Real Property, Probate & Trust

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The Impact of the Pension Protection Act of 2006 on Charitable Gift Planning

by Heidi L. G. Orr, Lane Powell PC[1]

On August 17, 2006, President Bush signed the Pension and Protection Act of 2006[2] (the "Act") into law. The Act, aimed at strengthening pension funds, also made sweeping changes to tax laws related to charitable gifts. While most of the Act's tax incentives are temporary, expiring on December 31, 2007, the Act's charitable reforms are permanent. This article summarizes the tax incentives and tax reforms, as well as addresses what practitioners should do to make sure that clients avoid problems with their charitable gift planning.

I. The Tax Incentives

A. §1201 – Tax-Free Distributions from Individual Retirement Accounts for Charitable Purposes.

Section 1201 of the Act permits taxpayers age 70 1/2 or older to make tax-free distributions of up to $100,000 from traditional IRAs or Roth IRAs directly to qualifying charitable organizations (except donor advised funds, supporting organizations, private foundations, and transfers used to fund a charitable gift annuity or charitable remainder trust). Distributions to qualified charitable organizations can be applied in satisfaction of the taxpayer's minimum required distribution for the year the gift is made. The transfer must be made directly from the IRA to the qualified charity (i.e., the gift must be made outright and the taxpayer cannot receive any economic benefit from the transfer). The charitable donation will be excluded from the taxpayer's gross income and may not be deducted on the taxpayer's income tax return as a charitable contribution. The tax-free distribution applies only to traditional IRAs and Roth IRAs.[3] This provision will expire on December 31, 2007.

Earlier this year, in Notice 2007-7, 2007-5[4], the Internal Revenue Service provided additional guidance regarding IRA distributions to qualified charitable organizations. In addition to the guidance set forth in the Act, the Notice provided the following additional guidelines:

- A charitable IRA distribution can be made from a SEP IRA or a Simple IRA as long as the SEP IRA or Simple IRA is not an "ongoing" IRA. A SEP IRA or Simple IRA is "ongoing" if an employer contribution was made to it during the same year in which a charitable IRA distribution would be made. Therefore, a retired taxpayer who has a SEP IRA or a Simple IRA can make charitable distributions from that IRA because an employer would not have made a contribution to the retired taxpayer's SEP IRA or Simple IRA in that year. (*See* Q & A 36.)
- A taxpayer over age 70 1/2 who is the beneficiary of an inherited IRA can take advantage of the charitable IRA exclusion. (*See* Q & A 37.)
- A qualified charitable IRA distribution is not subject to withholding under IRC §3405 because the taxpayer that requests such a distribution is deemed to have elected out of withholding under IRC §3405(a)(2). (*See* Q & A 40.)
- Distributions made by an IRA trustee directly to charitable organizations will be treated as a receipt by the IRA owner and therefore will not constitute a prohibited transaction. This rule applies to taxpayers with outstanding pledges to the recipient charitable organization. In other words, charitable

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IRA distributions can be used to satisfy pledges without violating the self-dealing prohibited transaction rules (*See* Q & A 44).

The taxpayers who will benefit most from the ability to make tax-free distributions from individual retirement accounts include taxpayers: (1) who are required to take minimum required distributions, but who do not need additional income; (2) who have exceeded the 50% adjusted gross income limitations for gifts; (3) who do not itemize their deductions on their income tax returns; or (4) whose major asset is an IRA.

Many practitioners will have clients who want to take advantage of this charitable giving opportunity. Given that the tax-free distribution option is new and IRA custodians will approach the process differently, practitioners should manage the transfer to make sure it takes place properly. Specifically, practitioners should: (1) advise the taxpayer to start the transfer early in the year and carefully document the transfer; (2) provide a letter of instruction to the IRA custodian to help ensure the taxpayer's intent to comply with the tax-free distribution under the Act; (3) assist taxpayers in determining whether the charitable recipient is a qualified charity; and (4) make sure the taxpayer receives an acknowledgement of the gift from the charitable organization, which acknowledgement should state that nothing of value was provided to the taxpayer in exchange for the gift.[5]

B. §1203 – Basis Adjustment to Stock of S Corporation Contributing Property.

The Act provides more favorable basis rules for gifts made by S Corporations. This change, which expires on December 31, 2007, provides that an S Corporation shareholder's basis reduction in his or her stock, by reason of a charitable contribution made by the S Corporation, will be equal to the shareholder's pro rata share of the adjusted basis of the contributed property.

C. §1206 – Qualified Conservation Contributions.

The Act increases the charitable deduction limit from 30% of adjusted gross income to 50% of adjusted gross income for qualified conservation contributions. This charitable deduction limit is raised to 100% of adjusted gross income for qualified farmers or ranchers. The provision allows taxpayers to carry forward and deduct the remainder over fifteen years. This incentive expires on December 31, 2007.

II. The Tax Reforms

A. §1211 – Charity Owned Life Insurance.

The Act provides that charitable organizations must report acquisitions of interests in insurance contracts for two years beginning on the date of enactment of the Act. The Secretary is required to issue a report within thirty months after the date of enactment examining whether such acquisitions are consistent with the tax-exempt purposes of those charitable organizations that acquire such insurance contracts. This reporting requirement does not apply to a donor who purchases a policy on his or her life and gives it to a charity or to donors who name a charity as the beneficiary of a life insurance policy.

B. §1212 – Increase in Excise Taxes Relating to Public Charities, Social Welfare Organizations, and Private Foundations.

The Act doubles the fines, penalties, and excise taxes for violations by private foundations and their managers for acts of self-dealing, excess benefit transactions, failing to distribute income, excess business holdings, jeopardizing investments, and taxable expenditures. Generally, the Act doubled the percentage of the taxes assessed, as well as the dollar limitations on the amount of initial and additional taxes.

C. §1213 – Charitable Contributions of Easements in Registered Historic Districts.

The Act provides that deductions for donations of land or structures located in registered historic districts will only be allowed only if the entire exterior[6] of the building is preserved. The donated interest must include a restriction prohibiting any change in the exterior of the building that is inconsistent with the building's historical character. The taxpayer must enter into a written agreement with the charitable organization certifying that the charity is a qualified public charity whose purpose is environmental protection, open-space preservation, or historic preservation, and that the charity has the resources to manage and enforce the restriction and the commitment to do so. The taxpayer must include a qualified appraisal with his or her tax return, photographs of the entire exterior of the building, and a description of all restrictions on the development of the building. The Act also reduces the taxpayer's charitable deduction if a rehabilitation tax credit has been claimed with respect to the property in the last five years.

D. §1214 – Charitable Contributions of Taxidermy Property.

The Act limits the basis for donated taxidermy property to the cost of preparing, stuffing, and mounting the property. The value of the deduction is equal to the lesser of basis or fair market value.

E. §1215 – Recapture of Tax Benefit for Charitable Contributions of Exempt Use Property Not Used for an Exempt Purpose.

The Act provides that contributions of tangible personal property may be subject to recapture of the tax benefit if the donee

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charitable organization disposes of the property within three years following the donation. In order for the taxpayer to receive a charitable deduction equal to the fair market value of the donated property, the charitable organization is required to use the property for three years before selling or disposing or it. The charitable organization must also provide both the taxpayer and the Internal Revenue Service a statement: (a) certifying that the use of the property is related to the charitable organization's exempt purpose; and (b) describing how the property was used and furthered such exempt purpose, or stating the intended use of the property by the charitable organization at the time of the contribution and that the intended use has become impossible or infeasible to implement. If the charitable organization sells or otherwise disposes of the property within three years of the contribution and does not file a certification, the donor's charitable deduction is reduced from fair market value to cost basis. Any person who identifies tangible personal property as having a use that is related to an exempt purpose and who knows that the property is not actually intended for such use is subject to a $10,000 penalty.

F. §1216 – Clothing and Household Items.

The Act provides that deductions are no longer allowed for contributions of clothing or household items unless the clothing or household item is in good used condition or better. The Act does not define the term "good used condition." In any case, taxpayers can no longer take deductions for used socks and undergarments donated to charity. Household items include furniture, electronics, and similar items, but not food, paintings, antiques, jewelry, and collections. Taxpayers who claim a deduction of more than $500 for any single item of clothing or household item must file a qualified appraisal with respect to the property.

G. §1217 – Recordkeeping Requirements.

The Act provides that no deduction shall be allowed for any contribution of a cash, check, or other monetary gift unless the donor maintains a record of the contribution (e.g., bank statement, cancelled check, or credit card statement to proving the donation was made) or a written communication from the charitable organization showing the name of the charitable organization, the date of the contribution, and the amount of the contribution. In other words, taxpayers will no longer be able to deduct cash gifts left in grocery store jars or church collection plates or coins dropped in Salvation Army buckets unless the taxpayer can obtain a receipt or other record of the gift. This rule applies regardless of the amount of the contribution. While taxpayers are not required to submit their receipts with their income tax returns, they are required to retain the receipts in order to substantiate their charitable deductions to the Internal Revenue Service in the event of an audit.

H. §1218 – Contributions of Fractional Interests in Tangible Personal Property.

The Act provides that taxpayers making fractional interest gifts of tangible personal property (e.g., artwork) must give the entire interest in the property to the charitable organization within ten years of the initial contribution or upon death, whichever occurs first. To avoid recapture of the taxpayer's charitable deduction and the imposition of a 10% penalty, the charitable organization must have taken substantial physical possession of the property and used the property in furtherance of its exempt purpose. The deductible amount of additional contributions will be the lesser of the fair market value of the property at the time of the initial fractional contribution or the fair market value of the property at the time of the additional contribution. In other words, the deduction does not take into account the appreciation in later years of the taxpayer's retained fractional interest in the property. Most

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property that a taxpayer would use to make fractional interest gifts will appreciate with time, which could make fractional interest gifts of tangible personal property problematic if the taxpayer bequeaths the retained interest to charity at death. The fractional interest in the property retained by the taxpayer will be included in the taxpayer's estate at death at its then fair market value, but a deduction will not be allowed for any appreciation occurring after the date of the initial gift. Therefore, a taxpayer would be subject to unwanted and unintended estate taxes if the final fractional contribution occurs at death.

I. §1219 – Provisions Relating to Substantial and Gross Overstatements of Valuations.

The Act applies additional penalties to taxpayers who claim gift tax deductions for property based on valuations that overstate the property's value by 150% or more. The reasonable cause exception for gross valuation misstatements was also eliminated. The Act also defines "qualified appraisals" and "qualified appraisers" for substantial and gross valuation misstatements.

J. §1226 and §1231 - §1235 – Extending the Application of the Private Foundation Excise Taxes and New Excise Taxes to Donor Advised Funds.

The Act directs the Secretary to study the organization and operation of donor advised funds and supporting organizations and make a report to Congress within a year. The Act also directs the Secretary to consider whether deductions should be allowed for contributions to donor advised funds, whether donor advised funds should be required to distribute a specific amount each year, and whether the retention by donors of rights or privileges is consistent with the treatment of such transfers as completed gifts for tax purposes.

In the meantime, the Act did address certain issues related to donor advised funds. The Act defines (for the first time) a donor advised fund as a fund or account that is separately identified by reference to contributions of a donor or donors, is owned and controlled by a sponsoring organization, and with respect to which a donor has or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in the fund or account by reason of the donor's status as donor. The Act also extended the application of the private foundation excise taxes to donor advised funds and added new excise taxes applicable to donor advised funds, as follows:

1. Taxable Distributions.

A taxable distribution is defined as any distribution to an individual or to any other person if the distribution is for non-charitable purposes or the sponsoring organization does not exercise expenditure responsibility with respect to such distributions. A 20% tax will be imposed on the sponsoring organization on each taxable distribution and a 5% tax will be imposed on any fund manager approving the distribution knowing it is a taxable distribution.

2. Prohibited Benefits.

Donor advised funds are prohibited from making distributions that create more than an incidental benefit to the fund donor, a fund advisor, a family member of the donor or advisor, or an entity controlled[7] by the donor, donor's advisor, or their family members. A tax equal to 125% of the improper benefit will be imposed on the donor, donor advisor, or other related person, and a tax equal to 10% of the improper benefit will be imposed on the fund manager who approves the distribution knowing it would confer a more than incidental benefit.

3. Excess Benefit Transactions.

The excess benefit transaction rules were amended to treat grants, loans, compensation, expense reimbursement or similar payments made by a donor advised fund to a donor, advisor, or party related to a donor advised fund as an excess benefit transaction subject to excess benefit transaction taxes. The entire amount paid to a donor, donor advisor, or related party will be treated as an excess benefit.

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The Act creates both planning opportunities and potential pitfalls for taxpayers. Practitioners should both encourage clients to consult with their tax advisors before making substantial charitable donations and continue to carefully advise taxpayers with respect to their charitable gifting options, while exploring other planning techniques available to help clients meet their charitable planning goals.

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2 The text of the Pension Protection Act of 2006 is available at *www.dol.gov/ebsa/pdf/ppa2006.pdf*.

3 Taxpayers may not make tax-free distributions from other forms of retirement plans such as 401(k) and 403(b) plans, defined benefit and contribution plans, profit sharing plans, Keoghs, or employer sponsored SEPs and SIMPLE plans. Owners of these types of plans may want to consider rolling certain amounts into an IRA in order to take advantage of this tax incentive.

4 See IRS Notice 2007-7, 2007-5 I.R.B. 395.

5 A check or electronic transfer from the IRA custodian will likely not state the taxpayer's name. Therefore, the practitioner should remind the taxpayer to alert the charitable organization that the gift is on its way and to follow up with the charitable organization to ensure receipt of an acknowledgement.

6 Including the front, sides, rear, and height of the building.

7 Control is defined as at least 35% of the voting interest in an entity.

Environmental 101 for Purchasers of Property in Washington State

by David Ubaldi, Davis Wright Tremaine LLP, Bellevue, Washington

Environmental considerations exist in any significant real estate transaction, whether the property at issue is industrial, commercial, or residential. While we may be less surprised when industrial or commercial properties suffer impacts from prior uses, such adverse impacts can also exist on residential properties where, perhaps, previous fill materials contained "dirty dirt" or where past paint removal operations resulted in lead-contaminated soil. Even undeveloped parcels can show impacts, especially where off-site activities may have affected the underlying soil and groundwater.

Most of us recognize the usual environmental suspects: the aboveground or underground storage tanks, the abandoned drums and containers, the nearby dry cleaner, the up-wind smelter, or the unsightly landfill or waste storage facility. But what about the not-so-obvious environmental risks, like those associated with the purchase of an older building, undeveloped agricultural land, or a downtown corner retail shop? We would normally not consider these properties to carry any significant environmental risks, but that is not always the case. Buildings constructed in the mid-1970s or earlier may contain asbestos in the floors, roofs, or construction materials (e.g., electrical equipment, electrical panel partitions, electrical cloth, wiring insulation or pipe insulation). Property located in an agricultural zone may have soil or groundwater contamination resulting from the past use of chemical substances such as fertilizers, and herbicides and pesticides. A centrally located commercial property may have underground storage tanks that were buried years earlier when a service station occupied the site.

Seen or unseen, environmental hazards can cause challenges for prospective purchasers, especially given current environmental laws. Under Washington's version of the federal Superfund law, the Model Toxics Control Act ("MTCA"),[1] a current owner or operator of a facility at which there has been a release of hazardous substances is liable for remedial action costs, including attorneys' fees and costs, resulting from that release absent the application of one of MTCA's limited defenses. "Owners or operators" are defined as "*any* person with *any* ownership interest in the facility or who exercises *any* control over the facility." RCW 70.105D.020(12). And liability attaches as soon as the property owner takes title, regardless of fault or causation.

Understandably, the prospect of "buying-into" an environmental liability is not an appealing concept to many clients. Prospective purchasers can take steps to shield themselves from liability and limit their exposure within a particular transaction. To take advantage of these options, however, buyers should learn as much as they can about the property's environmental condition before they buy. This includes learning about conditions on adjacent properties that may already affect the property your client is considering for purchase or could do so in the future.

This article provides an overview of the environmental due diligence process and discusses what steps are necessary to qualify for the "innocent purchaser" defense, one of the limited MTCA defenses available to buyers who can establish that they had no reason to know of environmental problems before they purchased the property. The due diligence issues discussed in this article are equally important, however, to prospective purchasers who know of environmental issues and who want to structure their transaction to minimize their exposure to the costs and liabilities associated with those environmental problems. Due diligence allows these prospective purchasers to identify early on the environmental issues that might delay or otherwise impact their development plans and to evaluate what it might take to clean up the subject property. Lastly, this article provides some tips on how your clients might tailor an indemnity to allocate environmental liability between themselves and the sellers.

I. What Is an Innocent Purchaser?

The innocent purchaser defense is one of two "third-party" defenses recognized under MTCA and the most commonly asserted defense by property owners facing environmental liability.[2] To qualify as an innocent purchaser, owners must show that they undertook "all appropriate inquiry"[3] into the previous ownership and uses of the property at the time of their purchase. The innocent purchaser must also show that, based on its investigation, it had no knowledge nor any reason to believe that hazardous substances are or were released at the property, "the release or threatened release of which has resulted in or contributed to the need for the remedial action" on, in, or at the property. *See* RCW 70.105D.040(3)(b). The innocent purchaser defense is not available to a property owner who causes or contributes to a release of hazardous substances. It is also not available to an owner who fails to conduct "all appropriate inquiry" (i.e., adequate due diligence).

II. What Is All Appropriate Inquiry?

All appropriate inquiry ("AAI") is a term of art that refers to the requirements for assessing the environmental conditions present on a particular piece of property. The U.S. Environmental Protection Agency ("EPA") recently promulgated regulations establishing the standards for conducting AAI. These new regulations, which became effective in November 2006, were developed in response to the 2002 Brownfields Amendments to CERCLA. The regulations expanded the scope of inquiry that had been required under the previous standard, which was published by the American Society for Testing and Materials ("ASTM"), a non-profit standards-writing organization. ASTM has since updated its standards to comply with the new EPA regulations, and the new standard, titled "Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process (E1527-05)" (the "New Phase I Standard"), is consistent with EPA's regulations and can be used to comply with the AAI requirements.

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Like earlier versions, the New Phase I Standard requires that a site assessment include the following four components:

- A **records review** to identify past uses of the property and adjacent properties that might indicate environmental issues. Typically, the records reviewed include regulatory information from federal and state databases, aerial photographs, Sanborn Fire Insurance Maps, tax records, Polk directories, local construction and land use records, and historical maps.
- **Site inspections** to identify signs of past spills and practices that might result in contamination. Commonly, the environmental professional will be looking for the presence of above and underground storage tanks, wells, sumps, drains, stressed vegetation, and stained soil.
- **Interviews** with current owners, tenants, and government officials to identify a potential condition that may have contributed to contamination.
- A **report** outlining the environmental professional's opinion regarding potential environmental impacts on the subject property and the logic and reasoning used to arrive at that opinion.

The New Phase I Standard goes further, however, by requiring specific educational requirements for the environmental professional who manages or supervises the investigation. The qualified environmental professional must have, at a minimum, (i) a state or tribal issued certification and three years' experience; (ii) a relevant Baccalaureate degree or higher and five years' experience; or (iii) ten years of relevant full-time experience.

The New Phase I Standard also requires a more rigorous interview process that includes mandatory interviews with current owners and occupants of the property, past owners and occupants, and, at abandoned properties, neighboring property owners or occupants. The New Phase I Standard also broadened the records review requirement to include a review of records from the time that the property first contained structures or was used for any purpose, to the present. The New Phase I Standard requires that the environmental professional disclose any identified data gaps in his/her evaluation and comment on the significance of those gaps in evaluating whether recognized environmental conditions exist. Lastly, the New Phase I Standard changed the shelf life for the Phase I assessment. Previously, a report was considered valid for only six months from the date it was issued. The New Phase I Standard contains the same six-month limitation but it also allows a prospective purchaser to use a previous assessment if the information in that assessment was collected or updated within one year prior to the date of acquisition or, where the transaction does not involve an acquisition, the date of the intended transaction. However, to use the previous assessment, prospective purchasers must update certain portions of the report—like the records review, visual inspections, and interviews—within 180 days of the purchase date or the date of the intended transaction.

III. All Phase I Assessments Are the Same, Right?

No. Even though the New Phase I Standard mandates a minimum level of inquiry, site assessments can vary substantially, depending on the consultants conducting and supervising the investigation. For example, the Phase I with the lowest price tag may come with the consultant with the least experienced consultant. A low-cost Phase I may also mean that less is done to analyze and understand the available information or to draft and develop the final report. A low-cost assessment may simply provide a laundry list of information without ever explaining how that information informs the decision as to whether environmental concerns exist.

A substandard Phase I report is also risky for your clients. A poorly performed investigation is less likely to satisfy the AAI requirement, thereby making it less likely that your clients will qualify as innocent purchasers. An unreliable report may also result in your clients paying more than necessary for contaminated property or underestimating environmental problems in their negotiations with their sellers. This last scenario can be quite costly, especially if the consultant's contract limits its liability. Consider the case of a client who reserved $300,000 from a property transaction based on the consultant's estimate. When the actual cost of cleanup exceeded $1.5 million, the client has no recourse against the consultant for its negligence because the contract limited the consultant's liability, much like many consulting contracts, to the project fee or $50,000, whichever was greater. For reasons like this, it is important that you carefully review the consulting contract and negotiate protective terms like reasonable limitations of liability that reflect the risk associated with the transaction. Unless your clients negotiate specific terms in their consulting contracts, the terms they receive will most likely be heavily weighted in favor of the consulting firm.

The consultant and lawyer should also work together to refine the scope of work. It is important to tailor a site assessment to the specific property that is being investigated, the ultimate goals of the client, and the overall costs involved in the transaction. Some transactions require that the site assessment include work that is beyond the scope of the New Phase I Standard, like evaluating environmental compliance issues where the purchase involves an ongoing business or testing for asbestos or lead-based paint. Lastly, an environmental lawyer or someone skilled in reviewing environmental assessments should review the final Phase I report to determine if any identified concerns require further investigation.

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Environmental 101 for Purchasers of Property in Washington State

IV. Using Indemnities to Allocate Environmental Liability

If environmental problems are identified on a piece of property, your clients will want to consider how to structure the transaction to limit potential liabilities.[4] As explained above, environmental liabilities require special consideration because the laws and their consequences are more stringent. The provisions in a real estate contract dealing with environmental conditions, therefore, need to be specifically tailored to address those issues. Buyers should not assume that a contract's general provisions will protect them from future environmental liability.

Buyers commonly use indemnities, for example, to transfer pre-closing liability to the seller. A general indemnity agreement, however, will rarely be sufficient to transfer environmental liabilities. Washington courts require that parties include specific language in their agreements if they intend provisions to clearly encompass environmental losses. *See e.g., Scott Galvanizing, Inc. v. Northwest Enviroservices, Inc.,* 120 Wn.2d 573, 844 P.2d 428 (1993); *see also Car Wash Enterprises v. Kampanos*, 74 Wn. App. 537, 874 P.2d 868 (1994) (holding that an "as is" clause that made no mention of environmental conditions was not sufficiently specific to pass liability on for future environmental liability, despite the buyer's knowledge that a service station had operated on the property). In *Scott Galvanizing*, a metal galvanizing company ("Scott") sought indemnity from a waste transporter ("Northwest") for its liability under CERCLA. A Hazardous Waste Agreement between the companies contained an indemnity provision that provided that Northwest would indemnify and hold Scott harmless from any and all liability including liability associated with pollution:

> [Northwest] agrees to indemnify and hold [Customer] harmless from any and all liability, damages, costs, claims, demands and expenses (including reasonable attorney fees), <u>including but not limited to pollution</u> or other damages, as and to the extent that such liability, damages, costs, claims, demands and expenses are caused by, arise out of or in any manner result from the performance by [Northwest] of its services under this agreement or arise out of the negligence of [Northwest] provided, however, that the loss or claim does not result from the misidentification or failure to properly identify the materials by the Customer or the negligence of the Customer.

Id. at 577 (alterations in original) (emphasis added). When Scott was sued for cleanup of a disposal site, it argued that the indemnity required Northwest to indemnify it for all past and future costs associated with Northwest's transport of waste to that site. *Id*. at 578. Northwest argued that its duty to indemnify only applied to the extent that the liabilities arose because of Northwest's performance under the contract. Because Scott's liability arose independently of the Hazardous Waste Agreement, Northwest argued it had no obligation to indemnify Scott for its claims. *Id*. at 583. In reversing the lower court's ruling on summary judgment, the Supreme Court held that an issue of material fact existed with regard to the "intent of the parties in executing the indemnity clause." *Id*. at 584.

At a minimum, an environmental indemnity should describe the environmental harms that the provision is intended to cover, the claims that will trigger the indemnity, the specific facilities that fall within the coverage, and how the parties plan to handle disputes regarding the indemnity obligations. The indemnity (or another part of the contract) should also contain a statement indicating how long the parties intend the environmental indemnity to survive. Otherwise, an environmental indemnity will expire at the same time (usually at closing) as other provisions in the agreement. And, of course, an indemnity is also only as good as the financial condition of the entity providing it. An indemnity is of little value if the entity providing it does not have the assets needed to meet its obligations or is likely to dispose of its assets. It makes sense, therefore, to check the financial health of the indemnitor before relying on an indemnity provision.

While useful, an indemnity is not a substitute for conducting thorough due diligence on a piece of property. Even though an indemnity from a financially sound seller may protect your client from liability, it may cost your client considerable resources to enforce it. You will want to ensure that your clients consider those costs when evaluating the property purchase as a whole.

V. Conclusion

Environmental risk should not deter your clients from proceeding with a property transaction. Armed with a thorough understanding of the environmental concerns at issue, your clients will be better able to evaluate the purchase and, if necessary, to take the steps to limit their exposure and allocate liability as between themselves and other parties. This article offers some general advice on handling these issues, but it is no substitute for discussing real-life situations with an environmental lawyer or other experienced practitioners. Each transaction is different, and each requires considerations specific to that particular deal. Your clients will save themselves money and years of grief if they take the time to properly investigate environmental risks and to hire and consult with the appropriate advisors.

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1 MTCA was modeled after the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") and there are many similarities between the two statutes.

2 The other "third-party" defense recognized under MTCA is often referred to as the innocent landowner defense, which requires that an owner show that the release of hazardous substances was caused solely by a third party with whom the current owner did not have a direct or indirect contractual relationship. *See* RCW 70.105D.040(3)(a)(iii). Owners must also show that they exercised "utmost care" with respect to the hazardous substance and foreseeable acts or consequences of the third party. While there are some differences in what owners must demonstrate to qualify for the innocent landowner and innocent purchaser defenses, at least one

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Recent Developments

Probate and Trust

by Brinette C. Bobb, Perkins Coie LLP, Seattle

***Estate of Knowles*, 135 Wn. App. 351 (Division Two, 2006)**

Summary:

To prove undue influence in the execution of a will, the will challengers must submit clear, cogent and convincing evidence establishing undue influence. A court looks to three main elements in determining whether a will was a result of undue influence: (1) Was there a fiduciary or confidential relationship between the testator and the beneficiary; (2) Did the beneficiary actively participate in the preparation or procuring of the will; and (3) Did the beneficiary receive an unusually or unnaturally large part of the estate under the will? Although meeting these elements will not automatically invalidate a will, they can raise a presumption of undue influence which may require the submission of rebuttal evidence.

Facts:

The decedent Merle had seven children. Three years before the decedent's death, his son, Randy, acted as the scrivener of the decedent's will, writing all material provisions on a preprinted will form. In this will, five of the seven children received certificates of deposit, which were already in their name, each valued at $5,000. Randy received the decedent's home, real property and all of residue of the decedent's estate, valued at $78,675. Randy was also appointed as the decedent's personal representative.

Two of the children filed a petition contesting the will, alleging primarily that it was the product of undue influence by Randy. They also alleged improper attestation of the will and unauthorized practice of law, which were not discussed in the court's opinion. The trial court rejected the petitioners' claims, holding that they did not prove undue influence by clear, cogent and convincing evidence. The petitioners appealed the denial of their petition to reject their father's will.

Discussion:

Once a Will has been admitted to probate, a contesting party bears the burden of proving its invalidity by clear, cogent, and convincing evidence. A will is deemed to have been a result of undue influence when a party interferes with the testator's free will to an extent that the testator is prevented from exercising his own judgment and choice. In determining whether undue influence was present, the courts look to three main elements: (1) Was there a fiduciary or confidential relationship between the testator and the beneficiary; (2) Did the beneficiary actively participate in the preparation or procuring of the will; and (3) Did the beneficiary receive an unusually or unnaturally large part of the estate under the will? Other facts the court will consider include the age or condition of the health and mental vigor of the testator, the nature or degree of the relationship between the testator and the beneficiary, the opportunity for exerting undue influence, and the naturalness or unnaturalness of the will.

Although the presence of these elements will not automatically invalidate a will, the combination of the facts may raise a presumption of undue influence. Such a presumption does not, however, automatically shift the burden of proof; the will challengers must still prove undue influence by clear, cogent and convincing evidence. If, however, the facts as suspicious enough to raise the presumption, such facts may be sufficient to invalidate the will absent rebuttable evidence to the contrary. In reviewing rebuttable evidence, the courts put weight on evidence of the testator's strength of mind.

Here, the presumption of undue influence was made based on the facts that (1) Randy had a fiduciary relationship with Merle, (2) Randy participated in drafting the Will, and (3) Randy received the bulk of the estate almost to the exclusion of the decedent's other children. As such, the court correctly requested Randy to produce evidence that would rebut the presumption. Randy's evidence did just that. The rebuttable evidence consisted of (1) testimony by the witnesses to the will that the decedent signed the will in their presence and that the decedent discussed the will's provisions with them during the signing, (2) at least four friends and associates of the decedent testified that the decedent was an especially strong-willed man of sound mind, (3) the decedent's banker testified that the decedent often added Randy as co-owner or sole beneficiary on various financial transactions and that he was unaware that the had any other children as the decedent never spoke of them, and (4) evidence that the unequal distribution among the decedent's children was reasonable in light of his relationships with his children (he had a very close relationship with Randy, and had very little contact with his other children in the 30 years prior to his death). The court made particular note of the fourth piece of evidence stating that "a disparately large gift to one beneficiary does not necessarily denote undue influence if there is a natural explanation for it, … [and] [t]his principal applies even where a fiduciary participates in drafting the will and receives an apparently unnaturally large gift.

After reviewing all of the evidence, the court held that although the facts surrounding the will's establishment raised suspicions of undue influence, they were not enough to prove by clear, cogent, and convincing evidence that Randy interfered with his father's free will and prevented his exercise of judgment and choice. In addition, the court held that Randy's uncontested rebuttal evidence clearly supported that the will was not a result of undue influence.

Notes from the Chair

by Stephen R. Crossland, Cashmere

In the last newsletter I reported that our Section has been very active in attempting to have the State Supreme Court amend Rule 1.15A of the Rules of Professional Conduct ("RPC 1.15A"). As now adopted, the rule would require a lawyer to send annual written reports to clients notifying the clients that the lawyer holds "property" for the client, including "original documents affecting legal rights such as wills or deeds." The WSBA's Board of Governors agreed with the Section's recommendation that the annual reporting requirement be restricted to "funds" held by the attorney for a client. The Washington Supreme Court recently approved for publication in the advance sheets the proposed amendment to RPC 1.15A (which would restrict the reporting requirement to "funds"). There will be a 60-day comment period. Favorable comments are recommended. The recent order also stayed imposition of the effect of the rule as it now is enacted until the comment period has passed and the Court can then take a formal position.

The Section has also agreed to make some recommendations to the WSBA and the Supreme Court with regard to the issues which the present RPC 1.15A sought to address. Those issues include succession planning for disabled and deceased solo and small firm lawyers to provide for the safe keeping and distribution of original documents held by the disabled or deceased lawyers.

Nominations for Executive Committee Membership

Pursuant to the Bylaws of the Real Property, Probate & Trust Section, the Nominating Committee, currently composed of Warren Koons of Davis Wright Tremaine LLP (Bellevue), Thomas M. Culbertson of Lukins & Annis, P.S. (Spokane), and William Reetz of LandAmerica Financial Group, Inc., have recommended the election of the following persons to the offices indicated for the 2007-2008 term of the Real Property, Probate & Trust Section:

Director, Real Property Council

Kathryn R. McKinley – Wolkey McKinley, P.S. (Spokane)

Real Property Council

Jean M. McCoy – The Landerholm Firm (Vancouver)
Mark A. Hood (Tacoma)

Probate & Trust Council

Brian P. Knopf (Spokane)
Ryan D. Rein – Riddell Williams P.S. (Seattle)

Pursuant to the Bylaws, the persons recommended by the Nominating Committee shall be elected at the annual meeting by a confirming voice vote of the Section members present at such annual meeting.

Your RPPT Section Website

by Jean McCoy, Webpage Editor, Landerholm Law Firm and Elizabeth Stephan, Assistant Webpage Editor, Stoel Rives, LLP

As many of you know, the Real Property, Probate & Trust Section has its own independently run website located at www.wsbarppt.com. The purpose of the site is to provide information and materials that are relevant and interesting to our Members. The site includes nine years of our Newsletters, selected forms that our Members have asked to share, information on upcoming CLEs relating to Real Estate and Probate and Trust matters, current Legislation and Legislative History, and information about your Executive Committee. The site includes a search engine so you can find that old Newsletter article on, for example, "perpetual leases."

The website also includes a Members' Only page that includes selected chapters from the Real Property Deskbook and the Community Property Deskbook, the current Newsletter, and a Section Directory. As Members of the Section, you have access to the Members' Only portion of the website through a common username and password.

The RPPT Section also hosts two List serves, one for Real Property and one for Probate and Trust. You can sign up for the Lists at our site, or review the historical List postings by clicking on the link at the bottom of our home page.

To receive the Members' Only access information, or for any questions or suggestions as to content, please e-mail *webmaster@wsbarppt.com* and your friendly webmasters will assist you. This is YOUR site. Do let us know what you would like to see, and if you have information or links to other sites that may benefit our Members!

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Environmental 101 for Purchasers of Property in Washington State

commentator has said that the level of inquiry required under the two defenses is similar.

3 Inquiry into the environmental condition of a property is also required to qualify for two other liability limitations under MTCA. The passive migration or "plume" defense exempts a property owner from liability under MTCA so long as they can show through an environmental investigation that hazardous substances have come to be located on the property solely as a result of migration through the groundwater from an off-site source. *See* RCW 70.105D.020(12)(iv). Similarly, a property owner can limit the extent of its liability by entering into a prospective purchaser agreement with the Attorney General and Department of Ecology. *See* RCW 70.105D.040(5). These agreements are sometimes used by developers who want to redevelop or reuse contaminated property. To qualify for a prospective purchaser agreement, developers first must fully characterize the property to demonstrate that they are not somehow responsible and that they have a thorough understanding of the site's cleanup needs.

4 Note that buyers and sellers cannot use their contractual agreements to avoid an underlying environmental liability, but they can determine between themselves whether the buyer or seller will be responsible to pay any costs associated with such liability.

Information for Your Clients

Did you know that easy-to-understand pamphlets on a wide variety of legal topics are available from the WSBA? For a very low cost, you can provide your clients with helpful information. Pamphlets cover a wide range of topics:

- Alternatives to Court
- Bankruptcy
- Communicating with Your Lawyer
- Consulting a Lawyer
- Criminal Law
- Dissolution of Marriage (Divorce)
- Elder Law
- Landlord/Tenant
- Lawyers' Fund for Client Protection
- Legal Fees
- Marriage
- The Parenting Act
- Probate
- Real Estate
- Revocable Living Trust
- Signing Documents
- Trusts
- Wills

Each topic is sold separately. Pamphlets are $9 for 25, $15 for 50, $20 for 75, and $25 for 100. Pricing for larger quantities is available on request.

To place your order or for more information, please contact the WSBA Service Center at 800-945-WSBA or 206-443-WSBA. Sales tax is applicable to all in-state orders.

Article Ideas?

Please contact Ryan Rein if you are interested in writing an article for the newsletter or if you have ideas for article topics. Ryan's phone number is 206-389-1610 and his email is *rrein@riddellwilliams.com*.

CLE Credits for *Pro Bono* Work?

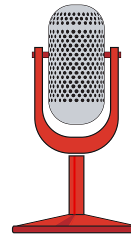
Yes, it's possible!

Regulation 103(g) of the Washington State Board of Continuing Legal Education allows WSBA members to earn up to six (6) hours of credit annually for providing *pro bono* direct representation under the auspices of a qualified legal services provider.

For further information contact Sharlene Steele, WSBA Access to Justice Liaison, at 206-727-8262 or *sharlene@wsba.org*.

Speak Out!

Wanted: Lawyers to volunteer to speak to schools and community groups on a variety of topics. For more information about the WSBA Speakers Bureau, contact Dené Canter at 206-727-8213 or *denec@wsba.org*.



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