXIS or WESTLAW, we will find that the Service views the tax consequences of our hypothetical transaction very differently from the above analysis. Private Letter Ruling 92-35032, dated May 29, 1992, deals with a situation very similar to the facts of our hypothetical case. While there is no guarantee that the position taken by the Service in a letter ruling is correct and would be sustained by the courts, the ruling does give an indication whether the IRS would accept or challenge the tax consequences of a transaction.

In that ruling, the taxpayer was involved in divorce proceedings, and pursuant to the terms of the property settlement agreement, the taxpayer proposed to create a trust that would pay a fixed amount per month to the other spouse. The trust would have been irrevocable. The trust would have made the required monthly payments to the payee spouse. Upon the death of the payee spouse, the trust

would have terminated and assets of the trust would have been distributed to the child of the divorcing parties. If, for whatever reason, the required payments could not have been made from the trust, the taxpayer and the taxpayer's estate would have retained personal liability.

The analysis initially concluded that the execution of the separation agreement and the funding of the trust to the extent of the payee spouse's annuity constituted a transfer for full and adequate consideration under §2516 because the timing rules were met. Accordingly, the taxpayer was treated as making a taxable gift to the extent the fair market value of the property transferred exceeded the value of the payee spouse's annuity interest.

The Service then examined the applicability of §2036 to the trust. The Service noted that regulation §20.2036-1(b)(2) provides that the "use, possession, right to income or other enjoyment of the transferred property" is considered to have been retained by or reserved to the decedent to the extent that the "use, possession, right to income, or other enjoyment" is to be applied toward the discharge of a legal obligation of the decedent or otherwise used for his or her pecuniary benefit. The term legal obligation includes a legal obligation to support a dependent during the decedent's lifetime.

Because, under the terms of the settlement agreement, a personal obligation is imposed upon the taxpayer to pay the monthly amount to the payee spouse, the taxpayer's transfer to the trust does not relieve the taxpayer or his or her estate of this personal obligation. Under the terms of the agreement the taxpayer is required to discharge the maintenance obligation in the event the trust does not have sufficient funds. The transfer to the trust provides a mechanism that enables the taxpayer to satisfy the obligation only if a payment is made from the trust. If a payment were not made from the trust, the taxpayer would be required to make up any shortfall from other funds.

The taxpayer has thus retained the use, possession, enjoyment, or right to income from the property under §2036(a)(1) of the Code and the regulations since the trust income and corpus is to be applied to discharge the taxpayer's continuing legal obligation under the agreement. Accordingly, at the time of the taxpayer's death, the full value of the trust will be included in the taxpayer's estate. However, the value of the payee spouse's remaining maintenance interest on the date of the taxpayer's death will be treated as a claim contracted for full and adequate consideration under §2043(b)(2) and be deductible from the gross estate.

The ruling then looks at whether §2702 applies to the transaction. The Service argues that although payments under the trust will be made only to the taxpayer's spouse and then to the taxpayer's child, the taxpayer has retained an interest in the trust since the annuity payments will discharge the taxpayer's obligation under the settlement agreement. The ruling then states that if this retained interest were valued at nothing under §2702, it would be irrelevant that under §2516 the taxpayer is deemed to have received adequate consideration and money or money's worth for gift tax purposes for the payments to the payee spouse from the trust.

In support of its position, the Service refers to Example 5 under Regulation §25.2702-4(d). In the example, the husband and wife enter into a property settlement agreement that requires the wife to transfer property into an irrevocable trust. At the expiration of a 10-year term, the trust is to terminate and the trust corpus is to be paid to the wife. The husband and wife divorce within two years after the agreement is executed. Pursuant to §2516 the transfer to the husband would be deemed to be for full and adequate consideration. Section 2702 does not apply to the acquisition of the term interest by the husband

because no member of the husband's family acquired an interest in the property in the same transaction or series of transactions. The regulation then provides that the result would not be the same, however, if at the termination of the husband's trust, the trust corpus were distributable to the children of the husband and wife rather than to the wife. That the property would come back to the wife or her estate rather than passing to the children is the distinguishing characteristic that makes §2702 - inapplicable.

The conclusion of the Service in PLR 92-35032 is that the applicability of §2516 is irrelevant to the question whether §2702 applies.

In the situation described in PLR 92-35032, the annuity payment to the surviving spouse (for the benefit of the taxpayer) met all of the requirements of §2702 of the Code because it was a qualified interest that consisted of the right to receive fixed payments payable not less frequently than annually for life. Accordingly, for gift tax purposes the taxpayer was treated as making a taxable gift only to the extent of the value of the remainder interest passing in trust to the child.

If we look back to our hypothetical example and apply §2702 to the assumed facts, there will be a problem because additional contributions can be made to the trust. Section 25.2702-3(b)(4) of the Regulations states that for a trust to have a qualified annuity interest, the governing instrument must prohibit additional contributions to the trust. Since additional contributions could be made to the trust, and in fact will even be required if the trust principal falls below \$1,200,000, the interest retained by the wife (because the trust would meet her legal obligation) would be valued at zero.

The result would be that instead of making a gift of the remainder interest of \$522,000, the wife would be considered to have made a gift of the \$1,500,000. Not only would the wife use up her unified credit, but she would also have to pay an additional gift tax of \$363,000.

The lesson to be learned is that transactions involving the use of alimony trusts must be carefully structured to either meet the requirements of §2702 or to avoid that section.

Several steps could be taken to solve the problem. For example, the makeup provision in the trust could be eliminated. Another approach would be to provide that the trust would be the sole source of funds for the divorced spouse and that the taxpayer would have no ongoing liability to make further payments. If the taxpayer had no personal liability and if the trust were funded after the divorce became effective, neither the taxpayer nor an applicable family member would have retained any interest in the trust, and the provisions of §2702 should not apply.

In situations such as divorce, where a transaction is structured as a result of hard bargaining between parties with adverse interests and where the potential for tax abuse is relatively low, the broad net of a new Code provision, §2702, originally aimed at a very different set of transactions, can still apply.

The purpose of this article is not to describe all situations in which §2702 could apply or all the ways to avoid its application in a divorce. Rather, it is to make practitioners aware that § 2702 can apply in the divorce context and that any settlement proposal that proceeds without analyzing the consequences of §2702 places the client at risk.