Real Property, Probate & Trust

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MERS: The Mortgage Electronic Registration System

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What* is *MERS? Mortgage Electronic Registration Systems, Inc. is the long name for MERS, the central electronic clearinghouse for the mortgage finance industry in the United States and a wholly-owned, bankruptcy remote subsidiary of MERSCORP, Inc. Both are Delaware corporations. Shares of the parent company are held by a broad base of organizations active in the residential mortgage industry, including Fannie Mae, Freddie Mac, the Mortgage Bankers Association of America and the American Land Title Association.

Why MERS? Residential mortgages are rarely retained and serviced by the originating lender. The beneficial interests in and servicing rights to most mortgages are assigned at least once in the secondary market, usually immediately after loan inception. Often, the mortgagees' beneficial interests are assigned multiple times before a mortgage is satisfied or a deed of trust is reconveyed. In many states, recording each assignment is a condition precedent to releasing the mortgage lien upon satisfaction and to commencing foreclosure in the event of default. These recording requirements can delay the release of a mortgage lien, delay commencement of foreclosure, and increase transactional costs. In addition, the recording requirements can create financial risks for title insurers and escrow closing agents if they fail to obtain and record timely lien releases after insuring or closing a residential real estate transaction.

MERS was created to eliminate the need to record assignments, because MERS can remain the mortgagee of record when lenders and servicers transfer their interests in mortgages and deeds of trust through purchase and sale agreements. In this way, the MERS system reduces the delay, expense and risk of loss associated with the recording requirements.

What Does MERS Do? The concept of MERS is simple. Either at loan inception or later by assignment, MERS is designated as the mortgagee or beneficiary solely as nominee for the original lender (if MERS is designated at loan origination) or the assignee lender (if MERS is designated by assignment after loan origination) and its successors and assigns. Subsequent transfers of the loan do not require recorded assignments. Instead, subsequent transfers are registered and tracked in the MERS electronic database. At all times, the nominal mortgagee/beneficiary of record, MERS, remains constant, and a borrower may contact MERS directly to obtain the current lender or servicer's name and telephone number.

MERS and the Washington Deed of Trust Law. Washington's Deed of Trust Act, RCW 61.24.005 *et seq.,* authorizes the beneficiary under a deed of trust to (1) appoint a successor trustee, RCW 61.24.010(2); (2) record, transmit or serve *and* post written notice of default, RCW 61.24.030(7); (3)

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Notes from the Chair

Mark W. Roberts
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I recently read a column in *The American Lawyer* concerning the declining involvement of lawyers, and particularly junior lawyers, in pro bono activities. There were basically two reasons cited for the fall off in involvement: the sharp escalation in starting salaries necessary to attract the best young lawyers coupled with the booming economy has forced many firms to work their young lawyers harder than ever both to meet client demands and to recoup their investment, leaving the firms less inclined to encourage nonbillable work. And the young lawyers themselves, with less time available, question the benefits, both short and long term, of involving themselves in nonbillable projects in addition to their other responsibilities.

Just as this trend has long term consequences for pro bono activities, it also threatens the vitality of bar-related activities, including specialty sections like the Real Property Probate and Trust Section. In this section, we have been fortunate to have many dedicated and talented lawyers who have shared their time and expertise over the years to make us better informed practitioners and to improve our laws in our areas of practice for the benefit of our citizens and ourselves. We have section members who review proposed legislative bills; organize, write and edit newsletter articles; serve on legislative drafting subcommittees; organize and present continuing legal education seminars; prepare lawyer deskbooks and public rights pamphlets; interface with industry groups; advise the Bar on professional responsibility issues and perform a host of other tasks. I am grateful for their efforts. We owe them our thanks, because after all, they are volunteers who do this on top of their active practices.

To continue to thrive as a section, we do need to impress upon others and ourselves that there are very real benefits to not only being a member of the section, but also being actively involved. In my view, there are tremendous benefits, albeit not all of them directly tangible. One is that involvement in these activities often improves our substantive skills, making us better and more valuable lawyers. If I am asked to write an article, review a piece of legislation or present a lecture, it forces me to organize my thoughts and thoroughly learn the issues. In our daily practice, we focus only on our client's direct problem. By contrast, many Bar projects require us to view the bigger picture, which can help the next time a slightly different twist on our client's problem arises.

Involvement in the Bar also opens us up to a network of fellow lawyers across the state that share many common interests and problems. This is a tremendous resource. Does this network lead to a lot of new business? Maybe for some, but not for most of us. Instead, over time, we learn whom outside our own offices to call if we have a substantive question we cannot answer or need a second opinion. The relationships we can develop through section activities give us a far broader view of our practice than we often can get from the other lawyers in our firms or offices we see on a daily basis. For a lawyer in it for the long haul, this is not only an asset to our own practice, but it makes our jobs more rewarding. Unfortunately, though, it is a benefit that develops only over time.

If you are a lawyer questioning whether it is worth it to get involved in Bar activities yourself, I think the answer is yes. The benefits are real, and lasting, but they are not immediate. If you are in a firm and have the opportunity to influence the development of other lawyers, take the opportunity to encourage others to participate. It is a great way to open up one's view of the practice. And it is not all give and no take. In fact, in my view, what you can take back from the experience can far exceed the time you give up. •

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MERS: The Mortgage Electronic Registration System

instruct the trustee to record, transmit or serve *and* post written notice of default, RCW 61.24.030(7); (4) instruct the trustee to commence nonjudicial foreclosure of the deed of trust pursuant to the power of sale conferred by the deed of trust, RCW 61.24.040 *et seq.*; and (5) request the reconveyance of the deed of trust, RCW 61.24.110.

Under the 1998 amendments to the Deed of Trust Act, the beneficiary's authority to act does not appear to depend upon the recording of the deed of trust or the recording of assignments of the beneficial interest under the deed of trust. According to RCW 61.24.005(2), a "[b]eneficiary" is "the holder of the instrument or document evidencing the obligations secured by the deed of trust, excluding persons holding the same as security for a different obligation." As to the beneficiary's authority to act, the 1998 amendments appear to have eliminated the need for recording deed of trust assignments.

Why is MERS Appropriate in Washington? If the beneficiary is the note holder, as defined under the Washington Deed of Trust Act, then it may appear that designating MERS as the nominal beneficiary is an unnecessary exercise. However, designating MERS as the nominal beneficiary provides notice that MERS is tracking the beneficial interests in and the servicing rights to the deed of trust. Typically, a secondary mortgage market investor is not equipped to receive the types of notices sent to the record beneficiary. MERS maintains a mailroom that forwards on to the current servicer mail addressed to MERS as nominal beneficiary. In addition, title insurance underwriting practices and potential statutory conflicts provide continued justification for pursuing a MERS solution in Washington.

Reconveyances. Deeds of trust are governed by the laws pertaining to mortgages to the extent the mortgage laws are not inconsistent with the Deed of Trust Act. Although the Deed of Trust Act identifies the deed of trust beneficiary as the current note holder, another statutory provision, RCW 61.16.010, provides that the assignee of a mortgage may acknowledge satisfaction of the mortgage only after the assignment to that assignee has been recorded. It is unclear whether the Deed of Trust Act's definition of beneficiary trumps the recording requirements of RCW 61.16.010. To date, title companies and legal practitioners in Washington generally counsel the safe approach and require that the entire chain of assignments be in place before the beneficiary may instruct the trustee to reconvey the deed of trust. Subscription to MERS and its procedures circumvents these issues, because the chain of title can start and stop with MERS.

Foreclosures. The deed of trust statute poses no corresponding potential conflict for a successor beneficiary appointing a successor trustee or instructing a trustee to commence foreclosure. Nevertheless, title companies have been cautious about insuring nonjudicial foreclosure sales in cases where the beneficiary appointing the successor trustee and/or initiating foreclosure is not the beneficiary of record. For this reason, MERS continues to make practical sense even in the nonjudicial foreclosure context in Washington.

Fringe Benefits. With the aid of MERS, escrow closers, lenders and title companies will spend less time tracking lost or missing beneficial assignments and identifying the current loan servicer. Without MERS, tracking beneficial interests can be a time-consuming process involving searching the public records, talking with borrowers to identify the party currently receiving loan payments, and contacting that party to confirm the identity of the true beneficiary.

Practical Applications — Documents and Title Products. *Assignments to MERS.* A lender unaffiliated with MERS may assign its interest in a deed of trust to MERS, as nominee for a MERS affiliated lender. For example, assume that Alec Borrower executes and delivers a promissory note and grants a deed of trust to Acme Mortgage Company (Acme), which is not a member of MERS. The deed of trust is recorded in the county land records. If Acme later assigns its beneficial interest in the deed of trust to Better Mortgage Company (Better), which is a member of MERS, Acme will endorse and deliver the promissory note to Better and record an assignment of beneficial interest in the county land records. The assignment of deed of trust will appoint MERS as nominee for the beneficiary, as follows:

Assignment of Deed of Trust
MIN: 123456712345671234

> For Value Received, the undersigned Acme Mortgage Company, Inc. as Beneficiary, hereby grants, conveys, assigns and transfers to Mortgage Electronic Registration Systems, Inc., its successors and assigns, as nominee for Better Mortgage Company, its successors and assigns, whose address is P.O. Box 2026, Flint, Michigan 48501-2026, and whose phone number is 1-888-679-6377, all beneficial interest under that certain Deed of Trust, dated….

As in the example shown, the new lender's (Better Mortgage Company's) address should <u>not</u> be disclosed on the recorded assignment of deed of trust, because MERS as nominee should receive all mail and service of process. Please note that the Mortgage Identification Number (the MIN), which identifies the MERS loan, is placed to the right of or below the form title but not within the top or side recording margins. Every MERS-related recorded document will show the MIN.

Transfers within MERS. When a MERS member transfers its interest in a deed of trust to another MERS member, the process is streamlined. Using the above example, assume that Acme has transferred its note and deed of trust to Better, a MERS member. Later, Better decides to transfer its beneficial interest in the deed

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of trust to Capable Mortgage Company (Capable), another MERS member. Better endorses and delivers the promissory note to Capable, Better notifies MERS of the transfer by entering the transfer information into the MERS automated system, and Capable confirms the transfer via an "electronic handshake." No assignment of deed of trust is recorded in the county land records, because MERS remains the record beneficiary (but now, as nominee for Capable). Instead, the transfer between Better and Capable is tracked electronically on the MERS system.

MOM—MERS as Original Mortgagee. In early 1998, Fannie Mae and Freddie Mac authorized changes to their uniform deed of trust to accommodate the addition of MERS as nominee for the lender, and the Mortgage Electronic Registration System is now being shown as the original beneficiary on deeds of trust executed in favor of lenders that are MERS members. When MERS acts as the original beneficiary/mortgagee, MERS calls it a MOM loan. Under the 1998 authorized changes to the uniform deed of trust, the beneficiary, MERS, is shown on the deed of trust as:

> The beneficiary of this deed of trust is MERS, the Mortgage Electronic Registration System, Inc. (acting solely as nominee for Lender and Lender's successors and assigns) and the successors and assigns of MERS. MERS is organized and existing under the laws of Delaware and has an address of P. O. Box 2026, Flint, MI 48501-2026 and a telephone number of (888) 679-MERS. The Lender is National Bank, Inc., a California corporation, which has an address of 123 Banker's Road, San Francisco, CA 99999.

More recently, Fannie Mae and Freddie Mac have revised their uniform instruments, including slight revisions to the 1998 MOM language. Now, under the Transfer of Rights in the Property section of the Uniform Instrument, MERS Modified Form 3048, 03/99, the beneficiary is now shown as:

> The beneficiary of this Security Instrument is MERS (solely as nominee for Lender and Lender's successors and assigns) and the successors and assigns of MERS. This Security Instrument secures to Lender: (i) the repayment of the Loan…[.]

Under the Definitions section of the Uniform Instrument, MERS Modified Form 3048, 03/99, the Lender is identified by name and address but is no longer identified as the beneficiary under the deed of trust. In addition, MERS is defined as:

> "MERS" is Mortgage Electronic Registration Systems, Inc. MERS is a separate corporation that is acting solely as a nominee for Lender and Lender's successors and assigns. MERS is the beneficiary under this Security Instrument. MERS is organized and existing under the laws of Delaware, and has an address and telephone number of P.O. Box 2026, Flint, MI 48501-2026, tel. (888) 679-MERS.

Washington Deed of Trust-Single Family-Fannie Mae/Freddie Mac Uniform Instrument, MERS Modified Form 3048, 03/99, Definitions, paragraphs (C) & (E). Some lenders may still be using the old MOM document, but lenders must use the 1999 MERS Modified Form 3048 after December 31, 2000.

Assignment from MERS. When a MERS member assigns its beneficial interest in a deed of trust to a non-MERS member, the MERS member will need to record the assignment from MERS to the new beneficiary in the county land records. Here, designated employees of the assignor lender are authorized by MERS' corporate resolution to execute and record the assignment, by signing the assignment of deed of trust as follows:

> Signed on the 23rd day of March, 2000.
> Mortgage Electronic Registration Systems, Inc. (MERS)
> By____
> George L. Hunter, Assistant Secretary

Satisfaction of Note and Reconveyance of Deed of Trust. When MERS is shown as the beneficiary of record, the escrow closer obtains the name and phone number of the current lender by contacting the MERS Voice Response Unit (VRU) at its toll free number, (888) 679-MERS. The escrow closer does not have to pay a fee to obtain the name and phone number of the current lender. Then, the escrow closer contacts the lender for the correct payoff amount. The payoff check should be made payable to the current lender and sent directly to the lender, not to MERS. However, if the payoff check is inadvertently made payable to MERS, the lender's designated employees (as officers of MERS) will endorse the check over to the lender.

After a note has been fully satisfied, the beneficiary of the deed of trust executes a request for reconveyance. The same procedure is followed when MERS is the beneficiary. For example, assume that Amanda Borrower borrows $10,000 from Affable Bank (Affable), a MERS member. Amanda executes and delivers a promissory note to Affable and grants a deed of trust to MERS, as nominee for Affable, the lender. When Amanda Borrower pays off the note held by Affable, Affable's employee, acting as an officer of MERS, will request the reconveyance of the deed of trust. If the trustee is satisfied that the request for reconveyance is valid, the trustee executes the reconveyance of deed of trust and records it in the county land records.

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Non-judicial Foreclosures – Trustee's Sale Guarantee. A deed of trust can be foreclosed in the name of MERS. By MERS' corporate resolution, a lender's employee becomes an officer of MERS, with the capacity and authority to sign necessary documents, such as the notice of default or the appointment of successor trustee.

Notice of Default and Appointment of Successor Trustee. If a borrower stops making payments on her note, at least 30 days before the notice of trustee's sale is recorded, the beneficiary or the trustee must send the borrower a notice of default. RCW 61.24.030(7). If the beneficiary/lender sends the notice of default, the lender's employee will sign the notice of default as an officer of MERS. If the beneficiary/lender desires that the trustee send the notice of default, the lender's employee, acting as an officer of MERS, will sign and record an appointment of successor trustee, to empower a new trustee to conduct the foreclosure. RCW 61.24.010(2).

For example, assume that Amanda Borrower has given a promissory note and deed of trust to Affable Bank (Affable), which is a MERS member. When Affable becomes aware that Amanda Borrower is in default, an Affable employee mails a Notice of Default, signed by the Affable employee in his or her capacity as a MERS officer. If Amanda Borrower fails to bring her payments current, Affable executes (again as an officer of MERS) and records an appointment of successor trustee, appointing Reliable Trustee Service (RTS) as successor trustee.

Notice of Trustee's Sale. Following the above example, if Amanda Borrower remains in default, the successor trustee, RTS, obtains a title report, called a trustee's sale guarantee, which discloses the identities of parties with liens against Amanda Borrower's real property. Thereafter, the trustee will foreclose the Affable/MERS deed of trust following the same procedures normally used in nonjudicial foreclosures, see RCW 61.24.010 *et seq.,* except that the trustee will act as trustee of the deed of trust granted to the Mortgage Electronic Registration System, Inc., (MERS), solely as nominee for lender, its successors and assigns. In other words, RTS will foreclose in the name of MERS, as nominee for the beneficiary/lender.

Trustee's Deed. After the trustee's sale, the foreclosing trustee records a trustee's deed to convey title to the real property to the successful bidder at the trustee's sale. If MERS, as nominee for the lender, was the successful bidder, the trustee's deed will name the lender as the grantee and will state that MERS, as nominee for the lender, successfully bid for the property at the trustee's sale.

Currently, over 1.4 million residential mortgages are registered on the MERS electronic registration system, and MERS anticipates that over 2.5 million residential mortgages will be registered before January, 2001. In the county land records within Washington, MERS related deeds of trust and assignments of deeds of trust are appearing more frequently. This article provides a basic outline for handling MERS related transactions, and additional information on MERS can be found at the MERS web site, located at http://www.mersinc.org/index1.htm. The web site provides state-by-state procedures for working with MERS, allows members and non-members to download MERS manuals, forms, and publications, provides information on MERS pricing and fees, and includes a member directory. •

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Family Partnerships — Recent Developments

John E. Poffenbarger and Marianne E. Jones, Stoel Rives, Seattle

Introduction

Several recent cases have helped to define the landmine-strewn area of family limited partnerships and their estate and gift tax consequences. This article briefly discusses the cases of *Estate of Nowell v. Commissioner*, TCM 1999-15 (1999), *Kerr v. Commissioner*, 113 TC No. 30 (1999), *Church v. United States*, 85 AFTR 2d 804 (W.D. Tex., 2000), and *Estate of Reichardt v. Commissioner*, 114 TC No. 9 (2000). While the estate tax consequences of family partnerships are likely to remain a source of dispute with the Internal Revenue Service (IRS), these cases provide a number of insights for practitioners in this area.

Estate of Nowell v. Commissioner

This case principally addresses two issues, the aggregation of partnership interests for valuation purposes where the estate includes a qualified terminable interest property (QTIP) trust, and whether interests should be valued as partnership interests or as assignee interests. The decedent's taxable estate included limited partnership interests both in a revocable trust and in a QTIP trust. The IRS argued that the partnership interests in both trusts should be aggregated and valued together for estate tax purposes, and that the interests should be valued as full partnership interests, rather than as less valuable assignee interests (the interest of a transferee who has not been admitted as a limited partner to the partnership).

The tax court, however, rejected aggregation of the interests, following the decisions in *Estate of Mellinger v. Commissioner*, 112 T.C. 4 (1999), and *Estate of Bonner v. U.S.,* 84 F.3d 196 (5th Cir. 1996). As a result, the court allowed the taxpayer minority interest and lack of marketability discounts, rather than applying the control premium sought by the IRS.

The court also held that applicable state law (Arizona in this case) is determinative of what type of interest is transferred at death. Arizona state law provides that unless the partnership agreement indicates otherwise, assignees of limited partnership interests do not become limited partners unless admitted as such by the general partners. The transferees in this case had not been admitted as limited partners by the general partners as the agreement required, and as a result, the court held the interests should be valued as assignee interests.

Practitioner Points

1. Use QTIP trusts to segregate interests in family limited partnerships.

2. Where assignee interests are desired, ensure that the partnership agreement does not automatically admit transferees as partners, but instead classifies them as assignees that must be admitted to full partner status.

Kerr v. Commissioner

Kerr is a case of sometimes you win, sometimes you lose, but playing by the rules will help your chance of winning. The Kerrs formed two family limited partnerships in Texas and undertook a variety of complex estate planning techniques with the assistance of Stacey Eastland, a noted practitioner in this area. The IRS sought to deny the valuation discounts claimed by the taxpayers in valuing the partnership interests by invoking I.R.C. § 2704(b), arguing that the restrictions on liquidation in the Kerrs' partnership agreements were more restrictive than Texas state law, thus creating "applicable restrictions" that should be ignored under that provision. Specifically, the IRS argued that the restrictions in the agreements on the limited partners' ability to withdraw from and their ability to liquidate the entities were more restrictive than Texas state law. The court disagreed with the IRS, holding that the restrictions on a partner's withdrawal were not part of the relevant inquiry under I.R.C.§ 2704(b), which the court ruled was instead limited to provisions related to liquidation of the entity, not partner withdrawals (a holding that could perhaps be questioned). The court also found that the specific provisions for dissolution of the entities were not more restrictive than Texas state law.

By way of comparison, Washington's partnership laws and limited liability company laws have been designed with these principles in mind, including changes in the last legislative session. Both the Washington limited partnership and limited liability company default provisions have been amended to provide that neither a limited partner nor a member of a LLC may withdraw from the entity, unless the agreement provides otherwise. (RCW 25.10.440; RCW 25.15.130). The most recent amendments to the statutes have made state law more restrictive on dissolution, providing default rules that generally allow the entity's existence to continue. *See* new RCW 25.15.270 and RCW 25.10.440. As a result, it is less likely that a LLC or partnership will be dissolved without the active effort of members to do so.

The other significant issue considered in *Kerr* was again whether the interest transferred constituted a full partnership interest or only an assignee interest. However, unlike the favorable decision in *Estate of Nowell*, the court here found that the transferred interest was a full partnership interest rather than an assignee interest. The court reached this conclusion largely due to the specific facts involved. The terms of the agreement related to the admission of partners had not been followed by the parties and the documentation of the transfers at issue suggested that the parties had intended to allow the transferees partner status, rather than that of an assignee as the agreement otherwise provided.

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Family Partnerships — Recent Developments

Practitioner Points

1. Partnership agreements should be carefully drafted to avoid creating impermissible restrictions under I.R.C. § 2704.

2. Even if the agreement is properly structured to allow assignee status, if that status is desired for a particular transfer, the transfer documentation and practice of the parties should reflect the desired status.

Church v. United States

In this case, Mrs. Church, the decedent, created (using that term somewhat loosely, as will be seen) a Texas limited partnership with her two children to consolidate their undivided interests in a family ranch and to hold approximately $1 million in securities contributed by Mrs. Church. The family's stated purposes for doing so were to provide centralized management of their interests in the ranch, preserve it as an ongoing enterprise for future generations, and obtain protection from tort claims. Each partner obtained an interest in the partnership proportionate to the partner's contribution.

On October 22, 1993, the parties all signed the partnership agreement and conveyed their interests in the ranch to the partnership. One of Mrs. Church's children also signed an assignment separate from certificate conveying Mrs. Church's securities to the partnership under a power of attorney, but the account holding the securities was not then changed into the name of the partnership. Mrs. Church died two days later, suddenly and unexpectedly according to the family and testimony from Mrs. Church's physician. At the time of her death, Mrs. Church was 72 years of age and had been fighting cancer for a number of years, although she was then in remission, according to her physician. The court accepted the testimony of the family and Mrs. Church's physician that her death was unexpected. The court also found the fact that various organizational affairs of the partnership were not completed prior to Mrs. Church's death (including failure to file a certificate of limited partnership and failure to form the corporate general partner) lent credence to the testimony that Mrs. Church died unexpectedly, and that under Texas law there was no significance or consequence arising from the failure to "complete the paperwork."

The IRS made a number of arguments in attacking the partnership (no doubt due to the unfavorable facts), all of which were rejected by the court. The government first argued substance over form, that there was no business purpose for the creation of the partnership and that the real purpose for creation of the entity was solely to reduce estate taxation. The court, however, found ample evidence of a purpose to preserve the ranch enterprise, including avoidance of ownership disputes, and accepted the family's stated purposes for the entity.

The IRS next argued that I.R.C. §§ 2036 and 2038 should be applied to pull the assets of the partnership back into Mrs. Church's estate. The court disagreed, however, finding that gratuitous transfers had not occurred. Although not exactly stated as such, the court presumably found that the exceptions to those sections for transfers for full and adequate consideration were met.

The IRS also argued that Mrs. Church had made a taxable gift on formation of the partnership because of the difference in value of the assets she contributed to the partnership as compared to the value of the interest she received in the partnership. In other words, the IRS argued that since the value of Mrs. Church's partnership interests totaled less than the value of the assets she contributed to the partnership, the difference should be viewed as an indirect gift by her to her children (the other partners), following the position first put forth by the Service in TAM 9842003. In a decision of first impression, the court rejected the government's argument, finding that a gift had not been made. The court found that in order for there to be a taxable gift, there must be a donative transfer, and no such transfer had occurred in this transaction because each partner had received a partnership interest in proportion to his or her contribution.

The IRS finally contended that I.R.C. § 2703 applied to the case. I.R.C. § 2703 generally provides that the value of property transferred must be determined without regard to rights or restrictions that are a device to transfer property to family members for less than full and adequate consideration, or with terms that are not comparable to those in an arm's length transaction. The IRS here attempted to use this provision to disregard the partnership agreement and eliminate the attendant valuation discounts. However, the court concluded that the restrictions in the agreement were consistent with state partnership law and not the type of restrictions Congress intended to reach with I.R.C. § 2703, as reflected by the legislative history of the provision. The court found instead that Congress had intended I.R.C. § 2703 to deal with buy-sell agreements and options that artificially depress fair market value. It is interesting to note that in *Reichardt v. Commissioner*, discussed below, the service apparently decided not to pursue this argument.

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Family Partnerships — Recent Developments

Practitioner Points

1. Death bed transfers and/or entities holding marketable securities do not necessarily preclude a successful transfer with attendant valuation discounts, but extra care should be taken in those circumstances, generally including a well-done appraisal.
2. Allocations of partnership interests (including voting rights) on a basis that is not proportionate to contributions should generally be avoided.
3. Document the non-tax purposes of the entity early and often.

Estate of Reichardt v. Commissioner

The newest case in this series is *Reichardt v. Commissioner*, which was issued on March 1, 2000. The decedent in this case formed a revocable trust in 1993, as well as a limited partnership for which the trust was the general partner. His two children were named co-trustees of the trust. The decedent transferred his residence and the majority of his other property, except for his car and miscellaneous personal property, to the partnership through the trust. Each of the decedent's children was then gifted a 30.4 percent interest in the limited partnership.

In reviewing the operation of the partnership, the court noted that the decedent had frequently commingled partnership assets and personal funds, deposited partnership income in his personal account and used the partnership checking account as his personal account. The decedent also continued to live in the house without paying rent after it was contributed to the partnership.

With little difficulty, the court found that there was an implied agreement between Mr. Reichardt and his children that he could continue to use and enjoy the partnership property throughout his life, and that therefore I.R.C. § 2036 applied to include all of the partnership property in the decedent's estate. It is worth noting that the partnership funds used by the decedent were only $8,000 in 1993 and $13,000 in 1994. It therefore apparently was not the value of the partnership assets used, but rather the consistent lack of respect for the partnership form that caused it to be disregarded.

The taxpayers argued I.R.C. § 2036 should not apply because the decedent had transferred the property to the partnership for full and adequate consideration (the partnership interests received by him) and because he was subject to fiduciary duties as a general partner. The court rejected those arguments, finding that the facts were simply too egregious.

Practitioner Points

1. Be sure clients correctly form and thereafter follow partnership formalities. Partnership funds should not be commingled and should be accounted for separately.
2. Personal use assets generally should not be contributed to the partnership.

Conclusion

In conclusion, recent decisions on family limited partnerships have generally been favorable to taxpayers, but the IRS clearly dislikes these entities and will no doubt continue to attack them when given an opportunity to do so. The *Estate of Church* case is particularly helpful, however, since it rejects virtually all of the IRS' current attacks on family partnerships. Whether the decision will be appealed and what the ultimate outcome of the case will be, of course, remains to be seen.

A few cautionary points are raised by the decisions. Where assignee status is desired for the gifted interest, care should be taken to ensure that such status is properly created. Restrictions on liquidation in partnership agreements should also be drafted with I.R.C. § 2704 in mind, and interests in the entity should generally be allocated proportionately. In addition, personal use assets should normally not be contributed to the entity, and care should be taken to ensure the form of the partnership is respected. •

Recent Developments

Probate and Trust

Wendy S. Goffe, Graham & Dunn PC, Seattle

Washington COURT OF APPEALS

***Estate of Curry*, 98 Wn. App. 107 (Div. II 1999).**

Summary: Where it is found that a decedent's intent is clear from the language expressed in her will and codicil, the words "I trust," in context, convey imperative language sufficient to create a testamentary trust, just as the words "desire," "will" and "request" would.

Facts: Kathryn M. Curry (Curry) lived in her home on Hood Canal. Curry's Will bequeathed her estate to her four daughters, Kathy, Carole, Patricia and Diane, in equal shares. At the same time that Curry executed her Will, she conveyed a two-thirds interest in her house to her daughter, Kathy, for use as collateral for a loan. The contract stipulated that if Curry died before the loan was paid, Kathy would execute promissory notes to her three other sisters so that each would have the equivalent of an equal share in the house. Later, Curry executed a Codicil giving Kathy all of Curry's interest in the house, so that Kathy could pay off the loan. The Codicil also included the provision that "I trust her [Kathy] to then give each of my other children…an equal share in that real property as though it had been unencumbered at the time of my death." Curry's attorney proposed the Codicil so that Curry could cancel it if Kathy paid off the loan before Curry's death.

After Curry's death, Kathy eventually sold the house, paid off her loan, but kept the remainder of the funds. The three sisters filed suit. The trial court entered a judgment awarding Kathy a one-half interest in the house sale proceeds and a one-sixth interest to each sister. The Court of Appeals reversed, finding that the words, "I trust," along with Curry's clear expression of her intent in the Will and Codicil created a testamentary trust. Accordingly, the Court of Appeals awarded each daughter a one-fourth interest in the house sale proceeds.

Discussion: In searching for the testatrix's intent, a codicil and will should be construed together. Curry's Will and Codicil evidenced a desire that each of her daughters share equally in her estate. In opposition to the trial court, the Court of Appeals found that the circumstances surrounding the Codicil were for a limited, temporary purpose (*i.e.* first obtaining and then paying off a loan), rather than a device to allow Kathy to have a greater share of the estate. The use of "I trust" was therefore sufficient in its context to create imperative language. Accordingly, the Court found that Curry had created a testamentary trust for the benefit of her three other daughters.

***Wilkes v. O'Bryan*, 98 Wn. App 411 (Div. I 1999).**

Summary: A community property agreement granting a fee simple interest to the surviving spouse nullifies subsequent language in the same agreement that grants remainder interests in the same property to third parties.

Facts: Annette and Thomas Wilkes married in 1971. Each had children from prior marriages. In 1982, they executed a community property agreement to convert their separate property assets to community property. The agreement provided that "upon the death of either of us, title to all community property as herein defined shall immediate vest in fee simple in the survivor." In addition, there was a clause which provided that upon the death of the survivor of them, the residue of the estate of the survivor's estate would be divided among their six children (four for Thomas; two for Annette) equally.

In 1984, Annette and Thomas executed identical Wills, giving their estates to the surviving spouse. A subsequent provision in the Wills stated that it was not their intent to revoke the community property agreement.

In 1993, Thomas died. Annette never probated his Will. Rather, she claimed his portion of the estate (land and a mobile home), under the community property agreement. In 1996, Annette executed a new Will, which revoked all former wills and codicils; however, it did not mention the community property agreement. Annette left the bulk of her estate to her son, Danny. Thomas' children filed suit against Danny and Annette's estate, seeking their respective one-sixth shares, arguing that the language in the community agreement created a vested remainder. The trial court found in favor of Danny and the estate, granting his motion for summary judgment. The Court of Appeals affirms.

Discussion: A community property agreement is a will substitute which allows a husband and wife to contract for the automatic vesting at death of their community property in the survivor, without court administration. The language in the community property agreement stated that all community property would vest in the surviving spouse in fee simple. The holder of property in fee simple allows one to sell, devise, encumber or otherwise alienate as he or she sees fit. The Washington State Supreme Court, in *Bartlett v. Bartlett, 183 Wash. 278, 48 P.2d 560 (1935),* analyzed a similar fact pattern and held that once a fee simple interest is conveyed, any further attempt in the same instrument to devise a remainder interest is void. Therefore, the section in this community property agreement seeking to devise a remainder to the children is void and does not create a vested remainder for any of Thomas' children.

***Tait v. Wahl,* 97 Wn. App. 765 (Div. I 1999).**

Summary: The list of wrongful death beneficiaries enumerated in RCW 4.20.020 applies to both wrongful death

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Recent Developments: Probate and Trust

actions under that section and survival actions under RCW 4.20.060. It is strictly construed so that the personal representative of a decedent's estate seeking to maintain wrongful death actions is strictly limited to claiming damages suffered by the beneficiaries enumerated in the statute, while if she wishes to maintain a survival action, she must do so only for the benefit of those same beneficiaries. Under RCW 4.20.046(1), Washington's general survival statute, the decedent's personal representative can recover damages on behalf of the decedent's estate, although these damages cannot include non-economic damages for pain and suffering, loss of enjoyment of life, anxiety, loss of consortium and emotional distress on behalf of the decedent's estate.

Facts: Mary Douglas was struck and killed by a truck. Her niece, Amber Tait, the personal representative of her estate, brought suit against the owner and driver of the truck on behalf of herself, her children, the decedent's non-dependent brother and the decedent's estate. The damages sought were for pain and suffering, medical and other out of pocket expenses, impairment of income and earning capacity, loss of enjoyment of life and loss of consortium. The trial court dismissed all claims brought on behalf of Amber, her children, and the brother as well as those brought for non-economic damages on behalf of the estate. The Court of Appeals affirmed the judgment.

Discussion: Under RCW 4.20.010, a personal representative may maintain a wrongful death action for damages against the person causing death. The damages are strictly limited to those suffered by the beneficiaries listed in RCW 4.20.020.

> The first tier of beneficiaries includes the spouse and children of the deceased…The second tier…includes the parents and siblings of the deceased [and] may recover only if there are no first tier beneficiaries and only if the designated beneficiaries were dependent for support on the deceased.

The courts have limited the application of this section to protect only beneficiaries clearly contemplated by the statute. Because neither Amber and her children nor the deceased's brother were clearly indicated by the statute, a suit under this section for damages suffered by them could not be maintained.

Under RCW 4.20.60, a personal representative may maintain a survival action against the person causing death. It can be maintained, however, only for the benefit of those beneficiaries listed in RCW 4.20.020. For the same reason given above, the present action could not be maintained.

Under RCW 4.20.046(1), a decedent's personal representative can recover damages on behalf of a decedent's estate. The statute has, however, been construed as prohibiting certain non-economic damages. According to the Supreme Court, these include damages for pain and suffering, anxiety, emotional distress or humiliation on behalf of the decedent's estate. The Supreme Court has also expressly held that a decedent's estate's right to recover damages under this section is limited to that which can be measured as a loss to the net accumulations of the decedent, which do not include the loss of ability to enjoy life's pleasures and amenities. Because the loss of enjoyment of life and loss of consortium are not assets that can be accumulated by the decedent, a decedent cannot recover damages for these claims under this section.

***Washington State Department of Retirement Systems v. Estrada,* 988 P.2d 492 (1999).**

Summary: The applicable law with respect to the determination of beneficiaries under a testamentary or quasi-testamentary instrument is that which is in existence at the time of the maker's death. A pension policy with a beneficiary designation qualifies as a quasi-testamentary instrument.

Facts: John McNulty designated his girlfriend Linda Estrada as beneficiary to his pension plan. At the time of designation, Washington law required such a beneficiary to have an insurable interest in the life of the holder of the policy. Under this requirement, Estrada would not have been able to collect as beneficiary since she did not have such an interest. Prior to John's death, however, the law was changed to delete the insurable interest requirement thereby removing the impediment to her being a valid beneficiary under the policy. Upon John's death, his sons claimed that they had all rights to his pension proceeds since, under the law at the time the beneficiary designation was made, Estrada's designation was void. The trial court rendered judgment in favor of McNulty's sons. The Court of Appeals reversed.

Discussion: "An instrument is testamentary if, after its execution, (1) the maker forfeits no rights in his property, and (2) no rights to his property have vested. [Further,] if the death of the maker is the only event that divests the maker of property allocating those rights to others, that instrument is testamentary in character." The beneficiaries of John's pension plan had only a contingent interest in the proceeds. He could have changed the beneficiary designations at any time. They also would have had no present interest in his account unless he died prior to retiring. The only way any of their interests could have vested was upon John's death. The plan was, therefore, both revocable and forfeitable. Thus the pension plan was a quasi-testamentary instrument.

Because the beneficiaries of such a pension plan acquire no legal interest until the employee dies, it is not until that date that their interest can be legally determined. Therefore, the relevant law is that which is in existence at the time death occurs. In the current case, the statute that was in effect at the time of Mr. McNulty's death gave Estrada a valid interest as a beneficiary of the pension. •

Recent Developments

Real Estate

Scott B. Osborne, Graham & Dunn PC, Seattle

WASHINGTON COURT OF APPEALS

***Svendsen v. Stock,* 98 Wn.App. 498 (1999)**

Facts: Svendsen purchased a home from Stock. The property had been subject to periodic flooding from clogged drainpipes. In completing the real property disclosure statement, Stock did not identify this problem at the instruction of the broker, because the broker believed the problem had been corrected. Stock also asked the broker to disclose the problem to any potential buyer. The broker did not disclose the problem to Svendsen. Following the purchase, the flooding re-occurred. Svendsen sued the seller and the broker seeking damages. A jury awarded $38,298 for damages for cleaning up the property and repairs plus $6,500 in punitive damages and $17,500 in attorney fees against the broker under the Consumer Protection Act.

Holding: The judgment was affirmed with respect to damages arising from fraudulent concealment. Although the Court stated that the facts presented a close case, there was substantial evidence to support the verdict against the broker for failing to disclose the drainage problem. The CPA violation was based upon a claim that fraudulent concealment was a matter of public interest. However, the concealment claim could not be separated by the claim that the disclosure statement was improperly completed. RCW 64.06.070 expressly states that matters covered by the statute are not matters of public interest. Accordingly, the portion of the verdict relating to the CPA violation was reversed.

***Janda v. Brier Realty,* 97 Wn.App. 45 (1999)**

Facts: Janda engaged a broker to help him locate a "fixer-upper" residential property. A property was purchased. The property was large enough to subdivide. The realtor gave Janda information concerning the cost of subdivision. This information proved to be inaccurate and substantially higher costs were incurred in completing the subdivision. Janda sued the broker claiming damages for negligent misrepresentation and breach of fiduciary duty. The trial court dismissed the claim.

Holding: The evidence did not establish any damages from the alleged misrepresentation. The price paid for the lot was equal to the value of the property, and thus no damages were sustained. Janda was not entitled to recover under a misrepresentation theory the alleged additional cost of subdividing the property or any alleged lost profits. Janda had claimed that the broker knew that Janda did not have the resources to complete the subdivision and breached his fiduciary duty by allowing Janda to enter into the agreement. The Court declined to accept this as a viable theory upon which to impose liability.

***Key Design, Inc. v. Moser,* 138 Wn.2d 875 (1999).**

Facts: Key Design entered into a purchase agreement with Moser for the sale of real property. The legal description of the property was never included in the purchase agreement. Moser refused to complete the sale with Key Design, and sold the property to another party. Key Design sued to enforce the agreement. The trial court dismissed Key Design's claim.

Holding: The judgment was affirmed. The statute of frauds requires that agreements for the sale of property include a legal description with the correct lot number, block number, addition, city, county and state for platted property. Since the agreement contained no description, it could not be reformed. The court also rejected the claim that since the seller admitted in court the correct legal description, the judicial admission doctrine should allow the agreement to be enforced.

***Friebe v. Supancheck,* 98 Wn.App. 260 (1999)**

Facts: Friebe agreed to purchase an apartment from Supancheck. The transaction did not close because one of the apartment units in the property constituted an illegal use. Friebe sued the seller for breach of contract and also asserted claims against the realtor. The seller did not appear in the action, because the seller believed that the realtor's lawyer would represent the seller. Friebe obtained a default judgment against Supancheck in an amount in excess of $41,000, including attorney fees based upon an affidavit detailing the damages incurred as a result of the breach of the agreement. More than one year later, the trial court vacated the default judgment on the motion of Supancheck.

Holding: The order vacating the default judgment was reversed. There existed no extraordinary circumstances justifying the vacation of the default judgment. Excusable neglect is a basis for vacating a default judgment only if the motion is made within one year of the entry of the judgment. •

REAL PROPERTY COUNCIL REPORT

Warren Koons, Davis Wright Tremaine LLP, Bellevue
Director - Real Property Council

"The leading rule for the lawyer, as for the man, of every other calling, is *diligence*. Leave nothing for to-morrow which can be done to-day. Never let your correspondence fall behind. Whatever piece of business you have in hand, before stopping, do all the labor pertaining to it which can *then* be done....If any one, upon his rare powers of speaking, shall claim exemption from the drudgery of the law, his case is a failure in advance."

—A. Lincoln, *circa* 1850

If you saw my office...well, for one thing, you would know that I have definitely failed to put all of Mr. Lincoln's admonitions into practice. I wish I *could* focus on one project and get it done before I had to turn and deal with the 14 other fires crying out for equal attention. And that little red message light on my phone is always crying out too—in these days, not returning calls the same day (or sooner) is letting your "correspondence fall behind"! I once tried covering that little indicator light, but it didn't work because I couldn't stand not knowing whether it was lit or not. Like Sisyphus, I am constantly striving to return those calls, but that little red light keeps coming back on—even as I'm returning my other calls.

I wonder what Abe's law office in Springfield, Illinois, circa 1850 looked like. It probably had a sleepy dog over by a wood stove. And I really wonder what Mr. Lincoln would make of some of the finer, high-tech accouterments of the 21st Century American law office: e-mail, voice mail, pagers, timesheets, FedEx, faxes, cell phones, telephones, timesheets, computer crashes, phone tag, teleconferences, word processing, internet, intranet, ultranet — timesheets! Would he believe me if I told him I once had a client give me changes to an agreement from his cell phone while taking a shower? I suspect there are many aspects of our current American law practice that Abe would find down right funny, if not bizarre or pathetic. At least we don't have to smell the office dog on a rainy day.

Yet, notwithstanding the revolutionary changes that have occurred since his day, there is still currency in Mr. Lincoln's words. Diligence and responsiveness are as essential to a successful law practice today as they were in 1850. They are still keys to a lawyer's successfully serving her clients. And Abe was right (and honest) about another thing, too. The hard work that underlies a successful practice often involves drudgery. Plain and simple. We may not want to admit it, but there it is. We can delegate some of it — but not all of it. It's part of being a lawyer. Perhaps the ultranet will be the silver bullet to free us from this humbling truth.

Quick legislative update: No bills of significance as to real property passed in the 2000 Legislative Session, nor are any pending. RPPT successfully opposed a bill (SB 6633) that would have imposed liability on beneficiaries and trustees for failing to release deeds of trust even if no request for reconveyance has been made. **Please e-mail your suggestions, comments or ideas to me at: *warrenkoons@dwt.com.*** •

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PROBATE AND TRUST COUNCIL REPORT

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

It was the best of times . . . it was the worst of times.

With the vibrant economy and demographics on our side, the estate planning field is enjoying a practice surge and there seems to be lots of work out there for the asking. At the same time, market conditions have led to a marked increase in overhead expenses for many firms and pressures have increased to make our practices more profitable. The end result is often a focus on billable hours and collections to the exclusion of other activities. I believe that to be shortsighted and ultimately bad for practitioners, both professionally and personally.

Recently, we have noticed a reluctance to volunteer for section activities. The common refrain is the need to focus on billable work. I wanted to take this opportunity to tell you why I have chosen to remain active in the section and encourage you to join me.

I have long struggled to balance the demands of my practice with the needs of my family (three children and a husband with a busy career), and my commitment to professional and community activities. I have chosen to maintain a commitment to section activities for the following reasons:

Professional development. Volunteering to prepare materials for and speak at section CLE's has provided me with a structured discipline to thoroughly learn a number of topics. In addition, it offers the opportunity to glimpse at the "big picture," something that everyday practice seldom affords. On the other side, I have benefited from attending section CLE's and appreciate the variety and quality of the programs.

Opportunity to make a difference. Serving on section legislative task force committees in drafting improvements to our probate and trust laws has given me the opportunity to make a change for the better in our practice area. Drafting legislation and testifying before Senate and House committees in Olympia is a rewarding, learning experience.

Personal contacts. Participating in section activities has put me in contact with outstanding practitioners across the state. A particularly rewarding activity for me was serving on the Probate Law Task Force where I had the privilege of working with a group of attorneys who I think are among the best in our area. We met every two weeks for several years and, although I was relatively new to the practice area then, the other task force members were patient and allowed me to learn a tremendous amount from them. By its nature, I think that our practice area attracts personable people and I have always found it a pleasure to meet fellow practitioners.

Client development. Referrals from other attorneys are a great source of clients, especially in our practice area. Knowing other attorneys to whom you can refer clients with confidence is equally valuable. Although the focus for associates in their early practices is often billable hours, that focus shifts as careers progress and the key becomes developing and maintaining clients. It is shortsighted for new attorneys not to get out and market their practices, and section activities are a great way to do that.

Taking a cue from public radio fund raisers, here's one more reason — guilt. You benefit from section membership so you should support it. This newsletter is the result of long hours of work by the writers of the articles, the editor, assistant editor, and editorial board members. They are all volunteers. Every section CLE you attend is available because of volunteer hours of the presenters, the chair and the section CLE coordinator. The section web page is up and running because of members' volunteered hours.

As with most things, the more you put in, the more you get out. We can use volunteers at all levels of practice experience and time commitment. Call or email me or any member of the Executive Committee and we'll be happy to put you to work.•

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