
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 (IRC) of 1986, because of the extensive changes made by the Tax Reform Act of 1986 (Public Law 99-514), the IRC 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 virtually every year, Congress passes substantive changes and technical corrections to the law.

Administrative Basis

Regulations—The Internal Revenue Service (IRS) is empowered to administer the IRC. 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. Regulations also serve as an enforcement mechanism. IRS regulations must be issued in proposed form subject to public comment before being published by the IRS in final form. Both interpretive and statutory 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 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. Private letter rulings generally are official replies given by the IRS to taxpayer inquiries concerning the tax consequences of proposed transactions. They are limited in application to the taxpayer who made the request, and may not be used as precedent by other taxpayers. Private letter rulings are available to the public under the Freedom of Information Act (FOIA; Public Law 85-619, as amended). Although not comprising general precedent, they can be 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 a private letter ruling, a TAM is limited in application to the taxpayer who made the request and may not be used as precedent by other taxpayers. Also available under FOIA, TAMs often are used to help interpret IRS positions.

Judicial Basis

If a taxpayer disputes the IRS position in a particular matter and the disagreement cannot 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 also can turn to the Federal District Court system or to the Court of Federal Claims, which is a single court in Washington, D.C. In both of the latter two cases, the taxpayer must first pay the disputed tax and then file 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 Federal Circuit Court of Appeals in the jurisdiction where the taxpayer resides. Appeals from the Court of Federal Claims are taken to the Appeals Court for the Federal Circuit. All appellate decisions may be taken to the United States Supreme Court, but as a practical matter, that court accepts very few estate and gift tax cases.

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 State 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 generally is 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 some other expenses. Also, guardians for minor children can be named in a will, and charitable bequests specified. With a will, the testator can stipulate that certain estate assets go into a trust to be created at the testator's death. Without a will, this cannot be done.

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; any portions that do not follow the law are invalid. An attorney always should 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 forest landowners with holdings 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, again either in a joint will or in separate wills. Even when State law permits, it generally is 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 provisions that restrict 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, which is 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, unless there is a provision in the will to the contrary. In such cases, a new will must 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 revoked automatically by the death of the grantor, and usually also by the grantor becoming incompetent, unless the instrument is a durable power of attorney, as described below. Revocable trusts (see chapter 9) sometimes are 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 still is alive and even if the grantor becomes incompetent.

Durable Power of Attorney

Most States now permit durable powers of attorney, which survive the incompetency of the grantor. For example, New York law allows a principal to 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.

Springing Power of Attorney

Most States now also permit so-called "springing" powers of attorney. A springing power of attorney becomes effective only when the grantor becomes incompetent. Under most State laws governing durable and springing powers of attorney, the attestation of two physicians is required to establish incompetency.

Probate

Probate is the legal process designed to protect, administer, and distribute a decedent's estate. It includes proving the validity of the will. Probate courts exist to protect the rights of the heirs or legatees, supervise the assembling of the estate assets, and assure 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; in most cases, it still is necessary for the court 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 a husband and wife automatically passes to the survivor upon the death of the other (see chapter 14 for a discussion of spousal joint ownership).

Other assets that do not pass through probate include life insurance policy proceeds (unless payable to the insured's estate), individual retirement account (IRA) balances (unless payable to the insured's estate), and some U.S. Government savings bonds (dependent upon how ownership is titled). Federal law governs the disposition of these items.

Probate administration includes such matters as the assembling of estate assets, payment of debts and taxes, clearing title to real property, and distribution of items to the heirs/legatees. In most cases, a final income tax return must be filed for the decedent. During administration of the estate, one or more fiduciary (estate) income tax returns also may 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 and depend on the attorney's fee schedule, and on the size and complexity of the estate. In addition to the attorney's fee, there are 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 the value of the estate.