

Real Property, Probate & Trust



Vol. 26, Number 3 Published by the Real Property, Probate & Trust Section of the Washington State Bar Association

Fall 1998

Formula Marital Deduction Gift Clauses And The IRC §2032A Election

Alan L. Montgomery

Montgomery, Purdue, Blankinship & Austin, P.L.L.C.

Perhaps the most common estate planning strategy for medium or high-net worth married couples (assuming they do not have children from prior marriages) is for the first-to-die spouse to give the exemption equivalent gift to a beneficiary other than the surviving spouse (“exemption gift”), and to give only the part of the estate that exceeds the exemption gift to or for the benefit of the surviving spouse (“marital deduction gift”). This makes it possible in most cases not only to achieve a zero estate tax at the first death, but also to take maximum advantage of the married couple’s combined federal estate tax exemption equivalents by excluding the exemption gift of the first spouse to die from the taxable estate of the surviving spouse. It is also a common practice to use a formula clause to define the marital deduction gift in the client’s will or other instrument (“Will”) with the residuary gift constituting the exemption gift (or vice versa).

If § 2032A is elected to specially value property (for example, a family farm) in the first spouse’s estate, a question may arise as to whether it makes any difference, for purposes of taking maximum advantage of the § 2032A valuation reduction, if the formula clause is a pecuniary clause or a fraction-of-the residue clause.

A common but unfounded perception is that only the use of a pecuniary formula marital deduction gift clause will produce the desired § 2032A optimum result. To the contrary, the reported cases and private letter rulings indicate that an appropriately drafted fractional clause is just as advantageous when used with the § 2032A election as is a pecuniary gift clause, and that the § 2032A-related problems arise only when the formula marital deduction gift is defined in reference to, or satisfied with assets valued at, estate tax values instead of fair market values.

Formula Pecuniary And Fractional Marital Deduction Gifts

1. **Pecuniary Gifts.** A “pecuniary” gift is one that can be expressed in terms of a fixed dollar amount or is determined under a formula or other method by which a fixed dollar amount can be computed. Rev. Proc. 64-19, 1964-1 C.B. 682, § 2.01. RCW 11.108.010(1) defines a pecuniary bequest as one expressed as an “amount” or “sum.” For example, “I give \$100,000 to my surviving spouse” and “I give to my surviving spouse the minimum amount necessary to reduce the combined Washington state and federal estate taxes to zero” are pecuniary gifts.

However, a pecuniary marital deduction gift that may be satisfied with non-cash assets must generally be satisfied with the assets valued as of the date or dates of distribution (“true-worth” pecuniary) for the estate tax marital deduction to be assured. If the Will authorizes the gift to be satisfied with assets valued as finally determined for estate tax purposes, then the Will or state law must require that such assets have a distribution-date value of at least the amount of the marital deduction (“minimum value” pecuniary), or alternatively must have a distribution-date value fairly representative of the post-death appreciation or depreciation in the estate (“fairly representative” pecuniary). Rev. Proc. 64-19, 1964-1 C.B. 682. See J. Price, *Price on Contemporary Estate Planning*, Little, Brown and Co. (1992), §§ 5.32 - 5.4.

Another way of looking at the alternatives is that the “fairly-representative” pecuniary gift is one which must result in essentially the same distribution as a “fractional gift” as described

continued on page 3

TABLE OF CONTENTS

Formula Marital Deduction Gift Clauses And The IRC §2032A Election	1	Recent Developments/Real Property	11
Notes from the Chair	2	Probate and Trust Council Report	15
Recent Developments/Probate and Trust	8	Real Property Council Report	16
		RPPT 1999 Budget Request	17
		How to Reach Us & Upcoming Seminars	18

Notes from the Chair

*John M. Riley, III
Witherspoon, Kelley, Davenport & Toole, P.S.*

I appreciate the opportunity to report to you as the new Chairman of the Section. First, for your information, on page 17 of this Newsletter is a copy of the Section's budget for the 1998-1999 fiscal year, which was recently approved by the Board of Governors. This budget tells you where we think we will make our money and on what we will spend it. If you have any specific questions about the budget, please feel free to call me.

Second, I wish to thank my predecessor, Douglas C. Lawrence of Stokes Lawrence, for his exceptional leadership of the Section last year. Under his leadership, the Section participated in enactments on both the real property and the probate and trust side, the most widely publicized enactment being the Amendments to the Deed of Trust Act. I add a special note of thanks to Gordon Tanner, Doug Lawrence's predecessor as Section Chair, who, in his year as past Chairperson, contributed countless hours overseeing the Amendments to the Deed of Trust Act Task Force and participating with many other lawyers in its good work.

This past year the Section continued its presentation of excellent continuing legal education seminars for the benefit of our members. We co-sponsored real property seminars on casualty and damage to real property and on standard provisions in real estate documents with drafting tips. On the probate and trust side, we co-sponsored seminars on preparing federal estate tax returns and selected strategies for the taxable estate. Please look forward to our upcoming seminars on the real property side on the new Deed of Trust Act and on project development from A to Z in February 1999. As well, we will be co-sponsoring a seminar in advanced will drafting in March of 1999 and on advanced probate in July of 1999. We had an excellent turnout and participation in the Section's Midyear meeting at Skamania Lodge this past June.

Under the guidance of Newsletter Editor, Hossein Nowbar, and Assistant Editor, Lora Brown, we continued to

provide our members with timely information on recent case law developments, legislative changes and in-depth articles on matters of interest to Section members. We are at present brainstorming ideas for additions to our Newsletter to provide our members with additional helpful information. In its first full year of existence, the Editorial Advisory Board provided excellent assistance to the Newsletter Editor and Assistant Editor in newsletter content, and lead article creation and preparation. This group has truly proved to be beneficial to the Section.

After due consideration, the Board has determined that this year we will switch to a bi-annual issuance of our Section Member Directory. The Board felt this would be fiscally prudent as well as of benefit to the Section members and our Directory advertisers. It will again be issued next year and you can look forward to seeing it then.

In the past year, we finalized the creation of our Web page and it now is posted to the Internet as a portion of the State Bar Association's Internet site (www.wsba.org). I strongly suggest you take a moment and contact the site. We have provided such information as a home page, a "what's new" page, an "upcoming events" page, CLE information page, and we anticipate a legislation page. The Board is presently discussing the procedures necessary to get proposed legislation of interest to the Section on the Web page for our members' review and comment to the real property and probate and trust council directors. Likewise, the Board is also brainstorming ideas for additional Web page content. I will be reporting to you further about that in subsequent columns.

You will quite soon receive our RPPT disk. This CD will contain relevant statutes and regulations commonly used by our Section members. We hope you will find it helpful in your practice.

In the coming year, it is anticipated that the Section will sponsor probate and trust legislation. I should be able to report to you on specific content in subsequent newsletters.

Real Property, Probate and Trust Section

Officers

John M. Riley, III, Chair
Mark W. Roberts, Chair Elect
Douglas C. Lawrence, Past Chair

Council Members

Real Property
Serena M. Schourup, Director
Bruce A. Coffey
Jane Rakay Nelson
William H. Reetz
Steven B. Tubbs

Probate and Trust

Barbara C. Sherland, Director
Thomas M. Culbertson
Marcia K. Fujimoto
Matthew B. McCutchen
J. Bruce Smith

Newsletter

Lora L. Brown, Editor
Maren K. Gaylor, Assistant Editor

Editorial Board

Real Property
Steve Crossland
Michael Currin
Warren Koons
Camille Ralston
Martin Strelecky

Probate and Trust

Karen E. Boxx
James A. Flaggert
Wendy S. Goffe
Carol Hunter
Kristina C. Udall
Kari M. Larson

WSBA Desktop Publisher, Clare M. Cox

This is a publication of a Section of the Washington State Bar Association. All opinions and comments in this publication represent the views of the authors and do not necessarily have the endorsement of the Association nor its officers or agents.

Washington State Bar Association
Real Property, Probate & Trust Section
2101 Fourth Avenue - Fourth Floor
Seattle, WA 98121-230



Printed on recycled paper

from page 1

Formula Marital Deduction Gift Clauses. . .

below (see Private Letter Ruling (“PLR”) 9143018), and the distribution under a “minimum-value pecuniary” gift is one which must more closely resemble that of the “true-worth pecuniary” gift, if the estate tax marital deduction is to be allowed under Rev. Proc. 64-19.

One consequence of using a “true-worth” pecuniary clause to define a marital deduction gift is to freeze the value of the marital deduction gift, since all post-death appreciation or depreciation in the value of the residue of the estate must be allocated to the exemption gift if the pecuniary gift is required to be satisfied with assets valued as of the date of distribution. Rev. Rul. 90-3. 1990-1 C.B. 194; PLR 8928004.

Another consequence of using a pecuniary marital deduction gift clause is that unplanned income tax liability may result upon funding the marital deduction gift. This is true whether the gift is funded with assets that have merely appreciated from estate tax valuation date values (in the case of the “true-worth” pecuniary clause), or funded with IRD as defined in IRC § 691 (in the case of all three types of pecuniary clauses). *Suisman v. Eaton*, 15 F. Supp. 113 (D. Conn. 1935); *Kenan v. Comm’r*, 114 F.2d 217 (2d Cir. 1940); Treas. Reg. § 1.661(a)-2(f)(1). See, generally, *Price, supra*, at §§ 5.34 - 5.37.6.

For example, the distribution of installment obligations in satisfaction of a pecuniary gift has been ruled to result in gain recognition under IRC § 453B and § 691 in PLRs 9123040, 9123043 and 9007016. Similarly, gain was ruled to result under § 691(a)(2) when distributions of IRD E bonds were made in satisfaction of pecuniary gifts in PLRs 9507008 and 9315016, and when appreciated stocks or other assets were distributed in satisfaction of pecuniary gifts in PLRs 9201029, 9044047 and 8447003.

2. Fractional Gifts. A “fraction-of-the-residue” or “fractional” gift is one that is not expressed in terms of a fixed dollar amount and which shares proportionately in the post-death appreciation or depreciation of the estate. Rev. Rul. 60-87 and Rev. Rul. 56-270. Such a gift might be expressed as follows: “I give to my surviving spouse the minimum fraction of the residue of my estate necessary to reduce the combined state and federal estate taxes as much as possible.” However, any gift defined with reference to the adjusted gross estate is a pecuniary rather than a fractional gift, since it does not fluctuate in value due to post-death appreciation or depreciation in the estate. See Rev. Rul. 60-87, 1960-1 C.B. 286 (“a percentage of the adjusted gross estate” is a pecuniary rather than a residuary gift) and PLR 8422011 (a gift of 50% of the adjusted gross estate is a pecuniary bequest).

One consequence of using a fractional share marital deduction gift is that no “freeze” of the marital deduction gift can result since both the marital deduction gift and exemption gift must share proportionately in the post-death appreciation or depreciation of the estate.

Another consequence is that no unplanned income tax liability results upon funding a fractional gift, either with assets that have appreciated from estate tax valuation date values or with IRD. IRC § 453B(c), § 691(a)(2), Treas. Reg. § 1.691(a)-4(b)(2), and PLR 9352015 (funding a fractional share QTIP trust with a tax-deferred state lottery annuity that is IRD does not trigger gain on funding under IRC § 691(a)(2)). In PLR 9537011, the non-pro rata distribution of IRD assets from a decedent’s estate (savings bonds with an untaxed interest component that accrued prior to the date of death) among the fractional residuary shares of the estate was ruled to be non-income taxable. The ruling concludes that the non-pro rata distribution of the IRD among the fractional shares is not taxable under IRC § 691(a)(2), since the executor had the authority to make non-pro rata distributions under the state law that was incorporated by reference into the governing instrument. PLR 9537011 is one of series of letter rulings (the others are 9801014, 9737017, 9731041, 9717012, 9717030, 9715024, 9709028, 9649015, 9625020, 9523029, 9422052, 9411033, 9410030, 9324015, 8119040, 8145026 and 8029054) providing that non-pro rata distributions between fractional shares of a decedent’s estate or a trust are not income taxable if done pursuant to authority contained in the governing instrument or state law.

3. Self-Adjusting Formula Provisions. The most certain method to obtain the optimum marital deduction gift is to define the self-adjusting marital deduction gift or QTIP election by reference to the desired level of estate tax. Simple, self-adjusting formula fractional clauses and QTIP elections designed to reduce the estate tax to zero are referred to approvingly in Treas. Reg. § 20.2056(b)-7, examples (7), (8) and (9). See also Technical Advice Memorandum (“TAM”) 9218002 (approving formula marital deduction gift of “the fractional share necessary to reduce the federal estate tax to zero”), PLR 9143008 (“the amount necessary to reduce the estate tax to zero”), PLR 8346046 (“the smallest amount that will exactly reduce the federal estate tax...to zero”) and PLR 9245021 (approving a self-adjusting disclaimer of “the maximum amount that can pass free of estate tax”). Similar self-adjusting marital deduction gift formula language appears in our marital deduction savings statute, RCW 11.108.040 (“the minimum amount which will cause the least possible amount of federal estate tax to be payable as a result of the testator’s death...”).

Marital deduction gift clauses which define the marital deduction gift (or a QTIP election) by reference to (i) values shown on the estate tax return (but not as finally determined), (ii) values shown on the estate tax return that are not fair market values (such as the special value determined under IRC § 2032A), or (iii) deductions or credits defined by the Internal Revenue Code instead of to the desired amount of estate tax liability, may

continued on next page

from previous page

Formula Marital Deduction Gift Clauses. . .

fail to properly define the desired minimum estate tax and should probably be avoided.

For example, in TAM9327005, a non-self adjusting fractional QTIP election resulted in reduction of the marital deduction (and an unplanned actual increase in estate tax) when asset values were increased in audit. The IRS ruled that the QTIP election would have automatically adjusted to produce the optimum result notwithstanding the increased estate tax values if the taxpayer had simply made the QTIP election applicable to “that portion of the residuary trust necessary to reduce the federal estate tax to zero....” This indicates that a truly self-adjusting optimum marital deduction gift clause will never produce other than the intended optimum result. Cf. *Estate of Allen v. Comm’r*, 101 T.C. No. 23 (1993), and *Estate of Henry Stanley McInnes v. Comm’r*, T.C.M 1992-558 (1992) (a self-adjusting disclaimer was ruled to produce the desired result despite a mistaken assumption about state law allocation of estate taxes and administration expenses).

Optimum Funding Under IRC § 2032A

The usual desired § 2032A optimum result is for the Will to allocate to the surviving spouse not more than the minimum gift necessary to reduce the estate tax as much as possible, and to allocate the balance of the estate to the exemption gift. Thus, the optimum § 2032A result is to fund the exemption gift by the full amount of the § 2032A value reduction. This is accomplished by calculating the gross estate and the marital deduction based on § 2032A values (as is required under *Estate of Evers*, 57 T.C.M. 718 (1989) and in PLR 8422011), but funding the formula marital deduction gift and the exemption gift with assets valued at fair market values (i.e., without regard to the § 2032A valuation reduction). PLR 8943004 provides that even though such funding at fair market values “decreased the amount passing to Trust A (the marital trust) and increased the amount passing to Trust B [the exemption gift trust] (which would benefit the remainder beneficiaries of that trust)...,” no taxable gift by the surviving spouse/executor resulted by her making the § 2032A election.

The presently available authorities indicate that any self-adjusting formula marital deduction clause (without regard to whether it defines a pecuniary or fractional gift) properly drafted to result in the minimum marital deduction gift necessary to reduce the estate taxes as much as possible, results in the maximum funding of the exemption gift with 100% of the amount of the § 2032A valuation reduction. If such a clause is used, *Libeu v. Libeu*, 89-1 USTC 13,796 (Cal Ct. App. 1988), is inapplicable.

Libeu is a case in which some of the § 2032A value reduction was allocated to the fractional marital deduction gift because of a poorly drafted clause, and therefore the optimum result was not

obtained. See Richard B. Covey, Marital Deduction And Credit Shelter Dispositions And The Use Of Formula Provisions U.S. Trust (4th Ed. 1997), pp. 106-107. In connection with a comparison of a *Libeu*-style fractional marital deduction gift (where the denominator is the estate tax value of the residue rather than the fair market value) to a “true-worth” pecuniary marital deduction gift, Mr. Covey concludes that the fractional share § 2032A result is not as desirable and that “the most desirable approach is a marital pecuniary amount bequest and a credit shelter residuary disposition.” *Id.* at 119.

However, the *Libeu* case is sometimes misconstrued to mean that no fractional clause will work well when the § 2032A election is made. *Libeu* does not support such an overly-broad conclusion. The over-funded marital deduction gift in *Libeu* was caused by the Will requiring a larger than optimum fractional marital deduction gift. The Will required the fraction to have a denominator equal to the adjusted gross estate (which is calculated with reference to § 2032A), rather than the fair market value of the residue of the estate on the applicable valuation date (which is not affected by the § 2032A election). This resulted in a larger marital deduction gift fraction than the minimum fraction required to reduce the estate tax to zero. The *Libeu* court described this less-than-optimum result as follows (italicized language added):

Under paragraph 4, the values to be used in the fraction to be applied to determine the “fractional share” of the estate are the values used “in finally settling my estate tax liabilities,” i.e., the values used on decedent’s estate tax return, which included special use valuation of some of the property.... A marital deduction [after excluding the value of assets qualifying for the marital deduction that passed other than by the Will] pursuant to paragraph 4 in the amount of \$14,577 was taken on decedent’s federal estate tax return. Decedent’s adjusted gross estate on the estate tax return was \$474,809. Using these figures, the fraction to be applied to determine “the fractional share” of decedent’s estate under paragraph 4 is:

$$\frac{\$14,577 \text{ marital deduction}}{\$474,809 \text{ adjusted gross estate}} = 3.07 \text{ percent}$$

The fair market value of the residue of the *Libeu* estate on the estate tax valuation date, unaffected by the § 2032A valuation adjustment, was \$819,160, which if used as the denominator of the fraction, would have resulted in the optimum marital deduction gift fractional share percentage of only 1.78% rather than 3.07%. 3.07% of \$819,160 has a value of \$30,309 rather than the optimum marital deduction gift value of \$14,577 shown on the estate tax return. Accordingly, it was simply a defective definition

continued on next page

from previous page

Formula Marital Deduction Gift Clauses. . .

in this particular fractional gift clause, rather than any characteristic common to all fractional clauses, that resulted in the less-than-optimum § 2032A result in *Libeu*.

On the other hand, a properly drafted fractional share clause will produce the optimum § 2032A result. In *Simpson v. U.S.*, 92-2 USTC Par. 60,118 (D.C. N.M.1992), the court upheld the funding of the exemption gift by the full amount of the § 2032A reduction when the marital deduction and exemption gifts were both formula fractional share gifts. The specific self-adjusting fractional marital deduction gift clauses in *Simpson* provided, in part (italicized language and emphasis added):

Trust A shall also include that fraction of separate and community property included in the gross estate of the first Trustor to die and qualifying for the marital deduction of a value....necessary to obtain for his or her estate the maximum [*converted to "the minimum" via a separate "cut-back" clause*] marital deduction allowable....The other trust shall be known as Trust B and shall consist of all other property included in the trust estate.

The *Simpson* court held that funding the marital deduction gift with the assets valued at fair market value rather than the § 2032A value was proper, which resulted in the allocation of 100% of the § 2032A valuation reduction to Trust B:

In funding Trust A at the time of Mr. Simpson's death, the Trustee correctly funded the portion of the marital deduction bequest allocable to the farm-land stock at fair market value rather than special use value.

TAM 8314001 and TAM 8314005 also provide the same result in the case of a fractional clause similar to the *Simpson* clauses. The executor was authorized by the governing instrument to make non-pro rata distributions of non-cash assets to satisfy the fractional shares, and the assets were to be valued at distribution-date values. TAM 8314001 provides that the benefit of the § 2032A value reduction inures to the exemption gift regardless of whether the special use property is actually allocated to the marital deduction gift or to the exemption gift. TAM 8314005 (which was a ruling related to the same fractional clause described in TAM 8314001) indicates that this elective maximum funding of the exemption gift by a discretionary act of the executor would not violate Rev. Proc. 64-19 principles.

The discussion of Rev. Proc. 64-19 principles in TAM 8314005 may give the impression that the marital deduction gift clause to which it related must have been a pecuniary clause (*i.e.*, see the discussion of these two rulings in *Covey*, *supra*, at 117). To the contrary, the Rev. Proc. 64-19 discussion in TAM 8314005 does not support a conclusion that the IRS considered the applicable

gift clause to be a pecuniary rather than a fractional gift clause. The IRS has ruled in other circumstances that Rev. Proc. 64-19 valuation principles apply to fractional share marital deduction gifts that may be satisfied with non-pro rata distributions of non-cash assets. See PLRs 9143018 and 8928004.

Rather, TAM 8314001 unambiguously describes both the marital deduction and exemption gifts as separate "portions" of the residue, and therefore they appear unmistakably to be fractional residuary gifts that share in post-death estate appreciation or depreciation:

After certain specific bequests, the entire residue of the estate passed to an inter vivos trust created by the decedent. Under the terms of the trust, a portion of the residue is to be set aside into a separate trust of which the aggregate value equals the amount of the maximum marital deduction allowable in determining the federal estate tax diminished by the value of property passing to the surviving spouse through specific bequests or outside the will and qualifying for the marital deduction. This separate trust was created in such a way as to qualify for the marital deduction. The remainder of the residue is to be distributed to another separate trust for the benefit of the surviving spouse during her life; then, upon her death, passes to specified heirs. [Emphasis added.]

See *Estate of Smith v. Comm'r*, 565 F2d 455 (7th Cir. 1977), *aff'g*, 66 T.C. 415 (1976), *acq.*, 1982-1 C.B. 1 (marital deduction and exemption gifts expressed as "portions" of the estate were both fractional share gifts), and PLR 8145026 (a gift of "part of my estate" is a fractional rather than a pecuniary gift).

Maximum funding of the exemption gift also resulted in PLR 8509001, where the exemption gift was an optimum formula pecuniary gift to be satisfied with assets valued as of the date of distribution, and the marital deduction gift was the residuary gift. The funding of the marital deduction gift with § 2032A property valued at fair market value on the date of distribution was approved, which resulted in all of the § 2032A valuation reduction inuring to the benefit of the exemption gift in precisely the same manner as the fractional share clauses in *Simpson* and TAMs 8314001 and 8314005.

Conversely, unintentional over-funding of the marital deduction gift and under-funding of the exemption gift can occur when an "estate tax value" pecuniary clause is used in conjunction with the § 2032A election. In PLR 8708001, a literal interpretation of a "fairly representative" formula pecuniary clause that required funding at "values as finally determined for estate tax purposes" (the § 2032A value) would have required overfunding of the marital deduction gift and under-funding of the exemption gift when § 2032A property was used to satisfy that gift, had not the IRS fortunately ruled that other language in the Will indicating a

continued on next page

from previous page

Formula Marital Deduction Gift Clauses. . .

clear intention to achieve the optimum § 2032A result overcame the literal interpretation. Thus, the “fairly representative” and “minimum value” pecuniary clauses are the defective pecuniary counterparts to the defective *Libeu* “estate tax value” fractional clause when a § 2032A election is made and the § 2032A property is used to fund the marital deduction gift.

In short, none of these cases or rulings support a conclusion that a properly drafted pecuniary marital deduction gift clause yields a better or different § 2032A result than a properly drafted fractional clause. Rather, they only indicate that any formula clause that incorporates estate tax values, instead of fair market values, into the funding provision or the definition of the denominator of the applicable fraction may fail to produce the optimum § 2032A result.

Examples

To illustrate the principles described above, consider the following four alternative marital deduction gift clauses, all of which are used in conjunction with a residuary exemption gift:

Clause A (“true-worth” pecuniary): “...the minimum amount necessary to reduce the combined state and federal estate taxes as much as possible, to be satisfied with assets valued as of the distribution date.”

Clause B (“fair market value” fractional): “...the minimum fraction of the residue of my estate necessary to reduce the combined state and federal estate taxes as much as possible, to be satisfied with assets valued as of the distribution date.”

Clause C (“estate tax value” fractional): “...a fraction of the residue of my estate, the numerator of which is the minimum amount necessary to reduce the combined state and federal estate taxes as much as possible, and the denominator of which is the federal estate tax value of my residuary estate, to be satisfied with assets valued as of the distribution date.”

Clause D (“fairly representative” pecuniary): “...the minimum amount necessary to reduce the combined state and federal estate taxes as much as possible, to be satisfied with assets valued as finally determined for estate tax purposes, the aggregate fair market value of which is fairly representative of the appreciation or depreciation in the estate.”

1. No Post-Death Appreciation; No § 2032A Election.

Assume a 1997 estate is comprised only of an interest in a family farm, with the interest of the first-to-die spouse having a fair market value of \$1,500,000 on the date of death, but with a § 2032A value of \$1,000,000. Assume further that the estate has an unused exemption equivalent of \$600,000, no other credits or

allowable deductions other than the marital deduction, and that the estate still has a fair market value of \$1,500,000 at the date of distribution. If no § 2032A election is made, all four clauses result in the same distribution in satisfaction of the marital deduction and exemption gifts, since the Clause A and D pecuniary marital deduction gifts (\$900,000) equal the Clause B and C fractional marital deduction gifts (\$900,000/\$1,500,000 times \$1,500,000):

	Clause A	Clause B	Clause C	Clause D
Adjusted Gross Estate:	\$1,500,000	\$1,500,000	\$1,500,000	\$1,500,000
Optimum Marital Ded. \$	900,000	\$ 900,000	\$ 900,000	\$ 900,000
To Spouse	\$ 900,000	\$ 900,000	\$ 900,000	\$ 900,000
To Exemption Gift:	\$ 600,000	\$ 600,000	\$ 600,000	\$ 600,000
Total Value Distributed:	\$1,500,000	\$1,500,000	\$1,500,000	\$1,500,000
Gain On Funding:	n/a	n/a	n/a	n/a

2. No Post-Death Appreciation; § 2032A Election Is Made.

If the § 2032A election is made, the same distribution in satisfaction of the marital and maximum-funded exemption gift results under clauses A and B, since the Clause A pecuniary marital deduction gift (\$400,000) equals the Clause B fractional marital deduction gift (\$400,000/\$1,500,000 times \$1,500,000). \$1,100,000 of value, instead of \$600,000, is distributed to the exemption gift under both clauses A and B (the full \$500,000 value of the § 2032A reduction goes to the exemption gift, thereby achieving the optimum result).

However, the Clause C “estate tax value” fractional (\$400,000/\$1,250,000 times \$1,500,000) results in the unnecessary over-funding of the marital deduction gift (and under-funding of the exemption gift) by \$200,000, which is due solely to the defective definition of the denominator of the fraction. Similarly, the Clause D “fairly representative” pecuniary clause produces the same undesirable result as Clause C since the property used to satisfy the marital deduction gift must be credited at its § 2032A estate tax value instead of its fair market value:

	Clause A	Clause B	Clause C	Clause D
Adjusted Gross Estate:	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Optimum Marital Ded. \$	400,000	\$ 400,000	\$ 400,000	\$ 400,000
To Spouse	\$ 400,000	\$ 400,000	\$ 600,000	\$ 600,000
To Exemption Gift:	\$1,100,000	\$1,100,000	\$ 900,000	\$ 900,000
Total Value Distributed:	\$1,500,000	\$1,500,000	\$1,500,000	\$1,500,000
Gain On Funding:	n/a	n/a	n/a	n/a

Thus, assuming no actual appreciation in the fair market value of the farm between the date of death and date of distribution, there is again no difference in the optimum result obtained by the Clause A “true-worth” pecuniary marital clause and the Clause B “fair market value” fractional clause. Per IRC § 1040(a), no gain or loss results by funding the Clause A pecuniary marital

continued on next page

from previous page

Formula Marital Deduction Gift Clauses. . .

deduction gift with the specially-valued property in this circumstance.

3. \$250,000 Of Post-Death Appreciation; § 2032A Election Is Made. Assume that the fair market value of the estate’s interest in the farm increases \$300,000 (from \$1,500,000 to \$1,800,000) by the date of distribution, and that the § 2032A election is made.

This circumstance illustrates the marital deduction gift “freeze” aspect of the Clause A “true-worth” pecuniary clause, in that the full \$300,000 of post-death appreciation is allocated to the exemption gift, per Rev. Rul. 90-3 and PLR 8928004. In contrast, the \$300,000 of appreciation must be shared ratably by the marital deduction gift and exemption gift under the Clause B and Clause C fractional clauses per Rev. Rul. 60-87 and Rev. Rul. 56-270, and the Clause D “fairly representative” pecuniary per Rev. Proc. 64-19 and PLR 9143018.

Although the marital deduction gift freeze shown in this hypothetical may produce an estate tax benefit at the death of the surviving spouse, it results independently from the § 2032A election, and at the cost of triggering unplanned taxable gain when the marital deduction gift is funded. \$400,000/\$1,800,000 times \$300,000 of appreciation equals \$66,667 of gain (and \$13,333 of tax at 20%) upon funding the Clause A marital deduction gift.

When compared to Clause B, the Clause C “estate tax value” fractional marital deduction gift formula (\$400,000/\$1,250,000 times \$1,800,000), and the Clause D “fairly representative” pecuniary (requiring the distribution in satisfaction of the marital gift to be credited at the § 2032A estate tax value) each unnecessarily over-fund the marital deduction gift by \$240,000:

	Clause A	Clause B	Clause C	Clause D
Adjusted Gross Estate:	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Optimum Marital Ded.	\$ 400,000	\$ 400,000	\$ 400,000	\$ 400,000
To Spouse	\$ 400,000	\$ 480,000	\$ 720,000	\$ 720,000
To Exemption Gift:	\$1,400,000	\$1,320,000	\$1,080,000	\$1,080,000
Total Value Distributed:	\$1,800,000	\$1,800,000	\$1,800,000	\$1,800,000
Gain On Funding:	\$ 66,667	n/a	n/a	n/a
Income Tax @ 20%	\$ 13,333			



clause coupled with a residuary exemption gift was the only way to achieve the optimum § 2032A result. Mr. Covey said he merely meant to convey that he was confident it could be achieved with that form of clause. He saw no reason why a properly drafted “fair market value” fractional marital deduction gift clause as described above (which does not contain the defective *Libeu* language and which authorizes non-pro rata distributions valued as of the date or dates of distribution) cannot generally be used with the § 2032A election just as effectively and advantageously as can a pecuniary marital deduction gift clause.

Pecuniary and fractional gift clauses may have different characteristics relating to the allocation of post-death appreciation or depreciation between the marital deduction gift and exemption gift, and to the recognition of gain upon distribution of estate assets. However, there is no authority or persuasive logic to suggest that the presence of potential § 2032A property in a client’s estate makes a pecuniary clause more appropriate than a fractional clause.

Rather, the *Libeu* case and PLR 8708001 indicate that if potential § 2032A property is in the client’s estate, only the “fair market value” fractional clause (or perhaps the “true-worth” pecuniary, subject to the risk of triggering unplanned taxable gain on funding) should be used in that client’s Will. All three “estate tax value” formula clauses (the “estate tax value” fractional, the “minimum value” pecuniary and the “fairly representative” pecuniary) should be avoided. If the § 2032A election is later made, defining the denominator of the applicable marital deduction gift fraction or the pecuniary gift funding clause with reference to “estate tax values,” “values as finally determined for estate tax purposes,” “the adjusted gross estate” or similar language, may needlessly overfund the marital deduction gift, and may possibly waste much of the benefit of the § 2032A valuation reduction.

Conclusion

In telephone conversations with Richard Covey in September 1995 and again in September 1998, in response to a letter inquiring whether Mr. Covey intended the previously described discussion at page 119 of his book to mean that a pecuniary marital deduction gift clause is generally more advantageous or appropriate when used in connection with § 2032A property than are all fractional share clauses, he indicated that it was not his intention to suggest that a pecuniary marital deduction gift

Recent Developments

Probate and Trust

Kari M. Larson, University of Washington School of Law (J.D. expected June 1999)
Wendy S. Goffe, Bogle & Gates P.L.L.C., Seattle

WASHINGTON COURT OF APPEALS

Toulouse v. Island County Bd. of Comm'rs, 89 Wn. App. 525, 949 P.2d 829 (Div. I 1998)

Summary: Real property acquired from a decedent is exempt from plat approval requirements, but this exemption is limited to property divisions that can be accomplished without the joint action of other co-tenants and where the property was acquired solely by testamentary transfer.

Facts: Mr. and Mrs. Toulouse each owned an undivided one-fourth interest in property at Mrs. Toulouse's death. The remaining undivided one-half interest was owned by an unrelated couple. Upon Mrs. Toulouse's death, she devised her interest to her husband as trustee for the benefit of her five children. The trust provided for the termination of the trust and the outright distribution of the property to her children upon the youngest reaching age 30. Mr. Toulouse then conveyed his own undivided one-fourth interest to his children. The children then purchased the remaining undivided one-half interest. When the youngest son turned 30, the property was surveyed, and the trust's interest was allocated to a 2.5 acre portion, which Mr. Toulouse attempted to quit claim to each of the children in five separate .5 acre parcels. The remaining 7.5 acres were allocated to a separate parcel. Mr. Toulouse attempted to record the deeds conveying the five separate .5 acre parcels but Island County challenged the validity of the testamentary division of the property. He then filed a declaratory judgment action arguing the division of the trust's interest was valid, and the superior court granted summary judgment to Island County. Mr. Toulouse appealed. The Court of Appeals upheld the superior court.

Discussion: RCW § 58.17.030 requires that all subdivisions of property must comply with plat requirements before any division may be recorded. However, RCW § 58.17.040(3) exempts divisions made by testamentary provisions, or the laws of descent. The Court of Appeals determined that this exemption does not apply where a co-tenant's consent is required in order to accomplish the division. In this instance, the only way that the trust's interest in the property could have been converted into six separate parcels—the five .5 acre parcels deeded to the children and the sixth 7.5 acre parcel—was by the joint action of all co-tenants. Because the joint action of all co-tenants is required to divide such property, the division is beyond the scope of the RCW § 58.17.040(3) exemption and thus must comply with the requirements of RCW § 58.17.030.

Erlenbach v. Estate of Thompson, 90 Wn. App. 847, 954 P.2d 350 (Div. I 1998)

Summary: Where an inter vivos trust provided that upon trustor's death the trust property would pass to two beneficiaries or the survivor of them, and the trustor has stricken an alternative provision that the property pass by representation, the survivorship language in the trust precludes application of the anti-lapse statute.

Facts: Ms. Thompson died in 1982. Prior to her death, she signed a pre-printed inter vivos trust form designating herself as trustee and her two sons as beneficiaries. On the trust document, Ms. Thompson crossed out "per stirpes" and initialed it, leaving the survivorship language intact. One son, Melvin, predeceased Ms. Thompson, and upon Ms. Thompson's death, the other son, Christopher, transferred the trust property to himself and held it without challenge until his death. Christopher's estate was admitted to probate in 1995. Melissa, Melvin's daughter, brought a quiet title action against the estate, alleging that the per stirpes language that had been stricken applied, and that she was entitled to a one-half interest in the trust property as Melvin's daughter. Both parties moved for summary judgment. The trial court agreed with Melissa, finding that the trust document was ambiguous and that the anti-lapse statute applied. The estate appealed and the Court of Appeals reversed the trial court, finding in favor of Christopher's estate.

Discussion: The Court of Appeals examined the trust agreement to determine whether Melvin's gift lapsed when he predeceased Ms. Thompson, or whether there was an alternate disposition provided for in the trust. The appellate court found the trust agreement valid and that it clearly and unambiguously intended the principal of the trust to pass to the survivor of the two sons and not per stirpes. The court indicated that there is a presumption in favor of the operation of the anti-lapse statute (RCW 11.12.110). Generally, when a testator does not provide an alternative in the event that a related beneficiary predeceases the testator, the anti-lapse statute acts to give descendants of that related beneficiary a share equal to what they would have received had the beneficiary been living at the time of the testator's death. However, the court reasoned that in cases such as this one, where the testator clearly indicates by words of survivorship that the beneficiary shall take the gift only if he or she survives the testator, the anti-lapse statute does not apply.

continued on next page

from previous page

Recent Developments: Probate and Trust

Furthermore, because Ms. Thompson took the additional step of crossing out a potential “per stirpes” (or by representation) distribution of the gift, her intent was clear that she did not intend for her gift to extend beyond her two sons.

Estate of Marks, 90 Wn. App. 1011, 957 P.2d 235 (Div. III 1998)

Summary: A nonlawyer who assists another in the preparation of a will is engaging in the unauthorized practice of law and, unless the person providing the assistance is a relative, he or she is precluded from inheriting under the will.

Facts: Diana Marks received assistance in preparing her Will from her friends, Eldon and Judith Blanford. The Blanford and a religious organization controlled by them were substantial beneficiaries under that Will. Mr. Blanford was also named as personal representative. The Will named some of Ms. Marks’ family members, except for her estranged brother, Hartwell Marks. After the Will was admitted to probate, Hartwell Marks filed a petition contesting the validity of the Will and seeking an order appointing himself as personal representative. At trial, two main issues were addressed: Whether the Will was a product of undue influence and fraud; and whether the Blanford had engaged in the unauthorized practice of law. The trial court determined that the Will was not a product of undue influence and fraud, but that the Blanford had engaged in the unauthorized practice of law. Further, the court removed Mr. Blanford as personal representative and ruled that the Blanford and their church should be divested of their bequests. Hartwell Marks appealed the finding that the Will was not the product of undue influence.

Discussion: Undue influence exists when influence overcomes the will of the testator, and the act of making the Will is the result of such coercion. Not all influence rises to the level of undue influence. The Court of Appeals determined that while the Blanford gave advice and were influential in Ms. Marks’ life, she had not been unduly influenced in the creation of her Will. With respect to the unlawful practice of law issue, the appellate court confirmed that the rules regulating the conduct of lawyers apply also to lay people who engage in the practice of law. Furthermore, the Rules of Professional Conduct generally prohibit a lawyer from preparing an instrument giving the lawyer or a related person a gift from the client. Thus, the court determined that the bequests to the Blanford were properly divested.

In re Estate of Toth, 91 Wn. App. 204, 955 P.2d 856 (Div. III 1998)

Summary: The statutory time period within which a will contest may be brought can be extended by three days under Civil Rule 6(e), which permits a three day extension of certain limitation periods when service occurs by mail.

Facts: Bela Toth died testate in 1995. His Will was admitted to probate on June 16, 1995. His personal representative, Mr. Cooke, sent notice of probate to Mr. Toth’s legatees, including the plaintiffs. On October 19, 1995, the plaintiffs filed a *pro se* petition in a separate matter asserting that Mr. Toth was not competent when the Will was signed and that the Will was a result of fraud, lack of capacity and undue influence, and therefore, an older Will was valid. Mr. Cooke moved to dismiss the petition under CR 12(b)(6). He alleged the petition violated the four-month statute of limitations pursuant to RCW § 11.24.010. The trial court granted Mr. Cooke’s motion, and the plaintiffs appealed.

Discussion: Any interested person may file a will contest, if the petition is filed within four months of the will being admitted to probate. RCW § 11.24.010. CR 6(e) provides that when a party may take some action within a certain period “after the service of a notice . . . and the notice or paper is served upon him by mail, 3 days shall be added to the prescribed period.” The appellants conceded that the four-month period begins to run when the Will is filed, not when notice is given. Nevertheless, they argued that because notice was given by mail, the four-month period should be extended. The Court of Appeals agreed. CR 1 requires the court rules to be construed so that they “secure the just, speedy, and inexpensive determination of every action.” The court reasoned that extension of the four-month period by three days because notice was sent by mail does not appreciably affect the speedy resolution of probate and does allow a legitimate dispute to reach the court. Therefore, the Court held that the appellants’ petition was timely.

King v. Marshall, 89 Wn. App. 746, 946 P.2d 1200 (Div. III 1997)

Summary: Under former RCW § 11.40.011 and RCW § 11.40.060, if a tort claimant presented an estate with a claim within the statutory time limitation of actions on that claim, then even where the estate denies the claim after the limitation period applicable to that claim has expired, the claimant still has 30 days to file an action against the estate.

Facts: In 1990, Mr. King and Ms. Candler were involved in a car accident. Mr. King sustained serious injuries. Ms. Candler died of her injuries. One day prior to the running of the applicable three-year statute of limitations, Mr. King filed a claim with Ms. Candler’s estate. The claim was limited to the amount of liability insurance carried by Ms. Candler. The personal representative of Ms. Candler’s estate rejected the claim and Mr. King filed this lawsuit. The personal representative moved for summary judgment, contending that the statute of limitations had run. Mr. King filed a cross motion for summary judgment, contending that the statute of limitations had not run. The court granted the personal representative’s motion. Mr. Marshall appealed the court’s order granting the personal representative summary judgment. The Court of Appeals reversed the trial court.

continued on next page

from previous page

Recent Developments: Probate and Trust

Discussion: The applicable statute of limitations case was three years. The plaintiff filed his claim one day prior to the expiration of the three-year period. Where a personal representative rejects a claim, as he did in this case, the claimant must file a lawsuit on that claim within 30 days of the notice of rejection. Based upon the facts, the Appellate Court ruled that the filing of Mr. Marshall's lawsuit in this case was timely. The personal representative contended that the lawsuit must also be filed within the three year statute of limitations period. The court rejected this argument, because the applicable statutes were clear on their face and not subject to judicial interpretation.

In re Estate of Tolson, 89 Wn. App. 21, 947 P.2d 1242 (Div. II 1997)

Summary: An order of the California court determining that the decedent was domiciled in California at time of his death was entitled to full faith and credit in subsequent probate proceedings brought by a personal representative in Washington probate proceedings.

Facts: Jack Tolson died in Washington in 1993. His daughters filed a petition to probate his holographic Will in California, which was granted in early 1994. That Will left two percent of the estate to the Decedent's son, and the remainder to his two daughters and granddaughter. In the meantime, the son instituted intestacy proceedings in Clark County, Washington, and Letters of Administration were issued to him in July of 1994. Then one of the Decedent's daughters sought admission of the holographic Will to probate as a foreign will in Washington in August of 1994. The Washington court admitted the Will. In the meantime, the California administrator petitioned the California court to

determine the Decedent's domicile, which the California court subsequently determined to have been California. Back in Washington, the Decedent's son filed a petition to determine the validity of the holographic Will. The Washington court ruled that the issue of the Decedent's domicile could be raised again in the Washington probate, determined that Decedent had been domiciled in Washington, and revoked admission of the foreign Will into probate in Washington. The daughters and granddaughter appealed the trial court's ruling, arguing that the trial court in Washington erred in refusing to give collateral estoppel effect to the California judgment. The Court of Appeals agreed with the daughters and granddaughter, and reversed its determination.

Discussion: The Court of Appeals first determined that the Full Faith and Credit Clause of the U.S. Constitution applies to a judgment determining jurisdictional facts, such as place of domicile, where the rendering court has probate jurisdiction. However, enforcement of a judgment under the Full Faith and Credit Clause can be challenged by a showing that the court rendering judgment lacked jurisdiction, and if the jurisdictional question has been litigated in the rendering court, principles of res judicata preclude relitigation. Thus, because the California superior court had jurisdiction to determine the Decedent's domicile, and to admit the Will to probate, the California order is entitled to full faith and credit in Washington. The Court of Appeals then examined each of the four elements of collateral estoppel, and determined that the trial court had erred in failing to give collateral estoppel effect to the California trial court's determination of domicile. Thus the Decedent's son was estopped from relitigating the California court's determination of California domicile in a Washington court.



Join Us Today!

The officers of the Real Property, Probate & Trust Section urge you to become an active member of this important Section. All members of the Washington State Bar Association are eligible. Simply fill out the coupon below and mail with check for \$15 to: **Real Property, Probate & Trust Section, Attn: Sheri Borgford, Washington State Bar Association, 2101 Fourth Avenue - Fourth Floor, Seattle, WA 98121-2330**

RPPT SECTION MEMBERSHIP FORM

Name _____
 Firm _____
 Address _____
 City _____
 State _____ Zip _____

- Please enroll me as an active member of the Real Property, Probate & Trust Section. My \$15 annual dues are enclosed.
- I am not a member of the Washington State Bar, but I want to receive your informational newsletter. My \$15 is enclosed.

Send this coupon with check to:

Real Property, Probate & Trust Section
 Attn: Sheri Borgford
 Washington State Bar Association
 2101 Fourth Avenue - Fourth Floor
 Seattle, WA 98121-2330

office use only

Date _____
 Check # _____
 Total \$ _____

Recent Developments

Real Property

Mark C. Griffin, Graham & Dunn, P. C., Seattle

WASHINGTON SUPREME COURT

Millay v. Cam, 135 Wn.2d 193, 955 P.2d 791 (1998)

Facts: Several interest holders in property sold under execution made multiple redemptions of the property. Cam asserted an interest senior to that of a prior purchaser and redeemed the property from that prior purchaser. Millay then redeemed from Cam. Cam, in turn, redeemed the property from Millay. Millay then attempted a second redemption from Cam and, in connection with the second redemption, requested a payoff statement and accounting from Cam. Cam provided the sheriff with a statement of the sum required to redeem the property in a document in which Cam purported to be the assignee of various other senior interests in the property. Millay believed Cam had inflated the sum required to redeem the property and filed a declaratory judgment action to establish the precise sum required to redeem. The trial court initially ruled in favor of Millay, holding that Cam was required to submit documentation verifying the sum required for redemption. The trial court also initially concluded Millay's declaratory judgment action was the equivalent of paying the sum required to redeem the property. Upon reconsideration, however, the trial court reversed itself by holding that redemption requires payment and that Millay bore the burden of determining the sum required to redeem and actually paying that amount. The trial court also held that the filing of a declaratory judgment shortly before the redemption period was to expire does not toll the running of the redemption period. The Court of Appeals affirmed the trial court's latter decision.

Holding: The Supreme Court reversed the Court of Appeal's decision. It ruled that the filing of a declaratory judgment action without paying the sum required to redeem the property does not toll the running of the redemption period or obviate the requirement that the redemptioner pay the sum required to redeem. The Court cited three reasons for this ruling. First, it noted that the statute expressly requires payment of the sum required to redeem. Second, the court reasoned that the scheme of the redemption statute "indicates the legislature intentionally omitted a pre-redemption procedure for determining the sum required." Third, the court explained that to permit a prospective redemptioner to file a declaratory judgment action instead of paying the sum required to redeem would allow unqualified purchasers to file actions to toll the redemption period to obtain financing and in the process would undermine "a well-settled preference for finality in land title." Millay argued that he had substantially complied with the statutory redemption requirements. The Supreme Court rejected that argument and found that the substantial compliance

doctrine applies only to statutes remedial in nature and that the statutory redemption requirements were not remedial. The Supreme Court did hold, however, that while Millay failed to pay the sum required to redeem and that substantial compliance with the statutory requirements does not suffice to effect a redemption, "the statutory redemption period may be equitably tolled when the redemptioner-in-possession submits a grossly exaggerated statement of a sum required to redeem and a prospective redemptioner cannot with due diligence ascertain the sum required to redeem within the time remaining."

Tiegs v. Watts, 135 Wn.2d 1, 954 P.2d 877 (1998)

Facts: Boise Cascade operated a paper and pulp mill with a discharge permit to emit certain pollutants into the nearby Columbia River. Watts leased farmland to Tiegs and Olberding that was located adjacent to the Boise Cascade mill. The lease was contingent on Watts supplying water to Tiegs and Olberding and granted them options to lease certain other farmland owned by Watts. The leases were not properly acknowledged. Tiegs and Olberding had a low crop yield that apparently was damaged by herbicides found in the water. Boise Cascade purchased the leased farmland from Watts and agreed to assume any liability Watts might have under the farm leases to Tiegs and Olberding. Tiegs and Olberding filed suit against Watts for breach of contract for failing to provide adequate water free of pollutants and contaminants and against Boise Cascade for polluting the water. After filing the suit, Tiegs and Olberding sent a letter to Boise Cascade notifying Boise that they wanted to exercise their option to lease the additional farmland. Boise Cascade responded by terminating Tiegs and Olberding's option. The trial court found for Tiegs and Olberding. The Court of Appeals affirmed the judgment holding, (i) that Boise Cascade's discharge of pollutants into the groundwater was an actionable nuisance, (ii) that a lease may be enforced without acknowledgement, (iii) that the risk that the groundwater would be contaminated was a risk borne by Watts such that Tiegs and Olberding could seek damages for the loss of the lease option, and (iv) that future lost profits were an appropriate measure of damages for the loss of the option.

Holding: The Supreme Court affirmed the Court of Appeals' decision. It first ruled that a party operating under a discharge permit issued by the State is not immune from liability for damages under a *nuisance per se* theory solely on the basis of having a valid discharge permit, if that party's discharge injures another party's property. The court found that a jury should

continued on next page

from previous page

Recent Developments: Real Property

decide whether one landowner's authorized discharge of contaminants or pollutants in fact caused damages to an adjoining landowner's property. The Supreme Court also held that an unacknowledged lease may be enforceable, notwithstanding the statute of frauds, on the basis of equity and part performance where the lessee pays the rent and takes possession, and the parties otherwise conduct their business according to the terms of the lease. Additionally, the Supreme Court held that lost profits are an appropriate measure of damage when "(i) they are within the contemplation of the parties at the time the contract was entered, (ii) they are the proximate result of defendant's breach, and (iii) they are proven with reasonable certainty."

Wilson Court Limited Partnership v. Tony Maroni's, Inc., 134 Wn.2d 692, 952 P.2d 590 (1998)

Facts: Wilson leased commercial space to Tony Maroni's. Anthony Riviera signed the lease as president of Tony Maroni's. Contemporaneously with the execution of the lease, Riviera executed a guaranty agreement and, in doing so, wrote the title "president" after his name. The guaranty was incorporated by reference into the lease. Shortly after execution of the lease, Tony Maroni's sought federal bankruptcy protection. Tony Maroni's assigned the lease to M&R Foods. M&R defaulted on the lease. Wilson then filed suit against Tony Maroni's, M&R, and Riviera, seeking a writ of restitution in damages. The trial court granted Wilson's writ of restitution. Wilson then moved for summary judgment against M&R for damages resulting from breach of the lease and against Riviera personally on the guaranty. Riviera also moved for summary judgment asserting that he was not personally liable on the guaranty, because he signed only in his capacity as president of Tony Maroni's. The trial court granted summary judgment to Wilson and the Court of Appeals affirmed this decision.

Holding: The Supreme Court upheld the Court of Appeals' decision. It found that a commercially reasonable construction of the guaranty compelled a decision holding Riviera personally liable under the guaranty. The Supreme Court reasoned that while the guaranty did not clearly specify the party to be bound, because the text of the guaranty referred only to the "undersigned" or "guarantor," the ambiguity in the guaranty was created by Riviera, and as such, should be construed against him as the party who drafted the language. The court also acknowledged that the very nature of a guaranty is such that Riviera created personal liability by his signature.

— WASHINGTON COURT OF APPEALS —

Pearson v. Gray, 90 Wn. App. 911, 954 P.2d 343 (Div. I 1998)

Facts: Pearson and Rauls received a loan from Gray. At closing on the loan, Rauls executed a quitclaim deed to Gray conveying a home quitclaimed to her earlier by Pearson, and both Pearson and Rauls executed a document entitled "Addendum/Amendment to Purchase and Sale Agreement." Pearson and Rauls defaulted on the loan by failing to timely make the payments required by the Addendum. Gray then recorded the quitclaim deed and filed an unlawful detainer action and writ of restitution. Pearson and Rauls responded by filing an action to quiet title for fraud and unjust enrichment. Gray then moved for summary judgment in the quiet title action, contending that neither Pearson nor Rauls had standing because they had quitclaimed their interest in the disputed property. The trial court granted Gray's summary judgment motion, ruling that neither Pearson nor Rauls in fact had standing to quiet title. The trial court also granted a writ of restitution to Gray for unpaid rent, late fees, and attorneys' fees.

Holding: The Court of Appeals overturned the trial court's ruling. The Court of Appeals agreed that an action to quiet title requires standing by a real party in interest, but concluded that a quitclaim deed alone is not dispositive of a grantor's intent to convey absolute title to property to another. Several facts persuaded the Court of Appeals that the parties intended to convey an equitable mortgage of, rather than absolute title to, the property. These facts included Addendum provisions providing that payments under the Addendum were to be secured with a deed of trust that would be returned upon full payment of the Addendum obligations. The parties had also deleted language requiring Pearson to vacate the property should she fail to make timely payments and replaced it with language requiring the payment of late fees. Although the Court of Appeals did not rule on whether an equitable mortgage was in fact created, the court concluded that these facts did give rise to a genuine issue of material fact such that the trial court should have denied Gray's summary judgment motion. The Court of Appeals also ruled the establishment of ownership to the property in the quiet title action necessarily presupposes a proper resolution of the unlawful detainer and writ of restitution actions.

Sullivan v. Purvis, 90 Wn.App. 456, ___P.2d___ (Div. III 1998)

Facts: Sullivan, a residential landlord, filed an unlawful detainer action against his tenant, Purvis, after Purvis retained occupancy of the leased premises after receiving a 30-day termination notice for violation of the terms of the lease. The trial court granted Sullivan's petition for a writ of restitution.

continued on next page

from previous page

Recent Developments: Real Property

Holding: The Court of Appeals reversed the trial court's decision. The Court of Appeals held that the trial court lacked subject matter jurisdiction to order the tenant to vacate the premises because, in an action for unlawful detainer based on breach of a covenant, the Residential Landlord Tenant Act (the "Act") requires the landlord to send the tenant a notice giving the tenant the alternative of performing the covenant or surrendering the premises. Sullivan argued that numerous written notices of non-compliance provided Purvis with more than ample notice of the breach which satisfied the statutory notice requirement. The Court of Appeals rejected this argument and held that residential landlords must strictly comply with the terms of the Act.

Steury v. Johnson, 90 Wn.App. 401, 957 P.2d 772 (Div. III 1998)

Facts: Johnson owned a lot burdened by an access easement along its eastern boundary in favor of Steury and several other landowners to the south. Johnson erected posts and a cable gate at the northern end of the easement entrance to limit increased public traffic on the access road. Johnson gave keys to the gate to Steury and the other owners benefited by the access road. Steury filed an action to quiet title to the access easement and to obtain a permanent injunction to prevent Johnson from gating the access road. The trial court granted summary judgment in favor of Steury and permanently enjoined Johnson from erecting any barriers to the entrance of the easement.

Holding: The Court of Appeals reversed the trial court's order. The Court of Appeals found that the intention of the original parties to the easement controls whether or not an owner of a servient estate may lawfully gate the entrance to an access easement. If the easement is ambiguous or silent regarding certain issues, such as obstructions, the situation of the property, the parties, and the surrounding circumstances must be analyzed. The Court of Appeals held that in granting Steury's summary judgment motion, the trial court failed to do this. The Court of Appeals also held that servient owners may lawfully impose reasonable restraints on access easements to avert a burden on the servient estate greater than that originally contemplated. The court stated that whether the restraints imposed by a servient owner are in fact reasonable is a factual determination based on the change in the circumstances of the easement and the balancing of the servient owner's burden with the dominant owner's inconvenience. Again, the Court of Appeals found that in granting the summary judgment motion, the trial court failed to weigh the relative burdens on the dominant and servient estates, and had the trial court done so, it may have concluded that the gate was a reasonable restraint. The Court of Appeals found persuasive the fact that two other dominant owners provided declarations stating that the gate dramatically reduced the traffic, noise, and litter caused by public use of the access road.

Pacific Northwest Group A v. Pizza Blends, Inc., 90 Wn.App. 273, 951 P.2d 826 (Div. I 1998)

Facts: Pacific Northwest Group A (PNGA) leased commercial space to Pizza Blends. The lease provided for a monthly holdover rental rate of 1.5 times the term rental rate and prohibited oral modifications. Pizza Blends continued in occupancy of the leased space after the lease term had expired. PNGA filed an action to recover past rent and associated late fees. Pizza Blends contended that PNGA had orally agreed to a holdover rate equal to the rental rate applicable during the term. The trial court granted summary judgment to PNGA.

Holding: The Court of Appeals reversed the trial court's judgment. It held that lease provisions prohibiting oral modification are unenforceable, explaining that "a paradox of common law is that a contract prohibiting oral modifications is essentially unenforceable because the clause itself is subject to oral modification." The Court of Appeals stated that long-standing Washington precedent is in accord with this common law paradox, and that while the state legislature has changed the common law rule in limited circumstances (such as in contracts involving the sale and lease of goods), the legislature has not abolished the rule in all circumstances, which suggests that the legislature intended the rule to remain applicable in other cases. The Court of Appeals found that there was reasonable evidence to suggest that the parties may have orally agreed to modify the lease, and that Pizza Blends raised a question of material fact as to whether PNGA was estopped from collecting the holdover rent. Therefore, the Court of Appeals found that summary judgment was not appropriate.

Manufactured Housing Communities of Washington v. State, 90 Wn. App. 257, 951 P.2d 1142 (Div. II 1998)

Facts: Manufactured Housing Communities of Washington (MHCW) challenged the constitutionality of RCW 59.23, The Mobile Home Parks-Resident Ownership Act (the "Act"), which grants mobile home park residents a right of first refusal to purchase the park if the park owner decides to sell. The MHCW contended that the Act allows the taking of property without just compensation under both the state and federal constitutions. The trial court dismissed the MHCW's suit.

Holding: The Court of Appeals affirmed the trial court's decision. The MHCW argued that the state constitution extends greater protection than the federal constitution in the area of regulatory takings, relying on six factors set forth by the Supreme Court in *State v. Gunwall, 106 Wn.2d 54, 720 P.2d 808(1986)*. Those factors are (i) the textual language of the state constitutional provision, (ii) differences in the parallel text of the state and federal constitutions, (iii) the history of the state constitution and the common law, (iv) pre-existing state law, (v) structural differences between the state and federal constitutions, and (vi)

continued on next page

from previous page

Recent Developments: Real Property

whether the state constitutional provision addresses a subject matter that is a particular state interest or local concern. The Court of Appeals ruled that all the *Gunwall* factors favor a co-extensive interpretation of the state and federal constitutions in the area of regulatory takings. The MHCW also argued that the Act was facially unconstitutional because it destroys certain fundamental property rights, including the right to sell property, exclude others and close on a sale immediately. The Court of Appeals held, however, that the Act constitutes a legitimate legislative interest in assuring suitable housing for state residents.

***Mastro v. Kumakichi Corp.*, 90 Wn. App.157, 951 P.2d 817 (Div. I 1998)**

Facts: Mastro purchased a parcel of property from the Kumakichi Corporation, taking title by a statutory warranty deed. An adjoining landowner filed a quiet title action based on adverse possession against Mastro for a portion of property on which it encroached. Mastro notified Kumakichi of the quiet title action and requested that Kumakichi defend the action on his behalf. Kumakichi failed to reply to Mastro's request. Mastro later settled the quiet title action in favor of the adjoining land owner without notifying Kumakichi. Mastro sought damages for breach of the warranty deed covenants, alleging that Kumakichi knew of the encroachment by the adjoining landowner at the time Kumakichi executed and delivered the deed and that Kumakichi later failed to defend his title. The trial court entered a judgment in favor of Mastro.

Holding: The Court of Appeals affirmed the trial court's judgment. It ruled that the Kumakichi breached both a present and a future covenant of the warranty deed. Kumakichi breached the present covenant of seisin in conveying property that was subject to an adverse possession claim by the adjoining landowner. The Court of Appeals found that this breach occurred without regard to whether the adjoining landowner's adverse possession claim was rightful or wrongful. The Court of Appeals also found Kumakichi breached the future warranty to defend Mastro's title in failing to defend Mastro in the quiet title action filed by the adjoining landowner after Mastro's tender of defense. The Court noted, however, the breach of the warranty deed covenants must be the proximate cause of the plaintiff's damage. In this case, the Court of Appeals found Kumakichi's breach was the proximate cause of Mastro's damages and that Mastro did not waive or impair his claim against Kumakichi when he settled the quiet title action with the neighboring landowner without notifying Kumakichi. Because it appeared likely that Mastro would have not prevailed in the adverse possession claim by the adjoining landowner, the Court of Appeals held that Mastro acted appropriately in settling the case even without notification of

Kumakichi. The Court stated that the alternative, requiring a grantor to defend a grantee's title only once a judgment on the ejectment action is issued, "discourages settlement, favors those who can afford lengthy litigation, and serves as a potential shield from liability for those who would otherwise be found liable for a legal wrong."

***State v. Wandermere Co.*, 89 Wn.App 369, 949 P.2d 392 (Div. III 1997), rev. denied, 135 Wn.2d 1012 (1998)**

Facts: The State condemned 5.56 acres of property owned by Wandermere as part of a highway construction project. Wandermere leased 24.45 acres, including the condemned property, to Acme Concrete for a sand and gravel pit operation. The State's offer was predicated on its analysis that the condemned 5.56 acres was part of the 24.45 acre parcel that contained little remaining sand and gravel deposits. Wandermere, however, maintained that the taking was part of a larger 62 acre parcel that contained several million cubic yards of unmined sand and gravel deposits. The trial court entered a judgment in favor of Wandermere, compensating the company for loss of the entire parcel, including those portions containing the unmined sand and gravel deposits.

Holding: The Court of Appeals affirmed the trial court's judgment. The court held that if the State condemns one portion of a larger parcel of property which results in a decrease in the value of the larger parcel, the owner may recover the decrease in value of the larger parcel if it can establish that the condemned property is part of a single, larger tract. To establish a single, larger tract, the owner must show that the parcels have "a present unified use." In this case, the Court of Appeals found that Wandermere presented sufficient evidence to permit the jury to determine whether the entire parcel was unified by use.

•••

PROBATE AND TRUST COUNCIL REPORT

*Barbara C. Sherland, Stoel Rives LLP, Seattle
Director - Probate and Trust Council*

Under Mark Roberts' capable leadership, the focus of the Probate and Trust Council has been to improve and increase the benefits of membership. As your new Council Director, I am committed to maintaining that focus. In a recent survey, members identified the Newsletter, CLE programs and legislative work as some of the primary benefits of membership. The Council met in a brainstorming session last month to determine ways to further improve our Newsletter and our latest means of communicating with members, the Section's new Web page. At our Council meeting this month, we explored steps to better inform members on legislative proposals and discussed ways to improve our continuing legal education programs. Our work this next year will include:

Newsletter. The Newsletter may look a little different next time. Along with format changes to make it easier to follow the substantive articles, Lora Brown has been working with the Council on ideas such as expanding coverage of the case notes, adding an annual review of new legislation (with practice pointers), including a summary of changes in the estate and gift tax area and developing an index of articles from the leading probate and trust journals.

Web Page. The Section's Web page can be a great tool for quickly making information available to members. We plan to take advantage of that this next legislative session by keeping an up-to-date posting of proposed probate and trust bills on the Web page. We would also want to add additional resource information for members. Doug Lawrence has done a great job of getting the Web page up and running and is graciously continuing to offer his expertise. If you have not had a chance to see the new Web page, please visit us at <http://www.wsba.org>.

Legislation. The Section is sponsoring the Trust and Estate Dispute Resolution Act (TEDRA), which offers a major improvement in resolving disputes regarding probate and trust matters. The Act would expand our existing non-judicial dispute resolution process by providing for party-initiated mediation and arbitration in trust and estate matters. Kenneth L. Schubert, Jr., Doug Lawrence, Bruce Flynn, Richard Klobucher and Watson

Blair have done an outstanding job in drafting TEDRA. You can find a copy of TEDRA on our Web page.

Tom Culbertson will head a subcommittee of the Council charged with clarifying and updating statutes, as necessary. We are mindful of the wisdom of the adage: If it works, don't fix it. Initially, the subcommittee will be looking at statutory presumptions regarding disposition of nonparticipant spouses' interests in IRAs and improvement of the durable power of attorney statute.

As noted above, during the next legislative session we hope to use the Section's Web page to keep members informed on proposed bills as we receive them from John Fattorini (head of the WSB's Office of Legislative Affairs). Our response time is often fairly short on these bills, so I encourage you to check the Web page frequently during the legislative session and get any comments to me as soon as possible.

CLE Programs. Matt McCutchen is coordinating our CLE programs. We are sponsoring an advance will drafting program in March 1999 and an advance probate program in July 1999. Also under consideration are a special CLE devoted to ethics and a CLE covering TEDRA.

Liaisons. We would like to develop a line of communication with the judiciary on probate and trust matters and are looking at improving liaisons with other sections, such as the Elder Law Section and the Gift and Estate Tax Subcommittee of the Tax Section. Marcia Fujimoto is the contact person for this.

Publications. Bruce Smith will oversee updating the probate and trust Citizens' Rights pamphlets. We are considering ways to make these more usable and available for members and the general public.

We have an executive committee of dedicated members to spearhead these projects, but we need you too. We will be following up on responses to our recent survey of members who indicated a willingness to get involved. You do not need to sit back and wait for a phone call though. We welcome and appreciate your involvement and encourage your thoughts and comments.



REAL PROPERTY COUNCIL REPORT

*Serena M. Schourup, Bogle & Gates P.L.L.C., Seattle
Director - Real Property Council*

I wish to take this opportunity to thank John Dahl of First American Title Insurance Company, Seattle, and William Green of Perkins Coie, Seattle, for serving as members of the Real Property Council for the last two years. I also wish to thank Hossein Nowbar, Microsoft Corporation, Redmond, for serving as our newsletter editor last year. This year, the Real Property Council will include two new members, William Reetz, Commonwealth Land Title Insurance Company, Seattle and Bruce Coffey, Foster Pepper & Shefelman, Seattle, and Maren Gaylor, Graham & Dunn, Seattle will serve as the assistant newsletter editor for the Section. As those of you who have served on bar committees know, the time and effort spent by individual committee members is considerable. Our membership surveys have consistently told us that both the newsletter and our work on legislation is of greatest value to the members of the Real Property, Probate & Trust Section. All of us on the Real Property Council will endeavor to make this another productive year.

The Real Property Council met during the Section retreat in Leavenworth on September 25th and 26th to discuss the legislation that we anticipate will need to be addressed during the upcoming legislative session. In the last legislative session, there were several bills submitted and reviewed by the Real Property Council which would have made substantive changes in laws affecting real property interests. While these bills did not for one reason or another complete the legislative process, we expect to see similar types of bills reintroduced during this upcoming legislative session.

The first area of activity was adverse possession. Several bills were submitted last year to abolish or significantly amend both the quiet title and the statute of limitation statutes in adverse possession cases. The only bill to be passed and signed into law was SB 6323 which limits adverse possession claims against forest land owners to those in which the cost of the permanent or semi-permanent improvements exceeds \$50,000. We expect several bills to be reintroduced this session which would have the effect of limiting the rights of litigants to claim title to real property by adverse possession.

The second area of activity was in the area of subdivision and binding site plans. SHB 2977 addressed an issue raised in a recent Court of Appeals case, *Strauss v. City of Sedro Woolley*, 88 Wn.App. 376 (1997), in which the Court held that creation of condominiums may be governed not only by the condominium statutes, but also by the state subdivision statute. SHB 2977, which clarified that condominiums do not have to comply with binding site plan requirements, was passed in the House and Senate, but was vetoed by Governor Locke. We expect to see another bill regarding this issue submitted this year.

We welcome your comments, observations and questions. Please call or e-mail any of the members of the Real Property Council.

•••

from page 2

Notes from the Chair

We also anticipate a busy and vigorous legislative session. We anticipate potential legislation on the real property topic of adverse possession and on the real property/land use topic of Amendments to the Condominium Act vis-a-vis the applicability of land use planning law to condominiumization. As in the past, we will coordinate with John Fattorini, the Bar Legislative Liaison, and will attempt to assist the members of the State Legislature to prevent enactment of problematic legislation and to clarify legislative proposals.

Our Newsletter is now under the able editorship of Lora Brown, with the assistance of our new Assistant Editor, Maren Gaylor, of the Graham & Dunn firm. Lora will do an excellent job, together with Maren and the Editorial Advisory Board, to continue to produce our first-rate Section Newsletter. We are at present contemplating layout modifications to make the Newsletter more organized and readable.

This Section has been very fortunate to have Executive Committee members who are fully committed to providing the best possible service to the Section. On behalf of the Section and the Executive Committee, we wish to thank departed Board

members Gordon Tanner, John Dahl, Tim Burkart, Janet Gray, William Green and former Newsletter Editor, Hossein Nowbar, for their timely and thorough contributions to the work of the Section. We welcome Barbara Sherland as the new Director of the Probate and Trust Council, new Board members Matt McCutchen and J. Bruce Smith to the Probate and Trust Council, and Bruce A. Coffey and William H. Reetz to the Real Property Council. We welcome Maren Gaylor as the new Assistant Newsletter Editor.

We encourage each of you as Section members to contact any Board member at any time to provide comments, insight and ideas with respect to the Section. We are constantly looking for ways to better assist you in your practice. Should you desire to contact me, I am at:

John M. Riley, III (509) 624-5265
Witherspoon, Kelley, Fax: (509) 458-2728
Davenport & Toole, P.S. E-Mail: jmr@wkdtdlaw.com
1100 U.S. Bank Building
Spokane, WA 99201

•••

REAL PROPERTY, PROBATE & TRUST SECTION
Washington State Bar Association
1999 Budget Request

	1999 Budget	1998 Budget
Revenues		
Section Dues Members: 2,170 @ \$15	\$ 32,550	\$ 32,550
Subscriptions Subs: 25 @ \$15	\$ 375	\$ 375
Seminars	\$ 7,310	\$ 3,810
CLEDEX	\$ 0	\$ 0
Directory	\$ 0	\$ 6,500
Total Revenues	\$ 40,235	\$ 43,235
Expenses		
Reimbursement of Vol. Exp.	\$ 5,000	\$ 5,000
Newsletter	\$ 12,500	\$ 9,500
Postage- photocopy	\$ 2,200	\$ 2,200
WSBA Admin. per Member	\$ 15,740	\$ 13,432
WSBA Admin. per Use	\$ 5,265	\$ 6,683
Seminars	\$ 4,000	\$ 4,000
Subcommittees	\$ 1,000	\$ 1,000
Retreat	\$ 5,500	\$ 5,000
Directory	\$ 0	\$ 8,150
Total Expenses	\$ 51,205	\$ 54,965
Net Income (Loss)	\$ (10,970)	\$ (11,730)
Estimated Carryover - Prior Year	\$ (\$7,731)	
Estimated Carryover - Earlier	\$ 60,004	
Net Income (Loss) w/ Carryover	\$ 41,303	

HOW TO REACH US!

Officers

John M. Riley, III, Chair
Witherspoon, Kelley, Davenport & Toole, P.S.
1100 U.S. Bank Building
Spokane, WA 99201-0390
Phone: (509) 624-5265
Fax: (509) 458-2728
E-Mail: jmr@wkdtlaw.com

Mark W. Roberts, Chair Elect
Davis Wright Tremaine, LLP
1501 Fourth Avenue, Suite 2600
Seattle, WA 98101-1688
Phone: (206) 628-7753
Fax: (206) 628-7699
E-Mail: markroberts@dwt.com

Douglas C. Lawrence, Past Chair
Stokes Lawrence, P.S.
800 Fifth Avenue, Suite 4000
Seattle, WA 98104-3179
Phone: (206) 626-6000
Fax: (206) 464-1496
E-Mail: doug.lawrence@stokeslaw.com

Real Property Council Director
Serena M. Schourup
Bogle & Gates, P.L.L.C.
Two Union Square, 601 University Street
Seattle, WA 98101-2346
Phone: (206) 682-5151
Fax: (206) 621-2660
E-Mail: sschourup@bogle.com

Probate and Trust Council Director
Barbara C. Sherland
Stoel Rives LLP
600 University Street, Suite 3600
Seattle, WA 98101-3197
Phone: (206) 624-0900
Fax: (206) 386-7500
E-Mail: bcsherland@stoel.com

Newsletter

Lora L. Brown, Editor
Stokes Lawrence, P.S.
800 Fifth Avenue, Suite 4000
Seattle, WA 98104-3179
Phone: (206) 626-6000
Fax: (206) 464-1496
E-Mail: lora.brown@stokeslaw.com

UPCOMING SECTION CLE SEMINARS

The Real Property, Probate & Trust Section will host the following events in 1999 and beyond.

Project Development from A to Z
February 25, 1999 - Washington State Convention & Trade Center (Seattle)
March 3, 1999 - Cavanaugh's Inn at the Park (Spokane)

Advanced Will Drafting
March 17, 1999 - Crown Plaza Hotel (Seattle)
March 19, 1999 - Cavanaugh's Inn at the Park (Spokane)

Real Property, Probate & Trust Section Midyear Conference
June 4-6, 1999
Wenatchee Center (Wenatchee)

Advanced Probate
July 21, 1999 - Seattle (Site to be announced)
July 22, 1999 - Cavanaugh's Inn at the Park (Spokane)

Real Property, Probate & Trust Section Midyear Conference
June 2-4, 2000
Skamania Lodge (Stevenson)