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Perspectives on Planning for Personal Property

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INTRODUCTION

All assets are classified as either real property or personal property. Then the classification of personal property is further divided into either (i) tangible, or (ii) intangible – like investment accounts, intellectual property, or digital assets. Accordingly, tangible personal property (TPP) is everything that is not real property or intangible personal property. TPP includes a wide range of things that must be disposed of at death, such as the cash in a wallet, the wallet itself, clothes in a closet, jewelry, dishes and silver, furnishings, vehicles, and even pets!

TPP can also include items that may be of great value. Examples include fine artwork, gold bars, boats, electronics, collections of all kinds (including coins, cars, wine or guns), and horses. Since everyone has items of TPP, it is advisable to address and consider the disposition of TPP during any thoughtful estate planning process.

EMOTIONAL ASPECTS AND BLENDED FAMILY CONSIDERATIONS

There are challenges in planning for the disposition of TPP, and sometimes both clients and their advisors may prefer not to delve into the complex nuances during the planning process. The failure to properly plan for such items, however, can cause significant family disputes and administration nightmares. Some of the challenges that lead to difficulties in dealing with the

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disposition of TPP include the emotional issues that attach to such items (e.g., grandpa's watch or grandma's silver tray that held her prized baking at every family gathering). People often have deep feelings regarding such items emanating out of memories and other attachments.

Since TPP includes personal journals and photographs, and all kinds of things that individuals may have, sometimes it is the items that are worth the least in financial terms that may cause the most conflict and heartache. Family members may all want the same items of memorabilia that belonged to a parent. Technology might offer a resolution in some instances. For example, digitizing family videos and photographs might reduce strife accompanying the disposition and division of such items. But what about other items that may have been left to a surviving spouse who then remarries?

Acrimony can arise if the surviving spouse cavalierly leaves all the tangible personal property, by default, to the new surviving spouse. Some of these items may only have sentimental value to the children of the first marriage. Other items that have monetary value may include the first spouse's jewelry or items that had been in the family for generations. By virtue of a boilerplate or common disposition provision that provides that all the decedent's TPP is left to the new surviving spouse, the children from his first marriage may have no ability to have access or obtain any of the items brought to or acquired during their parent's marriage to each other. The second spouse's family may not even consider the value such items may have (sentimental or otherwise) and may merely dispose of the items without consideration of (or out of spite because of) the decedent's children's desires. Addressing the disposition of items inherited from a first spouse can be important when attempting to avoid hard feelings and family strife following the surviving spouse's death, especially in a blended family scenario.

Even if the TPP is left to the second spouse in a QTIP which only permits use of the items by the second spouse, a usufruct interest may be required to be converted into income producing property. Therefore, it can be helpful to consider what should happen if this occurs. One option may be to provide for rights of first refusal to the children so that before the trustee sells an item to a disinterested party, the children can purchase the item and provide the QTIP with cash proceeds that can then be invested in a productive fashion. By thinking about and planning for such items during the estate planning process, estate planners may help the client problem solve, plan for, and deal with these issues and thereby maybe avoid litigation, hurt feelings, or acrimony amongst various members of the family.

Conversely, in a subsequent marriage situation, leaving all the TPP to the children can also be prob-

lematic especially if the intent was for TPP in the party's home to be given to (or used by) the surviving spouse, whether outright or while they continue to reside in the home. Giving a surviving second spouse the use of a home, when the children of a prior marriage remove all furniture, art, etc., may completely frustrate the testator's intent. These are issues that too often are not considered if one merely reverts to using a standard disposition clause without adequate discussion of the potential implications, as the disposition of TPP is sometimes not "standard."

The evolution of the American family unit makes reliance on "boilerplate" TPP dispositions potentially problematic. Fewer than 50% of families represent the traditional nuclear family with two different sex, cis-gender parents with only shared children from a single marriage.¹ These types of issues can arise in other non-traditional families as well. Perhaps an individual is cohabiting with another adult or is part of a polyamorous relationship. There could be multiple romantic partners all vying for the TPP. Consequently, the need to address these issues specifically may be more common than some practitioners realize.

Nonetheless, conflicts over TPP aren't limited to situations where blended or non-traditional families exist. They often arise between children, grandchildren and other inheritors in traditional families once the benefactor who was the glue that held the family together is gone. When a member of the family dies, many issues emanating from the family's dynamics may surface and foment acrimony amongst the surviving family members. They can relate to feelings that "mom favored you" or "that was the necklace that dad gave mom to celebrate when I was born, so I should get it." There can be a plethora of perceived emotional childhood traumas that may give rise to disputes when dividing the TPP. Sometimes people don't even want an item, but they vehemently don't want a sibling to "win" by inheriting the item. A lot of unnecessary tears might be avoided if careful consideration is given to the disposition of TPP.

Even when proactive steps are taken to address the disposition of the TPP, issues and disputes can still arise. An example of when this might occur is when list dispositions are provided, but the item can't be found or is no longer owned at the time of death. Another example is when a benefactor promises an item to someone, but then provides for a different disposition in the testamentary plan or gives the item away during life to a different person than is listed in the estate plan and the item is not removed from the list

¹ Gretchen Livingston, *Fewer than half of U.S. Kids today live in a 'traditional' family*, Facttank – News in the Numbers (Dec. 22, 2014), <https://www.pewresearch.org/fact-tank/2014/12/22/less-than-half-of-u-s-kids-today-live-in-a-traditional-family/>.

or other mechanism for disposition utilized in the plan. Disposing of an item, or giving it to a different person than provided for in the estate plan, can result in beneficiaries accusing others of stealing the item or exercising undue influence. A lifetime disposition different from that provided in the estate plan may even result in the intended beneficiary being effectively disinherited because the item which was to be left to that beneficiary is no longer available for disposition at death but everybody else receives the items left to them. It may be helpful to think about, contemplate and discuss such issues with our clients as we try to help them through the process of disposing of their TPP.

One other emotional consideration may be the emotional attachment that clients themselves have to their TPP items. As we talk to clients about their collections, or what they want to have done with their property, the client may find it difficult to find a resolution because their own attachments to the items might not align with how others view the items. A common example occurs when clients believe it is valuable to maintain the property in the family, while the inheritors simply do not want it.

Therefore, while a boilerplate approach may work in some instances, other options may be preferable to effectuate the client's true desires. Often, a team approach to estate planning solutions can help identify issues and problems that might be averted through drafting provisions specific to the client's situation. For example, an advisor other than the estate planning attorney might pick up on an issue, or the client might share concerns over a particular issue like TPP dispositions with only one advisor, but not the drafting attorney.

DIVIDING THE PROPERTY AND DISPUTE RESOLUTION OPTIONS

The emotional issues identified above, as well as the potential impact of usufruct provisions may, at times, be addressed using rights of first refusal. It's not uncommon, out of spite, for a child named as fiduciary, to sell something just to keep a sibling or other legatee from receiving the item. This may happen more commonly in a blended family situation, but it can happen in any environment where there are dysfunctional relationships between beneficiaries. Often default provisions provide the fiduciary with the discretion to make distributions in kind or of the proceeds from the sale of the items involved. Care may be required if the grantor wants the beneficiary or beneficiaries to have the right to receive items (even if under a right of first refusal or other type of purchase arrangement) before the items is sold to a third party. Providing sufficient direction to an independent

fiduciary, and safeguards against that discretion, when a grantor wants items to be retained in the family before being disposed of, may be important.

There are a variety of different ways to resolve disputes regarding the division and distribution of TPP under general TPP dispositive clauses. One approach is to require beneficiaries to purchase the items they want from the estate at fair market value or alternatively to create virtual bid dollar accounts. Each beneficiary can be allotted a specified number of fictional dollars that can be used to bid on TPP desired. Some default to or otherwise include a "round robin" approach. The oldest child may select first and then the next oldest and so on, and once each has selected, the process starts all over again. Others draw lots or straws to determine the selection pecking order. However, using a 123-123-123 selection process once the pecking order has been established, can significantly favor the child who draws first each round and penalize the others. A more thoughtful approach may use a more complicated ordering such as 123-321-231. Use of this selection order may be further enhanced by requiring mathematical intervention to endeavor to assure that the selection process (in terms of valuation allocation) is fair or even equal. Online tools exist that can further assist with these kinds of processes by cataloging and capturing data about the items and facilitating the division process.²

If there's a collection and you have a tangible property clause that provides for a rotational or lottery type disposition, does that apply to the whole collection? Does that apply to individual items? Have you just destroyed the collection by permitting a round robin approach on an item-by-item basis? Will operation of the clause impact the value of what is being passed on by dividing up a collection amongst various beneficiaries? Structuring the plan to reflect the client's intention may require a greater understanding of what the client wants, but also who owns the asset, how it is titled and whether it is part of a collection.

There are several approaches to engage in when structuring a selection process. The bottom line, however, is to think about the process of division ahead of time or empower somebody to be able to deal with disagreements when they arise.³ Often planners use a provision that indicates that the TPP will be divided amongst beneficiaries as they agree. But what if they can't reach agreement? Then there may need to be somebody who can be a final arbiter to determine how the issue is going to be resolved. Another option may be to include a mandatory mediation provision before

² See, e.g., FairSplit,™ <https://www.fairsplit.com/>.

³ David MacMahan, *Overcoming the Great Divide, Trusts & Estates*, 26-31 (Sept. 2020).

litigation can ensue. Such a provision may encourage family members to work out disputes through mediation rather than taking them to court, since disputes over the TPP can tear at the very fabric of continued family relationships.

STRUCTURING THE PLAN, TITLE, AND INSURANCE

It remains important to coordinate titling as well as the dispositive provisions comprising the client's plan. A failure to do so can result in assets passing in a fashion contrary to the decedent's intent. A common planning technique is to utilize a pour over will to a revocable trust. If assets are held in the decedent's individual name such that the will controls disposition, and the will has a different provision for disposition of TPP than those contained in the revocable trust this can create fodder for conflict, especially if some TPP has been transferred to the trust while other TPP has not. When assets have been transferred to the trust, it is advisable for property and casualty insurance to be updated to reflect the trust's ownership of those items, to eliminate the potential for further problems should a loss occur. Also, if TPP has been transferred to an LLC (e.g., such as TPP associated with a vacation home that has been transferred to an LLC), it is important that the LLC obtain and maintain insurance that covers valuable TPP held by the LLC. Many clients may have complex plans, with TPP held by a variety of trusts and entities. Use of a sophisticated insurance consultant who understands the nuances of the client's entities and TPP can be extremely important to assuring that proper coverage is in place.

With some artwork and collectibles, there might also be concerns of title challenges in the future, and it may be desirable for clients to investigate obtaining title insurance at the time of acquisition. Even when ownership is being documented, there are multiple non-theft title risks that could apply.⁴

There can be significant titling challenges when it comes to determining ownership of TPP. Unlike real estate, often there isn't clear evidence of title relative to TPP. Occasionally, for very valuable items or custom ordered furniture or jewelry, that there may be a bill of sale reflecting who purchased the item (which may be an indication of ownership, but the item may have been purchased as a gift). Hopefully, clients are keeping receipts and information relating to higher value items, but often such evidence is missing when administration of the assets is required. When it comes to boats and cars evidence of title should exist,

but, as to other TPP tracking title and what has occurred since acquisition can be incredibly difficult. If an art object is separate property (because one spouse brought it into the marriage or inherited it) but it's just hanging in the home, how do you establish that that is separate property rather than belonging to both spouses jointly?

When there is expensive separate property, or the marriage isn't the first for one or both of the parties, it may be important to adequately reflect who owns valuable items of TPP. One way of doing so may be to create a simple separate property revocable trust before the parties get married to hold separate property assets to maintain their identity. Another approach may be to create an irrevocable self-settled asset protection trust. A prenuptial or other marital agreement may be entered into by the parties to preserve the separate nature of assets. In any of those situations, providing an inventory that contains sufficient specificity to identify the items of TPP transferred to the trust (or identified as separate property) can be helpful.

When joint trusts are created, and TPP is transferred to the trust the creation of schedules that provide sufficient specificity to enable a determination of who owned the TPP before it was given to the trust is recommended. This is important if the trust provides that a surviving spouse has the right to revoke the trust as to assets which he or she contributed, but not regarding assets contributed by the deceased spouse or in a community property state. When a joint trust is utilized, even when the TPP has been properly conveyed to the trust, information beyond just the title that also documents the tracing and the tracking of the TPP contributed, can be extremely important.

Even if you're not dealing with a joint trust, it's not uncommon for somebody to say "Oh, no, my spouse gifted that item to me." Even though the bill of sale has been retained, and it shows that the deceased spouse purchased the item, an issue of title can arise. If the decedent didn't own the item (or it wasn't titled to his revocable trust) at the time of death, the dispositive provisions of the decedent's operative instruments won't control disposition.

Tracking actual title can be difficult. TPP may be assigned to a trust or LLC to avoid probate. Such assignments are often general blanket instruments covering broad categories of, or all, TPP (e.g., boilerplate forms assigning "all my rights and interests in all tangible property to my revocable trust"). Use of specific assignments or including a specific list that identifies valuable assets intended to be governed by the assignment can help to clarify who or what entity actually owns such TPP. For example, "I hereby assign my coin collection to my Declaration of Trust, dated March 20, 2021, as from time to time may be

⁴ Judith Pearson, *Establishing Clear Titles to Works of Art, Trusts & Estates*, A15-18 (Mar. 2018).

amended.” In addition, providing an itemized list of all the art that is encompassed by the collection (or attaching an inventory), that provides a history of acquisition and provenance, the artist, title of piece and other pertinent information, can be extremely helpful. Use of images can also be beneficial. For example, an electronic home inventory listing the owner of each item. Having a professional firm that creates home inventories or appraises collectibles will provide proper detailed descriptions of each item that might avoid any confusion. This process applies not only to art but jewelry and collections of all sorts.

PROVENANCE

Provenance is different than title. It’s the actual history or the story behind the TPP. Who currently owns it? Who has previously owned it? Was it created or owned by a famous person? Information regarding to the artist or production of the item can all impact the value of the TPP. This could relate not only to art but to clothing, historical documents or photos, wine, and a plethora of other items of TPP. Even though information may not relate specifically to the particular item owned by the grantor, other information may be important to establishing provenance. For example, consider a lithograph owned by an individual that is one in a series of 50 pictures. Perhaps an art dealer has published a catalog that reflects one in that series that is being sold; saving a copy of that catalog to show some of the history and background (which is often referenced in an art dealer’s catalog) which provides a description of the art and the story behind it, can aid in establishing provenance. Even if the catalogue doesn’t establish the provenance of the individual’s particular lithograph, the history of the art can be fascinating and make the artwork (or the collectible) come alive. This type of information can also result in added value.

Some clients may think they are saving tax dollars by buying collectibles through their family business because they deduct or depreciate the art (even when that may not be appropriate). When this occurs, the business actually has title to those items, and they will pass with the business as opposed to under a general TPP provision under the will or trust. Therefore, when discussing disposition of TPP with the client, it may be important to question whether there are any items of TPP held in entities that the client wants to dispose of in a fashion different than that which relates to the disposition of such entity. This can be nettlesome as it may require distributing the property out of the entity, addressing claims by other business owners, adverse income tax consequences, etc., but necessary to effectuate the client’s ultimate dispositive desires.

Provenance can be extremely important to effectuating disposition of protected material. A piano that

has ivory keys may be considered protected property. If the provenance of the piano isn’t maintained there may be limitations on the ability to transport it to a beneficiary who isn’t a U.S. resident. While understanding all the items that may be considered protected material and limitations on disposition and transportation are beyond the scope of this article, understanding that such limitations exist can be important to formulation of a plan of disposition during the estate planning process. A failure to maintain evidence of provenance can create impairments to distributions to non-resident beneficiaries and may also adversely affect the ability to sell, otherwise dispose of or obtain the benefits of the true value of such items (at sale or donation).

DEFINING THE TPP

How one defines TPP can also be important. The general default definition contained within a standard estate planning document may be sufficient for some clients, but in other cases, the practitioner may need to review the definition in the context of what TPP the client has. If the client has large dollars of cash, gold bullion, silver, or a coin collection, each of these items constitutes TPP, but the client may wish to treat such items differently than what a default clause would otherwise provide. As a result, it is common for the provision that disposes of TPP to exclude all cash, coins, gold and stock certificates.

Along the same lines, defining which items constitute a collection is helpful. Almost any type of TPP may be part of a collection (e.g., art, books, pens, watches, guns, alcohol, dolls and toys). If an item is part of a collection the sum of each item’s individual value may be far less than when the collection is valued as a whole. Therefore, it’s important to ask whether a client has any items that constitute a collection, and whether they wish that collection to be treated as a collection or as separate individual items in the scheme of disposition, such that when a beneficiary exercises a right of selection, they can select the whole or any part of a collection when it’s their turn to select an item, or only one item from amongst the collection may be picked. Obtaining a professionally prepared inventory of a client’s TPP may help to provide an indication of items which may go together as a collection, and how the collection will be treated in the dispositive scheme provided within the plan.

Furthermore, the location of an item may impact how a dispositive provision will effectively operate. For example, a client wishing their surviving spouse to receive certain portions of a collection (e.g., items on display in the primary home). Yet some of the collection may be on display outside of the home. Other items may be in storage. Still others may be located at

vacation properties, and some may have been consigned or on loan. How you delineate which items may either be distributed to the surviving spouse as a devise, which items are to stay with the house for use while it is occupied by the surviving spouse, versus which items are to be disposed of, may require careful drafting of definitions to avoid a significant deviation from the client's intent. What if an item historically on display, in storage or located at a different location, is delivered to the home just before the grantor dies? Just because it was located at the home at the time of death, did the grantor intend for that item to be bequeathed to (or be used by) the surviving spouse? TPP displayed in a home in a different state may be subject to different state law than the home state where the will or revocable trust is governed.

In addition, the location of some TPP may be at a location where the personal representative might not know to look (e.g., a hidden safe). An item might be on display somewhere where there's an agreement, and family members may know that, but has the arrangement been disclosed to the estate planner? What if the art owner has loaned the art to a family member, business, or is permitting their firm display the art in a conference room, office or lobby? Knowing that such items exist and are intended to be disposed of pursuant to the TPP provisions of the plan can be extremely important.

Sometimes a document might provide for TPP to be equally divided between a class of beneficiaries without further explanation. What is meant by "equal" can make a difference in what the beneficiaries ultimately receive. Does it refer to an equal number of items? Is it an equal value of those items? Is the intent to effectuate a division of an equal number of items that are of approximately equal value? While the last definition sounds imprecise, it may nonetheless be what the grantor intends. It is not possible to create a devise that will be perfect, because the division of TPP is rarely perfect in implementation, and the facts not only vary, but change. However, giving these issues consideration and engaging in discussion with the client can help discern more clearly and specifically what the client's wishes are, and permit the planner to draft in a fashion that attempts to effectuate the client's intentions. Clients often have their own agenda for what they want to discuss. It may be issues between their children, it may be a family business, and/or perhaps a desire to save every penny of tax. But too often tangible property just isn't on the radar for a lot of clients when it should be.

For Audrey Hepburn, the relationship between her children was of great importance to her.⁵ While her two sons were from different relationships, she provided that her TPP would be divided equally between them. Over the course of approximately 24 years following her death, her children were unable to amicably resolve the "equal" division between them of memorabilia contained in a storage locker. Ultimately, one of her children petitioned the court to resolve their disputes over the TPP, something Audrey likely hoped to avoid and did not anticipate. This led to two years of litigation before the children were able to come to a resolution that involved auctioning off the disputed items and splitting the proceeds.⁶

The client may be anxious about spending considerable time engaging in a discussion of their TPP, out of concern over professional fees. Utilization of others on the advisory team may lessen their cost concerns, e.g., a wealth adviser who is familiar with the family but who does not bill hourly. Thus, a wealth adviser who meets quarterly with the client might delve into the issue of whether there have been any major TPP acquisitions or disposition since the last meeting. When an important change has been identified that information can then be conveyed to the estate planning attorney. When the advisor team works collaboratively, which ever adviser is meeting with the client can endeavor to identify TPP issues. This is important because the client might not see the estate planner frequently enough to find out about an important change in time to revise the instruments to address the change.

THE EMPTY HOOK

Another common TPP issue is the so-called "empty hook" scenario.⁷ The client may believe that they can save tax dollars by simply not disclosing the existence or value of certain TPP to their estate planner or surviving family members may fail to disclose items to whomever is preparing an estate tax return. It's fairly routine, on audit of an estate tax return, for the IRS to ask for the riders on insurance policies to make sure that those items are accounted for on the return. Further, failure to disclose the existence of TPP (and its value) can make it more difficult for a fiduciary to administer an estate. Conversely, if an item has been dis-

⁵ <https://www.today.com/video/audrey-hepburns-sons-fight-over-her-memorabilia-453177923895>.

⁶ <https://www.dailymail.co.uk/news/article-4621912/Audrey-Hepburn-s-sons-settle-divide-memorabilia.html>.

⁷ This term is used by Michael Mendelsohn, *Life is short, art is long: maximizing estate planning strategies for collectors of art, antiques, and collectibles*, Wealth Management Press (Jan. 1, 2007).

posed of, it's important to update insurance and remove the item from any list disposition, inventory or insurance rider. Up to date recordkeeping on the part of the grantor can be important to eliminating conflict between beneficiaries and minimize wasted administrative time and professional fees.

Another issue is what the fiduciary may need to do to protect itself when it comes to TPP. If title to the TPP is held in the trust, a successor trustee, in fulfilling its fiduciary duty, may need to take possession of the items of TPP and secure them. But what if they don't? Perhaps the trustee decides to (or is required by the terms of the trust) to leave the TPP in the possession of the beneficiary so that they can continue enjoying use (such as the art on the wall). What happens if the items disappear? It can be important to not only consider what the grantor wants to provide to a beneficiary, but also consider the practicalities of how and whether a fiduciary is going to be able to police, inventory, and control the TPP.

The fiduciary may fear the image of walking into a house and finding that there's just nothing there. All that is left are empty picture hooks or shadows on the wall where valuable art used to hang. Jewelry seems to just grow legs and walk away without tracks to follow. Failing to keep an up-to-date inventory, with at least estimated values, can make the job of a fiduciary more difficult. The failure to maintain adequate documentation of provenance can adversely affect value. It is not in the client's best interest to rely upon a general disposition clause and a wink and a nod on what assets exists and are covered by that clause.

It can also be a problem if the individual has items of value and they pick a fiduciary who is not going to be able to recognize that there are items of value and not junk. Without direction or information from the individual the fiduciary may inadvertently dispose of a valuable piece, not realizing its value. It is not uncommon (particularly in a non-taxable estate) for the fiduciary (or others) to go into the decedent's house and "clean it out." Sometimes this results in TPP being donated or sold (e.g., at garage sale prices) not realizing its actual value (e.g., not realizing grandma's everyday drinking glasses are in fact depression era glass that may be quite valuable). We've all watched the Antique Road Show and marveled at the person seeking input on the value of an item bought for \$10 at a garage sale that turns out to be worth tens of thousands or more dollars.⁸ So how do we let the fiduciary know there is value there? It's part of selecting the right fiduciary, but it's may also be keeping the fiduciary properly informed.

⁸ See, e.g., <https://apnews.com/article/yard-sale-find-porcelain-bowl-worth-500k-6afe3261a5b4b74e9c02a533e0403081>.

Some clients may not actually appreciate or know that certain of their TPP has significant value. They may not have documentation of provenance, where an item came from, who created it, or even the medium that it is in. It can be helpful to bring in an outside appraisal firm to create a home inventory and valuation. The cost of doing so may be considered modest considering that it can result in the provision of professional photographs of the TPP, the generation of description and explanation of each collectible and piece of art, provide some indication of where it was made, perhaps even who created the item, historical information, and an indication of value. The report generated can also be helpful to the client in indicating who should receive such items. The report can also facilitate obtaining proper insurance for the items, as it's not uncommon for such items to be either over or under insured. Over insuring an item is a waste of money, and under insurance can be a disaster. The report will not only generate details that can help guide the fiduciaries but can also assist in the planning process.

VALUES CHANGE

If specific devises of TPP are premised upon valuation, it can be important to have updated appraisals conducted and to review dispositive provisions premised upon the valuations obtained. The value of art and collectibles can change dramatically – some may appreciate significantly while other items may decline in value because there no longer is a market for such items. It's important to understand whether a client has or desires to allocate specific devises of collectibles amongst beneficiaries based upon value, sentiment, beneficiary desires or any combination thereof. If the client ultimately wants the value distributed amongst his beneficiaries to at least be approximately equal, it may be important to include an equalization clause and to consider other issues that could impact the division and distribution of TPP.

It is beneficial for clients to verify the authenticity of their items and keep current on the valuation of items when they plan to assign particular items to specific children. One example inspired by Michael Mendelsohn, who wrote the book *Life is short, art is long: maximizing estate planning strategies for collectors of art, antiques, and collectibles*,⁹ could be where parents bequeath one valuable item to each of their three children thinking that they were providing for equal distributions, and then the children later learn that one of the works is a fake and worthless. This could also happen even if the items are all authentic, but one of the works could appreciate significantly after the time

⁹ See Note 7, above.

of purchase and dwarf the value of the other items. In both examples, while the client may have a mistaken belief that bequests were equalized among beneficiaries, this may not be the case. A competent appraisal of the items might have assisted the client in creating a plan that actually effectuated intent.

If the intention isn't to effectuate an equal distribution of the TPP based upon value, then it might be prudent to consider use of a tax apportionment clause, rather than allocating the payment of all tax to the residue. By doing so, the disproportionate division of TPP value might not be exacerbated by the remainder beneficiaries bearing the estate tax burden on the value of such TPP. Further, if equalization of the value of the TPP distributions is intended, then a mechanism for truing up the value of the TPP, to provide for equalization in the overall distribution of the TPP or the estate as a whole may be required to accurately reflect the grantor's intent.

COSTS AND OTHER DRAFTING CONSIDERATIONS RELATING TO DISPOSITION

When drafting dispositive provisions, consider contemplating the cost of disposition, the potential deductibility of such costs (e.g., qualifying for a charitable deduction). If there are items that aren't selected by a family member, will those items simply pour over to be allocated to beneficiaries under a residuary clause? Ordinarily the costs of selling assets not selected by family members won't be considered a deductible expense unless the sale is necessary to meet the cost of administration or to pay taxes. But what if the dispositive instrument includes a direction, that if an item is not selected, it must be sold, and the proceeds divided among the beneficiaries. Such a direction (rather than simply providing the fiduciary with the discretion to distribute such items in cash or kind), may provide an argument that the cost of sale should be deductible. Another option may be to direct that TPP not selected by beneficiaries is to be donated to certain charities. Might this lead to the ability to obtain a charitable deduction by the estate for the value of items so donated? If the unselected TPP simply pours over to the residue, deductibility may not be an option.

What about the costs of shipping, storing and insuring TPP? Clearly addressing who will be responsible for such expenses can avoid disputes and aid in securing deductibility. Perhaps the grantor only wants the estate to bear the costs of shipping and/or storage of some (but not all) of the TPP once the fiduciary is able to effectuate distribution. While these costs may be overlooked as routine or not significant, they can be. The cost to ship a piano may be greater than the value of the piano.

ADEMPTION

What if the estate lacks sufficient liquidity to address obligations resulting in the need to liquidate TPP to meet administrative, statutory claims or other obligations? Many planners don't really think about this issue, perhaps because they assume clients seeking sophisticated estate tax planning (or those who are just engaged in planning because they have an estate to be disposed of) will have sufficient liquidity to satisfy all such obligations. But that doesn't always happen. A plan once executed can remain in place for a very long time without further modification. An individual's financial circumstances can change. A spouse may make a claim for a family allowance or spousal elective share that impairs the estate's ability to fulfill all the devises otherwise provided for under the plan. Where and how the draftsman addresses TPP can affect whether the dispositive provision will be treated as a general or specific devise. Further, where the draftsman places such provisions can impact the order in which such a devise or bequest may adeem. While the order in which bequests may adeem can vary from state to state, proactive drafting may override statutory default provisions. Consequently, it is important to be sensitive to the issue and to be familiar with at least the statutory default provisions provided for by the law governing the instrument.

Ademption generally occurs when there isn't sufficient assets or liquidity to meet all the obligations and bequests set forth in the dispositive instrument. When this happens, the fiduciary may have to start eliminating satisfaction of bequests. Under such circumstances, the fiduciary (and perhaps a court) will be called upon to determine if a bequest is general or specific in nature. When ademption is to occur, one should look first to the terms of the governing instrument, and if not specifically addressed, then default provisions as provided by state law. When not specifically addressed by the instrument, planners may wish to note that the default provisions of state law will generally govern the order of ademption, and the law of the state that originally governed the instrument may differ from that of the law applicable at the time of administration.

Whether state statutory provisions addressing ademption are procedural or substantive in nature can be subject to debate with the outcome influencing how ademption will occur in the absence of specific provisions contained within the instrument, as to the order that bequests shall adeem. Generally, in the absence of specific provisions within the governing instrument, the residuary bequest will be eliminated first, followed by general bequests, and then specific bequests. Specific bequests then tend to be wiped out in reverse order, with the last specific devise reflected in the governing instrument being the first eliminated.

Therefore, depending on whether some or all the TPP has been addressed as a general class bequest, a specific devise of certain items of TPP to a beneficiary, where you place the bequest within the governing instrument, and how you organize bequests, can have a significant impact on which bequests will be eliminated when ademption occurs.

LIFETIME VS. DISPOSITION UPON DEATH

Whether TPP is disposed of during life or at death generally depends on the client's goals. While many clients want to hold on to their TPP (such as jewelry and items of personal use, and the artwork on their walls until their last day) others may want to instill the values of collecting and an appreciation of art or other collectibles in their descendants. This may influence whether the client engages in a gifting program. Consequently, whether to transfer TPP during life or upon death may be part a much broader philosophical discussion. This discussion might change significantly if new tax legislation eliminates the step-up in basis at death. And the situation might be even worse if a capital gains tax is imposed on death. Either or both of these unlikely changes to the law could dramatically change planning for TPP and the traditional planning goal of holding appreciated assets until death for a basis step-up.

For clients who wish to give interests in an art collection, one strategy is to transfer the collection to an LLC and have whichever individuals or trusts hold the art, to pay the LLC annual rent for use of the art. Thereafter, the creator of the LLC might gift membership interests in the LLC annually with the transfers intended to qualify for annual exclusion treatment. The problem or challenge with that approach when the LLC owns a collectible, is determining whether the gift of the LLC interest represents a present interest qualifying for the annual gift exclusion. To address this concern, one may wish to include Crummey-like withdrawal rights in the LLC, and fund the LLC with sufficient cash to make sure there's enough money to satisfy any withdrawal rights necessary to qualify gifts for annual exclusion treatment.

Another issue that one might consider if a lifetime gift is made, is whether it is intended to be an advancement. When a lifetime gift is intended as an advancement, it will be important to document such intent. Even if it's not intended as an advancement, one may still want to document that intent as well. If the client does not document a lifetime gift of TPP, it's possible that heirs will claim theft, advancement, or other issues. Therefore, documenting a lifetime gift (whether by a deed of gift, simple gift letter or otherwise) can be important, and if the gift is intended to

operate an advancement, the written evidence of the gift should so state. While it is possible to draft provisions establishing a default rule of thumb as to how lifetime gifts of TPP should be treated, in the absence of such default provisions or a transfer intended to fall outside the terms of such default provisions, documenting the intent as to treatment can be very important.

Additionally, if an item of TTP is disposed of during lifetime, such that it no longer belongs to the grantor at death (but continues to be reflected on a list disposition), it will be important to specifically provide what is intended to happen regarding the then ineffective list disposition of the TPP in question. Is it intended to lapse and be of no effect? Is a substitute gift of equal value or replacement gift intended? This could be a significant planning issue if income tax legislation passes that would tax capital gains at ordinary income tax rates of 39.6% once income exceeds \$1 million. The possibility of this type of change may motivate significant sales if it looks likely such legislation might pass, hence giving rise to the possible issued noted above.

CHARITABLE CONSIDERATIONS

When it comes to charitable planning for TPP, donations can be consummated during lifetime or at death. Generally, there are two primary reasons why clients might want to give their tangible property to charity. One is for the tax deductions, while the other is for the stewardship and care of the item. Perhaps the client has an important piece of art or an artifact the client wishes to preserve by making sure it ends up in the hands of an institution that will appreciate the historical or monetary value of the item and will be able to afford it proper care and preservation. Sometimes the cost of preservation, insurance, and proper storage is simply too expensive for individual inheritors. When this occurs, it may be important to talk to charity to make sure they want the item (whether it will be donated during life or upon death). Some charities have restrictive gift acceptance policies but may be able to have an independent donor advised fund accept property that they will not so that they may benefit from a cash contribution in the future if that comports with the donor's charitable desires.

Consider basis issues. When the client is an artist who wants to donate their own works, basis in the work is limited to the cost of the materials that went into the creation of the artwork. This may limit the charitable donation that may be recognized when a lifetime donation is made. Perhaps the mechanism for preservation of the TPP will be the creation of a private operating foundation that can continue to exhibit

and provide for proper maintenance, storage and insuring such items.

If the client wishes to establish a public museum to exhibit and maintain valuable items of TPP, it will be important to consider whether the museum will meet the one-third public support test. It can be very difficult to keep a public museum operating. As a result, the use of a private operating foundation may be a better approach. Current proposals include capping the benefit of itemized deductions at 28%. If the income tax rates are increased to 39.6% with deductions, such as charitable gifts, capped at a lower level, the tax benefit of the donation may be limited. This potential change might motivate some clients to consummate donations prior to the effective date of any such change.

When a donation to a public charity is contemplated, it can be helpful to work-out a donor agreement with the charity. When clients have valuable collections that are very dear to them, and they're donating the items because they want to have the collection remain intact and enjoyed by the public, unless they have an agreement, there will be no way to know if the charitable institution will actually display the items. Many museums have huge warehouses full of collectibles that either get rotated in and out of displays, or sometimes never leave the warehouse. If the client has very specific wishes about how TPP donated is to be treated, it will be important that they speak to the charities and memorialize what's is to be done in an agreement.

Perhaps the client's intent is that items donated (whether during life or devised upon death) are to be maintained permanently (and never sold) by the charity. The charity may or may not be desirous of receiving and maintaining the items or collection. Having a discussion with the charity during the planning process may permit the client to make other arrangements for the disposition of those items that the charity doesn't wish to retain or display. If these issues are addressed on front-end, other opportunities to effectuate donor intent may be foreclosed.

OTHER TAX AND PLANNING CONSIDERATIONS

While this article isn't intended to focus on the tax consequences that may be associated with TPP, a brief discussion is merited. Often collectibles face a higher capital gains tax. So-called "collectible assets" typically face a long-term capital gains tax rate of 28% compared to the currently much lower rates for other types of assets. A lack of liquidity may reflect a need to plan for the potential transfer of the art. One approach may be to use life insurance to assure sufficient liquidity to pay estate taxes associated with valuable TPP.

When gifting is to occur (whether for charitable purposes, or transfers to family members, LLCs or irrevocable trusts), obtaining a qualified appraisal can be important. In addition, if the client plans to make a lifetime donation of appreciated TPP to a public charity during, clients should first ensure that the TPP can be sufficiently connected to the charity's charitable purpose and will be utilized by the charity for a "related use" for the requisite number of years to qualify for a fair market value deduction.¹⁰

There may be challenges encountered when family members do not want TPP delegated to them or want TPP delegated to another. Clients or family members assigned to fiduciary positions may not want to shoulder the responsibilities of having to inventory, value and track TPP.

As an asset class TPP is often discriminated against by the income tax laws. Further, there may be insurance challenges – such as addressing what happens if TPP is destroyed or disappears. Special consideration may be required to address issues relating to transport, transfer or even the need to involve an auction house to dispose of an item. These are but a few of the challenges that come up when addressing art and other tangible property.

When specialized TPP is to be administered by a fiduciary, it may be advisable to provide for a special trustee or fiduciary to direct the management and disposition of such assets. Using a fiduciary who has specialized knowledge of the value and special considerations of a particular asset can be important to preservation and enhancement of value due, perhaps, to their special understanding of the market for such items. Also, because a fiduciary may have a duty to diversity, having a special director or fiduciary who can help document why an item should be held as opposed to disposed of can be helpful.

Some fiduciaries don't want to be responsible for TPP. Indemnification clauses may not satisfy their concerns regarding risk management when the TPP is to be left in the hands of a beneficiary. For this reason, it can sometimes be hard to find a corporate fiduciary willing to administer TPP over a period of time. Often, they want items, such as jewelry that can easily disappear, to be secured and placed in a safety deposit box. For a fiduciary who will take on the administration of TPP, they may need to take photos, do more inventories and engage in more frequent visual inspections.

When crafting a plan, considering such added administrative actions and expense associated with the same may be prudent. It may be important to check with a fiduciary, in advance, to determine if they will

¹⁰ I.R.C. §170(e)(1)(B).

be willing to maintain and be responsible for administration of TPP beyond the initial settlement phase of a trust or estate. If they aren't willing to take on such responsibility, appointing a special fiduciary for such purposes may be required. Another way to address such items may be to use an LLC wrapper for certain TPP (such as art or wine collections, horses, etc.). A family member or other individual can be the LLC manager, to ensure the management, well-being and disposition of the TPP, and avoid concerns that an institutional trustee might otherwise have regarding the administration of such items.

CONCLUSION

TPP is often addressed as an afterthought. It is an issue that receives limited time and attention during the planning process despite it frequently being the cause of family strife and a source of trouble during the administrative process. It is best to proactively consider and discuss a client's TPP and address potential issues in advance that might emanate from such assets. This can prevent the stresses and strains that administering and disposing of TPP might otherwise cause.