

Real Property, Probate & Trust



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Back to Basics with the New Matrix

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What a time to be practicing in the area of trusts and estates. New online legal services encourage people to do it themselves and draft their own estate planning documents. The now-permanent federal estate tax exemption of \$5.34 million means that most people will not pay a federal estate tax. So who needs to consult an attorney anymore? Just draft a simple will that leaves everything to your surviving spouse. No more complex credit shelter trusts. It appears that simple to the general public. But is it?

Traditionally, estate plans have used credit shelter trusts to keep the assets of the first spouse to die out of the taxable estate of the surviving spouse. Under [I.R.C. § 1014\(b\)\(6\)](#), in community-property states such as Washington, the assets of both the decedent and the surviving spouse receive a step up in basis at the first death. When a credit shelter trust is funded, however, the assets in the trust are not in the estate of the surviving spouse (that is the point), so they do not receive a second step up in basis when the second spouse passes. Thus, when the beneficiaries inherit

the assets held in the credit shelter trust, there is often a built-in capital gains tax. (Note that the step up in basis could also be a step down in basis if assets depreciate. For purposes of this article, we will assume that assets will appreciate over time.)

Which is larger: the potential capital gains tax (an income tax) or the estate tax (a transfer tax)? It boils down to an analysis of income tax versus transfer tax. Will income tax savings be greater than the transfer tax consequences? Should you fund a credit shelter trust to keep assets out of the estate of the second spouse to die and miss out on the step up, or should you rely on portability, keep the assets in the estate of the second spouse to die, and reduce the potential transfer tax burden for the beneficiaries? Or can you get the best of both?

To complicate matters, Washington has a somewhat unusual situation because it is a community-property state

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with its own state estate tax (10 to 20 percent on assets over \$2 million), but without either a state income tax or a gift tax. How does this distinct combination affect the way in which people need to plan in Washington? This article will do some much-needed number-crunching and compare the income tax versus transfer tax for residents of Washington. The tax tail, however, does not always wag the dog. After analyzing the numbers, we will examine other factors beyond the tax implications that should be considered when ultimately choosing an estate plan. Before we commence with the number-crunching, let's review DSUE and some of the traditional estate plans that have been used in the past.

DSUE

By now, we are all familiar with the DSUE amount (the deceased spousal unused exclusion amount) and know that portability allows the surviving spouse to use that amount against the surviving spouse's gifts or taxable estate. The issue that estate planners and their clients face is whether to continue to create the credit shelter trust or to rely on portability. There are certain important features of the DSUE.

First, unlike the surviving spouse's exemption amount, which increases each year with the rate of inflation, the DSUE is not adjusted for cost-of-living changes. Whatever the exemption amount was when the first spouse died is the amount available to the surviving spouse. Thus, when the DSUE is used, future appreciation is not sheltered as it would be by funding a credit shelter trust. (When a credit shelter trust is funded, all the appreciation on those assets occurs inside the trust, and so this appreciation remains outside the estate of the surviving spouse.) Second, the generation skipping transfer (GST) tax exemption is not portable. Third, Washington state does not allow portability of its \$2 million estate tax exemption.

The DSUE Election

To elect portability and take the DSUE amount, an estate tax return must be timely filed for the first spouse to die. (The extension for filing such an estate tax return was extended on a one-time basis to the end of this year, December 2014, for all decedents who have died since 2012.) From this point forward, however, the executor has just nine months (or 15 months if an extension is requested) to file the estate tax return and elect to take the DSUE. Estate tax returns making the portability election, along with all supporting documentation, should be saved indefinitely because of the unlimited statute of limitations.¹

Contention can arise between the surviving spouse and the children from the first marriage over who makes the DSUE election and who pays for the cost of filing the estate tax return. Especially in the case of second mar-

riages, the prudent estate planner will include language in estate planning documents regarding the decision to elect and payment of costs. Having a waiver letter signed by the executor and beneficiaries if no estate tax return is filed and portability is not elected would also be prudent practice as a matter of course.

THE INTERSECTION OF DSUE AND TRADITIONAL PLANNING

For simplicity, we will assume that husband (H) dies first, leaving wife (W) as surviving spouse; the same conclusions will apply in the reverse case or for same-sex couples. Note that plans are for U.S.-citizen spouses.

Before portability, estate planning for a married couple usually fell into one of three camps, the "I love you" will, the bypass trust, or the disclaimer trust.

"I Love You" Plan (a.k.a. Sweetheart Will)

The seemingly most straightforward option, which many couples prefer, is the "I love you" will, in which everything passes to W outright. No estate tax is due at H's death because of the unlimited marital deduction, and the full amount of DSUE is available to be "ported."

Bypass Trust (a.k.a. Credit Shelter Trust)

At the other end of the spectrum is the bypass trust (also known as the credit shelter trust). In this plan, a trust is funded with H's estate (up to the exemption amount) for the benefit of W. But whatever amount is funded into the credit shelter trust uses H's exemption amount and thus reduces the DSUE. Depending on the size of the deceased spouse's estate, there may or may not be any DSUE left to be ported.

Disclaimer Trust

A compromise to the two extremes is the disclaimer trust. With a disclaimer trust, everything passes to W, who is then given the option to disclaim into a bypass trust. Disclaimers have strict requirements and timelines, however. For example, the surviving spouse cannot enjoy any benefit from the asset disclaimed, and the disclaimer must be made within nine months of the date of death. While nine months may sound like a lot of time to make a decision, time passes quickly after the death of a spouse, and the deadline may be inadvertently missed. The major advantage of the disclaimer trust is its flexibility. A disclaimer trust delays the decision whether to fund the credit shelter trust until H's death, leaving the decision up to W, based on the state of the estate at that time. With the help of her adviser, W can evaluate the transfer tax versus the income

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tax. The drawback, of course, is that the surviving spouse may refuse to disclaim or may inadvertently not meet the requirements of a qualified disclaimer. In addition, the surviving spouse cannot retain any power of appointment over the disclaimed assets.²

WHAT ABOUT WASHINGTON?

While the rest of the country rants on about the newfound importance of considering income tax implications in planning and makes broad claims like you should “never use the applicable exclusion amount during your lifetime,” this is not true for Washington. Again, Washington is in a different situation because of its state estate tax and lack of an income tax.

First we will examine how the transfer tax and income tax compare when an “I love you” plan is used versus a credit shelter trust plan. We will start with some much-needed number-crunching and compare the income tax versus transfer tax for residents of Washington. After analyzing the numbers, we will consider factors beyond the tax implications.

BASIS AND CAPITAL GAINS

Before we engage in the actual number-crunching, a short review of the taxation of capital gains is in order. When you buy an asset, what you paid for it (that cost) is the asset’s “basis.” When you sell the asset at an appreciated price, you pay capital gains tax on the difference between what you paid for it (adjusted when applicable for depreciation and certain capital expenses) and the sales price. A different rate of taxation applies depending on how long you owned the asset. For assets held under a year, the short-term capital gains tax rate applies, whereas for assets held for a year or more, the long-term capital gains tax rate (currently 20 percent) applies. There is a higher tax rate for collectibles (currently 28 percent). There is also the Medicare surtax to consider (3.8 percent).

For example, when your client creates a start-up business from ground zero, the basis in that client’s stock is effectively zero. When the same client cashes out of the business and sells his stock, there will be capital gains tax on the sale price of the stock. For this client, the step up in basis is an extremely important factor to consider. But so is keeping these assets out of the estate of the surviving spouse. It just depends. You have to run the numbers.

THE NUMBERS

With the new paradigm shift of transfer taxation versus estate taxation, math has become the center of the analysis. We must crunch the numbers for our clients to compare the potential tax burden of capital gains versus estate tax (income tax versus transfer tax). To make the numbers simpler, the federal exemption is assumed to be \$5 million and the Washington exemption to be \$2 million instead of the amounts adjusted for inflation.

First consider the married couple with a \$3 million estate composed entirely of community property. Let’s assume that H dies first and gives everything outright to W. W can file an estate tax return and claim H’s unused DSUE. Now W has a \$10 million exemption. If she dies shortly thereafter and no appreciation occurs in her estate, then she has a \$3 million estate. She has a \$10 million federal exemption, so no federal estate tax is due. But her estate of \$3 million is above the Washington estate tax exemption of \$2 million. Her estate will have

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to pay Washington estate tax on the difference between her estate and the exemption: \$1 million (\$3 million less \$2 million). The Washington estate tax due will be **\$100,000**. The entire estate will receive a step up in basis at her death, so there will be no built-in capital gains for the beneficiaries.

Now consider what would happen if, instead of leaving everything outright to W, H left his estate to a credit shelter trust for W's benefit. W can file an estate tax return and claim the unused portion of H's estate tax exemption (DSUE). In this case, the DSUE is \$5 million less the \$1.5 million funded to the bypass trust. W now has her own \$5 million exemption plus the \$3.5 million that her husband didn't use, or \$8.5 million. If she dies without any appreciation on her estate, there is still no federal estate tax due (her estate of \$3 million is still under her \$8.5 million exemption). Nor is there any Washington estate tax due because her estate is just \$1.5 million which is under the \$2 million Washington exemption. Since \$1.5 million was in the bypass trust and not in her estate, it did not receive a step up in basis at her death. If these assets did not appreciate, however, then there is no capital gains tax issue. A good deal all around: **zero tax**.

Now consider what happens if the estate appreciates in value between H's and W's deaths. For simplicity, assume the value of the estate doubles. With the "I love you" plan, W now has a \$6 million estate. She still has the \$10 million exemption, however, so no federal estate tax is due. Her estate of \$6 million is well above the \$2 million Washington estate tax exemption, so **\$550,000** Washington estate tax will be due (tax on \$4 million). Again, because H has left everything outright to W, the assets in her estate will receive the second step up in basis at her death – no capital gains issue. The combined estate tax and transfer tax burden is **\$550,000**.

If H used a bypass trust and the wife's estate doubled in value, then she would have only \$3 million in her estate upon her death (instead of \$6 million), and there would be \$3 million in the bypass trust. There would still be no federal estate tax due. But there would now be Washington estate tax in the amount of **\$100,000**. And there would be some built-in capital gains. W's estate would receive a step up in basis for the \$3 million in her estate, but the \$3 million in the Bypass Trust would retain its basis from H's death: \$1.5 million. Capital gains tax on \$1.5 million at 20 percent would be **\$300,000**. The combined income and transfer tax effect would be **\$400,000**. Recall that without the credit shelter trust, the Washington estate tax was **\$550,000**. Comparing the Washington estate tax due (\$550,000 versus \$100,000) makes the Bypass Trust appear very tax-effective, even when income taxes (\$300,000) are factored into the equation (\$550,000 versus \$400,000).

Now let's consider what happens for a slightly larger estate. A married couple has a \$5 million estate. If H dies with an "I love you" will and gives everything to W outright, then she can claim his \$5 million DSUE. Now she has a \$10 million federal estate tax exemption. If she dies before there is any appreciation in her estate, then there will be no federal estate tax, but there will be Washington estate tax. Taxes will be assessed on \$3 million (\$5 million less \$2 million), and the amount of tax due will be **\$390,000**. But the assets will receive a second step up at W's death, and there will be no capital gains tax.

If H instead leaves his estate to a bypass trust for W's benefit, half of \$5 million will fund the bypass trust (\$2.5 million) and half (\$2.5 million) will be in W's estate. W can still file an estate tax return and claim her husband's DSUE. But since he used \$2.5 million to fund the credit shelter trust, she can claim only \$2.5 million. This, combined with her own estate tax exemption amount of \$5 million, gives her a new exemption of \$7.5 million. With no appreciation, there is still no federal estate tax. The Washington estate tax situation is improved too. W's Washington taxable estate would be just \$1 million, giving her estate a tax bill of **\$100,000**, a vast improvement over the **\$390,000** due previously.

Now compare what happens if there is appreciation in the estate. With the "I love you" plan, if the \$5 million estate doubles in value to \$10 million, there is still no federal estate tax because W can claim H's DSUE and have a \$10 million exemption. The Washington estate tax bill is much higher, however. With only a \$2 million estate tax exemption amount for Washington estate tax, W has an \$8 million taxable estate (\$10 million less \$2 million). The estate tax due on \$8 million would be **\$1.295 million**.

If H instead leaves his estate to a bypass trust for W, the trust would be funded with \$2.5 million and W would have \$2.5 million in her estate. If these numbers doubled in value, there would be \$5 million in the bypass trust and \$5 million in W's estate. W's smaller federal exemption of \$7.5 million would still be ample enough to make a federal tax problem disappear. And the Washington estate tax situation would be improved. W's \$5 million estate less the \$2 million Washington exemption would mean a \$3 million taxable state estate. This tax bill is just **\$390,000**. Funding the credit shelter trust, however, creates a capital gains tax issue for the beneficiaries. Only the assets in W's estate receive the second step up in basis. The \$2.5 million that funded the credit shelter trust has grown to \$5 million, so there has been \$2.5 million in growth; taxed at 20 percent, this would mean a **\$500,000** capital gains tax bill for the beneficiaries if they were to liquidate immediately. But even

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with this larger capital gains tax implication, the combined tax effect would still be better (i.e., lower) using a credit shelter trust (**\$1.295 million** versus **\$890,000**).

Even if the estate doubles in value, the combined tax effect is lower using a credit shelter trust than using none. While this may seem counterintuitive, the explanation resides in the numbers. Even though the tax rates of the Washington estate tax are progressive and do not hit 20 percent until the estate reaches \$10 million, the tax is applied to every dollar in the estate in excess of \$2 million, resulting in a larger number. The capital gains tax at 20 percent, on the other hand, is a higher rate than the effective Washington estate tax rate, but it is applied only to the appreciation in the estate. So the capital gains burden consistently comes in below the Washington estate tax burden. Thus, clients in Washington with estates above the \$2 million Washington estate tax exemption amount should continue to use credit shelter trust planning if they wish to minimize their tax burden.

So while planners around the nation may extol the benefits of keeping assets in the estate of the surviving spouse in order to receive the second step up in basis, the situation here in Washington is distinctive. At a minimum, credit shelter trusts should be used to preserve the Washington estate tax exemption amount of the first spouse to die. This will save the clients Washington estate tax. But is there a way to accomplish saving Washington estate tax while still achieving a step up in basis? Probably.

CAN WE HAVE IT ALL?

A credit shelter trust could be funded to preserve the Washington exemption amount and a federal QTIP election could be made so that these assets would come back into W's federal estate and receive the second step up in basis, eliminating the capital gains tax. (Note that there are strict requirements in order for a trust to qualify for a federal QTIP election (I.R.C. § 2056(b)(7)), including that all the income of the trust must be paid to the surviving spouse.) But is this perfect combination of preserving the Washington estate tax exemption while still achieving a second step up in basis too good to be true?

Beware Revenue Procedure 2001-38

Revenue Procedure 2001-38 applies to QTIP elections that were not necessary to reduce the federal estate tax liability to zero. Requests for relief were made to the IRS from estates for which a QTIP election was made when it actually was not needed. These were situations in which the taxable estate was less than the applicable exclusion amount, so no estate tax would have been due, and yet a QTIP election had been made. Other requests for relief

were made to the IRS from estates for which the QTIP election had been inadvertently made for both the credit shelter trust and the marital trust. The QTIP election for the credit shelter trust was unnecessary "because no estate tax would have been imposed whether or not the QTIP election was made" for that trust, 2001-1 CB 1335 Revenue Procedure 2001-38. The IRS provided relief in Revenue Procedure 2001-38.

Unfortunately, the situations described in the revenue procedure are exactly the situation in the "have it all" scenario. A credit shelter trust would be funded up to the state estate tax exemption amount and a federal QTIP election would be made to obtain a step up in basis. Thus, the concern is that estates of less than the federal exemption amount (\$5.34 million for 2014) would not be able to use the federal QTIP election.

The ABA Section of Real Property, Trust and Estate Law (RPTE) has proposed that Revenue Procedure 2001-38 be amended to state explicitly that "applicable QTIP elections will not be nullified if portability also has been elected" and to "make it clear that intentional qualified terminable interest property (QTIP) elections that are not necessary to reduce estate tax will be valid if the electing estate also makes a portability election."³ Only time will tell how this issue is resolved.

OTHER CONSIDERATIONS

Tax implications are but one consideration when planning an estate, however. When evaluating what type of plan to offer a client, the estate planner must consider a myriad of factors. All these factors taken together will impact the decision of what plan is most appropriate for each client. Now, more than ever, clients require customized analysis of their particular situations. The factors that push the decision in one direction or another are many and varied. Some are trump cards that will dictate the solution. Following is an evaluation of those factors that will push toward using a trust followed by those factors that will push away from using a trust.

NONTAX REASONS FOR USING A TRUST

Some of the reasons to use a credit shelter trust are as follows:

1. Control in the event of subsequent remarriage;
2. Spouse needs help managing assets;
3. Difficult-to-value assets;
4. Asset protection is desired;
5. Beneficiaries do not plan to sell assets and
6. Estate tax laws could change again.

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Control in Event of Subsequent Remarriage

It is often difficult for couples early in their first marriage to think of one spouse predeceasing the other, let alone to think of a spouse remarrying and having more children or treating the children of the new spouse as his or her own. Yet this definitely happens. If clients are in their second marriage already and have children from a first marriage, a credit shelter trust can solve issues—regardless of the tax situation. Funding a credit shelter trust for the benefit of the surviving (second) spouse (step parent) ensures that he or she is taken care of during his or her life, but then equally ensures that the assets remaining will pass to the children from the first marriage. One might even consider splitting the assets immediately at H's death. A portion of the estate could fund the credit shelter trust for the benefit of the stepparent and another portion could fund the trust for the children from the first marriage. That way, even if the stepparent spends all the assets in his or her trust, the children from the first marriage will not be disinherited entirely. Of course, this requires that the estate be large enough that the stepparent's trust can adequately support the stepparent for his or her lifetime. The risk of giving it all outright is that the stepparent will have a falling-out with the children from H's first marriage and completely disinherit them. In this scenario, an "I love you" plan combined with the DSUE does not make sense.

Spouse Needs Help Managing Assets

If the surviving spouse is not good at managing assets or perhaps is incapable of doing so, then a trust will be preferred over outright ownership. Placing assets in trust can also provide protection for the surviving spouse who might be vulnerable to exploitation by others.

Difficult-to-Value Assets

Assets that are difficult to value may undergo stricter scrutiny by the IRS. By putting these assets into a credit shelter trust, the client may be able to avoid valuation disputes simply by not having these assets in the estate of the second spouse to die.

Asset Protection Desired

Are the clients likely to be sued, or are they engaged in a risky business? Using a credit shelter trust with spend-thrift language can give those assets the benefit of being protected from the claims of creditors. Will the widow remarry and then later divorce? Funding a credit shelter trust with the first husband's assets can protect them in a subsequent dissolution proceeding.

Beneficiaries Do Not Plan to Sell Assets

If the beneficiaries intend to hold the assets rather than liquidate, then there is less concern about the second step up in basis. If the assets are not to be sold in the beneficiary's lifetime, then the capital gains tax will not be applied. On the other hand, if the beneficiaries are likely to liquidate the entire estate upon the death of the second spouse, then the step up in basis would be a much greater concern. Having these assets in the estate of the second spouse or making a federal QTIP election to get the second step up in basis may be more important for these clients.

Estate Tax Laws Could Change Again

The government's most recent proposal with regard to the estate tax is for a reduced \$3.5 million estate tax exemption, a \$1 million gift tax exemption, and an increased rate to 45 percent.⁴ There is much chatter in the profession about how, now that there is portability and a large estate tax exemption, we don't need complicated (read "credit shelter trust") plans anymore. But what if the tax laws change (again)? What if you base your decision on portability and the \$5 million exemption amount, the first spouse dies, you don't fund a credit shelter trust, you elect portability, and then the estate tax exemption goes down to \$3.5 million and the gift tax exemption goes down to \$1 million? And now the surviving spouse, who didn't think she was going to have a taxable estate based on a \$5 million exemption, has a \$600,000 (40 percent of 1.5 million) anticipated estate tax burden. What if she is too old or sick to get life insurance to cover this burden? We talk about the "permanence" of the new laws since EGRTRA and ACTRA, but is there ever really permanence when all it takes is a change in government and a vote of Congress?

NONTAX REASONS AGAINST USING A TRUST

Still, there are some reasons that a client will simply not want a credit shelter trust. Period. Some of these reasons are as follows:

1. Client willing to make gifts during life;
2. Client will spend down the estate;
3. Cost of operating the trust is more than it will save;
4. Client plans to move to a state without a state estate tax; and
5. Widow resents control.

Client Willing to Make Gifts During Life

Based on our analysis of the numbers, it would seem clear that a credit shelter trust should be used in Washington estate plans as a matter of course. However, funding a credit

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shelter trust is not the only way to remove assets from W's estate. If W gives away the assets during life, then they are no longer in her estate at her death. Since Washington currently has no gift tax, if W does not need the assets above the state exemption amount (\$2 million), she may simply give them away during her lifetime without a state gift or estate tax implication. As long as the amount transferred is under her federal exemption amount (\$5.34 million), neither will there be federal tax implications. A fly in the ointment is carryover basis. When an asset is transferred via a gift, it retains its basis.⁵ One must factor into the equation whether it would be more tax-advantageous to obtain the step up in basis at death or to go ahead and give the asset away during life with its inherent capital gains implication retained.

Client Will Spend Down the Estate

Are the clients spenders or savers? What is their lifestyle like? Are they likely to spend more than their assets earn so that the size of their estate will decrease over time? How is the widow expected to handle money? The widow who is a big spender may spend the estate down to a nontaxable level. Similarly, the widow who has health issues and is expected to have high end-of-life health care costs will necessarily reduce the size of the estate. Consider also whether the clients have long-term care insurance or are self-insured.

Cost of Operating the Trust Is More Than It Will Save

An important factor to consider is the cost of operating a trust over time. Many widows hate the formalities involved in their credit shelter trust. The trust has its own tax ID number, must file its own tax return, and must keep the beneficiaries reasonably informed.⁶ It makes a difference whether the surviving spouse is middle-aged versus elderly. A middle-aged widow would have greater lifetime expense of operating the trust – the annual cost of trust operation multiplied by her (presumably) longer lifetime – than the elderly widow. For example, if the cost of operating a \$1 million trust is a mere 1 percent per year, this is \$10,000 per year annual expense. If the spouse lives another 30 years, there would be an accumulated cost of operating the trust of \$300,000 (ignoring time value of money). On the other

hand, if the spouse lives only another 3 years, that cost would be only \$30,000.

Client Plans to Move to a State without Estate Tax

It is fine to create a plan that accounts for the Washington estate tax threshold of \$2 million, but if the clients plan to retire to California, which does not have a state estate tax, then it may not make sense to do a lot of complicated Washington-specific planning. On the other hand, if H dies while still residing in the state of Washington, then he (or his beneficiaries) would be thankful that the plan accounted for this lower threshold (the \$2 million Washington estate tax exemption). In such cases, the disclaimer plan can make a lot of sense.

Widow Resents Control

The widow who is competent and capable of managing assets may not benefit from having a trust. In fact, such a widow may simply not want the added cost or complexity of operating a trust and resent her husband's control from the grave.

CONSENSUS?

As you see, there is no one-size-fits-all with respect to estate plans. The unique situation of each client must be evaluated in the context of the new frontier of portability. For those concerned about the automation of the practice of law, we optimistically suggest that we attorneys cannot be replaced. Often our clients need to talk the decisions through with their trusted adviser – their estate planning attorney. Questions such as who would be a better choice to be the trustee of the trust for their children – brother Bobby, uncle John, or a professional fiduciary – require discussion and the counsel of a wise adviser. Now, more than ever, a good bedside manner is key.

1 I.R.C. § 2010(c)(5)(B).

2 Treas. Reg. § 25.2518-2(e)(2),(5) (Ex. 5).

3 http://meetings.abanet.org/webupload/commupload/RP509000/news-letterpubs/2013_06_11_aba_submission_re_2001_8.pdf.

4 General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals, March 2014: <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf>

5 I.R.C. § 1015.

6 RCW 11.98.072.

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\$3m estate	All to surviving spouse = QTIP Bypass Trust	All to Bypass Trust
Estate of SS <i>Assume that estate does not grow</i>	\$3m	\$1.5m
New Exemption After DSUE	\$10m	\$8.5m (\$5m less \$1.5m)
Federal Estate Tax	nil	nil
Washington Taxable Estate	\$1m taxable estate (\$3m less \$2m)	nil
Washington Estate Tax	\$100k tax	nil
Second Step Up in Basis?	yes	Not on \$1.5m in Bypass Trust
Capital Gains Tax	nil	No appreciation, so no capital gains tax
COMBINED TAX	\$100k	nil
Estate of SS <i>Assume that estate doubles in size</i>	\$6m	\$3m
New Exemption After DSUE	\$10m	\$8.5m
Federal Estate Tax	nil	nil
Washington Taxable Estate	\$4m taxable estate (\$6m less \$2m)	\$1m taxable estate (\$3m less \$2m)
Washington Estate Tax	\$550k	\$100k tax
Second Step Up in Basis?	Yes	Not on \$1.5m in Bypass Trust that doubled in value Basis: \$1.5m Value: \$3m
Capital Gains Tax	nil	\$300k (\$1.5m times 20%)
COMBINED TAX	\$550k	\$400k (\$100k plus \$300k)
Conclusion		<i>Bypass Trust is better than outright even though there will be a capital gains tax</i>
\$5m estate	All to surviving spouse = QTIP Bypass Trust	All to Bypass Trust
Estate of SS <i>Assume that estate does not grow</i>	\$5m	\$2.5m
With DSUE	\$10m	\$7.5m (\$5m plus \$2.5m)
Federal Estate Tax	nil	nil
Washington Taxable Estate	\$3m taxable estate (\$5m less \$2m)	\$1m (\$3m less \$2m)
Washington Estate Tax	\$390k	\$100k
Second Step Up in Basis?	yes	Not on \$2.5m in Bypass Trust
Capital Gains Tax	nil	No appreciation, so no capital gains tax
COMBINED TAX	\$390k	\$100k
Estate of SS <i>Assume that estate doubles in size</i>	\$10m	\$5m
New Exemption After DSUE	\$10m	\$7.5m
Federal Estate Tax	nil	nil
Washington Taxable Estate	\$8m estate (\$10m - \$2m)	\$3m estate (\$5m less \$2m)
Washington Estate Tax	\$1,295k \$1,100 + (19.5% of \$1m)	\$390k
Second Step Up in Basis?	yes	Not on \$2.5m in Bypass Trust
Capital Gains Tax	nil	\$500k (\$2.5m times 20%)
COMBINED TAX	\$1,295k	\$890k
Conclusion		<i>Bypass Trust is better than outright</i>

Recent Developments

Real Property

by Brian L. Lewis – Ryan, Swanson & Cleveland, PLLC

“Fair Value” Determination under RCW 61.24.100(5)

In *First-Citizens Bank v. Reikow*, 177 Wn. App. 787 (2013), Division Two of the Court of Appeals considered the effect of RCW 61.24.100(5) on a lender’s claim against a commercial loan guarantor following the lender’s non-judicial foreclosure. In one of few published opinions interpreting this statute, the court confirmed that a guarantor is entitled to seek a “fair value” determination from a trial court when defending a lender’s post-foreclosure collection suit.

Venture Bank made a loan for approximately \$6.8 million to a limited liability company (LLC) partially owned by the Reikows. The loan was secured by a deed of trust lien on commercial property owned by the borrower LLC. The loan was guaranteed by multiple parties including the Reikows. The bank’s guaranty agreement contained a general waiver of defenses including a waiver of “any defenses given to guarantors at law or in equity other than actual payment and performance of the indebtedness.”

After Venture Bank failed, its assets (including the loan) were sold to First-Citizens Bank. The borrower defaulted on the loan and First-Citizens commenced non-judicial foreclosure proceedings under the deed of trust. At the foreclosure sale, First-Citizens’ credit bid of \$5,215,000 prevailed, leaving unsatisfied indebtedness of approximately \$1.9 million.

First-Citizens then filed suit against the Reikows and their co-guarantors to collect the deficiency. In answering First Citizens’ complaint, the Reikows requested judicial determination under RCW 61.24.100(5) of the fair value of the property at the time of sale. The Reikows argued that, under the statute, the property’s “fair value” should be deducted from the total amount owed under the loan for purposes of calculating their guarantor liability.

On First-Citizens’ motion for summary judgment, the trial court made two findings. First, it determined that the amount of indebtedness owed under the loan at the time of sale was \$7,168,710. Second, it determined that the Reikows were liable for any deficiency between that amount and the “fair value” of the property. However, the court ruled that an evidentiary hearing was necessary in order to determine fair value of the property and calculate the proper deficiency amount. At the evidentiary hearing, the trial court found the fair value of the property at the time of sale was \$7,820,000 and, therefore, the Reikows were not liable for any deficiency because the fair value of the property exceeded the indebtedness owed at the time of sale.

RCW 61.24.100(5) provides that a guarantor may request the court or other appropriate adjudicator to determine the fair value of property sold by non-judicial

foreclosure. However, the statute also permits the court, in its discretion, to make a fair value determination. Accordingly, the waiver contained in the Reikows’ guaranty agreement did not preclude the court from conducting a fair value hearing. The court labeled First Citizens’ waiver argument a “questionable proposition” in light of the holdings of *Bain v. Metro. Mortgage Group, Inc.*, 175 Wn.2d 83 (2012) and *Schroeder v. Excelsior Mgmt. Group, LLC*, 177 Wn.2d 94 (2013) (declining to enforce deed of trust grantor’s waiver of other provisions of the Deeds of Trust Act). Even if the waiver was enforceable, under RCW 61.24.100(5) the court retains authority to conduct a fair value hearing.

“Fair value” is the most probable price, as of the date of the trustee’s sale, which would be paid in cash or other immediately available funds after deducting prior liens and encumbrances, for which the property would sell after reasonable exposure in the market where both buyer and seller are acting prudently and neither is under duress.

Evidence relied upon in determining the property’s fair value included an appraisal commissioned by First Citizens. The appraiser concluded that the property’s “as-is fair market value” at the time of sale was \$6,630,000 and that its “prospective market value at stabilization” was \$7,820,000. In addition, the Reikows introduced correspondence between First Citizens and the Internal Revenue Service confirming First Citizens’ belief that the “fair market value” of the property exceeded the debt.

Because the evidence supported the trial court’s determination that the fair value of the property exceeded the debt for which the Reikows were liable, the appellate court affirmed the trial court’s ruling and found no abuse of discretion.

Duty to Defend Insured Under Title Policy

The Supreme Court recently examined the scope of a title insurer’s duty to defend its insured in *Stewart Title Guaranty Co. v. Sterling Savings Bank*, 178 Wn.2d 561 (2013). Stewart Title issued a lender’s policy of title insurance to Sterling Bank in connection with a construction loan. Prior to funding the loan, Stewart failed to conduct an inspection of the subject property. Unbeknownst to Stewart, construction began before the loan funded.

During construction, a payment dispute arose between the project owner and its builder (Mountain West). Mountain West asserted a mechanic’s lien against the property and claimed priority over Sterling’s deed of trust. Sterling tendered Mountain West’s claim to Stewart under its

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Recent Developments: Real Property

lender's policy and Stewart appointed a law firm to defend Sterling from the claim.

The law firm concluded that Mountain West's mechanic's lien had priority over Sterling's deed of trust and agreed to a stipulation confirming Mountain West's lien priority. Stewart, apparently unhappy with the stipulation, fired the law firm and claimed that the firm should have raised equitable subrogation as a defense to Mountain West's claim of lien priority. If applicable, the doctrine of equitable subrogation would have elevated Sterling's lien to the same priority as an earlier lien paid off with the proceeds of Sterling's loan.

Stewart then sued the firm for legal malpractice. The firm moved for summary judgment on the grounds that, although Stewart was a third-party payor of its fees, it did not owe a duty to Stewart and that equitable subrogation would not have been a viable defense based on the facts of the case. The trial court rejected the firm's argument that it owed no duty to Stewart, but granted summary judgment on the basis that equitable subrogation would not have been a viable defense.

The Supreme Court accepted review of both issues and affirmed on different grounds. The Supreme Court agreed with the law firm that its only client was the person insured under the policy (Sterling) not the insurer (Stewart). Therefore, the firm's duty of care ran only to Sterling regardless of Stewart's status as a third-party payor of the firm's fees or the "alignment of interests" among Stewart and its insured. In so holding, the Supreme Court relied in large part on **RPC 5.4(c)**, which prohibits a lawyer from permitting a person who pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment. Having decided the case on this ground, the Supreme Court did not further analyze the issue of equitable subrogation.



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Real Property Legislative Update

by Jody M. McCormick – Witherspoon • Kelley – jmm@witherspoonkelley.com

During Washington state's 2014 legislative session, 49 bills were referred to the Real Property Council (the "RP Council"). The following table outlines the bills referred to the RP Council and the RP Council's position on those bills. Oftentimes the RP Council does not take a position on a bill because the proposed legislation does not relate

to or affect the practice of law or the administration of justice. **GR 12.1(c)(2)**. The RP Council is not asked to take a position on bills that are referred only on an "FYI" basis. If you have any questions about the 2014 legislative session or the RP Council's position on any proposed legislation, feel free to contact me.

RPPT - REAL PROPERTY COUNCIL 2014 End of Session Referral Report			
Bill Number	Short Title	Position	Final Status
HB 1029 **Returned from 2013	Concerning private road maintenance agreements	2013: Oppose as drafted, suggested edits submitted. 2014: Concerns, suggested edits submitted.	2013: Died in House Rules. 2014: Died in House Rules.
HB 2120	Concerning actions for damage to real property resulting from construction, alteration, or repair on adjacent property	No Position	Died in Rules
HB 2150	Encouraging recreational access to private property	No Position	Passed House, Died in Senate Rules
HB 2168	Concerning minimum room area and floor area square footage requirements for single-family residential areas	No Position	Died in Rules
HB 2218 / SB 6031	Concerning lake and beach management districts	No Position	Passed (SB 6031) - Chapter 85, 2014 Laws
HB 2232	Expanding the duties and obligations of manufactured/mobile home community landlords	No Position	Died in Committee
HB 2240	Concerning the reserve studies for certain unit owners' associations	FYI	Died in Committee
HB 2240 / SB 6147	Concerning reserve studies for certain unit owners' associations	FYI	Died in Committee
HB 2243 / SB 6508	Encouraging private landowners to allow public access to their land	No Position	Died in Committee
HB 2245	Addressing vesting in urban growth areas with recently added territory	No Position	Died in Rules
HB 2292	Concerning adverse possession	No Position	Died in Committee
HB 2306	Concerning current use valuation for farm and agricultural land	FYI	Passed House, Died in Senate Committee
HB 2311	Addressing notice requirements for land use applications and decisions	No Position	Died in Committee
HB 2353	Concerning actions for trespass upon a business owner's premises	Concerns	Passed House, Died in Senate Rules
HB 2367	Requiring internet notice of a trustee's sale	Concerns	Died in Committee
HB 2375	Allowing appraisers to place a lien on property for unpaid balances for services rendered	Concerns	Died in Committee
HB 2381 / SB 6251	Creating an inactive certification, license, or registration status for real estate appraisers	FYI	Passed House, Died in Senate Rules
HB 2452 / SB 6134	Addressing nondepository institutions regulated by the department of financial institutions	FYI	Passed (SB 6134) - Chapter 35, 2014 Laws
HB 2480	Concerning notice against trespass	No Position	Died in Committee
HB 2481	Concerning food and yard waste collection space for qualifying new residential occupancies with more than two dwelling units	FYI	Passed House, Died in Senate Committee
HB 2491	Authorizing online tax lien foreclosure sales	FYI	Died in Committee
HB 2493 / SB 6286	Concerning current use valuation for land primarily used for commercial horticultural purposes	No Position	Passed (HB 2493) - Chapter 125, 2014 Laws

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Real Property Legislative Update

Bill Number	Short Title	Position	Final Status
HB 2498	Establishing a process for the payment of impact fees through provisions stipulated in recorded covenants	No Position	Died in Committee
HB 2521 / SB 6269	Concerning the first mortgage interest business and occupation tax deduction	FYI	Died in Ways & Means
HB 2537 / SB 6291	Concerning tenant screening	No Position	Passed House, Died in Senate Committee
HB 2558	Disposing tax foreclosed property to cities for affordable housing purposes	FYI	Passed House, Died in Ways & Means
HB 2567	Concerning the approval of minutes from annual meetings of homeowners' associations	No Position but suggested edits provided and adopted	Passed - Chapter 20, 2014 Laws
HB 2581	Regarding on-water dwellings	FYI	Died in Rules
HB 2603	Revising county road vacation authority	No Position	Died in Committee
HB 2628	Concerning government ownership of vacant or undeveloped land for extended periods of time	No Position	Died in Committee
HB 2629 / SB 6521	Authorizing the imposition of a filing fee for certain property assessment appeal petitions	FYI	Died in Rules
HB 2656	Addressing civil infractions involving deeds of trust	FYI	Died in Committee
HB 2657	Requiring residential real property transfers and assignments to be recorded	No Position	Died in Committee
HB 2658	Prescribing penalties for false declarations by a beneficiary regarding a trustee's sale	FYI	Died in Committee
HB 2659	Addressing the restraint of a sale by a trustee	FYI	Died in Committee
HB 2674	Concerning the processing of quick titles by subagents	No Position	Passed - Chapter 12, 2014 Laws
HB 2677	Establishing a process for the payment of impact fees through provisions stipulated in recorded covenants	No Position	Died in Committee
HB 2723 / SB 6507	Modifying certain provisions governing foreclosures	Support with suggestions	Passed (HB 2723) - Chapter 164, 2014 Laws
SB 6030	Clarifying tenant remedies upon landlord's failure to perform duties	No Position	Died in Committee
SB 6089	Prohibiting the use of eminent domain for economic development	No Position	Died in Rules
SB 6125	Concerning eminent domain	No Position	Passed Senate, Died in House Committee
SB 6143	Clarifying tenant remedies upon landlord's failure to perform duties	No Position	Passed Senate, Died in House Committee
SB 6198	Protecting sport shooting ranges	FYI	Died in Committee
SB 6292	Concerning tenant relocation assistance	FYI	Died in Committee
SB 6309	Concerning legal fees and costs affiliated with notice of violation review under the manufactured/mobile home dispute resolution program	FYI	Died in Committee
SB 6319	Modifying the definition of residential real property in homeowners' associations	Concerns	Died in Rules
SB 6324	Disposing tax foreclosed property to cities for affordable housing purposes	FYI	Died in Committee
SB 6349	Implementing requirements for the condemnation of real property	No Position	Died in Committee
SB 6382	Extending the timeline for short plats	No Position	Died in Committee
SB 6534	Removing certain conditions for awarding prevailing party fees and costs for appeals of land use decisions	FYI	Died in Rules

Practice Tip: What to Do When a Residential Tenant Files for Bankruptcy During or Just Before an Unlawful Detainer Action

by Jason Edward Wax – Wax Law PLLC

If a landlord receives a bankruptcy notice from a residential tenant during the process of retaking premises leased by the debtor, moving forward with the unlawful detainer process may violate the Bankruptcy Code and subject a landlord to liability, cost, and inconvenience. This practice tip explains the potential ramifications of a tenant's bankruptcy filing on an unlawful detainer action and the process for obtaining approval from the Bankruptcy Court to proceed with such an action when a residential tenant files for bankruptcy during or just before commencement of an unlawful detainer action.

When a bankruptcy petition is filed, the debtor is protected by the automatic stay. The automatic stay prevents nearly all attempts to enforce a creditor's rights with regard to the debtor or the debtor's property, including pursuing an unlawful detainer action in state court. Serving a notice to vacate on the debtor will also violate the automatic stay.

Actions in violation of the automatic stay may subject your client to a cause of action by the debtor if the debtor can show that your client had notice of the debtor's bankruptcy at the time of the action at issue. In addition to potential liability to the debtor for the debtor's actual damages caused by the violation, costs, and attorneys' fees of the debtor's counsel may be awarded by the court. Additionally, all actions taken in violation of the automatic stay are void and will, therefore, have no effect on the debtor. In other words, your client will have to re-do the work that violated the stay in the first place, further increasing the cost of the violation.

This is true regardless of whether the tenant has been provided notice to vacate or whether an action has been commenced; however, the automatic stay does not prevent a landlord from enforcing a judgment for possession obtained prior to the filing of the bankruptcy petition. In such an event, the landlord is permitted to continue actions seeking to obtain possession of the premises, though the landlord is *not* permitted to attempt to collect back rent or other monetary relief without approval from the court. Even if the landlord has already obtained a judgment for possession, the landlord may not be able to move forward if the debtor can cure the monetary default underlying the lease dispute by making certain certifications in their bankruptcy petition and depositing funds with the clerk of the bankruptcy court, though this is uncommon. Regardless of whether this exception applies, due to the complexity of the law on this point, the best practice is generally to obtain a comfort order confirming the inapplicability of the automatic stay before taking further action against the debtor.

If the debtor has filed multiple bankruptcy cases in a continued effort to halt or delay eviction, the duration of the automatic stay may be limited. If the debtor has had one

bankruptcy case dismissed in the past year, the automatic stay will remain in place for only 30 days. The debtor may be able to get an extension if he or she can show that the subsequent case was filed in good faith, but the hearing on this issue must be held within 30 days of filing. If the debtor has had two bankruptcy cases dismissed in the past year, then the automatic stay does not go into effect at all. Regardless, the best practice in these circumstances is once again to obtain a comfort order confirming that the stay has been terminated by operation of law.

If the automatic stay protects the debtor involved in your unlawful detainer action, a motion for relief from the automatic stay must be filed with the Bankruptcy Court to allow your client to proceed. A landlord should typically seek relief under 11 U.S.C. § 362(d)(2), which requires the landlord to show that (1) the debtor does not have equity in the leased premises, and (2) the premises are not necessary for an effective reorganization. This burden is easily met by most landlords because most residential tenancies will have terminated prior to filing and, regardless, most tenants do not have equity in leased premises. Additionally, it is difficult for the debtor to make a persuasive case that the specific premises at issue are necessary for an effective reorganization of the debtor's financial affairs.

In practice, most motions for relief from the automatic stay are uncontested by debtors and relief is granted without a hearing. The time required to obtain an order will depend on whether or not the motion is considered on shortened time, but two to four weeks after filing is a reasonable estimate.

Normally, an order granting relief from the automatic stay is stayed for 14 days after entry of the order by Federal Rule of Bankruptcy Procedure 4001(a)(3), but this stay can be waived at the request of the moving party. Accordingly, a landlord's motion should request a waiver of the 14-day stay. Note, however, that such waiver requests are unlikely to be granted if the motion is opposed by the debtor.

There is generally not significant cost or delay associated with filing a motion to lift the automatic stay to pursue state court remedies against a tenant, especially because such motions often go uncontested. The benefit, by contrast, is substantial, as such motions, if granted, will prevent the landlord from incurring liability for violating the automatic stay by proceeding against the debtor.

Recent Developments

Probate and Trust

by Anna M. Cashman – Kutscher Hereford Bertram Burkart PLLC and Steven J. Schindler – Perkins Coie LLP

Anderson v. Dussault, et. al., 177 Wn. App. 79, 310 P.3d 854 (Div II) Oct. 1, 2013. **No Breach of Fiduciary Duty by Trustee of Special Needs Trust by Following Trustees' Accounting Act**

In November 1996, when Rachel Anderson was six years old, she was injured by a horse. Anderson sustained major skull and facial damage from the injury that required extensive surgery. Anderson's family hired personal injury attorney Richard McMenamin, who successfully negotiated a settlement with the horse's owner. McMenamin retained attorney William Dussault to prepare a special needs trust to hold the settlement proceeds. In August 1997, the Clallam County Superior Court approved the settlement agreement and the parties' creation of the special needs trust for the benefit of Anderson.

The initial trustee of the trust was Wells Fargo Bank. McMenamin and Anderson's mother, Andrea Davey, served as the trust advisory committee, which had "absolute and unfettered discretion to determine when and if [Anderson] needs regular and extra supportive services." The trust provided that the trustee "shall make an annual statement of transactions and assets concerning all financial and investment activity undertaken on behalf of the trust" to be delivered to Anderson, any court-appointed representative of Anderson, and the members of the trust advisory committee.

The trust was initially funded with approximately \$187,000. After the trust was funded, Wells Fargo hired Dussault to prepare its annual reports for court approval. The first report was filed on January 25, 2000. Included in the statement of all financial activity was the purchase of a 1997 Mercury Tracer automobile, in the amount of \$14,160. The report was approved by the superior court in its entirety. The second report was filed on February 12, 2001. This report covered all financial activity since the prior report and included a disbursement of \$41,462 for the purchase of real estate.

In August 2001, Anderson's father and maternal grandmother hired attorney Carl Gay, who sent a letter to the trustee, Dussault, McMenamin, and Davey, alleging improper distributions in violation of the trust and the use of trust funds to discharge parental financial obligations that were the responsibility of Davey. Dussault responded to the letter, but never heard back from Gay.

In February 2002, Dussault again wrote to Gay stating that he was ready to present the annual report to the court for approval. Gay responded by expressing concerns over (1) the purchase of real property, (2) reimbursement for parental obligations such as computer costs, vehicle costs, and birthday presents, (3) certain attorneys' fees,

and (4) trustees' fees. Dussault delayed presenting the report for court approval while he attempted to address Gay's concerns. In July 2002, McMenamin resigned from the trust advisory committee when it became apparent there were ongoing problems with the non-custodial parent (Anderson's father).

On December 6, 2002, Dussault submitted a two-year report for approval by the superior court. In addition to a description of the financial activity since the previously filed report, the report requested that the trust advisory committee be dissolved and have the trustee assume all functions designated to the trust advisory committee. All parties, including Gay, were notified of the hearing on July 11, 2003, but neither Gay nor his clients, Anderson's father and grandmother, appeared at the hearing. The superior court approved Dussault's report and dissolved the trustee advisory committee. The trial court's approval of the report was not appealed.

From December 2003 to December 2009, the trial court approved four additional reports, none of which were objected to by any party. The last report was approved on December 4, 2009, when Anderson was 19 years of age, and the court requested the next report be filed at the end of 2011.

On July 22, 2011, a few days before her 21st birthday, Gay – now acting on Anderson's behalf – filed a complaint against Davey, McMenamin, Dussault, Wells Fargo, and others alleging that each of the defendants "failed to discharge their fiduciary and other legal duties to [Anderson] as the beneficiary of the trust." Gay submitted an opinion from a certified public accountant stating that it was his opinion that the trust be reimbursed over \$56,000 for (1) the cost of a vehicle purchased by the trust; (2) the costs of computer-related expenses; (3) lost rental income from a house partially owned by the trust where Anderson and Davey resided at one point; (4) direct reimbursements to Davey; and (5) certain attorneys' and trustees' fees. Before the distributions for Anderson's post-secondary education, commencing in August 2007, the trust had a market value of \$197,045.

McMenamin, Dussault, and Wells Fargo all brought motions for summary judgment arguing that Anderson's claims were barred by the Trustees' Accounting Act or, alternatively, that Anderson could not establish a breach of legal or fiduciary duties because each was acting in accord with the trust's express terms. Dussault also argued that as the attorney hired by Wells Fargo solely to prepare annual reports for court approval, he had no legal or fiduciary duties to Anderson.

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Recent Developments: Probate and Trust

Gay argued that there were factual disputes over whether Davey committed fraud against the trust and whether McMenamin, Dussault, and Wells Fargo fulfilled their fiduciary and legal duties in ensuring the trust funds were disbursed in accordance with the trust terms. On March 1, 2012, the trial court granted summary judgment to McMenamin, Dussault, and Wells Fargo. Anderson appealed the order granting summary judgment.

The Court of Appeals held that summary judgment was proper because Anderson's claims are barred by the Washington Trustees' Accounting Act, Chapter 11.106 RCW. Under the Trustees' Accounting Act, a trustee may file with the superior court an account under oath showing the financial activity of the trust, including the total principal or inventory of the trust assets at the beginning of the period, an itemized statement showing all principal and income received and disbursed, and the balance of principal and income remaining at the close of the period. See **RCW 11.106.030**. If the trustee files such an accounting, the superior court must determine its validity and accuracy by entering a "decree either approving or disapproving the account or any part of it." **RCW 11.106.070**. Such decree "shall be deemed final, conclusive, and binding upon all the parties interested, including all incompetent, unborn, and unascertained beneficiaries of the trust." **RCW 11.16.080**. After the superior court's decree is final and the time to appeal expires, a complaining party in interest relinquishes his or her right to recover losses, even losses from willful or negligent breaches of trust. See *Barovic v. Pemberton*, **128 Wn. App. 196**, 201-02, **114 P.3d 1230** (2005).

The court rejected Anderson's argument that the statute of limitations should have been tolled because she was incompetent. The court ruled that the plain language of **RCW 11.106.080** controls, which states that a decree approving or disapproving of a trustees' accounting is binding on all parties, including all incompetent beneficiaries of the trust. The Court of Appeals also rejected Anderson's alternative argument that the Trustees' Accounting Act should not apply to her trust because it was a special needs trust. Although no Washington court had addressed whether the Trustees' Accounting Act applies to special needs trusts, Anderson could provide no cogent argument for why the Act should not apply to the trust. Therefore, the court held that the Trustees' Accounting Act applies to special needs trusts.

In summary, Anderson failed to show how the superior court's final decrees approving each trust report should not be binding on her, or that she was provided inadequate notice or protection as an incompetent to assess the performance of her own trust. Therefore, the Court of Appeals ruled that the trial court properly granted summary judgment in favor of Dussault, Wells Fargo, and McMenamin. *In re Estate of T. Mark Stover*, **178 Wn. App. 550**, **315 P.3d**

579 (Div I) December 23, 2013 (review denied 4/2/2014). ***Claimant Must File Suit Against Personal Representative Within 30 Calendar Days of Claim Rejection***

Stover serves as a reminder to follow the claims process strictly. More specifically, the case clarifies the manner of counting the statutory 30 day limit for a claimant to bring suit against a personal representative who has rejected the claim, under **RCW 11.40.100(1)**.

Shortly before his death, Mark Stover wrote a check to Teresa Vaux-Michel for \$150,000 and left it in his desk. He told friends that he had written the check as a gift to Vaux-Michel in contemplation of his death. The check was discovered after his death. Vaux-Michel timely presented a claim against the estate to collect the \$150,000.

By way of reminder, a claim against the estate generally must be presented by the earlier of (a) the end of the limitations period applicable to the claim without regard to the decedent's death, (b) 24 months from the decedent's date of death, or, (c) if notice is properly published, (i) four months from the date of first publication as to creditors not reasonably ascertainable or (ii) the later of four months from first publication or 30 days after actual notice is given as to reasonably ascertainable creditors. **RCW 11.40.051**. A claim is deemed presented on the later of the date the claim (which must satisfy the elements of **RCW 11.40.070(1)**) is (1) filed with the court and (2) either personally served or sent by first-class mail to the personal representative or the personal representative's attorney. **RCW 11.40.070**.

A timely filed claim imposes on the personal representative the duty to accept or reject the claim. If, after the later of four months from first publication or 30 days from the claimant's presentation of the claim, the claimant properly gives notice to the personal representative of the claimant's intention to petition the court to have the claim allowed, then the personal representative must accept or reject the claim within 20 days of the notice. If the personal representative does not act, the claimant may file a petition for a hearing to accept the claim and, if the claim is substantially allowed, to receive reasonable attorneys' fees. **RCW 11.40.080(2)**. If the claim is rejected, the rejected claimant then "must bring suit against the personal representative within 30 days after notification of rejection or the claim is forever barred." **RCW 11.40.100(1)**. If the notice of rejection is sent by certified mail, the postmark date is the notification date that begins the thirty day clock.

There is no dispute that on September 16, 2011, Vaux-Michel timely presented her claim for payment on the \$150,000 gift. On October 19, more than 20 days after the notice, the personal representative had not acted on the claim as required under **RCW 11.40.080(2)**, so Vaux-Michel sent notice to the personal representative of intent to peti-

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Recent Developments: Probate and Trust

tion the court to allow the claim. In a notice postmarked on December 19, more than 20 days after the Vaux-Michel notices, but before Vaux-Michel filed a petition to allow the claim, the personal representative rejected the claim. On January 23, 2012, Vaux-Michel petitioned the court to allow the claim pursuant to **RCW 11.40.100(1)**.

The trial court denied the personal representative's motion to dismiss as untimely, on two grounds. First, the court ruled that the personal representative forfeited authority to reject the claim after failing to accept or reject it within the 20 day period following Vaux-Michel's notice of intent to petition for its allowance. Second, and in the alternative, the court ruled that January 23, 2012, was within the 30-day period after applying **CR 6(e)**, which adds three days to the response period when notices are sent by mail, and accounting for the holiday weekend. After a bench trial, Vaux-Michel was awarded the \$150,000 she claimed plus attorney fees and costs.

The Court of Appeals reversed, avoiding the substantive merits of the claim and holding simply that the claimant's petition was untimely. The court first applied the "ordinary meaning of 'day,' which includes weekends" to the 30-day period during which a rejected claimant must bring suit against the personal representative. The court also rejected the claimant's "unsupported contention" that the estate's failure to act on the claim within 20 days of the claimant's notice under **RCW 11.40.080(2)** released the claimant of the obligation to bring suit within 30 days of its rejection under **RCW 11.40.100(1)**. Instead, the court stated that **RCW 11.40.080(2)** provides a simple and plain mechanism to prompt a personal representative to act on a claim. The claimant was permitted to bring the claim any time after the end of the 20-day period, but the personal representative's authority to reject was not curtailed at the end of the 20-day period.

The court then reiterated that "thirty days" under **RCW 11.40.100(1)** means "thirty calendar days" and that the statutory time limit is inconsistent with and prevails over **CR 6**. Here, the claim was rejected on December 19, 2011, making Wednesday, January 18, 2012, the deadline for filing the claimant's suit. The court suggested that neither the three-day extension for notice by mail under **CR 6(e)** nor the extension to the next court day after weekends and legal holidays under **CR 6(a)** applies to the 30-calendar-day limit in **RCW 11.40.100(1)**. The court reversed the attorney fee award and permitted the estate to seek attorney fees at the trial court on remand.

A final point worth noting is that the claimant's untimely petition was apparently brought as a petition under the probate cause number. The phrase "must bring suit against the personal representative" under **RCW 11.40.100(1)** may

be interpreted to require the claimant to file a separate civil action against the personal representative under a different cause number (and, if venue rules permit, in a different court), but the estate apparently did not assert that the claimant's petition brought under the probate matter did not constitute a "suit against the personal representative."

Cook v. Brateng, _____ Wn. App. _____, 321 P.3d 1255 (Div II) March 25, 2014. ***Attorneys' Fees Awarded Under TEDRA Arbitration Procedure Against Non-Prevailing Party***

The *Cook* case details two attorney fee provisions of the Trust and Estate Dispute Resolution Act (TEDRA), chapter 11.96A RCW. The more common provision of **RCW 11.96A.150** gives the court broad discretion to award attorneys' fees against (a) any party to the litigation, (b) any trust or estate assets, or (c) any nonprobate assets. The court may order fees and costs "to be paid in such amount and in such manner as the court determines to be equitable." The attorney fee provision of **RCW 11.96A.310(10)** is only available if the parties have submitted to arbitration under **RCW 11.96A.310** and one of the parties appeals the arbitrator's decision in a trial de novo before the superior court. The prevailing party of any such de novo trial must be awarded costs and fees against the nonprevailing parties in such amount and in such manner as the court determines to be equitable.

In 1995, Elmer Cook executed a living trust naming himself and A. Diane Brateng, his daughter, as trustees. Brateng became the sole trustee after Elmer was declared incompetent in 1997. Elmer passed away on January 1, 2000. In October 2001, Elmer's son, John E. Cook, sued Brateng over distributions from the trust and both parties entered into mediation and arbitration under TEDRA. Cook appealed the arbitrator's decision and requested a trial de novo under **RCW 11.96A.310(9)(a)**. The trial court found that Brateng had breached her fiduciary duty in compensating herself from Elmer's trust for caregiving expenses without informing Cook. The trial court awarded Cook all of his requested attorneys' fees to be paid from the trust and half of Brateng's fees to be paid from the trust pursuant to **RCW 11.96A.150**.

Brateng appealed and the Court of Appeals reversed the trial court's conclusion that Brateng had breached her fiduciary duties. The Court of Appeals also vacated the trial court's award of attorneys' fees to Cook and remanded the issue to the trial court to determine a reasonable award of attorneys' fees to Brateng for both the trial and appeal. On remand, Brateng requested an award for caregiving expenses, trustee expenses, and out-of-pocket costs from the trust. Brateng requested \$134,000 in reasonable attorneys'

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Recent Developments: Probate and Trust

fees against Cook personally under **RCW 11.96A.310(10)** and against the trust under **RCW 11.96A.150**. The trial court awarded Brateng reasonable caregiving expenses in the amount of \$38,250 to be paid from Elmer's estate. The trial court found Brateng's reasonable attorneys' fees to be almost \$54,000 for the trial, appeal, and remand. The trial court concluded that **RCW 11.96A.310(10)** did not apply and instead awarded the attorneys' fees against Elmer's estate under **RCW 11.96A.150** because the trial court found that Cook was "not personally liable for any of [Brateng's] attorneys' fees as that would penalize [Cook] for exercising his non-frivolous right to challenge the trustee's conduct in managing the estate." Brateng appealed the attorneys' fees ruling, arguing that the trial court erred by failing to apply **RCW 11.96A.310(10)**.

The only issue on appeal was the attorneys' fee award to Brateng. The Court of Appeals dismissed Cook's argument that res judicata bars Brateng's claim because the prior appellate ruling directed the trial court to award Brateng attorneys' fees under **RCW 11.96A.150**. The Court of Appeals disagreed, holding that res judicata does not apply here because this action was not a second suit between the parties but a subsequent stage of the same litigation. Further, the prior appellate decision did not direct the trial court to award attorneys' fees under any particular statute, but simply mentioned the attorneys' fee award statute under **RCW 11.96A.150** in reference to the trial court's award to Cook. Even if Cook had argued the law of the case doctrine, in which an appellate holding enunciating a principle of law must be followed in subsequent stages of the same litigation, there was no appellate holding regarding the method of awarding attorney's fees in this matter, and thus no appellate principle of law to be followed in later stages of litigation.

The Court of Appeals concluded that the trial court erred by failing to apply **RCW 11.96A.310(10)** to its attorney fee determination. The court examined the plain language of **RCW 11.96A.310(10)** and determined that a trial court is required to award fees against a nonprevailing party of a trial de novo following an appeal of an arbitrator's decision under **RCW 11.96A.310(9)**. Further, **RCW 11.96A.310(10)** explicitly states that it shall "take precedence over the provisions of **RCW 11.96A.150** or any similar provision." In this case, Cook appealed the arbitrator's decision and requested a trial de novo under **RCW 11.96A.310(9)**, thus invoking the fee provisions of **RCW 11.96A.310(10)**. Even

though the trial court found that Cook was not personally liable for attorneys' fees because that "would penalize [Cook] for exercising his non-frivolous right to challenge the trustee's conduct in managing the estate," the frivolity of the arbitrator's decision is not grounds to deny a fee award under this statute. Because Brateng was the prevailing party, the trial court erred by refusing to award attorneys' fees under **RCW 11.96A.310(10)**.

The court also held that the attorneys' fees provisions of **RCW 11.96A.310(10)** are not to be applied to the exclusion of **RCW 11.96A.150**, but that both statutes may be applied harmoniously. The case was remanded to the trial court to first determine Brateng's reasonable attorneys' fees award against Cook, personally, under **RCW 11.96A.310(10)**. Then, after making that initial determination, the trial court, in its discretion, may award Brateng attorneys' fees under **RCW 11.96A.150** in consideration of "any and all factors that it deems relevant and appropriate," including the initial fee award under **RCW 11.96A.310(10)**.

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If you are interested in writing an article, we are looking for authors and articles for the next three RPPT Newsletter issues for 2013-2014. Please contact our Newsletter Editor April Anderson at (509) 252-5659 or aanderson@workwith.com.

Notes from the Chair

by Karen E. Boxx – University of Washington School of Law

I am now completing my year as Chair of the section and reflecting on the progress we've made this year. This is the largest section of the WSBA, by far, and has for years provided tremendous benefits to its members, so just maintaining the quality of those benefits is a major undertaking. We are in a period of transitioning the method of delivery of those benefits, such as moving our newsletter from paper to digital and providing online access to CLEs. The newsletter transition is still a work in progress. Casemaker has agreed to provide live links to citations in the newsletter, which may be starting in this newsletter or the next, depending on our success in working out some technical issues. Many thanks to April Anderson, our newsletter editor, who in addition to her considerable duties of soliciting and editing articles and overseeing production of the newsletter, has arranged for this new enhancement. Both April and Sarah MacLeod, assistant newsletter editor who moves into the editor seat this coming year, have done a terrific job of maintaining the quality of the newsletter through the transition to digital and at the same time planning for additional improvements that are now a possibility because of the digital format and the cost savings from moving to paper. The survey of members that we conducted last year confirmed that you consider the newsletter to be a major benefit to section membership, and thanks to the hard work of our editors, we will see continued improvement.

The website is another significant membership benefit, according to the survey. We maintain our website separately from the WSBA website in order to provide more features and content and maintain flexibility. We had some difficulties with service providers this year and are exploring options to improve the operation of the website. This is another reflection of shifting resources away from print materials to online content. We now have a technology

subcommittee that can focus on website improvement, servicing of the listservs and exploration of other ways we can deliver information and enhance communication among our members.

These benefits are paid for through the section's share of your dues as well as the section's share of CLE revenues. We keep our dues as low as possible, and the WSBA increased its per member charge to sections after passage of the Referendum regarding licensing fees, so our major source of income is CLE revenue. The section sponsors at least four major CLE programs annually, in addition to the midyear meeting, and those programs have been very successful, particularly since the WSBA conference center allows for attendance via webcast. However, the WSBA's costs in administering these programs are increasing and we expect to see a reduction in the section's share of CLE revenues to cover those costs. This may present a challenge to the section to continue the same level of CLE programs as well as maintaining and improving upon the website, newsletter and listservs, but those services are the section's lifeblood and will continue to be the focus of the executive committee's work.

Finally, I want to recognize the hard work of executive committee members who monitor bills throughout the state legislative session. This is a critical function of the committee, and we are fortunate to have incredible support from the WSBA staff, particularly Kathryn Leathers. The probate and trust side had a relatively quiet year, but as usual, the real property side had a torrent of bills to review and comment on, often with extremely short turnaround times. So special thanks to Jody McCormick, Real Property Director, and the real property members of the executive committee: Annette Fitzsimmons, Don Russo, Jeremie Lipton and Kyle Branum.

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