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Steve Leimberg's Estate Planning Email Newsletter

Compilation of Meeting Notes from Heckerling 2017

Over the course of many years, **LISI** has been delighted to provide members with **Marty Shenkman's** notes from the proceedings at the **Heckerling Institute on Estate Planning**. Heckerling, as it is affectionately known, is the nation's leading conference for estate planners, attorneys, trust officers, accountants, insurance advisors and wealth management professionals. 2017 is the 51st installment of Heckerling, and for those not fortunate enough to be in sunny Orlando, the meeting this year runs from Monday, January 9th through Friday, January 13th.

These materials have been published with specific permission from the Heckerling Institute on Estate Planning. **LISI** very much appreciates the courtesy! The contents of this compilation include:

1. Pages 1 through 34: Monday, January 9th, 2017: Estate Planning Newsletter 2498, dated January 11, 2017.
2. Pages 35 through 50: Tuesday Morning, January 10th, 2017: Estate Planning Newsletter 2499, dated January 11, 2017.
3. Pages 51 through 68: Tuesday Afternoon, January 10th, 2017: Estate Planning Newsletter 2501, dated January 12, 2017.
4. Pages 69 through 83: Wednesday Morning, January 11th, 2017: Estate Planning Newsletter 2502, dated January 12, 2017.
5. Pages 84 through 101: Wednesday Afternoon, January 11th, 2017: Estate Planning Newsletter 2503, dated January 12, 2017.
6. Pages 102 through 128: Thursday, January 12th, 2017: Estate Planning Newsletter 2504, dated January 13, 2017.
7. Pages 129 through 138: Friday, January 13th, 2017: Estate Planning Newsletter 2505, dated January 13, 2017.

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HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Marty Shenkman

Steve Leimberg's Estate Planning Email Newsletter Archive Message #2498

Date:11-Jan-17

Subject: Marty Shenkman's Meeting Notes from Heckerling, Monday,
January 9, 2017

Heckerling Institute 2017 – Day 1 Notes

By Martin M. Shenkman, Esq.

The following are rough draft meeting notes prepared at the 2017 51st Heckerling Institute on Estate Planning sponsored by the University of Miami School of Law, and published in Leimberg Information Services, Inc. (LISI). These notes were published within a very short time of the conclusion of the proceedings and could not have been reviewed in order to be completed so quickly. There are no doubt errors, typos, etc. in these notes. LISI obtained special permission from the Heckerling Institute to publish these notes. Bear in mind that no notes appear below on more than 20 concurrent and other sessions. These sessions can be purchased from the source listed below. The final papers presented at this year's Heckerling Institute can be obtained from Lexis Nexis.

1. **Sunday: Pre-Game Warm Up: Talking to Barry D. Flagg of Veralytic.**
 - a. **Heckerling:** So some folks attending Heckerling think it is all about the technical sessions. While we hope to cover many of these in the coming days in LISI, Heckerling is about much more than just the regular lecture sessions. Heckerling provides an incredible opportunity to network with colleagues, vendors and referral sources. There is no other event where, apart from the sessions and contacts in the massive exhibit hall (how many pens from different financial and insurance companies can you collect in a week?) that you can have five+ networking meetings in the same day: breakfast, lunch, post-conference drink, dinner, post-dinner drink. So in this year's LISI notes we'll add to the usual sessions some insights and observations from some of those I meet for those business development meetings, kicking it off with Barry Flagg. If this appears to be a thinly veiled attempt to get free drinks and meals while at Heckerling, you are assuredly mistaken. This is all being done in the pursuit of knowledge to share with LISI readers! ☺ [hopefully my kids will be impressed that I know what an emoji is].
 - b. **Conference CDs:** Before a few comments from Barry a quick plug for another vendor. If you are not attending this year's conference you can obtain audio recordings of all the sessions from Convention CD's, Inc. 800-747-6334 or email scott@conventioncds.com. I have purchased these every year since with so many concurrent sessions it is not possible to hear about half of the presentations without it.

c. **Comments from a discussion with Barry Flagg.**

- i. What brings you to Hecklering?
 1. *"I'm an exhibitor, for the 15th year in a row. My company, Veralytic publishes pricing and performance research and product ratings for life insurance.*
 2. *These tools provide advisers a "ruler" to measure whether a client is being charged a fair and competitive price, and whether the client is actually getting good performance on, cash value life insurance. Financial planners, trust officers, independent insurance advisers and brokers, and others, use these tools to advise their clients.*
 3. *Heckerling is the premier gathering of estate planning professionals. There is no other place or time to find this many thought leaders in the industry in one place."*
- ii. What trends do you see in life insurance that estate planners should be aware of?
 1. *"The insurance industry has relied on tax benefits to drive sales for the better part of 40 years. A host of the techniques are no longer viable. For example, 412(i) and 419(i) uses of insurance as private retirement plans and private captives are under scrutiny. The estate tax had driven many sales but that has diminished with the large exemptions, and may even evaporate as a motive if Trump repeals the estate tax. The focus will change."*
 2. *"There is a lot of insurance that has been sold in past years and much of it may need to be repurposed. The information to evaluate those existing policies is needed to determine what to do next. Veralytic is the measurement tool to evaluate these policies."*
 3. **Example:** On a recent engagement I reviewed 1,000 ILITs. Of those 600 had excessive charges but only two of the 600 had insureds with taxable estates under the current exemptions. We used the West Point Draft of the Best Practice Standards provides a decision making framework as a decision tree to evaluate options. Some opted to cancel, some sold in secondary market, and so on. This is what needs to be done with many existing policies.
- iii. How significant can the results of a policy analysis be?
 1. *"The differential between good and bad pricing can be substantial, over more than what many realize. If you measure what the client is being charged you can determine where you are in terms of pricing. The difference can be 80% in hard dollar costs. The difference can be due to different companies. The process is complex as there are more than 10,000 pricing combinations to consider: gender, age, tobacco use, price or volume break points, funding strategies, etc. Do a factorial -- it can be that many permutations. You need to examine the actual pricing in the policy, not the illustration."*

2. *“When a client is presented with an illustration and another source brings a different illustration, those comparisons are generally misleading, fundamentally inappropriate, and unreliable, according to financial insurance and banking industry authorities.”*
3. **Example:** The attorney for the ILIT is counsel to the family member trustee. Counsel advises the trustee to have the insurance reviewed by calling the insurance broker who provides the trustee with an inforce illustration or worse a comparison of illustrations which the trustee files assuming the deed is done. A better for counsel to advise a non-professional or non-expert trustee (typically a family member or friend) to hire a consultant and to be certain that the following items are addressed:
 - a. Examine the internal pricing of the policy.
 - b. Examine the reasonableness of performance expectations. The rate of return must be reasonable and consistent with the client’s risk tolerance.
 - c. Is the policy titled correctly?
 - d. Is the funding adequate for the intended funding duration? A new permanent policy may be funded based on an assumption of age 121.

2. **Monday: Morning: Portability: Law and Zaritsky.**

- a. Zaritsky predictions.
 - i. By late 2017 the estate tax will be repealed.
 - ii. Estate tax will be repealed with a 10-year phase out (sunrise or sunset?).
 - iii. The gift tax will not be repealed.
 - iv. Portability will remain important.
- b. Portability.
 - i. If executor of a deceased spouse makes a timely election on deceased spouses estate tax return the surviving spouse gets the deceased spouses’ estate tax exemption.
 - ii. The concept of portability should have been easy, should have applied for GST, etc. but the statute is complex and the Regulations are complex.
- c. Regulations.
 - i. Reg. Sec. 20.2010-2 apply to first deceased spouse.
 - ii. Reg. Sec. 20.2010-3 apply to second deceased spouse.
 - iii. Reg. Sec. 25.2505-2 gift tax Regs apply to the deceased spouse
 - iv. Reg. Sec. 25.2505-3 gift tax Regs apply to second deceased spouse.
 - v. Read the preamble it is a good explanation.
 - vi. There is a period of time that the proposed regulations affect so they cannot be ignored.
- d. Making the portability election.
 - i. The election is made on Form 706.
 - ii. Must be filed at 9-month plus any applicable extensions (15-month) deadline.
 - iii. Only required when 6018 estate tax is required to be made.

- iv. Reg. Sec. 20.2010-2(a) you can only make the election on a timely filed and complete estate tax return.
- e. Portability regulations do not cause issues with respect to basis consistency.
- f. Computation of the DSUE amount.
 - i. In 2012 when portability became permanent the 706 had no provision for the calculation of the DSUE but the IRS accepted or deemed it “as if” the return was properly prepared.
 - ii. After 2011 Form 706 there is a box with the information to calculate the DSUE.
 - iii. See Form 709 page 4.
 - iv. The DSUE is the lesser of: (i) the BEA (basic exclusion amount); or (ii) the excess of the decedent’s AEA (applicable exclusion amount) minus (the taxable estate and adjusted table gifts).
- g. Opt out of portability
 - i. Do nothing – don’t file.
 - ii. File a Form 706 and indicate opting out.
- h. Who can make the portability election?
 - i. Appointed executors, e.g. appointed by court.
 - ii. Non-appointed executors. IRC Sec. 2203 provides statutory authority type executors. “The term “executor” wherever it is used in this title in connection with the estate tax imposed by this chapter means the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent.”
 - iii. Appointed executor supersedes non-appointed executors as to the right to file the Form 706 return.
 - iv. The Regulations, however, do not appear to address the situation where there is an appointed executor that does nothing
- i. Must file complete and properly prepared return.
 - i. Final regulations made clear that a return with mistakes can still qualify. Return does not have to be perfect but must reflect good faith effort to convey all information.
 - ii. This is a similar standard to determine if the filing of a return starts the tolling of a statute of limitations.
 - iii. You must in all instances sign the return. If the return is not signed it will not suffice for portability.
 - iv. If solely to elect portability the executor does not have to provide value of assets that pass to spouse or charity. Example \$4M estate you are filing only for portability and if all assets left to surviving spouse or QTIP (or combination of spouse and charity) no need to get valuation of assets. Just describe assets.
 - v. If estate is \$8M and all passes to spouse you must value all assets and obtain appraisals
 - vi. For some small estates may need appraisal **Example:** I leave \$4M to wife and rest to children must value what goes to wife to know the amount that

- will pass to children. **Example:** I leave \$10,000 to my spouse, and the balance to children. If this was a \$5M estate must value all assets.
- vii. The regulations require that you value the marital if value of the marital will determine the value for other tax benefits. But those only arise if there is a taxable estate (e.g., special use valuation), etc. Basis is not considered an estate tax benefit for this purpose. Is the filing requirement itself an estate tax advantage?
 - viii. Short form, the Form 706 EZ, for portability was never provided.
 - j. What if the return was not filed on time?
 - i. What if no return filed within required nine months and thereafter discovered that portability may have been lost?
 - ii. IRS will grant 9100 relief if the estate is below the threshold. Rev. Proc. 2014-18.
 - iii. If over threshold, e.g., \$6M estate all passing to surviving spouse, if fail to file on time you do not get portability and will not qualify for 9100 relief. You are out of luck.
 - iv. Generally, for 9100 relief need to show that you had consulted an adviser, etc. The PLRs seem not to mention this so perhaps the IRS is giving leniency to smaller estates.
 - k. Code versus Regulation differences.
 - i. Follow the regulations when there is a difference.
 - l. Gift tax paid.
 - i. Regulations cleaned up many of the issues in this area.
 - ii. If you made a gift and paid a tax that is not considered to affect how much DSUE you leave to your surviving spouse.
 - iii. H1 and W married and in 2003 made \$3M gift resulting in a \$2M taxable gift (the exemption being \$1M). When H1 later died his estate was \$10M all passing to W. His DSUE under the code would be \$5 BEA minus \$3M gift = \$2M DSUE which is incorrect. The Regulation correct this to reflect that H1 only used \$1M of his exemption so that his DSUE should be \$5 BEA - \$1M gift = \$4M DSUE. Reg. Sec 20.2010-2(c)(1)(ii)(B)
 - iv. Code says adjust for taxable gifts. Paid tax on \$2M. Regulations say that if you paid it on any adjustable taxable gifts don't use that to adjust DSUE just use the amount of exemption used, \$1M not \$3M above.
 - m. Use of DSUE by surviving spouse.
 - i. Can only use last deceased spouse's DSUE.
 - ii. If client is going to remarry may lose prior spouse's DSUE if new spouse dies.
 - 1. **Comment:** Consider prior to the marriage funding an irrevocable trust with the unused DSUE to safeguard it from this risk. If the client wishes access to the funds, consider funding a self-settled asset protection trust ("DAPT"). That should use the DSUE and safeguard it without putting the assets out of the client's reach. If the client is concerned about perceived risks of the DAPT consider as an alternative a 10 year and 1-day delay before he or she can benefit, or use a hybrid DAPT approach not naming the client as a

beneficiary but giving an independent person the right to add beneficiaries, e.g., descendants of the client's grandparents.

- iii. Black Widow issue – concerned about serial marriage. But are allowed to use exemption/DSUE of prior spouses. **Example:** H1 and W married. \$5M exemption. W marries H2 and on Feb 2, 2011 makes gift of \$5M. H2 dies later and leaves exemptions. Later W marries H3 and following that makes gift using H2's DSUE amount. Portability is elected. A month later marries H4 and following the marriage makes a gift to use H3's children. 2010-3b W was able to use H1, H2 and H3 DSUE amounts so long as used these before later husband died. This was contrary to what Congress initially intended.
- iv. A similar result could be achieved by creating a non-marital trust for each spouse but Congress did not seem to worry about this.
- n. Audit issue.
 - i. Return remains open but only the amount not the entire return remains open for audit.
 - ii. The IRS can audit the return of the deceased spouse through the period of time during which the surviving spouse's return can be audited. Reg. Sec. 20.2010-3(d).
- o. Non-resident aliens ("NRA").
 - i. A US citizen is subject to US estate tax on worldwide estate regardless of where they live.
 - ii. If a resident alien, you are subject to estate tax on worldwide assets. You get full exemption.
 - iii. NRA only is taxed on assets in fact in the US. Unified credit is \$13,000 equivalent to \$60,000 exemption (this was the estate tax exemption until 1977). That is all that is given. The \$13,000 credit is not portable. Portability does not apply unless a treaty provides otherwise.
 - iv. NRAs do not get a marital deduction for assets passing to a non-citizen spouse unless the assets pass into a QDOT. They do get a marital deduction for a US citizen spouse.
- p. QDOTs and portability.
 - i. Portability does not mesh well with QDOTs.
 - ii. A QDOT looks like a QTIP but is not taxed like one. You must have a US trustee. Any principal paid to non-citizen spouse during his/her lifetime are treated as property left to a non-citizen spouse from the original decedent. So they don't come out against surviving spouse's exemption but against the deceased spouse's exemption. So a QDOT only defers the timing of the tax result. Incidence of tax stays with first spouse. So you cannot determine the DSUE until the surviving spouse dies or becomes a US citizen you don't know how much of the exemption will be used. If surviving spouse is getting a ported exemption by a QDOT cannot use it to offset lifetime gift.
 - iii. There are treaties with 14 countries and 10 of those have provisions that might affect the DSUE.
- q. GST and portability.

- i. You cannot port GST exemption. Portability deals with unified credit but not with GST exemption. Not clear why Congress took this approach.
 - ii. If client wants to use portability may need to create a reverse QTIP for the surviving spouse in amount of unused GST exemption to use first spouse to die's GST exemption. You cannot do GST planning with an outright distribution to spouse.
- r. Portability analysis.
 - i. The following caption appeared in the speakers' outline and says it all: "Planning with Portability: It's an Art...Not a Science."
 - ii. Cannot use a simple form there are many variables.
 - iii. You can run some numbers if you set some parameters.
 - iv. Variables: spending, costs, turnover of assets, need to diversify after first spouse dies. Many clients hold concentrated assets. But after first death may sell and diversify. Consider different income tax rates on gains depending on type of asset, how long it is held, whether ordinary income or capital gains, is it tangibles/collectibles, etc.
 - v. **Comments:**
 1. The factors consider may well vary significantly from client to client. A portability approach may not be viable for a large swath of clients A client in a second or later marriage may well want to benefit children from a prior marriage and the funding of the maximum family or credit shelter trust may be an important personal objective. In 1950 78% of families consisted of a married couple. By 2010 that figure had declined to merely 48%. The married family with children, the presumed paradigm for most estate planning discussions, was the norm in 1950 with nearly half, or 43% of families fitting that description. By 2010 only 20% of families could be described as married with children, although many people choose to cohabit with a partner rather than marry. According to the Pew Foundation, 47% of Americans have an elderly parent and have a minor child or a dependent adult child. About 15% of Americans are supporting both of these family members. 32% of those who have a parent age 65 and older have provided financial support to that parent. Approximately 20% of baby boomers are supporting an elderly parent.
 2. If the Trump administration repeals the estate tax (see top of this outline) and enacts a capital gains on death, might assets in a credit shelter trust forever escape that tax? Might not funding the credit shelter trust to the maximum prove a mistake from this perspective?
 3. How long with the potential beneficiaries of a credit shelter trust live and what states will they all reside in. If the surviving spouse resides in a high tax state and the other beneficiaries in a no tax state shifting income low federal bracket/no state bracket beneficiaries of a sprinkle credit shelter trust may save significant sums over the duration.

- vi. There is no “one-size-fits-all” analysis.
 - vii. Portability should be the default rule then have the client help demonstrate why portability should not be used. Except in extraordinary cases portability is preferable then protecting part of the appreciation from estate taxes. Document in memorandum to client that you have chosen one approach over another based on what the client felt was more important. Mention in the memorandum what are the negative consequences (what is being given up) because the client felt these less important. “Your decision will almost always be wrong anyway.”
 - viii. **Comment:** With the rollercoaster tax law changes that have seem to become the norm is it ever possible for a practitioner to really have any certainty? All that can be done by any practitioner is to make a good faith effort to get a reasonable result weighing the ever-changing tax options and the myriad of often unquantifiable client personal goals, many of which clients struggle to delineate. Perhaps the best answer is for the estate planning attorney an all allied advisers to encourage (push) clients to have an annual review to keep their planning on track.
- s. Planning.
- i. Advantages of portability is simplicity. You may no longer need credit shelter trust. But not really. Portability includes using a QTIP trust which is as complicated as a credit shelter trust.
 - ii. **Comment:** The speakers incredible 171-page detailed single space outline for this presentation suggests that the use of the word “simplicity” in the same discussion as “portability” can’t possibly be fair.
 - iii. So while portability can be simple it is often not.
 - iv. Basis advantage. With a credit shelter trust those assets don’t get a basis step up on the second death (unless a mechanism is used to achieve that) [**Comment:** see planning for this later in this outline].
 - v. For retirement benefits portability creates tremendous simplicity as you can avoid a conduit trust etc.
 - vi. Disadvantages of portability when spouse dies that appreciation is included in the estate. The DSUE is frozen at point of first death. If instead had left in credit shelter trust that appreciation would be out of the estate.
 - vii. If surviving spouse following the death of the first spouse made gift of DSUE amount into an irrevocable grantor trust all the appreciation avoids tax so that the DSUE amount is not frozen by being used on first spouse’s death.
 - viii. GST exemption is not portable, but it effectively is if you use QTIP planning and reverse QTIP.
 - ix. Portability leaves estate tax open but that is really only as to the DSUE amount that the IRS can adjust.
 - x. 2001-38 IRS could make unnecessary QTIP void. Example: Exemption was \$1M and H died with \$600,000 estate. Lawyer inadvertently made QTIP election and put on Schedule M on 706. That is included in surviving spouse’s estate. W had \$5M estate. The QTIP election was

wasteful and IRS in ruling agreed to make the QTIP election void. But years later when portability was enacted you would want a QTIP election. Some practitioners were concerned that this would create a problem. Rev. Proc. 2016-49 Addressed this.

- t. Portability of different size estates.
 - i. Small estates less than one BEA.
 - 1. Example Net Worth \$5M. From a purely tax standpoint this client might be worse off with a traditional credit shelter plan. It may be better, leaving aside personal objectives, to use a full QTIP trust on first to die.
 - 2. **[Comment]:** caution the client about the risks of remarriage and the significant growth it divorces among other couples, called “silver divorce.”]. You may have reasons not to do this. The client may prefer outright and more simplicity. Results suggest all should be bequeathed to QTIP.
 - 3. But the small estate may always be better off because income tax was the determining factor since there was no estate tax. The basis adjustment under IRC Sec. 1014. was better. In a tax state with a state death tax the results are not as good with a QTIP as better plan may be to leave state death tax amount to a credit shelter trust that may be a preferable plan. The reason is you cannot make up difference of state death tax that will be imposed on assets.
 - ii. Medium estate more than one BEA but less than 2x BEA e.g. \$10M.
 - 1. The portability plan is better in first 3 years then traditional plan is better. But in the medium size estate at some point the income tax benefit will not outweigh the estate tax detriment. For a medium size estate in a state with a state death tax the traditional plan will be better for some number of years because for a short time a hybrid plan using exemption to state level amount works. But should portability be the default? Yes, but...
 - 2. Before portability had to use one exemption at first death.
 - 3. Only CT has gift tax so if make lifetime gift you avoid state death tax on the second death.
 - iii. Large estate say \$50M.
 - iv. Planning considerations in the above.
 - 1. Portability should be the default plan. Default portability plan probably involves one or more QTIP’able trusts, one for state one for federal. You get benefits of a trust asset protection, professional management, limitations on surviving spouse to divert assets [but this is contrary to distributions to kids].
 - 2. **Comment:**
 - a. Is this really true? But there is a carve out for the state exemption bypass trust and also if make a 2519 disclaimer what is the difference?

- b. If the couple funds non-reciprocal SLATs during their lifetimes for asset protection and other reasons there may be only modest exemption left to plan for.
 - 3. State level bypass trust.
 - 4. 2519 plan to use DSUE with QTIP. This has assets growing at same pace and out of estate.
 - 5. Use DSUE and surviving spouse makes gifts.
- u. Types of trust plans.
 - i. Outright “I love you will” with disclaimer. This is good in that it is simple. Allows tremendous flexibility. Surviving spouse will have the maximum flexibility. “They have a tendency not to use it.” Consider disclaimer permitted from QTIP to bypass since it is already in a trust.
 - ii. Disclaimer versus QTIP planning. Disclaimer – surviving spouse cannot redirect.
 - iii. Consider QTIP with partial QTIP election.
 - iv. 2519.
 - 1. Gift of any percentage of income is a gift of the remainder.
 - 2. Use affirmatively to plan to use DSUE.
 - 3. You cannot have a spendthrift limitation that prevents spouse from giving away income interest. You might provide that the spendthrift limitation shall not apply to a lifetime transfer of income interest. But be careful as this may expose the trust to the reach of creditors.
 - 4. Even after a 2519 disclaimer the surviving spouse can have an independent trustee make principal distributions.
 - 5. Contrast this with an outright bequest instead of a QTIP followed by a gift by the surviving spouse to a self-settled grantor trust.
 - 6. **Comment:** Code Sec. 2519 states that, if the surviving spouse who is the beneficiary of a QTIP trust with respect to which the marital deduction is elected disposes of all or part of the income interest in that QTIP trust, the disposition will be treated as if the entire interest in the QTIP trust, i.e., its full value, is deemed given by the surviving spouse. Several hurdles need to be cleared in order to achieve the Code Sec. 2519 results. Code Sec. 2519 does not provide that the disposition of all or a portion of the income interest causes the entire value of the QTIP trust to be deemed a gift. Rather, the gift transfer under Code Sec. 2519 is equal to the value of the entire trust, less the value of the income interest relinquished. The income interest is treated as an ordinary transfer. The combination of the two transfers results in a gift of all of the interests of the trust. No matter how derived, the net result of the disposition of all or a portion of the income interest will cause the full value of all of the assets of the QTIP trust to be treated as a gift by the surviving spouse.
- v. For small and middle size estates the one-lung QTIP trust with a professional fiduciary looks appealing. If state has state estate tax may

want part of QTIP not to be deductible/marital. If no professional fiduciary set up multiple QTIPs

vi. Clayton QTIP.

1. **Comment:** A decision made today on exercising the power under a so-called Clayton QTIP provision to have it qualify for the estate tax marital deduction might prove to have dramatically different tax consequences under a new post-repeal regime. (See Blattmachr & Zaritsky, "Coping With The New Clayton QTIP Regulations," 136 Trusts & Estates 41, May 1997, reprinted in The Monthly Digest of Tax Articles, November 1997.) For example, might assets in a credit shelter trust that is not included in the surviving spouse's estate be subject to a capital gains tax on death of the first spouse if funded with an amount greater than the new capital gain "exemption?" If that is the case might a current funding formula up to the decedent's remaining exemption be interpreted as funding the credit shelter trust with the amount of assets that will not trigger the capital gains on death? Might amounts passing to a marital-like trust (will a traditional QTIP qualify?) defer the capital gains tax on the death of the first spouse? If so might it be advisable for smaller estates to pass all assets to a credit shelter type trust to permit sprinkling of income among the beneficiaries, retention of income and more planning flexibility and not to a marital trust? Might it be advantageous to pass the amount above the new capital gains "exemption" to a marital type trust to defer the capital gains? See Blattmachr and Shenkman, "Drafting for the Possibilities of Trump Estate Tax Legislation," BNA Tax Management Estates, Gifts and Trusts Journal, Vol. 42, No. 1 page 3.

vii. Always provide ability to sever trusts.

viii. Speaker made a strong recommendation to use an institutional fiduciary so that someone objective and skilled can make the decisions involved.

v. Credit shelter trusts.

- i. Estate tax may not be an issue/benefit for a credit shelter trust, but the loss of basis step-up on death of the second spouse may be a negative. How can we build in mechanism to obtain a basis step up?
- ii. The absence of an estate tax benefit may result because the surviving spouse's estate may prove smaller, exemption may grow, surviving spouse may die when there is no estate tax, etc.
- iii. How do you get the equivalent of portability in a non-portability situation?
- iv. There are four ways but none are perfect.
 1. The easiest is with a non-marital trust that authorizes distribution of principal, better if no HEMS standard, if surviving spouse's health is fading and estate doesn't require exemption, and you want some of the trust included in the estate, distribute appreciated assets to the surviving spouse out of the credit shelter.

- a. Caution what if surviving spouse diverts assets to anyone other than the remainder beneficiaries? If the surviving spouse is incapacitated what might agent under POA do? Who is named as agent?
 - b. Some trustees are just uncomfortable making discretionary distributions. Assets will be added to probate estate. If there is a revocable trust the assets can be transferred into a revocable trust (even by POA if spouse is incapacitated).
 - c. You do not want to make the distribution automatic, it should be discretionary.
 - d. **Comment:** What will be required for an institutional trustee to become comfortable to make such a distribution? Perhaps if an institutional trustee is named the power to make distributions should be given to a named individual. Might this be a role for a trust protector? However, might there be an issue for anyone acting in a fiduciary capacity to distribute assets outright to the spouse to the detriment of other beneficiaries? Is it to their detriment if the basis step-up is valuable to them?
2. Give a trust protector the ability to grant the spouse or other beneficiary a general power of appointment over some or all of the assets.
- a. You can grant a general power of appointment without giving a lot of authority to diver the assets. “I give you the power to appointment to appoint these assets to the creditors of your estate but you may do so only with the consent of the following specified non-adverse parties [names].”
 - b. It is the existence of the power that suffices.
 - c. A power is not general if it can be exercised only with the consent of the creator. There is an argument that the person who creates the power not the settlor of the trust may be the creator.
 - d. Add this power as close as possible to the date of death since you need to know the size of their estate. If you make it too far in advance the power holder’s estate may change. Granting a power of appointment does not increase the probate estate which is positive. In many states it may not create an asset protection problem but disturbing assets as above would. In many states an unexercised general power is not reachable by the creditors of the power holder.
 - e. The trust protector has to obtain information on the health and wealth of the person who can get the general power and this is often practically difficult. Consider exculpatory language to the protector. You can grant this power only over appreciated assets. You cannot grant the power only as

- to the appreciation (but OK as to appreciated asset). What about making the grant of the general power automatic?
- f. Can you grant this as to only the exclusion amount? There is an issue with this illustrated in the case: *Kurz v. Commr.*, 101 TC 44 (1993), *aff'd* 68 F.3d 1027 (7th Cir. 1995). In *Kurz* person had GPOA. If you can get GPOA by your own action you are deemed to have the GPOA even if you did not take that action. There is an exception for an act of independent significance. While assets increasing in value might be an act of independent significance, Congress raising the exemption should be, but there are no precedents.
 - g. A formula grant should work but there is some concern because there is not full precedence. Consider a formula e.g. exemption without deductions under 2053 or 2055 since those are under the control of the surviving spouse.
 - h. **Comment:** should the person given the right to grant a GPOA or to expand a LPOA into a GPOA be a person appointed in a non-fiduciary capacity? Some practitioners believe that a trust protector is always acting in a fiduciary capacity. Might that impede granting the power?
3. Delaware Tax Trap.
- a. Trust assets could be included in the surviving spouse's estate by use of the Delaware tax trap. The surviving spouse is given a testamentary LPOA that can be exercised in a manner that springs the Delaware tax trap causing it to be taxed as a GPOA and thus creating the desired estate inclusion.
 - b. A LPOA is taxed as a GPOA under IRC Sec. 2014(a)(3) if:
 - i. The holder exercises it to create a transfer in further trust.
 - ii. The transfer gives someone else a new POA.
 - iii. The new power can be exercised to postpone the vesting or ownership of property for a period that is ascertainable without regard to the date on which the spouse's POA was created.
 - c. It is not clear that DE even has this law, but other states do. DE had a rule that if you had LPOA and you use it to create a new LPOA it restarts the perpetuities date.
 - d. There was a concern that you could create a perpetual trust that was not ever subject to estate tax so if you do this the LPOA will be treated as a general power. DE tax trap is an appealing way to bring assets into the estate since the person who knows the information to make the decision, i.e. the beneficiary, (his or her health, wealth, etc.) is in charge of the decision.

- e. You can spring the trap and unspring it and continue changing it until you die.
 - f. Few states follow the DE model. It is not, however, clear that even DE does. If you are in a state that does not, you can spring the DE tax trap if you create with the LPOA that appoints in a trust that gives the beneficiary a presently exercisable general power of appointment.
 - g. If your state has repealed the rule against perpetuities (“RAP”) it is not clear if you can spring the DE tax trap. It is also not clear that you can avoid springing it.
 - h. Estate of Murphy v. Commr, 71 TC 671 (1979) turned on the intricacies of rule against perpetuities. RAP applies to suspension of vesting, ownership or alienability. In many states they have adopted rules, e.g. Virginia and Wisconsin, that say you can suspend vesting and ownership so long as you don’t suspend alienability. So long as the trustee can sell assets it doesn’t matter. So trustee’s ability to sell assets doesn’t trigger estate tax.
 - i. If state has a fixed set rule against perpetuities, you can make provisions to violate it. If state has repealed RAP it is hard to figure out how to violate it.
- v. Power of appointment support trust.
1. POAST = power of appointment support trust.
 2. Example G1 is worth \$1M and worried they may run out of money.
 3. G2 can create a trust that names G1 as a discretionary beneficiary and from which G1 can receive income.
 4. Nuance is adding G1 as a beneficiary.
 5. Structure in jurisdiction with long or no perpetuities.
 6. Create a contingent GPOA limited to the lesser of G1’s unused GST exemption or unused estate tax exemption.
 7. **Example:** Trust assets \$10M. Dad = G1. If contingent GPOA is unlimited that would trigger tax on Dad’s death. At death estate tax inclusion in Dad’s estate so get a basis step up. As long as G1 does not exercise the GPOA the trust remains a grantor trust as to G2.
 8. After G2 dies it is no longer a grantor trust.
 9. What if G2 dies before G1? Statistical likelihood is small but you might be able to insure against this.
 10. Combine the POAST technique with a GRAT. G2 creates a GRAT and may use some exemption. G2 could have used gift tax exemption but what if the POAST is the recipient of GRAT assets. When G1 dies you can allocate G1’s GST exemption to the trust.
 11. Similarly, you could use a CLUT to pour into the POAST to save G2 exemption.
- w. State estate tax and GST tax must be factored into portability planning.
- i. State only QTIPs.

- ii. GST QTIPs.
 - iii. So you often won't get the simplicity many anticipate.
- x. Tax Basis Revocable Trust and the Joint Estate Step-up Trust ("JEST").
 - i. Other ways to maximize basis using GPOAs.
 - ii. Tax basis revocable trust. Goes back to TAM 9308002.
 - iii. Developed to get community property like basis treatment in a non-community property state.
 - iv. When first spouse dies surviving spouse can revoke trust as to what she put in. First spouse has GPOA to appoint property they did not put in. Because of this it is argued that the entirety of trust, i.e., both halves, are included in estate of first spouse to die. IRS said all is included in gross estate but no basis steps up on second 1/2 because it is deemed transferred within 1 year of death rule, as they deemed the transfer only to be effective at the moment of death. So IRS position is that this does not work.
 - v. There is also a step transaction issue to this planning.
 - vi. The JEST endeavors to circumvent the defects of the above 1993 ruling. JEST provides the first spouse has GPOA over part contributed but to extent of surviving spouse's applicable exclusion amount it goes to a trust for descendants so it circumvents 1014(e). This should work and should provide a double basis step up.
- y. Community property trust.
 - i. AK, TN and SD allow you to obtain a community property result.
 - ii. AK allows you do to this with a community property agreement. You can do this with a trust but it is not required.
 - iii. TN and SD permit it to be done with a trust. The AK approach which permits community property by agreement, not only be trust, may be a stronger statute to achieve this result.
 - iv. NC and FL are trying to create these community property trusts statutes as well.
 - v. Key is that it must be community property in the state in which the person died.
 - vi. This technique should work but there are no authorities that have directly addressed this technique.
 - vii. Commr. v. Harmon, 323 US 44 (1944). Electing to make something community property does not avoid anticipatory assignment of income. Harmon should be good law for the fact that this technique works.
- z. Portability and Marital Agreements.
 - i. Identify that there is portability and the election.
 - ii. Define who portability executor is. Use a defined term so it covers case of no court appointed executor.
 - iii. When spouses have different size estates you should put in a mechanism to have person with smaller estate to make portability election and compensate them for the cost of making the election.
 - iv. Conflicts waiver.
 - v. Administrative clauses as to how portability executor will act.

1. Require the portability executor to give the surviving spouse a copy of the Form 706 and all attachments (and perhaps state filings as well).
2. Require the portability executor to provide copies of all supporting documentation for the estate tax return.
- vi. What if have DSUE amounts from prior marriage? There is a possibility of losing it. Consider if before the marriage to have them use the DSUE before marriage. If they won't do that one spouse will lose the DSUE consider buying life insurance to insure.
- vii. For a married couple with no prenuptial agreement consider recommending a post-nuptial agreement addressing just DSUE.
- viii. Address in the prenuptial agreement who should pay for the preparation of the return?
 - ix. What should the non-moneyed spouse agreeing to file to secure portability be paid? In Swisher the spouse agreed to relinquish DSUE for \$5,000 even though worth millions. Whoever advised them to accept \$5,000 may be subject to the next suit. *Walton v. Swisher*, 3 NE 3d 1088, 2014 WL 325666 (Ind. App. 2014).
3. **Monday: Afternoon: Recent Developments: Belcher, Aucutt, Hughes, and Porter-Part 1 – 2704 Proposed Regulations.**
 - a. Why discuss the 2704 Regs?
 - i. 2704 addresses an issue that has been around for some time.
 - ii. 2704 Regulations were aimed at the Harrison case and the Kerr case. *Kerr*, 113 T.C. at 463-64.
 - iii. Problem aimed at 2704 is real, it bothers the IRS that practitioners can create entities and discount values.
 - iv. Even if estate tax repeal occurs most practitioners believe that the gift tax will be retained and hence valuation will remain relevant.
 - v. **Comment:** If Trump's proposed capital gains on death is enacted the value of assets will have to be determined for that purpose. So the issue of discounts would still have to be addressed.
 - b. Background and Timeline of 2704 Regulations.
 - i. Harrison case.
 - ii. 1990 2704 enacted.
 - iii. 1992 2704 Regulations enacted.
 - iv. States became estate planner friendly in terms of applicable restrictions that supported discounts.
 - v. 2003-4 Priority Guidance Plan.
 - vi. Legislative proposals.
 - vii. 2009-2012 Obama administration the Greenbook included a proposal about valuation discounts and revenue estimates were quite fine tuned suggesting someone had a draft of proposed Regulations.
 - viii. 2010-2013 Greenbook included items that were reflected in the proposed regulations: Would create an additional category of disregarded restrictions that would be ignored in transfers to family, assignee interests

would be valued as full-fledged interests, third party involvement in removing restrictions will be limited, etc.

- ix. Regulations discussed at professional meetings and in tax press.
 - x. August 2, 2016 Proposed Regulations issued.
 - xi. September 21, 2016 House introduced bill to protect family farms and businesses saying that the proposed regulations should have no force and effect and that no federal funds may be used to finalize or support, etc. The bill lapsed.
 - xii. January 2017 bill reintroduced.
- c. **Comment:** See **Planning for the Proposed 2704 Regulations**, by: Martin M. Shenkman, Esq., Jonathan Blattmachr, Esq., Ira S. Herman, CPA, and Joy Matak, Esq., an e-book published by Trusts & Estates Magazine.
- d. Purpose.
- i. Make 2704 applicable again to achieve its intended purpose.
 - ii. Since initial publication in 1992 much had changed.
 - 1. Court cases clarified that 2704(b) only applied for purpose of liquidating entire entity: Kerr, Jones, Harper.
 - 2. A non-family owner with nominal ownership defeated family control in Kerr.
 - 3. ULPA – exception that applied if restriction no more restrictive than applicable law was irrelevant because you could not be more restrictive than applicable law.
 - iii. Want to narrow regulatory exceptions. Lapses are taxable – Harrison Case. Regulations provided an exception. The Proposed Regulations narrow the exception so it does not apply to death bed transfers defined as 3 years within death. IRS new people would question 3-year period. Some have suggested 1 year others have suggested using an annuity definition.
 - iv. Another example of narrowing regulatory exception is the exception that deals with comparison to local law. Proposal would eliminate that exception. This was a mistake and a different threshold should be substituted.
 - v. Another approach is to create a new category called “disregarded restrictions” which should be ignored by appraisers in determining FMV. These are provisions that limit a restriction that limits an individual’s right to liquidate his or her interest.
 - vi. Like applicable restrictions the disregarded restrictions did not distinguish generally between cooperative and dysfunctional families, or between operating and non-operating businesses. It was intended to reach artificial bells and whistles that artificially inflated valuation discounts.
 - vii. Nothing in the proposed regulations is intended to eliminate all minority discounts if regulations become final.
 - viii. As a response to Kerr the proposed regulations included a provision that would apply to lapses and disregarded restrictions saying the only non-family interest that would be considered is a non-family interest that meets 4 tests:
 - 1. Held more than 3 years

2. At least 10%
 3. In aggregate more than 20%
 4. Each family owner has a put right
- ix. These were intended to assure that this interest was created just before a transfer or that the interest was significant. Goal was to prevent small transfer to a charity that later would be repurchased for pennies on the dollar.
- x. **Comment:**
1. A third party (unrelated) equity holder must have at least 10 percent interest, the aggregate interests of all third parties must be at least 20 percent and those interests have to have been held for three years to be considered.¹⁹ For purposes of determining if the family controls the entity, it's irrelevant that a key employee of a family business holds a 15 percent interest in the entity unless the "20% third party test" is satisfied in the aggregate. The regs suggest that any percentage of third party interests will not be relevant if held less than three years prior to transfer.
 2. Example: Taxpayer is diagnosed with a terminal illness and negotiates a succession plan with a key employee, transferring a 25 percent equity interest in the business to her. In the following year, Taxpayer transfers 45 percent of his interests in the business to a trust for the benefit of his children. Since the key employee didn't hold her 25 percent equity interest for at least three years as of the date of transfer of the 45 percent interest to the trust, the third-party test isn't satisfied – even though there was a pure non-tax motive for transferring interests to the key employee and despite the fact that the key employee's interests hold real economic power.
 3. From a practical perspective, most family business enterprises will be precluded from giving equity to a third party or charity in an attempt to bolster restrictions for discounts.
- xi. Proposed regulations addressed the fact that at the time the statute was enacted LLCs were hardly used, so the proposed regulations include control definitions for an entity that is not a corporation or partnership. Discussed type of entity you were when created under law; not what box was checked under the check the box regulations.
- xii. "imposed or required to be imposed by federal or state law" which is an exception to an applicable restriction has been redefined to exclude a default statute. If you can choose an alternative statute it is not, then imposed or required to be imposed.
- xiii. Disregarding an applicable or disregarded restriction means you pretend it does not exist for valuation purposes. When you disregard a restriction that does not mean you assume a fact that was not there, e.g., the put right or minimum value. There is no intent for a deemed put right.
- xiv. The transfer to an assignee is a lapse under 2704(a) it is not tested under 2704(b).

- xv. Effective date 2704(a) lapses and 2704(b) effective on date of publication. The proposal with respect to disregarded restrictions was 30 days after publication since this is deemed a legislative regulation and it cannot be effective before that 30-day date.
- xvi. 3-year rule and lapses. In proposed regulations a lapse was deemed to occur at moment of death. That will be corrected in final regulations so that it will not be made retroactive to someone who made a transfer before the regulations became effective and died within three years.
- xvii. The Regulations were not finalized by December 31. They will not be enacted by January 20, 2017.
- xviii. Hearing on December 1, 2017. The hearing was 6 ½ hours. 36 witnesses including lawyers, accountants, appraisers, family business owners, owners of franchisees, and representatives of business associations. Many alternatives to the 3-year rule were presented. It was suggested to exclude passive assets and exempting operating businesses from proposal.
- e. Targeting passive businesses.
 - i. Some commentators express that they viewed the proposed regulations as targeted non-operating businesses. Example, the minimum value is a passive concept. For an operating business that does not really happen.
- f. Broad interpretation.
 - i. Applicable restriction language. Was in original 2704(b) Regulations. Prior to Kerr IRS felt this could apply to liquidation rights and withdrawal right if more onerous than state law default rule. If ignore language in the governing agreement you look to the state law default rule. Proposed Regulations say it is a restriction to liquidate the entity in whole or part. Look at language in governing documents, if nothing provided for, then look to state law rules. If family using control test can remove this, then ignore it.
 - ii. D owns 76% interest and each child owns 12% and agreement requires consent of all partners to liquidate. This is a voting restriction. Requirement that all partners consent is an applicable restriction and since all of the family members can remove it, then it is ignored for valuation purposes. What if agreement requirement is 60% vote and D dies owning 12% interest do you assume the 12% interest carries with it the right to liquidate the partnership? The proposed regulations assume the voting restriction is ignored.
 - iii. The notion that the regulation would cause the transfer of a 12% interest to be a lapse of a power that interest never had is problematic.
- g. Minimum value and put right.
 - i. Proposed regulations create a new level of restrictions on withdrawing from the entity.
 - ii. Disregarded restrictions, 4 types:
 - a. Limits holder's ability to withdraw either a time restriction (cannot withdraw for 10 years) or a vote (need 60% of vote).

- b. Limits or permits limitation of amount that can be received by holder of interest to an amount less than the minimum value. Minimum value means interest share in entity which is the FMV as finally determined under 2031 or 2512 of property held by entity reduced by outstanding obligations. This is the net value of the entity x the ownership interest. Any restriction that prohibits a withdrawing partner from getting less than this minimum value appears to have to be ignored.
 - c. Limits time or defers payment, e.g., LP can withdraw but must wait one year to get paid proceeds of withdrawal.
 - d. Payment of portion of redemption proceeds in anything other than property but property excludes notes that might be issued by partners or related parties.
 - 2. What is the disregarded restriction? The features associated with the withdrawal right? Or do you assume withdrawal right doesn't exist. **Example:** LP agreement permits withdrawal and LP to receive FMV of interest. Also says the FLP can pay LP within a year and with a note at AFR over 10 years. FMV of interest is not necessarily minimum value. Can IRS ignore this and assume a withdrawal right at FMV? If you strip all these provisions out, you have effectively a withdrawal right at a pro-rata share of the entity's net asset value.
 - 3. A different view.
 - h. Appraisers.
 - i. Nothing needs to be done now.
 - ii. The proposed regulations will affect the standards of value so appraisers will have to work closely with tax advisers to know what to do.
 - i. Reporting.
 - i. After August 2, 2106 some commentators suggest that you should disclose that the position in a valuation report may be contrary to position taken in the appraisals. Must refer to the proposed regulations and say that position was taken contrary to the regulations.
 - ii. But this is problematic as there are many different interpretations of the proposed regulations. It may be better to take an expansive view (i.e. that the proposed regs cover it so you disclose the variance from that interpretation) rather than have the IRS later argue that the statute of limitations has not tolled.
 - j. No reason to make transfers now in anticipation of these Regulations being enacted.
- 4. **Monday: Afternoon: Recent Developments: Belcher, Aucutt, Hughes, and Porter – Estate Tax Repeal.**
 - a. Trump proposals.
 - i. Trump proposals could be costly and contentious.
 - ii. Trump tax agenda includes repeal of the death tax but subjecting capital appreciation taxable at death over \$10M but transfers to private

foundations won't avoid. These are simple statements and it is difficult to predict how these might play out.

- b. Republican blueprint.
 - i. Proposed in June 2016 "our vision for a confident America."
 - ii. Election has breathed new life into this blueprint.
 - iii. Some speakers think that the Republican blueprint will be what goes forward as the actual proposal rather than Trump's general plan.
 - iv. 3 goals.
 - 1. Job creation.
 - 2. Simplify broken tax code and make it less burdensome.
 - 3. Transform IRS into an agency focused on customer service.
 - v. Note that Congress has been cutting IRS budget.
 - vi. Summary of income tax proposals.
 - 1. Compress and reduce income tax brackets.
 - 2. AMT repealed.
 - 3. 25% tax rate for small businesses. That requires definitions and complexity.
 - 4. Simplicity and complexity compete.
 - 5. Post card return.
 - 6. Mortgage interest, charitable contributions and education are the only deductions that may continue to receive tax benefits.
 - 7. Current tax incentives for retirement savings will be retained. Perhaps stretch IRAs will remain
 - vii. Business tax provisions.
 - 1. These will be more important for estate planners.
 - 2. This will be more relevant to many clients than estate taxes.
 - 3. Emphasis on expenses the costs of equipment.
 - 4. Finance with the tax break no more business deductions for net interest expense. Can deduct interest expense against interest income but not in excess of that.
 - 5. NOLs will continue to be carried forward indefinitely but can only shelter 90% of income.
 - viii. Blueprint on transfer taxes.
 - 1. Repeals estate and GST tax. Does this imply the gift tax will intentionally be retained?
 - 2. Trump plan website says it repeal the "death" tax and have some type of capital gains tax on death.
 - ix. Gift tax.
 - 1. Insures integrity of income tax by preventing transfers to low bracket family members and retransfer back.
 - 2. With compression of tax rates and need to backstop income tax is not as significant when you had a larger differential.
 - 3. With higher exemption income shifting can be done now by most Americans without incurring a gift tax so the incentive for this is not as great as it was historically.
- c. Congress will have to address increasing deficits.

- i. If repeal the estate tax is not large revenue raiser but then allows carryover basis that increases the tax burden.
 - ii. The income tax was enacted in 1913 and the estate tax in 1916. Neither said anything about basis of assets received from a decedent. In 1921 included a rule for basis of assets at death. 1930 supreme Court decision resolved this. Then as string provisions began to be subject to estate tax issues arose.
 - iii. Estate tax does not pay for step up in basis.
 - iv. Step up in basis at death may make sense from a perspective of fairness but it also addresses the lack of Americans keeping record. There is a resistance to carryover basis a no one wants to look back to determine basis.
 - v. How will they prioritize what is to be paid for?
- d. Alternatives to the current system.
 - i. Canadian system. No estate tax but on disposition of asset there is a capital gains tax. Tie revenue from estates to income tax. Capital gains on gift and death. These could have exemptions onto this structure (e.g. Trump's \$10M and special rules for family farms), etc. Under Canadian system still have valuation issues, like 2704. Canadian estate planning focuses on how to reduce valuations and tax free dispositions like life insurance.
 - ii. An alternative system is make inheritances and gifts and treat it all as income.
 - iii. Another approach is an accessions tax. The recipient pays the tax. Recipient includes gift or inheritance on income. This moves emphasis from estate to the recipient.
 - iv. The estate tax is despised.
 - v. \$20B is collected and \$19.6B is incurred in costs planning for this.
 - vi. There is revenue that has to be replaced if the estate tax is repealed.
 - vii. Tax reform is coming but it is likely to start with businesses. May see many deductions curtailed. Might see large LLCs and corporations pay an excise tax.
 - viii. Optics are an issue. You have several billionaires in the cabinet.
 - ix. Basis will be an issue. How will it be addressed in tax reform or repeal?
- e. If Estate Tax Repeal Occurs How Long Might It Last
 - i. Republicans may want tax reform completed by August recess.
 - ii. Some Republicans think they will get control of the Senate in 2018 and might want to wait to get more through then.
- f. What to do?
 - i. Wait and see, but this may miss opportunities.
 - ii. What if estate tax is repealed but comes back? So if clients want to shift appreciation you don't want to trigger gift tax so
 - 1. GRATs
 - 2. Sales to IDITs of hard to value assets that is not intended to trigger gift tax is a viable planning option.

3. For gift and sale use a formula clause similar to a Wandry or Petter type transaction selling a dollar value of units as finally determined for federal gift tax purposes. Consider a King type clause.
 4. So traditional estate planning techniques that shift appreciation should be considered even in light of uncertainties.
 5. Estate freezes.
- iii. We had this discussion in 2009. If the client can wait until after we know what is going on we all may be better off. But many clients cannot or do not want to wait.
 - iv. Point out to clients that you cannot predict what will happen.
 - v. Flexibility is key.
 1. GPOAs can provide flexibility.
 2. QTIP Trusts and don't make election for marital treatment so assets pass tax free at spouse's death.
 3. Consider how close the estate tax rate is to the income tax rate.
 4. Consider the appreciation that will build up in a QTIP trust. If state has a 5% income tax rate, 20% federal rate and 3.8% Surtax so arbitrage between income and estate tax is only about 10%.
 5. Use Clayton QTIP so independent executor can flip to credit shelter type trust.
- g. **Comment:** There are a number of steps practitioners might consider when structuring new trusts in light of possible repeal and a possible capital gains on death:
- i. Many of the recipient/donee trusts to be used in the above planning should be structured in a robust and flexible manner to address the uncertainty of future tax legislation. Depending on the size or nature of the transaction, it may be worthwhile to create a new trust or decant an existing trust into a more robust trust to add flexibility that current trusts crafted prior to the prospect of repeal may not reflect. This could include any array of common trust powers, and several less common or new ones. Consider any or all of the following:
 - ii. Assure grantor trust status.
 - iii. Include a swap power described in Section 675(4)(C) and draft the language in a sufficiently flexible manner to permit reverse swaps. Under current law it can be advantageous for a settlor to swap highly appreciated assets out of a grantor trust prior to death to include those assets in his or her estate for basis step up purposes. Under a capital gains tax on death regime the inverse of swapping highly appreciated assets into a grantor trust prior to death might prove advantageous. This might provide a mechanism to avoid the capital gains that might be incurred if those were retained. This possibility is another factor to weigh in favor of pursuing planning now.
 - iv. A broad class of beneficiaries to provide more flexibility in planning distributions and future income tax planning under whatever changes may be enacted. Also consider whether distributions to charities should be permitted.

- v. Situs and governing law in a trust friendly jurisdiction that is likely to more quickly take legislative action in the event of a significant change in federal tax laws. If a self-settled trust is created in a DAPT state and there is a desire for estate inclusion moving the situs and governing law back to a non-DAPT home state may suffice to cause estate inclusion.
- vi. Use GST exempt trusts when feasible.
- vii. A flexible trust protector provision to facilitate change to address future developments without the need, if possible, of court intervention.
- viii. Consider granting a person acting in a non-fiduciary capacity the authority to make a loan to the settlor with adequate interest but without regard to adequate security, triggering grantor trust status pursuant to Section 675(2). While this can characterize a trust as a grantor trust it can also be used as a means of providing economic benefit to a settlor if warranted.
- ix. Consider providing the power to a person to give a Section 2038 power to the grantor to cause estate inclusion, as described above, some portion or the entirety of the trust assets in the settlor's estate if that proves desirable under future permutations of the tax law.
- x. Consider a hybrid domestic asset protection trust (DAPT) approach. Create the trust in a jurisdiction that permits self-settled trusts and grant someone, again in a non-fiduciary capacity, the power to add descendants of the settlor's grandparents to the trust as beneficiaries. If the estate tax is repealed, the power can be exercised making the settlor a beneficiary if appropriate.
- xi. When structuring GRATs consider naming an existing irrevocable trust as the remainder beneficiary so that if the estate tax is repealed the grantor can buy the remainder interest and merger the annuity and remainder interests into fee (complete) ownership can occur.

5. **Monday: Afternoon: Recent Developments Part 3: Speaker: Belcher, Hughes, Heller.**

- a. Basis consistency.
 - i. Duty of consistency.
 - ii. **Comment:** Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, P.L. 114-41; Sec. 2004 (the "Act"). Temporary Regulations (TD 9757) were issued and Proposed Regulations were issued on March 2, 2016. REG-127923-15.
 - iii. 1014(f) step up in basis rules. Subsection (f) limits this to the finally determined value for estate tax purposes.
 - iv. **Comment:** "Finally determined" means: (1) The value of the asset as shown on Form 706 which is not contested by the IRS within the statute of limitations (an unaudited return result); (2) A value set by the IRS which the executor does not contest on a timely basis; or (3) A court determination. If the property value is not finally determined, as above, for federal estate tax purposes the beneficiary is bound to use the value reported on the new Form 8971. These rules do not preclude otherwise allowable basis adjustments that may occur post-death. For example, if an executor makes a capital improvement to property, that cost may be added

to the above basis in determining the actual tax basis to the beneficiary.
Prop. Treas. Reg. Sec. 1.1041-(a)(2).

- v. Prior to 1014(f), taxpayers could whipsaw the IRS. This could be done by the executor including an asset, e.g., a parcel of real estate valued using a large discount on the estate tax return. Later, a beneficiary sells the same property after the statute of limitations on estate tax audit has tolled, and takes a different and inconsistent position with what the executor took on the estate tax return. The beneficiary might take the position that the discount was excessive and therefore use a higher value and thus generate a lower capital gains. Courts only imposed a duty of consistency when the beneficiary was the executor. Now under new IRC Sec. 1014(f) there is a duty of consistency.
- vi. But the duty of consistency only applies to those who have an estate tax. Thus, for estates below the estate tax threshold or marital property there is no duty of consistency.
- vii. Under IRC Sec. 6035 the executor who have to file a federal estate tax return must furnish notice to beneficiaries within 30 days after return is filed. If executor fails to comply there is a \$250/failure. Maximum penalty cannot exceed \$3M per year. If there is willful failure the penalty is 10% of the amount that should be shown on return. For a \$10M estate that is a \$1M penalty. 6035 applies to all executors for which a return is filed regardless of the duty of consistency
- viii. Temporary regulations were intended to confirm notices of delays for due date. Finalized in December 2nd 2016 confirming June 2016 date for first reports.
- ix. Proposed regulations address a number of issues in the statute.
 - 1. Final estate tax value caps the recipient's initial basis. If heir invested that is not intended to limit overall basis for those improvements, just initial basis.
 - 2. Consistency requirements apply until its basis in hands of whoever holds it no longer depends on the basis in the hands of the decedent. So if given several times rules still applies.
 - 3. If subject to debt to you report value net or gross? It doesn't matter for 1014(f) how you report it, it is the gross number
 - 4. 1014(f) is only taxable property. If there is no estate tax due there is nothing subject to consistency. If tax is due every asset in the estate contributes to that tax liability with the exception of property that qualifies for charitable or marital, household effects that don't require appraisal valued over \$3,000, etc.
 - 5. **Comment:** The de minimus rule is based on the Proposed Regulations excluding items governed by Treas. Reg. §20.2031-6(b) which provides as follows: "Special rule in cases involving a substantial amount of valuable articles.—Notwithstanding the provisions of paragraph (a) of this section, if there are included among the household and personal effects articles having marked artistic or intrinsic value of a total value in excess of \$3,000 (e.g.,

jewelry, furs, silverware, paintings, etchings, engravings, antiques, books, statuary, vases, oriental rugs, coin or stamp collections), the appraisal of an expert or experts, under oath, shall be filed with the return. The appraisal shall be accompanied by a written statement of the executor containing a declaration that it is made under the penalties of perjury as to the completeness of the itemized list of such property and as to the disinterested character and the qualifications of the appraiser or appraisers.”

6. What if you find an asset that was not reported on the return? The basis is zero under the proposed regulations. Not clear how that will be resolved.
7. 6035 reporting requirements affect a much broader universe of property. If only reason you are required to file a return that is not a required return for IRC 6035 so those reporting requirements don't apply.
8. Form 8971 is due to IRS and Schedule A to that form is due to each beneficiary. Idea is that each beneficiary only gets a copy of their Schedule A so you don't have to inform each beneficiary of all estate assets.
9. If distribution is made to a trust the recipient is the trustee. Some comments have suggested giving a choice as to whether you give report to trustee or look through the trust and give it to the beneficiaries.
10. Proposed regulations address life estate and contingent beneficiary.
11. If executor sells no need to report.
12. If not sure who will get which property can list all on schedule A so no need to amend the Schedule A to indicate or confirm that only certain assets received.
13. You must supplement the information on Schedule A if a missing beneficiary is found or there is a disclaimer. Any change that makes the information incomplete. If there is an estate tax audit you must supplement the information. If there is a probate estate or revocable trust you don't have to provide the supplemental filing until 30-days after the distribution.
14. Due date is a big issue.
15. Subsequent transfers were the subject of many comments. If you make a gift of inherited property you have to give a Schedule A to that recipient and file with the IRS so that the IRS will have information to match it against the selling donee.
- x. When final regulations are issued forms will again be revised.
- xi. Issues.
 1. Schedule A indicates that the beneficiary has received property when in fact they may not have been.
 2. Beneficiary is getting a list of assets that he or she may receive some or none of.

3. What if beneficiary is a trust that has not been created at the time the form has to be filed so that there may be no tax ID number for the estate.
- b. **State Taxation.**
- i. New Jersey is only change and repealed estate tax effective 1/1/18.
 1. **Comment:** For a detailed discussion of the repeal and planning considerations see: Martin M. Shenkman, Richard Greenberg & Glenn Henkel, “New Jersey Estate Tax Has Been Repealed! What's Next?” Estate Planning Newsletter #2466 (October 19, 2016).
 - ii. Kaestner.
 1. NC taxed trust income solely by virtue of having a beneficiary in NC. Court held that this was unconstitutional. Looked at minimum contacts requirement of due process clause. Basing taxation on state of domicile is constitutional but requires more than just that.
 1. **Comment:** NC held statute unconstitutional since taxed if beneficiary was domiciled in NC. Kaestner Family Trust v. North Carolina, 2015 WL 1880607 (NC Super. Ct), aff’d 2016 WL 3585978 (NC Ct. App.). No assets or trustee in NC. One beneficiary moved to NC but no distributions made to that beneficiary. Everyone agrees if distribute taxable income to a beneficiary that will be taxed by state. The issue is whether the state can tax undistributed income of that beneficiary? This case held that this was unconstitutional. The taxpayer must purposefully avail itself of the benefits of the state to be subject to tax and in this type of fact pattern the trust had not done so.
 2. See Nenno article on web on state taxation.
http://www.actec.org/assets/1/6/Nenno_state_nongrantor_tax_survey.pdf
 - iii. Bank of America Case – MA.
 1. How do you determine residence of a corporate trustee?
 2. BofA said its domicile and principal place of business were in NC not MA. A person can only have one domicile and a business only one principal place. Court concluded that BofA was an inhabitant of MA as it maintained offices in MA, had administrative activities in MA, etc. Bank of America v. Comr. of Revenue, 2016 WL 3658862 (Mass.).
 3. This issue comes up when a trust is about to recognize large capital gains. Does trustee resign to break nexus to a high tax state? If the trustee does not resign is that a breach of fiduciary duty?
- c. Priority Guidance Plan.
- i. Grantor trust.
 1. 1014(a). This will likely restrict position some have taken arguing for basis step-up.
 - ii. Valuation of promissory notes.
 1. 7872 if use required AFR on promissory note it is not a gift.

2. IRS has seen many of these notes and on death the executors are discounting the notes.
 3. **Example:** \$100,000 note to child and mid-term AFR. For gift tax purposes no gift involved. But for estate tax purposes how do you value the \$100,000 note? Appraisers will suggest looking at security, interest rate, child/borrower's credit worthiness, etc. The estate tax regulations say that the only difference in value of the note from the face value is if there was a change in the interest rate from date of issuance to date of death. But this is a proposed regulation has not been finalized and it differs from what appraisers would say.
- iii. Defined value formula clauses.
 1. Trying to provide clarity.
 - iv. Spousal support in divorce trust
 1. IRC Sec. 682 does not contain definition of income. Is it fiduciary accounting or taxable income?
 2. **Comment:** Problem with alimony is former spouses have to interact. So instead put it in a trust. No need for interaction. There are a number of uses: (1) If there is a family business. Example: Wife is 10% owner in family business and cannot give to ex-husband. Perhaps she can put 5% of her interest in an alimony trust and the ex-husband can receive income for term of years then reverts to family; (2) What if one ex-spouse is uninsurable and cannot get insurance? Use alimony trust to guarantee alimony to hold assets since no insurance is feasible; (3) Use an alimony trust to protect an ex-spouse that is not financially sophisticated; (4) Address financial insolvency risk. What if ex-spouse's career is risky? Example, professional athletes. Average NBA \$5M earnings 60% broke a few years after retirement. Most professional athletes if there is alimony owed must won't be able to pay it. Use an alimony trust if client is going to get support from a professional athlete so payments will continue if becomes involvement or bankrupt. There is no income tax deduction on set up of an alimony trust. It is a grantor trust but IRC Sec. 682 says not taxed on income distributed to former spouse. Will be taxed directly on income, same character. If trust has \$50,000 of income and \$100,000 is paid, recipient spouse is taxed only on \$50,000 of income. However, it is still not clear what "income" is taxed to former spouse. Is it fiduciary accounting income or taxable income? This issue is on IRS priority guidance plan. Define in trust instrument what income shall be defined at. Might also say that if IRS changes rule former spouse will reimburse for tax payments made.
 - v. Loan guarantees and impact of discounting to present value.
 1. Regulations should be issued soon.
 - vi. Proposed regulation uniform definition of a child under IRC Sec. 152.

- vii. Final regulations on carryover basis in 2010.
- viii. 6166 Proposed Regulations.
 - 1. Key issue is security.
 - 2. Trying to replace existing regulations which were applied to former 6166.
- ix. Material participation of trusts and estates.
 - 1. IRC Sec. 469.
 - 2. More important due to Medicare Surtax.
- x. Private trust companies are still in the hopper but dropped off this list.
- d. PLR 201634015
 - i. Son is beneficiary of trust set up by parents and has right to appoint whatever is in trust but even though the trust called it a GPOA it is a LPOA.
 - ii. Reformation to make it a LPOA and wanted IRS to respect that the GPOA was not released/converted to a LPOA.
 - iii. IRS said no since court said under state law they could correct for scrivener's error so no release of a GPOA.
 - iv. Key to securing ruling was that the state court said it was a correction of scrivener's error. This was not a modification of the trust by agreement. The correction was effective from inception.
- e. Woelbing Case.
 - i. Pair of Tax Court cases settled in 2016 on favorable terms for the taxpayers. 2006 sale of non-voting stock to a trust for a note. A typical installment sale to a grantor trust. The trust had sufficient seed capital based on the 10% test some speak of. The seed was based on life insurance policies with significant cash value. The sale was subject to a defined value mechanism that caused the shares to adjust based on the final gift tax value. Mr. Woelbing died in 2009. IRS asserted gift tax deficiencies against both Mr. and Mrs. W based on her gift splitting.
 - ii. For gift tax.
 - 1. 2702 IRS asserted retained interest should be valued at zero and treated all shares as transferred by gift.
 - 2. IRS transferred value of the gifts.
 - iii. For estate tax.
 - 1. Because the note was a form of retained interest then the full value of the trust on the date of his death should be included in his estate under 2036.
 - iv. IRS Settled in 2016 with Mr. W's estate but Mrs. W's estate remains open.
 - v. The fact of no change suggests that the IRS accepted the defined value clause so fewer shares should have been transferred because of the adjustment mechanism. So those shares would be transferred on Mr. W's death to Mrs. W as marital deduction.
 - vi. Mrs. W died in 2013.
 - vii. There may have been a part of the settlement an agreement to include those shares in Mrs. W's estate.

- viii. You cannot cite a settlement as precedent but IRS could have pursued the defined value clause in the Woelbing but they did not.
- ix. Estate of Donald Woelbing v. Commr., Tax court docket No. 30261-13.
- f. True Case.
 - i. H.A. True III v. Commr., Tax Court Docket No. 21897-16.
 - ii. Defined value mechanism challenged.
 - iii. Quality appraisal firm and appeal goes to 10th Circuit where Wandry case was heard.
 - iv. Anticipate the taxpayer prevailing in this case.
- g. Estate of Johnson v. Commr. Tax Court Case No. 11708-16.
 - i. SCIN.
 - ii. Requires premium on interest or principal.
 - iii. In Johnson there was a principal premium because of back-loading of payments.
 - iv. The estate reported gain on the cancellation of the note on the decedent's final income tax return not on the estate's first income tax return generating a debt deduction. The IRS disagrees with this approach.
 - v. Similarities to Davidson case with an aggressive SCIN and IRS assessed a significant deficiency. Malpractice case is on appeal.
- h. FLP Cases.
 - i. Estate of Purdue v. Comr., TC Memo 2015-249.
 - 1. The IRS challenged the transfer of assets to the FLP as not meeting the adequate and full consideration requirement. They also challenged gifts of FLP interests as not meeting the preset interest requirement.
 - 2. Marketable securities were owned in separate accounts managed by different firms. There was also an interest in a net leased rental property.
 - 3. The business purpose argued by the taxpayers was consolidation of assets and aggregation to meet qualified investor requirements.
 - 4. The Court held for the taxpayers noting no commingling of personal and entity assets, assets were properly transferred to the entity, the entity formalities were adhered to, taxpayers were in good health when the entity was created.
 - 5. The case also involved a Graegin loan which was upheld even though there were assets outside the entity that might have been used to pay estate tax.
 - a. **Comment:** Under the current tax regime where maximization of income tax basis is so important, planning may more often than in the past retain the non-marketable assets that will benefit from a step up in income tax basis, e.g., depreciable real estate, family business interests, etc. and transfer assets not as likely to benefit from a basis step up (e.g., life insurance, or borrowings on the appreciated assets). This can shift value out of the taxpayer's estate and

leave in the estate the asset that will benefit most from a step up.

- ii. Holliday v. Comr., TC Memo 2016-51.
 - 1. The steps critical to the planning were all performed in a single day – contributing cash and marketable securities to the entity followed by gifts of entity interests.
 - 2. The Court was not swayed by the taxpayer’s justifications of business purposes for the transaction. Asset protection motives were dismissed as the taxpayer lived in a nursing home and the court did not see those as realistic.
 - 3. The entity did not keep books and records. The formalities of the entity were ignored in making distributions, etc.
- iii. Estate of Beyer v. Comr., TC Memo 2016-183.
 - 1. Assets were included in the decedent’s estate under IRC Sec. 2036(a)(1) even assets purportedly sold to a grantor trust. The taxpayers violated several of the cardinal FLP “no-no’s.” Formalities were ignored, distributions were made to the wrong people, tax returns were filed listing incorrect owners (but amended to correct), and more. There was no bona fide sale exception as the purported business purposes were not recognized. In Beyer the Court did not accept the alleged significant non-tax reasons for creation of entity.
 - 2. In Beyer the taxpayers claimed that the decedent wanted to keep primary investments intact. Stock was in trust they could have addressed that goal in that context. Could have named nephew as investment adviser or co-trustee. Taxpayer failed to carry burden of proof to create credible evidence. Beyer is decided on burden of proof grounds.
- iv. All three cases involved marketable security LLCs or FLPs but “nature of assets is not predictor of failure.”
- v. In Holliday and Beyer taxpayers failed to respect the entity itself. In Beyer made distributions to trust that no longer owned interests. Failure to respect formalities of entity created was the downfall.
- i. Rev. Proc. 2016-49.
 - i. **Comment:**
 - 1. The executor of an estate electing portability of the decedent’s unused applicable exclusion amount (deceased spousal unused exclusion amount, or DSUE amount) may wish to make a QTIP election without regard to whether the QTIP election is necessary to reduce the estate tax liability to zero.
 - 2. Before “portability” the IRS issued a ruling to help taxpayers. Perhaps taxpayers and advisers have been skeptical that the IRS would just be a nice guy, so advisers worried about how that old “nice IRS” ruling might interact with the new concept of portability. Rev. Proc. 2001-38, 2001-24 I.R.B. 1335, provided a procedure by which the IRS will disregard and treat as a nullity for

federal estate, gift, and generation-skipping transfer tax purposes a QTIP election made in cases where the election was not necessary to reduce the estate tax liability to zero.

3. The IRS, in the new Revenue Procedure 2016-49 modifies and supersedes Rev. Proc. 2001-38 to eliminate this one worry of tax practitioners. The new Revenue Procedure confirms the process by which the IRS will disregard a QTIP election, but it excludes from its scope those estates in which the executor made the portability election in accordance with the regulations under § 2010(c)(5)(A).

j. *Morrisette v. Comr.*

- i. *Morrisette v. Commr.*, 146 T.C. No. 11.
- ii. Used economic benefit not loan regime.
- iii. On mom's death issue is what is the value of the receivable? Mom gets repaid with intergenerational life insurance until children's death. The valuation of the receivable at her death was about \$7.5M on the \$30M premium paid.
- iv. **Comment:**
 1. In a private economic benefit split-dollar arrangement, the ILIT typically pays only the term cost of the life insurance, which is modest in the early years of the arrangement. Another party, such as a family member (often the insureds) or a family trust [e.g., an existing funded marital (QTIP) or dynasty trust] pays the remaining portion, which is typically the bulk of the insurance cost in the early years of the arrangement. This arrangement can substantially reduce the amount of current gifts the donor/insured is required to make to the ILIT to purchase the insurance, but nevertheless can assure that the insurance proceeds are removed from the donor/insured's taxable estate
 2. *Morrisette* was in her 90s and incapacitated. She created a revocable trust (the payor) that advanced funds to be used for premium payments for life insurance owned by three dynasty trusts (formed by her conservator), under a split-dollar arrangement. Each child had a dynasty trust, and that trust used the funds received from *Morrisette's* revocable trust to buy a life insurance policy on the two other siblings. The insurance was to be used as part of the succession plan for the family-owned businesses, which included Interstate Van Lines. Family members entered into a buy/sell/cross-purchase shareholders' agreement that required the surviving children to purchase shares held by a deceased child. *Morrisette's* revocable trust contributed approximately \$10 million to each of the three dynasty trusts, for a total of \$30 million. Of the \$10 million received, \$5 million was used immediately for insurance premiums, which was sufficient to cover the anticipated cost of the insurance for each child's lifetime. There was, however, also a non-tax reason for the split-dollar

arrangement and insurance, and courts might view an arrangement that has no non-tax motives differently.

3. See:

k. ING Trusts.

- i. Generally created to save state income taxes.
- ii. Taxpayer in high tax state transfers assets to a non-grantor trust it may be possible that the trust is structured so not subject to state income tax. If taxpayer retained assets the gain would be subject to state income tax.
- iii. Intent is that it is not only a non-grantor trust but it should also be an incomplete gift on the transfer to the trust so that there would not be a gift on the transfer.
- iv. This is a thin line to walk – non-grantor and incomplete gift. This is because the powers retained to make a trust gift incomplete will often cause the trust to be a grantor trust. So ING rulings are very fact specific.
- v. PLR 201642019.
 1. IRS revoked a prior 2014 ING trust ruling.
 2. The ruling was as to 673 grantor trust status.
 3. 2014 ruling assumed that if two members of trust distribution committee ceased to serve trust would terminate and assets would be distributed.
 4. In 2016 ruling this possibility was in itself sufficient to cause the trust to be a grantor trust under IRC Sec. 673.

l. PLR 201633021.

- i. Trust no. 1 had the power so that it could withdraw all income of a second trust, trust no. 2. To the extent trust no. 1 did not exercise the right to withdraw income of trust two and if it did not it lapsed.
- ii. Can sell asset from one trust to another trust, i.e. From a non-GST trust to a GST trust.
- iii. **Comment:** Having a trust be a grantor over another trust with different tax attributes can open up a range of interesting planning opportunities. If assets are sold from a QTIP trust to a new trust that is grantor a to the QTIP can the appreciation in those assets thereby be removed from the QTIPs value and reduce estate tax on the death of the second spouse? Can the new trust be GST exempt so as to effectuate improved planning? How would the IRS view such a transfer for gift tax purposes? Can a trust make a gift to another trusts?
- iv. Are there fiduciary issues? Will modification to give withdrawal right create risks to the GST protected trust?

m. Substantiation of charitable gift.

- i. Charitable contributions may remain one of the few planning areas left.
- ii. Taxpayers must follow requirements to properly document donations.
- iii. *Beaubrun v. Commr*, TC Memo. 2015-217 – 4 years to get corroboration was too late.
- iv. *Brown v. Commr.*, TC Memo 2016-39 – No contemporaneous records so deductions claimed by a pastor were denied.

- v. French v. Commr., TC Memo 2016-53 – get bank consent which is required for an easement.
- vi. Payne v. Commr. TC Summ. Op. 2016-30– Donated personal property and claimed \$170,000 deductions for personal property but the taxpayer presented no meaningful corroboration for the contribution. IRS found no credibility to corroboration. Penalty imposed.
- n. Conservation easement cases.
 - i. Adding restriction to prohibit change in use of property without consent of charity holding the covenant.
 - ii. Large income tax deduction FMV at highest use minus FMV at current use.
 - iii. IRS fully inspects these and requires all details of formalities be complied with. Must follow the formalities.
 - iv. Notice 2017-10 issued Jan 3rd. It is not a listed transaction if after 2009 there is a syndicated partnership where the promotional materials promise charitable deduction more than 2.5 times what was invested.
- o. Uniform Acts.
 - i. FL Senate Bill 206 permit persons to execute wills on line without a lawyer or witnesses. Witnesses can be satisfied by Skype or other webcam presence.

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Steve Leimberg's Estate Planning Email Newsletter Archive Message #2499

Date:11-Jan-17

Subject: Marty Shenkman's Day 2 Morning Notes from Heckerling 2017

Heckerling Institute 2017 – Day 2 Morning Notes

By Martin M. Shenkman, Esq.

The following are rough draft meeting notes prepared at the 2017 51st Heckerling Institute on Estate Planning sponsored by the University of Miami School of Law, and published in Leimberg Information Services, Inc. (LISI). These notes were published within a very short time of the conclusion of the proceedings and could not have been reviewed in order to be completed so quickly. There are no doubt errors, typos, etc. in these notes none of which should be attributed to the presenters. LISI obtained special permission from the Heckerling Institute to publish these notes. Bear in mind that no notes appear below on more than 20 concurrent and other sessions. These sessions can be purchased from the source listed below. The final papers presented at this year's Heckerling Institute can be obtained from Lexis Nexis. For recordings of the sessions contact Convention CDs, Inc. 800-747-6334.

1. Tuesday: Morning: Placebo Planning: Pennell.

a. Introduction.

- i. Ron Aucutt says estate tax won't be repealed but Republicans may have to make good on two decade promise to repeal estate and GST tax but less certain gift tax will be repealed as they may be concerned about income shifting.
- ii. If they keep gift tax, which seems likely, chapter 14 will be retained.
- iii. But what is payback? What will be enacted to offset loss? Either capital gains on death like AET tax in Canada or carryover basis.
- iv. The topic this morning has a downside of loss of basis step up at death but if we end up with carryover basis or capital gain on death it may not matter.

b. IDGTs.

- i. Estate freezes come in many varieties.
- ii. **Example:** Create IDIGT to sell assets in exchange for a note. If you exchange a frozen value note for an appreciating asset, it is a freeze.
- iii. What most ascribe to this type of estate freeze is not meaningful because we are in a flat tax environment.
- iv. The principal that makes this planning work is not what many historically speak about.

- v. Income in grantor trust grantor pays income tax. Alternative - retain asset and pay income tax and gift income to heir. It is not really about shifting the income since you can do that either way (i.e. in the IDIT or if you retain the asset). It is about creating the vehicle to do the sale. When practitioners suggest the client pays the income tax that can be done anyhow. From that perspective the note sale is a “placebo.”
- vi. If you retain the asset until you die. By doing the transfer today you are shifting the income without incurring a gift tax. That is not what is really going on either. What is really different is that the remainder has gotten bigger over time. The difference is the valuation. The income interest may be worth more if it is valued at a lower amount in the estate freeze.
- vii. In a flat tax environment prepayment of the tax does not generate a benefit.
- viii. If there is depreciation there is still no difference. This suggests the time for paying the tax is irrelevant so what we speak about as an estate freeze is a zero sum game in a flat tax environment. At a flat 40% rate it makes no difference. There is a benefit from delaying payment with portability if there is depreciation.
- ix. Balance sheet. IRD – retirement benefits. Consider the income tax liability at state and federal level that could result in a 50% reduction. If estate will decline from end of life expenses and taxes.
- x. Hot assets are those that will explode in value. Cold assets do not increase in value. If all assets are either hot or cold planning has no impact. The real planning benefit is if you use cold assets to pay the tax, i.e. assets that are unlikely to appreciate, to preserve assets that are hot, i.e., that are likely to appreciate. Cold assets include cash (unless it is invested to grow),
- xi. 2nd to die life insurance is not what many would want. Might prefer single life so can pay tax on first death to shift/protect assets that are hot.
- xii. With carryover basis what will be the best investment? The internal build up in a life insurance policy is not subject to income tax during lifetime and the proceeds are received on death without a built in capital gains liability?
- xiii. Consider distinction between retirement plan and insurance. In a retirement plan generate appreciation that would be capital gain to the plan holder and instead on retirement is taxed as less favorable ordinary income. Contrast to life insurance. Is there a cross over point at which you should not continue funding a retirement plan because of this tax disadvantage? There is no crossover point but in a carryover basis world traditional thinking of funding a retirement plan should be rethought.
- xiv. IRA to Roth IRA conversion is it worth doing? Notion is that you will accelerate the income tax liability. Assume 40% income tax environment. Do not address a possible increase in tax rate. It is a zero sum game whether you accelerate the tax or not. Tax paid to convert the \$100,000 Roth if paid outside IRA. The \$100,000 in the Roth is a hot asset relative

to the \$40,000 that is a cold asset because it is subject to the annual income tax on ordinary income.

- xv. The Roth conversion illustrates the same principal as the sale to a IDIT. It is not the freeze but the source of the payment of the tax that matters.
 - xvi. What are cold assets? The coldest asset is the unified credit. The first \$5,490,000 is taxable but the tax on that is the unified credit with which you pay the tax. The dollars you use first to pay the tax are the unified credit. The unified credit does not grow over time. The value you are taxing goes up but the unified credit is a cold asset in the sense that it doesn't get bigger when the wealth you are taxing gets bigger. The coldest asset to pay to shelter assets is the exemption. Use of the credit sooner rather than later is the benefit in all of these examples. Use the cold asset now to shelter more growth on hot assets. Not an easy analysis since we don't know what will happen.
- c. What does a capital gains on death do to this analysis?
- i. The Canadian system, AET, is the worst of all worlds since will have to preserve wealth transfer tax notions of what you own. Life insurance, trusts, retirement benefits, all of the estate inclusion rules will be necessary under AET to determine which assets are subject to a capital gains on death. How should you use your credit in light of this?
 - ii. If there is a \$10M exclusion for capital gains on death that is a cold asset. The \$10M may be spread across all assets pro-rata although there may be an election to spread it over all asset. How should you use it? The best result may be based on two factors. Using a cold asset to shelter tax on hot asset. Use exclusion to shelter gain on first assets you may sell. Avoid tax as early as possible to preserve tax dollars you would otherwise pay for investment. If you have assets subject to depreciation or depletion may be a good use since you can then start new depreciation even if you will be subject to recapture on an eventual sale.
 - iii. The core principal is to use the cold asset of the exclusion from capital gains on death to shelter hot assets.
- d. 5 and 5 power.
- i. When a 5/5 power lapses it is not subject to gift tax. The annually accumulated lapses won't incur estate tax liability on death.
 - ii. Under IRC Sec. 678 the powerholder becomes the deemed grantor of the trust. The BDIT is built on this notion.
 - iii. What happens in year of death? If 5/5 is available on death IRC Sec. 2041 requires the inclusion of the 5/5 amount in the year of death. This is why some draft power on only one day of the year so that if you die on any other day of the year you won't have this inclusion. There is no authority indicating whether this works or not. This mechanism is "placebo" planning as it may do no harm but it may do some good.
 - iv. Should the power be available only on January 1? December 31? We limit to one day only to avoid inclusion if the individual dies on that day.

2. **Tuesday: Morning: GRAT Results: Mcaffrey.**

- a. GRATs.

- i. GRATs are a great tool with so much uncertainty.
- ii. GRATs don't trigger gift tax and they work great in low interest rate environment.
- iii. If we have estate tax repeal, there may be benefit to shifting assets out of a client's estate in case estate tax comes back. Also may benefit a client if a capital gains tax on death is imposed. **Comment:** In light of the possibility of repeal consider a hybrid DAPT as the receptacle for the remainder so that if the estate tax is repealed the client/grantor can access the assets. See GST planning below.
- iv. Many techniques expose transfers to gift tax risk.
- v. GRATs are a good technique for uncertain times. The GRAT delivers its benefits without any potential gift tax risk.
- vi. Why so good when interest rates are low? Shift value to next generation to extent exceed interest rate so the lower the rate the greater the likelihood is that value will be shifted.
- vii. At end of GRAT term assets pass to beneficiary or group of beneficiaries or trusts for them.
- viii. If recipient beneficiaries are family under IRC Sec. 2702 and the trust satisfied requirements of GRAT then the full value of the transfer will be reduced by grantor's retained interests. The requirements are:
 - 1. Annuity payment at least once a year.
 - 2. Cannot use note or financial arrangement to pay the annuity.
 - 3. Annuity must be fixed dollar or fixed percentage.
 - 4. Adjustment clause must satisfy requirements in Regs.
 - 5. Trust instrument must prohibit additions.
 - 6. Trust instrument must prohibit commutation.
 - 7. Trust instrument must prohibit payment to anyone other than grantor before end of qualified term.
 - 8. Term of annuity must be for life of annuitant or term of years.
- ix. But if there is a slip up in complying with the requirements a draconian result will occur which is a 100% gift tax. This makes it critical that clients comply with all the regulation in the drafting and administration of the GRAT.
- b. Can enhance likelihood of a successful GRAT: drafting, administration, etc.
- c. Drafting.
 - i. Good drafting can ensure regulatory compliance, enhance portability of GRAT succeeding.
 - ii. First objective is that the GRAT must comply with requirements in the Regulations. However, mere documentary compliance is not enough since IRS takes position that actual failure to comply will cause the GRAT to fail.
 - iii. How can we draft to give client a defense against missing a payment or inadvertent addition?
 - iv. Incorporate a clause to address an inadvertent failure to pay the annuity. IRS agents often ask for proof of timely payments of annuity payments. You may argue that all the regulations require is compliance in terms of

the document but this is tough to argue with an agent. Instead provide in the trust instrument that a portion of the GRAT will automatically terminate to the extent an annuity payment was not made on time.

Example \$5M GRAT at end of 105-day grace period \$2M that belongs to grantor 2/5 of the GRAT will terminate. Argument is now that this property now belongs to the grantor not the trust.

- v. What about inadvertent additions? The problem can arise in many situations including a purchase by the grantor of assets from the GRAT, a loan to the GRAT that the IRS argues is an addition, or the property transferred to the GRAT is unvested interest in property and the vesting occurs during the GRAT term that is the date of the gift. Draft so that any inadvertent addition is required and is held in a new trust.
- d. Reducing valuation risk.
 - i. If funded with hard to value assets define annuity by formula not fixed amounts.
 - ii. Despite IRS opposition to valuation formulas but the 2702 Regulations permit exactly this.
 - iii. Define annuity amount as the amount to reduce gift to zero if IRS reevaluates transferred property the annuity will adjust.
 - iv. This is for many the most important reason to use a GRAT since it is the most assured way to transfer hard to value assets and minimize risk.
- e. Exposure to economic risk.
 - i. In 2008 when the financial market collapsed and wiped out value of trusts engaged in installment notes. If the value of the asset sold collapsed the children as guarantors were still on the hook. This left the children who guaranteed debts with significant obligations. In a gift to a GRAT this is unnecessary as there are no guarantees required.
 - ii. Similarly, a note sale would use exemption if a seed gift is made. In contrast, there is no reason to create a GRAT with more than a modest current gift as that reverse leverage could produce a negative wealth transfer result if the property performs worse than the 7520 rate.
 - iii. If the value is really zero should the grantor file a gift tax return? Yes, as the Code requires it and also you want the statute of limitations to run on the valuation and other positions in the GRAT. This is particularly important if you define the annuity payment based on the value finally determined for gift tax purposes. Without filing a gift tax return this mechanism will not function.
 - iv. Be sure to include all gifts, including charitable gifts, when filing the gift tax return. If fail to list charitable gifts and only other gifts is zeroed out GRAT will exceed 25% and statute may be 6 years.
- f. Morality Risk.
 - i. IRC 2036 brings back into estate a transfer if the transferor retains an income interest in that asset. An annuity right is not the right to income.
 - ii. Annuity amount/7520 rate at death = amount included in the estate. That amount invested at the 7520 rate has to produce annuity amount.
 - iii. Reduce mortality risk by using short term GRATs.

- iv. For married grantors whose estate plans include marital deduction GRAT planning should consider preservation of the marital deduction. If annuity payments go to spouse the remainder passes to someone else and that would violate the terminable interest rule. Can have grantor retain power of appointment over remainder interest to extent included in gross estate and exercise to surviving spouse and bequeath annuity interest to the trust as well and bet the non-deductible terminable interest rule. If a marital deduction trust will be used as a recipient need clause that says if spouse survives trustee must pay all income to grantor's estate even if it exceeds the annuity amount and surviving spouse must have ability to require the trustee to produce reasonable income.
- v. Proposed repeal of death tax and if combined in carryover basis creates a new mortality risk. If this happens the GRAT won't provide an estate tax savings. If GRAT was funded with appreciated property, the use of appreciated property to fund an annuity after the new law is enacted may be a taxable event. Consider grantor transferring the remaining annuity payments to a new trust and under the terms of that new trust the trustee of the GRAT could withdraw property of trust at any time so that the new trust is a grantor trust as to the GRAT, i.e. the new trust would be grantor trust as to the GRAT. **Comment:** See PLR 201633021 in the Recent Development notes from Day 1.
- vi. Another approach to mortality risk if client has existing grantor trust in place with assets, structure existing trust so that trust can purchase remainder interest. See GST discussion below.
- g. How can drafting increase probability of successful GRAT?
 - i. Use short term GRAT to minimize mortality risk.
 - ii. Short term GRAT minimizes risk of poor performance years bringing down performance of good years. A series of short term GRATs is always better.
 - iii. Use an increasing GRAT annuity payment 120% per year.
- h. Funding and operating GRATs.
 - i. If use multiple GRATs the successful GRAT will produce a benefit to beneficiaries. But if combine two assets in one GRAT the gain on one may be offset by loss on another.
 - ii. Most freezing techniques only freeze. Multiple GRATs make assets disappear as some of those assets will result in losses and those losses will reduce client's estate while gains increase or inure to beneficiaries.
 - iii. Fund with fractional interests. These may depress value initially but may disappear over time. Look for transferability restrictions placed on assets by third parties, securities laws or family entity restrictions. The third party or securities law restrictions generally disappear over time but this does not mean they are ignored in valuing assets put into the GRAT. Fractional interests in art or other personal property or a family business enhances the result of the GRAT. If the asset is sold while the assets is I the GRAT the discount disappears and the value and success of the GRAT can be enhanced.

- iv. Use securities in a family investment entity and value at a discount from the share of the underlying assets. Transferring these types of interests without a GRAT presents a valuation risk. Make these transfers instead inside a GRAT as it makes this risk disappear.
 - v. Leverage can help. If you want a short term GRAT and want it zeroed out, you will have to make large annuity payments. If you have to transfer assets back in kind that is problematic (costs of appraisal, shifting asset back to client). Consider a leveraged GRAT. Put asset into an LLC worth \$1M and take back a \$900,000 3 year note. Now transfer 100% of entity into GRAT and the annuity payments are modest and it may be funded with the cash flow from the asset. **Comment:** This is the Stacy Eastland leveraged GRAT. Consider whether the IRS may argue that the leverage is the GRATs use of a note to make an annuity payment on what they may argue is an unencumbered asset transfer.
 - vi. Consider preferred interests? Use high yielding preferred interests. The coupon may exceed the 7520 rate. If do not want to go into market to buy a preferred interest (and that exposes to interest rate rise). Grantor transferring \$5M of securities to LLC and take back two classes of interest, a preferred interest with an 8% return and a growth interest representing the balance of the economic interests. The growth in interests will receive income and profits not necessary to fund the preferred interests. The GRAT will pay the annuity each year with distributions on the preferred and perhaps distribute some of preferred back to Grantor. At end of the GRAT the beneficiaries will receive remainder. The beneficiary of the GRAT will have a positive return so long as the family LLC doesn't lose too much. Grantor could transfer remaining interests to a second GRAT. Consider IRC 2701 because grantor will get back preferred interests. Initial valuation of the preferred is complex. IRS may argue that two GRATs should be consolidated so make them different (trustees, terms, beneficiaries).
- i. How can we help client with administration and monitoring of GRATs?
 - i. GRAT will not succeed if grantor dies during term or assets don't perform adequately.
 - ii. What if grantor's life expectancy becomes short?
 - iii. Who does this monitoring? Someone should assume this responsibility.
 - iv. If the GRAT underperforms in initial years unlikely to be successful. Grantor could buy back assets. No income tax consequences since it's a grantor trust. Can use a note if client doesn't have cash. Could then re-GRAT the purchased assets.
 - v. What if GRAT does well in initial years? This is no guarantee that it will perform well. So lock in successful investments. The Grantor can repurchase assets from the GRAT and lock in the gain. You could purchase for a note. This might lose possibility of shifting future profits to beneficiaries. No do a new GRAT with those assets with a new baseline.
 - vi. What if the grantor or the trustees of client revocable trust purchase remainder from remainder beneficiary? If remainder is a separate grantor

trust this should be feasible. GRAT should not contain a spendthrift clause or remainder beneficiary will not be able to participate in a sale of the interest.

- vii. Monitor to protect against mortality risk. If grantor looks like he or she will die have the grantor purchase the remainder interest. If grantor created a 5 year GRAT and funded with \$1M she is entitled to annuity and remainder after year 5 goes to a separate grantor trust. Determine the present value of annuity interest at this point and the remainder interest and the remainder can be purchased.

j. GST and GRAT planning.

- i. Why worry about GST?
- ii. Draft so that the termination of the GRAT should not be treated as a taxable termination for GST purposes.
- iii. Would ideally like to benefit future descendants without another tax.
- iv. Most advisers believe that the creation of the GRAT creates an ETIP during which time the GST cannot be allocated. Some believe that the exception for possible inclusion if probability of inclusion is less than 5% it may not be ETIP but may still have to protect by allocating GST exemption based on value of entire property which is not an efficient use.
- v. First, be certain that GRAT is a skip person. So don't define remainder as issue per stirpes. This could result in a partial taxable termination. The predeceased ancestor exception won't apply since child may die after transfer to the GRAT. The terms of the GRAT that a trust for all grantor's descendants should be a beneficiary consider GST implications. The client/grantor can provide under her will a bequest of an extra amount to issue of a child who predeceased GRAT termination.
- vi. A remainder interest in a GRAT could be viewed as an investment and if bought by a purchaser should not be viewed as a distribution.
- vii. GRAT remainder passes to grantor's daughter and gave her a GPOA exercisable by will. If she exercises in favor of at trust for her children. Identity of transferor shifted when daughter died holding GPOA. IRS has disagreed with this position saying that if at the time the child died she became a transferor only to the extent of her proportional interest in the trust which would only provide partial protection. So this approach is not optimal. Have power exercised in favor of a trust with multiple generations including her sibling and spouse.
- viii. Use a sale of a remainder interest. Assume client has GST exempt trust that is perpetual. Client creates a GRAT and a remainder interest is say worth \$46,000. That remainder interest that will pass to trust for children but you want to pass as a sale to a different old and cold GST exempt trust. Some time after the creation of the GRAT the remainder trust can enter into a sale and sell the remainder interest to that old and cold GST exempt trust. When remainder is actually paid to GST exempt trust that purchased remainder it is not a transfer from a trust and is not a taxable termination but is merely a change in an investment the GST exempt trust

made years earlier. Trust should not be a skip person trust so if argument fails it will not be a taxable termination.

3. **Tuesday: Morning: Retirement Accounts and Marriage: Hoyt.**

- a. Retirement account taxation.
 - i. Predicts Congress may attempt to impose 5-year stretch limit.
- b. ERISA.
 - i. Federal law governs.
 - ii. Contrast IRAs governed by state law.
 - iii. Dichotomy between federal and state laws.
- c. Difference between employer plan and IRA.
 - i. Divorce.
 1. Need QDRO which is a divorce court order with precise requirements for 401(k).
 2. An IRA will not require a QDRO and can divide by property settlement agreement.
 - ii. Distribution.
 1. Cannot withdraw from 401(k) during employment except for loan, hardship or at age 59.5+ can make in service distribution. There is no requirement for these but company can allow.
 2. For IRA no comparable law. You can just take money out. If under 59.5 there is a 10% penalty but there is no prohibition as there is for a qualified plan above.
 - iii. IRA rollover.
 1. 60-day rollover can get money out and put into rollover. If you are required to receive a minimum distribution you can only rollover the difference, you cannot rollover RMD. A better alternative is a trustee to trustee transfer. With a 60-day rollover you get a check and must make transfer.
 2. If you miss deadline you can apply to IRS for waiver but the cost is \$10,000. 2016-47 if you missed the rollover because of one of these reasons you can self-certify and avoid the waiver fee. IRS can audit you but this is a positive improvement.
 - iv. Beneficiary designations.
 1. Qualified plan law supersedes state law.
 2. Children from prior marriages named at work. Federal law trumps this and if you die your spouse is entitled to 100% of assets in your 401(k) unless she exercised a waiver.
 3. A prenuptial agreement is not effective as a waiver. To be a valid waiver you must be married. In prenup say “we will sign all documents after marriage to make the waiver valid.” But must follow up.
 4. With an IRA the kids from the first marriage will get the IRA assets.
- d. Distributions.
 - i. 3-5 10% penalty for distribution before 59.5 is subject to this. There are exceptions. If distribution is made to a beneficiary or to an estate or trust

after the death or employ distributions from an inherited account are exempt from the penalty. Hardships – medical expenses are exempt but all other hardships are taxable.

- e. Community Property and retirement accounts.
 - i. Community property laws can apply to IRAs.
 - ii. P.L.R. 2016-23001. Child is named beneficiary. IRC Sec. 408 must be applied without regard to any community property laws. So widow may not be treated as able to rollover. If child assigns to widow it will be treated as a distribution to child.
 - iii. What would happen in the above case in a second marriage? Will spouse get distributions and children have to pay the tax?
 - iv.
- f. Stretch.
 - i. Objective of retirement account is to keep balance as large as possible.
 - ii. Traditional or Roth you want to keep balance as large as possible but must take out distributions after 70.5 and after death. Exception if married to someone more than 10 years younger than plan holder.
 - iii. Use Uniform Lifetime Distribution Table. 80-year-old takes out 5.35%.
 - iv. Planning focuses on stretching the IRA. You want to take it out over remaining life expectancy of beneficiary. Names granddaughter as beneficiary.
 - v. On death retitle to “Client Name for benefit of Granddaughter Name” and change plan holder Social Security to granddaughter’s.
 - vi. Granddaughter’s life expectancy at age 30 is 53.3 years. Sister is age 80. If give her 1/3rd. Granddaughter takes out 1/53.3 or 1.9% but sister takes out 1/10.2 or 9.8%. The differential illustrates the benefit of the stretch.
 - vii. Congress asks why should we let payments drop so low as above for so long. September 21, 2016 Senate Finance Committee proposal JCX-87-16. Exceptions are provided for minor under 21 and someone who is disabled or has a chronic illness or someone within 10 years of age of plan holder.
 - viii. Trust.
 - 1. If have both sister and granddaughter may have to use sister’s life expectancy.
- g. Key terms.
 - i. Required beginning date = RBD – while you are alive this is first date IRS can assess 50% penalty. Year you turn 70.5...April 1 after you turn 70.5 is the RBD. For corporate plan if still working it is 70.5 or when you stop working unless you own more than 5% of the business.
 - ii. Designated Beneficiary = DB – a human being. A trust or charity or a probate estate are not DBs. To get the best tax outcome every beneficiary must be a DB.
 - iii. Determination Date – September 30 the year after death. It is at this date that you look at DBs so between death and that date you can get rid of problem beneficiaries.
 - 1. Disclaim.

2. Cash out charity. They are tax exempt and they don't need stretch IRA so pay off charity.
 3. Separate accounts. Divide the accounts.
- h. Rules and planning.
- i. Probate estate is the worst result as it is a 5-year payout. Must liquidate IRA in 5-years.
 - ii. General rule for a non-sibling spouse is life expectancy.
 - iii. But if you work for a corporation the corporation might be able to do stretch payments but must have a policy that within a short time of death they will liquidate account. But you might be able to tell them to move it to a stretch IRA.
 - iv. Special rule for married beneficiaries. Only a surviving spouse can do a rollover. Do not do a rollover for surviving spouse age 59.5. if you rollover and then take a withdrawal before age 59.5 there is a 10% penalty on the withdrawals. Ask how much money will be needed before age 59.5 rollover what is not needed. With a rollover surviving spouse can name her own beneficiaries, etc. Once she attains age 59.5 rollover whatever was kept out but not spent.
 - v. Surviving spouse can recalculate.
 - vi. If spouse died before age 70.5 no required distributions until year, he/she would have attained age 70.5 so long as spouse is sole beneficiary.
 - vii. 50% of estate tax returns for men filed after age 80 for women 84. You want to plan for longevity. Only surviving spouse can do a spousal rollover. Might also use a bypass conduit [but portability may be better and simpler].
 - viii. IRA can be payable to a credit shelter trust structured as either an accumulation trust or conduit trust. A well drafted trust will have instructions as to what to do if it gets distributions out of a retirement account.
 - ix. Special rule on distributions to trust can look through to
 1. Conduit trust – instrument says must distribute, and the distribution is effectively from the IRA straight to the beneficiary, the trust cannot accumulate it.
 2. Accumulation trust if you have an accumulation trust may be able to accumulate and not flow through.
 - x. IRA payable to a trust for surviving spouse or to probate estate and the widow got IRS to let the check be issued to the widow and permitted her to do a rollover. PLR 201632015 for trust for spouse. PLR 201511036 to the estate which pours into trust for spouse.
- i. Divorce case study.
- i. Prenuptial does not apply to qualified plan only to IRA unless waiver signed.
 - ii. With a rollover the surviving spouse has control and can name her kids from her first marriage.
 - iii. Use life insurance.
 - iv. Split retirement plan between kids and spouse.

- v. Use a two generation CRT.
- 4. **Tuesday: Morning: Asset Protection: Rothschild.**
 - a. Introduction.
 - i. 40% of states have some type of asset protection trust legislation.
 - ii. Many trusts have historically been drafted with mandatory distributions at some age. Risks.
 - iii. Drafting and planning should address a combination of strategies depending on age, marital status, state of domicile, etc.
 - iv. If client resides in a state that does not recognize self-settled trusts it might be better to use spendthrift trusts, third party trusts, FLPs, LLCs, etc.
 - v. Example: Real estate developer guaranteed a \$20M loan. Assets were limited. Project failed. Uncle left bequest outright and if nephew predeceased to charity. The avoidable transfer law or fraudulent transfer law prevents him from transferring the inheritance of \$25M. If he disclaimed it would go to charity. If his uncle had left bequest in trust developer nephew could have declared bankruptcy the next day and the inheritance would have been preserved.
 - b. Transfer to spouse.
 - i. Must be married.
 - ii. Poor man's asset protection planning since not much required in terms of legal services.
 - iii. Put assets into name of spouse less likely to be sued.
 - iv. From an estate tax perspective this might waste exemption in a state with a state estate tax if that state does not have portability nor does it help with GST planning.
 - v. Divorce risks.
 - vi. Spouse giving away assets may want control and to enjoy the assets so creditors may bring forth constructive trust arguments.
 - c. Trusts.
 - i. Modern trusts are used to minimize income and estate tax but can provide asset protection. Trusts can protect beneficiary from bankruptcy, claims that arise in tort, etc. Trusts may protect assets from ex-spouse.
 - ii. What about an outright marital bequest? From a creditor protection perspective, it is reachable by future spouses, rights of election and creditors so a marital trust bequest is almost always preferable.
 - iii. Spendthrift trust provides for beneficiary and recognized in every state by statute or under common law. 502c of UTC beneficiary cannot transfer interest in a trust in violation of a spendthrift provision and a creditor may not reach distribution by trustee before receipt. This is predicated on public policy that anyone can make any distribution of their assets they wish. Under British law spendthrift trusts are not recognized. Nichols case.
 - iv. Most states do not recognize spendthrift for creditors. Since 1997 16 states + Michigan....
 - v. Spendthrift trust can be pierced in many cases by necessities, for spouse or 504b UTC provides that a creditor cannot compel distribution from a

discretionary trust even if expressed as a standard and even if trustee has abused discretion. 504c if trustee has abused discretion a court may order a distribution for support or maintenance for spouse, child or former spouse. Marital claims against trust presents special issues.

- vi. Support trust gives trustee power to pay trust income to provide for support and maintenance. A support trust is protective of beneficiary's interests as beneficiary is only entitled to distributions for support. These are only appropriate if grantor does not wish to give discretion. A spendthrift provision should be included. A
- vii. A discretionary trust – distributions wholly in discretion of trustee. Beneficiary creditors cannot compel trustee to pay. The interest of the beneficiary does not qualify as a property right so even preferred creditors like spouses may be prevented access. It may not provide protection in some jurisdictions from such super creditors.
- viii. Avoid creating a discretionary trust subject to a standard. Use word "may" not "shall." Court generally won't substitute its judgment for the trustees unless the trustee has breached a fiduciary duty.
- ix. Other self-settled types of trusts like GRAT, QPRTs, CRUTs, etc. commonly used for estate planning purposes the issue is that inters treated by the grantor reachable by creditors? It is to the maximum extent trustee can distribute. QPRTs are commonly used to lever age settlor's unified credit but also provides some asset protection. Settlor has transmuted interest in real property to a right to reside in the residence for a term of years. If settlor forces sale of property it will convert to a GRAT and would only have limited right to distribution. In a QPRT the grantor can point to estate tax benefits as primary intent or purpose of establishing the QPRT not asset protection. Establishing other non-asset protection purpose is important.
- x. Other trusts like SLATs. This is a trust for the benefit of the spouse that may include other sprinkle beneficiaries. If both the client and spouse are citizens unlimited distributions can be made to spouse. Can be incomplete gift trust by settlor retaining a veto power. Risks of SLATs are premature death or divorce. Could provide if settlor is unmarried he or she becomes a beneficiary of the trust. Could use a floating spouse provision, the person who settlor is married to at any particular time. Could give person loan to settlor. Could give done spouse a LPOA in favor of spouse but this may not avoid self-settled trust exposure because of relation back doctrine so use self-settled trust jurisdiction.
- xi. The greater the access the beneficiary or settlor has the greater the risk.
- xii. A trust in a DAPT jurisdiction with an institutional trustee may be better than a SLAT in the home state with the spouse as a trustee. No means of measuring risks and comparing.
- xiii. In a divorce is the SLAT corpus considered? Perhaps a post-nuptial agreement may be useful.
- xiv. If client establishes trust for spouse and spouse established trust for the other spouse and if not identical (i.e., not reciprocal) the risks may be in

between the other options. Trusts should be sufficiently different that creditors cannot argue that reciprocal trusts leave both spouse in same position. They would be uncrossed if too similar in asset protection context just like in tax context. Consider different beneficiaries, different lifetime powers, different trustees and different powers. Consider using self-settled trust jurisdictions.

- xv. Recent legislative developments have given the inter-vivos QTIP as a tool. This is not perhaps as good as a SLAT since donee spouse can be only beneficiary and must continue after divorce. Beauty if inter-vivos QTIP structure the donee spouse can be given a power of appointment or the QTIP could provide that the donor spouse becomes a beneficiary. This appears to be a self-settled trust. Several states have enacted legislation saying this will not be a self-settled trust. Florida spearheaded this. Is this trust to be considered in a divorce as part of equitable distribution of marital assets? Post-nuptial agreement might provide that this should be treated as a transfer for beneficiary spouses benefit if there is a later divorce.
- d. Self-settled trusts.
- i. Is protection provided by these trusts available to clients not residing in those states? What is protection for someone in a non-DAPT state?
 - ii. Restatement conflicts of law 273 speaks to restraints on alienation of trust interests. It is determined by local law of state in which the settlor has manifested an intention for the trust to be in. From this definition a NY resident creating a DE trust NY should respect DE law. In some jurisdictions the ability of a settlor EPTL 7-1.10 provides you can designate controlling law. But there is a different section 270 of restatement that an intervivos trust is valid under local law of state designated provided application of its law does not violate a strong public policy of state under state law in which most significant interest. This suggests and has been cited by courts that this is a basis for not upholding a DAPT. If public policy provides an exception for conflict of law rules marital context raises unique public policy issues. So perhaps for protection from marital claims consider a foreign self-settled trust where full faith and credit clause does not apply (in fact they provide for non-recognition and require proof beyond a reasonable doubt is required, etc.). Many offshore jurisdictions prohibit contingent fees.
 - iii. Public policy. Uniform voidable transactions act raises concerns. Some commentators have raised concern under Sec. 4 comment 2 about NY which is considering adoption but which has no legislation for self-settled trusts. That might make a DE DAPT voidable per se for a NY resident.
 - iv. There are estate planning benefits of using self-settled trusts. Clients may not want to give assets away but a DAPT may provide an option. Completed gift transfers were made in 2012 to such trust. 20094402 PLR IRS backed off as to whether trusts would be included in settlor's estate under 2036, e.g., pattern of distribution or implied understanding would result in inclusion. So it may be advisable when drafting these trusts to

- allow third party or trustee to exclude settlor as beneficiary in case the law might change or in case settlor no longer has need for access.
- e. Drafting to maximize trust protection from creditors and divorce.
 - i. General rule of thumb the greater the beneficiary's access the less protection.
 - ii. Trust should ideally have sprinkle power to many beneficiaries rather than limiting to single person.
 - iii. Should have at least one independent trustee an objectively independent trust is especially important to a DAPT. This may reduce arguments that there is a prearranged understanding.
 - iv. Even for non-self-settled trust using a bank or trust company is best and can give a third party protector the power to remove and replace.
 - v. Beneficiary receipt of distributions should solely be in trustee's discretion without any standards and should be able to make distributions for the benefit of the beneficiary and not direct.
 - vi. Consider including a spouse or significant other as a beneficiary so distributions can be made to that person and not to the beneficiary.
 - vii. Long term trust, ideally perpetual or the maximum period permitted under state law. Consider using a jurisdiction that repealed RAP, 27 states have done this.
 - viii. If the grantor wants an outright distribution at a certain age give someone the right to extend the term of the trust in the event of a creditor problem. But this is still a dangerous approach. What if the issue arises later? Consider a hold back provision.
 - ix. Encourage the trustee to acquire a home or invest in beneficiary's business and make loans instead of making distributions that could be reached by creditors or which could become marital property.
 - x. Consider automatic termination in favor of another beneficiary if the first beneficiary is deemed insolvent or provide that an attempted attachment by a creditor eliminates that beneficiary's rights. Similarly convert an absolute interest into a discretionary interest.
 - xi. Beneficiary may have power to withdraw principal may make property available to creditors so avoid ascertainable standards, 5/5 powers, etc.
 - xii. If trust owns real estate it should be in LLC. Consider putting the real estate into an LLC. NY Case Heller. Divide trust into two: one holding real estate and one holding marketable securities.
 - xiii. Consider decanting. If home state does not have decanting statute move trust by naming a trustee in a state with a strong decanting statute like NY or AK and moving the trust and then decanting.
 - f. Non-Trust planning.
 - i. Tenants by the entirety can only exist between spouses and requires five unities to exist. Differs from joint tenancy in that it cannot be partitioned during marriage unless both spouses agree. If it is exempt under state law it is exempt under bankruptcy law. In some states like NY only real estate can be held TbyE. In other states like FL other assets if titled properly can

- be so held. Risk is divorce or death as that protection is lost. So on death entire assets could be lost.
- ii. Title to non-risks spouse and provide in that spouse's will that all passes in protective trust for spouse. But there is an issue of putting all assets in one spouses name and should consider post-nuptial agreement.
 - iii. Tenancy by entireties trust which is better than a typical TbyE title as it may provide protection after death of first spouse. Example, TN.
 - iv. Disclaimer by beneficiary with creditor issues. In some states, e.g. NJ an insolvent beneficiary cannot disclaim. In NY it is not a fraudulent transfer. There are exceptions to effective disclaimers. Can a minor disclaim? Guardian at litem would argue no. A disclaimer won't be effective against Medicaid or against the IRS. The right to inherit is subject to a federal tax lien.
 - v. GPOA versus LPOA. No state permits a LPOA to be reached by a creditor. In some states a GPOA is not available to creditors until exercised. One approach might be if to be a donee of a LPOA exercise serially. Instead give LPOA to spouse of beneficiary and she can exercise only when no creditor problems. This may even be better than having the intended person be a direct beneficiary.
 - vi. Retirement assets under ERISA pension plans are exempt. State law governs protection of IRAs and inherited IRAs. Supreme Court has ruled that inherited IRAs not protected in bankruptcy filing so consider a trust as a beneficiary, conduit or accumulation trust. Some states have enacted legislation protecting inherited IRAs. But even if state law does you don't know where beneficiaries will reside. So consider trusts.
 - vii. Homestead exemptions may provide a last resort. If live I SD, FL, KS etc. there are generous homestead exemptions. FL courts have held that cannot unwind purchase of a FL homestead notwithstanding it was past the 11th hour.
- g. Planning thoughts.
- i. Action should be taken in advance of claim, ideally as far in advance as possible.
 - ii. Too often clients only think of protection planning after a claim occurs.
 - iii. The planning should be placed on today's agenda.

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Steve Leimberg's Estate Planning Email Newsletter Archive Message #2501

Date:12-Jan-17

Subject: Marty Shenkman's Meeting Notes from Heckerling 2017: Day 2
Afternoon Notes

Heckerling Institute 2017 – Day 2 Afternoon Notes

By Martin M. Shenkman, Esq.

The following are rough draft meeting notes prepared at the 2017 51st Heckerling Institute on Estate Planning sponsored by the University of Miami School of Law, and published in Leimberg Information Services, Inc. (LISI). These notes were published within a very short time of the conclusion of the proceedings and could not have been reviewed in order to be completed so quickly. There are no doubt errors, typos, etc. in these notes none of which should be attributed to the presenters. LISI obtained special permission from the Heckerling Institute to publish these notes. Bear in mind that no notes appear below on more than 20 concurrent and other sessions. These sessions can be purchased from the source listed below. The final papers presented at this year's Heckerling Institute can be obtained from Lexis Nexis. For recordings of the sessions contact Convention CDs, Inc. 800-747-6334.

1. Tuesday: Morning: Preferred Partnership Freezes: Angkatavaich.

a. Freezes.

- i. Shift assets from less efficient bucket (red), e.g., not GST exempt, to a more efficient bucket (green), e.g. GST exempt.
- ii. Freeze planning generally involves an exchange of the growth potential for something more secure, e.g. more cash flow from more secure type of interest. This can take many different forms. GRATs are an example of this. You put assets into a GRAT in exchange for an annuity payment. What you put in, in a zeroed out GRAT, is such an exchange. In a sale to a grantor trust you take back a more secure asset in the form of a promissory note. A preferred partnership is a different variation of this. You are splitting an entity into different economic pieces: a preferred frozen interest and a common growth interest.

iii. GRATs

1. Blessed under IRC Sec. 2702.
2. You can do a gift tax free shift of future appreciation if the annuity paid equals value of what you put in.
3. The Greenbook proposals have included changes like a 10-year minimum term. A minimum gift requirement was also proposed to be the greater of \$500,000 or 25%.
4. Not sure what Trump might do.

5. Hearing from practitioners of increased audits of GRATs. There are strict requirements that if you trip over them there will be issues.
- iv. Sales to grantor trust –
 1. Is note is a true debt? IRS argues not true debt and parties did not intend to respect the note.
 2. Woelbing/Karmazin arguments. More technical types of arguments. In Karmazin argued that note should be characterized as something different. In Woelbing should be characterized as disguised transfer into trust with retained interest which did not meet qualified interest under GRAT regulations so entire transfer should be taxable. In Woelbing argued what was included in parent's estate on death was the appreciated stock.
 3. Valuation issues. Unlike a GRAT which has a self-adjustment mechanism with the annuity, a note sale does not unless a defined value mechanism is added. In the note sale you have to address other risks.
 - v. Trump.
 1. Possibility of estate tax repeal.
 2. Trump has proposed a mark to market at death after estate tax repeal. If we have that type of regime there will still be a need application of freeze planning to shift value away from parent's estate.
 3. Will still need appraisals and that will entail valuation issues.
- b. Preferred partnership.
 - i. Exchange where parent gifts assets and takes back preferred equity interest. The parent is giving up the growth interest.
 - ii. Must be IRC Sec. 2701 compliant.
 - iii. A number of applications.
 1. Straight preferred partnership.
 2. Can use to freeze a GRAT
 3. Can use it to freeze a QTIP trust, etc.
 - iv. Perceived abuse. Pre 2701. 2701 is a deemed gift tax provision that can have sharp teeth. Look at pre-1990 preferred partnership. Recapitalize LP and large value was attributed to the preferred interest. This value was enhanced or loaded up with discretionary rights that the parent held on to. Made gift of common interest which was valued lower based on subtraction method. After gift the discretionary rights were not exercised and value shifted to the common interests.
 - v. 2701 puts a lot of limitations on the preferred interests.
 - vi. 2701 applies when the transferor makes a transfer to an applicable family member and holds an applicable retained interest after making the transfer to a member of the transferor's family.
 - vii. Transfers include recapitalizations, capital contributions and change in capital structure.

- viii. 2701 compliant partnerships post-1990 you must comply with a right that is mandatory and quantifiable. Parent cannot opt to take or not to take the right. A qualified payment right is a common way to do this: annual payment, cumulative and at a fixed rate.
- ix. The attribution rules are something that need to be carefully considered as they can change the analysis.
 - 1. Entity attribution rules.
 - 2. Trust attribution rules
 - 3. Multiple attribution rules
 - 4. Grantor trust attribution rules.
 - 5. Tie-breaker rules.
- c. Forward preferred freeze.
 - i. The client has a trust that is existing and at the time it was created the old trust distributed assets outright to the child at some age, or perhaps the old trust was not GST exempt, a red bucket trust. The goal is to contain the growth in this old trust.
 - ii. You could make distribution out of the old trust to G2 and let G2 fund their own dynasty trusts and assets will be outside of any estate.
 - iii. If the new dynastic/green trust created by G2, and the old bad/red trust can combine together to create a preferred partnership interests.
 - iv. Must be 2701 compliant. Goal is to shift common growth interest to the new/green GST exempt new trust. Over time the use of the preferred partnership will hopefully shift growth in the entity to the next generation trust.
- d. QTIP trusts.
 - i. Will be included under IRC Sec. 2044 at date of death value of surviving spouse.
 - ii. Have QTIP make contribution into a preferred partnership for a preferred interest. Perhaps a trust for the children could make a contribution to the same preferred partnership and take back common interest. This may give a steady stream of income to the QTIP to be paid to spouse and shift growth to children.
 - iii. Be mindful of IRC Sec. 2519.
 - iv. FSA 1999 that addressed QTIP that made a contribution into a single class FLP. IRS looked at whether this would be a 2519 disposition. It is a facts and circumstances determination. Because of the current distributions to the QTIP it was not deemed a distribution of an income interest.
 - v. So in a preferred LP the QTIP is getting a mandatory right not a mere expectation that should give a strong basis to avoid a 2519 argument.
 - vi. You could alternatively make the distribution to the surviving spouse and let her do the preferred partnership without this issue.
- e. Trump Proposal.
 - i. You would still have a death tax but in the form of a capital gains tax on death.
 - ii. This new tax regime might favor planning that is a mark to market freeze.

- iii. Have parent's interests given to a preferred partnership and they receive back preferred interests. Structure the plan so that the growth beyond that shifts to a trust that is not taxed under the mark to market rules.
 - iv. You might be able to build up basis. Now you want low basis assets in the parents' estate but you might want to do a "reverse Paul Lee." And try to get appreciated assets out of the estate to avoid the Trump capital gains on death if enacted.
 - f. Adequacy of coupon.
 - i. If adequate coupon might be 7-8% and perhaps a 5% interest may be provided so you will still have a gift because of the shortfall. There is still a gift tax component.
 - ii. Determine adequacy of coupon under Rev. Rul. 83-120.
 - 1. What do high grade public stocks pay?
 - 2. Adjust to yield as compared to risk adjusted market comparables.
 - 3. Dissolution rights?
 - 4. Coverage of coupon is very important which is influenced by capitalization of the partnership.
 - 5. 50/common 50% preferred paying 7% versus 90%/10% paying 7%. The second partnership is much riskier than the 50/50. As a much riskier investment with weaker coverage it will require a higher coupon. Consider these factors when structuring coupon.
 - 6. These concepts give some flexibility to structure the coupon.
 - iii. The preferred coupon will generally be significantly higher than AFR since it is different methodology.
 - iv. See: Richard Dees article for Notre Dame
 - v. De minimis rule your common must be at least 10% of the capitalization. This will impact the coupon based on the coverage.
 - g. Reverse preferred partnership.
 - i. Parent takes back common growth interest.
 - ii. Child gets income preferred interest.
 - iii. Under 83-120 you may have a risky investment and hence a higher coupon. If explodes in value common growth goes back to parents' estate and you have a reverse wealth transfer.
 - iv. Parent is not taking back a distribution right.
 - v. You still need to make sure you don't have an extraordinary payment right
 - h. Private equity.
 - i. Vertical slice has become synonymous with hedge fund planning.
 - ii. It is a proportionality exception.
 - iii. If you have different interests into an entity.
 - iv. GP interest may have a 20% profits allocation and you may have LP interests in the fund. If you give a proportional interest in each interest to the next generation you cannot manipulate discretionary rights since you gave proportionate interests.
 - v. This exception has limitations.
 - vi. If want to gift 1/2 of carried interest, you would have to gift 1/2 of LP interest that could trigger a large gift tax that is not desirable.

- vii. Non-vertical preferred partnership
- i. Preferred partnership GRAT.
 - i. GRATs are subject to ETIP and cannot allocate GST to them until after the ETIP ends.
 - ii. Parent creates preferred partnership and takes back a 2701 complaint interest.
 - iii. Gift that interest into a long term GRAT and GRAT uses that to make annuity payments,
 - iv. Old and cold trust makes contribution into 2701 complaint partnership. This green trust will hold the common interest. Now growth can inure to green GST exempt trust.
 - v. At end of GRAT term the preferred interest drops into a GST non-exempt trust.
 - vi. If we end up with 10-year minimum GRATs you can minimize estate tax exposure if die in GRAT term since growth is shifted to GST exempt trust from inception. No 2036 inclusion since parent never owned that common interest.
- j. Preferred CLAT.
 - i. Section 457A end of 10-year grace period for keeping deferred fees offshore. Grace period ends this year for fund that have been offshore since 2008.
 - ii. No magic bullet but may be able to lessen the blow.
 - iii. Contribution to grantor CLAT. Get income tax deduction because CLAT is structured as grantor trust. Income of CLAT in later years is taxable to grantor too.
 - iv. Preferred partnership can make income tax free investments into private placement life insurance. insurance funds under it.
 - v. Rising tide CLAT fund without vertical slice.
- k. Intentionally defective preferred partnership.
- l. Throw-back freeze.
 - i. Foreign non-grantor trust with undistributed income will be taxed as a non-US person. When undistributed income is distributed to US beneficiaries you have a draconian tax that can come into play.
 - ii. Use a preferred partnership approach to shift value to a preferential/green bucket.
 - iii. What if foreign trust takes back a growth interest and other trust takes preferred interest and under 83-120 you have an appropriate preferred coupon.
 - iv. Another application may be if foreign non-grantor trust has a preferred interest that might set a ceiling so can make distributions without triggering throwback tax.
- m. Preferred partnerships.
 - i. Many moving parts.
 - ii. Section 2036(a) can be an issue. Parent takes back preferred interest. Based on risk/reward analysis. Common interest may go in from inception. Should be a strong argument that 2036 should not apply.

- iii. Bona fide sale exception – best practices. Have separate counsel. Have appraisal to corroborate adequacy of coupon. Lillstrand case. Bad facts. Income generated by the partnership was \$43M and coupon to parents was \$43M and court viewed this as being “engineered.”
- iv. Liquidation of participation rights. If you violate IRC sec. 2701 could be a deemed gift of the entire interest.
- v. Disguised sale “reasonable payment.” Safe harbor. If preferred interest is not more than 150% of AFR not considered a disguised sale. But with historically low interest rate you will be higher than this threshold.
- vi. Qualified payment right election.
- vii. “Lower of” rule.

2. **Tuesday: Afternoon: Trustee Liability: Wolven.**

- a. Pitfalls for trustees.
 - i. Loan from trusts present issues.
 - ii. Common transactions for family businesses, real estate and concentrated positions that create issues for fiduciary.
 - iii. It is easy to create bad facts and we need to create and document good facts to protect the fiduciary.
 - iv. Must prove that fiduciary had a plan and followed necessary steps.
 - v. What actions can trustee take to document decisions?
 - vi. What can be drafted differently, or amended/corrected to obtain a better result (e.g., via decanting, etc.)? What can be done?
- b. Loans to beneficiaries.
 - i. Is a loan a substitute for a distribution?
 - 1. Some call loans a “chicken trust distributions.” Is it really a chicken distribution? The trustee may not want to tell beneficiary no but doesn’t want to upset other current and remainder beneficiaries when they see a distribution. This is exactly the situation when you should be cautious of making a loan.
 - 2. Older trust permitting only income distributions may need or want to make a loan because the income may have declined so much that a beneficiary cannot meet living expenses without more.
 - 3. Perhaps the beneficiary has been successful but has an illiquid estate and needs cash but don’t want to increase beneficiary’s taxable estate so make a loan.
 - 4. Want beneficiary to have some skin in the game. So instead of giving beneficiary money to buy a house, make a loan so the beneficiary is more vested in the new house purchase.
 - ii. What is entailed in making the loan right?
 - iii. Loans are investments. You are investing trust assets in that loan. So if trust is invested in securities earning 4% and needs to liquidate some of the portfolio to make a loan, can the trustee then issue a loan at the AFR at say 2%? Can you justify reducing the trust’s investment return?
 - iv. Checklist.
 - 1. Too often loans are made without proper authorization? Does the trust instrument permit it? What are the prerequisites?

2. Would a large loan cause too great a concentration of trust assets?
 3. Does trust permit concentration of investments? Could someone sue for concentration?
 4. Is interest rate on loan higher or lower than return on other assets that were previously held?
 5. Are there clear purposes of the trust that support making the loan? Is making the loan consistent with settlor objectives?
 6. Can you charge the beneficiary's share of the trust? Some state statutes permit that if a loan is made from a trust to a beneficiary you automatically charge their share? If the beneficiary agrees to this if not in trust provisions this should work but if trust has a spendthrift clause it may not.
 7. Even if trustee does not have statutory authority to charge beneficiary share may have right to recoup. Beneficiary went bankrupt and loan discharged so trustee with discretion under doctrine of recoupment could charge beneficiary's share using equitable powers. In re Lunt 477 B.R. 812.
 8. Does trust require security, interest, limit class of permissible borrowers? What due diligence should the trustee make on borrower's ability to repay, etc. In a litigation scenario should be able to corroborate how these points were considered? Even if security was not required it may be prudent for trustee to secure the loan using a UCC filing or mortgage. If you take the security and have not taken the follow up steps that could be problematic.
 9. Example, trustee wants to help family business stay afloat which may be a significant trust asset. Conant v. Lansden 341 Ill. App. 488. At some point the trustee should not have made loans when they knew it wasn't viable for beneficiary/borrower to repay.
 10. If trustee takes collateral what type of due diligence must be done? May take back a mortgage. Do you trust the beneficiary as to the value of the house? It is a private loan so they may not get an appraisal but any commercial lender would get an appraisal. It is a good idea for a trust to get an appraisal. Some due diligence should be done to corroborate that the decision by the trustee was rational. Determine what an independent lender would do and decide how much you might deviate from that.
- v. If there is an incurable default with trustee take action? If trustee won't proceed against the collateral, why take the collateral? If you are taking commercial real estate as collateral do you know if there are environmental issues? Would the trustee make a distribution to the beneficiary to pay off the loan?
 - vi. Who will sue if don't collect? Who will sue if do collect? Who will sue if the trustee makes a distribution to enable the beneficiary to pay off the loan?

- vii. Corporate fiduciaries are held to a higher standard and may have multiple relationships with trust beneficiaries. *Smith v. First National Bank* 254 Ill. App. 3d 251.
- viii. Make sure the correct parties sign off. If a loan is an investment the investment adviser must sign off. Unless the trust agreement says otherwise the investment adviser must sign off. If a revocable trust holds most of beneficiary's assets may have the beneficiary sign in individual capacity and as trustee of the revocable trust. Might have revocable trust sign off as a guarantor.
- ix. How do you cure a default? Is there a penalty while the beneficiary is in default?
 - x. Non-waiver – if you make a loan to a beneficiary and they are late get a non-waiver clause if do not pursue them now.
- xi. How the trustee signs any type of contract is important. Under common law there is no entity, a trust is not a legal entity. The contract is between the trustee and the third party. So unless the document or trust instrument says that the trustee is not liable the trustee could have personal liability for signing the instrument. Uniform Trust Code permits trustee to avoid liability if signs “as trustee.” However, since may not be sure as to the terms of the trust instrument always have trustee sign in this capacity.
- xii. Revocable trust issues do crop up. *Cresta v. Tepper*. Contracts signed in name of revocable trust. Surviving spouse took position that since revocable trust signed and the trust did not die the result should not follow. Trust had a taxpayer ID number and filed its own tax return. The argument did not succeed.
- xiii. Trustees were held liable. They had not done a public records search against the real estate developer nor had they had an appraisal, nor had they obtained personal financial statements from those who gave guarantees. *Estate of Ralph W Collins* 72 Cal. App. 3d 663. Trustees should take steps and if deviate from commercial norms should document reasons for doing so that are consistent with the terms of the trust.
- xiv. If making a non interest bearing loan interest may be imputed under the original issue discount (OID) rules.
- xv. Guidelines for making loans.
 1. Would loan be prudent if made to third party.
 2. Weighing prudent investments versus purpose of trust.
 3. Do you get other beneficiaries to sign off? Many states permit trustee to limit liability through a non-judicial settlement agreement, or a consent (agreement before transaction), ratification (after transaction). Documenting consent should work if you give adequate disclosure. Must advise beneficiaries to obtain independent counsel and if they do not there should be something in a letter sent to them.
 4. It is a conflict/self-dealing transaction so get siblings and others to sign off. Give them details of the transaction and copies of documents.

5. What happens when beneficiary dies? Do you need to file a claim in probate court? Do you need to notify trustee of the borrowing beneficiary's revocable trust?
- c. Concentrated positions.
 - i. A loan discussed above may be a concentrated position.
 - ii. Kettle and Dumont were Kodak stock cases. Will of Dumont, 791 NYS2d 868. In re Estate of Kettle 73 AD2d 786.
 - iii. Trustee had direction to hold stock but did not address what a "compelling reason" was. While the case was overturned it was on technical reasons so the court's admonitions of the trustee still are valid.
 - iv. Dumont case: Where a fiduciary is administration an estate ... must understand testator's words... critical that fiduciary's actions that the retention clause does not exculpate from poor judgment and laziness...demands a delicate balancing act....
 - v. In Kettle the fiduciary sold and was held liable. In Dumont the fiduciary did not sell and was held liable.
 - vi. Third case Matter of James 223 A.D.2d 20 (NY App. Div. 1996).
 - vii. Trustee does have duty to diversify even with retention language unless there are special circumstances. Wood v. US Bank, NA 828 N.E. 2nd 1072 (Ohio App. 2005). Court of Appeals said retention language alone is insufficient. Authorization to retain must be specific. If intend trustee to hold a concentrated position, then must expressly state that. If want trustee not to be liable, then should so state that as well.
 - viii. A prime example of this issue is the holding interests in a family business.
 - d. Family business.
 - i. When one sibling put in charge often have conflicts of interest or issues with power.
 - ii. Child in business did not 'behave' and JP Morgan went to court to get child to behave and thereafter to sue. Other children sued JP Morgan. This case demonstrates the benefits of having an independent fiduciary but they are hamstrung when a family member is controlling family business and prevents the institutional trustee from getting information. Scherer v. JP Morgan Chase & Co. 508 Fed Appx. 429.
 - iii. Consider permitting trustee to suspend distributions if information not disclosed.
 - iv. Rollins v. Rollins, 338 Ga. App. 308. Inserted partnerships to prevent beneficiaries from getting assets at age 45 as trusts provided. Were actions they took in good faith?
 - v. Shares were owned by trust and trustees could not get anything done. Trustees sued. Court said that the corporation was not a beneficiary and did not have standing. Yost v. Yost, 713 S.E. 2nd 758.
 - vi. Insurance problem. Langdale Co. v. National Union Fire Ins. Co. 609 Fed. Appx. 578. Beneficiaries got judgement against trustee. Company indemnified. D&O insurance said transactions were not done in capacity as officer of the company and they would not cover. Court said to extent

they were acting as officers and directors it was so inextricably intertwined with actions as trustees that D&O did not apply.

- e. Real estate.
 - i. There is a reason corporate fiduciaries charge extra for managing a real estate investment portfolio.
 - ii. Must seek expertise to manage real estate.
 - iii. Must know limits of expertise. Trustee has general duty to protect property from damage and destruction.
 - iv. How much money do you have to spend to keep property in shape? “...as a reasonably prudent man....to accomplish objectives of trust”
 - v. Matter of Trust of Rosati, 441 NW2d 30. Trustee had forgotten to pay water bill and pipes froze. Court found trustee had not cared for the property. The trustee did not have a plan to manage the property. The trustee did not take charge in the way it should have. The trustee should have had a plan.
 - vi. Trustee sold 5 parcels of the many it owned. Quality Stores developed those parcels creating drainage problems on the related parcels. Wells Fargo Bank Wyoming v. Hodder, 144 P.2 3d 401. Trustee failed to market or promote the property. The court found that the trustee should have hired a realtor and taken more steps. Trustee failed to obtain approval from trust oversight committee and did not hire real estate expert. So trustee did not act faithfully.
 - vii. Environmental issues affect real estate. Important that if trustee is aware of environmental issue it may have duty to remediate before it sells or transfers the property.
 - f. Trustees that lack capacity.
 - i. What is standard for removing trustee?
 - ii. What steps are necessary to move to the next trustee and avoid gaps.
3. **Tuesday: Afternoon: Senior Financial Exploitation: Bear.**
- a. What is senior exploitation?
 - b. Signs or red flags.
 - i. Withdrawals of money inconstant with spending habits.
 - ii. Will bequeathing to one person, e.g. 4 children but one child is beneficiary.
 - iii. Withdrawals of money inconsistent with income.
 - iv. Will or title or beneficiary designations favor a “new” beneficiary.
 - v. Lack of necessities.
 - vi. New credit card accounts. Seniors generally don’t pay finance charges and often pay bills like clockwork so that is a sign.
 - vii. Caregiving disproportionate to net worth or income.
 - viii. Documents missing.
 - ix. Suspicious signatures on documents.
 - x. Mail redirected.
 - xi. Acquaintance takes up residence with the elderly person.
 - xii. Incessant phone calls – walling her off from other family members.
 - xiii. Change in advisers.

- c. Steps.
 - i. Revisit plan every 3-5 years.
- d. Mental capacity and undue influence.
 - i. Capacity
 - ii. Requirements to sign will, testamentary capacity.
 - 1. Nature of one's bounty. I have a house a farm, some money in the bank, etc.
 - 2. Objects of bounty. I know I want it to go to the natural objects of my bounty, spouse, partner, certain kids.
 - 3. Holding in one's mind.
 - 4. While doing legal document.
 - iii. Less than capacity to sign contract including other conveyance documents like a beneficiary form or a deed of trust.
 - iv. Transitory nature of capacity – e.g. different times of day.
 - v. Due an assessment. Recommend that client have an assessment completed in writing to corroborate capacity.
- e. Avoidable Change.
 - i. **Example:** Mary elected lower benefit to provide for husband. At 60 becomes incapacitated stops and changes beneficiary election to higher payout and no death benefit. Change is voidable and would have been foolish in light of her life expectancy. Restatement of Contracts 2 Sec. 15(1).
- f. Signs of diminished capacity.
 - i. Confusion as to time or place.
 - ii. Challenges solving a problem.
 - iii. Mislacing things.
 - iv. Withdrawal from social activities.
 - v. Changes in mood.
 - vi. Difficulty completing familiar tasks.
- g. SEC red flags.
 - i. Investor appears unable to process simple points.
 - ii. Investor appears to have memory loss.
 - iii. Investor appears unable to recognize or appreciate the consequences of his or her decisions.
 - iv. The investor's behavior is erratic.
- h. Who is the client?
 - i. Take care to identify and confirm who your client is.
 - ii. Visit client at hospital.
 - iii. A mere diagnosis of Alzheimer's disease may not render person incapable of completing estate planning documents.
- i. Undue influence.
 - i. Vulnerability.
 - 1. Any impairment of cognition.
 - 2. Loss of mood control.
 - 3. Recent personal losses that are significant.
 - 4. Little or no social contacts.

- ii. Assessment.
 - 1. Medical records.
 - 2. Observations.
 - 3. Live examination.
 - j. Powers of attorney.
 - i. General durable power of attorney.
 - 1. Durable remains effective even if principal incapacitated thereafter.
 - ii. Springing power.
 - iii. Statutory short form power.
 - 1. Creatures of legislature to make powers of attorney documents more readily available.
 - 2. Smaller banks pushed for this so it would be easier for bank officer to discern if valid.
 - 3. Consumer concerns.
 - 4. Most contain gifting restrictions.
 - iv. Special or limited power of attorney.
 - k. Health care documents.
 - i. Name an agent who thinks like the principal.
 - ii. Be certain it is disseminated.
 - iii. Send to agent via email.
- 4. **Tuesday: Afternoon: Non-Tax Developments: Pennell and Cohen.**
 - a. Uniform Probate Code.
 - i. No need for witnesses if signed or acknowledged before a notary.
 - ii. If don't have two witnesses the notary who signed self-proving affidavit can serve as one of two witnesses.
 - 1. **Comment:** In re Estate of Harris, 2016 WL 1588826 (Ohio Ct. App.) the drafting attorney was notary and testified that he wasn't certain that another witness actually witnessed the signing. The attorney's signature as notary was allowed to count as the required second witness. Flawed execution one witness is not valid. Have a self-proving affidavit and notary. Question is whether the notary who witnessed the execution ceremony counts as the second witness. The answer is yes. UPC has gone so far as to say if you have a notary signature you do not need other witnesses but it is not clear if any states have adopted this.
 - iii. Michigan case. Will not signed at all is valid under UPC harmless error provision.
 - iv. Will execution formalities are evolving in the direction of trust execution formalities.
 - v. Haste case – With respect to an IRA the court applied the doctrine of substantial compliance test under will execution rules to the IRA beneficiary designation. Haste v. Vanguard Group, Inc. 2016 WL 3382038.
 - b. Debt provision in will.

- i. A will provision that stated: “Pay all my debts.” How should that be applied? How broad? What does it mean? Real estate is held TOD does will require repayment of debt that is not probate real estate? Court held yes. But do you really want to pay off long term mortgage? Most clients think of credit card debt but without specificity are non-probate assets covered? What about mortgages? Do you really want to accelerate this? “Pay my debts” is boilerplate language. State law mandates any way. The language is really meant to describe from what source you pay debts not whether you should. Carlson reminds us that this common provision deserves more attention.
 - ii. Consider how you draft pay debt provisions.
 - c. Transfer to trust.
 - i. *Carne v. Worthington*, 246 Cal. App. 4th 548. No recorded deed just an indication on Schedule A to the client’s revocable trust of the property. The court held that the listing on schedule sufficed. Recordation only important as to trustee’s ownership as to third party claim
 - ii. **Comment:** Might this suggest listing all of a client’s assets that are intended to be transferred to the revocable trust on Schedule A to at least provide a fallback position in the event the client dies before consummating the intended transfers?
 - d. Revocation.
 - i. Under common law if a trust was silent as to whether or not it was revocable, it had been deemed to be irrevocable.
 - ii. UTC deemed to be revocable if silent. Opposite of old common law.
 - iii. Be clear in document.
 - iv. If trust is revocable how do you revoke or amend it. Provide the mechanisms
 - v. In re Hyde Trust individual created revocable trust in 2006 and transferred real estate and a Schwab account holding company stock. Signed 5+ codicils to his will some with attorney help some not. In one codicil said Schwab account should pass to siblings not to charities name in trust. Did his will amend the revocable trust? Where codicil provided that Schwab goes to siblings and not charity court said not clear enough.
 - vi. In FL case individual created revocable trust and provided for all assets to pass to four charities on death. Language of subsequent will “I declare this to be my last will and testament and revoke all prior wills and trusts...”. Court said will can amend trust and permitted extrinsic evidence to amend.
 - vii. Above cases reached opposite results.
 - viii. Suggestion is to provide that a revocable trust cannot be amended by will to avoid this confusion.
 - ix. This is becoming a trend of court allowing extrinsic evidence to interpret wills.
 - e. Power of appointment.
 - i. *Shott Trust* 2016 WL 1056969.
 - ii. Court found exercised by codicil to will.
 - iii. Codicil satisfied the requirement.

- iv. If you want a power of appointment to be subject to amendment, make it clear how that should be exercised.
- v. For POA may said has to be delivered inter-vivos to avoid issues.
- f. Modify 1930 trust to include removal power.
 - i. Current trustee is Wells Fargo and they objected to modification.
 - ii. Lower court said you cannot use trust modification to end run trustee removal provisions.
 - iii. If one statute more specific and one more general, follow the more specific statute. At superior court level said only need to get into statutory construction unless statute is ambiguous and therefore it is OK to modify the trust to add a removal power.
 - iv. Issue presented is whether court erred in whether trust beneficiaries can circumvent removal of trustee.
 - v. Cassatt 2016 WL 5122265 “Subject to all provisions... and with all powers thereby conferred... gave power to remove and replace...”
- g. Decanting
 - i. Harrell v. Badger 171 So. 3d 764. SNT would pass on death to others. Initial trust would pass to siblings. Some time had passed before sibling found out about this. The decanting added new remainder beneficiaries and FL law of decanting says cannot change trustee. At trial court held they had no cause of action and held siblings responsible for fees. Note that before that trustee had already been convicted of taking trust funds. On appeal the court held that decanting was invalid and remanded to find value of trust before decanting.
 - ii. Not clear if you can exclude beneficiaries in decanted trust. You may be able to exclude beneficiaries even if you cannot add. But if trustee did exclude a beneficiary does that beneficiary have a cause of action? If cause of action is not asserted will that constitute a gift?
- h. Swap power.
 - i. Trustee was wife and mother of daughter who was beneficiary of trust. Divorced. Now ex-husband tried to exercise swap power and now ex-wife trustee refused. He tried to swap in a note and the ex-wife/trustee objected saying it was not of equivalent value as required by the trust.
 - ii. Schinazi v. Eden 2016 WL 5867215.
 - iii. **Comment:** In the divorce the issue of trustee and trust actions should have been addressed. It may have been preferable for all involved to have had the wife/ex-wife to be resign as trustee in favor of an independent and ideally an institutional trustee.
- i. Is trust a will substitute?
 - i. UTC law in 2/3rds of states.
 - ii. UTC is confident that a trust is a will substitute. UTC provides that while settlor is alive and competent (only in some states the latter is an add on that UTC does not require) the trustee only owes duties to the settlor.
 - iii. Does trust require formalities of will?
 - iv. Babbit v. Superior Court, 246 Cal. App. 4th 1135 (2016). The settlors of a joint revocable trust were both trustees. The remainder beneficiaries had

- no rights to receive accountings, nor any cause of action while the trust was revocable.
- v. In re Trimble Trust, 826 NW2d 474. Mom relinquished trusteeship to bad daughter during gap period after mom incapacitated but while alive. Court said good daughter had no right to an accounting while mother was still alive.
- vi. A recent FL case denied petition for administrator ad litem since courts are saying beneficiary has no standing.
- j. In Terrorem.
 - i. Every practitioner sees cases where these are warranted.
 - ii. They are clearly disfavored in some jurisdictions.
 - iii. Stewart v. Ciccaglione, 2015 WL 1283481. Held that the in-terrorem clause was boilerplate and settlor was not fully apprised.
 - iv. Include a good faith exception.
 - v. Heathman v. Lizer 2016 WL 3753328– Trustee tried to invoke when beneficiaries brought action to limit trustee compensation. This was certainly not the intent of an in terrorem clause.
 - vi. A majority of courts are adverse to enforcement of anti-contest provisions.
- k. Binding Arbitration provisions.
 - i. Original arbitrator often makes errors.
 - ii. Why should arbitrator be immune to same type of challenge.
 - iii. Nursing home admission arbitration provisions are not valid per Department of Health. They are contracts of adhesion and nursing home with these will forfeit Medicare and Medicaid benefits.
 - iv. POA does not have authority to enter into binding arbitration.
- l. Joint estate plans.
 - i. Important in community property states.
 - ii. What about in separate property states? Often don't make sense. If opt to do so be careful.
 - iii. Many things can go wrong with joint estate plans particularly where one spouse is trying to bind what surviving spouse can do in a will contract. Too often these do not succeed.
- m. Misconduct.
 - i. State laws disqualify a surviving spouse for misconduct like adultery.
 - ii. 3 cases have recently been published: In re Estate of Peterson, 2016 WL 2992474 (Mich. Ct. App.); In re Estate of Racht, 2016 WL 2909701 (Pa. Super. Ct.).
 - iii. 12-13 states have these types of statutes, including Michigan.
- n. Elective Share.
 - i. There has been an explosion of elective share cases. A common issue is determining which non-probate assets or transfers should be subject to the reach of an elective share claim. What is included in the “augmented estate” the surviving spouse can claim against? See UPC Sec. 2-205.
 - ii. Beneficiary designations may not be included in share of surviving spouse.

- iii. *Bays v. Kiphart*, 2016 WL 2064789 (Ky.). Wife was terminally ill and modified her plan cutting out her husband. In issue was change made to life insurance beneficiary designations. The court held the insurance proceeds were beyond the reach of the husband's elective share.
- iv. *Beren v. Beren*, 349 P.3d 233 (Colo. 2015). The court held the surviving spouse was not entitled to an equitable adjustment to the elective share based on appreciation during the period of contest. The court did permit interest to be paid on the delayed distribution of the elective share. See UPC 2-202(a). Colo. law views the elective share as a pecuniary amount and not as a fractional interest in the estate.
- v. *Dinin v. Patten*, 116 A.3d 275 (Conn. 2015). This reached the opposite conclusion of *Beren* because of CT law views the elective share as a fractional interest in the estate not as a pecuniary amount.
- vi. *Ammerman v. Callender*, 245 Cal. App. 4th 1058 (2016) – A pecuniary is different than a fractional share. The share of the royalty income earned during an extended period of probate administration \$67M of income. What is the fraction for the surviving spouse and other family members?
- vii. Elective share calculation and marital funding. A pecuniary vs fractional share.
- o. Equitable Distribution.
 - i. Is trust to be considered as part of the marital estate?
 - ii. Mass. Has considered trusts as part of marital estate if more than an expectancy and then subject to division. Instead of dividing 50/50 if one spouse is beneficiary of substantial trust might divide 80/20. Facts not favorable to Husband.
 1. Court decided when divorce took place 11 beneficiaries, Husband, 2 siblings and grandchildren and not a closed class because other descendants would be added as born.
 2. Ascertainable standard of sorts was included: support, etc.
 3. Lower court said it was part of the marital estate and said value was $1/11 \times$ full value since husband was one of 11 beneficiaries and gave wife 60% to wife.
 4. Appealed. Court noted that it was manipulative of trustees to stop making payments on eve of divorce
 5. SJC decision. Found that it was a mere expectancy so it is not subject to division. Note that does not mean it cannot impact how marital assets are divided.
 - iii. Lessons
 1. Don't include ascertainable standard.
 2. Better to have pooled trust for many beneficiaries than a trust just for one child.
 3. Even if you don't practice in Mass. You have no idea where beneficiaries may eventually reside.
 - iv. State law is changing. Mass. Is out there but it is not that unusual a case. Under a conflicts of laws application, it will be the laws of the jurisdiction that governs the divorce that may determine the rights of the beneficiaries.

- p. SNT.
 - i. *Pikula v Department of Social Services* 138 A.3d 212 (Conn. 2016).
 - ii. Trust was not SNT but court held it was.
- q. Reformation.
 - i. UPC and UTC reformation.
 - 1. Duke CA case. They do not have legislation authorizing reformation but court concluded court by fiat fixed formed with botched survivorship provision. Court fixed document even in absence of legislative authority.
 - ii. Flynt case.
 - 1. DE Case. 80% in one stock. Trustee wanted to diversify. Beneficiaries wanted to amend trust to make it a direction trust.
 - 2. Court said they would not permit reformation.
 - 3. DE court said they respect settlor intent.
 - 4. Tension between dead hand of settlor and beneficiaries who say that the trust doesn't reflect their desires or modern trends.
- r. Secondary disclaimers.
 - i. *In re Friedman*, 7 NYS3d 845 (Surr. 2015).
 - ii. Daughter wanted to disclaim on her behalf and on behalf of infant child so estate would pass per a marital deduction.
 - iii. Was this in the best interests of the child? If mom did not disclaim child would not get anything so it is in child's best interests.
 - iv. Court said they don't see how this would be in child's best interests.
 - v. So if there is a minor child you need to be careful as to whether you can meet the best interest of the child test.
- s. Conflicts of law.
 - i. *Steiger v. Steiger* 2016 WL 4156689. Provision stating governing law but will it apply?
 - ii. If decant will new state's laws apply? Yes, as to administration but perhaps not as to construction or validity. You need a broad governing law provision.
- t. Adult adoption.
 - i. State law varies.
 - ii. Can you adopt an adult to change inheritance?
 - iii. What if adopt law in state that permit adult adoption but state of where will is does not permit?
 - iv. Law of state of adoption should govern.
- u. Defacto parents.
 - i. Unmarried couple has child.
 - ii. What parental rights does parent have if did not adopt child?
 - iii. If they created child together and held themselves out as parents, they should have right to visitation and custody.

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Steve Leimberg's Estate Planning Email Newsletter Archive Message #2502

Date:12-Jan-17

Subject: Marty Shenkman's Meeting Notes from Heckerling 2017: Day 3 Morning Notes

Heckerling Institute 2017 – Day 3 Morning Notes

By Martin M. Shenkman, Esq.

The following are rough draft meeting notes prepared at the 2017 51st Heckerling Institute on Estate Planning sponsored by the University of Miami School of Law, and published in Leimberg Information Services, Inc. (LISI). These notes were published within a very short time of the conclusion of the proceedings and could not have been reviewed in order to be completed so quickly. There are no doubt errors, typos, etc. in these notes none of which should be attributed to the presenters. LISI obtained special permission from the Heckerling Institute to publish these notes. Bear in mind that no notes appear below on more than 20 concurrent and other sessions. These sessions can be purchased from the source listed below. The final papers presented at this year's Heckerling Institute can be obtained from Lexis Nexis. For recordings of the sessions contact Convention CDs, Inc. 800-747-6334.

1. **Wednesday: Morning: Donations Abroad: Bjorklund.**
 - a. International philanthropy.
 - i. Structures supporting US deductions for funds spent abroad.
 - ii. Income tax and private foundation taxes.
 - iii. International charitable giving is 2-4% of total giving.
 - iv. US generosity extends overseas but deductibility limited to US under IRC Sec. 170.
 - v. Most tax authority on international giving is more than 50 years old and there has been relatively recent guidance.
 - vi. Difficulty – if make a mistake client could lose deductibility or the organization recipient charity could lose exemption.
 - b. Does client need tax deduction for donation?
 - i. Example: Gift of painting overseas but
 - ii. Non-tax matters. Post 9/11 a tremendous change in non-tax side of charitable giving internationally such as Patriot Act, OFAC = office of foreign asset control that publishes SDN = specially designated nationals, criminal or terrorist enterprises. People posted on list administered by OFAC.
 - iii. Financial Action Task Force = FATF regulates non-tax side of charitable giving.

- iv. If you are doing a one off gift don't address this so use structures discussed below.
- v. Charity Security Network = CSN formed to help charitable organizations share information and work with IRS and work with Financial Action Taskforce. In November 2016 helped get FATF to get charities off list to make wire transfers easier.
- vi. Might be easier to work with organizations familiar with above.
- c. Deductions is based on geography.
 - i. IRC Sec. 170 governs deductibility and depends on geography "to or for the use ofcreated or organized in the United States or any possession..."
 - ii. If client gives to organization not created in the US, there is no way to save deductibility when gift already made. See IRS Publication 78 on line to see all organizations that qualify for deductions.
 - iii. **Example:** US person living in Belgium formed a charity to fund hurricane relief. Contributions were not deductible by US donors since formed in Belgium. They reincorporated in North Carolina to correct this.
 - iv. Corporate donors face another risk. If the charity is formed as a trust in flush language word "corporation" is missing in Rev. Rul. 69-80 cannot claim deduction for overseas use unless given to charitable corporation. If charity set up as a trust it won't be deductible.
 - v. Private foundation as donors face their own rules. Three countries can have deducibility by treaty exception: Canada, Mexico and Israel. Must have income sourced in country where you are taking the deduction. Special way to use rules for Canadian college.
 - vi. Avoid conduits at all costs.
 - vii. An organization that markets itself as a qualified charity is not necessarily a good idea to use. Non-US lawyers create entities and tell US donors they are eligible for deduction. The solution is the "American Friends of..." This is not a legal classification and this is how you avoid the conduit problem. Need exercise of control. Many kinds of "American Friends of..." The American Friends of Historic British Churches," etc. They are listed in publication 78. There are many "Friends of..." organizations that don't have "Friends of..." In their name e.g. Doctors without Borders. Guesstimate about 3,000 such organizations.
 - viii. Two key revenue Rulings form 1960s. Kennedy thought US influence could be increased around the world if we were more flexible in grant making.
 - 1. Rev. Rul. 63-252 – reviewed and approved. Us entity forms foreign subsidiary. But these examples are not particularly helpful.
 - 2. Rev. Rul. 66-79 this became the roadmap for international grant making. Board of us entity must have control over donations coming in and direction of grants going out. US board must approve each project as being in furtherance of US entity. This is important because in some countries, e.g. Germany, a charity can foster political endeavors but in US cannot. US Board must have

- right to withdraw support from a particular project at all times.
Board must have majority of US citizens or residents.
- ix. Entity funding abroad does not have to have operate in the US to qualify.
 - x. Avoid mistakes.
 1. Board of Directors construction/composition. Many foreign charities don't seem to understand that they cannot control the board. Competing control issues since foreign charity may have to satisfy that it is controlling its mission. Create two classes of directors, foreign and US directors. Foreign directors can be appointed by foreign charity and US directors are one more in number.
 2. Rulings where organizations are recognized as conduits but no deductibility. This type of ruling is "deadly." No one will give, no deduction. It is inefficient and not recommended.
 - xi. Funding procedures – US organization should fund specific projects and not just send funds. Can you send funds for general operating support? Advise against that because you don't know if the proposal being made is actually something eligible for US charitable treatment. **Example:** A Texas charity funded purchases boots and tents for Bosnia. Boots and tents for children camp is acceptable but not for terrorists so they ended up on a watch list. If you are going to fund general operating support you can give for rents and salaries but you must know what it is. Another approach is to approve a project list and then if a donor gives you can grant to the project list. This can be an efficient approach to use.
 - xii. Earmarking – what if donor irrevocably earmarks funding for a particular purpose? May conflict with control the US charity has to exercise. That is a problem in the "American Friends of..." Context. Ask the friends of charity in writing whether a grant it would make for a project could be pre-approved before the client makes the grant. That way the client knows in advance what he or she is funding.
 - xiii. Preapprove the grants is quite easy with emails. Emails can include wording of the resolution and reports, etc. Group emails can facilitate asking questions and pre-approving. But this is not a conduit.
 - xiv. IRS picked a group of "Friends of..." five years ago and audited them. The IRS went through each of the provisions of the Revenue Ruling and many were not following procedures. Substance is important but so is form.
 1. LTR 201511033 adverse ruling. The organization failed the operation test because they did not know what the money was used for. 50% of the funds could not be documented. There were no reports back. This is the first time in 50 years where the IRS spelled out these details. Board had to approve specific project and not just issue checks. It is not OK to just fund "general support."
 2. Another failure was LTR 201403018 lost exemption because little or no control on money sent outside US and allegedly disbursed to

scholars. No one had control or knowledge of what the money was used for.

- xv. Must register to solicit in 40 states. This is costly.
 - xvi. Use an organization that already has the infrastructure to properly administer the requirements.
 - 1. American Ireland Fund makes grants into Ireland.
 - 2. CAF American has comprehensive services for grant making around the world and has special fee based advisory services. They will name funds for foreign charities.
 - 3. Give2Asia. It is experienced with many small charities throughout Asia.
 - 4. Tides Foundation.
 - 5. Donor Advised Funds at a national sponsoring organization like Vanguard or Fidelity, Schwab Fund for Charitable Giving, these may work with CAF America or others.
 - d. Private Foundations.
 - i. Ask if recognized by IRS.
 - ii. Equivalency determination. Few will do this as few foreign organizations want to file Form 990 each year.
 - iii. 4 steps for expenditure responsibility:
 - 1. Pre-grant inquiry
 - 2. A written grant award contract containing specific limitations
 - 3. Annual report.
 - 4. Report on grant progress.
 - iv. In 2015 effort made to improve accessibility and use of this alternate procedure where find that entity in foreign country is e 9/25/15 final regulations issued.
 - 1. Cannot rely on affidavit of foreign charity as sole means of determining that foreign charity was equivalent of a US charity. That has been taken away. You still get the affidavit but you must do additional diligence.
 - 2. No longer need opinion of legal counsel but need opinion of qualified tax practitioners. Now have an equivalency repository.
 - 3. Two organizations acting as repositories of such information NGO Source (150-member grant makers) and CAF America.
 - e. Under a Trump administration may see foreign grant making curtailed. An America First organization is seeking to repeal above rulings and to prohibit deduction for funds used overseas. This would create an incredible recordkeeping problem for US donors and charities.
2. **Wednesday: Morning: Foreign Ownership US Assets: Graham.**
- a. Foreign investment encouraged in US.
 - i. No restrictions on foreigners owning US real estate. Switzerland, China and Mexico for example do.
 - ii. We have freedom of movement of capital. This
 - iii. Foreign investors view US as a stable economy to invest in.
 - iv. US is a top country for foreigners to invest in.

- b. Intake process.
 - i. FATF = Financial Action Task Force. 40 recommendations on how to monitor and detect money laundering. Patriot Act and bank secrecy reflect this. Stringent customer due diligence rules. Must file transaction report if suspect money laundering. Have a no tipping-off rule. UK follows a strict due diligence and an attorney must file report and not tip off client.
 - ii. FATF 35 countries involved. Pressure in US to apply to attorneys. ABA is opposing rules as it would alter attorney client relationship.
 - iii. Client intake to use with foreign client. Basic Client Intake Checklist:
 - 1. Client identity.
 - 2. Client due diligence.
 - 3. Understanding facts.
 - iv. FATF evaluates countries as to how they comply with these. 260+ page US report. Compliant with 9, substantially compliant with 21 of the 40. Four areas failed to comply. One such failure was that in the US gatekeepers such as CPAs and attorneys and trust officers are not held to the FATF standards. Beneficial ownership registration was another failure. There is a global movement towards total transparency. In US we don't have this. There is legislation pending. In US you can form an LLC or trust in a day and there is no place a foreign person can go to see who the ultimate owner/beneficiaries are.
- c. Intake procedures.
 - i. Make sure you understand client you are dealing with. Be thorough. If dealing with someone foreign, their spouse and children. Where are they nationals of? Where are they resident? US is one of only two countries that tax based on citizenship. You may have clients subject to tax in multiple jurisdictions.
 - ii. Should be formalized.
- d. Understand what type of country you are dealing with:
 - i. Common law country like the US where have freedom of disposition – where assets can be bequeathed. Joint tenancy with rights of survivorship is in many common law countries. US, UK, New Zealand, Canada. Tax at death is typically an estate tax.
 - ii. Civil law – 75% of countries are civil law countries this includes most in EU, Asia and Latin America. Often they have forced heirship meaning testator by law can only pass law to specified individuals like spouse and children and the percentages are set. So there is less freedom on disposition of the estate. This is why in those countries there are fewer attorneys that specialize in estate planning. Tax at death is typically an inheritance tax paid by person who inherits. Rate of tax will vary based on relationship. A trust is often viewed as unrelated and could face 60% tax as an unrelated person whereas a child inheriting directly might pay 5%. May not permit husband and wife to have an account together and if they do it may not be a survivorship type title. Notary publics are used in civil law countries. Often they are an attorney they are viewed more like a

- judge. They can be positions held for lifetime and they are held in high regard. They may draft wills, handle real estate transactions, etc.
- iii. Islamic countries operated under Sharia law. Difficult to generalize. They are more like a civil law country. They will have requirements as to who inherits what. Sons may inherit double what daughters do. If investing in US will Sharia law apply to US investments and how can you deal with US estate planning documents.
- e. Conflicts of law.
- i. Whose law applies?
 - ii. Must address on an asset by asset and matter by matter basis.
 - iii. Common law country the convention is that the law where real estate is located will generally control. For personal property may look at law of residency of the individual.
 - iv. Civil law countries will instead look at nationality of the individual. This can create conflicts.
- f. Income tax.
- i. What tax will taxpayer be subject to if he or she invests in the US? A number of factors must be considered.
 - ii. Where was the client born?
 - iii. US citizen.
 - 1. If born in the US, they are a US citizen (exceptions are provided for if the client gave up citizenship, and special rules are provided for diplomats). Some are surprised by this if they have not been in the US since birth and have no US passport.
 - 2. Can be a US citizen if born abroad to parents both of whom are US citizens. This is true even if have no Social Security number, etc.
 - iv. If born with one US parent and one non-US parent, ask an immigration attorney as it is not clear. There may be compliance issues and estate plan may be different.
 - v. US Resident.
 - 1. 1st way green card. If not a US citizen will they be considered a US Resident. If they have a Green card, they will be taxed like a US citizen on worldwide income.
 - 2. 2nd way physical presence. 183 day look back test. If fail will have to report worldwide income. If not 183 days the rule of thumb is 120 days. If consistently spend 120-days year after year. To flunk the substantial presence test must be in US 31 days or more. If spend 300 days in preceding year, etc. add all and if 190 does not matter if did not pass threshold of being in US 31 days or more in current year. Exclusions are provided. Example, if become ill and could not leave because could not travel. Get notes from physicians. Tax filing with IRS. Some types of visas do not have to count days, example student visa, etc.
 - 3. 3rd way - make election.
- g. Types of income.
- i. Effectively connected.

1. Net capital gains that are effectively connected with US trade or business are taxed similar to citizen.
- ii. FDAPI
 1. Subject to flat 30% tax unless there is a tax treaty that applies.
 2. Verify if there is a treaty and what it provides. May reduce to 5-10%.
 3. Income tax is withheld at source.
 4. Only tax US source income. If payer is US, it is US source.
 5. Real estate is
- iii. Real estate.
 1. Real estate rental income is subject to tax.
 2. A gain on sale taxable – foreign investors in real property tax act = FIRPTA.
 3. Withholding is done on gross amount.
 4. May apply to IRS for reduced holding.
- h. Estate tax.
 - i. Different residency rule different than the rule above for income tax. Just because resident for income tax purposes doesn't mean they are resident for estate tax purposes
 - ii. Two prong test.
 1. Have they spent time in US?
 2. Do they intend to remain in the US indefinitely? This is a “fuzzy” test.
 - iii. Planning is completely different depending on whether the foreigner is characterized as US person or not.
 - iv. If US person, they get full \$5,490,000 exemption. If not, they get a mere \$60,000 which is not inflation adjusted. But then only subject to US estate tax on US situs asset. For some it is better to be characterized as a US taxpayer to get large exemption. For others not so.
 - v. Look at facts and circumstances: driver's license, where is home, where do they belong to religious organization, etc.
 - vi. What is a US situs asset? Stock in a US company and real estate are US situs assets. Tangible property in US is US situs but there are exceptions for traveling and for an art collection on exhibit.
 - vii. If you put debt on real estate does that reduce value? This planning has gone by the wayside as it is difficult for many foreign persons to get loans. In some states the type of mortgage is a recourse loan and with a recourse loan you cannot get to deduct it from the gross value. You can take it as a deduction on the estate return and it is pro-rated.
 - viii. Marital deduction.
 1. Spouse is US citizen.
 2. If not use a QDOT and should comply with requirements. Can do a QDOT after the fact within 9-month period. Must have required provisions. Be certain QDOT won't create problems for surviving spouse in her home countries. Civil law countries do not recognize trusts.

3. **Wednesday: Morning: Questions and Answer: Belcher, Aucutt, Donaldson, Heller, Porter**

- a. Repeal.
 - i. Many possible scenarios.
 - ii. Repeal with basis step up.
 - iii. Repeal with carryover basis.
 - iv. Repeal with a Canadian capital gains on gift and death system.
 - v. Repeal with or without repealing the gift tax.
 - vi. Other variations.
- b. 2704 and Form 709 disclosures.
 - i. Disclosures on gift tax return. What type of disclosure should there be? Required 6501(c) regulations if take position contrary to proposed regulations. Important to start statute of limitations running.
 - ii. Some commentators interpret the regulations too broadly as they are not, per Treasury comments, intended to eliminate all minority interests which is consistent with legislative history.
 - iii. Speaker reads them broadly and if not intended to severely restrict or eliminate discounts what was the purpose?
 - iv. If filing a gift tax return and want to make sure the statute of limitation runs need proper disclosure.
 - v. If you don't start the statute of limitations running on a hard to value asset that does not trigger gift tax such as a non-taxable sale to a grantor trust. If statute doesn't run under 6501 you have unlimited time for IRS to audit. Marshall case was a 1995 transaction litigated as recently as 2016. Similarly, the Redstone case continued for years. In those cases, liability is not just for the donor but also for the donee because the statute does not run as to donee until 1 year after the statute runs as to the donor. So if the gift tax return doesn't toll the statute for donor it never runs for the donee either.
 - vi. What type of disclosure might be required 8275 or 8275R? Speaker doesn't think so.
 - vii. Google: "AICIPA adequate disclosure 2704" you will find suggested language. Disclosure under 301-.6501(c). The transaction reported by may be contrary to the Section 2704 Regulations but those regulations have not been taken into account in valuing the interest... No requirement that they be considered in this case. This type of disclosure attached to the gift tax return as a separate page should suffice to toll the gift tax statute of limitations. See https://www.aicpa.org/InterestAreas/PersonalFinancialPlanning/Resources/TaxPlanning/DownloadableDocuments/Suggested_Disclosure.pdf
 - viii. Audit rate for filed gift tax returns is 1-2%.
 - ix. Over disclose, don't under disclose.
- c. Planning in light of repeal - Clayton QTIPs.
 - i. If estate tax is repealed how can you make a QTIP election?
 - ii. Are there drafting considerations now to preserve a second death step up.

- iii. Clayton QTIP 5th Circuit Court of Appeals. Clayton v. Commr. To extent that the executor did not make a QTIP election for asset flowing into marital trust the unelected assets flow into credit shelter trust. IRS said the QTIP election doesn't qualify and Court said it does.
 - iv. Portability can be a better result for a house or IRA than a credit shelter trust. Credit Shelter Trusts work well when surviving spouse lives a long time. This provides a lot of time for asset to appreciate.
 - v. Clayton QTIP provides flexibility. If don't want to use outright gifts use trust. Clayton QTIP gives ability after the fact to determine if credit shelter trust or QTIP is better. If want credit shelter don't make QTIP election for those assets or the fractional share that then pour into credit shelter.
 - vi. Perhaps the Clayton QTIP may make sense in a post-estate tax world. If estate tax is repealed, then may not make QTIP election anyway. Pour over trust will no longer have to be a traditional credit shelter. Example surviving spouse may only have 5/5 power or right to distribute pursuant to a HEMs standard but in a post-estate planning world may not need that. The Clayton QTIP provides flexibility.
 - vii. Clayton gives a mechanism to get a basis step up on death of surviving spouse by leaving assets in the QTIP (i.e., by the Clayton executor making the election).
 - viii. **Example:** couple in their 40s with \$8M estate. Transfer tax is not an issue. You want a step-up in basis on second death. If assets pass to credit shelter don't get step up (but see Monday notes for options). 1014(b)(9) you get step-up for all property included in decedent spouse's gross estate. But if estate tax is repealed and there is no estate and there may be no means of getting a step-up in basis on assets in that trust. Congress should give consideration to this.
 - ix. Not certain how basis rules will eventually work. Build flexibility into trust to permit assets to be distributed outright to surviving spouse to permit basis step-up.
 - x. If the spouse drafting the plan trusts the other/surviving spouse then an outright distribution with right to disclaim to a trust in which she has an interest may provide flexibility.
- d. Hubble Trust v. Commr, TC Summ Op. 2016-67.
- i. Issue arising under a will. Taxpayer was not successful.
 - ii. Court reformation and modification to avoid a problem.
 - iii. Charitable deduction for distributions from a trust. Died in 1960 and named beneficiaries of annuity amounts and gave trustee right to use income and principal in such a way that would not subject to an inheritance tax. For many years the trust was in existence trustees made charitable contributions. IRS said it would deny charitable contribution deductions.
 - iv. Court said ambiguity in the trust. Court order authorized distributions in the past to charity based on the ambiguity. IRS said no ambiguity and Tax Court agreed and denied the charitable deduction.

- v. Amy Heller article in 2014 Heckerling. Problem in the above case is the cure came too late. Perhaps they should have reformed before making contribution.
- e. CCA 201651013
 - i. CCA addressed trust modified by state court order to give beneficiary LPOA exercisable in favor of charity.
 - ii. IRS said if beneficiary exercised LPOA to appoint income to charity the trust would not be entitled to a Section 642(c) income tax charitable contribution for trusts.
 - iii. For a non-grantor trust to get a deduction for income distributed to charity the distribution must be made pursuant to terms of governing instrument.
 - iv. IRS said modification to governing instrument even though made pursuant to a valid state court order did not meet the requirement of “pursuant to the governing instrument.” So when income was appointed there was no permissible charitable contribution deduction.
 - v. If the instrument is validly modified under state law the change to the instrument should become part of the governing instrument, but the IRS did not think so.
 - vi. IRS can challenge validity of state court modification under *Bosch v. Commr.* IRS can have a federal court determine the proper result as to state law rights unless a decision has been reached by the highest state court.
 - vii. In the CCA the court order that modified the trust was not issued by the state’s highest court.
 - viii. But in the CCA the IRS did it by challenging the court’s modification. But if modification was appropriate and no language in 642(c) that says “pursuant to governing instrument” refers only to instrument as initially drafted and without modification, if governing instrument is modified then those contributions should be deductible.
 - ix. CCA is consistent with the Hubbell case above.
- f. Repeal Question.
 - i. Low basis asset in H’s revocable trust that gives W GPOA over that assets. W dies and has not exercised GPOA. Real estate over which she had power is worth \$10M. The GPOA is drafted in a manner that permits its exercise only to the extent its exercise would not cause an increase in estate tax. When H dies there is step-up in basis.
 - ii. What if estate tax repealed? If when W died there was no longer an estate tax so estate tax then perhaps it could be argued that her estate cannot be increased by GPOA because of the limitation that it is only valid to the extent there is no estate tax. Another approach might be to argue that the GPOA is tantamount to outright ownership but this is a difficult argument especially if it is only a testamentary GPOA.
 - iii. If estate tax repealed is ownership in a revocable trust tantamount to outright ownership? This is a better argument but again no certainty. In other words if there is no estate tax but a step up in basis for assets owned on death (the current concept of inclusion in the gross estate may not exist

- if the estate tax is repealed) do you get a basis step up for assets in a revocable trust or would those assets be viewed as not the taxpayers?
- iv. In the absence of an estate tax we need clarification in whatever Congress does.
 - g. Trust Modification/Bosch Rule.
 - i. Trust funded with assets. Trust provides on grantor's death assets distribute 1/3rd W2, 1/3rd C1 and 1/3rd C2. Want to amend to have all assets pass to W2 and all will consent.
 - ii. What are the transfer tax implications to modifying the trust?
 - iii. Consider the Bosch rule that tax authorities not obligated to follow lower state court proceeding.
 - iv. Also have a completed transaction rule. There is a trust with vested interests. Beneficiaries on grantor's death are W2 and 2 children from first marriage.
 - v. Unless the court proceeding is a reformation of a mistake, which sounds difficult in these facts, it will be difficult to modifying this trust without gift tax consequences. The children are giving up rights in the trust and transferring them to W2.
 - vi. After death there may be a restructure based on litigation such as a will contest, etc. Need to consider transfer tax implications. Bosch analysis is applicable even if you have a probate court order blessing the result. The cases seem to have worked out that if the case is a reasonable compromise of rights parties had there is no tax.
 - h. Basis Consistency.
 - i. Form 8971 obligation to file only applies to executors required to file 706 i.e., gross estate exceeds exemption. So if you file only for portability you do not have to file 8971. If file only for GST do not have to file if estate below exemption.
 - ii. Do you only have to list assets subject to estate taxes? No, must list all assets. You have to check a box if asset increases estate tax. If check yes, then basis consistency rules apply.
 - iii. Form 8971 what is practical experience with penalties? Are they assessed automatically or is the IRS giving any leeway? Is there any defense to assessment? This has only been effective for six months so it is too early to know what the IRS is doing. Under the statute the IRS has to assess penalties.
 - iv. Do we expect significant changes in the proposed regulations? Treasury is considering options.
 - v. Beneficiary penalized with zero basis is harsh. But it is also unfair since the beneficiary cannot participate in the process of determining value. The beneficiary is being penalized for error or inaction by the executor.
 - vi. These rules will create potential liability for a fiduciary that does not report an asset in good faith or at a value the beneficiary believes is too low. Will this mean the executors will involve or at least inform beneficiaries of the valuations and 706 preparation?
 - i. Life insurance.

- i. Life insurance policy held by trust for daughter formed for her under her Dad's will. Dad's will created a trust for daughter and that trust purchased life insurance on daughter's life. Daughter had testamentary LPOA power of appointment over that trust.
- ii. Does LPOA constitute an incident of ownership to cause insurance to be included in her estate under IRC Sec. 2042 even though daughter did not create the trust? Yes/maybe, it could.
- iii. If have power to change beneficial ownership of proceeds of policy or time or manner of enjoyment of policy proceeds.
- iv. What can be done?
 - 1. In Illinois there is a statute that allows for a release of powers. If state permits this daughter could release the testamentary power of appointment. There is also a 3-year rule limitation under 2035 if power holder releases.
 - 2. If trustee can eliminate the LPOA the 3-year rule won't apply.
 - 3. Move to a state that has decanting power and decant to a new trust that does not have offending LPOA and that should cure 2042 issue without a 3-year rule problem.
- j. Capital gains on death.
 - i. All hypothetical.
 - ii. If there is a transfer in Canada by gift or death a capital gains tax is imposed. 50% of the appreciation is taxed at capital gains rates and 50% taxed at ordinary income tax rates from 20% to 29% of gain.
 - iii. Example: \$10M of assets all capital gain. \$5M deduction. \$5M taxed at 30% = \$1.5M. This is a tax increase over the current estate tax system.
 - iv. There should be some adjustment or allocation of basis on the appreciation.
 - v. Suppose decedent invested \$1M in real estate and only retained a life estate and gave away remainder. Is that taxable at that point or is it included in his estate? Determining what would be subject to tax could be quite complex with a capital gains on death.
 - vi. In Canada, if an individual dies between Jan-October the capital gains tax on death is due April 30.
 - vii. Is tax offset by decedent's losses? Yes.
 - viii. Like kind exchanges. Cannot do this at death. Canada has a limited lifetime exchange provision during lifetime.
 - ix. Are there differences other than tax rate? Yes, with a marital deduction. There is no tax if spouse takes carryover basis. If spouse does not take carryover basis tax is due.
 - x. What about provisions for closely held businesses? No 6166 under Canadian law. There is a lifetime exemption of \$800,000.
 - xi. If have negative basis assets and significant appreciation the capital gains on gift or death could be greater.
 - xii. A replacement system could be as complex as the existing estate tax system.
- k. Repeal of estate tax and QDOTs.

- i. Principal distributions would be subject to the equivalent of an estate tax.
 - ii. If repeal is a possibility at all favor qualifying non-citizen spouse for US citizenship to avoid the QDOT-tail.
- l. FLP.
- i. FLP with substantially appreciated assets. Planning to get basis step-up?
 - ii. Are there facts that support 2036 argument to have assets included in decedent's estate?
 - iii. It is a completed transaction so absent a reasonable 2036 argument there may not be any recourse.
 - iv. What if there is no estate tax and there is no gross estate for them to be included? Option may not then be available.
 - v. If estate is under exemption and no Form 706 filed how would you take this position? Do you file a return taking that position? If partnership is above exemption amount taking that position is that you may trigger an estate tax.
- m. Partnership income tax.
- i. Father wants to sell a 25% FLP interest.
 - ii. Appraisal lists discounted value much less.
 - iii. Includes hot assets with depreciation recapture.
 - iv. 741 says when sell LP interest sale or exchange of capital assets but 751 inventory or unrealized receivables ordinary income assets recognize that portion as ordinary income.
 - v. If the gain is net \$800,000, but that might be \$1M ordinary income and a \$200,000 capital loss. That is a lousy result because of the significant restrictions on deducting a capital loss.
 - vi. Death with a step-up in basis and a 754 election may solve the problem. If estate tax is repealed there is no step up in basis.
- n. Electronic Wills Act.
- i. Act provides an individual can sign a will on line without witnesses being in same room and without the involvement of a lawyer. You can go to Legal zoom and prepare a will and sign it on line and witnesses can be satisfied by Skype or other webcam presence.
 - ii. Being introduced in FL Senate bill 206. Being considered in NH, Virginia and NV. **Comment:** Great so now the home health aide can get the elderly patient/client's will changed naming him/her as beneficiary without leaving the client's home or seeking out a different lawyer!
 - iii. Prevalence of revocable trusts as will substitutes do not require formalities of wills also suggest change in formalities.
- o. Charitable gifts on Form 709.
- i. Tax is zero so no penalty.
 - ii. Issue is tolling of statute of limitations.
 - iii. If more than 25% of donor's gifts are not reported on a gift tax return, then the statute of limitations on the return is six years not three.
 - iv. If there are larger gifts to charity this could extend overall statute of limitations for entire year.

- v. With a gift to a large GRAT the taxable gift is modest so a small charitable gift may end up extending the audit period for a very large GRAT transaction.
- p. 2704.
- i. Treasurer is continuing to work on these Regulations.
 - ii. 2704(b)(4) is a particularized analysis like the 2703 device test. Was this provision respected, etc. What does language say, how is it interpreted and what impact on value.
 - iii. Gives Treasury authority to go “somewhat” beyond what Congress has done in the statute.
 - iv. Matter of hot debate.
- q. Estate tax liens.
- i. This arises in sale of real estate where property is being sold and title company or buyer’s attorney wants a document releasing lien.
 - ii. To get that the proceeds of sale have to be deposited with IRS and treated as a payment of estate tax (you would get interest if refunded) or with an escrow agent the IRS agrees to. The agent must be bonded.
 - iii. Notice issued Form 4422. No Rev. Proc.
 - iv. Significance is IRS is trying to collect estate tax. The handling of a discharge of an estate tax lien was moved from the examining agent to the collections division.
 - v. Escrow is required to be with bonded agent may be a “nudge” to get the funds deposited with the IRS.
 - vi. To get the funds released you have to show a closing letter. Will the accounting transcript under Notice 2017-12 suggests yes?
 - vii. There have been many complaints on this new policy. Hughes indicated the IRS is considering this but what they may do is “up in the air.”
 - viii. Consider putting real estate into single member LLC. Estate tax lien applies to the LLC and not to the real estate. If selling the real estate from the LLC, you might avoid this process.
- r. Filing/timing questions.
- i. Is there any way to get a late portability election for good cause? No, if late only way to address is to obtain 9100 relief. \$27,500 for ruling. Portability rulings often do not recite that a professional was engaged that failed something. There seems to be a lower standard under 301.9100-3. So there may not be a professional to “throw under the bus.”
 - ii. With new 2016-49 can you file a supplemental estate tax return to file a QTIP election? No if original filing period has passed you cannot file a supplemental election since the time for QTIP election has passed.
- s. Crummey notices.
- i. Are they required if the trustee is a beneficiary?
 - ii. Crummey case does not require notice.
 - iii. What are the terms of the trust agreement? Many require notice so if it is required you should comply with the terms of the trust.
- t. Life insurance trust.
- i. Can client pay premiums directly?

- ii. Yes, but it is not the best way, follow the formalities.

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Steve Leimberg's Estate Planning Email Newsletter Archive Message #2503

Date:12-Jan-17

Subject: Marty Shenkman's Meeting Notes from Heckerling 2017, Day 3
Afternoon Notes

Heckerling Institute 2017 – Wednesday, Day 3 Afternoon Notes

By Martin M. Shenkman, Esq.

The following are rough draft meeting notes prepared at the 2017 51st Heckerling Institute on Estate Planning sponsored by the University of Miami School of Law, and published in Leimberg Information Services, Inc. (LISI). These notes were published within a very short time of the conclusion of the proceedings and could not have been reviewed in order to be completed so quickly. There are no doubt errors, typos, etc. in these notes none of which should be attributed to the presenters. LISI obtained special permission from the Heckerling Institute to publish these notes. Bear in mind that no notes appear below on more than 20 concurrent and other sessions. These sessions can be purchased from the source listed below. The final papers presented at this year's Heckerling Institute can be obtained from Lexis Nexis. For recordings of the sessions contact Convention CDs, Inc. 800-747-6334.

1. Wednesday: Afternoon: I-B: Minimizing Fiduciary Risk: Wolven, Flubacher, Singer
 - a. Administrative Trustee.
 - b. Removal powers.
 - i. Should you limit so cannot shop for result beneficiary wants?
 - c. Should trustee have retirement age?
 - i. But if have retirement age and trustee is doing a good job should they have to step down?
 - ii. You could build in a retirement age and at that age the adult beneficiaries have to agree to trustee continuing and then renew approval every say two years.
 - iii. Be certain definition of incapacity covers trustee and addresses how you get medical information.
 - iv. By accepting role of Trustee I agree to permit access to medical information, or to sign a HIPAA release, etc.
 - v. **Example:** Christiansen (sp?) case. Mom and dad acting as co-trustees. Dad diagnosed with Alzheimer's. Mom did not go through the procedures required to remove dad. A child duped Mom. Dad signed documents for sale. Transaction was unwound based on Dad's incapacity.

- d. New Trustee due diligence process.
 - i. Named trustee, what should be looked at to determine whether to accept the role? What should be done prior to starting to serve?
 - ii. Consider:
 1. What are the common law or general duties of the trustee (loyalty, take control over property, etc.)?
 2. What are duties under trust instrument? What are the specific provisions? What restrictions and responsibilities are placed on the trustee? For example, is there a lack of language dealing with concentrated positions and the trust holds a concentrated position? Is it the kind of issue trustee can step in a deal with this or is the type of issue that should be resolved before accepting trusteeship? Might use decanting or non-judicial settlement agreement to resolve.
 3. What are the tax attributes of the trust? Is it a grandfathered GST trust?
 4. Is there an ability to charge fees? Is it limited?
 5. Is there an ability to get out of the position? Can you resign? What is required?
 6. What assets does the trust hold? What are they worth? What efforts will they require to manage?
 7. Are there loans in the trust portfolio? Are there loan documents? Are they signed properly? Are payments current?
 8. Is there real estate? Has an environmental analysis been done? Could or should you at least have some basic analysis done?
 9. Do you have a concentrated position in the trust? Does the trust expressly permit this holding and does it expressly discharge or hold the trustee harmless for this position?
 10. Was the prior trustee a professional or accommodation family member? What type of job did the prior trustee do?
 11. Will beneficiaries sign off on issues?
 12. Has there or should have been a delegation of responsibility to another party?
 13. Are there governing documents for the interests owned (e.g., family business)?
 14. Does the trust have sufficient liquidity to meet its obligations?
 15. Who has received statements? Has the trust complied with UTC or other applicable law? Is the trust a quiet trust? Will new people get statements and be unhappy?
 16. Is it a special needs trust? If so, has it been administered properly?
 17. Does the trust have an employee?
 18. How many prior trustees have there been? Have prior trustees been fired? Is there a concern?
 19. Are you OK taking on this trust?
 20. Document the due diligence done. If you could not identify a problem and you did good faith and reasonable due diligence.

- e. Conflicts.
- i. Family members control family business and are trustees, it is a conflict.
 - ii. **Example:** Modell sporting goods case. Michael died. Michael and Mitchell were brothers and 50/50 partners. Main asset stock in company. Sued to remove other trustees. Mitchell was enjoying power too much and Joel was going along for ride. Notice of trustee actions not given to 3rd trustee. Salary of surviving brother before brother's death about \$1.8M and after death rose to \$6M. IRS issues on business over millions in personal expenses. This reduced dividends that would have otherwise been distributed to Michael's children, etc. Large salaries paid to family members who were not working in business. Trust had large concentrated position.
 - iii. **Example:** Client had two sons who did not get along. Father new this and insisted on naming two sons as co-executors and co-trustees. Battles ensued and costs escalated.
 - iv. When there is a personality conflict or self-interests like the Modell case the settlor can expressly or impliedly waive a conflict. Better to do it expressly in the trust instrument. "I am aware that X has interest in business and nonetheless appoint X as trustee and waive"
 - v. "He's my brother and he would not do anything to hurt me....."
 - vi. This all has to do with a range of trustee duties: duty of care, duty of loyalty, duty of impartiality, etc.
 - vii. Delaware cases 1975 case trustee was buying asset from trust. Court said even if in best interests of beneficiaries and for fair value it was held a void transaction. 1999 Magnus case with an interested transaction and a conflict of interest. Court said not void but voidable. It would be valid if deal fair and if beneficiaries consent. The law has evolved.
 - viii. UTC 1009 addresses a beneficiary's consent, release or ratification of Trustee action. Comments suggest that in case of a self-dealing transaction consent not binding if not fair and reasonable.
 - ix. *Mennen v. Wilmington Trust* case. 2015 WL 1914599. Could beneficiary represent minor through a virtual representation statute? Court's analysis found conflict of interest because of relationship with brother who was being sued. John and Jeff siblings. Business purchased by Colgate. Jeff did not have a job. Father made him trustee of John's trust. Father appointed Jeff as Jeff had been a good brother and Jeff was financially sophisticated. Dad thought Jeff would act in John's best interest. You don't get this with a corporate trustee. Jeff viewed himself as a great investor, but he wasn't. By the end when John finally sued him the trust had declined dramatically in value do to Jeff investing poorly. \$97M award to trust. Court said Jeff used his brother John's trust as his own personally piggy bank. There as a corporate co-fiduciary. Why didn't they stop Jeff? Because the corporate trustee viewed the trust as a directed trust. Court held that the trust company misinterpreted the language.

- x. Courts will look at source of hostility. Are the beneficiaries just angry because trustee said no, or are they angry because trustee is not performing properly?
 - xi. Estate of Gilmaker, 371 P.2d 321 (Cal. 1962) issue of trustee hostility.
 - xii. Matter of Duell, 258 AD2nd 382. Trustee destroyed rent checks, etc. Trust was doing well and growing but in other aspects trustee was being malicious which is not acceptable. Trustee was removed because of hostility.
 - xiii. If you have a trustee and know of conflict how can you protect the trustee? Settlor's intent about conflict (I understand the conflict and waive...) that should also be paired with a clause exculpating the trustee for good faith. Waivers should be express. If the trust doesn't expressly alleviate the trustee for the action the trustee will be in a difficult position.
 - xiv. Trustee can go to court and ask the court to give the trustee instructions. Is the transaction fair?
 - xv. KY Case US Dist Eastern Dist. Elizabeth Osborne v. Griffin. All about conflicts and issues that arise in a family business.
- f. Choice of Law; Conflicts of law.
- i. These issues are important as often trusts are not set up with local bank in home state. Often trusts are set up in jurisdictions that are viewed as more favorable.
 - ii. Want to make sure the situs of the trust will be in that jurisdiction and the laws of that jurisdiction will apply so that if a beneficiary wants to challenge validity or administration they cannot.
 - iii. Trusts have unique set of rules under conflict of law rules as to how to select law of governing jurisdiction. Contrast a contract just need a reasonable relationship to the jurisdiction. A trust is a fiduciary relation. Trustee takes legal title to the assets and administers trust pursuant to the agreement. The nature of this is what gives rise to the issues.
 - iv. Laws may differ for inter-vivos versus testamentary. In many cases real estate will govern (law of jurisdiction where the dirt is located) so will generally want to put real estate into an LLC not only for liability protection but for conflict of laws purposes.
 - v. Restatement divides into: validity, construction and administration.
 - 1. Validity – if you set up a dynasty trust. Was it a valid trust or is it void ab initio because of the RAP. If Texas grantor is setting up a DE trust can he get over conflict of law rules. If a great grandchild of the settlor wants to break the trust that there were no contacts with DE and the Texas RAP applies, etc. FL has a provision against no contest clauses so if a FL resident set up a trust in another jurisdiction that permits no-contest clauses will that work?
 - 2. Construction goes to meaning of terms in the instrument? Should you define these in the document so that if the trust changes jurisdictions you have consistent definitions? Yes.
 - 3. Administration.

- vi. If a trust migrates the law concerning validity and construction may not change but only the law governing administration of the trust.
- vii. Old trusts are often silent on all of these issues. Modern trusts tend to have situs and governing law provision that often contemplate change in situs and governing law.
- viii. If trust language gives broad right to change situs does that create an obligation on the trustee to survey various state laws and determine periodically the optimal situs?
- ix. 3 prong approach to analysis:
 - 1. Domicile of trustee.
 - a. Where corporate trustee has main office or corporate charter.
 - b. If have multiple trustees may list in trust which is the administrative trustee that would determine this.
 - 2. Place of administration.
 - a. Where trust administered.
 - 3. Settlor intent.
 - a. Choice of law provision.
- x. If migrate a trust issues may arise. State tax laws may tax based on location of grantor when trust funded, location of beneficiaries, etc.
- g. Directed trusts.
 - i. 43 states permit directed trusts. Part of uniform law commission is working on a uniform directed trust act. It has become commonplace to structure directed trusts bifurcating traditional trustee roles. 8 states do not have any directed trust statutes.
 - ii. Clients often like to have life insurance, closely held business, and so forth in trusts and these types of assets conflict with traditional trustee duties. Liability exposure to trustee holding a concentrated position is significant so a directed trust may resolve that concern.
 - iii. Consider changing situs and converting a non-directed trust to a directed trust.
 - iv. Strong form state statutes give general trustee the most protection. Settlor may also want this if trust will hold unique or special asset or to have a specific person be responsible for investment or distribution decisions then you want this type of strong protection. Having a trustee to act by direction you need a jurisdiction where there is no duty to monitor. Some statutes do not make this as clear.
 - 1. Enabling statutes – simple statutes that rely heavily on trust instrument. Trustee will follow direction of the adviser and if so will not have liability absent misconduct. Does not have to be limited to investments or distributions but can be anything. Be careful under this type of statutory approach clarifying what powers are exercised by direction. Some of these statutes like GA, OK, UT only contemplate investment adviser. Some contemplate only investment or distribution. In these cases, only those functions

can be directed. Illinois statute defines role and states trustee shall exercise role as directed by the of investment adviser.

2. Off the rack statutes – provide clarity and detail on direction. But these may have less flexibility.

h. Planning solutions.

- i. Care and feeding of the trust during the administration of the trust to protect the trustee.
- ii. If you have a direction make sure you document it. Get it in writing and signed. Have the back up of what you received, when you received it and when you acted on it.
- iii. There is a fundamental duty to send information, render accounts, keep records.
- iv. Tax elections, document why you did or did not make an election.
- v. Requests for equitable adjustment.
- vi. Whether an asset should be retained or diversify. Retain documentation showing reviewing at least annually and why the decision was made.
- vii. Trustees can make bad decisions but they are not allowed to make lazy decisions. Must have a process, put it in place and follow it.
- viii. Communicate with the beneficiaries. If you don't inform them they cannot raise issues. Big problem is when a beneficiary finds out about something bad long after it happened. Look into who is getting statements and who should get statements.
- ix. Let beneficiaries know what their rights are.
- x. Trust companies have committees that make these decisions and document the discretionary decisions.
- xi. 187 Restatement and Sections 50 and 60 of Restatement 2nd address standard "arbitrary and capricious." Have documented policies and procedures.

2. **Wednesday: Afternoon: II-C: Fiduciary Cases: Fitzsimons**

- a. Use and abuse of Powers of attorney.
 - i. State law and uniform POA Act and financial institutions all grappling with how to use them but balancing against risks of abuse of power.
 - ii. One has called POAs the most effective tool for burglary since the crowbar.
 - iii. Cashion v. Hayden.
 1. Nephew used POA to steal money.
 2. Put funds in Nevada trust.
 3. 2016 voiding all documents and damages confirmed by AL supreme court.
 4. Nephew sued court and judges etc. Alleged constitutional violations and more. Vexatious litigation and abuse of court system.
 - iv. Reineck case Virginia Supreme Court decided Nov 2016 2106 VA Lexis 178.
 1. 2nd marriage between Frank and Jane. Frank had children. Parallel estate plans 40% to Frank's kids and 60% to Jane's heirs at law.

2. Frank incapacitated from Lewy Body dementia.
 3. Jane disinherits kids and leaves all to her heirs at law who got assets after her death.
 4. Frank's kids use POA to fund with Frank's assets and it all passes to Frank's children. Then Frank died.
 5. Jane's complained POA was used to disinherit them from the estate plan.
 6. Compelling fact situation that there was an implicit agreement Jane breached. Court recognized POA as valid to disinherit Jane's heirs.
- v. Glass TN.
1. Glass v. Sun Trust Bank, 2016 Tenn. App. LEXIS 305.
 2. Do you have duty to fully fund revocable trust and save probate fees?
 3. Court held no. The revocable trust did not have a tangible property clause as did the will. Also because of tax refund avoidance of probate was impossible.
- b. State income taxation of trusts.
- i. Non grantor trust sever ties with taxing jurisdiction.
 - ii. Cases in prior years were taxpayer friendly, but not all so now.
 - iii. Bank of America NA v Mass. Commr. Of Revenue. C314596-8.
 1. Created by in state resident. No in-state income.
 2. Sole issue is whether BofA is an "inhabitant" of Mass. State statute requires a place of abode in Mass to be an inhabitant. How does this apply to a corporation?
 3. Corporation's acting as fiduciary should be taxed like individuals. All decided that an out of state corporation can be "inhabitant" if maintains place of business for 183+ days and performs administrative functions.
 4. Risk/issue is double taxation under the Commerce clause. This issue was not litigated in this case.
 - iv. Nov 29 Commissioner of Taxation of Mass issued notice asserting that a single act of fiduciary administration concerning a trust can trigger taxation if maintain an office in the state.
 - v. Kaestner
 1. Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Dept. of Rev. 2015 NCBC LEXIS 39.
 2. Domicile of beneficiary in NC is only connection.
 3. No mandatory distributions.
 4. NC tax commissioner attempted to impose tax.
 5. 2016 Taxpayer victory with NC Court of appeals found imposition of tax was violation of due process.
 6. NC Supreme Court granted appeal 2016 west Law 71899500.
- c. Fiduciary litigation that arises out of tax planning.
- i. Benson v. Rosenthal 201 US Dist. LEXIS 89238.
 1. Swap power retained by grantor if irrevocable trust to make trust a grantor trust under IRC Sec. 675(4).

2. 2016 West Law 2855456.
 3. Trust funded with interests in landmark properties and so forth.
 4. Fight about the trust. Exercised swap power and puts in a promissory note and some real estate with a value adjustment clause.
 5. Trustee rejects substitution and sues to compel trustee to honor swap.
 6. Benson adjust the note again and adds more collateral and bases valuation of note on valuation by Empire same appraiser used by trustee and trustee again rejects. Trustee tries to use aggressive discovery requests.
 7. Courts reject these.
 8. Court rejected trustees attempt to treat this as a loan. If it was a loan trustee had discretion to lend. Court rejected trustee interpretation and said swap power was a unilateral power subject only to verification of value by trustee not a discretionary power of the trustee.
 9. Issue as to whether a swap power can be done with an unsecured promissory note is a loan or swap.
- ii. Condiotti unpublished CO decision 2014 CA 969
 1. dealt with a swap power for an unsecured promissory note into the trust for \$9M+ hard assets. Trust prohibited loan to settlor without security.
 2. Court reached opposite conclusion as Benson above.
 - iii. GA case Schinazi v. Eden A16A0769.
 1. Settlor tried to swap in 58.3M promissory note swap for business on eve of sale of business and ex-wife trustee objected to valuations.
 2. Technicality of assignment of interests under partnership agreement.
 3. Will settlor have standing to compel exercise of swap power? How do you value an unsecured promissory note?
 - iv. Matter of Thomas L. Clancy, Jr. Estate No. 101962.
 1. Amended family trust before death to make it qualify for QTIP election to permit it to qualify but did not amend tax apportionment clause. Did include marital deduction tax savings clause.
 2. Under these circumstances which prevails? The tax savings clause (lower court enforced this) or the tax apportionment clause? The appeals court agreed that the tax savings clause prevailed.
 - v. 12/20/16 Heisenjer Case CT 2016 West Law 724539.
 1. What is standard of care must an executor exercise in valuing assets for estate tax purposes?
 2. Court protected executor.

3. Will gave executor power to hire appraiser without liability so long as selected with due care. Executed used due care in hiring a well-regarded firm.
- d. Spousal Desertion.
 - i. Lovett v Peterson, 2016 Mich. App. LEXIS 1053.
 1. Husband died.
 2. Tried to disinherit from spousal right of election.
 3. Spouse deserting does not have to make continuous efforts in order to exercise spousal right.
 - ii. Estate of Talerico, 2016 PA Super 66.
 1. Moving out did not forfeit marital rights but multiple affairs does.
 - iii. Brown v. Alley, 2016 OK 112.
 1. Physical separation alone does not extinguish right to be executor.
 2. But planning to marriage even though marriage was void she was precluded from serving.
 - iv. Estes v. Young, 2016 Miss. App. LEXIS 225.
 1. Never lived together. H went into hospital 3 days after marriage and W refused to care for him.
 2. Petitioned to have H involuntarily committed.
 - e. Business cases.
 - i. Rollins v. Rollins, 2013 Ga. App. LEXIS 332.
 1. Ran business and was trustee. What is standard?
 2. Trustees took actions as trustees and directors.
 3. Paid beneficiaries who did not complain \$9M and those that complained nothing. Imposed family code of conduct. Conditioned distributions on life pursuits that trustees deemed meaningful and personal good conduct.
 4. GA Supreme Court looked at each action and applied corporate director standards for business actions and trustee standards for trustee actions not the same standard. Basis for this is that the settlor not the individuals involved set this up and the inferred settlor intent to parse the duties.
 - ii. Osborne v. Griffin, Civil Action No 2011-89.
 1. Brothers abused their offices to force sister out of the business.
 2. Awarded damages to each of six daughters' plus damages to daughter who had partially settled claims, of over \$1B.
 - iii. Ellis 2016 Kansas App. LEXIS 65
 1. Decided in November.
 2. Widower abused position of trustee of wife's trust and extracted all of the trust assets and put them all into his revocable trust and then amended it to disinherit children and leave all to charity. Court held it was a willful fraud.
 3. Widower died before holding and court said that punitive and double damages don't survive death of wrongdoer.
 - f. Trust investments.
 - i. Adams v. Regions Bank 2016 US Dist. LEXIS 1027.

1. Courts refused to allow beneficiaries to lure trustee into a breach of trust case.
 2. Testator was former bank officer and trust had waiver of diversification.
 3. Took loan from same bank to benefit her own business and they pledged bank stock in trust by the brothers for that loan.
 4. Brother's resign and Kay appoints same bank as trustee and signs release and indemnification.
 5. In 2010 discover deficiency in paperwork and Kay petitions court to fix it.
 6. Stock declines in value.
 7. Kay defaults on debt.
 8. Kay sues bank in 2016 alleging bank erred by holding concentrated position.
 9. All claims dismissed.
 10. Equitable point is that bank did not put itself in conflict those were put in place before bank became trustee.
- ii. *Glass v. Sun Trust Bank*, 2016 Tenn. App. LEXIS 306.
 1. Discussed elsewhere in outline in different context.
 2. Beneficiary was head of trust department.
 3. Estate had concentration of bank stock and declined during administration in 2007.
 4. Courts protected the bank from the beneficiaries' claims.
 5. One month after death son chose in kind distribution of assets, he told bank to keep stock, received statements, etc.
 6. Court found special circumstances to hold stock and son's request for in kind distributions created the special situation.
 7. Good process and good documentation protected bank.
 - iii. *Estate of Gilliland*, 2016 Cal. App. Unpub. LEXIS 157.
 1. Trustee not liable for investment losses while awaiting instructions (PLR agreed to in settlement agreement).
- g. Trust construction.
- i. *Mechanics Bank v. Hink*, 2016 Cal. App. Unpub. LEXIS 5185.
 1. Beneficiary was lobbying for own advantage cannot use common fund to shift your costs to trust.
- h. Disclosure and Privileges.
- i. *Schrage v. Serberger*, 2016 Ind. App. LEXIS 62.
 - ii. If your only interest in trust is a pre-residuary cash receipt, e.g. \$10,000 if you survive. Does trustee have to give you full trust agreement? Holding only entitled to trust certification as is not a qualified beneficiary but closer to the status of a creditor.
 - iii. *Smith v. SunTrust Bank*, A13A225.
 1. How much notice and disclosure must beneficiaries get? Statute of limitations in many states 6 months to one year. When does that being to run?
 2. Must give sufficient information to begin statute tolling.

- iv. Meyers v. First Tennessee Bank, 2016 Tenn. App. LEXIS 371.
 - 1. Can you use totality of communications to establish a report since the term report is not defined in most states? Comments to UTC don't define report.
 - 2. Court rejected attempt.
 - 3. UTC requires an actual report not merely being put on notice. A phone call, fax, email, etc. may suffice but you have to establish the content of those.
 - 4. You don't want to have a factual trial that is costly. You want to have claims dismissed at a summary stage as being time barred claims.
 - 5. In this case there was a problem proving what was in the report.
- v. Andersen v. Andersen, 2016 Cal. App. Unpub. LEXIS 7677.
 - 1. Clock doesn't start if trustee left out something material. Trustee cannot determine what is valid or not that is role of courts.
- i. Creditor protection.
 - i. Turkish v. Brody 201 FL App. LEXIS 17684 November 30, 2016.
 - 1. Settlor owed \$1M gift tax to IRS.
 - 2. Trust distributed \$1M to son and son loaned to mom to pay tax and mom gave \$1M promissory note.
 - 3. Son put \$1M promissory note into trust.
 - 4. All disclosed on trust statements.
 - 5. Court said this was not adequate to disclose since the statements don't disclose that promissory note is worthless because that was based on mother's lack of assets.
 - ii. Pfannenstiehl v. Pfannenstiehl, 2016 Mass. App. LEXIS 123.
 - 1. Probate court decision included 60% of spendthrift trust in marital estate.
 - 2. Mass. Supreme Court reversed the probate court since trust was discretionary and ascertainable standard did not change that, trust has spendthrift clause and husband was one of 11 beneficiaries so interest was indeterminate.
 - iii. Duckett v. Enomoto, 2016 US Dist. LEXIS 51502.
 - 1. "Shall be distributed" and used ascertainable standard.
 - 2. Owed IRS money.
 - 3. Court held to be discretionary support trust not fully discretionary so IRS can reach it if it can meet burden of prove.
 - iv. In re Erskin, Case No. 15-2841-L.
 - 1. Lesson in how not to do an asset protection trust.
 - 2. At time of creation he had already filed two bankruptcy cases a case against him for Replevin.
 - 3. Titled trust as irrevocable but reserved right to revoke.
 - 4. Named himself as trustee.
 - 5. Trust had mandatory income distributions to hm.
 - v. Summary.
 - 1. Trusts work, but...

2. Should use institutional trustee with full discretion
 3. Name multiple beneficiaries and sprinkle.
- j. Charity.
- i. IRC Se. 4942 pay out 5% but charities often look to get more access to assets.
 - ii. Estate of Loucks, 2016 PA Super 206.
 1. Trust for two churches income only.
 2. One of the church's needs more.
 3. Court rejects petition to modify the trust to provide for discretionary principal right as it will undermine perpetual nature of trust and violate settlor's intent.
 - iii. Shriners Hospitals for Children v. First Northern Bank of Wyoming, 2016 WY 51.
 1. Income until 2100. In 2100 whereupon assets distribute outright.
 2. Settlor stated express intent land be open and devoted to agriculture until that time.
 3. Shriner wanted to take land now claiming trust violated RAP.
 4. Court advocated for settlor's intent of land preservation as well as benefitting charities. Desires of charities for more income does not require termination. Trustee owes duty to settlor intent and not just go to whim of charities.
 - iv. Matter of Rockefeller University, 2016 NY Slip Op 31556(U).
 1. Want to modernize old trust investment provisions.
 2. This was a successful attempt to do this.
- k. Revocable trusts.
- i. General Comments.
 1. Courts grapple with what can be done during settlor's lifetime. Results are inconsistent.
 2. CA seems to have a looser approach.
 3. Deviation from common law rules when the facts have overtones of elder abuse.
 4. Concern about how revocable trusts are being administered.
 5. Cases are split.
 6. Courts will err on side of having some limited standing to sue and deferring until Settlor is dead. This seems to be the trend.
- l. Third Party Liability.
- i. Fiduciary breaches but also sue trustee's lawyers, financial institutions who handled transactions and CPAs, etc. Claims are often in tort.
 - ii. Deep pocket searching has made its way into trust area.
 - iii. Erosion of privity rule has been steady.
 - iv. Throson vs. Richmond 292 Va. 257 the privity rule has fallen in Virginia.
- m. Litevich v. Legalzoom, 2015 Conn. Super. LEXIS 1702.
- i. Court hit Legalzoom by letting customer who got faulty execution instructions. Disinherited heir sued in tort.
 - ii. In same case court chose to enforce the terms of use and forced the disinherited heir into binding arbitration

- n. Matter of Levitin, 2015 NY Slip Op 25184.
 - i. Archie comics.
 - ii. Trustee compelled to submit to mental examination.
- o. Stephens v. Beard, 2016 Tex. LEXIS 219.
 - i. Texas supreme court. Shot and killed wife and took 2 hours to shoot himself. That was not a common disaster under will.
- 3. **ABA Book Launch: Trust Owned Life Insurance TOLI Issues.**
 - a. The following remarks and comments are based in part on a review of a recent book The Life Insurance Policy Crisis by E. Randolph Whitelaw and Henry Montag published by the American Bar Association, in part based on an article I wrote that appeared in the appendix to the book, remarks made to a presentation about the book January 11, 2017 at Heckerling, and some additional thoughts and comments as to how the changing estate planning environment may have a significant impact on all of this. To purchase Henry and Randy's book go to www.shopABA.org.
 - b. Some startling statistics from the book emphasize the importance of practitioners encouraging all clients to monitor their insurance coverage and certainly for trustees of ILITs.
 - i. 90% of ILITs are managed by trustees that have no particular background or skill to manage life insurance.
 - ii. About 39% of in force non-guaranteed universal life policies, and 34% of in force variable universal life policies, are illustrated by the carriers to lapse during the insured's lifetime or within five years of life expectancy. While this sounds incredibly worrisome, it likely understates the problem. There is a significant correlation between wealth and longevity so that the clients that have significant life insurance inside life insurance trusts are likely to have greater than average life expectancy.
 - iii. Those over age 65 appear to lapse life insurance policies at a shocking rate. Based on 2008 data 1.1 million policies with a face value of \$112 billion were lapsed. It appears that few of these considered the possibility of a sale of the policies prior to lapse.
 - iv. In 2013 the insurance policy lapse rate was 5.7%. 82% of those were merely allowed to lapse with no value to the owner.
 - c. ILIT issues arise with common frequency in practice.
 - i. Policies about to lapse or that have lapsed because no one had looked at the performance of the policy or the carrier since the policy was purchased decades earlier. **Example:** In one case the client retained counsel to pursue the matter. When presented with two separate retainer agreements that expressly excluded life insurance selection the law firm opted only to pursue the insurance broker.
 - ii. Policies cashed in instead of being sold or retained because a client with no input from any adviser decides they no longer need the policy because the estate tax has become less relevant or irrelevant. **Example:** A surgeon by the time he came to me for an initial consult had cancelled a number of Guardian Life policies that had been in force for nearly two decades and which were all owned by a well-crafted ILIT. His reaction was that he did

not need it because of the increase in the estate tax exemption in 2013 without any consideration of the income tax and significant asset protection benefits the well-done plan had afforded.

- iii. A policy and trust that may be adequate but for which there are no records. Often there are changes in trustees that have never been reported to the insurance company and no documentation of those changes. **Example:** A new client presented an existing ILIT. The ILIT was so old that the only copies of the trust anyone could find were missing several pages. There were two changes in trustees none of which had been reported to the carrier who continued to list the initial trustee, and the documentation appointing the successor trustees was also lost. Consider preparing a compilation of the trust instrument and all consents, actions or documentation from inception to date anytime there is a significant change.
- iv. The policy is found to be adequate but the trust instrument no longer serves the client purposes so a combination of trust protector actions, decanting, disclaimers, etc. may correct the problems. **Example:** The initial ILIT held funds in trust from a survivorship policy until each child was 35. At the time of evaluation each child was 50+. The old ILIT was decanted into a new ILIT with similar timers but lifetime trusts for the children.
- d. Flexible premium non-guaranteed death benefit policies have become common and many clients and individual ILIT trustees do not understand that these policies shift the performance risk from the insurance company to the policy owner.
- e. Life insurance can be viewed as an asset class: the death benefit does not correlate with other asset classes, tax deferral and tax free withdrawals and loans are unique features that differentiate insurance from other assets.
- f. Trusts, including ILITs, are the keystone of most estate plans. Whether a client has sought asset protection benefits, estate tax savings, probate avoidance, or most recently basis step up techniques, trusts have often been part of the solution. The incredible flexibility that trusts bring to financial and estate planning has placed them in a position of prominence in the planner's toolkit. An essential component of every trust plan is the client's selection of fiduciaries. Most clients have, and continue to, shun institutional trustees. After all, institutional trustees charge fees, and are rigid in their willingness to act. The solution to many clients appears simple, an individual trustee that is typically a close family member or occasionally a friend. While theoretically that decision can provide as beneficial a result as naming a skilled institutional trustee that is unlikely to be the case. The siren call of simplicity and low cost too often leads clients and their families down a dangerous path.
- g. Duties of the ILIT Trustee.
 - i. The terms of the trust agreement create obligations on the trustee as do state law. The Prudent Investor act may apply.

- ii. Because IRC se. 2042 prohibits the grantor/insured from retaining incidents of ownership in the policy the grantor/insured cannot exercise powers of the policy, the trustee must do so.
- h. Family and friends can serve effectively as trustees, but most will require professional guidance to do so.
 - i. The means of achieving this positive fiduciary experience, for the both the trustee serving and the beneficiaries involved, is rather simple and obvious to the professional adviser, but unfortunately not so for many if not most individual trustees.
 - ii. Individual trustees should meet with appropriate professional advisers before beginning to serve. A trust attorney and dissect the trust governing the trustee position so that the trustee can understand in specific terms what the trustee's rights, duties, obligations and so forth are. Annotating and or summarizing the trust instrument to create a more accessible guide to the provisions of the governing trust. A checklist of operations can also be quite useful. Council should advise the client trustee about the importance of periodically reviewing the operations and status of the trust, communications with and distributions to beneficiaries, etc. Unless counsel has the expertise to address insurance specifics consider expressly excluding in the retainer letter insurance design and selection decisions.
 - iii. Meet with a CPA who has specific expertise in trust income tax planning to general planning implications, year-end tax planning if the ILIT holds more assets, and trust recordkeeping. The CPA should arrange for the filing of Form 56 informing the IRS of the new trustee relationship and Form 1041 if applicable.
 - iv. Meet annually with the professional advisers guiding the investment in trust assets if the client is not an expert in the field. This might be, depending on the nature of the trust, a wealth manager for marketable securities, an insurance consulting for life insurance, or other specialist. Certainly the key take home message of the book is that periodic reviews by an insurance expert to actively monitor insurance coverage. This is important as the ILIT trustee should demonstrate a reasonable process of evaluation of steps taken. See *Cochran v. KeyBank*.
 - v. Non-professional ILIT trustees need to understand that life insurance is not a buy and hold proposition but rather an asset that must be actively managed including the following steps:
 - 1. Life insurance policy statement.
 - 2. Product suitability and product design determinations. This is complicated by the broad range of products and product enhancements insurance companies offer.
 - 3. Carrier selection and underwriting.
 - 4. Annual performance monitoring and risk management.
 - a. Is the policy performing in a manner consistent with the illustrations?
 - b. What is the insured's age at the date the policy is projected to lapse?

- c. Are policy charges competitive?
 - d. Has the insured's health changed? Consider an actual life expectancy analysis.
 - e. What riders exist?
- 5. Periodic remediation and restructure. The book caution how replacement of policies, while sometimes warranted can be detrimental to the client/policy owner. A new policy may provide a more efficient premium and new benefits. If a policy is sold into the life settlement market consider the income tax implications. Rev. Rul. 2009-13. Agents may have an obligation to inform policy holders of the existence of the life settlement market. Larry Grill et. al. v. Lincoln National Life Insurance Company, 5:2014 cv 00051 S District court, California Central District.
- vi. While there are certainly more steps individual trustees can and should take, it is not that difficult or costly to hire the appropriate experts to guide the trustee in carrying out his or her fiduciary duties. Appropriate professional guidance, with a modicum of recordkeeping, diligence and follow up, may suffice for many individual trustees. The reality is that few individual trustees consult with professional advisers after the trust is formed other than to have an accountant (and not always one with particular trust expertise) prepare income tax filings, unless and until a problem arises.
- i. Individual Trustees Do Trip Up.
 - i. While it might be theoretically possible for an unskilled individual trustee to carry out his or her duties in a reasonable manner without consulting professional advisers regularly, unless that individual trustee has particular knowledge and training, or is one of those rare individuals who thoroughly researches and tackles the unfamiliar, that positive result may be unlikely.
 - ii. Consider the nearly ubiquitous ILIT trust administrative step of completing Crummey powers. How many individual trustees that do not work with their professional advisers actually complete this task reasonably well with any degree of consistency? If this task is not completed often or well, what of more complex tasks?
 - iii. How many individual trustees have an investment policy statement ("IPS") governing the trust they serve? How many individual trustees are even familiar with what an IPS is?
 - iv. Individual trustees should solicit trust beneficiaries to identify information relevant to the trustee decision making. How can a trustee identify beneficiaries to whom distributions may provide an overall tax benefit without knowing the current and likely future tax status of the beneficiaries? How can, in the context of an ILIT, the trustee assess the continued relevance of the original rationale for the insurance plan, policy design, etc.?
 - v. When is the last time individual trustees have reviewed life insurance held in a trust for which they serve as fiduciary? What is the likelihood of a trust insurance plan succeeding without regular professional involvement?

For many ILITs, not particularly likely. This is a key point of the book and why it goes to lengths to stress the importance of advisers guiding unskilled (in terms of life insurance knowledge) ILIT trustees to retain appropriate experts to assist in monitoring coverage.

- vi. For ILITs when is the last time that an individual trustee inquired with some specificity as to the health status of the insured? This might actually be a task that is more difficult for the family member or friend than an institutional trustee to perform. How can the appropriateness of an existing life insurance program be evaluated without the trustee having any current medical knowledge?
- vii. How many individual trustees have sought guidance as to the usefulness of a particular ILIT insurance plan in light of the dramatic changes in estate and income tax laws in the 2012 tax act? How many have simply cancelled existing policies and terminated ILITs (typically with no formal documentation) because “the policy isn’t needed any longer to pay estate tax,” with no analysis whatsoever of the performance of the policy, income tax benefits, possible legacy building and other non-estate tax paying purposes? Few of these individual trustees could imagine the liability exposure they might face for inappropriate cancelling a policy with no supporting corroboration. If the Trump administration eliminates the estate tax as proposed, there is likely to be a flurry of cancellations or surrender of ILIT policies for their cash value. Individual ILIT trustees should be warned not to act in haste. Before any modification of the coverage consideration should be given to the original purpose for the policies and the relevance of those factors in the current environment. While a policy may have been purchased to pay a federal estate tax that no longer applies, it may still have relevance to pay a state estate tax or a capital gains tax on death the Trump administration has proposed.
- viii. Even if the individual trustees take the appropriate action, in many cases they fail to document that action to demonstrate why their action was reasonable, or to inform beneficiaries of their actions and the reasons for them. Endeavoring to corroborate the rationale for an action after the fact is never easy and rarely as persuasive as contemporaneous records.
- ix. As the population continues to age and the myriad of existing trusts mature, the potential for problems with these informalities mounts, and the likelihood of lawsuits grows.
- j. Worse Issues with Individual ILIT Trustees.
 - i. While the “bad” steps above that are so common with individual trustees at the helm of the trust are substantial, individual trustees because they often do not adhere to trust disclosure rules or other formalities may well be tempted to engage in inappropriate self-dealing transactions, mismanagement, over charging and worse. Unless checks and balances are built into the trust (e.g., a trust protector, specified reporting, a co-trustee, etc.) the ability to take advantage of the position of being a trustee, or even to defraud beneficiaries, may be too great.

- ii. If the trustee can use trust resources to pay legal fees that can often be a potent weapon that alone can dissuade struggling beneficiaries from pursuing accountability.
- iii. Professional and institutional trustees often make a concerted effort to communicate with current and even certain remainder beneficiaries absent quiet trust provisions or extenuating circumstances. Individual trustees may not be aware of the obligation to communicate with beneficiaries about the trust. How likely is it that some or even many beneficiaries do not even know if the existence of the trust?
- k. Modern trust drafting, with increasingly complex mechanisms (e.g., swap powers to create grantor trust status and powers of appointment to secure basis step-up) and more fiduciary and other positions (administrative trustee, investment advisor, trust protector, etc.), have made some ILIT trust administration a more involved and variable endeavor. All these trends will increase the advantages of using professional or institutional trustees over individual trustees, or having a proactive professional term working with the individual trustee.

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Steve Leimberg's Estate Planning Email Newsletter Archive Message #2504

Date:13-Jan-17

Subject: Marty Shenkman's Meeting Notes from Heckerling 2017, Day 4

Heckerling Institute 2017 – Thursday Day 4 Notes

By Martin M. Shenkman, Esq.

The following are rough draft meeting notes prepared at the 2017 51st Heckerling Institute on Estate Planning sponsored by the University of Miami School of Law, and published in Leimberg Information Services, Inc. (LISI). These notes were published within a very short time of the conclusion of the proceedings and could not have been reviewed in order to be completed so quickly. There are no doubt errors, typos, etc. in these notes none of which should be attributed to the presenters. LISI obtained special permission from the Heckerling Institute to publish these notes. Bear in mind that no notes appear below on more than 20 concurrent and other sessions. These sessions can be purchased from the source listed below. The final papers presented at this year's Heckerling Institute can be obtained from Lexis Nexis. For recordings of the sessions contact Convention CDs, Inc. 800-747-6334.

1. Thursday: Morning: Private Foundations: Rothschild

- a. 3 rules or areas that are different for non-public charities.
 - i. Nonprofit entity – charitable entity classification rules.
 - ii. Charitable deduction rules.
 - iii. Operating restrictions and requirements post-1969.
- b. Gift substantiation.
 - i. IRS Pub. 1771 Provides rules for gift substantiation letter.
 - ii. Be sure taxpayer has gift substantiation letter. CPAs should not rely on just their typical questionnaire for large gifts – ask clients for a copy of the letter.
 - iii. **Example:** \$1M wire transfer from brokerage account to foundation. Did not provide himself as donor with letter but he checked on income tax return that he had documentation thinking brokerage statement sufficed. IRS denied the entire charitable deduction.
 - iv. Must receive earliest of due date of return or the date the return claiming charitable deduction is filed.
 - v. Help clients understand substantiation rules in private foundation context.
- c. Special rules.
 - i. When classified as private foundation a number of special rules apply based on 1969 Tax Act.
 - ii. Excise taxes affect 3 areas

1. Grant making – IRC Sec. 4942.
 - a. Private foundations must annually distribute 5% of net assets in terms of qualified distributions, e.g. charitable grants and also reasonable and necessary administrative expenses.
 - b. Has until end of following tax year to make distribution. By 12/31 this year must distribute 5% of net investment assets based on 2016 values.
 - c. Code imposes excise tax for failing to make distribution 30% of amount. If fail to timely correct 100% excise tax is assessed.
 - d. If don't make by 1/1/18 excise tax applies.
2. Taxable expenditures.
 - a. There is also an excise tax on persons associate with foundation if spent on political campaign activity or distribution or non-charitable purposes. IRC Sec. 4945.
 - b. Scholarship grant is not a taxable expenditure if awarded on an objective basis and procedure approved by IRS. Get IRS approval of scholarship program when Form 1023 is filed. If later opt to add (i.e. after the Form 1023 is filed) this the foundation should file Form 8940 and request preapproval.
 - c. A grant to a public charity can be done with no follow up other than corroborating the charity/recipient's qualification on the IRS list of exempt organizations.
 - d. Other grants are treated as taxable expenditures unless exercise expenditure responsibility. Must obtain reports from grantee as to how funds are spent and file reports as part of form 990PF advising IRS as to how taxable expenditure was documented and how the foundation went through the process.
 - e. IRC Sec. 4945 25% excise tax imposed for each taxable expenditure. If not addressed, then there is a 100% excise tax.
 - f. Tax can be imposed on foundation manager 5% of amount expended and if not timely expended a second 50% excise tax is asses.
3. Operating rules.
 - a. IRC Sec. 4940 Excise tax. 2% of net investment income. It is the equivalent of an income tax. This tax was not implemented to regulate foundation behavior but was a user fee to govern oversight costs of foundations as a result of the 1969 Tax Act.
 - b. Gross investment income plus capital gains in excess of deductions.

- c. Can reduce excise tax from 2% to 1% if meet certain requirements but these are quite complex.
- d. It is usually not worth accelerating grants to reduce the excise tax from 2% to 1% but better to use appreciated stock to fund grants. Give appreciated stock to public charity. Cleaner and simpler.
- e. Prohibition on self-dealing under 4941. Transactions between private foundations donors and board members are subject to these rules.
- f. If private foundation sold real estate to board member even if price is above FMV that is a self-dealing transaction.
- g. To analyze these rules disqualified persons include board, foundation staff who have authority to act, substantial contributed, and family members of all of these. Sibling is not one of these so may be able to do a transaction with a sibling to get asset out of private foundation.
- h. Foundation should maintain updated list of disqualified persons = DPs, on a regular basis to make it easier to identify problems.
- i. **Example:** A director lets the foundation have office in your business without charging rent is fine. Provision of goods, services etc. to the foundation is OK. Can the same director use a conference room in the foundation's office? Yes if that conference room is made available on same terms to general public. Example, use of a public meeting room that can be rented and the director pays the same price.
- j. Personal services are not defined. Regulations indicate legal services, professional financial services, etc. are listed as examples. Performance of trust functions and general baking functions for a private foundation by a corporate trustee are OK. However, the regulations and PLRs suggest personal services do not include maintenance, repair, landscape or similar operational services. Real estate management services are the type of professional management services for which payments by foundation to DP are OK.
- k. **Example:** foundation renovated office and DP wants to host personal function there. Cannot do it since prohibited if not a foundation activity. Only exception if rented to general public DP could rent on same terms, as noted above.
- l. **Example:** Indemnification of board member for attorney fees arising out of board activities is OK.
- m. Self-dealing excise taxes are imposed on individual not on foundation. 10% tax imposed even if DP did not know the transaction constituted self-dealing. Another 5% excise tax

- if knowingly participated in transaction. Failure to correct can result in a second tier tax of 200%.
- n. Historical comment - Private benefit and private inurement existed prior to 1969 Tax Act but Congress felt they were too subjective. If violated penalty was loss of tax exempt status which was too draconian a result.
4. Investment Rules applicable to private foundations and not public charities.
- a. 1969 Act addressed perceived abuse of involvement in family business after donation. IRC Sec. 4943 limits investment to 20% of company voting stock. Excess of this is defined as excess business holdings. Can increase to 35% if foundation can establish that neither foundation nor DPs have control.
 - b. Aggregation rules apply to this test. Reg. Sec. 53.4943-8(a)(1).
 - c. In estate planning be mindful that any excess business holdings acquired by gift or bequest can be held for 5 years by foundation and IRS can extend for an additional 5 years if plan to dispose of holdings is submitted to IRS.
 - d. Two tier tax 10% of excess holdings and if does not dispose in timely manner additional 200% tax.
5. Jeopardizing investments.
- a. Investments deemed to jeopardize carrying out of foundation's mission. IRC Sec. 4944.
 - b. Prior to 1969 Act foundations made speculative investments. Excise tax two tier 10% on amount of jeopardizing investments and if not a second tier tax can be assessed.
 - c. Exception to both of these are the mission related activities PRI = program related investments. To qualify:
 - i. Purpose is to accomplish 170(c)(2)(B) purpose
 - ii. No Significant purpose of investment is production of income or appreciation of the property. Test is whether an independent investor would make investment on same purpose.
 - iii. No purpose is to participate in political activity.
 - iv. Final regulations issued to address PRIs. Examples as broad as promotion of art, micro-loans, child care facilities in low income neighborhoods. Can support both domestic and international activities. Can include loans to individual and exempt organizations, even private investments in for pro
 - v. Notice 2015-62 can consider foundations charitable mission.

- vi. Not bound to choose investments solely for highest return.
 - d. Winding down.
 - i. Most foundations formed to operate in perpetuity but may want to wind down because assets diminished through grants or perhaps family lost interest. Some are organized as limited life foundation.
 - ii. Example Chuck Feeney “Big Bets” spending down foundation. Bill and Melinda Gates want to sunset foundation 50 years after their deaths.
 - iii. Must give advance notice to IRS and repay tax benefit or get abatement of tax through a private letter ruling. IRC Sec. 507(b).
 - iv. Transfer all assets to public charities is not a termination.
 - v. Roadmap on how to terminate private foundation by transferring assets to a public charity including a transfer to a DAF.
 - 1. After completing state mandated termination procedures.
 - 2. Comply with IRC Sec. 507.
 - 3. File final Form 990PF.
 - 4. Show no assets remain.
 - 5. Excise tax on termination but if no assets it is avoided.
 - vi. May desire to split foundation so different branches of family can handle separate foundations. This can be done without a termination.
 - e. Private foundations are the ideal philanthropic vehicle for many clients. Important to recognize that most of operating burdens on foundations are intended to prevent bad behavior and most clients, once educated about the rules, can comply. There are some situations where a DAF is better, others where a private foundation may be preferable. Some clients use both types of giving vehicles in tandem.
 - f. Three benefits
 - i. Accelerate charitable contributions sine deductible when made but retain control over ultimate charitable distribution. Similar immediate deduction is available for gift to DAF and since it is public better limits on deduction.
 - ii. Institutionalize family giving, structure and governance to assure perpetuity of family philanthropy beyond parent/donor’s life.
 - iii. Buffer between donor and grantees. Shift asks from donor individually to the family giving vehicle.
 - iv. Offer maximum flexibility and opportunity for donor and her family to retain control over governance, investments, and ultimate selection of charitable recipients.
 - v. Can pay reasonable compensation to family members who work for the foundation.
 - vi. Can invest in creative program related investments.
2. **Thursday: Morning: Settlements Binding IRS: Willms**
- a. Introduction.
 - i. Litigation – IRS is not at table in litigation when structuring modification or settlement agreement.

- ii. Parties could get private letter ruling but may not be efficient from a cost or timing perspective.
- iii. Two landmark cases.
 - 1. Commr. V. Est. of Bosch, 387 US 456.
 - 2. Ahmanson Found v. US, 674 F.2d 761.
- b. Duties of Personal Representative = PR.
 - i. PR could be executor or successor trustee on a revocable trust.
 - ii. PR must make distributions, marshal assets, file tax returns, etc. This includes unfiled income taxes, final return for decedent, unfiled gift tax returns, and an estate tax return. This is a non-delegable duty to file tax.
 - iii. What about paying tax? Executor is defined as anyone in actual or constructive receipt of decedent's assets.
 - iv. USC 3713(b) – looks like a complete absolute. PR is personally liable for unpaid taxes. Does IRS always get paid first?
 - v. Must go to rulings and court cases to get a complete picture. PR Is only liable if knew could not pay IRS and paid other debts or made distributions.
 - vi. There are exceptions to priority of IRS.
 - 1. Expenses of administration of the estate.
 - 2. Widow's and family allowance.
 - 3. Funeral expenses.
 - 4. These are debts that relate to assets that are carved off before estate takes hold of them.
 - vii. If executor makes distribution to beneficiary and then not enough assets to pay estate tax, then executor has personal liability.
 - viii. PR would have to get money back from beneficiaries. Likelihood of this is pretty slim. What about a refunding agreement? That may help but will the beneficiary have the funds left?
 - ix. Special estate and gift tax lien. Last 10 years from date of death.
 - x. Transferee liability -- the distributees may have liability. IRC Sec. 6901(a).
 - xi. State law comes into play as well. Must consider whether under state law if the IRS is a creditor. If IRS as a creditor can go after transferee. If so the matter will be bought in federal court but federal court will apply state law.
 - xii. Statute of limitations stays same.
- c. How to avoid fiduciary liability.
 - i. Tolling of statute of limitations. 3 years or 6 if substantial understatement but unlimited if fraud. Lesson is to file the returns and toll the statute.
 - ii. Form 4810 for prompt assessment. Can provide information required to accomplish the same? This shortens period to 18 months.
 - iii. Can request discharge from liability by filing Form 5495. Don't think that this raises audit issue, although some practitioners feel otherwise. This doesn't shorten statute of limitations but shortens period of time for which fiduciary can be held personally liable o six months for estate tax and nine

- months for other taxes. In that period of time the IRS must send notice of any deficiency in that time.
- iv. Spouse is not always executor. If spouse has not remarried the executor can file joint return with surviving spouse. Does executor want to do this? This will make PR jointly and severally liable with the surviving spouse.
- d. Controversies in which IRS is not party.
- i. Bosch case.
 - ii. Private parties cannot just state what they agree and have tax authorities follow it. Bosch says must look to underlying claim.
 - iii. In Bosch must meet state law requirements based on enforceable state law rights. IRS must follow ruling of state's highest court. If not, then must give proper regard to other state courts. Historically this is ignored by IRS but there are rulings where IRS will look at lower court holdings.
 - iv. 4 parts to the analysis.
 1. There must be a bona fide dispute. Doesn't have to be a war but it helps.
 2. Controversy that involves state law rights. A true right must exist under state law that supports result.
 3. You cannot get more than you should have gotten, i.e. What you are entitled to.
 4. Must be in reasonable range of outcomes had you gone to trial. Doesn't, however, require a trial.
 - v. In many situations it is difficult or impossible to get to the highest state court for a ruling.
 - vi. Carlson v. Sweeny Indiana case. Settlement had agreed order so could not appeal to highest state court. Legal malpractice action filed. Appealed it then to highest state supreme court. The supreme court acknowledged that they understood they needed order to bind them.
 - vii. Kansas if you have an appealable order you can shortcut to supreme court to bind IRS. In re Darby. This approach, however, can backfire. It was a trust modification issue and Supreme Court overruled lower court.
 - viii. Rev. Rul 73-142 – Regardless of Bosch if you have a lower court ruling that is contrary to another state court ruling if final and non-appealable IRS is bound by it. Be careful relying on this. Facts in ruling may differ from other situations. A trust modification was sought before death of grantor so grantor was involved in modification. Grantor had a “string” that would have caused estate inclusion. Consummated a trust modification to remove that string. The Rev. Rul. Recognizes that once have modification order that is final and parties are bound by it. Ruling hinged on fact that modification occurred prior to the event that triggered the tax, i.e., the estate tax.
 - ix. Reformation action – language relates back to beginning date of document.
 - x. Is there a gift or is it a sale/exchange treatment?
 - xi. By a settlement you cannot shift interests. If you do you may shift tax consequences as well.

- e. Fiduciary income tax.
 - i. Inheritances are income tax free.
 - ii. Fiduciary must track fiduciary accounting income and taxable income. What is taxable income and what is not.
 - iii. Is it income or principal. Read instrument.
 - iv. DNI rules determine what portion of distribution is taxable to the beneficiary or to the trust/estate. DNI rules endeavor to harmonize rules.
 - v. Any income that stays in the estate/trust the estate/trust pays the tax.
 - vi. Is bequest a specific sum of money or an asset?
 - vii. Separate share rule.
 - viii. If bequest is of income that beneficiary will receive and report income.
 - ix. *Harrison v. Commr.*, 119 F.2d 963. H required to set up trust for W to pay her income. W had option under state law to elect ½ estate. Settlement gave W specific sum of money. That amount affected delay in funding of trust. Court held that specific sum that correlated with state law election was tax exempt and excess over that amount that related to delay in funding was income to W.
 - x. *Getty v. Commr.*, 913 F.2d 1486. Siblings received income during their lives. It was held to be an inheritance and tax exempt.
 - xi. Is it in nature of income? A bequest for services that had not been compensated? May have to look “behind it” to see what made it up. What if bequest for services already rendered? Example \$10,000 to my long term caretaker. This is treated like a bonus and it will be income to the beneficiary but deductible by the estate.
 - xii. Will contest? If paid by estate may be deductible by the estate. But if beneficiary incurs the expense not deductible by them because inheritances are income tax free.
 - xiii. IRC 642(c) if governing instrument provides that income is to be distributed and permanently set aside and paid from gross income there will be a charitable income tax deduction. But governing instrument must state this.
 - xiv. Non-prorata distributions. If not a split of all assets, then may trigger gain to be recognized by beneficiaries. If it is supposed to be pro-rata and if distribute it non-prorata it is viewed by IRS a pro-rata distribution followed by beneficiary’s exchange interests which has tax consequences. State law or instrument may provide the support for non-prorata distributions.
 - xv. Basis considerations. There are exceptions to basis step-up, e.g. IRD such as retirement assets. An installment sale on which payments are coming in. IRD is income earned by decedent but not reported by decedent so tax not paid.
 - xvi. If trying to settle a trust funding claim what are basis considerations? Example a testamentary trust and it was not funded or fiduciary commingled assets (e.g., surviving spouse commingled).
 - 1. Debt approach. It is a claim for damages against the fiduciary for not funding. Fiduciary’s assets are used to pay the debt. There

should be a basis adjustment and a deduction when debt paid. Be careful that if use appreciated assets to satisfy a pecuniary bequest you may trigger gain.

2. Constructive trust approach. It is as if it has always been funded and fiduciary was just holding them.

xvii. Gift taxes.

1. Settlement of bona fide dispute transfer is deemed to be at full and adequate consideration so no gift.
2. Estate of Redstone v. Commr., 145 TC 259. Tax issues on settling family dispute. Dan and two sons in business owned 1/3rd of stock each. Edward has to put some stock in trust for his kids and rest is redeemed. IRS said transfer to Edward's kids is a gift. Discussion by Tax Court is subject to close scrutiny. If it is bona fide and no donative intent, it may not trigger gift. Was there a controversy involved? Was the value of the property substantial? Was there a desire to avoid litigation? Was it a real controversy or a collusive attempt to make it something it was not? Did taxpayer act as they would with a stranger? Edward did not get consideration from the children. Edward's transfer was part of a cold business bargain. Sumner, the good brother, as part of settlement he transferred assets into trust for his children. That was viewed as a gift. Sumner's testimony was that the transfer was donative.

xviii. If surviving spouse is involved, he/she may be willing to give up something in a controversy. Might that undermine the marital deduction? Who is a spouse? What about common law marriage? It is married. What of community property laws? If it is community property 1/2 of assets automatically go to surviving spouse perhaps leaving more on table.

xix. Is claim deductible? Must be bona fide, paid by estate, etc. May have to file Schedule PC as part of Form 706 and file later for refund.

xx. A charitable deduction may leave more on the table. Be cautious of split-interest gifts. Is the taxpayer just trying to get a charitable deduction?

xxi. Consider Hubert case and possible offset for estate transmission expenses.

xxii. Summary.

1. Bosch.
2. State law rights.
3. Cannot get more than entitled to.
4. Must get in the range of what you would get had you gone to trial.

f. Decanting

- i. Trustee exercises discretion and moves assets to new trust.
- ii. No ruling so no PLR.
- iii. Income tax issues.
 1. When assets move will it be treated as a continuation of the old trust?
 2. Do you change EIN?
 3. Contrast old trust terminates, distribution out to trust.
 4. Grantor to grantor trust – should be no income tax Rev. Rul. 85-13

5. Grantor trust to non-grantor trust. Look at whether this is a disposition.
 6. Non-grantor to grantor trust. Should not be a problem. That is not a recognition event. Only change is who is paying tax.
 7. Non grantor trust to non-grantor trust. Cottage Savings considerations. What are specific facts involved? Have entitlement become materially different than what they had before? Example they were entitled to income and made an annuity payment instead.
- iv. Gift issues.
 1. Was there a transfer for less than full and adequate consideration.
 2. What if beneficiary consents? Don't want involvement that would turn it into a gift.
 - v. Estate taxes.
 1. IRC Sec. 2036 or 2038 issues. If grantor not involved these should not be triggered.
 2. Has beneficiary retained a power of appointment?
 3. Has RAP been extended? Has DE tax trap been triggered.
 4. IRC Sec. 2036 or 2038 could be issue for beneficiary?
 - vi. GST Tax.
 1. Regulations provide guidance as to grandfathered trusts.
 2. Look for safe harbors.
 3. If non-grandfathered GST should be safe if use safe harbors.
 - g. Many tax issues with settlements and trust modifications. Look at issues early. Have litigation counsel get tax counsel involved early.
3. **Thursday: Morning: State Taxation Trusts: Nenno.**
- a. Trust tax myths abound.
 - i. My state has no income tax so state taxation of trusts doesn't matter. Clients will come with trusts that are taxable.
 - ii. My trust says NY law governs trust this means that the trust will be subject to NY tax forever. Myth because governing law is rarely relevant in determining where trust is taxable.
 - iii. If I'm the trustee and if I move to CA trust won't pay tax. Not true as CA taxes on residence of trustee.
 - iv. Taxpayers due win suits.
 - b. Definitions.
 - i. Resident trust – States tax all income of resident trusts. Definitions vary widely.
 - ii. Non-resident trusts – states tax only source income
 - iii. Source income – attributed to business activity, real property or tangible property.
 - iv. Exempt resident trust – some states treat trusts that meet definition of resident trust as non-resident in certain circumstances.
 - v. Trustor – taxed on all income of trust treated as grantor trust.
 - vi. Source income taxed by state where property is located or activity occurs.
 - vii. Non-source income – tax planning is for non-source income of non-grantor trust.

- c. Savings can be substantial.
 - i. NY resident trusts paid substantial tax.
 - ii. If trustee of trust created by CA resident incurred \$1M long term capital gain could save \$100,000 CA tax with non-CA trustee.
 - iii. Trust tax rates are compressed so trusts make larger distributions and try to include capital gains in DNI.
 - iv. State income tax – distributed ordinary income or capital gains may be subject to state income tax.
 - v. Non-grantor trust not subject to CA income tax would owe \$236,000 federal tax and no CA tax. But if distributed \$1M to CA beneficiary and elected to include long term capital gain in DNI beneficiary would have owed about \$108,000 CA income tax and \$204,000 of federal income tax. Thus, about \$108,000 CA tax paid for a \$35,000 approximate tax savings.
 - vi. IRC Sec. 645 election can result in treating trust as part of revocable trust as part of estate. If revocable trust is in FL and probate estate is in state that taxes income the election might subject that income to state income taxation.
 - vii. 8 states don't tax income of non-grantor trusts: AK, FL, SD, TX, WA, WY. TN only taxes dividends and interest. ND 2.9%, 12.696% in NYC, etc.
 - viii. Resident trust based on 5 criteria.
 - ix. FL and Texas have no income tax.
 - x. NJ, NY, PA tax using domicile or residence of the trustor. This is useful for non-residents to create trusts in those states.
 - xi. T. Ryan Legg Trust. Ohio case. Determined trust was non-resident trust.
- d. A trust is a relationship not an entity.
 - i. Trust doesn't pay tax only the trustee does.
 - ii. If state has no jurisdiction over trustee it cannot tax it.
 - iii. Trustees win
 - 1. Procedure irregularities.
 - 2. Commerce clause.
 - iv. Residuary Trust u/w/o Kassner v. Director Div. Taxation decision.
 - 1. NJ says resident trust is a trust created by testator domiciled in NJ. Died in 1998 and created trust in his will so met definition of resident trust for NJ purposes. In 2006 trustee lived in NY and administered the trust outside NJ. Court held trust was not taxable. In 2006 division of revenue had outstanding notice saying trust would not be taxed in this case.
 - 2. So the trustee was only taxed on NJ source income, not on all income.
 - v. Linn v. Dept. of Revenue, 2 NE3d 1203.
 - 1. Illinois trustor created in 1961 designated Ill. Law to govern. In 2006 no trustee or beneficiary were in Illinois and held no Illinois assets. Court held that trustor's domicile did not satisfy due process.
 - vi. McNeil v. Commonwealth, 67 A.3d 185.

1. PA classified trust created by resident trustor as PA trust. In 1959 PA domiciliary created PA trust. Corporate trustee was in DE and all administration took place in DE. 4 prong test in 1977 Complete Auto Transit Inc. v. Brady
2. Must have substantial nexus to taxing jurisdiction. Court noted that in Quill noted must have physical presence. Because all trustees and administration outside PA test was not met. The fact trustor and beneficiaries PA residents did not matter.
- vii. What does this all mean? Probably unconstitutional to tax a trust solely because trustor was resident. But if you end up in that state by probate proceeding you might lose so using revocable trust may be preferable.
- e. State taxation can be tax on 4 bases, resident of Trustor discussed above. Some states tax trust if administrated in the state.
- f. State attempt to tax nonresident trust Kaestner NC case.
 - i. Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Dept. of Revenue, 789 S.E.2d 645.
 - ii. Beneficiaries lived in state of NC but connection of NC to trust was held to be insufficient to satisfy the requirements of due process but the case is on appeal. GA takes a similar view of taxation. Other states consider the existence of beneficiaries in assessing tax.
- g. States.
 - i. New York.
 1. Most relevant cases and ruling are generated in NY
 2. Tax based on domicile of testator and trustor.
 3. Statutory exemption for an exempt resident trust. This is a trust with no NY state trustee, assets or source income. \$1 of NY source income might destroy exemption. Must file informational return.
 4. Maximum 12.696% rate.
 5. Recent changes. Throwback tax on distributions of ordinary income to NY resident beneficiaries in certain circumstances. Tax did not extend to capital gains. 2014-15 budget bill provided that an "ING" trust will be treated as a grantor trust in NY.
 6. Rice Case.
 - a. Named NYC attorney as trustee and he moved to FL. Trust qualified as exempt resident trust but trustee continued to file returns showing NYC firm and paying tax. When discovered trustee filed for refund for open years and those were issued but not for close years.
 - b. In the Matter of Joseph Lee Rice III Family 1992 Trust, 2010 NY Tax LEXIS 268.
 7. NYC resident trust can save \$103,000 in tax on \$1M LTCG if properly structured.
 - ii. DE.
 1. DE has an income tax.
 2. Resident trust is a trust created by testator or trustor domiciled in the estate or has one or more DE trustees.

3. A trust is taxed only if it has DE beneficiaries.
 4. Trustee does not have to file a return if no tax is due.
- iii. Mass.
1. Treats trust as grantor trust under IRC Sec. 671-678 not 679.
 2. Treats trust created by will of MA resident as a resident trust.
 3. An intervivos trust must have a resident trustee to be treated as a MA trust.
 4. Only taxes income attributed to resident beneficiaries.
 5. Beneficiary is resident if domiciled in MA or has permanent place of abode and spend 183+ days in MA.
 6. Residence for corporate trustee is not defined by statute. In *Bank of American v. Commr. of Revenue*, 54 N.E. 3d 13. Resident if maintains established place of business where it conducts business more than 183 days in tax year. Technical Release 16-14 interprets this case.
 7. Consider if MA individual moves out of MA and wants to name a MA trustee should revoke trust and create a new trust.
- iv. NJ.
1. Structure trusts to qualify as exempt resident trusts.
 2. Create separate trusts for NJ and non-NJ beneficiaries.
- v. Ill.
1. Taxes testamentary trusts created by Ill. Domiciliary and intervivos trusts created if trustor domiciled in Ill. When became irrevocable.
- vi. CA.
1. Follows federal grantor trust rules.
 2. Non-grantor trusts taxed at rates up 13.3%.
 3. Resident trust defined in two ways: if it has resident fiduciaries or resident non-contingent beneficiaries. If in state for other than temporary or transitory purpose deemed a resident for this purpose. Resident individual fiduciaries can escape tax by delegating responsibilities to non-resident corporate trustees. A non-resident trustee that has discretion to make payments to resident CA beneficiary can postpone taxation until distribution is made.
- h. New trusts.
- i. Consider state income taxation when planning. Easier to eliminate tax initially then to pry refund out of an estate.
 - ii. A trust created by resident trustor, and if state taxes on this basis, try to fit into exemption for exempt resident trust. If there is no clear exception move or don't do it. Moving is the only way to be sure to escape tax without a constitutional structure. If not don't use a testamentary trust. Create and fund a revocable trust in another state during lifetime this may enable client to escape income taxation that would otherwise be paid on probate assets.
- i. Existing trusts.
- i. Look at trusts paying state tax and see if tax can be eliminated.
 - ii. Changes may require court involvement.

- iii. Taking action to reduce income tax won't create problems for a GST grandfathered trust or to which GST exemption has been allocated.
 - j. Other issues.
 - i. Navigating state taxation of trust income is complex. You might request a ruling from state tax department.
 - ii. If that is not an option continue to pay tax
 - iii. Continue to file returns and pay tax but request refunds.
 - iv. File tax returns reporting no tax is due and fully disclose why and segregate funds to pay tax, penalties and interest if you lose.
 - v. Stop filing returns.
 - k. Long term trusts.
 - i. 31 states permit long term states.
 - ii. Avoid Arizona, Nevada, Wyoming whose constitutions prohibit perpetual trusts.
 - iii. **Comment:** The above is one of many points on which experts taking differing views. See "Steve Oshins on Bullion Monarch Mining, Inc. v. Barrick Goldstrike Mines: Unconstitutional Perpetual Trusts - Not So Fast Says the Nevada Supreme Court!" (LISI Estate Planning Newsletter 2297) which describes Nevada's Supreme Court ruling that the law in Nevada is in fact 365 years. Other areas for which experts hold opposing views include the use of BDITs, seed gifts, the receptacle for defined value mechanism and so forth.
- 4. **Thursday: Morning: Impact Investing: Gary.**
 - a. Introduction.
 - i. Impact investing
 - ii. Effect on portfolios.
 - iii. How fiduciary duties play into all of this. How do fiduciary duty rules affect impact investing?
 - b. Definitions.
 - i. Problem is that there are no agreed/set definitions.
 - ii. Some people create new terms for marketing purposes, e.g., "green investing."
 - iii. Original term was "socially responsible investing" but have pulled away from this because of some negative connotations. This term developed before Apartheid. Came into wider use when SRI = socially responsible investment funds screened out companies that invested in South Africa. Used negative screens and moved those companies out of the portfolio. It was a political not financial decision.
 - iv. SRI funds developed around sin stocks: alcohol, gambling, weapons and tobacco. These funds still exist.
 - v. ESG – environmental social and governance. Referred to as ESG integration. Take traditional financial analytics and use with governance, social and environmental factors to reach results. Goal is to invest in a more socially responsible way but also to improve financial returns. There is no cost to investing in ESG but there may be a benefit.

- vi. **Example:** Look at BP Oil to see if they have good social practices, e.g. labor practices. Before deep water horizon BP was screened out because there were problems with how employees working and environmental issues so ESG funds avoided BP. There was a huge financial implication of deep water horizon to BP so the ESG funds that avoided it benefited. So avoiding companies with bad labor/safety records may be a good investment screen.
 - vii. **Example:** A company builds widgets and has a factory overseas and use sweat shop labor and have poor conditions. But if there is a factory fire the company may suffer significant reputational damage so avoiding them may provide social and investment benefits.
 - viii. What types of processes are used? The metrics are still less traditional.
 - ix. ESG integration and SRI more broadly does not necessarily result in a financial cost. But there has been an assumption that SRI would have had a negative investment impact. That assumption was based on a lack of data as to the performance of socially responsible funds. At core of modern portfolio theory is diversification. Financial restrictions are OK but a non-financial restriction on a fund would have a negative economic impact by reducing the universe of investments. Link between negative screens and diversification has led to an assumption that this leads to a financial hit. Therefore, it is inappropriate for a fiduciary to use SRI because of this negative. Overall there is no negative result. Studies have confirmed this.
- c. Fiduciary duties.
- i. Individual can invest however they wish to match their values. But is that appropriate for a fiduciary?
 - ii. Prudent investor standard has evolved to include ESG and SRI if done thoughtfully.
 - iii. When the uniform prudent investor act was promulgated UPI “no form of social investing is consistent with the duty of loyalty if the investment activity entails sacrificing the interests of trust beneficiaries by accepting below market returns.” The fiduciary duty is to act in the best interests of the beneficiary. This comment was based on an assumption of below market returns.
 - iv. Consider fiduciaries for charities versus for private trusts. A fiduciary for a charity is operating to carry out the mission of the charity and for a charity the SRI may relate to the purpose of the charity.
 - v. Notice 2015-62. Good read on how IRS views this area. UMIFA. Notice says SRI is not a jeopardizing investment for private foundations.
 - vi. For a charity it may be able to align its mission with investing. But for a private trust it may be different unless settlor has indicated purpose of trust is to align trust investing with settlor values. How does mission relate to investments? For a private trust is only mission to benefit beneficiaries with financial returns? Must show that engaging in ESG investing is prudent under UPIA or UMIFA.

- vii. DOL issued a bulletin focused on duties of those managing ERISA funds. That bulletin discusses use of factors that relate to financial performance. Issued because a prior bulletin said could look at factors only if improved performance and this was viewed as limiting consideration of ESG factors. The newer guidance established that using ESG factors could be considered. Purpose of those pension/ERISA funds is the beneficiary of those funds those goals are important and extraneous social issues should not be taken into consideration, but ESG may be considered and won't be a breach of fiduciary duty if have economic merits.
- viii. Alternative, instead of screening companies out invest and engage in shareholder advocacy.

5. **Thursday: Afternoon: III-C: Sophisticated Estate Plans: Porter Eastland.**

- a. Make transfers but without incurring gift tax in light of repeal.
 - i. Audit rate on gift tax is 1-2% so even if you believe you don't have a gift tax incurred on a transaction, report it and adequately disclose it and address 2704 disclosure.
 - ii. Get statute of limitations running.
 - iii. If structured properly, there should be no gift tax owed.
 - iv. If gift tax statute of limitations has not run IRS may audit it well into the future. Also, if statute does not run the donee's statute won't run. 6901 and 6324(b)
 - v. US v. Marshall, 798 F.3d 296 296.
 - vi. Donee's liability for donor's gift tax is capped at the amount of the gift. So if there is a \$20M gift that limits the donee's liability for gift tax. There is a split in the circuits if that is overall cap or whether it includes interest or not. 11th circuit says interest is not capped. IRS has discretion to choose who it goes after for tax. So if there are, subject to 6901 limitations, three donees, IRS can go after just one.
- b. All ideas have considerations.
 - i. Considerations = disadvantages.
 - ii. There are alternative structures.
- c. Sales to defective grantor trusts.
 - i. "I think this is one of the best techniques out there."
 - ii. Grantor trust status can shift a lot of wealth whether or not use discounted assets.
 - iii. Hard to value assets can be used to leverage the technique.
 - iv. IRS has gone after these transactions: Karmazin, Woelbing, etc.
 - v. **Example:** Create grantor trust for kid. Sell LP interest H and W own. Make seed gift to the trust. Some use LP interests to make seed gift using unified credit of \$5M. Then sell interests into the trust say worth \$45M.
 - vi. Issues with the above transaction.
 - 1. What is FMV of interest given?
 - 2. What is FMV of interest sold?
 - 3. Pierre case is relevant in this context. If giving LP interests and selling LP interest should not matter but in Pierre gift and sale to defective grantor trust of LLC interests. 9.5% interest given and

- 40.5% interest sold IRS said value was incorrectly. IRS claimed since same day transaction they should be valued as the same aggregate value. Taxpayer did well in case as IRS did not put up valuation evidence. What if that 50% interest had right to liquidate that 40.5% right did not have? Could have very different results.
4. Put time between date of seed gift and later sale of LP interests. I prefer 30 days. 60 days is better. The longer the better.
 5. What is the FMV of the consideration received? This was an issue in Woelbing. Taxpayer argued that under 7872 is that it should be valued at face. But IRS says 7872 is an interest rate safe harbor and doesn't address whether the note is properly secured, the ability of trust to pay, etc. If instead you have a seed gift of cash or other assets, these additional steps may reduce this risk.
 6. Is it a deemed retained interest? General rule of thumb is 10:1 debt to equity.
 7. Karmazin challenged this but backed off. Dallas case.
 8. Some practitioners like to use a guarantee instead of a seed gift. That might be OK but what is financial wherewithal of guarantor. Typically guarantee 10% of note. If not good for it the guarantee may be illusory. Also, under state law guarantee has teeth. In one case in 2008-9 company value plummeted so assets in trust could not satisfy obligations to mom and kids were guarantors of the note. They restructured the transaction and guarantees forgiven an IRS audited and claimed Mom made gift when sold assets and a second gift was made in 2009 when she forgave the guarantees sons had made. Guarantees work but they have real world implications clients must be aware of. For a guarantee to provide substance to the transaction there should be an ability to pay. Should pay guarantee fee.
 9. Big 2036 Schauerhamer case. IRS tried to ignore LP and bring all back into estate because of bad administration.
 10. Little 2036. If I sell LP interest into the trust for a note and what is used to pay the note are distributions from the LP just sold the IRS will argue that donor/seller has retained interest in LP interest sold. This arises in particular where there is a circular flow of funds via distribution from LP to trust and from trust as interest on note to donor/seller.
 11. Exception to 2036(a)(1) is bona fide sale for full and adequate consideration. Consider step-transaction issues. See the Pierre case. Makes it difficult to satisfy applicable consideration test so space out seed gift and sale. Use a formula clause based on values as finally determined for gift tax purposes. Easy to avoid (a)(1) taint if use distributions to pay note make the distributions from the LP at different times and in different amounts than the note payments.
- vii. Possible solutions to issues with sale to grantor trust.
1. No basis step-up on assets in the irrevocable trust.

2. To avoid 2036 and 2038 arguments. Instead of seed capital make contribute assets to a single member LLC. Take back managing and non-managing interests and a debt equal to 90% of the FMV of assets contributed.
 3. Have a grantor trust own some percentage of LLC so it is disregarded for tax purposes but has two members for state law purposes.
 4. At a later time transfer LLC interests.
 5. If IRS attacks notes, try to use authorities for the validity of the note.
 6. If lose on the debt characterization (e.g., too much leverage) the downside is that is not a retained interest in the trust it is instead a retained equity interest in the disregarded member LLC. There should be nothing taxable in the estate except that portion, not the entirety of the trust. May help deflect a step-transaction challenge.
 7. Hard to turn a grantor trust on and off so perhaps the power to control the tax consequences should not rest with trustee. Even if the power rests with an independent person to turn on/off don't you always have that power? With the disregarded LLC you can turn off the disregarded LLC status by making it into a straight up partnership.
 8. What about basis step-up? If you have low basis assets in the trust have grantor purchase the assets back to pull them back into the estate? You don't have to use the AFR use higher FMV rate. You get a step up in basis and since estate owes note to trust the value remains outside the estate. Rev. Rul. 85-13.
 9. What is trust's basis in note?
 10. Consider bank financing?
- viii. How to get a hard to value asset from G1 to G2 with defined value.
1. Spillover to:
 - a. Use charities in the planning.
 - b. Have a formula to kids trust and excess to charity.
 - c. Marital deduction trust with independent trustee.
 - d. Excess to a GRAT.
 - e. Defined value as finally determined for gift tax purposes going to charity is best option. Petter and Christiansen. Watch excess holdings and private inurement rules.
 - f. Using a lifetime QTIP or GRAT works just as well.
 2. Spillover trust or charity should have skin in the game and an incentive to audit the transaction, not merely wait for the excess spillover.
 3. Wandry Tax Court in memo decision said it worked. IRS has not acquiesced to this result.
 4. King case with consideration adjustment – selling \$10M of units based on values as finally determined. Adjust consideration with

interest. 10th Circuit blessed this type of clause but mixed results in negotiating with the IRS.

5. Include a formula disclaimer wherein the trustee doesn't except anything that they are entitled to.

d. Reporting.

- i. Report transaction consistent with the transaction.
- ii. File a gift tax return or you can never have a "value as finally determined for gift tax purposes."
- iii. Reflect in gift tax schedules that this is a transfer of a specific dollar amount. You can say that initial estimates based on attached appraisal is X number of units.
- iv. Include 2704 disclosure.

e. GRATs.

- i. What can go wrong?
- ii. May GRAT audits. Why?
- iii. IRS is looking at compliance with GRAT regulations and terms of the agreement. One of the regular questions do the terms of the agreement comply with the 2702 regulations? Prohibition on commutation of annuity interest.
- iv. IRS will ask for proof of annuity payments.
- v. Was methodology used to value distributions the same methodology used to value gift into the GRAT. What if discount was too high so that the annuity amount was underpaid in kind. That is a deemed new contribution to the GRAT that could undermine the entirety of the GRAT.
- vi. Atkinson analysis.
- vii. Grantor has power of substitution.
 1. IRS has taken position of mismatch in asset values.
 2. Consider a built in formula so if there is an adjustment for values as ultimately determined. Or use a Wandry formula in the payment documents.

f. Disregarded LLC.

- i. LP formed with financial assets.
- ii. Private equity and cash put into LLC.
- iii. Note at short term rate back to client.
- iv. Client takes non-manager interest.
- v. Hard to value asset.
- vi. Might get two levels of discounts.
- vii. What is effect of leverage?
- viii. Use GRAT for hard to value assets as the revaluation clause is automatic.
- ix. No discount on cash but cash may cover annuity for GRAT term so no need for additional appraisal. That is a significant advantage.
- x. Contributed leveraged LLC to the GRAT. Double leverage.

g. BDIT.

- i. No seed gift but a guarantee of note by third party.
- ii. Typically, guarantor is a trust.
- iii. Beneficiary treated as owner of trust for income tax purposes.

- iv. Doesn't see gift tax risk but sees estate tax risk. Is there evidence that transferor (beneficiary in this instance) retained the right to possess or enjoy the property sold or the income from the property sold to the BDIT?
- v. Some planners have suggested that clients can sell into BDIT and have whatever access they want. This will be more problematic if client conducts themselves in this manner. 2036(a)(1).
- vi. 2036(a)(2) did she retain right to designate who will possess or enjoy property. The LPOA is implicit in the structure.
- vii. A defense to this is a transfer that is a bona fide sale for full and adequate consideration. Two components:
 - 1. Full and adequate consideration – if you miss by a little you may miss it completely. If you take aggressive approach to valuation the greater the chance that this test will be difficult to meet. You might use a formula clause to help meet this. That might help. IRS may open up valuation issue.
 - 2. Is it a bona fide sale? In LP area case law says you need a legitimate non-tax purpose. Wheeler and Ambrosia. Do you have a real transaction? Did you really give up assets transferred? IRS may argue that the transaction is illusory. A lot of this may depend on marketing materials and power points as to how this is used.
- viii. In court the judge may ask the donor of the \$5,000 whose idea was it to set up the trust. The donor well may be put on stand. Tough questions will be asked. Whose trust was it? Where did the money come from? Who was the lawyer that represented you? The lawyer may be on the witness stand and the power points used to explain the transaction is not privileged. If the beneficiary stands on both sides of the transaction that may undermine the plan.
- ix. The transaction has a lot of risk associated with it. **Comment:** Other experts view the BDIT, properly one, from a different risk lens.
- h. Non-Compliant preferred partnerships.
 - i. You can make it a non-cumulative preferred interest if you have sufficient exemption.
 - ii. What if it is a single member disregarded entity with a non-compliant preferred interest.
 - iii. Sell \$50M to trust.
 - iv. Have rights of creditor instead of beneficiary. Have non-compliant preferred interest.
 - v. Self-settled trusts.
 - 1. Grantor trusts.
 - 2. Why not sell preferred interest into this type of trust?
 - vi. Sell into non-reciprocal trusts.
 - vii. Many ways you can get to so that client has investment control and no issue of running out of money. Give spouse LPOA.
- i. Intergenerational split-dollar insurance.
 - i. Mom puts cash into GST generation skipping trust.

- ii. Can put money into GST grantor trust and trustee will use it to buy life insurance on her son.
- iii. recital in agreement that it is only intended as an economic benefit arrangement.
- iv. Trustee has no access to the cash value.
- v. Mom pays all premiums until her death or child's death.
- vi. Contract is freely transferrable so Mom can get rid of it at any time. Prohibits mom from having access to cash value of the life insurance. But the charges may be paid
- vii. Contract prohibits mom from unilaterally terminating the contract. She must have trustee's cooperation.
- viii. Hoped for results life insurance proceeds are income, estate and GST tax free. But the mother's rights might be severely discounted because on her side of the contract she cannot be paid until the son dies. All she gets back is premiums paid.
- ix. Morrisette, 146 TC 11 – strong business purpose.
- x. 2703(a)(2) is this a restriction on the right to sell insurance contract? This would be analogous to the old FLP cases where IRS argued that the LP agreement was itself a restriction on the right to sell the interest. But with the insurance contract these are state law property rights.
- xi. Should you use GRAT for note?
- j. Private annuities and SCINs.
 - i. Private annuity is a technique many use.
 1. Private annuity can insure that grantor/seller's consumption needs are always met.
 2. Risk from an estate tax perspective if transferor outlives life expectancy added value to the estate. Could make annuity payments terminate on shorter of a term of years or annuitant's life. Term can be more than mortality but it does provide a limit.
 3. If selling into a trust to comply with 7520 need some equity.
 4. Must have 50%+ chance of surviving one year or in fact lives 18 months. Issues arise if in poor health and in fact dies shortly after doing the private annuity transaction. Issue is then whether or not the senior family member was terminally ill at the time the transaction was consummated. Be certain to obtain physician letters. Notices of deficiencies often include penalty assessments.
 5. Need to use a grantor trust.
 6. Note proposed regulations.
 - ii. Self-cancelling instalment note (SCIN) technique.
 1. With a SCIN you have an installment note for a term of years. If debtor dies during term of note it is cancelled.
 2. Issues are that because of the mortality feature the payments under the note must be greater than under a regular promissory note.
 3. Issue in Davidson case is whether you can use the 7520 tables with respect to the note. IRS took a tough position that you could not. Mr. Davidson created SCINs that were balloon payment notes.

Argument was that you could use tables because he had greater than 50% chance of surviving one year. IRS argument was that Mr. Davidson's actual life expectancy was 2.5-4 years so they argued that these are balloon notes and because all payments were due end of 5-7 years the notes were illusory.

6. **Thursday: Afternoon: IV-D: Malpractice Protection: Snyder, Campisi, Uzcategui.**
 - a. Davidson case.
 - i. SCIN case generally taxpayer friendly.
 - ii. Davidson owned Detroit Pistons. Died and audit assessment was \$2.6B+ and settled for \$600M.
 - iii. Fiduciaries sued estate planners for failure to provide reasonable and appropriate advice and for failure to prepare a defensible plan.
 - b. Risks.
 - i. How much of valuable work as professionals is done in gray area. How do we protect ourselves? There are no guarantees.
 - ii. Other gray areas. Who is our client and is there an issue?
 - iii. What about changes in the law after our plan?
 - iv. What risks do we take as practitioners?
 - v. What ethical issues surround the practice?
 - vi. What can practitioners do to protect themselves?
 - c. Walk through hypothetical of what can go wrong.
 - d. Prior to accepting a new client – pre engagement.
 - i. A lawyer should be judged not by the client he has but rather by the quality of clients he turns away.
 - ii. Not taking a bad case could be every bit as important as taking a case.
 - iii. Every attorney should have authority to turn down a case if it protects the firm.
 - iv. Look at the cost to a practitioner of taking a potentially poor cases/client. Lost time and unbillable time dealing with an unhappy client. Lost focus on good clients.
 - v. How can we screen clients? What type of due diligence should we do on a client?
 - vi. How many lawyers have they had/fired?
 - vii. If client has significant assets overseas what issues might this suggest?
 - viii. Consolidated search programs that can be used. Lexis Nexis Accurint product for \$20 get info on background, holdings, etc.
 - ix. How do you manage due diligence information?
 - x. Have a written policy on what due diligence you do so that no client can claim they have been signaled out. Get client permission in writing to do the due diligence. Perhaps include it in the engagement letter.
 - xi. Have a policy on what information is actually kept in the file and how do you dispose of information that is not relevant. May not want information in file that may be embarrassing to client.
 - e. Taking on the client – Engagement letter.

- i. Do you need an engagement letter? Depends on jurisdiction but ABA Model rules (adopted everywhere but CA) don't absolutely require engagement letter in all circumstances.
- ii. Engagement letters are not required but are preferable. Only requirement is fee is reasonable.
- iii. What do you want in the engagement letter?
- iv. If will represent more than one client what should be in the engagement letter? What if attorney for multiple generations? What if representing groups of beneficiaries.
- v. What are your ethical obligations when entering into a joint representation
- vi. Model Rule 1.7 joint representation is prohibited when there is concurrent conflict of interest. Can proceed if lawyer believes he or she can provide competent and diligent representation to all clients, the representation will not be prohibited by law, the representation does not involve the assertion of a claim by one client against another, and they each give informed written consent, which means an engagement letter. The clearer the explanation the more likely the consent will be found sufficient.
- vii. Sample clause: "Because we are representing more than one client it is conceivable that conflicts of interest may arise between you. Although we perceive no such conflicts existing at this time. In such event, since we owe each of you an undivided duty of loyalty, we would not be in a position to advocate the position of one of you versus the others, but might be required to withdraw from the engagement, absent your fully informed joint consent to our continuing to represent you. In no event, however, will we represent one of you against the other should disputes arise amount you. Only in this fashion can we insure that our ethical responsibilities to you jointly are met in full."
- viii. Must address how you will treat confidential information between clients. ATEC suggest that clients agree that all information be shared. Some state laws address this matter. If not, counsel may have an issue later if learn something from one client that she wants to keep from someone else. Attorneys have undivided duty of loyalty to each client. Without an agreement what can be done? Counsel has an obligation to keep W's confidences but has obligation to H to disclose significant events during representation. Have agreement up front that any information you obtain can be freely shared.
- ix. What if someone else pays fees, e.g. a parent for a child or one of a group pays for all (e.g. one sibling pays fees for all). That doesn't change the duties counsel has to the non-paying clients. You can accept compensation from another if there is no interference with counsel's judgement and you have consent. If mom pays legal fees for kid that does not give her right to communications about kid.
- x. What happens if you might change engagement after you have begun? Initial relationship is presumed to be an arm's length transaction. Once you start the relationship will the change violate the fiduciary duty? How

- do you prove subsequent engagement was not a product of undue influence. Remember it is hard to prove a negative.
- xi. If client is bequeathing bequest to pool boy 23 states require reporting suspected elder abuse. Do you see evidence of undue influence? Banks, SEC and other institutions compel reporting elder abuse and impose a standard of care.
 - xii. Watch conflict of interests. If selling property from one generation to another generation be worried not only about IRS but that someone may accuse you of representing people on both sides of the transaction? Did you make disclosures of conflict and get a waiver? Be mindful that someone might make a claim in the future.
 - xiii. If one of clients is paying bill others may assume favoritism. If you cannot agree to have all be responsible for fees what might counsel do? What if one of the beneficiaries stops paying? Can you fire them? Should have that if you terminate one client that client will not object to your using information to help remaining clients and that they will not object to use of confidential information.
 - xiv. What if have multiple clients? Should lawyer be able to act by majority rule? Should address what would happen if they cannot agree. Might a special trustee or another procedure be useful?
 - xv. Document that there was an effective conflict of interest waiver signed by the people impacted.
- f. Expert certification.
 - i. Some states look at certified expert as any other expert. Same standard. Other states require a higher standard of care from someone who holds themselves out as an expert to a higher standard of an expert. Will you have to meet that heightened standard of care?
 - g. Conflicts of interest.
 - i. If conflict is known and appreciated by settlor then there may be an implicit waiver of the conflict.
 - ii. UTC 802 speaks to how to deal with conflict and whether there is a presumption of breach of fiduciary duty.
 - iii. In planning estates some may take over fiduciary functions such as looking at prudence of a transaction. There may be a claim that counsel doing this role may have taken over financial matters and may have taken upon himself a fiduciary responsibility.
 - iv. See, Section 9 of UPIA uniform prudent investor act.
 - h. Kovel Letters.
 - i. A Kovel letter is advice you seek from a CPA to assist a client dealing with tax matters. How can you get this to be privileged because that transaction may be scrutinized?
 - ii. Kovel principal from Federal 2nd Circuit case the role was analyzed as the CPA being an interpreter assisting the attorney in carrying out his duties.
 - iii. Problem is that the 2nd Circuit issued other decisions, like the Cavallaro v. US 284 F.3d 236 case. Court held that there may be a fraud exception

- involved so must produce documents. CPA firm was actually working for the son and was not helping the estate planner for the parents.
- iv. Suggestion is to use a new CPA not the one that has been used for 10 years.
 - v. Attorney client privilege does not work if crime or fraudulent conduct is involved.
 - vi. *Cohen v. Donald J. Trump*, 2015 WL 361714 (SD CA). In this case addressed whether there was fraudulent conduct in operation of Trump University. Required production of a variety of documents because a case of fraud is made.
- i. Change in the law.
 - i. What if regulations or other change may affect past transactions?
 - ii. What can practitioner do? Attorney has ethical obligation to keep clients informed of significant change in the law.
 - iii. Sooner lawyer advises client of potential problem the better. Note that rules may always change.
 - iv. Did lawyer raise possibility that rules may change?
 - v. Can lawyer give concrete advice as to options? Show that you are protective and protective to help client in light of unsettled waters (i.e., law changes).
 - vi. What if there is talk at conferences about potential changes in the law? Might that have made it necessary to draft a different plan? No, but may have had a duty to disclose issues and perhaps options.
 - vii. If there had been “talk” of change then more important to send letter to client.
 - viii. All of this is more important if counsel is considered a specialist and should be held to a higher standard of care.
 - j. Multiple Generations.
 - i. Some have a lot of money and others do not. What are pitfalls?
 - ii. Who are people involved and what is their initial status before you make planning changes? For example if all assets controlled by parents or in their revocable trusts they can change anything they want. This is important as noted above so that if transfer is made to trust with inherent conflict then they may impliedly waive it.
 - k. *Heine v. Neuman Tennenbaum*, 856 F. Supp. 190 (SD NY 1994).
 - i. Brother lost money so look for deep pocket, the attorney and CPA.
 - ii. Advice did not stop when estate plan done. They assisted in business and the professionals were involved. Mom sued saying the advisers did not inform her of what was going on and they were still her attorney.
 - iii. \$9M+ of damages.
 - iv. Lawyer may have duty to warn clients if viewed as family attorney. Client may have reasonable belief that you are family attorney.
 - l. What practitioner should do if sued for malpractice.
 - i. Can children sue? Depends on state law.
 - ii. Think about defenses in advance as need to document what has been done in the moment to educate clients.

- iii. Counsel should document protective steps at the time they are being done.
- iv. Judgmental immunity or protection.
 - 1. Uncertainty in the law.
 - 2. Attorney who acts in good faith and his advice is well founded and in best interest of client is not liable for mistake in judgement or for matter for which reasonable doubt might be entertained by lawyers.
 - 3. Must act in good faith and in client's best interest.
 - 4. Attorney is not answerable for mere error in judgment. If law is unclear lawyer should not be liable for making a judgment call.
 - 5. If act reasonably based on law at that time should not be liable because of a change in law.
 - 6. Lawyer should not be held liable for a mistake in the law if the issue is not settled in the law and if the issue is in reasonable doubt among lawyers. Whether the law is settled can be established by different experts.
- v. Should judgmental immunity apply? Was lawyer's advice at the time based on exercise of informed judgment?
- vi. Cases concerning whether spouses' s pension was community property and whether and how it would be distributed in divorce. One lawyer said H's pension was not community property and years later court held it was. W's sued lawyers. Court found attorney had failed to do necessary research to educate himself. Even with an unsettled area of the law attorney had obligation to do research. *Smith v. Lewis*, 13 Cal. 3d 349.
- vii. In another case attorney showed that he was aware of relevant literature and attorney was protected because of documentation.
- viii. Some suggest client sign a letter acknowledging understanding of situation. This is more important in state where heirs can sue attorney.
- ix. Statute of limitations defense.
 - 1. Tolled until representation to be concluded.
 - 2. What does this mean when representation is concluded? Client should have knowledge that attorney was not providing no more legal services.
 - 3. Lawyer should send closing letter and statute of limitations starts.
 - 4. Davidson case mentioned at beginning of program addressed this. In August of 2016 at trial court level decided in favor of estate planning team. But it was decided on a statute of limitations technicality. When entered into engagement letter it said any action brought against the estate planning team had to be brought within one year of the conclusion of representation. Court found representation ended when Mr. Davidson died. The fiduciaries engaged advisers with new engagement letter with new scope so statute of limitations started. One year from date of death closed/ran.
- x. Advice client to seek legal advice before signing engagement letter.
- xi. Binding arbitration.

1. Waiving right to trial by jury.
 2. Waiving right to appeal
 3. Waving road discovery.
 4. Client could pay significant upfront costs.
 5. Client still can make disciplinary complaints against the attorney.
 6. Client should speak to independent counsel before signing.
 7. Client should be fully informed as to types of claims that will be submitted to arbitration.
 8. Arbitration provision was included as an addendum without a provision for client to sign so court did not find in Batof case that no evidence existed that client read clause let alone understood it.
 9. Batof v. Widin (No. 2014102350).
- m. Malpractice coverage.
- i. Review policy.
 - ii. Analyze role you were playing as family attorney to determine if role is purely as attorney or if you were doing more.
 - iii. Do you have coverage for claims made at former firm? Did you get a tail policy before you left? Don't want to start at new firm and discover you have an occurrence policy and you don't have coverage at prior practice.
 - iv. Insurance company wants you to report any problem right away.
 - v. Insurance company may be able to assist in working it out with client before something goes on public record.
 - vi. Aiding or abetting or colluding with a fiduciary. Lawyer is assisting in operating trust. Is your role strictly as professional giving advice or have you transmuted into doing other things?
 - vii. Pierre vs. Lyman case in CA. Attorney is representing trustee after settlor died were they liable for conduct of bad fiduciary? Court rule was if you do not have independent duty to disclose or independent duty to the parties involved, and all you are doing is being the CPA or attorney, then there should be an exception and professional should not be liable. There were omissions and attorney obtained an interest in the transaction involved. So because of personal interest in the transaction that removes lawyer from protection of exception. Must be careful.

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Steve Leimberg's Estate Planning Email Newsletter Archive Message #2505

Date:13-Jan-17

Subject: Marty Shenkman's Meeting Notes from Heckerling 2017, Day 5

Heckerling Institute 2017 – Friday Day 5 Notes

By Martin M. Shenkman, Esq.

The following are rough draft meeting notes prepared at the 2017 51st Heckerling Institute on Estate Planning sponsored by the University of Miami School of Law, and published in Leimberg Information Services, Inc. (LISI). These notes were published within a very short time of the conclusion of the proceedings and could not have been reviewed in order to be completed so quickly. There are no doubt errors, typos, etc. in these notes none of which should be attributed to the presenters. LISI obtained special permission from the Heckerling Institute to publish these notes. Bear in mind that no notes appear below on more than 20 concurrent and other sessions. These sessions can be purchased from the source listed below. The final papers presented at this year's Heckerling Institute can be obtained from Lexis Nexis. For recordings of the sessions contact Convention CDs, Inc. 800-747-6334.

1. Friday: Morning: Social Security: Frolik.

- a. Social Security.
- b. Old age survivor's disability insurance program.
- c. Pays benefits to 60M people.
- d. Benefits three groups.
 - i. Retired workers.
 - ii. Disabled workers.
 - iii. Derivative benefits – e.g. spousal benefits from being or having been married to a worker.
- e. It is a lifetime benefit with COLA. It is almost a two life annuity because of spousal benefit to your surviving spouse if you die
- f. Pay tax on income up to \$127,200 which is inflation adjusted. This cap reflects cap on benefits. Maximum benefits are supposed to replace 25% of maximum wages subject to Social Security. If retire at 66 would get about \$33,000 in benefits.
- g. Benefits percentage of income replaced increases as income declines. Lower earners can get up to 40% of wages. Higher income earnings get a lower percentage but more dollars.
- h. You need 40 quarters = ten years of earnings.
- i. Full retirement age is age at which get full benefits. For those born up to 1953 age 66 is full retirement age. Afterwards it increases.

- j. To get Social Security you must apply in person or on line.
- k. Although you can get Social Security at 66 you can claim it at age 62. That is still the most popular age at which people claim Social Security but you reduce your benefits by 25% over a lifetime. It is a monthly calculation The longer you wait the more the benefit up to the cap. If you wait until age 70 you get an increase. If you wait from 66 to 70 get a permanent 8%/year (actually a monthly calculation). If you were getting 30,00 at 66 you would get about 40,000 if wait until age 70.
- l. In 2015 maximum benefit was about \$24,300 if took at 62, at 66 \$32,000 and if waited to 70 \$42,000. You can go on line and get a calculation of your benefit. If you take your benefits at age 62 you get a permanent reduction but also if you have earnings in excess \$16,920 (2017) you have an earned income reduction, \$1 reduction for every \$2 of earned above \$17,000.
- m. Spousal derivative benefit. Began in 1930s when most households were single income families and most spouses were “stay-at-home” most of their lives and had little earnings.
- n. Restricted application. H and W. H is 70 and W is 66. At age 70 H deferred taking benefits. At age 66 W can file a “restricted application” for Social Security. At 66 H’s benefits are 3,000. W’s also 3,000/month. W can take a spousal benefit. If W files regular application her benefits are more than 50% of H’s. Restricted application is filing only for spousal benefits, not based on W’s work record. W’s benefits will be lower, \$1,500/month based on H. Her benefits grow 8% to age 70. So W gets \$1,500/month 66-70 and a bigger benefit at age 70. W has given up ½ her benefits/month for four years but she will get \$4,000/month or 33% more from 70 onward. This won’t apply to people born 1953 or earlier. This benefit has been abolished after that.
- o. File and suspend. Done until 2016. H could file at 66 and then suspend but his filing would have sufficed for W to get benefits. This is no longer possible.
- p. Suspension. Filed at age 66 and realize you should have waited. You can suspend, or stop getting benefits, until age 70. If it was a real mistake you can pay back the money you got and then get the 8% increase.
- q. Widows and widowers. On death of spouse you can claim 100% of what was actually being paid to the deceased spouse. A deceased spouse only gets what the actual payment was. So if deceased spouse claimed early that limits the surviving spouse’s benefits as well.
- r. Divorced spouses can get benefits based on record of prior ex-spouse. Key to divorce. H and W. W was high earner. Married 10 years and divorced for 2 years (must meet 10 year/2 year requirements). H can get benefits based on what W would get at 66. H’s taking benefits based on what W got has no impact on ex-W’s benefits. There is no impact on subsequent spouses so many ex-spouses can be earned on the same person’s work benefits. H can get benefits even if W never filed so this prevents an ex-spouse from spitefully not filing to harm ex-spouse. Remarriage does not impact. So if H remarries W-2 before 60 it will affect benefit based on W-1.
- s. Social Security is subject to income tax based on various rules. This is why many who are working also do not claim benefits if working as they may be in a higher tax bracket (this is in addition to the reduction noted above).

- t. If client lives until age 82. Assume if at 62 you would have received \$420,000 from 62 to 82. If start at 66 would get \$488,000. If start at 70 only \$443,000. If you only live to early 80s not a dramatic difference. So determining optimal decision depends on life expectancy. For many at 66 may be better to draw down savings if you have it and defer to get higher benefit. Some claim benefit at 68 as they not know how long they will live....splitting the baby in regards to the decision.
 - u. H is 62 when started benefits and W is 66. Spouse can only file for spousal benefits if 66 if spouse they are claiming on has not reached 66 based on 50% of what other spouse will get when he or she hits age 66.
2. **Friday: Morning: Basis Consistency Income Tax Issues: Akers.**
- a. The current budget resolution includes a repeal of the estate tax. There is a lot of political wrangling but we may well get a repeal. We might get repeal only for 10 years.
 - b. If there is no estate tax, we may not worry about basis consistency since there will be no estate tax return.
 - c. Basis consistency is a solution in search of a problem. Very few people have ever claimed a basis different then the estate tax return basis.
 - d. There is real difficult with reporting issues, but that is the tail wagging the dog. The real issue is potential fiduciary liability created by these basis rules.
 - e. Time line.
 - i. Statute enacted July 31, 2015.
 - 1. Part of Highway Trust Fund bill.
 - 2. As part of 3-month extension they included this revenue raiser to pay for some of it.
 - 3. New Section 1014(f).
 - 4. Added 6035 reporting rules.
 - 5. Changed penalty provisions.
 - ii. January 2016 forms and instructions.
 - iii. Regulations March 2016.
 - iv. Revised instruction draft June 8 2016
 - v. Hearing to discuss regulations June 27, 2016.
 - vi. New final instructions to Form 8971 October 13, 2016.
 - vii. December 2016 finalization of Regulations and extension of filing date.
 - f. Issues: What property is subject to it. Who files. Who receives it. When is it due. What particular problems are there?
 - g. Statute enacted July 31, 2015.
 - i. Part of Highway Trust Fund bill.
 - ii. As part of 3-month extension they included this revenue raiser to pay for some of it.
 - iii. New Section 1014(f).
 - iv. Added 6035 reporting rules.
 - v. Changed penalty provisions.
 - h. What property subject to this?
 - i. Only property subject to increased estate tax.
 - ii. Marital deduction property is not subject to this.

- iii. Several aspects made clear in final Regulations. If estate is not paying estate tax because it is below exemption amount there is no basis consistency problem.
 - iv. If there is property that qualifies for marital deduction or charitable deduction these rules do not apply
 - v. So surviving spouse can say \$50M inherited has basis different then what was on Form 706 but the reporting rules still apply.
 - i. What estates are subject to the reporting requirements?
 - i. If the estate is required under 6018(a) to file an estate tax it is subject to reporting rules.
 - ii. If gross estate exceeds exemption amount it is required to deliver these reports even if no estate tax due. The estate must still file.
 - j. Who files?
 - i. Executor is required to file basis reports.
 - ii. If there is no court appointed executor it is the person in charge of property.
 - k. Who receives the reports?
 - i. IRS and any person receiving property.
 - ii. If there is a trust the report goes to the trustee of the trust not to the beneficiaries of the trust.
 - iii. Uncertainty as to revocable trust. Does report go to trustee or to beneficiaries.
 - l. When are the reports due?
 - i. Reports are due 30-days after due date of estate tax return.
 - ii. 9 months after date of death with extension so could be 30 days after 15 months after date of death.
 - iii. If the statute gives a due date IRS does not view itself as having authority. But instructions in this instance give an extension. If form 706 is not filed on time you have 30-days after that filing to file, the basis consistency filing requirements. Comments to IRS have requested that this information in the instructions be corroborated in the Regulations.
 - iv. Statute applied to estate tax returns filed after date of enactment. These were extended until June 30. Now have final regulations confirming.
 - m. Penalties.
 - i. Inconsistent basis reporting subject to penalties.
 - ii. General penalty
 - 1. \$250.
 - 2. Even though there may be mistakes on Form 8971 only one penalty.
 - 3. Each schedule A is one penalty.
 - iii. Additional penalty for intentional disregard.
 - 1. Greater of \$500 or 10% of what was required to be reported.
 - 2. That is potentially a huge number. We cannot ignore these rules.
 - iv. Instructions have great detail on penalties but don't even mention the 10% penalty.
 - n. Form 8971.

- i. Received instructions and Form in late January 2016.
- ii. Part 2 information on beneficiaries.
- iii. Schedule A on which you list assets from gross estate passing to that beneficiary.
- iv. For each item list time number for 706, estate tax value, whether or not asset resulted in increased estate tax liability.
- v. Notice at bottom of Schedule A is very misleading.
- vi. Must list all assets that “could be used” to satisfy the bequest.
- vii. If executor is a beneficiary must send himself a form as well.
- viii. Must send to IRS.
- ix. Finalized in September 2016.
 - x. Draft in June said no attachments to Schedule A. Some wanted to just send estate tax return to beneficiary. June forms said don’t do that – no attachments. IRS relented in September 2016 instructions saying you can use attachments to list related property. But instructions said do not attach appraisals. Creates complexities.
 - xi. Penalties can apply even if there is no estate tax due if the parties who are supposed to get reporting forms don’t get them.
 - xii. Must get beneficiary tax identification number. What if executor cannot get it? Executors must request it in writing and if not given the number say “requested” and attach copy of written letter.
 - xiii. What about foreign individual not required to get a TIN? Instructions say no penalty for not providing a number.
 - xiv. Power of attorney Form 2848 September instructions give detail about power of attorney to deal with Form 8971. It is not intuitive. Under description of the matter you list “civil penalties.” What will beneficiary think about that?
 - xv. Cash is not reported. It is not reported on Form 8971 or Schedule A. So if beneficiary is receiving only cash don’t list that beneficiary on Part 2. This should be the same rule for all four exceptions.
- o. Regulations.
 - i. Transitional relief until June 30.
 - ii. What if a Form 706 was filed before July 30 and discover additional assets? You file a supplemental report Is that an estate tax return filed after effective date so now the executor must deliver reports. It is not clear. Practical suggestion is that if you do this and file supplemental don’t re-run the 706 and file new 706 instead just file the information for Schedule B and take position that filing a Schedule B is not filing a Form 706.
 - iii. There is never a problem with over reporting. If there is an issue, over report. That is the conservative position.
 - iv. Non-recourse debt. Always had question for non-recourse indebtedness subtract from gross value and put net value on the schedule of the Form 706 Schedule A. Is that the basis number (i.e. the net?). Regulations say no that the basis adjustment is to the gross value. September instructions made this clearer. The values reported on Schedule A are the full gross values unreduced by mortgages. How do we do it? Instructions say list

estate tax value which is the net value. One suggestion, list net value on schedule A and add an attachment showing real basis adjustment to the gross amount.

- v. Tangible personal property for which you don't have to get an appraisal, property under \$3,000, you don't need to report. Example is for items in a particular category, example, if all jewelry under \$3,000 no need to get appraisal so jewelry is subject to exception and not subject to reporting or appraisal or basis consistency even if overall tangible property is worth more than \$3,000.
 - vi. What if basis should have been lower but beneficiary sold asset. Regulations make clear that the beneficiary could owe a deficiency. Comments to IRS said unfair to impose penalties on beneficiary for using best information they had.
- p. Zero basis rule.
- i. If after discovered or omitted property is not reported on a supplemental report before statute of limitations runs on Form 706 the basis in those assets will be zero.
 - ii. It appears that the executor does not have a duty to file as long as initial Form 706 filed in good faith.
 - iii. If the executor files, the supplemental information and estate is paying estate tax it is a 40% estate tax. If don't file get a zero basis so would pay say capital gains tax. Difficulty will be that there may be different beneficiaries paying estate tax versus those receiving the assets and having to pay the capital gains tax on sale.
 - iv. Not hopeful IRS will change this.
 - v. Side effects of above are odd. What if cash is discovered? Basis of that cash could be zero?
- q. What assets must be reported?
- i. All assets in gross estate.
 - ii. Marital deduction property must be reported even though not subject to basis consistency.
 - iii. Four exceptions:
 - 1. Cash
 - 2. IRD
 - a. What if some contributions non-deductible?
 - b. Regulations don't discuss so include an attachment/statement to beneficiary saying for IRD asset contact tax adviser.
 - 3. Tangible person property.
 - a. See above.
 - 4. Assets sold.
 - a. To meet diversification requirements may be selling anyhow.
 - iv. Consider issues for actively traded brokerage account.
 - 1. What if sold stock and repurchased same stock.

- v. Great care. Distribution of asset for funding pecuniary bequest may have gain recognition at estate level. Does that mean don't have to report anything passing to a beneficiary pursuant to a pecuniary bequest? Not clear, no answer.
- vi. Unlapsed Crummey withdrawal amount. Must this be reported? If in doubt report.
- vii. No exception for non-probate assets: 2036, 2042, etc. all string assets must be reported. Executor is required to report even though may have no information.
- r. Who receives report?
 - i. What if all beneficiaries receive excepted assets, e.g. all assets sold or all estate is cash and insurance? Do you file 8971? Yes, file with no beneficiaries listed on Schedule A but attach explanation.
 - ii. What about assets passing to a revocable trust? Do you give information to trustee or beneficiary? What about other trusts included in the estate under string statutes e.g. 2036. Unclear what to do. Persons making comments to the IRS have suggested both options.
- s. Undistributed property.
 - i. Biggest surprise and controversy is undistributed property rule.
 - ii. IRS view is a "mini" 706 would go to each beneficiary as you have to list any property that might be used.
 - iii. If the executor has not determined which assets will go to which beneficiary. Perhaps list assets that might be distributed to a particular beneficiary.
 - iv. ACTEC recommended allowing the executor to show on Schedule A the initial valuation of the bequest and provide supplemental information when assets are actually distributed.
 - v. Consider how misleading this is to beneficiaries.
 - vi. If listing same assets on various schedule A attach a parenthetical saying "Duplicate reporting." This is not required by the Regulations.
 - vii. Beneficiary may get schedule listing 50++ assets. Consider how confusing.
 - viii. Some executors will be very concerned about this type of disclosure.
- t. Subsequent reporting by beneficiary.
 - i. Subsequent gift donor/beneficiary must file report.
 - ii. If asset received from gross estate I contributed to a partnership 40 years later there is a requirement of a transferee report. No statutory authority for this.
 - iii. Assets form estate passing to a trust. 20 years later asset is still in the trust. Trust is going to make a distribution to a beneficiary. Must the trustee give a report to the IRS and the beneficiary/distributee? It is not clear. Comments have requested clarification.
 - iv. Does the holder of power of appointment get a report? Does she have to give report to IRS if exercises power?
- u. Miscellaneous.

- i. List all beneficiaries and attach statement to indicate which are not getting Schedule A.
- ii. Keep proof of mailing.
- iii. Signatures on Form 8971 of executor and of beneficiary.
- iv. Stock portfolio in brokerage account. You can use an attachment.
- v. A number of the valuation services firm can tie into 706 software reporting. Must go through the report “with a fine tooth comb” to see what was sold, etc.
- vi. Transmittal letter. Beneficiary getting a schedule A will have no idea what it is about so use a transmittal letter. Planner wants to be helpful but do not lead beneficiary to believe you are representing so suggest beneficiary speak to his or her tax adviser. Statute says executor send reports so have letter come from executor to avoid above issue.
- vii. Mechanics of processing this. Both the executor and the preparer must sign Form 8971. So if sending to executor to sign need to confirm date provided to beneficiary. Best practice have executor come to preparer’s office and sign and date form. Mail all schedules A’s on that date to IRS and beneficiaries via certified mail.

3. **Friday: Morning: Wrap Up: Technology: Harrison.**

- a. Technology.
 - i. Technology is changing how we should look at our practices.
 - ii. Increase speed in communicating ideas.
 - iii. Comfort.
 - iv. Time shifting, can communicate at any hours.
 - v. Allows projects to be completed quickly.
- b. Clients need us to help them protect their wealth.
 - 1. Either the client or heirs may not have ability to properly spend money.
 - 2. “Too much money can pollute.”
- c. Use of trusts to accomplish this.
- d. Portability.
 - i. Multiple trusts.
 - ii. Clayton flip. If I don’t elect QTIP floats to another trust. Single fund QTIP.
 - iii. GST trust if doesn’t match unified credit.
 - iv. Possible repeal of estate tax, so use conditional language.
- e. What do these documents do for the client?
- f. If estate tax repealed default plan might be a single lung marital type trust.
- g. How can a preparers review existing documents/plan?
- h. Be certain that the trustee has the right to distribute in “best interests” so can get property out of the trust for basis purposes.
- i. Estate tax repeal.
- j. Evaluate risks and rewards of different practice matters.
 - i. Matrimonial. Even the best prenuptial agreement may be challenged if the client divorce.
 - 1. Retitling property between spouses has a number of implications.

2. Does non-marital property transferred to a joint trust lose its character as non-marital property?
 3. Did parties intend to make a gift?
 4. Consider a separate document signed by the parties confirming intent as to characterization of property.
 5. Will the agreement be respected for contract purposes?
 6. Is there a conflict in representing the husband and wife in this type of arrangement and what should be done?
 7. With portability there is less need to retitle assets for estate tax planning purposes and practitioners can focus more on other implication.
 8. **Comment:** What of all the assets retitled in prior decades of planning when exemptions were much lower? It appears that few if any clients have revisited those purely tax motivated changes in asset title since the exemption has begun its long march upward. A Trump repeal will only increase the importance of reviewing those prior actions.
- ii. Estate tax planning risks.
 1. SLATs done well but IRS asserts that it is included in the estate.
 2. FLP done perfectly and well administered but proves unnecessary.
 3. The likelihood of a gift tax audit has been mentioned to be 1-2% but those figures may be historical and not correct any longer in light of the smaller number of returns likely file with the significant increase in exemption.
 - iii. Non-tax trust planning. Very important and has not received enough attention.
 1. Asset protection planning.
 - a. Creditor shield trusts.
 - b. How protective are these trusts? Depends on terms of trust and state law.
 2. Trusts to protect children.
 - a. Creditor protection trusts for adult children.
 - b. Withdrawal rights 25/30/35. Get rid of those.
 3. Trust administration.
 - a. “As estate planners, we often focus on our role as strategists, planners that set up a workable estate plan....Once techniques are implemented, both planners and clients often experience a certain laissez faire towards the steps post signing, the actual administration of these strategies.”
 - b. Income tax issues including state income taxation.
 - c. Basis. Survey irrevocable grantor trusts.
 - d. Decanting.
 - e. Non-tax aspects of trusts, e.g. loan that are compliant.
 - f. Trust investment decisions.
 - g. Proper communications with beneficiaries by trustees.

- h. Other.
- k. Commoditization.
 - i. Increasing exemptions, technology, commoditization is changing practices.
 - ii. 50%-80% of prior tax plans have now been rendered obsolete. Comment: Not certain how a percentage can be determined but if the number is anywhere in this range it is great cause for concern. How many clients understand the magnitude of the likelihood that their plans are obsolete? How can practitioners communicate this to their clients? What obligations to communicate exist?
- l. Communications.
 - i. Malpractice considerations and concerns.
 - ii. All of us make mistakes.
 - iii. To minimize harm through better communications with clients.
 - iv. Clients don't want or care how much the lawyer knows. They want to know how much you care.
 - v. Use technology to show clients how much you care. This will decrease malpractice exposure and increase client happiness.
 - vi. Email note to clients.
- m. Tax opportunities for planning in the current environment.
 - i. Grantor trust planning remains first and foremost.
 - ii. GRATs are the number 1 strategy.
 - iii. Sales to grantor trusts.
 - 1. Woelbing settled on favorable terms to taxpayers.
 - 2. True case is still in the tax court.
 - 3.
 - iv. 2701 preferred partnerships.
 - v. Shifting low basis assets.
 - vi. Domicile planning to avoid inheritance and income taxes.
 - vii. CLTs.

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