

Chapter 5.

The Legal Process

BASIS OF THE LAW

Statutory Basis

The Internal Revenue Code, Title 26 of the United States Code, is the primary statutory source of the Federal estate and gift tax law. Known as the Internal Revenue Code of 1986, because of the vast changes made by the 1986 Tax Reform Act, the Code is continually being amended by Congress. The tax component of the estate and gift tax planning process is in a constant state of flux. In every year since 1981, with the exception of 1985, Congress has passed substantial changes. For example, the Revenue Act of 1987 made significant changes in the estate and financial planning area. The 1988 Technical and Miscellaneous Revenue Act, the 1989 Revenue Reconciliation Act, and the 1990 Revenue Reconciliation Act, although billed as technical corrections legislation, also included many new substantive provisions.

Administrative Basis

Regulations.--The Internal Revenue Service (IRS) is empowered to administer the Code. It does this by issuing regulations that interpret the law according to perceived Congressional intent. Other regulations are statutory in nature, dealing with subject matter that Congress failed to legislate in detail. The regulations also serve as an enforcement mechanism. Regulations must be issued in proposed form subject to public comment before being published by the IRS in final form. Both statutory and interpretive regulations have the force of law; they may be overturned only by the courts.

Revenue Rulings.--Revenue rulings are interpretive rulings published by the IRS to apply the tax law to specific factual situations. Although they sometimes have significant general application, the rulings generally have less force than do regulations because of their limitation to specific sets of facts. Therefore, they provide valid precedent only if a second taxpayer's facts are substantially identical to those outlined in the ruling.

Private Letter Rulings.--These comprise another IRS interpretive tool to apply the tax law to specific situations. Letter rulings are generally official replies given by the IRS to taxpayer inquires concerning the tax consequences of proposed transactions. They are limited in application to the taxpayer who made the request; they may not be used as precedent by other taxpayers. Letter rulings are available to the public under the Freedom of Information Act. Although not comprising general precedent, they are nevertheless often quite useful as an indication of the IRS position on a certain point.

Technical Advice Memoranda.--A technical advice memorandum (TAM) is a special after-the-fact ruling issued by the IRS upon request from either a taxpayer or the IRS auditing agent during the course of an audit. As with letter rulings, a TAM is limited in application to the taxpayer who made the request; it, too, may not be used as precedent by other taxpayers. Also available under the Freedom of Information Act, TAM's are often utilized to help interpret IRS positions.

Judicial Basis

If a taxpayer disputes the IRS position in a particular matter and the disagreement is unable to be settled administratively, the issue may be litigated by the taxpayer filing suit. There are three courts of original jurisdiction for estate and gift tax cases. The Tax Court conducts hearings in most large cities, with or without a formal trial. To file in the Tax Court, a taxpayer must have received a notice of tax deficiency from the IRS and refused to pay. A taxpayer can also turn to the Federal District Court System or to the Claims Court. The latter is a single court in Washington, DC. In both cases, the disputed tax must have first been paid. The taxpayer then files suit for a refund. The District Court is the only one of the three courts in which a taxpayer can request a jury trial in a tax matter. Decisions of the Tax Court and the District Courts may be appealed by either the taxpayer or the government to the Circuit Court of Appeals in whose jurisdiction the taxpayer resides. Appeals from the Claims Court are taken to the Appeals Court for the Federal Circuit. All appellate decisions may be taken

to the Supreme Court. As a practical matter, however, very few estate and gift tax matters are accepted by the Supreme Court.

WILLS

A will is a legal document that directs the disposition of a decedent's assets. It takes effect at the death of the decedent through the probate process. A will should not be confused with a letter of last instructions or other nonlegal written statements relating to the decedent's last wishes. These are not legal and binding documents as is a will.

Need for and Advantages of a Will

A person who dies without a will (that is, intestate) leaves the distribution of his (her) property to be governed entirely by State law. In some cases, State law will do exactly what the decedent had in mind; in other cases it will not. Under State law, all heirs of the same class (children, siblings, etc.) are treated equally if there is no will. There is generally no way the court can alter the distribution of the estate assets.

The advantages of a will are many. With a will, a person can dispose of his (her) property as he (she) wishes within the limits of the law, can name the executor of the estate, and can save probate expenses by waiving (not requiring) bonds and sometimes other expenses. Guardians for minor children can also be named in a will, and charitable bequests specified.

Will Preparation and Execution

The exact legal requirements for preparing and executing a will vary by State and must be followed for the will to be valid. Even handwritten wills must meet certain legal specifications. Only dispositions and other provisions in a will that are permitted by law are valid; the portions that do not follow the law are invalid. An attorney should always be consulted when writing a will. An important point to remember is that, with respect to real property, the law of the State in which the property is located will govern its disposition--not the law of the State in which the owner resides if the two are different. This is an important consideration for those forest landowners whose holdings are in a State or States other than their State of residence. The cost of a will is generally minimal--usually less than the cost of the bond that must be posted if there is no

will.

Joint, Mutual, and Reciprocal Wills

A joint will is a single will executed by two or more individuals. A mutual will is one made pursuant to an agreement between two or more persons to dispose of their property in a special way. The will in such a case may be joint, or there may be separate wills. Reciprocal wills are those in which each testator names the other as his (her) beneficiary, either in a joint will or in separate wills. Even when State law permits, it is generally undesirable for persons to bind themselves with joint, mutual, or reciprocal wills; they run the risk of being unable to deal with changed circumstances upon the death of one of the parties. If executed by spouses, such wills can jeopardize the marital deduction (discussed in chapter 6). The safest procedure is for each spouse to execute a separate will, with no provision that restricts the survivor's freedom of disposition.

Changing a Will

A will may be revoked, modified, or changed at any time before death. All changes, however, must be made in accordance with State law. Minor changes can be made by preparing a codicil, a short attachment to an existing will. In some States, a will may become invalid if the person making it subsequently has a child, including an adopted child. In such cases, a new will would have to be written.

POWER OF ATTORNEY

A power of attorney is a legal document prepared under State law by which the grantor transfers the right to legally act for him (her) to another person. A power of attorney can be limited to only certain acts or may be a general power of attorney covering all actions permitted by State law. Powers of attorney may be revoked at any time by the persons granting them by executing a written revocation in the format provided by State law. They are usually automatically revoked by death or incompetency of the grantor. Therefore, revocable trusts (see page 60) are sometimes used instead of powers of attorney. Under a revocable trust, the trustee can act even if he (she) is unable to ascertain whether the grantor is still alive and even if the grantor becomes incompetent.

Durable Power of Attorney

Many States now permit durable powers of attorney, which survive the incompetency of the grantor. For example, New York law allows a principal to expressly provide that his (her) subsequent disability or incompetency shall not automatically revoke or terminate the authority of an attorney-in-fact who acts under a power of attorney.

PROBATE

Probate is the legal process designed to protect, administer, and distribute a decedent's estate. It includes proving the validity of a will. Probate courts exist for the purpose of protecting the rights of the heirs and/or legatees, supervising the assembling of the estate assets, and assuring proper and orderly distribution of the assets, either by terms of the will or in accordance with State statutes in the absence of a will. Basically, the probate court performs the same function in all States although its name may vary from one State to another.

Probate Administration and Costs

The existence of a will does not necessarily avoid probate. It is still necessary for the court in most

circumstances to supervise distribution of the estate assets. Under some circumstances, depending on the type of property ownership involved and State law, all assets of an estate need not go through probate. In many States, for example, property owned jointly between husband and wife automatically passes to the survivor upon the death of the other (see chapter 15 for a discussion of joint ownership).

Probate administration includes such matters as the assembling of estate assets, payment of debts, clearing title to estate property, payment of taxes, and distribution of the assets to the heirs/legatees. In most cases, a final income tax return will have to be filed for the decedent. During administration of the estate, one or more fiduciary (estate) income tax returns may also have to be filed. In most cases, the executor named in the will or the administrator appointed by the court if there is no will--together with the attorney for the estate--actually handles these details, but always under the court's supervision.

Probate costs vary among States. They depend on the attorney's fee schedule, and on the size and complexity of the estate. In addition to the attorney's fee, there will be court costs, the administrator's or executor's fee unless waived, and the cost of the administrator's or executor's bond unless waived. Although it is difficult to generalize, costs typically range between 2 and 6 percent of estate value.

