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To: [Martin Shenkman](#)
Subject: FLASH: Marty Shenkman's Compilation Notes from Heckerling 2016 Steve Leimberg's Estate Planning Newsletter
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Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2381

Date: 17-Jan-16
From: Steve Leimberg's Estate Planning Newsletter
Subject: **FLASH: Marty Shenkman's Compilation Notes from Heckerling 2016**

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. 2016 was the 50th installment of Heckerling, and for those not fortunate enough to be in sunny Orlando, the meeting this year ran from Monday, January 11 through Friday, January 15.

LISI has made the compilation of all of Marty's notes for the week at Heckerling 2016 (including Thursday and Friday's sessions) available to members through the following link:

- [Marty Shenkman's Compilation Notes, Heckerling 2016](#)

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Martin M. Shenkman, CPA, MBA, PFS, AEP, JD is an attorney in private practice in Paramus, New Jersey and New York City who concentrates on estate and closely held business planning, tax planning, and estate administration. He is the author of more than 40 books and 800 articles. Marty is the Recipient of the 1994 Probate and Property Excellence

in Writing Award, the Alfred C. Clapp Award presented by the 2007 New Jersey Bar Association and the Institute for Continuing Legal Education; Worth Magazine's Top 100 Attorneys (2008); CPA Magazine Top 50 IRS Tax Practitioners, CPA Magazine, (April/May 2008). His article "Estate Planning for Clients with Parkinson's," received "Editors Choice Award." In 2008 from Practical Estate Planning Magazine his "Integrating Religious Considerations into Estate and Real Estate Planning," was awarded the 2008 "The Best Articles Published by the ABA," award; he was named to New Jersey Super Lawyers (2010-13); his book "Estate Planning for People with a Chronic Condition or Disability," was nominated for the 2009 Foreword Magazine Book of the Year Award; he was the 2012 recipient of the AICPA Sidney Kess Award for Excellence in Continuing Education; he was a 2012 recipient of the prestigious Accredited Estate Planners (Distinguished) award from the National Association of Estate Planning Counsels; and he was named Financial Planning Magazine 2012 Pro-Bono Financial Planner of the Year for his efforts on behalf of those living with chronic illness and disability. He sponsors a free website designed to help advisers better serve those living with chronic disease or disability www.chronicillnessplanning.org.

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

Marty Shenkman

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50th Heckerling Institute on Estate Planning
Draft “Compilation” Meeting Notes
By: Martin M. Shenkman, Esq.

1. **Business Income Tax for Estate Planner.**

- a. Forms of entity.
 - i. Sole proprietorship, disregarded.
 - ii. General partnership, limited partnership, or LLP, taxed as a partnership for income tax purposes.
 - iii. LLC disregarded if only one member, if multiple members treated as a partnership for income tax purposes unless elect S corporation status.
 - iv. S corporation, generally pass through.
 - v. C corporation.
- b. C Corporation.
 - i. Beneficial tax considerations.
 - 1. No recognition of gain on formation unless receive property other than stock (boot), the transferors own less than 80% of equity, or liabilities exceed basis. See discussion below and contrast with partnership rules.
 - 2. IRC Sec. 1202 excision for gain on sale of qualified small business stock.
 - a. Must be active business, gross assets less than \$50M.
 - b. Protecting Americans from Tax Hikes (“PATH”) tax act made 100% exclusion permanent.
 - i. Whether you get 50, 75, or 100% exclusion is a function of when you acquired the stock.
 - ii. Must hold more than 5 year holding period to get exclusion.
 - c. If client is considering sale of stock to get out of investment this 0% or 14.9% may be preferable to an S corporation.
 - d. It may be incorrect because of Sec. 1202 to recommend by default using an S corporation.
 - e. You can complete a like exchange with Sec. 1202 qualified small business stock under IRC Sec. 1045. You can preserve unrecognized gain in basis of new IRC Sec. 1202 stock you acquire. This can provide another means of transitioning out of the stock of a particular corporation.
 - 3. Mitigating double taxation of C Corporation profits.
 - a. Paying dividends (preferential rate under IRC 1(h)), but no deduction to the corporation.
 - b. In closely held C corporation shareholders are often employees of the corporation, creditors of the corporation (lenders), and/or landlords renting property to the corporation.

- c. Avoiding double taxation of C corporation earnings may be in part achieved by paying reasonable increased compensation, interest and/or rent. The C Corporation gets a deduction for these expenses (in contrast to dividend which does not provide a deduction). While these are taxable to the shareholder as ordinary income these payment eliminate corporation tax on these dollars. So this might net more after tax dollars to the shareholder.
 - d. Caution - interest received on a loan to a C corporation may be net investment income subject to NIIT. Employment taxes may apply to wages paid to the shareholder/employee, etc.
 - e. There can be a significant positive difference in net after tax income form the above planning. But, these payments must be reasonable or the IRS may argue that they are disguised distributions. How do you draw the line between generous rent and “obscene” rent?
4. IRC Sec. 303 Redemption to Pay Death Taxes.
- a. If value of the corporation’s stock is more than 35% of value of adjusted gross estate any redemption used to pay for taxes or expenses (i.e., not to exceed tax and expenses of the estate) automatically qualifies for sale treatment. Thus, it will be treated as a sale or exchange and not a dividend. Now the dividend distribution is taxed at same rate as capital gains and in many closely held corporations the basis may not be significant, this treatment may not be significant in some lifetime situations. However, if the stock being redeemed from an estate or a beneficiary who inherited it, the stock will have had a basis step up under IRC Sec. 1014. This basis step up should eliminate gain on a sale treatment.
- ii. Negative tax aspects of C Corporation.
- 1. Accumulated earnings tax.
 - a. All undistributed income less amount held in reserves for the reasonable needs of the business, could be subjected to a penalty tax on accumulated taxable income. If the corporation is hoarding earnings and profits this tax provision creates an incentive to distribute by imposing a 15% tax. The first \$250,000 of retained earnings (\$150,000 for a professional corporation) are deemed reasonable.
 - b. This is a penalty assessed by the IRS on top of the tax deficiency it may add on the accumulated earnings tax.
 - c. Burden is on taxpayer to prove that accumulated taxable income is zero since all accumulated income is for reasonable business needs. This shift of burden is significant.

- d. Reduce exposure by paying out earnings through salaries, corroborating need for capital or electing S corporation status (see below).
 - 2. Corporate AMT tax.
 - a. Small corporation's are exempt.
 - b. Planning can be done to reduce corporate AMT but the overall tax burden in some instances might actually be reduced by paying AMT.
 - 3. Buy-sell agreement considerations for C corporations.
 - a. What payments should be made on the death, expulsion, or retirement of a shareholder?
 - b. May acquire life insurance to acquire stock of deceased shareholder or use permanent insurance to help fund redemption of retiring or disabled shareholder (using cash value).
 - c. If insurance is purchased by corporation it may provide greater certainty in funding in contrast to a cross purchase arrangement in which individuals hold and pay for policies. Example an individual shareholder might miss a payment and there is more complexity with the cross purchase approach.
 - d. Corporations may be in lower tax bracket than shareholders in many instances so that there is a tax advantage of having the corporation pay for the insurance.
 - e. There are drawbacks to using a redemption agreement. The redemption could be treated as a dividend instead of a sale or exchange so cannot offset gain with IRC Sec. 1014 basis step up. Corporate owned life insurance increases value of the corporation for estate tax purposes. If you will use corporate owned life insurance must weigh the downside of this.
- c. S Corporations.
 - i. Benefits.
 - 1. May be beneficial to reduce the overall tax burdens.
 - 2. Ability to use cash method instead of the accrual method of accounting.
 - 3. No corporate penalty taxes.
 - 4. Restructuring a C corporation as a partnership may trigger a taxable event. Making an S election may not.
 - ii. Income/Basis.
 - 1. Income and loss items are determined at entity level and passed through. Basis is essential to determine.
 - 2. It is essential to determine tax basis when sell S corporation in order to determine gain or loss.
 - 3. Take basis as of beginning of the year and increase by all income items that flow through (including tax exempt income). Then

reduce basis by any distributions made. Note that distributions are tax free to the extent shareholder has tax basis (determined after increase for income items). Then reduce basis for non-deductible expenses.

4. Different tax regime if S corporation had previously been C corporations.
 - a. Different rules apply that use a LIFO concept on distributions for the entity. Distributions are deemed to come first from Subchapter S profits before C corporation profits. The Accumulated Adjustment Account (“AAA”) is used as the mechanism to track previously taxed income of the S corporation. Distributions come out of S corporation’s accumulated undistributed previously taxed income. That income is taxed as below for a corporation that has always been an S corporation. If AAA is depleted then treat the distribution as a dividend to extent of former C corporation earnings and profits. So when AAA is exhausted you will have taxable dividends. If all E&P is exhausted, then distributions are tax free to extent of basis. Distributions beyond that level are taxed as a capital gain.
 - b. Contrast the above tax regime with that for S corporations that have been solely S corporations since inception of the entity. Distributions are tax free to extent of basis. Distributions in excess of basis treated as if there had been a sale of S corporation stock and generate capital gain.
5. Liquidation.
 - a. Rules similar to C corporations apply, however in an S corporation any gain or loss will pass through to the individual shareholders.
 - b. Converting from an S corporation to LLC or partnership is often undesirable as it may trigger a taxable event.

iii. S requirements.

1. Ongoing requirements must be met while an S election is in place. If violate these rules the entity’s status could revert back to being a C corporation and may then have to wait 5 years to re-elect S corporation status. However, the IRS may permit inadvertent termination relief, but there is also a fee that may be associated with this.
2. Eligibility is critical for S corporations. For many of the requirements permit options to more readily satisfy them.
3. Domestic corporation. Corporation must be organized in the US. This includes organizations that are co-organized. If it is desired to have a foreign entity become an S corporation, organize that entity as a corporation in the US. There is no reason that the entity cannot be “organized” in two locations. This may be all that is required to solve the domestic corporation requirement.

4. Cannot have more than 100 shareholders. Originally, years ago, this requirement was only 15 shareholders. All members of a “family” are treated as a single person for purposes of 100 shareholder test. Find any common ancestor and can go down six generations of lineal descendants. Spouses of these lineal descendants are also included.
5. Trusts as shareholders.
 - a. See below.
6. Nonresident aliens.
 - a. A nonresident alien cannot own S corporation stock or the election will be lost.
 - b. Community property state law presents a potential problem. If a US shareholder marries a nonresident alien and resides in a community property state, community property laws would treat the S corporation stock as if it is owned one-half by each spouse, resulting in disqualification.
 - c. If you want a nonresident alien to be involved as a 1/3rd owner in a business held by an S corporation, a restructure might solve the problem. Have the S corporation drop assets into LLC and have the foreign investor make his or her investment directly into that same LLC. For example the foreign person could own 1/3rd of the drop down LLC and 2/3rds by US persons via the S corporation. All are flow through entities. This is a workaround to involve a nonresident alien owner.
7. Cannot have Entity Shareholders of an S Corporation.
 - a. S corporations can be members of an LLC (as in the example above) but S corporations cannot have LLCs or other entities own interests in the S corporation.
 - b. Transitory ownership has been permitted. PLR 200237014.
 - c. Must be individual shareholders or qualifying trusts only.
8. Single class of stock.
 - a. An S corporation can only have one class of stock. The rationale is that all income must pass through pro-rata.
 - b. How can this be planned around? In common estate planning context you may wish to plan around this restriction. Mere differences in voting rights are not considered to be a second class of voting stock. So you can have Class A voting and Class B non-Voting. Voting rights do not count. This provides flexibility to do a tax free recapitalization and perhaps concentrate voting into a 1% interest, and the remaining economic interests into non-voting stock. The latter may then be used in wealth transfer planning.
9. Must elect Sub Chapter S status.
 - a. All shareholders must elect.

- b. Must complete election by 15th day of third month by filing Form 2553.
- iv. Planning for S corporations.
 - 1. Be careful not to jeopardize S corporation status when planning to avoid the consequences of termination.
 - 2. Leveraging the purchase of additional shares.
 - 3. If you borrow from bank you could deduct interest as an expense. As part of the 1986 tax act you must trace interest. If interest was incurred in connection with business then the interest is deductible as a business expenses. If you borrow from a bank and use it to purchase stock that interest expense is investment interest and that is subject to the investment interest expense limitation that limits the deduction to net investment income. If exceed then must defer deduction. Other interest expense is personal interest and only specific personal interest expense is deductible.
 - 4. If a shareholder borrows money from lender to purchase S corporation stock this would seem to give rise to investment interest subject to the investment interest limitation. However, S corporations are subject to a favorable rule. Reg. Sec. 1.163-8T it is treated as if it is debt was incurred to purchase the underlying S corporation assets. Thus, if the S corporation is involved in an active business, then the interest expense will not be subject to the investment interest limitation. This benefit is not available with a C corporation stock.
 - 5. Distributions are tax free to extent of basis. This can present a planning opportunity by paying less compensation. This is the opposite planning approach than that described above for a C corporation. Distributions from an S corporation are not subject to employment taxes. Caution is in order because if no compensation is paid and shareholder is working the IRS could recharacterize the distribution as compensation. *Mike J. Graham Trucking, Inc. v. Comr.*, T.C. Memo 2003-49.
 - 6. So the goal should be to pay a “reasonable” compensation but as limited as feasible so that the excess over that amount can be paid as a distribution. Compensation abuse by S corporations is on the IRS radar. On average 41-47% of profits are taken out as salary. But this data may not be the appropriate touchstone. The real litmus test is what the shareholder could earn if he or she worked for an unrelated employer.
- v. Shift Gain to Co-owners.
 - 1. The rules governing allocation of pre-contribution gain for S corporations are different then for partnerships.
 - 2. If a shareholder contributes appreciated property to an S corporation and that property is sold the gain can be allocated to the shareholders pro-rata to ownership interest.
- vi. Basis planning to maximize loss deductions.

1. An S corporation shareholder can only deduct losses up to basis. In most closely held corporations there is not a lot of stock basis. How can you “get” basis to support loss deduction?
 2. You could contribute dollars to the corporation, or the shareholder can loan dollars. While either of these steps may support the deduction as a result of the increase in basis but that is not reasonable.
 3. Based on Crane case if borrow you get basis. Debt must have commercially reasonable note and there should be some payment of interest.
 4. Considering buying stock on a deferred basis. With a note you defer the payment of the priced and the tax advantage of the up-front deduction of the flow through losses may make the planning worthwhile.
 5. US vs. Grace you cannot have Shareholder A buy stock from B and B buy stock from A to achieve basis.
- vii. Tax Traps of S corporations.
1. Interests given to employees.
 - a. It is common to want to reward a key employee, but this could be fraught with problems.
 - b. Any 2% shareholder is treated as a partner in a partnership and not treated as an employee for purposes of employee fringe benefits. So some of the tax free benefits an employee would otherwise receive become taxable since the employee now owning sufficient stock is treated for tax purposes as a partner in a partnership. Examples: Meals and lodging on employees premises [IRC Sec. 119]; group term life insurance, cafeteria plan, etc.
 - c. What is a 2% shareholder? Someone owning more than 2% of the S corporation stock. So if own 2% of stock the employee will not violate this rule, but anything above 2%, the restrictions apply.
 - d. Not all employee fringe benefits become taxable. Some are excluded from this. Depending care assistance program and IRC Sec. 132 benefits, de Minimis expense.
 2. If a partnership borrows money it is treated like a cash contribution from the partners. S corporations do not have this favorable rule. When an S corporation borrows money from a bank it is a nonevent to the shareholder and there is no basis gained from this.
 3. Review the S corporation balance sheet. If there is debt owed to bank or third party lender bear in mind that may be able to be restructured in a manner that would generate basis (since borrowing by the corporation will not do so). In most cases of a closely held S corporation the shareholders likely have to sign a personal guarantee. If instead, the loan was made directly to the shareholder and then loaned or invested into or to the corporation,

then the shareholder should obtain tax basis. Miller v. Comr. TC Memo 2006-125.

4. If debt is straight debt it will qualify under safe harbor. If not, it may not be assured that it won't be challenged by IRS as constituting a second class of stock. Straight debt is a written unconditional promise to pay held by a US person, interest is not discretionary nor is it variable based on profitability. If the debt does not have a fixed interest payment it may be less likely to be characterized as debt. There is a greater risk that it will be considered a second class of stock.
5. Perils of former C corporation.
 - a. See comments above concerning taxation of distributions. There are other dangers to S corporations that had been former C corporations.
 - b. LIFO recapture. If a C corporation is using LIFO inventory accounting a tax trap may be triggered on conversion. The additional income that would have been reported had FIFO been used instead of LIFO may be treated as income in the year of conversion. This can be reported in four installments. The size of this income tax consequence can make it uneconomical to convert.
 - c. IRC Sec. 1374 tax on built in gain. If an S corporation sells built in gain property during the recognition period there will be a corporate level tax at a flat 35% rate (maximum corporate rate) on that net recognized built in gain. This is in addition to the income tax incurred. Assume a \$10,000 asset grows to \$100,000 = \$90,000 gain that flows through. But in addition pay a 35% tax. The recognition period had been 10 years and it has been reduced. Under the 2015 PATH Act the recognition period has been permanently reduced to 5 years. As one planning idea, consider having an S corporation donate built in gain property to charity. If donate no recognized built in gain and 1374 only applies to a recognized gain so there is no such tax (since there is no recognized gain if the asset is given to charity). If the property donated is long term capital gain property it should generate a full fair market value deduction, and that deduction will flow through to shareholders pro-rata. You generally reduce value of stock basis by the distribution made. However, since 2006 S corporation shareholders only have had to reduce stock basis by the adjusted basis of the property donated to charity and not for its fair market value. So the reduction in stock basis might be \$10,000 on the \$100,000 property but yet the shareholder will obtain a \$100,000 deduction. The PATH act of 2015 made this benefit permanent. Thus, using appreciated S corporation

property, especially property subject to the BIG tax, may provide substantial tax benefits.

- d. IRC Sec. 1375 – benefits of S election are to be for active businesses, not for passive income. A “sting” tax is imposed if passive income is excessive. The corporation will have to pay flat tax on excess net passive investment income of the corporation. This only applies if the S corporation has Subchapter C earnings and profits (E&P) that have not be distributed out. So the shareholders may avoid this sting tax if they can purge old E&P out of the S corporation. If the S corporation is subject to this tax for 3 straight years S corporation status will be lost. Another planning alternative or approach is to manage the S corporation’s gross receipts to remain under the 25% gross threshold (passive investment income exceeds 25% of gross receipts).

viii. Trusts owning S corporation stock.

1. 5 types of trust only are permitted to hold S corporation stock. If another type of trust holds S stock it is not a qualified shareholder and the S election could be lost.
2. QSST = Qualified Subchapter S Trust. Must be a domestic trust. Has a single income beneficiary who has income interest for life. You can divide a pot trust and treat each share as a separate trust. That single beneficiary must receive all income, i.e., a simple trust. That person/beneficiary must be a US person. Trust must provide that income must be distributed to that person.
3. ESBT = Electing Small Business Trust. It can have many beneficiaries but only individuals, estates and certain exempt organizations. Subject to maximum flat tax of 35% on income. The trust is deemed the shareholder for purposes of paying tax on its share of S corporation income. Tax is only paid on share of S corporation income. The trust can subtract tax paid attributable to S corporation stock, and subtract administrative expenses and interest expense on indebtedness used to acquire S corporation stock. So you are really paying tax on trust income attributable to S corporation stock.
4. Grantor trust can be an S corporation shareholder. But be certain the grantor qualifies as an S corporation shareholder. Consider whether you need to force a QSST/ESBT election. It may not be necessary.
 - a. Comment: Consider the implications of QSST, ESBT and grantor trust as to which person is the touchstone for determining active participation for purposes of the Net Investment Income Tax (NIIT).
5. Testamentary trusts can hold S stock for two years.

d. Partnerships.

- i. Partnerships are very flexible, but that flexibility creates incredible complexity.
- ii. Unlike a corporation, partners can allocate income, gain loss etc. among them subject to only two requirements. Partners that meet these exceptions/requirements can allocate with considerable freedom and change it from year to year.
 - 1. To be respected for tax purposes must have substantial economic effect. If the partnership agreement requires 704(b) requirements, liquidating distributions in accordance with positive capital accounts, and a deficit restoration, then no problem.
 - 2. IRC Sec. 704(c) must also be addressed.
- iii. IRC Sec. 721 if you contribute property to a partnership no recognition of gain or loss. Contrast with a corporation that had limitations for boot and an 80% requirement. These concepts are not applicable under IRC Sec. 721. Only two situations in which you recognize gain.
 - 1. IRC Sec. 721(b) if transfer property to an investment partnership. 80% or more of assets are portfolio assets and transfer to partnership diversifies your portfolio.
 - 2. Example: A contributes 80% stock X, and B contributes 20% cash. Gain on stock is triggered since this is deemed a diversification.
 - 3. Second situation is contributing property with debt in excess of basis. If the debt is nonrecourse debt of a general partnership it will be taxable. Often it is recourse debt and since contributing partner is liable for debt there is no issue of gain recognition.
- iv. Outside basis is basis in partnership interest analogous to basis in stock. Inside basis is basis partnership has in its assets analogous to basis a corporation has in its assets.
- v. Distributions.
 - 1. Cash distributions are tax free to the extent partners has sufficient outside basis to absorb the distribution. If cash exceeds partner's outside basis gain will be recognized. IRC Sec. 731(a)(1).
 - 2. Property distributions are generally not a recognition event. This is viewed as a take back of partner's own property so not gain recognition.
- vi. What can partnerships do, other than special allocations that you cannot do with a corporation? An IRC Sec. 754 election can be made on death of partner. The partnership outside basis is stepped up or down under IRC Sec. 1014. But nothing happens to the inside basis of the underlying assets of the partnership. However, if an election is made under IRC Sec. 754 the partnership (or LLC taxed as a partnership) can obtain a partial step up in basis. This is only a partial step-up because the election will not eliminate all built in gain. If a 20% partner dies the partner's 20% interest gets a step up to fair market value. If have a 754 election in effect 20% of each asset gets a step-up in basis as well. That basis step up only happens from the perspective of the person who inherits the deceased partner's interest. It has no impact on the gain allocable to the other 80% partners. Minimizing

value on Form 706 for the estate will also have a negative impact on basis step up under 754.

- vii. Under the check the box regulations an election can be made to treat a partnership as a corporation. Why would a client make this type of election? There are some situations when this might be an advantage. For example, the compensation planning strategy discussed above for an S corporation may be useful. Perhaps avoiding IRC Sec. 704(c). If the partnership has special allocations and try to elect S status it may have a second class of stock which would be problematic.
- viii. Partner's death.
 - 1. S corporation and partnerships can benefit from the options for how to handle allocations when an equity owner dies.
 - 2. Example: 3 partners A, B and C. Partner A dies ½ way through the year. Assume the partnership only has income items March \$900 and November \$300.
 - 3. If the partnership takes no action the default result is a pro-rata allocation of all gain. Partner A will be allocated $1/3^{\text{rd}} \times 1/2$ (portion of year he lived). This would be even though \$300 of gain was incurred after death. Partner C and B would get \$375 and Partner A would get \$125 of the November gain.
 - 4. Can elect to close the books and end the taxable year at the date of death of Partner A. This gives a short tax year. Each get $1/3^{\text{rd}}$ of gain for March gain. The November gain is allocated solely to Partner B and C at $\$300/2 = \$150/\text{each}$. Which approach is preferable depends on whose interests are being represented/considered.
 - 5. Many form partnership agreements mandate a closing of the books, or that the books will not close on death. This locks the entity into one of the options. Why do this? In some instances it may be preferable to leave the determination open until the end of the tax year and determine which the preferable result is and then make the determination?
- ix. There are detriments/risks to some of the partnership tax rules.
 - 1. If there were special allocations in the partnership and if there were leveraged wealth transfers of partnership interests a Chapter 14 issue might arise. Arguably (no ruling or case on point) if transfer equity interests in a partnership it may be a transfer of a junior equity interest triggering Chapter 14 rules triggering a transfer of the entire interest. Chapter 14 has no definition of what a subordinated partnership interest is in this context so it is not clear whether this would be a problem. Reg. Sec. 25.2701-1(c)(3).
 - 2. IRC Sec. 704(e)(2) family partnership rules. These rules will generally require an allocation of fair compensation to a parent/donor for services rendered to the partnership. Also, IRC Sec. 704(e)(2) provides that if there has been a gift of a limited partnership interest, the donee/limited partner must be allocated

income proportionately to the donor's contributed capital. If all of capital was contributed by parents this position may under (e)(2) require a pro-rata allocation to that interest. The rationale is that the Code is endeavoring to limit assigning income.

3. Property distributions within 7 years of the contribution of that same property present additional concerns.
 - a. IRC Sec. 704(c)(1)(B) mixing bowl rules. If partner contributes appreciated property and it is distributed to another would shift gain without this rule. This should be treated as a sale. The assignee steps into the partner's shoes for purposes of this rule. So if partner gifts interest to a child and within 7 years of the original contribution to the partnership, the child steps into the parent/donor's shoes and recognizes gain. There is a "return to sender" exception if the appreciated property is merely distributed back to the original contributing partner.
 - b. IRC Sec. 737 if within 7 years partnership distributes non-cash asset back to partner who had contributed appreciated stock this is treated as a sale of the stock to the partnership and gain must be recognized.

2. **Recent Developments.**

- a. General comments.
 - i. Consider income tax consequences of each estate tax technique. See comments below concerning relative rates for income and estate tax.
 - ii. Wealth preservation is key for many clients.
 - iii. Number of estate tax returns filed have decreased. 2014 only 12,000 returns. There are still many gift tax returns so clients are still doing transactions.
 - iv. Perception is that practitioners remained busy in 2015. 2016 should be a busy year.
- b. New Basis Consistency Rule.
 - i. Surface Transportation and Veterans Health Care Choice Improvement Act.
 - ii. Basis consistency new reporting provisions. For income tax purposes you cannot claim a basis different than that reported for estate tax purposes. The rationale of the change was to eliminate planning that some had done to claim higher basis when later selling an asset that was reported on an earlier estate tax return at a lower value. See: *Janis v. Comr.*, TC Memo 2004-117. The abuse was that a beneficiary would claim a higher basis on an asset than the value that was reported on the estate tax return. Speaker does not believe this happened quite often. Another speaker at most a handful of clients considered this and few if any pursued this type of planning. The government revenue benefits from this change seem to be overstated.
 - iii. What if opposite occurs and now with a non-taxable estate and a beneficiary wants to report a low or no discount with an FLP interest?

Note that statute does not prohibit IRS from arguing a lower basis if the IRS believes that the taxpayer/estate has over-reported basis.

- iv. A variety of unanswered questions remain concerning these rules.
- v. IRC 1014(f).
 - 1. Increased estate tax. So if estate is below exclusion then the new rule should not apply.
 - 2. Speculating – does the new rule not apply because you don't have a tax payment obligation because it was zeroed out because of charitable or marital deduction?
- vi. IRC Sec. 6035 the reporting requirement.
 - 1. Requires that the executor file a statement with IRS within 30 days of due date for filing Form 706 federal estate tax return and report to beneficiaries.
 - 2. "...the application of this section to property with regard to which no estate tax return is required to be filed..."
 - 3. Form draft has been posted to IRS website along with instructions.
 - 4. Statute states Regulations can be issued. but information returns must be furnished no later than 30 days after due date or after filing if earlier.
 - 5. The instructions suggest that if filed after due date, then the basis reporting is due 30 days after that filing, which appears to contradict the statute.
- vii. Per return penalty \$250/return with a maximum of \$3M, but if intentionally disregard the penalties increase and could be as great as 10% of the values involved. IRC Sec. 6721(e).
- viii. For tax returns due after July 31, 2015, so requirements apply to estates prior to effective date as well.
- ix. Filing due date has been postponed Feb. 29, 2016.
- x. A practical issue is that the executor will generally not know which assets which beneficiary will receive other than assets which are specifically bequeathed. Report might be a useless list of all assets in estate, etc. It would seem to make it impossible for the IRS to match reporting to what beneficiaries ultimately receive.
- xi. Does the beneficiary have a right to participate in filing or audit process? No. But under state law the beneficiary could have an action against a fiduciary who did not properly represent his or her interests. The basis reporting presents a new dynamic on estate tax audits. In the past, agreeing to an audit report did not imply agreeing to anything other than tax due. Now it means agreeing to values on specific properties/assets. So now executor may have a responsibility to negotiate with the IRS over how specific assets are reflected on the audit report. While an equitable adjustment can be made that may not suffice. The executor perhaps should advocate for a higher value.
- xii. Example: Assets pass to equal trusts for son and daughter. Can the executor determine what to report as passing to each beneficiary? Most documents and state law permit an executor to fund trusts/bequests in a

non-pro-rata manner. So until the executor funds the bequests you may not know. Should the executor notify the beneficiaries of what is done to foreclose a challenge later?

- c. Tax Extenders.
 - i. December 19, 2015 Protecting Americans from Tax Hikes (“PATH”). Public Law 113-295. There were 55 tax extenders. Some retroactive to January 1.
 - ii. Income exclusion for direct charitable distributions from IRAs to charity.
 - iii. Sec. 179 expensing of \$500,000 made permanent.
 - iv. 50% bonus depreciation phased out over 5 years.
 - v. Closely held business capital gain exclusion made permanent.
 - 1. Comment: See discussion in Monday morning Fundamentals program.
 - vi. Sec. 408 of the PATH Act provided that the gift tax will not to apply to contributions to certain organizations. The purpose of this provision is to answer the question about contributions to 501(c) (4) social welfare organizations that educate public. There was no issue as to whether they qualified for a charitable deduction, they did not, so the question was if not qualified for a charitable deduction for income tax purposes that implied that they were therefore subject to gift tax. Gifts in the past may be “fair game” but going forward it should not be an issue.
- d. ABLE Act.
 - i. Sec. 529A is analogous to 529 college savings plans. The account is tax exempt and distributions can be made for benefit of the disabled beneficiary.
 - ii. Intended to benefit persons with disabilities.
 - iii. States must enact legislation. More states in 2016 will create ABLE contributions.
 - iv. Annual contributions cannot exceed \$14,000/year. Maximum account balance cannot exceed \$100,000 or beneficiary’s eligibility may be jeopardized.
 - 1. Comment: While ABLE accounts are helpful the limitations will make their application for wealthier clients quite limited.
- e. Administration’s Proposals.
 - i. Greenbook proposals for reform. While practitioners ignore these administration proposals as unlikely to be enacted remember that IRC Sec. 1014(f) was enacted last year (see above). So be cautious as some of these might be enacted as well.
 - ii. President proposed Canadian Appreciation Estate Tax (AET). At death you have a deemed realization event for income tax purposes and a deemed sale of appreciated property. Exceptions provided for this, but in general it is a capital gains tax on gift or death. The difference from the proposal and the Canadian law is that Canada enacted its AET when it repealed the estate tax. The Administration likely knows this is not politically doable if not coupled with the repeal of the estate tax. This might be a way to introduce a really draconian change then compromise

with the repeal of estate tax for this at a future date. It is not clear that the capital gains tax under a Canadian-like system would raise more revenue than the repeal of the estate tax would cost. There has even been another more draconian proposal that the basis of any gifted asset shall be zero to the donee. Panel does not see any legislation like this being enacted in 2016. It is no longer popular to be wealthy in the US and that fact might make it difficult to eliminate the estate tax.

- iii. GRAT proposal has been around since 2012 but new more stringent provisions have been added. The original proposal included a 10 year minimum term for GRATs. The latest proposal has the maximum term the life of grantor plus 10 years to eliminate the 99 year GRAT concept (but for now that technique may remain viable). The new proposal would destroy GRATs would require a remainder interest of 25% of value contributed or \$500,000 (but not more than value of property contributed). This would destroy GRATs. Another new provision is no decrease during annuity term and no tax free transactions between grantor and GRAT. The proposed effective date is date of enactment.
- iv. Sales to grantor trust is a new iteration of prior proposals. This would effectively eliminate note sales to grantor trusts.
- v. If transactions are contemplated they should be completed.
- f. Crummey.
 - i. Estate of Cristofani and the recent Mikel cases have reinforced the perception of abuse by the wealthy of annual demand powers and gifts to trusts.
 - ii. Crummey powers in the Mikel case were substantial. The taxpayer claimed 60 annual exclusions along with spouse or 120 annual exclusion gifts. The proposal is designed to end that type of planning. Exceptions are provided from the proposed new restrictions. Taxpayers will continue to be permitted to make annual exclusions for outright gifts, gifts to a tax vested trusts under IRC Sec. 2642(c) (the concept already exists for GST), and 2503(e) gifts for education and medical expenses paid directly to providers.
 - iii. The new requirement would cap total Crummey powers at \$50,000 per year per donor (to whatever number of donees). Speaker believes this is one of the more likely changes to be enacted (be wary, see 1014(f) above that was pushed through). An old ILIT may be subject to this rule for future gifts. Practitioners might consider, for new irrevocable trusts that are drafted, adding more flexibility in this regards, or perhaps a provision to amend the Crummey power included in the irrevocable trust.
 - 1. Comment: For existing insurance plans that require large Crummey powers to finance gifts to insurance perhaps if the limitations are enacted other irrevocable trusts could enter into split-dollar arrangements with the ILIT to finance insurance premiums.
 - iv. With respect to Crummey annual demand powers, notice is not required under any authority. The perception that notice is required to qualify is a

misperception of existing authorities. There is a PLR, which is not authority, indicating a notice requirement. In contrast to that, there are 3 cases Crummey, Holland and Turner which do not require notice. Thus, there is substantial authority that no notice is required. There is a revenue ruling saying that if there was no notice AND there was an unreasonably short withdrawal period of only 4 days the power was illusory.

1. Comments: Consider that since there is no written notice requirement for more moderate wealth estates (likely to be under federal exemption) perhaps requirements for written notice should not be included in trust instruments or a single waiver should be signed. This could greatly simplify administration of these trusts. This could make insurance trusts more palatable to protect insurance proceeds even if the client cannot anticipate any federal estate tax savings.

g. State Death tax.

- i. About a score of states with state death tax or inheritance tax (2 have both). NJ has lowest at \$675,000. TN will phase out in 2016.
- ii. If you have a condo in NYS prior planning had been to transfer the residence in an LLC and avoid NYS estate tax as an intangible property. NYS Tax Department has issued an advisory opinion saying owning real estate in a single member LLC will not avoid situs in NY by converting it to an intangible asset. IRS took a similar position in *Pierre v. Comr.* Instead use a limited partnership with an LLC as the GP to avoid the consequences of this ruling. TSB-A-15(1)M (May 29, 2015).
 1. Comment: States have become more astute and aggressive on a host of these and similar issues. See Indiana Letter of Findings 01-20140470, posted 04/29/2015 as an example of how a state has looked through a QPRT to continue to find that a client has owned a home in and remained domiciled in state.
- iii. Also see TSB-A-08(1)M (Oct. 24 2008) regarding an S corporation owning a house.

h. State Income taxation of Trusts.

- i. Many combinations and variations of how states attempt to tax trust income. States are being more aggressive. Beneficiaries and trustees are more mobile. The confluence of these factors has resulted in more cases arising.
- ii. What is a sufficient nexus for a state to have jurisdiction to tax? If you have state law apply to the governance of the trust will that suffice to create tax nexus? If a trust is created under a will in a particular jurisdiction but no trustees or beneficiaries reside in that state. Some states will tax this (two are noted below) others will not.
- iii. Many clients name family members as trustees without considering the tax implications of this. Consider when you are including other “people” or positions in the trust instrument, e.g., investment trustee, trust protector, etc. If it is a directed trust and you have a mere administrative trustee in a

trust friendly state will that suffice to avoid tax in another higher tax jurisdiction that has nexus?

1. Comment: This should be a question CPAs might consider inquiring of clients when completing state trust income tax returns. Have you considered options to address state taxation? Too often clients assume irrevocable trusts are carved in stone and don't return to any of their advisers to revisit the current status of the trust and planning options that might exist. In some instances having one family trustee resign in favor of another out of state family member might have a positive tax impact.
- iv. Consider that if the trustee does not file a state income tax on the presumption that the trust is not subject to taxation in a particular jurisdiction, the statute of limitations on the state auditing the return will not run.
- v. Cases have challenged situations where settlor resided in state when trust formed but later there were no assets, no income, and no trustees in the state. Most courts have held that under such facts the state cannot tax the trust. One other theory is that if a will created trust that the probate court's involvement (DC case) in administering the trust gave right to taxation. CT Gavin case. Speaker believes these two cases are outliers.
- vi. NC held statute unconstitutional since taxed if beneficiary was domiciled in NC. *Kaestner Family Trust v. North Carolina*, 2015 WL 1880607 (NC Super. Ct). 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. Must purposefully avail yourself of benefits of state to be subject to tax and in this type of fact pattern the trust had not done so.
- vii. *Kassner* NJ Court of Appeals case. NJ Resident created trust. Even though no current assets in NJ, Trustee outside NJ and no NJ in beneficiary. No administration in NJ. But trust held S corporation stock and that S corporation held NJ assets and this NJ income showed up on the return. Everyone concedes that NJ income is taxable in NJ. NJ claimed all income was subject to NJ income tax because there was some income in NJ. The Court reached a conclusion that they could not tax more than NJ source income of the trust. It was held not fair to retroactively change the rules without notice. There seems to also be a constitutional issue with this. *Kassner v. Division of Taxation*, 2013 N.J. Tax LEXIS 1 (January 3, 2013); 2015 N.J. Tax LEXIS 11 (2015).
- i. Basis not increased on Grantor trust.
 - i. Can you get new basis on assets on death of grantor on assets held in a grantor trust that is not included in the grantor's estate? While a PLR held this was possible in an unusual foreign context, this may not be viable for other circumstances. The IRS will not rule on these cases.
- j. QTIP and Portability.

- i. Rev. Proc. 2001-38.
 - ii. Filed estate tax return and qualified estate for marital to preserve unified credit although that marital deduction was not required to reduce a federal estate tax as there was not tax.
 - iii. The Rev. Proc. Says if you claim marital deduction when don't need it, you can void the QTIP election. This was a favorable ruling to protect the taxpayer.
 - iv. If you did not need to file a return but you did file a Form 706 to claim portability what is the effect of this ruling on a QTIP on that return?
 - v. IRS said they will resolve the conflict. It is believed that this will be resolved favorably but may eliminate a whipsaw opportunity by taxpayers in doing so.
- k. Promissory Notes: valuation and other issues.
 - i. Individual client writes loan of \$1M to son for 9 years and looked at AFR say 2.1%. Note required quarterly interest and principal balloons in nine years. Was there a taxable gift as a result of this loan? No. A gift loan is protected under IRC Sec. 7872 from a gift tax so long as the minimum interest rate is specified. See *Frazer v. Comr.*, 98 TC 554 (1992).
 - ii. Lender/parent is now dying and note is appraised and an independent appraiser values it at 50% of face. Death occurs. What is the FMV of the note for estate tax purposes? Have the facts and circumstances changed significantly since the loan was issued until the date of death?
 - iii. You can make a good argument that the rules are different. The IRS has had proposed regulations on this since 1985. What do you do? Agent may view your taking a low value on the estate tax return and may assess an estate tax deficiency or that a gift was made at an earlier date.
 - iv. Consider Davidson case.
- l. Priority Guidance Plan.
 - i. Personal guarantees and contingent liabilities.
 - ii. What is the value of a contingent liability on the guarantor's estate tax return?
 - iii. Deductible amount of expenses and claims, such as under Graegin loan arrangement. You can deduct currently since loan in Graegin cannot be prepaid even though interest cannot be prepaid.
- m. Defined Value Formula Clauses.
 - i. McCord/Hendrix. A charity makes an agreement.
 - ii. Petter is a formula allocation clause. This may be safer.
 - iii. Wandry – gift a specified dollar amount. Is that effective? Wandry said it was. With a small gift it is easy to use. With a larger gift using a determination made by independent parties may be preferable or a spill-over to GRAT.
 - iv. IRS does not like these clauses.
 - v. Belk case involved a savings clause (not a formula clause) in the context of a conservation easement. The transaction involved a conservation easement subject to a contribution agreement that permitted the substitution of property. The IRS disallowed the deduction on the basis

that the substitution right violated a principal requirement of qualifying for a conservation easement. The taxpayer asserted a clause in the agreement that purportedly cured any tax defect so that the easement involved would qualify for a deduction. This raises similar issues as Procter. Belk v. Comr., 774 F.3d 221 (4th Cir. Dec 16, 2014). The court felt that the savings clause endeavored to have the court re-write the easement based on the court's decision and it would not do so under the rationale of Procter.

- n. Chapter 14, 2704(b)(4).
 - i. Appraisers will discount based on restrictions on liquidation and transferability. If governing document prohibits transfer, cannot get out, affects discount.
 - ii. State law had Uniform Partnership Act and corporate laws. Example in VA required 2/3rds+ to liquidate. So a restriction under state law should be respected. So practitioners had states “bump up” the state law restrictions for discount purposes. So applicable state restrictions had to be given affect by appraisers.
 - iii. Speaker commented that the IRS was surprised at how effective practitioners were at getting states to modify state law in this regards.
- o. Same-Sex Marriage.
 - i. Obergefell v. Hodges, 576 US ___, 135 S. Ct. 2584 (June 26, 2015).
 - ii. A myriad of tax and legal benefits are impacted. If clients have not revised their planning they should do so.
 - 1. Marital deduction.
 - 2. Gift-splitting.
 - 3. Same-sex spouse is “family” for Chapter 14 purposes.
 - 4. Intestacy laws.
 - 5. Spousal right of election.
 - 6. Tenants by the entirety depending on state law.
 - iii. Review beneficiary designations, pre-“nuptial” and other marital agreement.
 - iv. Consider the status of those who are not married but rather are domestic partners.
- p. Aggregation of Real Estate Holdings
 - i. Pulling v. Comr., TC Memo 2015-134 (July 23, 2015).
 - ii. Real estate valuation case. 3 parcels plus interest in entity that owned adjacent parcels.
 - iii. Auditor valued all parcels. Executor said to value parcels owned by entity separately from the 3 owned directly. Values were much lower because of access issues. Tax Court said valuing individual parcels from entity parcels was valid.
 - iv. IRS tried to aggregate interests of spouses for a control interest in the Bright v US 658 F.2d 999 and Court held no family aggregation. Note also, Rev. Rul. 93-12 holding that family aggregation should not be argued.
- q. Family LLC Valuation Case.

- i. Purdue Tax Court Memo 2015-249.
<http://www.ustaxcourt.gov/USTCInOP/OpinionViewer.aspx?ID=10657>.
There were five separate investment accounts with three different investment advisers and an undivided fractional interest in a commercial real estate property in Hawaii. Taxpayer died owning interest in entity owning those underlying assets. IRS argued that discounts not applicable.
- ii. Issue was whether the transfer was for adequate and full consideration. Was it a bona fide sale for adequate and full consideration? This depends on whether there were legitimate non-tax reasons? The court held favorably for the taxpayer.
- iii. Court identified significant non-tax reasons:
 - 1. Significant purpose to consolidate investments to meet minimum investment requirements.
 - 2. Withheld enough assets outside entities so not dependent on distributions.
 - 3. No commingling of outside and inside assets.
 - 4. Formalities of entity respected.
 - 5. All assets properly and formally transferred to entity.
 - 6. Husband and wife of family were in good health when planning was done.
- r. Crummey Powers in the Mikel Case.
 - i. IRS going after “dummy Crummey” provisions.
 - ii. The IRS attacked the Crummey powers in Mike based on in-terrorem clause and binding arbitration together which they argued made beneficiary right of withdrawal illusory.
 - iii. The court looked at language in in-terrorem provision and said it only applies if the beneficiary challenges discretionary distribution not the trustee’s actions concerning the Crummey powers. The court did not see that a beneficiary had to be able to go before a state court to enforce rights. The court stated that it did not see that a beneficiary would suffer harm by having to submit a claim to a Jewish arbitration panel, a Bet Din.
 - iv. In NY binding arbitration provision is not enforceable under NY law.
 - v. Binding arbitration, most courts say not enforceable.
 - vi. Make sure binding arbitration does not apply to marital or charitable deduction to minimize dispute with IRS on these.
 - vii. See Mikel v. Comr., TC Memo 2015-64 (April 6, 2015) and ILM 201208026.
- s. Net Net Gifts.
 - i. Steinberg case (2nd case), 145 TC No. 7 (Sept. 16, 2015).
 - ii. Net net gift. There were two distinct obligations which the donees assumed in this case. First is the actual gift tax on the gift to 4 daughters. The second is that the daughters also agreed to pay any estate tax if donor died within 3 years of the transfer and the gift is included in the donor’s estate for federal or state estate tax purposes.
 - iii. Under Sachs case it doesn’t matter who paid the gift tax, it is deemed paid by donor. This is why it was a net net gift.

- iv. The agreement was negotiated. Court noted they were assuming liability they would have faced. One daughter had been cut out in a prior will and could have been cut out again. Assumption of liability is a significant legal difference from mother holding assets and paying tax.
- v. IRS initially challenged notion that the value of the gift tax included in the estate.
- vi. Net gifts can be useful if donor wants to part with a specific amount.
- vii. While life expectancy at age 89 life expectancy can remain significant.
- t. Adequate Disclosure.
 - i. FSA 20152201F (March 13, 2015).
 - ii. The disclosure described/mentioned the partnership interests and listed the EIN (although one digit was missing). The IRS asked the taxpayer to extend statute on gift tax return and taxpayer refused. Because of this lack of cooperation this result may have occurred. There was no indication of the rationale or basis for discount. The taxpayer did not follow the requirements of the regulations.
 - 1. Comment: Follow the cookbook instructions provided by the regulations to comply with adequate disclosure to avoid this type of issue.
- u. IRC Sec. 2801 Expatriates.
 - i. The Heroes Earnings Assistance and Relief Act included a tax when someone expatriates.
 - ii. Proposed Regulations issued on gift and estate transfers. REG 112997-10.
- v. Davidson Case.
 - i. Estate of Davidson v. Comr. Tax Court Docket No. 13748-13.
 - ii. Age 86 with \$2B+ net worth.
 - iii. Did series of sales to trusts. Sales were funded with gifts and sold for SCIN. To have a FMV on sale must be premium of interest rate or premium of principal. Mr. Davidson did sales to trusts for SCINs and contributed the notes to GRATs with 5 year term. The GRAT will return property to grantor at FMV of gift plus 7520 rate of about 2%. One note had 13%+ premium. If he died before note due it was gone. If he lived, the GRAT reduced the value.
 - iv. Mr. Davidson died 50 days after the transaction. IRS said you cannot use mortality tables. Taxpayer said they could as had physicians stating he had more than 50% likelihood of surviving. The IRS also said mortality tables could not be used for SCIN.
 - v. Matter was settled so don't know if you can use mortality tables with a SCIN and there are different views on this.
 - vi. Taxpayer paid \$708M in tax. A malpractice complaint was filed. The complaint stated estate was over \$3B in value. Is \$708M a good result? 23.6% taxes, but much of the estate went to charity, etc. Average rate of estate tax for mega estates is about 19%. \$717M marital deduction and a large charitable deduction. Suit is for more than \$500M.
 - vii. How should premium calculation be determined? Plain vanilla note and decreasing term policy if insured dies before note pays off. Should

premium be amount life insurance company would pay for this? That might be correct under willing buyer and willing seller, but IRC Sec. 7872 was enacted to simplify that. The question is whether you can use the tables.

- viii. Some lessons on malpractice claim. If accused of malpractice get another attorney involved to avoid the argument that the matter could have been handled better.
- ix. If doing a transaction with residual marital or charitable consider what happens if something goes wrong. If comes out of residue if don't have allocation to charge against gift then the tax on the table is expensive. Consider having tax come out of the gift so it becomes like a net gift.
- w. *Woelbing v. Comr.*
 - i. *Estate of Donald Woelbing v. Comr.*, Tax court Docket No. 20361-13.
 - ii. Note sale to a grantor trust. Note must be respected as a valid indebtedness. Questions concerning use of AFR for the note.
 - iii. Unclear from facts if there were 10% other assets in the trust.
 - iv. There is no 10% rule of law it comes from corporate transactions.
 - 1. Comment: So often the 10% "rule" is cited as if it were statutory. The comment above provides some clear confirmation that at most it is a convention or suggestion but nothing more.
 - v. IRS is being aggressive but not clear whether it will settle or go to trial.
 - vi. What happens if clients want to pay some of note back? This could be used to bring business back into the estate.
- x. GST rulings.
 - i. PLR 201523003. Reg. 26.2652-1(a)(4) permits gift splitting for GST purposes. The taxpayers made election to split-gifts on gifts that did not qualify. If wife is beneficiary and could not sever interests cannot split gifts. But once statute of limitations on audit tolls the IRS is foreclosed from challenging legal issues. If affirmative allocating to trust you want it to be exempt from GST so you opt into GST automatic allocation with a formula. If you want zero inclusion ratio you don't want to risk having a mixed exclusion ratio in the future.
 - ii. PLR 201509002. Sale of property between two GST trusts to a beneficiary did not cause either trust to lose GST exempt status. The IRS should not rule on factual matters. This is a *Bosch* issue and ruling should not have been issued.
 - iii. PLR 201530008. A grandfathered GST trust was divided into two trusts and had no negative impact on GST status.
- y. Portability Regulations Finalized.
 - i. Final regulations were issued June 12, 2015. TD 9725.
 - ii. Treasury has discretion to file a late portability election for smaller estates under the basic exclusion amount, but not for larger estates.
 - iii. The DUSE for a non-citizen surviving spouse who is a beneficiary of a QDOT is not adjusted after the spouse becomes a citizen.
 - iv. Most of the provisions of the temporary regulations were retained.

1. The mere filing of a return suffices to constitute the portability election.
2. The executor can revoke the portability election until the filing due date.
3. The election relates back to the decedent's date of death.
4. Filing a complete and proper return is required but special valuation rules are provided for marital and charitable deductions if non return is otherwise required. These rules permit estimates within certain parameters. Reg. Sec. 20.2010-2(a)(7)(ii)(A). This leniency is not permitted if:
 - a. If the marital or charitable bequests are based on a formula that divides those bequests with non-charitable/marital.
 - b. If less than then the value of the interest included in the gross estate is marital or charitable.
 - c. If only a portion of the property qualifies for the marital deduction because of a partial disclaimer or partial QTIP election.
5. Use the DSUE before the surviving spouse's basic exclusion amount ("BEA").
6. Divorcing a later spouse before he or she dies will preserve the DUSE from the last predeceased spouse.
7. With a non-citizen surviving spouse a QDOT presents complications. The property in the QDOT is taxed as if it was the deceased spouse's with the tax due deferred until the death of the surviving spouse. Thus, the DSUE cannot be known until the death of the surviving spouse. Reg. Sec. 20.2010-2(c)(4)(i).
- v. If there is a filing deadline established by regulation you can get IRC Sec. 9100 relief. If you have an estate that should have elected portability but did not regulation will give relief if and only if estate is below exclusion amount.
- vi. Special QDOT rules.
- vii. Order in which use available credits. If you have a 2014 foreign death tax credit and unified credit. Which credit is applied first? Regulations (wrong?) state use unified credit first and exhaust the amount of credit that would otherwise be available for portability. But 2013 and 2014 are meant to avoid double taxation so those should be used first but that is not what the Regulations did.
- z. Estate tax closing letters.
 - i. Not being issued unless affirmatively requested.
 - ii. Taxpayers would want this to show that the return has been filed and you can firm the tax paid so that executor will know and can distribute assets. Title examiner for real estate might ask for closing letter to show that tax has been paid.
 - iii. As an option you may ask electronically for a transcript. You must be registered as a professional tax preparer. Must set up e-file as e-filer and use a different number, not PTIN. IRS will send you a code to use.

- iv. Call or write requesting.
- aa. Executor's personal liability.
 - i. Executor sold real estate in the estate and distributed assets to himself as beneficiary and siblings. Executor claimed estate had been depleted by bad advice from lawyer. Not sure why case was litigated for \$71,000
 - ii. Priority statute. Executor held liable.
 - iii. Test is did executor make estate insolvent when made the transfer?
- bb. IRC Sec. 67(e).
 - i. 2% floor and miscellaneous itemized deduction and investment expenses for trusts Regulations are final. Apply to fiduciary income tax return for years that begins after 2014.
 - ii. IRS may focus on unbundling. If fiduciary fee is a consolidated fee for all services performed then must unbundle. The one item stressed in regulations is that you must segregate the portion attributable to investment advice.
 - iii. If fiduciary owns assets being invested and perform investment services they are not rendering advice to anyone and an argument according to one commentator is that all of the fees in such a case are for being a trustee are for being a trustee and none of the fee is for rendering investment advice. Others disagree and believe that the above argument is not viable.
 - iv. If you have a separate fiduciary fee you must identify the portion attributable to investment advice. If the fiduciary fee is not computed on an hourly basis you must unbundle. Safe harbor – identify what portion is investment advisory. Might consider the way individual trusts are invested and estimate the fee based on different assets.
 - v. These rules apply to legal and accounting fees.
 - vi. Tax preparation.
- cc. SEC v. Wyly.
 - i. SEC sought penalties, injunctive relief and tax savings.
 - ii. 3 protectors for each of 17 inter-vivos trusts. None were related or subordinate. Nonetheless the trustees followed all investment recommendations made by the protectors including collectibles, etc.
 - iii. There were additional IRS investigations.
 - iv. Charles Wyly died. Another Wyly testified recently in bankruptcy.
 - v. Conduct of protectors and settlors is that all actions of protectors imputed to settlors since there was a pattern of action.
 - vi. Operate trust powers using powers sparingly and not to fine tune.
 - vii. Protector should have his or her own counsel.
 - 1. Comment: While the Wyly case might be a bit extreme, the concept of a pattern of conduct is problematic in so many situations (pattern of distributions from a trust that is then attacked in divorce). Clients so often do not understand the need to meet annually with legal counsel. Identifying inadvisable (or inappropriate) patterns of payments, investments, etc. is something that may well come up with periodic reviews.

- viii. Weber case had similar consequences in that the court ignored the structure. The case involved private placement life insurance.
- dd. IRC Sec. 642(c).
 - i. Green v. US F. Supp, 3d, 2015 WL 6739089.
 - ii. Distribution to charity must be sourced to gross income of the fiduciary entity.
 - iii. In year in which they had gross income an asset was purchased but did not immediately distribute to charity. Question relates to the gross income requirement. Can they deduct the full FMV or is the deduction limited to basis? The IRS argues that only basis is income. Taxpayer filed original return with lower deduction then filed amended return for higher amount.
 - iv. Court said there is no answer to question in the Code so we should favor taxpayer making gifts to charity. In case taxpayer filed refund action for larger deduction based on FMV.
 - v. Treatise suggested different result. Commentators suggest that Green may not have reached the correct result.
- ee. Charitable Substantiation.
 - i. Must have receipt from donee.
 - ii. Regulations that indicated IRS can be notified instead of receipt withdrawn.
 - iii. Requires appraisal over specified dollar amounts.
 - iv. Appraisal must be quite specific. Must include description of property and be dated and signed by appraiser.
 - v. Appraisal must be included with return.
 - vi. What must be appraised is property worth more than \$5,000 other than money or publicly traded securities.
 - vii. Interests in split-interest trusts are being contributed to charity. Example, - create CRT and give income interest to charity. That permits the donor a charitable deduction but since this income interest is not money or marketable securities there must be an appraisal.
- ff. Inflation Adjusted Figures.
 - i. Gift exclusion remains \$14,000.
 - ii. Estate tax exemption is \$5,450,000.
 - 1. Comment: Considering amending standard clauses in POAs and revocable trust gift provisions to sop up inflation adjustments to the exemption (or all of the unused exemption). Standard language that has been used so commonly in the past may not permit this.
 - iii. Annual exclusion for non-citizen spouse is \$148,000.
 - iv. Note the relationship between the various tax rates. Highest ordinary income rate is close to estate tax rate. If add state income tax rates very close to federal estate tax rate on even capital gains. If add state income tax, Surtax, etc. even capital gains rates get close to estate tax rates.
- gg. Revocability of Inter-vivos Trust.
 - i. UTC permits will to revoke revocable trust. The historic rule was that a trust was only revocable if the trust instrument itself stated that the power

to revoke it was retained. Modern rule is that a trust is revocable unless it states that it is not revocable. UTC Sec. 602(a).

- ii. UTS has been adopted by more than 30 states.
- iii. Under uniform POA Act can execute a trust agreement and fund a trust agreement during lifetime.
- iv. Unexpected that you might be able to do by trust what you cannot do by will.
- v. UPC permits will to be reformed. UTC permits a trust to be reformed for scrivener's error but not all state laws permit this.

hh. Trust Protectors.

- i. Trust protectors are still a new concept.
- ii. Recent case: *Minassian v. Rachins*, 152 So. 3d 719 (Fla. Dist. Ct) App., 2014).
- iii. The Florida court upheld the decedent/testator's second wife appointing a protector under the terms of the instrument to amend the trust thereby clarifying that the children from a prior marriage were not beneficiaries of the current trust but of a trust to be formed on the death of the surviving second spouse/beneficiary.
- iv. Wife withdrew substantial principal from non-marital trust. Children sued widow for accounting. Widow objects saying children lack standing. Protector clarified trust provisions. Speakers believe children had standing. But district court wanted drafter/protector. Court let protector due this.
- v. If children cannot challenge what spouse did, who can?

ii. Reformation.

- i. If clear and convincing proof of error Court will reform will. Issue comes down to quality of evidence.
- ii. Duke case was a self-drawn document. *Estate of Duke v. Jewish National Fund*, 352 P.3d 863 (Cal. 2015).
- iii. With less risk of estate tax and growth of internet options there will likely be more of this.
- iv. Question – what is clear and convincing evidence? It seemed to be the provisions in the self-drawn will itself.

jj. Decanting.

- i. Beneficiaries of the new trust can only include beneficiaries of the decanted or old trust. *Harrell v. Badger*, 171 So. 3d 764 (Fla. Dist. Ct. App. 2015).
- ii. Note that tax issues may exist in a decanting. For example, if you delay the time to vest you may have GST problem.
- iii. Flint case in DE raised additional concerns over decanting. It also made clear that a trust friendly jurisdiction won't approve everything brought before it. Wanted to reform trust. Corporate trustee did not want liability so wanted to change trust to permit direction trust. Court said if settlor wanted direction trust it would have said so and there is no evidence of this. *In re Trust Under Will of Flint*, 118 A. 3d 182 (Del. Ch. Ct. 2015).

- iv. Was it a material purpose of the trust to prohibit direction trust structure? Was this inferred by court? If a trustee violates material purpose of trust with decanting it won't work. Should draftspersons consider adding a statement of material purpose statement?

kk. Adult Adoption.

- i. Which state law governs an adult adoption?
- ii. This is a full faith and credit decision. State required to respect other state law.
 - 1. Comments: See comments by Joshua Rubenstein in the Tuesday morning lecture.

ll. Secondary disclaimer.

- i. One person disclaims property so that it goes to another person who may then disclaim to achieve a tax or other benefit. NY Surrogate's court did not see how it served purpose of infant. Cannot build into a settlement agreement if you want a disclaimer.
- ii. In re Friedman, 7 NYS 3d 845.

mm. Informing Trust Beneficiaries.

- i. UTC Sec. 603. Treat trust as will substitute.
- ii. Beneficiaries under will cannot challenge what you do with your money. But do remainder beneficiaries under a revocable trust have right to challenge what you do with wealth before you die.
- iii. UTC says while settlor is alive trustee has no obligation to report to remainder beneficiaries.
- iv. If remainder beneficiaries believe fiduciary is doing something wrong not entitled to accounting.
- v. Tseng v. Tseng, 352 P.3d 74 (Or. Ct. App. 2015). Cannot get information while alive but may later.
- vi. What if grantor is incompetent? Could perhaps get guardian appointed to raise issue on behalf of settlor but this is cumbersome and will take a long time.
 - 1. Comment: Consider the issues that this raises in terms of protecting the grantor/beneficiary of a revocable trust during aging and health challenges. See comments by Diana Zeydel in her Tuesday morning presentation "Effective Estate Planning for Diminished Capacity..." Proactive steps should be taken to assure that while a settlor/beneficiary is alive but "fading" that protection is in place. Consider perhaps an institutional co-trustee, CPA as monitor, trust protector, etc.

3. **Advising Wealthy in Times of Change.**

- a. General comments on Change.
 - i. Frequent changes in tax and other laws.
 - ii. Changes in conflict of laws.
 - iii. Concentration of wealth.
 - iv. Political upheaval.
 - v. Social change, changing views of family, marriage, etc.
 - vi. Safety concerns.

- vii. Family business.
- viii. Emotional problems for the wealthy.
 - 1. No sympathy.
 - 2. Whatever problems they have they have enough money.
 - 3. This has an impact on our clients.
- ix. Secrecy is pretty much dead. Global tax enforcement and information sharing have become common. Common Reporting System (CRS) 42 countries have signed on. The US is the only major country that has not signed on to this.
- x. Tax laws from country to country will become more uniform since disparity creates loopholes.
- xi. What reasonable expectation of privacy with cyber breaches, etc.
- b. What has happened since 2008?
 - i. Worldwide recession in which every asset category was down in value. Even in the great Depression
 - ii. Collapse of major investment houses.
 - iii. Near collapse of global banks.
 - iv. Accounting scandals involving large companies like Enron and WorldCom.
 - v. Ponzi schemes like Madoff.
 - vi. Patriot Act.
- c. Income versus transfer taxes.
 - i. Income taxes are paid by everyone. No general social policy behind it, it is intended to raise revenue.
 - ii. Transfer taxes don't have a revenue policy. They were not created for revenue. Account for less than 1% of revenue of all OECD countries. Instead they serve as a social policy of redistributing wealth by people to do socially desirable acts like giving money to spouse and charity. It is a voluntary tax, you can avoid them. Warren Buffet and Bill Gates and others have advocated for transfer taxes. Justice Brandies 100 years ago stated we can have concentration of wealth or democracy, but not both.
- d. Trusts.
 - i. Consider historical context. If people use to live only into their 30s and a trust lasted for life in beings how long was that? Contrast that with a modern perpetual trust.
 - ii. Can "beat" income taxes in some countries using trusts for planning.
 - iii. Many countries have repealed Statute of Elizabeth permitting self-settled trusts.
 - iv. Some jurisdictions have restricted or eliminated the need to inform beneficiaries about trusts.
 - 1. Comment: It is increasingly common to have institutional trustees to endeavor to secure nexus in a trust/tax friendly jurisdiction and also for aging or infirm clients to protect themselves. Some institutions have policies on informing all beneficiaries over a certain age about the existing of a trust (trust instrument and statement) and may only permit deferral of disclosures if a

designated representative is named, or if a specific condition exists warranting deferral. So even if state law permits a silent trust that still may not be feasible from a practical perspective. Also, consider the comments later that disclosure of the plan may minimize later litigation. A silent trust that only becomes known e.g. on the death of the grantor may be detrimental to those goals.

- v. Directed trusts have become common and using protectors, etc. grantors have meaningful controls and law is changing rapidly. The relationship of a settlor to a trust has changed significantly to what that relationship had been historically.
 - vi. Purpose trusts may make trustees naked power holders.
 - vii. Trusts can be used to defeat property interests and marital rights.
 - viii. Some countries view trusts as per se shams.
 - ix. Increasingly foreigners are creating US trusts to take advantage of the positive view of trusts in the US in contrast to the negative views of trust elsewhere in the world.
 - x. In other parts of world using commercial foundations to avoid negative perception of trusts. The UK is looking at concepts similar to limited partnerships in lieu of trusts. When using partnerships it is subject to business and commercial law not laws of wills and trusts. This requires a business purpose and has served as the basis for many IRS attacks. These have been attacked using business purpose, sham transaction, step-transaction, and other doctrines. Another issue with family partnerships and entities is the failures to manage and operate them properly.
- e. Litigation.
- i. Major increase in client litigation is a trend.
 - ii. ACTEC identified litigation as a major growth area for the profession.
 - iii. Why? Increasing popularity of American rule of paying legal fees (you pay your own way). In most countries loser pays all. While this discourages frivolous suits it also means that many valid claims are not brought because you cannot afford to lose. The American approach is becoming more popular in other parts of the world.
 - iv. Many lawyers are taking matters on a contingency fee so there are no fees unless the plaintiff wins. This has encouraged significant litigation.
 - v. Aging population. People are living longer. Clients are living to 100 so many “children” inherit in their 80s. Not only are people inheriting later, but because of economic issues they are inheriting less. The result of these and other factors is that estate litigation is growing more common.
 - vi. Heirs don’t appreciate inheriting in a dynastic trust. Although the client and the client’s lawyers understood the benefits of the trusts, many heirs do not and view the entire process negatively.
 - vii. Large divorce rates, blended families, same-sex marriage, adult adoption, post-death conception, and other factors have all changed the nature of what constitutes a “family.”
 - viii. For example you might adopt your partner instead of marrying your partner so that your partner as you child can inherit from a family trust.

All 50 states permit adult adoption. The historic context of adult adoption was to permit a caring step parent to adopt an abandoned child, etc. but the modern applications can have very different implications.

- f. What else has changed?
 - i. Secrecy is gone and availability of information has burgeoned. This has changed forever.
 - ii. Our tolerance for change has changed.
 - iii. Should we tell our clients to live their lives in a manner that does not call attention to themselves?
 - iv. Change is the new norm.
- g. What do you do?
 - i. You have to plan for change.
 - ii. You have to plan for controversy.
 - iii. Once size does not fit all. Use customized solution and a variety of approaches.
 - iv. It costs more to plan better.
 - v. Don't use structures for purpose for which they were not intended.
 - vi. Keep drafting flexible. You cannot anticipate where change will come from, only that it will occur.
 - vii. Don't put every bell and whistle on every structure. Keep things simple when you can.
 - viii. If people knew what you had in store for them they would be more likely not to sue. Don't let people be surprised. Tell heirs.
 - 1. Comment: Involving next generation in meetings so they understand their role as health care and financial agents can protect an aging parent. Explaining to them conceptually what the plan is can minimize angst. It can often provide new clients and continuation for existing clients.

4. **Partnerships in Estate Planning.**

- a. Overview.
 - i. New tax math. 40% transfer tax. Effectively income tax rates are close to estate tax rates.
 - ii. Tax basis management, so called "free-basing," has become a common planning goal. Most estates are "free-base" situation. With an unlimited marital deduction, same-sex marriage and most couples with less than \$5M each there will be little transfer tax so you have created a free step up in income tax basis.
 - iii. Instead of aggressively removing assets out of the client's estate for estate tax purposes, income tax planning is as important as transfer tax importance. In particular, the income tax savings from basis step-up is more important for these clients than estate tax savings.
 - 1. Comment: Compare the relative benefits of adding irrevocable trusts in trust friendly jurisdictions to provide additional matrimonial/asset protection planning to the asset protection

planning provided by the LLC/partnership structures provided below.

- iv. How do you take advantage of free-basis situations and proactively manage opportunities for step up in basis.
 - v. This is more nuanced and complex than prior planning.
 - vi. With zero basis asset die with it. With 100% basis asset remove it from the estate. For mixed basis assets the partnership techniques below might create nearer zero and 100% assets that make planning better.
- b. Planning with FLPs, LLCs, GPs, and LLPs.
- i. Any entity taxed as partnership.
 - ii. Goal use to be maximizing discounts. This is not necessarily the case.
 - iii. How can you proactively use partnerships to change the basis of an asset without requiring death or sale of the asset?
 - iv. Use partnerships to transfer basis between assets to create binary basis assets so you can better identify which assets to remove from the estate.
 - v. Partnerships permit different classes of economic interests.
- c. Preferred and Common Shares.
- i. From an economic and tax standpoint there are benefits.
 - ii. S corporations have a single class require that is not a requirement for partnerships.
 - 1. Comment: See fundamental program from Monday Morning.
 - iii. If you can create a preferred partnership interest with a 12-14% yield (while bonds are currently yielding 2%). The yields on preferred partnerships are based on public securities. Because of the declines in oil and gas values, yields on public oil and gas securities are up. As a result a preferred whose yield is determined based on these will also carry a higher yield.
 - iv. This planning can be quite flexible. You can effectively give away preferred, you can retain the preferred, etc. You can determine within reason the rate of return and who should get it.
 - v. The simplified version is that if you retain the preferred and you are the transferor of the common 2701 is likely to apply. If you transfer the preferred that is an exception to 2701 and normal gift tax rules apply.
 - vi. If you gave 10% of S corporation to child they will get 10% of the income forever and 90% will continue to be paid to the senior generation. In contrast a preferred can let you give disproportionately more income to a lower tax bracket taxpayer.
 - vii. The most common technique is for grantor to retain a preferred interest and give away common interests (called a “forward freeze”). The grantor retains the 8-12% annual payment each year frozen in value. What is included in the estate is the preferred interest. You can freeze the value at the estate tax exemption amount and burn up the excess while still receiving the fixed payment.
 - viii. You can give away the common and retain a qualified income right, i.e. a qualified preferred interest. The value included in the estate is the liquidation preference. As a qualified payment interest, the right in the

- preferred interest has a value. Value the entity and then subtract the value of the qualified payment interest.
- ix. Giving away common may give you, from an income tax perspective, the ability to reduce values more than if instead you made a transfer using a pro-rata partnership with valuation discounts.
- d. Partnership.
- i. Holds highly appreciated assets. Younger generation hold minority interest.
 - ii. Want to increase amount included in estate subject to 754 election.
 - iii. Convert to a general partnership. This changes the state law applicable to it. There are few restrictions and limitations under state law on a GP. So converting it eliminates restrictions. If you are worried about personal liability and put GP interest into single member LLC disregarded for tax purposes but which provides limited liability.
 - iv. Older partner dies. You will get step up in basis. But the partnership is subject to a valuation discount. That discounts may reduce the basis step-up.
 - v. Caution the IRC Sec. 754 election is permanent. Once the election is made the partnership is stuck with.
 - vi. Basis adjustment under IRC Sec. 743 is not a real adjustment but rather a book item personal to the decedent's estate and distributees of that estate. Separate books have to be maintained for each distributee. Because it is irrevocable you will have hypothetical inside basis adjustment for each person (as explained later, really each asset). The paperwork on this is complex and quite costly. Consider an FLP owning 300 securities? How you allocate basis adjustment is determined under IRC Sec. 755. It has to be allocated to every asset in the partnership narrowing gap between tax basis and FMV. Watch mixing bowl rules if assets not held 7 years. One large partnership was estimated to incur \$50,000/year in additional accounting costs tracking all the basis adjustments.
 - vii. Assume 2 assets one with basis and one without basis. Take high basis asset and distribute in kind in a partial redemption or full liquidation of older partner's (parent's) interest in the partnership. What happens under the partnership rules? What had basis in the partnership has its basis replaced by the basis of the distributee's partnership interest. It is now a zero basis asset. When the senior family member dies with this there are no discounts and there is a full step up in basis in his or her estate. This is called a "basis strip."
 - viii. So how do you move basis? This is called a "basis shift." In year you make distribution in a basis strip, have a 754 election in place. When dealing with property in-kind distribution you get an inside basis adjustment which is determined under IRC Sec. 734 (not IRC Sec. 743). This is an inside basis adjustment on actual partnership assets. What comes off of the asset distributed gets added to basis of the other asset retained in the partnership making that assets basis flush or approximately equal to its value. You can later sell this asset with modest or no gain.

- ix. You have accomplished a basis step up on death and moved basis from one asset to another asset for the benefit of everyone. This was done without a taxable event.
- x. This is only viable if you can engineer partnership to be as simple as the above illustration. You need a partnership with one asset with basis and one asset with low basis to receive shift in basis. How can you accomplish this in the real world? See unitary basis rules.
- xi. What is unitary basis rule? It is the opposite of what most practitioners think about basis. Example: If you buy Apple stock at 50 and 100 you have two lots of stock and can choose which lot to sell. This is not the case in partnerships which go by the unitary basis rule. Assume two partners A and B. Contribute assets one with 0-basis and one with \$100 basis.
- xii. Divide the partnership using an assets over division. This is where the partnership drops down one of the assets into a wholly owned disregarded entity (e.g., single member LLC) and simultaneously distributes out interest to partners pro-rata. The result is two partnerships. One with no basis and one with high basis. This is a vertical slice division. On a vertical slice division there is never a taxable event.
- xiii. In a vertical slice where you have two continuing partnerships both are considered continuations of the previous partnership. As continuing partnerships all elections, including the 754 election, follow to each of the continuing partnership.
- xiv. Assets must be in partnership 7 years (old and cold) to avoid mixing bowl rules.
- xv. Consider anti-abuse rules.
- e. Example.
 - i. Have client put all assets willing to give to plan into partnership. Let all assets sit for 7 years.
 - ii. After 7 years the assets are ripe for planning.
 - iii. Go into partnership balance sheet and identify low basis asset and match it to high basis asset that you will never sell. Then take both assets isolate them in a vertical slice.
 - iv. You may have to manipulate outside basis with guarantees, disproportion distributions of cash or public securities, etc.
 - v. Then make 754 election. Take high basis asset and distribute it out to the zero basis outside partner. The basis then moves over to the other asset you chose to shift basis to.
 - vi. Under Subchapter K must segregate assets into three categories:
 1. Hot assets IRC Sec. 751 which are ordinary income assets. Segregate these. Subject to 1245 (not 1250) recapture.
 2. Marketable securities partnerships because general rule is that distribution of marketable security is treated as distribution of cash equal to FMV, i.e., it is treated as cash. This won't help with basis strip. Exception for qualified investment partnerships which are essentially partnerships that have since inception have only held publicly traded securities. If you do this then the cash rule does not

apply to marketable securities. So in theory you can move basis off publicly traded securities over to highly appreciated stock position without triggering gain.

3. All other assets (i.e., other than hot assets or marketable securities).
- f. Another example.
 - i. 50/50 partnership, one is low bracket taxpayer and other is a high bracket payer. Pro-rata partnership.
 - ii. Can you shift income from high to low bracket taxpayer (these may be individuals or non-grantor trusts).
 - iii. Key to planning is depreciable property. \$1M cash and \$1M 5 year remaining life depreciable property with basis \$400,000.
 - iv. Book tax disparity. From a book standpoint FMV is \$1M but for tax purposes that is not the case. The high tax bracket partner B.
- g. For book purposes partner B should get \$100,000 book depreciation but for tax purposes you don't have that much basis since only have \$400,000 of depreciable basis or \$80,000/year or \$40,000 depreciation per year for 10 years. IRC Sec. 704(c) says this is incorrect since partner A by putting in depreciable property A has shifted deductions/depreciation to A and now shifts income to Partner B. So no more depreciation deductions to contributing Partner A so shift deductions to Partner B. So result is for next 5 years IRC Sec. 704(c) shifts all depreciation to Partner B, i.e., \$80,000/year to Partner B. Make curative allocations.

5. Privileges.

- a. Documents prepared by.
 - i. Estate planning lawyer.
 - ii. Client.
 - iii. Third party: Accountant, financial adviser, insurance agent, MD.
- b. Understand IRS broad summons power and limits to those powers.
 - i. IRS can issue summons and request (demand) documents, interviews and information.
 - ii. Purpose of summons power is to allow IRS to ascertain correctness of return filed or not filed.
 - iii. Information as to whether a return was filed or was not.
 - iv. To determine ability of any person for any tax.
 - v. May examine books, records, or other data.
 - vi. IRS can talk to any person liable for tax, and person who is an employee of the person liable for the tax, or any person having possession or custody or care of documents, and "any other person the IRS may deem proper," which is all inclusive.
 - vii. You do not have to automatically comply with IRS summons but you better have a good reason. IRS may go to local federal district court with a motion to enforce its requests.
 - viii. You can file a motion to quash the IRS summons. IRS can respond to this motion to quash or file a motion to enforce.
 - ix. Court will determine if you should turn over documents.

- x. Privileges is where court may uphold your right not to respond. It may be a privilege log or a more substantive form.
 - xi. Federal rules of evidence may not apply. Example hearsay rules may not protect.
- c. Privileges.
- i. Attorney client privilege.
 1. Purpose to insure clients can have frank communications with their attorney so attorney can offer legal advice. Absent frank communication attorney may not be able to offer proper advice.
 2. Purpose is to encourage complete exchange of all sensitive information.
 3. Exception is that criminal attorneys don't want to "hear it."
 4. What does the privilege cover?
 - a. A communication
 - b. Made in confidence.
 - c. For purpose of securing legal advice
 - d. From a legal adviser
 - e. Example client cannot call you the attorney, and have you as the attorney get the client's broker on phone to talk to the client and thereby make the discussion/comments from the client to the broker covered.
 5. The privilege is for the client to waive, not for the attorney.
 6. There can be an inadvertent waiver by client or by attorney.
 7. Lawyer as counselor or planner can be legal adviser.
 8. A secretary, CPA, financial adviser or other third party may be covered only if the communications are made for purpose of the lawyer rendering legal advice to the client. Example lawyer calls CPA and asks for information so can render legal advice that might be privileged. If client calls secretary of lawyer and says tell lawyer "such and such" that is likely privilege. If client asks the lawyer to keep CPA in the loop that is likely not privileged. The key to privilege is a lawyer rendering advice to client.
 - a. Comment: See discussion Tuesday afternoon by Zeydel that if a client with waning capacity's children are brought into meetings to help the lawyer serve the client those conversations with the children are privileged.
 9. Even discussions with prospective clients are covered by the privilege (e.g., before you run conflict check client "spills the beans," that is likely covered).
 - ii. What is privileged?
 1. Disclaimer. Many computers when turn on have disclaimer that no rights of privacy and that all communications are open to the company. So if client writes you email from office at Exxon his communications to you as counsel are not privileged. Therefore, clients should only communicate from private email account and computer and not from a work computer.

2. The communications must be between privileged persons. IRS tries to make narrower. IRS has said that client communications to attorney are privileged but attorney communications to client may not be although practitioners argue with IRS that such a position is wrong.
 3. What might the privilege cover? What about non-client spouses, financial advisers, CFOs of closely held company, etc.? Be careful when client shows up with someone not on engagement letter. The privilege may not cover non-client family member. Consider what to do. There is a risk of waiving attorney client privilege. Attorney could have client sign letter acknowledging that privilege may be undermined if others are in meeting. What about a child listening in on a video conference?
 4. Stock brokers, CPAs and other third parties, be careful who you copy or blind copy on an email. If you blind copy referral source on a letter that may undermine privilege.
- d. What privilege may not cover?
- i. Work papers of attorney, but see work product doctrine.
 - ii. Bills and invoices are generally not privileged.
 1. Form 4421 sworn statement that the estate has or will pay the people listed. IRS can ask for further substantiation.
 2. In some instances IRS has asked for more detail. Give checks, dates and amounts.
 3. In some instances ask for invoices so they may have to be redacted, e.g., "Telephone conference with [black mark out details]."
 - iii. Underling facts are not covered.
 - iv. Business advice is not privileged. Business advice tied into tax advice is referred to as dual purpose advice.
 - v. Tax opinions are privileged but may need to turn them over to IRS to show that client reasonably relied on advice of professional to avoid penalties. The defense to penalties may be reasonable reliance and the opinion shows that.
 - vi. Attorneys as tax return preparers are not privileged. If you draft a Form 709 your work is not privileged. How do you separate that from the advice given from client? Segregate files and have separate files and advice for tax return preparation and for legal advice.
 - vii. Advice rendered in connection with tax return preparation may not be covered as "dual purpose" advice. Documents prepared for tax return and litigation may not be privileged.
 - viii. If you are merely verifying the accuracy of a tax return the representation is "accountant's work." However if you are a lawyer dealing with interpretation of the law and statutory interpretation or case law analysis, that is lawyers' work.
- e. Beware of waiver.
- i. What you have in your file may be the evidence needed to make the case.

- ii. Keep clients materials “as pure as possible.”
 - iii. In Tax Court the party asserting that there is no waiver is the party that bears the burden of proving that there has been no waiver.
 - iv. Inadvertent waiver may be imputed to client.
 - v. Accidentally turned over a document that you did not mean to. Can you get it back? There is no claw back rule in the tax law so that your inadvertent turnover of a document will waive not only that document but the privilege with respect to every matter covered in that document.
 - vi. Example: You have a letter saying planning is done for marital and creditor protection but also large discount.
 - vii. Read requests carefully and respond carefully.
 - viii. When might you want to waive? If 2036 is asserted you may need to waive privilege. It is a follow on of the old Murphy case that if the only reason you are doing something is to save taxes. It has subjective intent issues. 2036 by definition only applies in estate tax cases.
 - ix. Materials prepared “in anticipation of litigation.”
 - x. Different standard for “anticipation.”
 - xi. Work product does not theoretically cover taxpayer. It is the attorney’s work product that is critical. Client can prepare information for attorney and it may be covered.
- f. What is purpose of privilege? Prevent IRS from using taxpayer’s lawyer’s work to bolster IRS case at trial.
- g. When does work begin to be covered as work product?
- i. Historically difficult to argue that planning from inception is covered by work product but it has been recognized in case law.
 - ii. But if client knows you will look at his return (e.g., when IRS began to focus on FLPs) then privilege and work product should attach at least at that point.
 - iii. Two types of work product. One is “core” work product. Your impressions. That cannot be disclosed. The other is “non-core” work product such as factual work product. Can be forced to be disclosed if cannot secure that information elsewhere because of hardship or because of substantial need. Will we see IRS argue substantial hardship because of budget cuts they don’t have the manpower to do the work? Example, spreadsheet of a decade of tax return data.
 - iv. With respect to undue hardship,
- h. Medical privilege.
- i. There is no such privilege with the IRS.
 - ii. Federal versus state privileges.
 - iii. You cannot claim medical privilege except for psychotherapy because the Supreme Court held that this is predicated on trust.
- i. Tax Practitioner Privilege
- i. IRC Sec. 7525
 - ii. Extends attorney client privilege to confidential computations between taxpayers and tax practitioners.
 - iii. Same communications between taxpayer and an attorney.

- iv. Does not cover or extend to:
 - 1. Criminal matters. So if CIE gets involved anything that was privileged because available retroactively.
 - 2. Tax shelters are not covered.
 - 3. Bankruptcy.
- j. Goal.
 - i. Put client in position of being able to produce file.
 - ii. Best evidence of non-tax reasons for file is to produce records. Often these are shielded by attorney client privilege.
 - iii. Consider “eye to litigation” that when you write emails and letters that they may be used in later litigation.
- k. Voicemail.
 - i. If you have a phone system or cell phone there is Voice Over IP (VOIP). It has turned deletion into non-deletion.
 - ii. IRS will define “documents and information” to include “ESI” which includes all electronically stored information which includes voicemails, etc. which are all discoverable.
 - iii. How can you talk to client? In person. While oral communications are perhaps discoverable, a few years later the oral communication will be less dependable in trial than a written email.
- l. Kovel.
 - i. Attorney should hire consultant.
 - ii. Consultant is working at attorney’s direction.
 - iii. The work is not return preparation.
 - iv. Work belongs to attorney.
 - v. Purpose of work is to assist the attorney in rendering legal advice to client.
 - vi. All communications prior to Kovel letter are not privileged.
 - vii. Problem with Kovel, what does it really say? In Kovel an attorney was working with a client and had sophisticated accounting issues. The attorney hired the CPA to serve as a translator in the attorney rendering legal advice to the client. Kovel has since been used to try to bootstrap appraisers work as privileged.
 - viii. Should the attorney not the CPA hire the appraiser? There is no accountant taxpayer privilege or appraiser client privilege so you cannot create a privilege by merely involving the attorney. This is different from the attorney hiring the appraiser to assist the attorney. Then it is mere interpretation that the attorney is hiring the appraiser for. But if the appraisal report will be attached to the return it is not privileged.
 - ix. Can an appraiser’s communications be privileged? At return stage likely not. At the trial stage communications that are strategic with an appraiser are privileged. Communications that are factual in nature are not.
- m. Burden of proof.
 - i. IRC Sec. 7491 you can shift the burden of proof from the taxpayer to the IRS if you have complied with all requests for information, etc.
 - ii. Kohler case. Kohler estate immediately turned over documents after filing motion to quash. IRS said burden should not shift. The court held that the

motion to quash did not prevent the shifting of the burden of proof from the taxpayer to the IRS

6. **NIIT and Trusts.**

- a. Challenges in planning for Net Investment Income Tax (NIIT).
 - i. Consider the planning implications to what might be called a garden variety irrevocable trust.
 - ii. Short term income tax planning versus long term wealth transfer planning. Tension in administering trust to minimize NIIT while having assets grow long term for wealth transfer. It is a balancing act.
 - iii. 3.8% tax is not small when aggregated over decades of trust income.
 - iv. Most strategies involve distribution out of trust to reduce NIIT. But what can and should a trustee do? Avoid or minimize NIIT or keep wealth in trust to maximize wealth accumulation inside the trust.
 - v. Drafting considerations.
 - vi. Complexity of addressing rules and costs militate against planning for it for many clients.
- b. Balancing act in drafting and administering trust.
 - i. Should you use separate trusts for each beneficiary or a pot/sprinkle trust. Most draftspersons divide trust at some point such as grantor's death or when youngest beneficiary attains a certain age say 23, except for special purpose trusts.
 - ii. Most grantors believe more equity in dividing trusts so each beneficiary can do what they wish in the structure of trust.
 - iii. However, to minimize exposure to NIIT you may have more planning flexibility with a pot trust with many beneficiaries over many generations.
 - iv. With many beneficiaries chances are greater that one of the beneficiaries won't be subject to NIIT in any year.
 - v. Kiddie tax taxes income of minors or college students under 24. This prevents having income shifted taxed at a lower bracket but each child will nonetheless have his or her own NIIT bucket. So while the Kiddie Tax may tax that income at the same rate as the trust but until \$200,000 of income no NIIT.
 - vi. Look to who is entitled to income distributions. If income distributed out exceeds there share allocated proportionately.
- c. Example.
 - i. Trust with two beneficiaries' son and grandson. Trust will get deduction for distribution to child but if child's income is great enough there will be a NIIT. If trust retains income NIIT.
 - ii. If instead distribute to grandchild and grandchild's income is less than the threshold amount there will be no tax.
 1. Comment: Consider when broadening a class of trust beneficiaries to facilitate more income tax and NIIT planning the implications of the broader class on disclosure requirements, especially with an institutional trustee who may insist on informing every beneficiary above some age, e.g., UTC, of the trust. These disclosures could be upsetting to some clients. This might be addressed by moving the

trust to a jurisdiction that permits silent trusts, or perhaps be drafting provisions that permit notice to a designated representative. But with each additional layer consider the practical comment in the outline above about balancing the costs and complexity versus the tax savings.

- d. Trust design.
 - i. In some instances practitioners might revisit how they draft trusts.
 - ii. As noted above consider pot versus separate trusts.
 - iii. What is the distribution standard in a trust? What if it is HEMS? Is a distribution from a trust to avoid NIIT within that standard? Will the HEMS standard inhibit that tax-desired distribution?
 - iv. What about grantor trust status? Should it be a grantor trust under IRC Sec. 671-677 or should it be a separate taxpayer? What is the NIIT implications of a grantor trust? Grantor trusts are not subject to NIIT but all income is reported on grantor's income tax return and the NIIT calculation will be made on that return. Often with grantor trusts you are focused on overall benefits of grantor trust not just NIIT. There are two special cases.
 - 1. Retired grantor. Retirement plan distributions are not deemed investment income so there may be a bracket play.
 - 2. Grantor who is an active participant.
 - v. Will separate taxpayer status for trust avoid NIIT? Should the trust therefore be a complex trust?
 - vi. Draft so grantor trust status can be toggled off.
 - 1. Comment: Larry Brody made a suggestion at a prior Heckerling Institute about the issue providing in the trust a right, e.g., perhaps held by a trust protector, to prohibit the use of trust income to pay premiums on life insurance on the settlor to assure that aspect of grantor status can be shut off.
 - vii. What happens when deemed owner dies? How will this impact NIIT planning?
- e. Investment Income.
 - i. Capital gains are included in net investment income but absent authority under trust agreement or applicable state law capital gains are typically not pushed out with a distribution.
 - ii. Treas. Reg. Sec. 1.643(b)-1.
 - iii. Include provision in governing instrument to allow trustee to adopt a practice of including capital gains in DNI. If you have not revised trust instrument you might wish to revise it in this manner.
 - iv. If you don't want to decant or modify the document convey the assets to an LLC and if don't come out of LLC will be treated as trust accounting income
- f. What about business interests?
 - i. What if trust includes interests in a family business?
 - ii. What is impact of NIIT on family business?
 - iii. NIIT has changed drafting and kids in the family business.

1. Might it be sufficiently beneficial for child not working who is beneficiary of a trust to go back to work in the business to save NIIT as a material participant?
- iv. For trust not to be subject to NIIT must show material participation.
- v. Income is subject to NIIT if from a passive activity. Must show material participation.
 1. 500 hour rule.
 2. More than 100 hours and more time in business than anyone else.
- vi. What about real estate? Must show that the trust is a real estate professional or the income from real estate will be treated as passive. More than ½ the personal services in the trade or business must be performed by taxpayer, more than 750 hours in real estate trade or business, etc.
- vii. If the trust is a separate taxpayer look at trustee but what about an investment trustee?
- viii. For a trust engaged in a trade or business material participation is determined at the trust level.
- g. Cases and rulings.
 - i. All authorities are IRC Sec. 469 not NIIT since 1411 was not around then.
 - ii. IRS takes narrow view as to whether a trust or estate can materially participate.
 - iii. Executor of fiduciary in his capacity as such is so participating.
 - iv. Matti K. Carter Trust. Court looked to all agents and all those who worked in further of the business. IRS objected saying look at history of IRC Sec. 469. IRS does not recognize Carter decision as precedent.
 - v. Be careful about using special trustees. If only appointed to vote shares that is not sufficient.
 - vi. Work performed by trustee as employee per IRS won't count must consider work by trustee as a trustee. There is a discrepancy in how IRS treats individual taxpayer versus individual as a trustee.
 - vii. Frank Aragona Trust. Tax Court says trust can materially participate. Services as employee/trustee count because you cannot take off your hat as a trustee. You are still a fiduciary. IRS did not appeal Aragona but silence does not equate with agreement.
 - viii. Example Client had 3 kids and 9 trusts. 9 trusts own all interests in a real estate group. Son M came into business and is CEO and Chairman of the Board and is trustee of all trusts. If we look to M's activities to determine material participation and 750 hour rule, can you aggregate the 9 trusts. Or do you have to look at each trust separately. The IRS position is that M has to satisfy 750 hours for each trust separately and M's hours as an employee of the business don't matter. Agent said that IRS does not agree with Aragona but did not appeal because of issues unique to that case. IRS backed off and permitted loss after Tax Court filing. If the IRS does in fact take this type of approach may need pot trust.
- h. S Corporation held in trust.
 - i. Material participation depends on tax status.

- ii. ESBT look to trustee.
 - iii. QSST look to activity of deemed owner who is beneficiary of QSST until year stock is sold. When stock is sold in that year the trust becomes a second taxpayer. If relying on QSST status to avoid NIIT you may have a problem in year of sale as the trustee not the beneficiary will be the litmus test.
- i. Trustee considerations and NIIT.
 - i. What is the tax impact of the selection of the trustee?
 - ii. If deemed trustee is not active and not a grantor trust only way to solve NIIT is to distribute money out.
 - iii. What if multiple trustees? Does it suffice if only one is active in the business? Not certain.
 - iv. What if you include a provision that as to business interests only child active in business can make the decision?
 - v. What about institutional trustees? How can a corporate trustee materially participate? There are many people acting on behalf of the trust?
 - vi. What if slice and dice role of trustee? With modern trust provisions you might appoint special trustees as to business assets. They must be vested with actual authority. In a PLR a special trustee who could only vote shares did not suffice. Need more.
 - vii. Whether trust will be subject to NIIT will depend on
 - viii. What about trust protector provisions? Give ability to remove and replace trustees. What about authorizing trust protector the right to take NIIT into account in taking action.
 - ix. Rethink special asset provisions, e.g. right to hold business. May need to go further and require trustee to hold business.
 - x. Consider a sub-trust. Drop business into a sub-trust and appoint an active person for the sub-trust.
 - xi. What can you do with an old trust? Decant to a new and better trust. Perhaps a trust protector can amend administrative provisions to fix issues for NIIT planning.
- j. LLCs.
 - i. Member managed LLCs may be preferable for NIIT purposes to a manager managed LLC.
 - ii. Consider Steve Gorin's approach for a closely held business.
- k. Trust administration.
 - i. Discharge obligation of support issue.
 - ii. Allocation of trust expenses against investment and non-investment income. Can use any reasonable method except direct expenses must be allocated to the income that they relate to.
- l. Investments.
 - i. Shift from corporate bonds to tax exempt.
 - ii. Equities minimize return.
 - iii. Convert to unitrust but may have to sale assets to generate unitrust payments.

- iv. Consider life insurance products for long term trusts using private placement life insurance products.
7. **Non Profit Board Service.**
- a. General comments on size and nature of non-profit environment.
 - i. Intermediate sanctions – can impose taxes on board members rather than revoking status.
 - ii. State Attorney General under Pension Protection Act 2006 AGs communicate directly with IRS.
 - iii. Internet – common exposure of fraud or theft on charitable boards.
 - iv. AGs have become more active.
 - v. 1.4 million Non-profits in US.
 - vi. 5.4% of GDP.
 - vii. Revenue \$1.65 Trillion.
 - viii. Growing at 100,000 new non-profits a year.
 - b. Difficult issues.
 - i. United Way, William Aramony stole more than \$1.2M and spent 7 years in jail but a 37 member board did not notice.
 - ii. Second Mile charity and Jerry Sandusky.
 - iii. These issues continue to happen.
 - iv. There are a myriad of examples of thefts by officers of charities, etc.
 - v. Issues of transparency and communication with donors and stakeholders have grown.
 - c. 3 Duties if serve on board.
 - i. Fiduciary role. Must act with good faith and candor. High duty of care. Duty to manage assets. The assets are not ours.
 - ii. Generative role of board. Ask right questions. Framing work of the organization. Good discussion of who you are and where you are going and how you will get there.
 - iii. Strategic role.
 - d. Board responsibility.
 - i. If your name is on board you should be engaged.
 - ii. If you do not participate you might be at greater risk.
 - e. Entity.
 - i. What form of entity?
 - ii. Most are organized in one of three ways.
 - 1. Non-profit corporation. Most states have adopted some form of the model non-profit corporation act. Most states have modified the uniform act.
 - 2. Trust form. This is less common. It had been the favored form in the early 1900s.
 - 3. Unincorporated entities. Quite uncommon. There is a uniform unincorporated non-profit association act.
 - iii. Flexibility – the corporation structure is the most flexible since the board can change the terms of the purpose, size of board, change bylaws, and in how the corporation operates. Because of the flexibility afforded to non-profits as perpetual organizations this is the most common.

- iv. Trusts are less flexible since if you want to change it you have to operate within the terms of the trust. Once the grantor is deceased charitable trust may live on. May need AG and court approval to change.
 - v. Difference in standard of care. Trustees generally are held to a higher standard (not a substantially higher standard). With the non-profit corporation look for personal benefit to determine if there has been a violation of trust. You do not need evidence of personal benefit with a trust.
- f. Steps and Standards.
- i. Actions.
 1. Do you review policies?
 2. Do you ask questions when issues come to board?
 3. Did your review 990?
 4. Monitor programs and services.
 5. Insure adequate resources.
 6. Is board prepared and active?
 7. Showing that you have engaged in these activities will show that you have engaged in the appropriate standard of care.
 - ii. Duty of loyalty.
 1. Disclose any interests that may conflict.
 2. Keep information at meetings confidential. See state statute for guidance.
 3. Legal and ethical integrity.
 4. Urban institute found in 20% of organizations there were contracts between board members for professional services.
 - iii. Duty of obedience.
 1. Ensure that organization follows its mission.
- g. How are laws enforced?
- i. AG is responsible to enforce charitable laws and monitor charities in the state.
 - ii. More actions than ever before. AGs file suit against boards of organizations for accountings. This is occurring in a variety of states.
 - iii. A lot of this activities is coming from social outcry. With the internet disgruntled donors or board members or other organizations in the community put complaints on social media. When enough attention is given then the AG may intervene. If AG investigates a charity the IRS may also become interested.
 - iv. IRS audit.
 - v. Securities laws.
 - vi. Employment laws.
- h. Prohibited Transaction rules.
- i. If serving as a trustee be aware of these rules, in particular the self-dealing rule.
 - ii. If you have a non-profit corporation and you engage in conduct that might be considered a conflict of interest you can obtain and move forward.

There are ways to work with it or cure it so long as there is no undue personal benefit. There is a process for this in a public charity.

- iii. This is not the case for a private foundation and in the latter case it is a per se violation and it cannot be cured even if there is no personal benefit. You cannot engage in any transaction with the foundation.
- i. Key areas of liability.
 - i. Employee management.
 - 1. Excessive compensation especially of CEOs.
 - 2. Senate finance committee and independent organizations have looked at CEO compensation.
 - 3. Guidestar does comparative analysis.
 - 4. Use this data to assure salaries are commensurate with duties, and with organization of the size and nature of the particular charity involved.
 - ii. Employee lawsuits. So many rules organizations must comply with.
 - 1. ERISA.
 - 2. Civil rights act.
 - 3. Age discrimination.
 - 4. OSHA.
 - 5. FSLA.
 - 6. Etc.
 - iii. Have policies to address the relevant compliance issues for the particular organization.
 - iv. Diversion of charitable assets to benefit of executives or board.
 - 1. Baptist Foundation of Arizona had accounting issues.
 - v. Insuring donor intent.
 - 1. Suits against Princeton, Tulane and more illustrate the concerns of donors, and often family members, suing charities.
 - 2. Herzog case court held no standing to sue. But courts have granted standing to family members.
 - 3. These are state law issues so decisions vary by state.
 - vi. Investment management.
 - 1. In 2008 in 9 month period on average family foundations lost 35-40% of asset value. This year has been bad and heavy losses.
 - 2. State laws, uniform prudent management of institutional funds act (replaced UMIFA). This act provides that for permanent charitable funds there are 7 factors to consider when making investment decisions. There are another 6-7 factors to consider when setting spending policy for charity.
 - 3. As a board member document in minutes that these factors have been considered.
- j. Serving as counsel and board member.
 - i. 4 situations to be wary of.
 - 1. What if asked to pursue a result for the organization you opposed.
 - 2. Give advice on action you made decision on.
 - 3. Any action that organization may take that impacts firm.

- 4. Asked to give advice on series of options when you have already taken a stand on one of them.
 - ii. Transparency is key.
 - iii. Role as board member is to be voice to bring to table.
 - k. Data management.
 - i. How are you safeguarding donor records?
 - ii. Do you sell donor information? Under what circumstances?
 - l. 7 Best practices.
 - i. Ask questions before and after appointed to board.
 - ii. Know applicable laws. Know type of entity.
 - iii. Focus on having a role that protects the charities reputation. Assume everything you do will become public.
 - iv. Adopt policies that govern all aspects from financial accounting, data management, donor data protection, etc. Be certain board is following.
 - v. Know non-profit liability laws in state.
 - vi. Keep records.
 - m. Engage in planning.
- 8. **Naked Derivatives and Exotic Wealth Transfers.**
 - a. What if clients have assets that are “bad” to transfer?
 - i. What can be done to facilitate some type of wealth transfer in these situations?
 - ii. Example: Client may have low growth assets, e.g. T-bills.
 - iii. May have issues in transferring the types of assets client owns.
 - iv. Difficult to plan for assets such as race horses.
 - v. Some assets don’t generate cash flow, e.g., unimproved real estate or art collection. Cannot fund GRAT as nothing to pay annuity and cannot sell for note since cannot pay interest.
 - vi. Rev. Rul. 98-21 gifts of unvested stock options are not completed gifts until options vest.
 - vii. IRC Sec. 2701 issue in transferring non-vertical slice and client does not wish to transfer carry.
 - b. What about private derivatives?
 - i. Private contract.
 - ii. Similar approaches are used by businesses to hedge risk. Example, weather derivatives. Can buy deviates on rain, stock indices, etc. Farmers use derivatives all the time.
 - iii. It is a contract. If this occurs you owe me money but if not I’m just out what I paid you on the contract.
 - iv. These are private contracts, e.g., a contract between grantor and the trust the grantor set up.
 - v. Virtual asset private derivative.
 - 1. Client only owns T bills and horses and doesn’t want stock market risk.
 - 2. Set up a private contract that looks like Apple stock. Say Apple is 100/share for 1,000 shares. Trust pays grantor for this contract. If Apple pays divided grantor pays that amount. If trust wants to

- tender stock. If Apple has a split you adjust the contract. Did not actually buy Apple just created a private contract to mimic Appel.
3. You could give trust a piece of artwork that does not generate cash flow.
 4. If stock goes down then trust paid grantor and lost. Or if Apple increases grantor pays trust. You could buy a virtual portfolio.
 5. This could be done in conjunction with a sale to a grantor trust.
 6. You could have a time limit, e.g., 5 years, on the contract.
 7. Combine this concept with other strategies.
- vi. Example, client has negative basis real estate and want to hold for step up. So did derivative contract with trust that measures difference in value of the property today and at the end of 5 years and the trust is owed money based on that value change. Must also factor in cash flow and distributions.
- c. Some specifics.
- i. These contracts can be customized, e.g., up to a cap of e.g. \$120/share.
 - ii. Use this concept with hedge funds and carried derivatives. If use this private derivative may be able to avoid security restrictions on transfer, etc. Create instead a private derivative contract based on how the fund performs.
 - iii. There are about 10 PLRs on CRTs and UBIT (100% rate). One form of UBIT is debt financed income e.g., on fund that uses leverage. These CRTs may invest in University endowment that has debt. Instead go to university and donate \$1M CRT and have contract that it will track what endowment does. If endowment is up 10% the CRT derivative contract will be up 10%. All of these rulings IRS agreed it is not a UBIT issue since it is a different asset even though tied to investment that has debt.
 - iv. Use these contracts in the context of a grantor trust. You don't want virtual asset to be a taxable gain nor do you want gain when it is settled.
 - v. Structure so that on death there may be a potential liability grantor owes trust that may not be deductible under 2053 no deduction is allowable if not shown that decedent is liable for at death. You can have a contingent claim and it doesn't end at death
 - vi. You can put a cap on it. This will be factored into the valuation (reducing what trust pays for it).
- d. What else can be done?
- i. What about stock options? You can buy a call option on the stock instead of buying the stock. You can capture upside. Option may have limited life, e.g., 90-days. If stock hits a certain number you profit. But if stock does not hit strike price you lose entire investment. But what if options are between grantor and the trust?
 - ii. Significant wealth can be transferred using stock options.
 - iii. Investment by trust is only option premium.
 - iv. If use these in conjunction with GRAT you can lower rate of return on stock for GRAT to be successful.

- v. Example: John smith has \$1M trust. Macy's stock is at \$49.50. John sells option to kids trust. A 50 day option Macy's had volatility figure of 35% so an at the money option (strike price is \$49.50). Use a black shoals calculation. \$2.44/share for a 50 day Macy's stock option. So for \$1M can buy options on 408,000 shares. If stock did not move lose \$1M. If stock is at \$52.00 make \$1M back and net effect is zero. If Macy's go to \$53 trust gets \$1.4M. If Macy's increase to \$57 that is 15% increase in price of stock the trust gets \$3M.
 - vi. Magnification from options is significant.
 - vii. But you are risking losing exemption allocated to the \$1M gift. How can you avoid reverse estate planning?
 - viii. Use GRAT. You get the amplification. Avoids wasting gift exemption. If took Macy's stock and put actual stock in 2 year GRAT 7520 rate 3% and stock is at \$49.50. End of 2 years stock is \$52.51. No benefit at end of term. If stock grows to \$54.57 the net benefit of the GRAT is \$31,000. But if did this GRAT with options this is 408,000 shares. Stock increases to \$52.51 benefit will be \$185,000. At \$54.57 it is a \$1,027,000 benefit. This is the effect of an option (including a private option) to magnify results.
 - ix. What about a single client with no spouse to sell to? Set up an incomplete gift trust for children. Retain limited power of appointment. Incomplete gift. So if transfer \$10M into irrevocable trust that could be the counterparty to the transaction. Be certain trust (and client) has means to pay.
 - e. "This is not for the faint of heart."
 - f. IRC Sec. 2703.
 - i. 2703 is addressed to transfers of property where value is reduced by option or other agreement unless various criteria are met.
 - ii. Not transferring an asset or claiming it is worth less. It is a contract that is measured by something like Macy's stock. We are just paying on the option not claiming a reduction in value, just settling up.
 - iii. See Rev. Rule. 80-186.
 - g. C-PAS.
 - i. Contingent Private Annuity Strategy.
 - ii. You could structure a private derivative transaction pegged to a person's life.
 - h. Other considerations.
 - i. 2702/2036. Should not apply any more than a sale to at rust for a note or private annuity. It is not a retained interest rather a sale of assets.
 - ii. Transactions with grantor trusts.
 - iii. Report on gift tax return.
 - i. Conclusions.
 - i. For clients with assets that are not conducive to planning.
 - ii. Can transfer wealth regardless of what clients actually own.
 - j. Options can accelerate wealth transfer.
9. **Diminished Capacity and Guardianship.**
- a. Background.

- i. Estate planning to avoid guardianship: durable POA, preneed guardian designation, revocable trust, etc. But if there is family disharmony and someone does not like who has been appointed there could still be a challenge.
- ii. Example: Mother was having “wrong minded notions about some of the children.” When children heard they commenced an action for emergency guardianship. Hearing the next day. Guardianship proceeding could trample on fundamental rights of client. How could this happen if all documents in place? How likely is this to happen?
- iii. Adult disability is on the rise. An individual with mental or physical impairment that substantially limits one or more major activities of the individual. Disabilities increase with age. Of 40.7 million people age 65 and older, 38.7% had one or more disabilities. Those 85+ have greater problems. Disability included physical as well as mental disability. So it could include cognitive issues. 28.8% have some cognitive disability up to 39.9% for 85+.
- iv. Representing clients as they age will involve these issues.
- v. Has client suffering from hearing loss just nod to what counsel says? How do you plan for that?
- vi. What is your right to continue to represent a client that may be suffering from some form of mental disability?
- vii. If you have serious concern over clients disability can you continue represent them? You can represent client so long as can have attorney client relationship.
- viii. ABA 1.14 Model Rule on professional conduct. Your role transforms to protector. The lawyer shall as far as reasonably possible maintain lawyer client relationship. As much as you can proceed forward. If client has diminished capacity and is at risk of substantial harm the lawyer may take reasonably necessary protective action including consulting with those who can help. The duty of confidentiality is limited in favor of protecting the client. The rationale is that it is in the client’s best interest that his or her lawyer continue to protect him or her.
- ix. Lawyer can be impliedly authorized to reveal information about the client but only to the extent reasonably necessary to protect the client.
- x. Rules give lawyer latitude to work with client.
- xi. You may ask for assistance from family members if necessary to repetition. Those conversations remain privileged because children are now necessary to representation.
 1. Comment: See Stephanie Loomis-Price comments on privilege.
- xii. Lawyer can consult those who are capable of protecting the client. If client cannot make all decision client may nonetheless have sufficient capacity to decide who should make decisions for them. So client might be able to put protective documents in place. The client might still be able to formulate enough judgment to determine who should handle.
- xiii. Comment 6: Lawyer should consider and balance various factors. Consider client’s ability to articulate reasoning behind a decision. Can

client no longer articulate a reason for decision? Is it consistent with client's prior values or is it unanticipated? The latter may be an indication that the client is no longer acting for himself. Lawyer in appropriate circumstances can seek guidance from a diagnostician.

- xiv. ABA – American Psychological Association manual.
 - xv. Client has the right to make a bad decision. Bad decisions alone are not a basis to determine lack of capacity. More is required.
 - xvi. Does your client really understand what he or she is doing? This is an ongoing daily consideration. Lawyer should be involved and should understand.
 - xvii. Handbook lists signs of issues with capacity. Lack of mental flexibility. Calculation problems. Disoriented as to time or place. Signs that the client is no longer themselves. Poor grooming and hygiene. In context of estate planning doubts of these determinations are resolved in the lawyer's favor so lawyer can carry out the client's wishes. It is the court that will ultimately decide whether what was done is valid. So don't preempt the client if there is lack of clarity what client can do.
 - xviii. Can lawyer be liable for failure to make an assessment as to capacity? Is lawyer liable for proceeding with a will or trust if client did not have capacity?
 - xix. Lawyer can permit client to execute documents if lawyer believes client is competent. If you believe the client is incompetent, no.
 - xx. Lawyer can prepare codicil for client terminally ill and on pain medications. Court said lawyer should try to carry out client's wishes and leave to Court to determine. Do not preempt client. Consider policy to enable client to change will at last minute. Equities are in favor of continuing unless lawyer can no longer communicate effectively with client.
 - xxi. ACTEC commentaries suggest lawyer can proceed even if client's capacity is "borderline."
- b. What state law planning tools available to avoid guardianship.
- i. Civil rights of client – can documents control these personal items? Where will client live and which doctors will they see?
 - ii. Historically POA was about financial matters and health proxy was about life and death decisions.
- c. Durable power of attorney.
- i. Agent is a fiduciary.
 - ii. Little developed law. Varies between due care and trustee standard.
 - iii. Agent may not know appointed.
 - iv. May not have any obligation.
 - v. Is there an obligation to continue to serve if took on the task, e.g., to pay bills? If did not take on task you may not have to and may not have liability. You can parse what tasks the agent takes on and the liability associated with that.
 - vi. Many powers, like making estate decisions must be specified.

- vii. California POA statute authorizes principal to grant to agent authority with respect to property, personal care or any other matter. Very broad.
- viii. If not limited to financial matters why not address care and other issues in the POA.
 - ix. Coordinate with health care surrogate.
 - x. Can determine where principal will live, arrange recreation, mail, etc.
 - xi. Historically POA was merely financial but there is no reason you cannot make it broader.
 - xii. CA form says no affirmative duty (like a trustee) to act unless there is a separate agreement.
 - xiii. NY short form power appear to follow uniform act and are financial in nature only. What can be done about that? Can you execute a POA in another state? If forum shop for trusts why not for POAs?
- d. Health Care Proxy and advanced directive.
 - i. Not only about life and death decisions.
 - ii. You can delegate decision making even if you are not incapacitated. Principal's decisions will override agent but you can give agent authority to arrange for health care, get PHI (private health information) and more even if the principal is not incapacitated.
 - iii. Some clients if they don't want life sustaining measures withdrawn don't sign health care directive. They should and say what they want.
- e. Pre-Need Guardian.
 - i. Creates presumption of who should be guardian.
 - ii. This will likely stand unless evidence of improper conduct.
 - iii. An allegation that there is disharmony may not undermine this.
 - iv. Powerful document.
- f. General statements for all documents.
 - i. Effective Date.
 - 1. None of these work well if principal must be incapacitated to be effective.
 - 2. Better off to be effective to avoid uncertainty of when incapacity occurs.
 - ii. Name successor agents on everything.
 - iii. Conflict of interest may undermine document but if conflict of interest created by client when documents done this will not undermine.
- g. Guardianship.
 - i. A few minutes of routine is all it took to strip a person of their rights. While the situation has improved the guidance is not what it should be. There are no standards as to what a client must be able to do to retain the right to vote or marry, or drive.
 - ii. Legal protection. Need clear and convincing evidence.
 - iii. Attorney for the guardian has duties to the ward.
 - iv. Just because the client is making bad decisions does not mean client is incompetent.
 - v. There is room in guardianship for guardian to engage in estate planning but will be closely tied to estate plan of the ward prior to incapacity.

- vi. No affirmative duty for a guardian to engage in an estate plan except perhaps to assure that ward does not lose Medicaid benefits.
 - vii. Guardianship used to express family disharmony when child or others use guardianship proceeding to dislodge those in control.
 - viii. Anyone can attempt proceeding. It could be a caregiver or other person not just a family member.
 - ix. FL has a two part process to a guardianship proceeding. First part is a determination of incapacity. If that is done rights are taken away before figure out if there are less restrictive alternatives. In other states have to allege alternatives to guardianship and must make statement why those alternatives won't work to protect the ward's problems.
 - x. FL statute creates a bifurcation. If you amend power of attorney to deal with more rights FL statute gives you a sense of that. You cannot give right to non-delegable rights (e.g. drivers' license or marriage). But everything else can be delegated. You might still be able to put these in the POA.
 - xi. This is a different construct than much of estate planning where, for example, a wide open discretionary trust is used so that the extra verbiage that might create problems does not appear. In contrast in a POA or HCP more may be better as it will help the court understand the wishes of the client. These personal statements as to wishes may well constrain the guardian and the court may have to abide by it. This is the client's civil rights. There is a broad right to control destiny.
- h. Planning for Flexibility.
- i. Chance that estate planning documents will survive a guardianship have improved.
 - ii. Consider how succession will be implemented.
 - iii. How articulate is document about when succession will occur? Do family members have right to determine succession? Are there enough HIPAA waivers to get information from health care professionals if needed? Do you want health care professionals to make decisions?
 - iv. Have gifting provision in POA and revocable trust coordinated.
 - v. Consider possibility of conflicts between family members.
 - vi. Let family know expectations in advance.
 - vii. Do this in advance of the client becoming ill or incapacitated.
 - viii. Do family members really want the decision powers that they may be given? Do they really want to serve?
 - ix. What about more people rather than less?
 - x. Should any independence be built into the documents?
 - xi. See Appendix I an extra document to support health care directive. Study done as to how well health care directive assisted decision making. It did not because most don't say much about the circumstances. Create a more fulsome description of circumstances and give client options.
 - xii. Consider protecting assets from problems. Consider an irrevocable trust, use a co-trustee, or require approval of someone to approve revocation of trust.

- xiii. Address compensation.
- i. If client wants to preserve estate plan say so, with an escape hatch.

10. Special Needs Trusts.

- a. Types of Special Needs Trusts (“SNTs”).
 - i. 1st party funded by individual with disabilities.
 - 1. (d)(4)(A) trust.
 - 2. Self-settled.
 - 3. Include payback provision.
 - 4. Presently must be established by another, e.g. court. This has created delays in beneficiary qualifying for government program and proposals made to modify this.
 - ii. 3rd Party funded by someone other than the person with disabilities.
 - 1. No payback provision.
- b. Inter-vivos vs. Testamentary.
 - i. Testamentary.
 - 1. Surviving spouse. If want spouse to be beneficiary of a special needs trust it cannot be inter-vivos it must be testamentary. Example, to trust to supplement care spouse is getting in nursing home and on his death to children. Cannot leave outright as it would disqualify him for benefits. Statute is clear the trust must be created in a will. If not created in a will and spouse is beneficiary it will not qualify as a supplemental needs trust.
 - 2. Contingent SNT.
 - ii. Inter-vivos.
 - 1. If set up inter-vivos can inform family that they can make gifts to it as well.
 - 2. Revocable. Some practitioners prefer revocable.
 - 3. Irrevocable.
 - 4. Must coordinate with other relatives planning (don’t want outright gifts to special child).
 - 5. Estate tax planning considerations.
- c. Disinherit.
 - i. Disinheriting will protect special child’s benefits.
 - ii. Some parents believe they can leave special child’s share to siblings who will take care of special child but this rarely works. Well-meaning siblings might get married and new spouse won’t permit use of funds for special needs sibling. Divorce or lawsuits could jeopardize the funds.
- d. Tax issues 1st Party SNTs.
 - i. Irrevocable trusts.
 - 1. Compressed income tax rates.
 - ii. Grantor trusts.
 - 1. Most 1st party trusts are grantor trusts.
 - 2. Most give trustee ability to distribute 5%/year.
 - iii. Gift Tax.
 - 1. Most no gift tax since subject to creditors.

- iv. Estate tax.
 - 1. What is left is subject to estate tax.
 - 2. What is paid back to Medicaid will be an estate tax deduction.
 - 3. Rarely an issue with current high exemption.
- e. Tax issues 2nd Party SNTs.
 - i. Inter-vivos.
 - 1. Revocable
 - a. Who will contribute to a trust you can revoke?
 - 2. Probably has to become irrevocable on receiving contribution from a 3rd party.
 - a. Probably a complex trust.
 - 3. Grantor trust.
 - ii. Irrevocable trusts.
 - 1. Compressed income tax rates.
 - iii. Grantor trusts.
 - iv. IRC 642 Qualified Disability Trust
 - 1. \$4,050 full personal exemption if trust qualifies. This is often missed.
 - v. Gift tax.
 - 1. Crummey powers.
 - a. Caution beneficiary on government benefits right of withdrawal may be considered an asset for public benefit purposes could disqualify.
 - b. Failure to exercise could be a transfer to other beneficiaries.
 - c. Recommendation don't use special beneficiary as Crummey power. Use other beneficiaries to hold Crummey powers.
 - d. If you have trust with bad Crummey powers see if it can be fixed or if not perhaps you can decant.
- f. 529A ABLE Act.
 - i. 12/19/14 Achieving a Better Life Experience (ABLE) Act.
 - ii. Money in ABLE account accrues tax free.
 - iii. Can take money out of ABLE for qualified disability expenses and won't count as income (states can interpret) nor will it disqualify beneficiary for benefits.
 - iv. Contributions are not deductible.
 - v. Onset of disability must occur prior to age 26.
 - vi. On death subject to Medicaid payback rules similar to a 1st party SNT.
 - vii. Entitled to only one ABLE account per person (cannot have multiple accounts) – take the first one.
 - viii. Can only contribute \$14,000/year. Aggregate contributions from all donors are capped at one \$14,000 gift.
 - ix. Cannot have more than \$100,000 in ABLE or lose Medicaid but not SSI.
 - x. In Extenders bill passed 12/15.
 - 1. Could only be set up in residence of state where special needs beneficiary lives but changed this rule in 12/15 Act.

- xi. Each estate needs to enact legislation.
- g. Who can/should be trustee?
 - i. Consider co-trustee using one institutional trustee.
 - ii. Need professional to monitor.
 - iii. Corporate trustee may not do the personal work of visiting child, etc. See cases where banks as trustees did not visit the special child. In the Matter of the Accounting by JP Morgan Chase Bank, NA v. Marie H. (NY Surr. Ct. No. 2005-1307 Dec. 31, 2012).
 - iv. Fee schedules.
 - 1. Minimum fees.
 - v. How many times will trustee visit special child?
 - vi. Be cautious not to spend money on special child if Medicaid would pay those expenses.
- h. Trust protectors.
 - i. SNT beneficiary may not have capacity to oversee trustee. Using a protector can provide a safeguard over the trustee (see bad cases of institutional trustees).
 - ii. Protector might be given power to amend to comply with changes in Medicaid or other applicable laws.
 - iii. Powers can be limited or broad.
 - 1. State law.
 - 2. Trust instrument.
 - iv. Trust amendment without court order.
 - v. Some state Medicaid agencies may not permit.
 - vi. Is trust protector a fiduciary? Some commentators say always. Others suggest it depends on powers given.
 - vii. Does protector have affirmative duty to act/
 - viii. What about paying protector?
- i. Drafting.
 - i. Some give unfettered discretion to trustee.
 - ii. Why include SNT standard if can give trustee unfettered discretion? While that may work courts (e.g., Cook case out of OH) are getting tough on distribution standards and it may be safest to protect benefits to have express supplemental needs language in lieu of a broad discretionary standard.
 - iii. Poison pill provision could be a problem. Provision permitted distribution of trust if certain conditions met. One case treated this provision as making it an available asset. Be careful to expressly exclude special beneficiary so that only other beneficiaries can receive it.
 - iv. Trustee discretion.
 - 1. Do you itemize what the special needs are? Benefit of this is it is clear to trustee.
 - 2. Rather, should you use a broad discretionary standard? Trustees prefer broad standard but then some trustees will go to court to get clarification and confirmation as to what distribution is permitted. This can be costly to trust assets.

11. Question and Answer.

a. Viacom/Redstone.

- i. Estate of Edward Redstone 145 TC 11 (one of two sons) and 2nd Redstone case involving Sumner Redstone, TC Memo 2015-237. Viacom Stock.
- ii. Contributions made to company that were not equal to father but agreed that dad and 2 sons would take equal shares.
- iii. Edward is black sheep of family. Sumner gets better jobs. Edward threatens to leave and wants his 1/3rd of stock. Litigation follows. Father asserts that unequal contributions meant that neither Edward nor Sumner were not to get equal distributions. Claim 1/3rd of Edward's stock was to be in oral trust for his children.
- iv. Agreed to give Edward 2/3rds of the 1/3rd he owned if 1/3rd put into trust for his children. IRS assert that transfer into trust for children above was a gift. Since no return filed statute of limitations did not run and IRS wanted tax from Edward's estate. 2006 litigation put this on IRS radar. Court found no gift.
- v. The other Redstone case involved Sumner. IRS went to 2006 litigation and found that Sumner testified that Edward's transfer to trust was not voluntary. 3 months after Edward's settlement Sumner voluntarily transferred 1/3rd of his stock into trust. Court held that this was correctly a gift.
- vi. Court rejected double jeopardy argument.
- vii. Court said there was adequate and full consideration for transfer of Edward's stock into trust for stock. Problem is that kids did not give Edward consideration. Consideration for Edward's transfer into trust for his kids came from father.
- viii. The issue may arise in other cases as to whether a legitimate adversarial controversy existed that or if instead the situation really entailed a family exploiting possible disputes among family members to potentially create litigation to obtain a better tax result. Tax Court looked at facts and was convinced this was real family disharmony.
 1. Comment: For many decades practitioners have been able to use the potential tax savings generated from a negotiated settlement to broker resolutions of often ugly family disputes. The high estate tax exemptions have eliminated, for most client families, the ability to realize estate tax savings that could be used to push a settlement.

b. Mennen Case in DE.

- i. Case on Appeal.
- ii. Ruling on virtual representation by magistrate. Virtual representation did not apply because parent (adult beneficiary) was so emotionally dependent on his brother that he had a conflict of interest with his own descendants. The Judge ruled that the father of the children's actions, if they resulted in an agreement, did not bind his minor children because he was emotionally so dependent. Counsel does not think that is how virtual representation

works. Absent something nefarious it should bind heirs. Emotional dependence should not be an exception.

- iii. Trustee defended loss of trust assets based on standard in documents. Judge found that his investing in “fly by night” companies without documented due diligence was so egregious as to be bad faith. This was an unusual interpretation of bad faith standard.
- iv. Corporate trustee in case settled out early. They believed that they were a directed trustee. Corporation trustee sent statements every quarter. If you are a directed trustee and you think you are off the hook, consider some of the possible implications of this case. You have to be careful if investments is not valued easily. If cannot value private equity (or other trust assets) what is reflected on the trust statements? If the trust statements merely carry a value based on what was initially invested then perhaps the corporate trustee cannot rely on those statements to constitute disclosure of the status to the beneficiaries. Should have at least some type of indication on the statements that an issue exists as to the particular investments. For example a footnote, e.g., “Company is in bankruptcy and we have no data on value.” Be careful as even a directed trustee. The corporate trustee’s settlement was confidential so nothing can be discerned.
- v. Someone has to be responsible for trust investments. You can try to remove the institutional trustee’s responsibility by having a directed trust structure, but in the end someone must remain accountable for the inappropriate investments.
- vi. What should a corporate trustee do?
- vii. Uniform Law dealing with divided trustee positions.
 - 1. Comment: Some institutional administrative trustees have a mere notation of private equity interests on statements at \$1 as a place holder. Some institutional trustees do not reflect any data on private equity on the tax return data they circulate. None of this would serve to provide any protection.

c. Loans.

- i. If discount note you may get estate tax benefit but there is an income tax downside in that payment in full would generate ordinary income. The combination of federal income tax, and the net investment income tax, can aggregate a tax rate of 43.4% before state income tax. So you have a time value of money analysis of saving estate tax up front but having a potentially costly income tax later.
- ii. Client lent brother money on note. Should client write off note while alive or at death? What are income tax consequences to the debtor/brother and what are transfer tax consequences to lender/brother. Consider cancellation of debt generally means taxable income unless come under an exception. The exceptions include:
 - 1. Amounts cancelled as gift, bequest or inheritance is not cancellation of indebtedness income. Example cancel debt to child.

- So brother could cancel note as a gift. But debtor/brother may have income.
2. If cancelled in bankruptcy or insolvent at the time (but no bankruptcy) no income but need facts to confirm insolvency. Reduce note to value brother could pay. Could then make a gift at that point.
 3. If forgiving debt always watch cancelation of debt rules.
- iii. Discounting promissory notes.
1. \$4.7M face \$3.5M value at death a few years later with perhaps no change in facts.
 2. On audit IRS claims Prop. Reg. Sec. 20.7872-1 note must be valued at face per agent. 8/85 proposed regulations issued. These said for estate tax purposes loans must be valued at face unless interest rates have changed or credit worthiness of debtor has changed since loan was made.
 3. There is a value for beneficiary to use money free of interest. This is a property right. Congress simplified with enactment of IRC Sec. 7872 with enactment of rate. With low interest rates there has been a lot of lending to younger generations.
 4. Agent above is citing a proposed regulation as authority on the audit. A proposed Regulation is merely one litigant's position. It does not have the power of law. But that doesn't mean it won't have some consideration.
 5. Look at income tax consequences of discounting the value of a note. As illustrated above income tax rates could be more costly than estate tax rates.
- d. Estate of Schafer v. Comr., 145 TC NO. 4 (July 28, 2015).
- i. Charitable remainder unitrust ("CRUT"), see Priority guidance plan and Sec. 344 Extender Act.
 - ii. Unitrust must have minimum 5% payout. You may also provide a make-up provision so in a future year if there is excess income you can make up deficiency from prior years. NIM-CRUT.
 - iii. Valuation is relevant at times, such as determining the lead and remainder interests for charitable deduction purposes. Does the net income limitation be reflected when determining the lead interest and the remainder interest?
 - iv. Taxpayer wanted to maximize the value of deduction and argue value of remainder is greater. So taxpayer said the net income limitation will reduce amount taxpayer is paid during the lead interest and that this limitation should be considered. Valuation of deduction it is clear you ignore the limitation in determining contribution deduction.
 - v. Remainder must have a minimum 10% value. That requirement must be satisfied. Schafer case dealt with unusual fact situation. Two trusts with payouts of 10% and 11% respectively, each with a net income limitation. With 10% and 11% remainder interest was below required 10% remainder. Taxpayer said you should consider restriction on lead interest in order to evaluate the 10% test. Taxpayer said that they met the 5%

requirement but court said rule is that you ignore the limitation just as you would if you valued the deduction itself.

- vi. PATH Act dealt with issue at termination of charitable remainder trust. Holder of lead interest may gift lead interest to charity thereby accelerating the remainder interest. Alternatively both the lead individual interest, and the charitable remainder interest, may sell to third party.
 - vii. IRS has argued that you must reflect the income limitation that would reduce the value of the income interest. This meant the deduction on giving income interest to charity would be smaller. PATH Act said ignoring limitation for deduction but consider it down the road should be eliminated. Thus, the PATH Act requires consistency in all situations. So now if you terminate a CRUT early the lead interest would be worth more. You now value the lead interest at formation and termination.
- e. Crummey Notice Issues.
- i. Should you stop giving Crummey notices? If you have been giving notices you should continue. Why have an argument with an agent if you can avoid it.
 - ii. If we did not give notices over prior years should you concede the qualification for the gift tax annual exclusion issue? No since there is no authority for IRS that notice is required. Crummey, Holland case and Turner (2011) all said no requirement for notice. There are 3 cases which specifically say no notice is required. So if an agent says no annual exclusion because of lack of notices, ask for authority. There is a Revenue Ruling that held a withdrawal right was illusory. First note that Revenue Rulings are not binding in Tax Court. The Ruling had a 4 day withdrawal period and no notice. The Ruling did not have an “or” rather an “and.”
- f. Executor Responsibility to identify prior gifts.
- i. Client has died. Generous individual. No record of gift tax returns. How much due diligence must executors perform until they determine no taxable gifts? Decedent had kept detailed notes of all financial transactions.
 - ii. If decedent was so meticulous in keeping records why would you not presume decedent was similarly meticulous in keeping records of taxable gifts as well?
 - iii. How will IRS prove gifts? What might the IRS want to see? Checkbook registers that are available.
 - iv. Executor should hold reserve until tax issues with IRS closed.
 - v. Ask IRS for transcript of tax filings.
 - vi. Make a reasonable effort to review records.
 - vii. What is size of estate in determining how much work is reasonable in reviewing the records?
 - viii. Ask decedent’s CPA if he or she was aware of gifts. Make reasonable inquiry.
- g. Notifying Beneficiaries.
- i. IRC Sec. 1014 basis.

- ii. Estates only filing for portability are not subject to new rules. Only executor required to file has to furnish reports.
 - iii. But statute gives IRS right to issue regulations to address situations when no return is required to be filed. Regulations should be issued "...as necessary..."
 - iv. Not quite clear what this statement means or how IRS might interpret.
 - v. Might it apply to foreign estate? Perhaps.
 - vi. If you are over filing limit you have to furnish statements. But if no tax is due because of marital or charitable deduction no tax was increased because of inclusion of item but you may still be required to report 1014(f).
- h. Gift Splitting and GST.
- i. PLR 201523003 – split gifts incorrectly because interest in trust included spouse as beneficiary and her interest was not severable so no gift splitting election was correctly available. However, statute of limitations had run so gift splitting was permitted and spouse was treated as transferor for ½.
 - ii. Rule is that if any part of the gift can be split for gift tax purposes than for GST tax purposes each spouse is treated as transferor for ½.
 - iii. If none of it can be split can you still make a GST split election? No there must be at least \$1 of gift splitting election to split for GST. PLR supports this.
 - iv. In current year under PLR both spouses could not be treated as transferors for GST purposes because there was no split gift.
- i. QTIP appraisal fee.
- i. QTIP marital trust to be included in estate of surviving spouse.
 - ii. Estate of surviving spouse goes to other people.
 - iii. QTIP holds hard to value assets. Hire appraiser. Who pays appraiser fee? QTIP trustee or executor of surviving spouse's estate?
 - iv. It is the increase in tax that is apportioned. IRC Sec. 2207A but this does not address fees.
 - v. Fees might be expense of administration.
 - vi. Do the documents address this issue?
 - vii. In New York the Surrogate has discretion to apportion such a fee.
 - viii. Who will notify beneficiaries about basis in this case? Statutory executor acting or person in possession of property. Executor may not have control over valuation but may have to issue report of value to beneficiary.
- j. Steinberg Net Net Gift.
- i. Daughters agreed to pay gift tax and estate tax on gift being included in estate if mom died within 3 years.
 - ii. If mom died in 3 years would the amount the children owed mom's estate would be an asset included in her estate.
 - iii. See first Steinberg case. Judge Lauber made this point.
 - iv. You could do a transaction just net of the estate tax not net of the gift tax.
- k. Closing.
- i. If you don't get a closing letter how long can 645 election stay in place? 6 months after date of final determination. The closing letter is one event but

not the only event that could terminate or end the IRC Sec. 645 election. Another choice is resolution by Tax Court decision or settlement agreement. Finally, the statute of limitation for the return sets a date. Once the statute of limitations has run, the estate has six months.

- ii. Not requesting the closing letter would give you the longest time above, statute plus 6 months.
- l. Don't trade your malpractice for another's.
 - i. \$7M estate with \$5M marital deduction and return not file. Will DSUE \$3M be disallowed? You cannot get portability without filing a timely return. You can request 9100 relief and must prove it was not taxpayer's fault.
 - ii. 9100 relief could be costly.
 - iii. Who will pay for 9100 relief?
 - iv. You may not want to elect marital for \$5M. Perhaps use late QTIP election and use all of first spouse's exemption.
 - v. If you pay filing fee of \$27,000 and legal fees.
 - vi. Perhaps all that you had to do is solve problem by using full exemption instead of relying on portability.
- m. Unbundling.
 - i. What do you recommend fiduciary clients do about apportioning bundled fees as between investment advice and everything else they do?
 - ii. Prior to final 67(e) fiduciary would charge 80-90% of full fee to investments. Should that percentage of bundled fee be allocated to investment performance?
 - iii. One fiduciary looks at nature of investments in trust. Example bonds might have 50 basis points of fee, bond funds 10 basis points, etc. and apportion fees based on this type of analysis.
 - iv. Others have said that some fiduciaries are simply picking a percentage.
 - v. Regulations state that any reasonable method might be used.
 - vi. Do you have to use what you charge for investments? Can you consider the number of hours you worked?
 - vii. Fiduciary should be safe to go below cost of investment since there is a different profit margin on trust and that there is a lot more work on a trust. There should be analysis done.
- n. Guarantees and Sales to Grantor Trusts.
 - i. Guarantees is 10% really necessary?
 - ii. Courts addressed in corporate context. Sensible notion. If you lend all to company you have equity. If you have 10% equity perhaps it can be respected as a loan.
 - iii. Should guarantees have consideration? Yes but how value the compensation or consideration for a guarantee.
 - iv. 10% is not always something you can have.
 - v. Consider step-transaction if seed gift is same asset.
 - vi. Wait if possible 30 days from seed gift to sale of primary asset involved.
 - vii. Project cash flow to see if transaction can support the payments.
 - 1. What if unimproved real estate.

- viii. Should interest payment be ballooned?
- ix. There are some commentators that believe no equity is needed and these commentators cite real estate leverage transactions with no cushion.
- x. In Davidson one alleged fault in malpractice case was insufficient cushion.
- xi. You can lend to a trust and you can repay a note in kind, note could say that.
- o. Woebling
 - i. Are GRATs being used more in light of the Woebling case audit of a note sale? If so, can client allocate GST? Not in a GRAT but there may be a work around.
 - ii. Consider that children or their estates will be remainder beneficiaries of GRATs. Similar analysis to CLAT. Be sure vest interest in child or child's estate.
 - iii. Be certain that there is no spendthrift clause in trust will prevent transfer of remainder interest.
 - iv. Do a sale of the remainder interest by the child to a GST trust.
 - v. Transfer by gift not by sale.
 - vi. This is an aggressive technique. IRS has not ruled favorably in this area.
 - vii. If audited there could be GST consequences.
 - viii. Mother creates GRAT. Child beneficiary sales interest to an old and cold trust to avoid step-transaction issue. Trust terminates and IRS argues GST should be assessed. This might not be the worst result as assets would have passed to child and been subject to gift tax on transfer.
- p. Power Ball.
 - i. \$1.4B payout in lump sum.
 - ii. Elect annuity payment and die.
 - iii. Are annuity payments included in estate? Yes.
 - iv. How will they pay the tax?
 - v. Discounted present value \$916M tax of about \$366M.
 - vi. How do you value the stream of payments if, as is true in many states, is not assignable. That is analogous to spendthrift provision.
 - vii. Donovan 2005 and Davis 2007 both say no discount available for valuation purposes.
 - viii. Court of Appeals Shakelford and Grobaskis 2003 both granted a discount because right to annuity payments not assignable.
 - ix. IRS will get paid, they will have a lien for payment and they will get interest. IRS will take all of every annuity until paid.
- q. PFICs.
 - i. No step up in basis for US taxpayer on PFIC.
 - ii. If never a US taxpayer during holding period for PFIC you do get a step up in basis.
- r. 2036 and Manager of LLC.
 - i. Safer is not to have the parent be the manager.
 - ii. Depends on rights parents has in the position as manager.
 - iii. Not a lot of case law on this since Strangi. Is here business purpose?

- iv. Using ascertainable standard analysis does not make sense in an LLC context.
- v. Consider using multiple managers. Having co-power holders does not solve problem.
- vi. Operating agreement should follow state law and not take away fiduciary obligation to members.
- vii. Make pro-rata distributions of profits.
- viii. Appears not to have been raised on audit.
- s. Single member LLC.
 - i. NY State Department of Revenue did not recognize condo owned by disregarded LLC as transmuting NY situs real estate into an intangible asset that would not be subject to NY estate tax for an out-of-state resident.
 - ii. What about coops? Coops are personal property in NY and there are rulings on this.
 - iii. Washington state instructions say LLC cannot be formed for improper business purpose or it will be disregarded. What is improper?
- t. DSUE
 - i. Can claim DSUE if deceased spouse had no assets.
- u. Revocable Trust.
 - i. On disability of mom, dad becomes trustee and trust cannot be changed.
 - ii. Dangerous to draft in that manner. If person is disabled cannot amend and trust does not need to state this. Could give power of attorney to amend or make irrevocable.
 - iii. Could be possibility of a gift on this occurring.
 - iv. Child challenges father actions as trustee.
 - v. UTC addresses revocable trust. If irrevocable daughter would have standing. If revocable perhaps not.
- v. Entity purchase buy sell.
 - i. At book value. Is this binding on IRS?
 - ii. IRC Sec. 2703 applies to non-grandfathered agreements (post-1990).
 - iii. If not, requirements under 2703 but also pre-1990 requirements. 2703 did not replace prior law requirements. If post 2703 effective date the transaction must comply with all seven requirements, not just the four that existed prior the effective date.
 - iv. Must have bona fide business purpose and terms must be comparable to similar buy sell agreements. Cannot be advice to transfer value for less than adequate consideration for family members (natural objects of bounty).
 - v. Pre-change in the law, the buy sell could not be device to transfer. Must be bona fide business requirement. Must be binding inter-vivos and at death. Question seemed to anticipate only binding on death. Strike price must be reasonable.
 - vi. St Louis Bank case a strike price of -0- is prima facia unreasonable.
 - vii. Is the book value in this question reasonable?
- w. GST Trust.

- i. Do you have to reduce GST exemption for annual gifts to trust?
 - ii. Gifts to a trust could qualify for the annual gift exclusion.
 - iii. Annual exclusion for GST is very limited, more so than for gift tax purposes. 2642(c) (2) trust for single skip person and tax vested in skip person, will be included in skip person's estate at death. Don't have to allocate exemption since has -0- inclusion ratio. For any other transfer in trust you must elect in, make an affirmative allocation (opt in in case miss allocation in future), or make late allocation or ask for 9100 relief. A timely allocation under 9100 may use up more exemption than a late allocation.
- x. Testamentary CRUT.
 - i. Planned giving officer with major university.
 - ii. Irrevocable CRUTs funded with \$1 and asset pour in at death.
 - iii. Only advantage for client is to minimize undue influence but client can change will. No other real advantage to this.
 - iv. Advantage to institution of knowing that assets will come to the institution (but that too assumes will won't be changed).
- y. Grantor Trust.
 - i. Grantor sells asset to grantor trust for a note.
 - ii. Grantor trust sells asset to third party for gain. That gain flows through to the grantor. Grantor is paying income tax on income in the trust.
 - iii. Now grantor is running out of money. What can you do?
 - iv. Grantor's estate is below the exclusion amount?
 - v. Can you convert trust to a non-grantor trust to cut off income tax burn? Problem is that it will burn inside the trust.
 - vi. Trust loses grantor trust status on grantor's death.
- z. Form 1023 vs. 1024.
 - i. Depends on goal.
 - ii. Cannot deduct gifts to (c)(4) but can to (c)(3).
- aa. Unmarried client with taxable estate.
 - i. Cannot make clients plan.
- bb. Send CYA letter to client pointing out income tax offsets and steps that could be taken to reduce estate tax.

12. Trust Design.

- a. Decisions.
 - i. Grantor vs. non-grantor.
 - ii. Trustee or divided trusteeship.
 - iii. Trust protector or not.
 - iv. Domestic or foreign trust.
- b. Trust Income Tax Considerations.
 - i. Income tax rates compressed for trust.
 - ii. NIIT.
 - 1. Threshold is not inflation adjusted.
 - iii. Relative rates.
 - 1. Income tax rates have been as high as 90%.
 - 2. Convergence to estate tax rates.

- iv. Complexity of IRC.
- v. All clients pay income tax even though so few pay estate/transfer tax. Also the income tax is collected each year so over a number of years the impact is substantial.
- vi. Income tax funds 46% of budget and about 24% is payroll taxes.
- c. Transfer taxes.
 - i. Simplicity in terms of a single rate and exemption.
 - ii. Has remained “steady” for four years.
 - iii. Clients’ subject to estate tax is quite modest.
 - iv. Only 2 of each 1,000 estates are subject to estate tax.
 - v. From a policy perspective intended to be “equalizer.”
 - vi. Funds less than 1% of the budget.
- d. Non-Tax.
 - i. 41 Trillion dollars of wealth to be transferred by 2050.
 - ii. How equip inheritors to be successful with wealth.
 - iii. Rules without relationship means litigation risks. The more heirs are educated the lower the litigation risk.
 - iv. Generational shift of wealth is affecting the practice of law. Client base is getting older. Growth in estate and trust administration work.
 - v. Changes in trustee succession.
 - 1. When senior generation becomes disabled.
 - 2. Death.
 - vi. Trustee succession and other matters are under trusts that were crafted with older style drafting.
 - vii. Typical family is no longer the traditional family.
 - 1. 40% of children in US born to unmarried parents.
 - 2. 50% of households headed by single person.
 - 3. Clients are marrying later and more often.
 - 4. 90% of people eventually marry but 40% of the marriages in any given year are not first marriages.
 - 5. Deferral of marriage and single again phenomena makes planning for singles more important.
 - 6. How do you transfer assets to a trust for a young entrepreneur when no family yet exists? What do you do?
- e. Income tax design of trust.
 - i. Power of grantor trust.
 - 1. How do you turn off grantor trust status when client is unhappy about estate burn that status creates?
 - 2. In designing trust consider how to toggle off grantor trust status.
 - 3. Harder in spousal gift trusts (but not impossible).
 - 4. Once you toggle off or on once perhaps should not toggle gain.
 - 5. Beware of transactions of interest in which IRS may view transaction as “gaming system.”
 - 6. QSST at moment of sale grantor trust status turns off and gain may be taxed to trust instead of beneficiary. Sale ends IRC Sec. 678 status.

- ii. Tension of grantor trust status as clients live long and grantor trusts are larger in light of higher exemption.
- iii. Stated tax brackets for trust and individual same but trust reaches highest bracket more quickly.
- iv. Discuss with client what grantor trust status might mean to them in 10-15 years.
- v. Commonly used powers to create grantor trust status.
 - 1. Power to add charitable beneficiary. Does not automatically make a trust a grantor trust. IRC Sec. 674. If there is a change in trustees evaluate power and relationship of power holder.
 - 2. Power to make loans. IRC Sec. 675. Some say only if loan outstanding on last day of year.
 - 3. Power of substitution.
 - a. Creates grantor trust status and adds flexibility.
 - b. Substitute out high basis assets and put cash of equivalent value into trust. On death assets included in estate get step up.
 - c. Need for greater income generation to pay for current expenses. Might swap income generating assets held in the trust to the grantor and swap in non-income generating assets.
 - 4. Power to make payments of income to insurance premiums. May not trigger grantor trust status unless use income to pay premiums.
- f. Current Planning environment.
 - i. Interest rates remain at historic lows. 7520 rate remains very low. Opportunity for wealth transfer in current environment.
 - 1. A simple plan, loan money to a grantor trust at current low rates.
 - 2. GRATs to facilitate trust to grow tax free, transfer appreciating assets, if it doesn't work no harm in terms of exemption if zeroed out.
 - 3. Have post-GRAT trust as a grantor trust fbo spouse so client can access it. Spouse can have power of appointment. Must vest in next generation because GST not allocated.
 - ii. Sales to defective grantor trust.
 - 1. Woebling case has introduced uncertainty.
 - 2. Sale is still a viable option.
 - iii. NING.
 - 1. Incomplete non-grantor trust.
 - 2. For clients seeking to save state income tax especially those who have used all exemption.
 - a. Transfer assets that have appreciated to trust resident in tax favored state like Nevada.
 - b. No federal tax savings.
 - c. If trust is resident in tax friendly state could have substantial state income tax savings.

3. Trust must be a separate taxpayer, i.e., do not want to trigger grantor trust status. Also don't want settlor not to give up dominion and control so that gift is incomplete.
 4. See PLRs. Many clients doing this apply for their own rulings.
 5. In CA be mindful of reporting obligations.
- g. Domestic vs. Foreign trusts.
- i. General.
 1. Default rule is foreign trust.
 2. 3,000-4,000 people expatriate per year.
 3. 500,000 immigrants a year, many with significant wealth. Many of the visas are not sponsored by spouse but rather by adult children.
 4. They may "bring" foreign trust with them. Rules of distribution on foreign trusts may be quite different.
 5. Also see US persons establish foreign trusts.
 - ii. Differences.
 1. Grantor trust rules apply different if foreign person involved.
 2. Must
 - iii. Is trust foreign?
 1. Tests revolve around individual control.
 2. If a US citizen they are a US person no matter where they live.
 3. 183 day rule. If in US 183 days they are considered "present" for US income tax purposes. This is not the entire analysis. Consider 2 prior years and do a weighted average calculation. If in the US 31+ days look at prior years. 100% of days in current year plus 1/3rd in prior year plus 1/6th of days in second prior year.
 - iv. Trust must satisfy court and control test.
 1. A US court must have supervision over trust. This means 50 states and DC, but does not include Commonwealths such as Puerto Rico.
 2. State specifically in trust instrument if intent is to be foreign or US.
 3. Consider QSST – enabling provision often included stating intent is to be a QSST and election should be made and if anything in instrument inconsistent, statement of intent controls.
 4. Rethink how drafting documents.
 5. Control test. Trust must be controlled by US persons. "Control" is broadly defined to include decisions to distribute income or corpus, power to add beneficiaries, etc. If trustor is non-US person and they have a control decision the trust will be characterized as a foreign trust with the associated implications.
 6. Foreign trust has unique reporting obligations.
 7. Power held by foreign person to designate a successor fiduciary will characterize as foreign person. This type of power should be restricted to US person.
 8. If trust is foreign income subject to tax is more narrow than if domestic. Foreign non-grantor trust rules applied differently.

Transfers by US person to foreign trust can cause recognition of gain.

9. Accumulation in foreign non-grantor trust and distribute in later year lose characterize and all is taxed as ordinary income. Throwback rules and interest charge. Consider 65-day election to purge.
10. Opportunities to cure. If change in power holder, someone moved, etc. You have 12 months to cure an inadvertent change. The difficulty is counsel may not know about change. IRC Sec. 684. If US person make transfer to foreign non-grantor trust it is a recognition event. Consider if US trust because of addition of a beneficiary or death of trustee changes status. If start cure in 12 month period but cannot complete cure there are rules for an extension. A number of hedge fund traders have looked to change residency to USVI or Puerto Rico. Be wary of rules on trusts in these regards.
11. Separate compliance obligation 35200, 3520A, etc. Penalties for failure to comply can be as high as 35% of the value of the assets of the trust so be careful. Thresholds at which reporting obligations apply differ.
 - a. FBAR has \$10,000 threshold.
 - b. FATCA are at higher thresholds.

h. NIIT.

- i. Material participation rules.

i. Tax design issues.

- i. Challenge in creating trust is that it may be created for transfer tax opportunities but that trust will then have to be administered long after counsel is gone.
- ii. Trustee relationships.
 1. Divided trust relationships.
 2. Helpful when have special circumstances or special assets.
 3. Who has responsibility? Directed trustee must understand scope of direction power, act within scope as directed, to raise issue if breach of fiduciary duty, etc. Not a panacea. Very developed law in DE and in Missouri Trust Code. Be mindful of the jurisdiction if using a divided trustee relationship.
 4. Is all of this a good thing? It is a great opportunity to “slice and dice” trustee roles, deal with trust assets, deal with beneficiaries, etc.
 5. Challenge is in drafting, cost of the complexity, etc.
 6. Watch for wrongful exercise of authority.

j. Curing old trust.

- i. How cure a defect if document does not accomplish what is currently desired?
- ii. Income tax planning is more important the longer the trust term.
- iii. Techniques to get basis step up on grantor’s death.

1. Swap power.
2. Drafting trusts that will intentionally be included in someone's estate for estate tax purposes.
- iv. Construction.
 1. Having trust instrument construed may be preferable technique if you want binding authority for change desired.
- v. Reform a trust.
- vi. Decanting.
 1. Relatively new.
 2. Some old trusts may have provisions.
 3. Can help address trust provisions that no longer work.
- vii. Virtual representation.
 1. May not be sufficient if desire change to be respected for tax purposes.
- viii. Disclaimer approach can fix various issues.
- ix. Powers of appointment might help fix problems.
- x. Don't always do what you can do. For example, if you have a GST grandfathered trust you need to be mindful of staying within one of the four safe harbors under IRS Sec. 2601.
- k. Domicile of Trust.
 - i. Start with trust agreement.
 - ii. Next read the statute.
 1. Example, Illinois has resident by origin rule.
 2. Inter-vivos trust look at where settlor resided when trust become irrevocable. If toggled off grantor trust status after moved to FL may be FL trust. If toggled off grantor trust status in Illinois may remain taxed in Illinois.
 - iii. If, for example, trustees are an issue for state income tax purposes, consider if changing trustees may help.
 - iv. Example: Settlor in one state, beneficiary in another, and trustee in a third state. Is it taxable in no state or one state or more than one state? The rules between states do not always work together.
 - v. How change domicile of trust?
 1. Harder to move a trust for income tax purpose than for an individual to change his or her domicile.
 2. There is more litigation around the state income taxation of a trust on constitutional basis. This is costly and time consuming. It can take years.
- l. What about changes in family?
 - i. Pace of change is accelerating.
 - ii. Trust protectors were only used in foreign trusts. Now the default approach in many trusts will be to use a trust protector.
 - iii. Will we have trust protector provisions in a revocable trust?
 - iv. What powers should a trust protector be granted?
 - v. Who can be the trust protector?
 - vi. Who is successor?

13. Fiduciary Cases.

- a. Clergy.
 - i. Matter of Sister George Marie Attea, 2015 NY Slip Op (Erie County).
 - ii. She had signed a vow of poverty which included giving all assets to church.
 - iii. Injured and awarded settlement which was managed by her biological sister, funds of \$1.7M. Some money given to church to offset costs of care.
 - iv. New will divided assets to others. Church objected that new will violated vow of poverty.
 - v. Court said breach of contract was cause of action to pursue, not blocking probate.
- b. Business Interests.
 - i. Rollins v. Rollins, 2015 Ga Lexis 904 decided Nov. 2015.
 - ii. Case addressed issues concerning the fiduciary duties of trustee who also served as a director.
 - iii. Fight between family members.
 - iv. Mr. Rollins founded Orkin Pest Control. Trust distributed outright to grandchildren at specified ages. Named sons Gary and Randall and family friend Tippie as co-trustees, etc. Parents served as co-trustees on trusts for children.
 - v. Holding companies in partnerships put into trusts.
 - vi. Died in 1991. Suit by Gary's children (not Randall's) against all trustees claiming that Gary and Randal changed partnership structure to condition distributions on children adhering to a family code of conduct.
 - vii. Randalls' kids who did not complain got a lot of money and Gary's kids who complained got nothing. Court felt trustee duties did not apply to corporate actions. Court of Appeals said need to apply corporate law to corporate actions. One of the problems in the case was that the parties used trust and corporate terms interchangeably. All mixed up.
 - viii. Consider the destructive impact of the litigation on the family and the family wealth.
- c. Entity vs. Trust Documents/Provisions.
 - i. Blechman v. Blechman, 2015 Fla. App. LEXIS 4808 (2015).
 - ii. Lesson of the case is be certain that the estate planning documents don't violate entity documents.
 - iii. Paramours were excluded in LLC governing documents and he gave LLC interests to a trust to benefit his Paramour then on her death to children. Effectively he gave his paramour a vested income interest in trust, but that transfer violated the express provisions of the operating agreement governing the entity and in particular the transfer restrictions in that agreement.
 - iv. Court held entire gift void.
- d. Special Fiduciaries – Trust protector.
 - i. Schwartz v. Wellin, 2014 US Dist LEXIS 143644 (Charleston South Carolina Oct 9, 2014)

- ii. Did children as fiduciaries breach their fiduciary duties?
- iii. Drafting lawyer named himself trust protector. Court said he did not have enough standing to sue Trustees even though trust gave him that right.
- iv. Protector could name an additional trustee, so the protector named a new trustee, who as a co-trustee had standing, sued.
- v. Father died and under trust document as original drafted children could remove protector and they put in a new trust protector. The new protector tried to get rid of the new trustee. But before this happened the old protector used his powers to amend the trust to remove the power of the children to remove the protector.
- vi. Court respected power of protector to do that.
- e. Trust protector could amend trust.
 - i. *Minassian v. Rachins*, NO. 4D13-2241 (Dec. 3, 2014).
 - ii. Settlor's intent was to assure widow could enjoy lifestyle of legal gambling and court respected power to do that.
 - iii. Wife was trustee of family trustee. On her death assets pass to husband's children from a prior marriage. The children sued her and she appointed the lawyer as trust protector so that he could exercise powers to clarify the trust in that capacity.
- f. Trust protector role doesn't violate LA public policy.
 - i. *In re Eleanor Pierce Marshall Stevens Living Trust*, 2015 La. App. LEXIS 284 (2015).
 - ii. Trust protectors do not inherently violate public policy of LA.
 - iii. Drafting lawyer named as protector and injected himself into active dispute in document that he drafted.
- g. Trust Investments general principals.
 - i. Is there a grand unifying principal of investment liability?
 - ii. Is there a way to reconcile the many and often seemingly divergent cases?
 - iii. Do trust equities always drive result? Good process, disclosure, etc.
 - iv. Does presence or absence of good equities determine results?
- h. *Moss v. Northern Trust Company*, No. 07 CH 24749 (Cook County, Illinois, Circuit Court 2015).
 - i. Corporate trustee was sued for failing to diversify holding of family business.
 - ii. Distribution of income only no corpus.
 - iii. Members of every generation of family worked in company.
 - iv. Bank had experience and process to handle company and had multiple levels of review and spoke to family about diversification.
 - v. Board heavily weighted with family members and trustee backed off.
 - vi. Trustee stayed engaged and recruited independent board members.
 - vii. Reported on impending doom of publishing industry. Some of beneficiaries sued the trustee and found that in spite of all the processes etc. the trustee did not document some of the key factors, such as tax costs of selling stock. Ultimately court found in favor of the trustee. Beneficiary hypothetical model earned less than what company actually earned. Failed to prove that company earned less than what a diversified

1. Comment: Case seems to list many great steps for any trustee to take when holding a family business.
- i. Challenge to Investment Actions by Trust.
 - i. *Mennen v. Wilmington Trust Company*, 2013 Del Ch. LEXIS 204 (2013); CA No. 8432-ML (Jan 17, 2014); Final Master's Report (Apr 24, 2015).
 - ii. Spendthrift trust for company stock.
 - iii. Trust for son John. Jeff had his own trust. Bank served as co-trustee. Bank position was that it was directed and bank settled out so issue is about John serving as trustee for John. Special master recommended surcharge for investments by Jeff in start-up companies etc. Found Jeff was motivated by reputation as skilled investor and Jeff's pride and ego was responsible for the breach of trust. No good faith defense since no records of due diligence in making investments. Jeff had \$100M spendthrift trust and family members could not recover against his trust. So the award may be of little practical benefit.
 - iv. Case on appeal.
- j. Trust Investment Suit.
 - i. *Matter of Mary Moder*, 2015 Ind. App. LEXIS 131 (2015).
 - ii. 35% concentration in JP Morgan stock.
 - iii. Took daughter a year to get new trustee a year to get basis information so that delayed plan to divest.
 - iv. Sold ½ then eventually sold more in 2009.
 - v. Most of sales were for a gain.
 - vi. Sister surcharged because delay in investment plan was due to her delays in getting basis data to the successor trustee.
- k. Trust Investment Suit.
 - i. *Matter of Wellington Trusts*, 2015 NY Slip Op 31294(U) (Nassau County Surrogate, 2015)
 - ii. Trustees grew trust from \$2M to \$36M.
 - iii. Beneficiary got regular distributions and discretionary distributions. She sued when there was a temporary downturn in the market. Bank prevailed because Herbert as co-trustee had power to sell and had power to change banks so Herbert had "thumb on bank" and the strategy was a long term success.
 - iv. Stocks held were regularly reviewed and were on banks approved list.
- l. Improper Use of Trust Assets.
 - i. *In re Morriss Trust*, Case No. 12SL-PRO3035 (St. Louis, Missouri Probate Court, Sept. 30 2015).
 - ii. Long complex case.
 - iii. Trust fbo Barbara. Barbara, her son Douglas, and a bank became co-trustees. No beneficiary, under trust terms of the trust instrument, can participate in any transactions for his own benefit (not a HEMS standard). Douglas given \$40M line of credit to invest in private equity. Douglas signed agreement as trustee.
 - iv. Loan renewed many times with bank and Barbara signing later loan renewals.

- v. 2010 Douglas defaults and everyone is angry at bank.
 - vi. Barbara became the representative for all beneficiaries and sued the bank for allowing a line of credit she allowed as a co-trustee.
 - vii. Bank is found liable for allowing Douglas to violate trust terms, participating in its breach, etc.
 - viii. Barbara got \$17.8M she was found 25% liable. Court orders that whatever bank pays as trust Barbara cannot have benefit.
 - ix. Conflicts of interests were significant.
 - x. Lessons: Use good process, avoid conflicts, and communicate well, and when (not if) challenged, will protect fiduciaries.
- m. Revocable Trust.
- i. Trzop v. Hudson, 2015 IL App. (1st) 150419 (2015).
 - ii. Do remainder beneficiaries of revocable trust have rights to get information during lifetime of settlor?
 - iii. Abuse will move to funded revocable trust as abuser is often named as executor of estate and will not sue themselves.
 - iv. Courts seem anxious to find ways to help victims.
 - v. While remainder beneficiaries should not have information or get anything courts will not rigidly adhere to this when there is abuse.
 - vi. Allowed challenge to amendment to revocable trust because of risk of potential abuse.
 - 1. Comment: The law on revocable trusts makes it difficult for beneficiaries other than the settlor to gather information and thereby to protect a settlor who ages, has health challenges or is a victim of financial abuse. Powers of attorney have been a major tool used in perpetrating elder financial abuse. The statistics are rather startling. Much of elder financial abuse is committed by family. It seems that revocable trusts might provide even more fertile ground for those seeking to take unfair advantage. Some of these issues might be deflected by integrating into a revocable trust plan any or all of the following: institutional/corporate co-trustee or even sole trustee, consolidating assets at one institution to minimize recordkeeping confusion, having a CPA named in some type of monitor capacity (e.g., duplicate monthly statements must be sent to CPA, etc.), care manager provisions (e.g., a care manager shall be required to complete an independent quarterly assessment), and a trust protector.
- n. Revocable Trust standing to obtain information.
- i. Tseng v. Tseng Case No. 120891165; A153639 (Oregon Court of Appeals, 2015).
 - ii. 5 children in China by another wife. Fled to US believing wife and children died. Married in US and 2 more children and 25 years later finds out that 1st wife and 5 children alive. Sets up trust for all 7 children. Died in 2009 and all trust assets gone.
 - iii. 5 children from China tried to get info from 2 US children about what happened with money.

- iv. Court in UTC jurisdiction allows them to get info on admin of trust during his lifetime. Wanted to find out if settlor had directed distributions himself.
- v. Under UTC would have no rights but court said when Settlor died they can get info to protect their rights even if that includes info on trust admin during his lifetime. They held remainder beneficiary rights while grantor alive not extinguished just deferred.
- o. ILIT.
 - i. Rafert v. Meyer, 290 Neb. 219 (215)
 - ii. \$8.5M life insurance policy.
 - iii. Lawyer named as trustee and waives every duty in the document and gave insurance company false address and policies lapse.
 - iv. Beneficiaries sue trustee. Court held for trustee because of waivers but on appeal held that there is a non-waivable duty to act in good faith.
- p. Surcharge Trustee.
 - i. Miller v Bank of America, NA, 2014 NMCA 053 (New Mexico Court of Appeals 2014); 2015 NM LEXIS 159 (2015)
 - ii. Trust with bank as trustee. Trust says cannot invest trust in assets that do not produce income and trust only permits income to be distributed.
 - iii. Trustee purchases commercial real estate which becomes non-income-producing. Borrow money from affiliate and renovate. They wanted to sell other assets off and repay debt but instead of paying off debt put more money into the property. The called money from sale of stock “income” and distributed it to beneficiaries so that the beneficiaries would not complain. This under principal and income act should have been characterized as principal.
 - iv. Court surcharged bank but gave bank credit for the phantom income given to the beneficiaries. Court of appeals increases damages and takes away credit since that was not income but corpus and distributing corpus in violation of the terms of the trust and two wrongs don’t make a right.
 - v. Bank appeals again and state Supreme Court orders bank to disgorge fees earned on mortgage from an affiliate.
- q. Trustee Fees.
 - i. In re Trust under Deeds of Luise E. W. Jones 2015 Phila. Ct. Com. Pl. LEXIS 110 (2015).
 - ii. Old trust. Methods of investing are different now.
 - iii. Bank informed beneficiaries of fee changes. Process protected bank form later suit.
 - iv. Accountings were filed.
 - v. Bank had sent consent letters to beneficiaries and all approved the fee increase.
- r. Trustee Counsel Fees.
 - i. Mater of Speyer, 2014 NY Misc. LEXIS 4870 (NY Sup. Ct. Nov. 13, 2014).

- ii. Corporate trustee hired counsel not because it was trying to defend itself but to get family to stop fighting and to broker an agreement to end the disputes.
 - iii. The beneficiaries then all sued bank for paying out of trust assets the lawyer that the bank hired who solved the beneficiary disputes.
 - iv. Court held bank can decide to use inside or outside counsel.
- s. Statute of Limitations.
 - i. Wells Fargo Bank v. Cook, 332 Ga. App. 834 (2015).
 - ii. What is enough of a report (disclosure) for a trustee to send out to the beneficiaries in order to get out of a longer statute of limitations and trigger a shorter statute of limitations? (1 year under UTC).
 - iii. Trustee wants to get out disclosure and “get short clocks running.”
 - iv. Bank trustee statements are detailed with all relevant facts. Would a court find a bank statement to be adequate to start statute of limitations? Court held yes.
 - v. CRAT with 7.5% annuity payment.
 - vi. Sued because financial professional that set up CRAT claimed that bank by taking the trust “guaranteed” the payout rate forever.
 - vii. CRAT payment failed after 11 years.
 - viii. Court threw out case and found bank statements adequate.
- t. Laches; Accounting by Trustee.
 - i. Corya v. Sanders, 2015 Fla. App. LEXIS 1846 (Fla. Dist. Ct. App. 4th Dist. 2015).
 - ii. Beneficiary sued for failure of trustee to provide accountings.
 - iii. On appeal court noted that trusts had been in existence for decades and discussed the issue of laches and what reasonable should be required from the trustee.
- u. Trustee Removal.
 - i. Trust u/a Edward Winslow Taylor, 2015 PA Super 199 (2015).
 - ii. Court allows the modifications under UTC 411 to modify trust to give beneficiary’s power to remove and replace corporate trustee.
- v. Reformation of Trust; Trustee Removal.
 - i. In re Rutgers Trust, 2014 NY Slip Op 32863(U) (2015).
 - ii. No removal power court would not impute one and would not reform trust to add one.
 - iii. Court allowed division of trust.
- w. Power of Appointment.
 - i. Estate of Zucker, 2015 PA Super 190 (2015).
 - ii. Claimed exercised Power of appointment in bad faith.
 - iii. Donee of power does not owe duties to potential appointees.
 - iv. Only responsibility of the power holder is to comply with the terms and scope of the power granted.
- x. Scope of Power of Appointment.
 - i. BMO Harris Bank, NA v. Towers, 2015 IL App. (1st) 133351.

- ii. By appointing to revocable trust and by not specifying sub-trust it violated scope of power and was fraud on power and assets therefore pass by default.
- y. Decanting SNT Failed.
 - i. Harrell v. Badger, 2015 Fla. App. LEXIS 11183 (2015).
 - ii. Decant into new trust.
 - iii. Lawyer set up new trust that is a pooled SNT. Would provide for David for life than on death would benefit others in need. It would distinguish family members' interests.
 - iv. This was a scam and funds stolen.
 - v. Held that decanting void since decanted to trust with other beneficiaries.
- z. Decanting cannot broaden class of beneficiaries.
 - i. Petition of Katharine A. Johnson, 2015 NY Misc. LEXIS 51 (2015).
 - ii. Decant to change permissible appointees of daughter's power of appointment to make it to his heirs not to ex-wife's. This decanting was void for broadening class of beneficiaries.
- aa. Decanting to protect trust assets from divorce.
 - i. Ferri v. Powell-Ferri, 2013 Conn. Super. LEXIS 1938 (2013); 2015 Conn. LEXIS 151 (Ct. Supreme Court, 2015).
 - ii. Decanting after bad divorce.
 - iii. Court held invalid decanting because attempts to strip someone of a vested right.
 - iv. Wife wins. Then sues husband in tort for not stopping decanting. Then brought another lawsuit against spouse for not blocking a decanting and to preserve marital estate. Case thrown out since such an action does not exist.
- bb. Directed Trust.
 - i. Trust u/w Wallace B. Flint FBO Katherine F. Shadek, 118 A. 3d 182 (Del. Chancery Court, 2015).
 - ii. Original trust only had trustees.
 - iii. Went to DE to make the beneficiary/trustee the directed trustee and this is why court may have rejected.
 - iv. Shows you cannot take courts for granted and expect anything to be approved.
- cc. Will Construction.
 - i. Radin v. Jewish National Fund, Ct. App. 2/4 B227954 (Cal. S. Ct. 2015).
 - ii. Court allowed reformation of will including consideration of extrinsic evidence.
- dd. Abuse.
 - i. In re Estate of Regan, 2015 Miss. App. LEXIS 179 (April 7, 2015).
 - ii. Arranged for new will to leave assets to care giver but did not say to whom. Caregiver wanted to reform document to put her name in.
 - iii. Court said it was a failure of a residue.
- ee. Funding Formula.
 - i. Nancy Crowe et al. v. Leonard M. Tweten, 2014 Cal. App. Unpub. LEXIS 9292.

- ii. Death caused unintended disinheritance of spouse since no savings clause. She signed amendment but not notarized and trust required amendment be notarized.
 - iii. Spouse disinherited.
 - iv. Daughter sued that trust could not be reformed and her father should be disinherited.
 - v. Court ordered reformation.
 - ff. Tax Apportionment.
 - i. Matter of Thomas L. Clancy, Jr. Estate Number 101962.
 - ii. QTIP and tax apportionment clause.
 - iii. Amended family trust for wife and child from second marriage to make it QTIP'able but did not amend tax allocation clause.
 - iv. QTIP since it did not cause tax did not have to pay tax.
 - gg. Benson v. Rosenthal.
 - i. Tried to exercise swap power to swap in note and swap out asset.
 - hh. Trust reachable in divorce.
 - i. Pfannenstiehl.
 - ii. Matrimonial case.
 - iii. Spendthrift clause did not protect.
 - iv. Not entirely discretionary and had pattern of
 - v. Should have been wholly discretionary and with independent trustee and no pattern.
 - ii. Elective share.
 - i. Beren v. Beren, 2015 CO 29 (2015).
 - ii. Draggged out case for so long so court tried to give widow upside in run up of assets. On appeal held no but set forth how to accomplish it.
 - jj. Gifts.
 - i. Reed v. Grandelli, CA No. 8283-VCG (Del. Chancery Court 2015).
 - ii. Elderly man gave waitress expensive gifts. His children challenged these.
 - iii. No indication of abuse so court would not require her to return gifts.
14. **Lifetime QTIPs.**
- a. Safeguard Exemption.
 - i. Create inter vivos QTIP and make gift tax QTIP election but not reverse.
 - ii. Give H income interest. Must have qualifying income interest for life and no one can appoint property to anyone other than surviving spouse.
 - iii. Could give trustee right to make distributions, e.g. For HEMS or appoint independent trustee
 - iv. On H's death drop down to GST trust for kids. Executor of H will allocate GST to trust.
 - v. If W's transfer to QTIP is not a fraudulent conveyance protect from her creditors. Standard spendthrift clause will protect from H's creditors
 - b. W wants to use H's exemption as soon as possible because she has used hers.
 - i. Want grantor trust as to W.
 - ii. Use inter-vivos QTIP.
 - iii. H releases income interest in trust. 2519. Assets drop into continuing trust for W's kids.

- iv. These continuing trusts for descendants can be grantor trust as to W. H becomes transferor of assets for gift, estate and GST when he releases his income
- v. 1.671-2(e) define transferor for income tax purposes. It is W since she funded trust. When does this transferor status change? Only changes to H if H had GPOA which he did not so grantor trust status continues.
- vi. W could give someone swap or other power to assure grantor trust status continues.
- vii. If W gave H assets outright to make these gifts W would not be grantor.
- viii. H must be able to release his power. Spendthrift clause should permit release.
- ix. Step-transaction doctrine issue. If W creates QTIP and H releases income interest IRS could argue W was really transferor to trust for descendants. Let time lapse. But arguably step transaction doctrine should not apply. QTIP was designed to address second marriage by providing for 2nd spouse while providing for children of a prior marriage. Deeming rules. When donor spouse creates inter vivos QTIP all economic interests transferred to donee spouse and on surviving spouse's death all is deemed to pass from him to the descendant's trust.
- c. Use lifetime QTIP to minimize risk associated with transfer of hard to value assets.
 - i. Election can be made on formula basis.
 - ii. Petter/Wandry no regulatory authority for formula approach but QTIP does have.
 - iii. In estate tax QTIP regulations have formula approach. I treat portion of property necessary to reduce gift tax to zero. This should apply in gift tax as well.
 - iv. Use disclaimer. Any portion of transfer disclaimed by H will drop into bypass trust for spouse and descendants as 2518 disclaimer regulation example of formula disclaimer. Any portion of transfer not disclaimed will be QTIP. Note that 2518(b)(4)(A) property passing to surviving spouse so doesn't contemplate a lifetime disclaimer but same rules should apply.
- d. W has asset to sell and wants to use formula clause.
 - i. Use Petter type clause.
 - ii. Have lifetime QTIP be spillover from Petter clause.
 - iii. On date of transfer what each transferee will receive is known. This is why a gift tax marital deduction should be available using a lifetime QTIP.
 - iv. Advantage of lifetime QTIP is that it would be grantor trust for income tax purposes.
 - v. Use when interest in a privately held company is being transferred.
- e. Grantor Bypass trust.
 - i. When bypass is created it is a separate taxpaying entity. Can you create a bypass trust that is also a grantor trust as to the surviving spouse?
 - ii. Reg. 1.671-2(e)(5).
 - iii. Rule against self-settled spendthrift trusts.
 - iv. Use an inter-vivos QTIP trust or DAPT jurisdiction.

- f. Discounts.
 - i. Don't aggregate ownership interests on QTIP and surviving spouse.
 - ii. Minority interest discount on most of equity.
- g. Elkins Art Discount.
 - i. Split art between lifetime QTIP and SLAT.
 - ii. Should get discount under Elkins, Mellinger, etc.
 - iii. 2036 should not apply.
 - iv. QTIP can hold personal use property.
- h. Use QTIP to Address 2036 Issues.
 - i. W creates lifetime QTIP and transfers \$3M. QTIP loans cash to SLAT for promissory note.
 - ii. SLAT buys asset from W.
 - iii. 2036 and 2702 cannot apply because there is no retained interest between W and SLAT that purchased asset.
 - iv. What if W transferred asset to QTIP and later QTIP sells some of asset to SLAT for a note.
 - v. In the above variations of the transactions the note is between the trusts not the client.
- i. Asset protection.
 - i. Death bed strategy.
- j. Other considerations.
 - i. Donor spouse may survive donee spouse.
 - ii. When is election to be made? For inter-vivos QTIP time period is set by statute. IRS has no discretion to grant relief so be certain to address on a gift tax return.
 - iii. Divorce issues. To obtain gift tax election must provide a qualified income interest for life regardless of divorce. Income of trust will be taxed to donee spouse but capital gains could be taxed to donor spouse.
 - iv. Post formation planning, sales to other grantor trusts.
 - v. 2519 planning once QTIP is in place. Note that IRS could use this as sword but can be used as affirmative planning tool by taxpayer.

15. **Trust to Trust Transfers.**

- a. Stale old trust.
 - i. No longer fits family needs. What are options?
 - ii. Example, may be grantor trust, or not grantor and you want the opposite.
 - iii. You might have a standard trust and it now owns a concentration stock position.
 - iv. Poorly drafted.
 - v. Poorly administrated.
- b. Change and repurpose old trust.
 - i. Use a stale trust to leverage new transactions.
 - ii. Joint purchases.
- c. Issues to address.
 - i. Fiduciary issues must be addressed first. If you want to move wealth into a new trust and use the old trust to make a newer trust more valuable, you must first address fiduciary issues.

- ii. Under state law has very specific rules on transactions between trusts that have the same trustee. Likely need different trustees for each trust involved in this type of planning.
 - iii. Who is involved? Trustees of old and new trusts, beneficiaries and first tier remaindermen (all beneficiaries, may be defined by class, etc.). Consider the final takers type provision as all people named may have to be named.
 - iv. Consider creditors of trust and other third parties. Be wary of possible fraudulent conveyance issues on making a transfer.
 - v. Can lawyer be disinterested if on both sides of the transaction? Complicated.
 - vi. Can trustee be disinterested if on both sides of the transaction? Complicated.
 - vii. Duty of impartiality. Even if trust gives broad discretion that may mean can favor a beneficiary but it is not a “you can do whatever you want.”
 - viii. Duty of care. Buying, selling, exchanging, loaning, etc. UPIA applies unless trust provides otherwise.
 - ix. Can lawyer represent the trustee and the client?
 - x. Proper administration of trusts and observance of fiduciaries, is vital.
- d. Tax consequences.
- i. Transfer of old to new trust is there a tax consequence? If not for full and adequate consideration there might be a gift. Trustee doesn't make gift but trustee may violate fiduciary duty.
 - ii. Beneficiary consent to transaction. Beneficiaries could face gift tax problems.
 - iii. Gifts can occur because of a variety of reasons. Trust funded with Crummey powers and there is LPOA or hanging powers. When shift to new trust without similar rights there is a completed gift of lapsed Crummey power.
 - iv. If beneficiary has vested interest or expectancy like an income interest, withdrawal right or GPOA susceptible to value and value shifts to another trust in which the beneficiary does not have those powers that beneficiary may be making a gift. If beneficiary has no authority or right to object then it might be the trustee's discretion. But if the beneficiary consents or is exercised by a beneficiary who is also a trustee there may be a tax problem.
 - v. Once a gift is complete it cannot be “completed” again.
 - vi. QTIP trust IRC Sec. 2519 inclusion if transfer for less than full consideration. May be able to limit risk by dividing QTIP. If in QTIP spouse has LPOA that might take QTIP out of “low hanging fruit” environment. 2519 transfer triggers transfer of all assets in QTIP. If IRS asserts but QTIP includes an LPOA that makes the gift incomplete that might deflect the issue.
 - vii. GST issues could be triggered if shift assets from exempt to non-exempt trust.
 - viii. If gift involved consider generational assignment.

- ix. Estate tax might be an issue. If you want settlor's consent (e.g. in modification) does this regenerate 2038 issue See Regs.
- x. Chapter 14 can be an issue.
 - 1. 2701 - Slicing entity interests and recapitalization but requires a gift, doesn't apply if only estate or GST tax is involved then 2701 cannot be a problem.
 - 2. 2702 – GRATs, QPRTs, but also applies to split interest purchases that are treated like a trust. Only applies if a gift.
- e. How harvest benefits from old stale trust?
 - i. Loan.
 - 1. Can old trust loan money to new trust that it can use in a purchase from client?
 - 2. Does old trust document allow it?
 - 3. Is it a good investment for the old trust?
 - 4. Is old trust getting good value for the old trust beneficiaries?
 - 5. Loan is a freeze technique. Have you considered all the beneficiaries?
 - 6. What do terms of new/borrower trust say? Can it distribute assets so that debt will never be repaid?
 - 7. Do you charge AFR? That is a pretty low amount. Is the long term AFR what you would really invest at?
 - 8. Should you have life insurance to assure loan is repaid?
 - 9. Is loan is secured?
 - 10. Should there be subordination?
 - 11. Should there be guarantees from beneficiaries?
 - 12. Is the trustee qualified to negotiate or document it? What about perfecting security interest?
 - 13. Can you defer interest and use a balloon payment? What does that do to the various beneficiaries?
 - ii. Purchase and sales.
 - 1. Old trust has asset that is wanted in the new trust.
 - 2. Or old trust is not GST exempt and would prefer asset in new GST exempt trust.
 - 3. This is a purchase and an investment and both trusts have fiduciary issues.
 - 4. Seller must think of consequences of sale, e.g., valuation.
 - 5. Buyer trust should exercise due diligence. "Everyone knows about the family business." Don't assume. What about a charitable contingent beneficiary or unborn children? At minimum go through motions of getting financial statements and documenting it.
 - 6. What if sell for less than full and adequate consideration? There are transfer tax and fiduciary issues so you need to corroborate the value. If it is grandfathered GST Trust and you add value it could be disastrous.

7. Use a Wadry or other formula clause to assure the appropriate transfer of value. But who settles formula? Do you add an arbitrator? Do you give beneficiary the way to value? Can you use an old fashion price adjustment? There may be no gift tax reporting so who will challenge? Document say that at any time there is a determination that the value is wrong it will be corrected? Must you do something like this as a fiduciary?
 8. Should you file a Form 709 and report? But what do you file? Does old trust file Form 709GST saying no GST issue. Does settlor file 709 saying he/she made no gift as a result of these transactions? Do you go to court and have the court “bless” the transaction? But that is not binding on IRS under Estate of Bosch. Would a client spend \$28,300 to get a private letter ruling?
 9. What if there is a loss? Old trust sells asset that has declined in value. IRC Sec. 267(b) may prevent loss by old trust if related parties. Where does loss go? The purchaser/new trust gets to add the loss that was disallowed to the selling related party. Will beneficiaries of old trust be agreeable to that?
 10. Installment sales between two trusts. If grantor trusts no gain or loss.
 11. What happens when grantor trust status terminates?
 12. What if buying trust sell assets? Gain to selling trust that had been deferred may be triggered.
 13. Private annuities may be viable if buying trust will give selling trust funds upfront to cover tax.
 14. Consider Starker exchange 1031.
- iii. Joint ventures.
1. If both old and new trust have cash or other assets can they do a joint venture? Can old trust buy real estate and lease to new trust and new trust builds real estate on leased property?
 2. Other split interest ideas.
 3. If 2701 and 2702 don't apply because no gift you can slice and dice all day long.

16. **Government Regulations Money Laundering.**

- a. General.
 - i. Worldview of trusts.
 1. Negative.
 2. Reporting of trustees and beneficiaries.
 - ii. Tax transparency.
 - iii. Growing reporting requirements.
- b. Anti-Money Laundering.
 - i. Identification of beneficial owners of financial accounts.
 - ii. Key part of anti-money laundering strategies.
 - iii. Use financial institutions to determine who is opening accounts and verify identify. Have this information available for governments and law enforcement.

- iv. Beneficial owner is the natural person that owns or controls the account.
 - v. Most of world misunderstands trusts and mistakenly assume beneficiaries are in control of trusts and since cannot determine who is in control ask for information on trustees, beneficiaries, and more.
- c. EU money laundering rules.
- i. Changes and expands definition of beneficial owner for any account in EU.
 - ii. Bank will have to identify each person and get a passport and copy of utility bill and keep on file.
 - iii. Company –anyone owning 25% plus 1 share direct or indirect.
 - iv. For trust will have to identify and verify identity of settlor, trustee, any other natural person that can control trust like a protector, must identify all beneficiaries at start but only certain beneficiaries, such as those named in the trust. Must verify identify of any beneficiary with a vested remainder or income interest (something you can measure). If you have a discretionary trust (e.g. descendants of X) only need to identify them when their interests' vests or a distribution is made to them.
 - v. While these rules are less onerous than the past they show the continued mistrust of trusts.
- d. In US.
- i. If you open an account for a company may want certificate of formation and operating agreement, etc.
 - ii. Banks for a trust will want trust agreement.
 - iii. In contrast to EU banks are not required presently to determine who is behind the trust or to verify the identity of those people but this will all change.
- e. FINCEN.
- i. FINCEN arm of treasury that deals with money laundering proposed legislation that will require US institutions to gather information comparable to that required in EU, i.e. to determine beneficial ownership of entities and trusts.
 - ii. For a company will have to determine 25% or greater direct or indirect shareholders. Will have to verify identify with a Social Security number, passport, etc. Bank can accept information from customer and will not have to investigate.
 - iii. Persons with significant responsibility to manage or control entity will also have to be identified.
 - iv. For trusts rules are less onerous than EU. Bank must verify the identity of the trustee and any other person that controls the trust. Example, for a revocable trust the person holding the power to revoke. May have to identify a trust protector as well. Do not have to identify beneficiaries because a trustee that is acting properly will have the information on the beneficiaries. This is a more practical approach to dealing with trusts than the EU and demonstrate the greater use and understanding of trusts in the US as compared with the EU.

- v. FINCEN will issue a standard form that client will have to use when opening an account and provide passports, etc.
- f. Central Registries of Information.
 - i. Purposes of collecting the information is to fight money laundering and terrorism. Shouldn't this information be held in a central registry so policy can access it without going to a bank?
 - ii. Example if you want to know the name and key information about a company go to a state registry but you won't find information on who owns the company. Only the Island of Jersey has a central registry of owners.
 - iii. Countries have committed to plan to be part of a central registry of beneficial ownership and will require banks to know identify of beneficiaries.
 - iv. Task force recommended creation of a central registry of trusts.
 - v. EU has done the following.
 - 1. Must set up central registry of companies with information on beneficial owners.
 - 2. Under EU rules beneficial owners is someone who owns 25% plus one share.
 - 3. Anyone who can demonstrate a legitimate interest (whatever that might be) may be able to gain access.
 - 4. For trusts in the first and second draft of the AML directive they proposed having all information on beneficial owners with public internet search feasible. But in the final AML directive there is a much watered down version of this. Must collect information on settlors, trustees and beneficiaries but only must send information when it has tax consequences. Available to government and others who can demonstrate a "legitimate interest."
 - vi. US is out of step with rest of world on all of these rules.
 - 1. Does that mean US by not requiring information is not as effective in fighting money laundering or terrorism?
 - 2. A uniform act was proposed that would require companies to collect information on beneficial ownership and make it available to law enforcement upon request but companies could inform beneficial owners so it was pretty useless. No state enacted this.
 - 3. Incorporation transparency act has been proposed 4 times but never enacted. States would have had to collect information, etc. Strong lobbying by state secretaries of state, etc. helped prevent enactment.
 - vii. Title companies required to collect information on high end purchases of real estate in Dade County and Miami (\$1M) and New York City (\$3M) when entities purchase with cash. They must collect information on these entity cash transactions and transmit to FINCEN. This is a "test run" of a new approach by the government. While we won't have a central registry any time soon this represents the erosion of the privacy and the trend of where reporting is likely to evolve.

- g. Trend to make lawyers part of AML system.
 - i. This could require due diligence.
 - ii. May have to report client matters and not tell the client.
 - iii. If you help client manage bank accounts, managing trust companies, or buying real estate and you know the client is using proceeds from criminal act you must disclose this to the government in your country.
 - iv. UK went further and said if lawyer has a suspicion that proceeds from crime are being used it must report it.
 - v. Canada had been aggressive in imposing anti-money laundering obligations on lawyers to file reports. Initial efforts were defeated in court. A later rule required lawyers to maintain records that Canadian authorities could inspect without a warrant. Lots of controversy and in 2015 the Supreme Court of Canada held it unconstitutional.
- h. Tax reporting issues.
 - i. Automatic exchange of tax information has become common.
 - ii. In the past governments had to submit request to other country usually under a tax treaty. Trend is for governments to automatically share tax related information among themselves including Switzerland and other offshore financial centers.
 - iii. What about vulnerability of this information to hacking and theft?
 - iv. Compliance burdens on clients will be significant.
 - v. Overseas information on clients from overseas will be reported to US government.
 - vi. Other countries tend to be stricter on trusts.
 - vii. US has FATCA.
 - 1. 2010 legislation.
 - 2. Foreign financial institutions must report directly or indirectly on US owners of foreign financial accounts. It is analogous to putting requirement on foreign banks to file 1099s to the US government for US account holders.
 - viii. OECD multi-national non-government organization CRS = Common Reporting Standard. About 75 countries have agreed to share information.
 - 1. Who is not part of CRS? The US.
 - 2. Banks overseas will be collecting information on this and will know when their tax residents will have accounts in offshore havens.
 - 3. US system is more lenient than CRS.

17. Trustee Selection.

- a. General concepts.
 - i. 2514.
 - ii. 2041 provides that the gross estate includes property over which decedent at death had a general power of appointment (GPOA).
 - iii. You may want to cause estate inclusion.
 - iv. GPOA vs. LPOA.
 - v. Broad or restrictive powers of appointment

- vi. PLR 8836023 if GPOA is to creditors of holders estate or if limited to creditors of holders estate that suffices to create GPOA. Example: You can craft GPOA so child cannot appoint to spouse but to creditors of his estate and lineal descendants. This is a narrow restricted GPOA.
- vii. 2041(b)(1)(A) ascertainable standard or HEMS power, health education maintenance and support.
- viii. Exception for any power exercisable in conjunction with grantor or someone with an adverse interest.
- ix. For grantor we think of 2036, 2038, 2042 etc. (2041 applies to everyone else).
- x. Related or subordinate.
 - 1. Safe harbor is 672(c) using someone not related or subordinate but independent.
 - 2. 672(c) a related or subordinate party is spouse, sibling, employee, employee of company grantor owns or over which grantor is executive, etc. This could trigger adverse characterizations.
 - 3. 672(c) says non-adverse party that is on the laundry list.
 - 4. 672(a) says an adverse party is one with a substantial interest that would be affected by exercise of power. What is a substantial interest? 5% or greater interest.
 - 5. Example H wants to create trust fbo children and name person as trustee and she is related and subordinate but she is not adverse as she has no interest. That will cause certain implications you may wish to avoid. But what if spouse was a current beneficiary of the trust along with the children. Now W has a stake in the matter. She is now an adverse party if she is a current beneficiary with the children and not covered under 672(c).
 - 6. Be mindful when structuring trust to understand roles and whether they fall under IRC Sec. 672(c).
- b. Client control issues.
 - i. Challenge when trying to structure trust. Must understand settlor issues in trustee selection.
 - ii. Completed gift. If donor makes a completed gift the assets will be outside estate. If gift is incomplete then assets outside the estate. You may not want a completed gift, e.g., DING or NING.
 - iii. May create powers or retain interests specifically to make the gift incomplete.
 - iv. What is client's purpose?
 - v. To be complete must part with dominion and control. If there is a "string" the gift may be incomplete.
 - vi. Client may be willing to allow a child to be a trustee. Is a contribution by the donor over which the donor is a current beneficiary a completed gift? Likely not.
 - vii. Just be intentional as to what is objective regarding completion of gift.
 - viii. Retained rights, e.g., enjoyment of income or property trust corpus will be included in the estate of donor/settlor regardless of who the trustee is.

- c. Example.
 - i. Retention of beneficial enjoyment or trustee selection can cause estate inclusion and tax.
 - ii. Estate of Turner 138 TC 14. Concern is client may create scenario, may have made discount gifts and IRS argues step-transaction doctrine and discount evaporates.
 - iii. Circular tax calculations if use marital to pay tax.
 - iv. Look for weak links in planning chain.
- d. Retained power and other concerns.
 - i. Absolute discretion issues.
 - ii. If donor wants to be trustee and retain broad power of distribution to herself, her creditors, satisfaction of support obligations this is a GPOA and causes estate inclusion. Exception is ascertainable standard if donor is trustee and children are beneficiaries may permit estate inclusion.
 - iii. Do documents require trustee to consider resources. Must or should trustee consider resources of beneficiary? Will this create an estate tax concern?
 - iv. 2036 and 2038 there is no statutory safe harbor like an ascertainable standard. It is only available for 2041 and 2514. Some have presumed ascertainable concept embedded for powers of appointment applies to 2036 and 2038 but it does not.
 - v. If limit discretion to HEMS standard we can have protection.
 - vi. What if client wants to be trustee and retain administrative powers and management of the trust? Intervivos marital deduction trust and be sole trustee with authority over investments. Note if QTIP must have productive property, etc. Can the investment decision change beneficial enjoyment? Yes it can. If trust invested in fixed income versus invested in private equity with a lock up and capital calls it is different. There is a difference. The ability of the grantor serving as trustee to have this type of power is that an estate tax inclusion concern? Maybe, depends on fine print in document. Cases have held that if there is fiduciary oversight, if a beneficiary can go to court and claim that a trustee is abusing his or her discretion then a donor can be trustee and have management authority without having a tax inclusion problem. DO not exculpate investment trustee.
 - vii. 2008-22 can have substitution power IRC Sec. 675 to swap in non-fiduciary capacity. But there can be challenges in trustee selection for donor if retained rights in trust agreement.
 - viii. Life insurance. Will substitution power create 2042 incident of ownership. Even after rulings saying it is not a gift event if pays tax, and in 2008 not a problem to substitute, but what about insurance. Rev. Rul. 2011-28 says it is not a problem to have substitution powers over life insurance but trustee must have fiduciary duty to assure exchange of equivalent value and no shifting of beneficial interests by substitution. If these requirements are met can swap without creating incident of ownership under 2042.
 - ix. What about swapping shares in a controlled corporation and 2036(b) retained right to vote. Some commentators suggest you still should

prohibit and others argue that it is not an issue. 2036(b) says that the retained right to vote shares of a controlled corporation is an estate inclusion concern. Worry is over shares put into trust. Is right to swap another asset into that trust for those voting shares a retained right to vote those shares? No rulings on point.

- x. Toggling on and off of grantor trust powers. Should this be vested in grantor or another person? Grantor might have ability to relinquish power but someone other than the grantor should have power to turn on 672(e) could make this a problem for spouse to hold power to turn on grantor trust status. Give it to the trust protector.
 - xi. Power to remove and replace trustees. Can grantor retain power to remove and replace? Is that a concern? A for cause removal might be different. Rev Rul. 95-58 safe harbor says no imputation of bad powers to grantor if the replacement is to an independent trustee and not to a 672(c) related or subordinate party. Converse of this is that bad powers can be imputed to grantor if there are certain involvements, such as power to remove and replace with a non-independent trustee. If grantor should not hold a particular power is bad then don't want to be able to replace trustee and end up imputing back to grantor.
 - xii. 2503(c) cannot have substantial restriction on distribution powers so should the parent/donor serve as trustee of an IRC Sec. 2503(c) trust? No. Spouse should also not serve in that capacity either. Spouse is even worse. If spouse dies while serving there will be inclusion in his or her estate because 2503(c) trust can relieve trustee of support obligation so if dies may be in spouse's estate. That might also constitute a taxable lapse of a general power of appointment when child attains age 21. This all arises because cannot limit to ascertainable standard or limit to avoid distributions to prevent trustee from discharging a legal obligation of support because of the requirements of IRC Sec. 2503(c).
- e. Foreign.
- i. Avoid by meeting two criteria, US courts supervision, etc.
 - ii. If the trust is tainted as foreign throwback tax, S corporation issues, reporting and more problems.
 - iii. Avoid by providing that all substantial decisions must be made by US persons. This is broadly defined. Includes allocation between income and principal, removing or adding trustees, distribution decisions and more.
 - iv. Be careful to avoid foreign trust status if that is objective.
- f. Beneficiary issues.
- i. Beneficiary as trustee should not have discretion to distribute broadly to others.
 - ii. If child as beneficiaries can distribute broadly to himself and siblings distribution will trigger a taxable gift or there will be estate inclusion.
 - iii. Answer – limit to a HEMS standard. Exclude restriction so cannot discharge his or her own legal obligations of support.

- iv. For the ascertainable standard resist “creative writing.” Impossible to understand court opinions on this definition they are all over the board and look to state law.
- g. Tax Reimbursement.
 - i. If can reimburse beneficiary for taxes or expenses there could be an inclusion issue.
 - ii. If done wrong may have to go to state court and get reformation based on mistake.
- h. Situs selection.
 - i. Depends on trustee selection.
 - ii. Example, may want DE so can get bifurcated trustee selection that home state may not provide.
 - iii. Defacto concerns, e.g. SEC vs. Wyly that involved independent trust protectors. Every time grantor’s indicated a desire the protectors did exactly what grantors wanted. Document independent action and decisions without consulting grantors.
- i. Savings clause.
 - i. No payment for legal support obligation.
 - ii. Ascertainable standard.
 - iii. Do not rely on state law savings clauses even if they can be effective. States not likely to retreat, but they could. But what if trust moves to another state that has different or no savings clauses.
 - iv. So include directly savings clauses in trust document.

18. Trustee Selection – Special Section.

- a. Power issues.
 - i. 2036(b).
 - 1. Retained right to vote stock
 - ii. 2038
 - 1. Retained power to alter, amend or revoke or retained.
 - 2. Sprinkling powers.
 - 3. Note 2036 had to be retained power. In 2038 power has to exist at death so you may have done it right initially but the client may have reacquired the “bad” power before death thereby creating a problem.
 - iii. 2041 and 2514
 - 1. Ascertainable standard exception.
- b. Completed gift issues.
 - i. Gift is complete only if grantor has so parted with dominion or control that he has no power to change disposition.
 - ii. Powers of trustee that could be imputed to grantor could create an issue.
 - iii. Grand Case.
 - 1. Don’t be creative.
 - 2. In case distribution could be made for “comfort” which is not an ascertainable standard.
 - 3. Gift not completed.
 - iv. Issue with self-settled trusts.

1. Cannot have ascertainable standard in favor of grantor.
 2. Discretion to shift benefits. Trustee cannot have unless independent or subject to ascertainable standard limitation.
 3. Consider removal provisions.
- v. 2012 ILM.
1. Trustee could do away with power by making distributions during lifetime.
 2. Completed gift as to the income interest.
 3. Make it an inter-vivos and testamentary power.
 4. Include in divorce decree so it is an obligation, so it is included in the gross estate but then there is an offsetting deduction.
- c. Estate tax issues.
- i. Trying to avoid string provisions.
 - ii. SLAT trusts spousal limited access trusts.
 1. Watch reciprocal trust doctrine.
 2. Those generally address retained interests of grantor not rights of trustee
 - iii. If trustee can pay off debts of grantor or discharge support obligation.
 1. If funds available but don't reduce legal obligation it may be OK.
 2. Creditors and discharge indebtedness – consider power to reimburse for income 2004-64?? Power alone won't cause estate inclusion. But if you reimburse every year it may be a problem.
 - iv. Retained income rights.
 1. Grantor should not be trustee nor should grantor have possibility of being named trustee.
 - v. Transfer tax concern where administrative provisions can affect distribution.
 1. If subject to a fiduciary standard may not be a problem.
 2. Consider Byram issues.
 - vi. S provisions.
 1. QSST issues.
 - vii. Sale to grantor trust.
 1. Grantor should never be trustee.
 2. Grantor should not have ability to be named trustee.
 3. Should have independent trustee.
- d. Income tax considerations.
- i. Tax reimbursement clause.
 1. Discretion to trustee to reimburse grantor for taxes.
 2. If mandatory reimbursement it causes estate tax inclusion. It is not a gift tax issue it is an estate tax issue.
 3. Facts and circumstances. Argument about implied agreement or prearrangement. All could be a concern.
 4. 682(e) presumptions of spouse doing bidding.
 - ii. Foreign trust status.
 1. Reporting requirements.
 2. Disqualified S corporation shareholder.

3. Grantor trust issues.
 4. Throwback tax under special DNI rules for accumulated distributions.
 5. Avoid by 2 point test.
 - a. US court must have primary supervision over trust.
 - b. All substantial decisions must only be made by US persons.
This is very broadly defined.
- iii. Grantor trust powers.
1. 2004 payment of taxes by grantor is not a deemed gift to the trust.
 2. 2008 swap power if held in non-fiduciary capacity and trustee has fiduciary duty to assure equivalent value and no shifting of interests no tax con
 3. 2011-28 for 2042 purposes swap power is not deemed an incidence of ownership. No worry about substitution of life insurance policies (subject to similar rules as for swap powers).
 4. 677(a)(3) paying life insurance premiums by non-adverse party. Consider an irrevocable trust that owns no life insurance but no prohibition against acquiring life insurance or using income to pay life insurance premiums? What if there is life insurance in trust is the entire trust a grantor trust or is it only grantor to the extent income is used to pay for premiums. A literally reading of code suggests it could be everything but case law says otherwise. This is why some practitioners suggest not relying solely on this power.
- e. Beneficiary issues.
- i. Gift tax consequences.
 1. GPOA considerations.
 2. Exercise or release of GPOA is a transfer. The transfer may be incomplete so it will be taxed when complete.
 3. Example client creates trust for B and gives B as trustee power to distribute to B and others (e.g. all children). There is a GPOA issue unless limited to ascertainable standard. What if B releases right to distribute to himself. This is a transfer but it is not yet taxed since trustee still has distribution power to siblings. So as distributions are made there would be a gift taxable event at those future dates.
 4. If there is a GPOA in a beneficiary trustees there is a taint that is very difficult to remove.
 5. What about LPOA? If beneficiary/trustee has a mandatory income interest in trust the exercise of a power of appointment is a taxable gift. What if discretionary? What if ascertainable standard?
 - ii. Estate tax issues as to dispositive provisions in trust.
 1. 4 scenarios may exempt from problem of Beneficiary having POA.
 2. Ascertainable standard will prevent inclusion.
 3. If power is joint, e.g. power of distribution, e.g. requires grantor's approval then it is not an estate tax inclusion issue as to the beneficiary.

4. What if you have co-trustees and one of which is an adverse party? 8911028 says adverse party is someone with a substantial interest. 5% is deemed substantial interest. A taker in default could be an adverse party. Beneficiary is a co-trustee with an adverse party there is no inclusion issue as to the beneficiary.
 5. Contingent powers have become more important in tax basis management planning. What are these and are they effective? A power that will arise only if certain contingencies occur that are set forth in the document. *Kurz v. Comr.* 101 TC 44. Contingencies will be respected if meet 2 prong test: not illusory and have independent significant non-tax consequences. In *Kurz* marital trust gave mom right to all income and mom might whenever she wants could withdraw 100% of the principal of the marital trust. The family trust provided that mom could withdraw from family trust principal of up to 5% per year if and only if the marital trust is exhausted. Issue is whether family trust included in mom's estate or was mom's power contingent so that it is not included. On mom's death there remained assets in the marital trust. Court concluded that it was an illusory contingency since mom could take all of the money she wanted at any time out of the marital trust. Therefore included in mom's estate.
 6. Formula general powers of appointment designed to include in survivor's estate to get step up in amount of remaining exemption. Marital and charitable deductions are within the control of the surviving spouse. Don't want formula to be illusory.
 7. Mom and dad simultaneous death. Presumption of survivorship in mom's estate. Dad's will said assume wife/mom survived and gave her GPOA over her assets and all were included in her estate because POA existed. Will was never probated. Court holding said did not matter came into existence at moment of H's death. Be careful about survivorship provisions.
 8. What if have will and give GPOA to spouse before H's death spouse/W becomes incapacitated and cannot exercise power. Is that still a valid power? Yes it is. It does not matter if power holder is competent, or whether he/she was ever competent, as long as power existed it will cause tax inclusion.
 9. Summary: Consider dual standards. Related and subordinate parties with limitations on distributions as pursuant to a HEMS standard, non-payment of legal support obligations, independent trustees with absolute discretion. The discretion should not be totally absolute as it must be subject to court oversight or it will be problematic. Watch the boilerplate.
 - iii. Estate tax issues as to administrative provisions in trust.
- f. Trustee Considering Beneficiaries Resources in HEMS distribution.
- i. This has a significant impact on real life distributions.

- ii. For tax analysis purposes it doesn't matter whether this requirement is added.
- g. Small Trust.
 - i. Small trust termination provision – we can terminate if too small. If you don't have an objective standard this should only be vested in an independent trustee. If you have an objective standard, e.g. \$50,000 (Holland uses \$100,000 to \$250,000) that is objective and any trustee can hold. If vague and no specific standard be sure vested in an independent trustee.
 - ii. Consider giving similar power to waive funding trust if too small as well.
- h. Appendix A.
 - i. No trustee may – this may be too broad as may apply to independent trustee.
 - ii. No trustee may participate in decision to make discretionary distribution that would discharge legal obligation of support of that trustee. Note should not be limited to how the obligation arose.
 - iii. Maintenance of assets, settlement options under insurance, except with respect to policy insuring life of that trustee.
 - iv. Cannot serve as trustee if you made a qualified disclaimer. Be careful. May limit that if you made a disclaimer you cannot act as trustee with respect to making decision as to distribution of disclaimed property unless pursuant to an ascertainable standard.
 - v. No powers of any trustee can be construed to permit a trustee to purchase for less than full and adequate consideration. Note that this would violate fiduciary duties.
- i. Appendix B.
 - i. 1, 2, 10, 13 and 18 have to be case by case basis.
 - ii. All others you should do in all cases.

19. **Asset Protection Planning.**

- a. Disclaimer (Renunciation).
 - i. Typically viewed as an estate tax planning tool but can be effectively used as an asset protection tool.
 - ii. Parent bequeaths assets outright to son and if son predeceases to son's descendants. Father dies and son is subject to large judgement. If does not disclaim creditors will take all so son disclaims to avoid creditors receiving property and property passes to sons children.
 - iii. Disclaimant has right to disclaim and it is legally as though that disclaimant predeceased (relation back doctrine under common law) so creditors lien cannot attach and it is deemed as if property transferred from father to grandchildren above. Property passes as if never received by disclaimant.
 - iv. Exceptions.
 - 1. Some states preclude use of disclaimer if would be disclaimant is solvent. This is a public policy decision.
 - 2. Some states prohibit disclaimers for Medicaid.

3. Drye Family 1995 Trust v. US, 152 F.3d 892 (8 Cir. 1998). IRS did not believe should be able to disclaim and avoid federal tax lien. Court held that interest was a right to property to which 6321 tax lien would attach. Relation back worked under state law but did not work for federal tax lien. Look to state law to determine rights but look to federal law to determine meaning under 6321.
 4. What should have been done in the Drye case was that they should have bequeathed inheritance into a trust instead.
- v. Issues of using disclaimers.
1. 2518 to be qualified must meet requirements: writing, 9 months within date of transfer or within disclaimant attaining age 21, not accepted benefit from property to be disclaimed, and property must pass without direction of disclaimant and to person other than disclaimant unless person disclaiming is a spouse.
 2. If cost of disclaimer is a 40% gift tax disclaiming may not be worthwhile to do.
 3. Can agent disclaim? Only if you could prove it would be in the best interests of the principal which is unlikely. Even if because no disclaimer was permitted the assets that they wanted to disclaim might then pass to a creditor of the principal and that would pay down debts of the principal which is arguably to the principal's benefit.
- vi. How proactively plan for use of disclaimers?
1. May not be able to.
 2. Often comes up because a benefactor did not plan properly.
 3. Plan with disclaimers in wills.
- b. Powers of appointment.
- i. 2 classes GPOA and LPOA (special).
 - ii. Basic rule is that donee of LPOA does not hold power subject to creditors. When, however, you hold a GPOA, the property subject to the power may (but is not necessarily) subject to the power/reach of the donee of the powers creditors.
 - iii. Historic doctrine that above is based on is that no title in donee until exercises the power. It is akin to an offer and no title can vest until donee accepts, even for benefit of the creditors. Donee of power only has naked power until exercise. So until actually exercised it is not available to creditors.
 1. Many states have changed this rule NY 10-7.2 EPTL
 2. Bankruptcy Code provides that GPOA since can be exercised for benefit of debtor is included in bankruptcy estate.
 - iv. How can you use powers in planning?
 - v. Mother, instead of bequeathing outright give heir, instead give intended heir a GPOA which will be exercised only if no creditors. If you live in jurisdiction that has modified the historic rule then you have mom give LPOA or give to another person, example daughter in law LPOA with power to appoint to a class of persons that include son. Daughter in law

- can appoint property to son as he wants to use it and if no creditors at that time. It is not reachable by wife's creditors since she only holds a LPOA.
- vi. Why go through this instead of giving outright to daughter in law? She may have her own creditors. Also, you don't want to create a conflict of interest in the donee of the power. If daughter in law held property in her own name she could use it for her own purposes. 2514 no tax consequences. What if it was a friend or adult child of heir so that marital deduction would not protect?
 - vii. Can use LPOA to create self-settled spendthrift trust. Example in Arizona or Texas (which have specific statutes). H could give W LPOA and W could create using LPOA trust for H. This is a self-settled trust but the transferor of the property is W not H so that this might be a means of creating an asset protection like trust in a state that does not permit them. Why use this approach? Protects from W's creditors and exercise of LPOA is not a taxable event.
- c. Tenants by entirety ("TbyE").
- i. TbyE is unique as a form of joint ownership only available to married couples.
 - ii. 5 unities required to create tenants by entirety: Time, title (same instrument), interest (must be same in property), possession and marriage.
 - iii. Spouses must join together to sever interests in property. Neither spouse can do this unilaterally – cannot unilaterally alienate property. So creditor of one but not the other cannot reach property.
 - iv. Alaska has abrogated this rule so TbyE won't protect.
 - v. Illinois provides TbyE asset protection
 - vi. 522 of Bankruptcy code provides that property held TbyE before commencement of case may be protected in bankruptcy.
 - vii. US v. Craft, 535 US 274 (2002). Failed to file or pay taxes. Tax lien filed. H and W owned real estate in Grand Rapids, MI TbyE. Quitclaimed property from names together to W's name. Years later W sought to sell property and title company found tax lien. W settled with IRS subject to 1/2 of proceeds being placed in escrow pending final determination of tax lien. Looked to state law to see taxpayer's rights in property and federal law to see if under 6321 IRS could reach it. Even though H did not have unilateral right to sever he had right to use the property, to exclude third parties with property, etc. H also had right to join with W to transfer property.
 - viii. Criminal fines are also not protected by TbyE.
 - ix. In many states TbyE only applies to real estate. Are Coops in NY realty? In NY law amended to permit coops to be held TbyE. If acquire coop before 1996 TbyE doesn't automatically convert to TbyE so need to retitle from H and W to H and W so default is TbyE and gives it protection.
 - x. Ownership of real estate TbyE could be bad estate planning since each spouse cannot have exemption amount in each spouse's name. Often real estate is only property that can be held TbyE but it may be primary asset. Now with portability is this as important? But NY estate tax exemption

and GST are not portable, etc. Might be able to use post-mortem disclaimer to address.

- xi. Other issues.
 - 1. Marriage is one of the unities. If divorce that is destroyed and may not get cooperation so property will not be protected.
 - 2. Joint creditor is not prevented from reaching property. What if have swimming pool and own house together that is a joint creditor.
 - 3. What if non-debtor spouse dies? Entire property will be reachable by creditors. Could you do a quitclaim deed to the non-debtor spouse? Would that avoid being a fraudulent conveyance? Perhaps.
 - 4. Tenants by Entirety Trust e.g. TN, is a trust into which H and W can transfer TbyE property. Even though owned in trust retains TbyE character. If non-debtor spouse interest is held for debtor spouse in trust.
- d. Exemption planning.
 - i. Exists inside and outside of bankruptcy.
 - ii. Discharge in bankruptcy is intended to give debtor fresh start. Certain assets so necessary to debtor's existence are excluded under 522 Bankruptcy Code. Public policy deems these assets exempt.
 - iii. 522(e) states can opt out and force debtors to use only state exemption statute instead of exemptions provided under Bankruptcy Code.
 - iv. Forum shopping since exemptions vary significantly from state to state. Debtors may establish residency in a favorable state before filing for bankruptcy.
 - v. Some exemptions have no real value to planning. So professionally prescribed health aides are exempt, \$2,400 in motor vehicles, etc. These don't provide meaningful planning opportunities. But an exemption for life insurance annuities, IRAs, etc. could be a very meaningful exemption to plan with, depending on the specifics of applicable state law and the ability to have the client take advantage of them.
 - vi. Convert non-exempt assets into exempt assets.
 - vii. Whether this planning will be permissible depends on whether it is intended to hindering, delaying or defrauding creditors.
 - viii. In re Levin, 40 BR 76 permissible pre-bankruptcy planning and endorse it over to mortgagee to pay down mortgage. Court held this was permissible pre-bankruptcy planning.
 - ix. In re Reed, 700 F.2d 986 found that liquidating non-exempt assets to pay down mortgage was found to hinder, delay or defraud creditors. Holding may be a result of it being done a mere two weeks before filing.
 - x. Home Exemptions.
 - 1. NJ and PA are only states without a homestead exemption.
 - 2. NY homestead exemption is \$125,000 if have home in one of five boroughs, etc. Elsewhere in NY it is lower.

3. Only six states have unlimited in amount homestead exemption, FL, SD, and DC are among them. In FL it is a constitutional provision.
 - a. *Havoco of America, Ltd. V Hill*, 790 So. 2d 1018 (Fla. 2001). Bought FL house after lost lawsuit even though he always had lived in TN. Havoco claimed that this should fail as it was a conversion of non-exempt asset into an exempt asset on eve of bankruptcy. FL court said only 3 exceptions to homestead exemptions and this was no one of them. There could be civil and other liabilities to attorney for giving such advice.
 - b. 2005 Bankruptcy Protection Act has limits 522(o) on homestead exemption under certain exemptions. Limit if home acquired within about 40 months.
 4. How plan for this? Move from NY to FL and stay out of bankruptcy long enough. Buy a more expensive home if covered or pay down your mortgage.
- xi. Annuities.
1. Annuities reasonably necessary for support of debtor and dependents of debtor are exempt.
 2. Rules differ significantly from state to state.
 3. FL annuity exemption Sec. 22214 unlimited. Proceeds of annuity contracts shall not be liable to attachment, garnishment or legal process.
 4. So in a state like FL legal issue becomes whether the asset is really an annuity. In *re Mccollam*, 612 So. 2d 572. Exempt. Other cases, such as *In re Pizzi*, 153 BR 357. State of FL purchases commercial annuity to assure payment of lottery winning. But the state of FL is the annuity owner/beneficiary not the lotter winner. So not protected. In *re Solomon*, 95 F.3d 1076 involved a structured settlement.
 5. In *re Mart*, 88 Br 436. Daughter in law took \$2,000 and funded trust. Trustee was debtor's daughter. Trust was set to terminate on later of death of debtor or his wife. Debtor took \$350,000 and gave to daughter as trustee and took back daughter's promise to pay a fixed amount per month for life. 13 months later filed for bankruptcy. Statute of limitations at that time was 12 months and filed just after. Was this an annuity contract? Bankruptcy trustee argued that anyone could sell property and take an annuity.
 6. Should GRATs be done in FL or under FL so annuity is protected?
- xii. Life insurance.
1. Varying protection under different state laws.
 2. You can take residency in a state and put millions into life insurance policy is recognized by courts. Courts have said fraudulent transfer law may protect creditor and courts have been hesitate to get involved in state law matters.

- xiii. Retirement plans.
 1. Patterson v. Shumate, 504 US 753.
 2. 522(n) limits exemption on contributory account so only \$1M is protected. Rollover retirement plans should be rolled into a separate IRA as there is no limit for them.
 3. State law varies. Some provide unlimited exemption for retirement accounts others have dollar limitation or other requirements (e.g., contributions within a certain time period before a creditor's claim).
 4. Inherited IRAs are not protected. Clark et ux v. Rameker, Trustee, et al, 134 s. Ct. 2242 (2014) funds have to be retirement funds and Supreme Court held that funds in an inherited IRA are not retirement funds since no longer based on retirement. Owner of an inherited IRA can withdraw funds at any time without penalty. Owner of inherited IRA must withdraw pursuant to a minimum distribution schedule or 5 years none of which have any relationship to retirement. Inheritor cannot make contributions to the inherited plan.
 5. Outside bankruptcy the status of an inherited IRA are governed by state law and other than Idaho no state protects an inherited IRA.
- xiv. 529 Plans.
 1. Exempt from bankruptcy estate if contributed prior to two years before bankruptcy filing.
 2. State exemption exist in more than 1/2 the states.
 3. Useful for asset protection planning purposes is contributor to plan still owns the plan and can pull money out for any purpose. Could face penalty and income tax but it is available to client.
 4. There is a cap on these.
- e. Corporations.
 - i. Inside out protection.
 - ii. Creditor of corporation won't be able to pierce corporate shield but a corporation does not provide outside-in protection so a creditor of a shareholder can attach shares of debtor and if they are a majority can act on those.
 - iii. Creditor may argue for piercing of the corporate veil.
- f. Partnerships/LLCs.
 - i. Better than a corporation is partnership and LLC. Sec. 303(b) of the LP act and 304(b) of LLC law provide that failure of entity to observe formalities of management of activities and affairs is not a grounds of imposing liability on member. So in contrast to a corporation which could be deemed alter-ego and pierced is off the table for partnerships or LLC, i.e., failing to observe formalities is not a grounds for piercing.
 - ii. Charging order is available to partnership or LLC but with the exception of two states not to corporations.

- iii. Charging order is not only or sole remedy. Court has option if charging order will not result in debtor getting paid in reasonable time to issue order foreclosing on interest.
 - iv. In many states you need a business purpose to have a partnership or LLC. It is a creature of statute NY Partnership Law 121-107 or NY Limited Liability Company Law Sec. 201. If holding securities is that sufficient?
 - v. In re Ashley Albright 291 BR 538 trustee can liquidate company. Court noted that there may be an issue with a second member with a small and passive interest. Will a court respect that interest?
 - vi. Nevada and Wyoming permit protection for single member LLC other states do not.
 - vii. Under RULPA not sole remedy. State law varies.
 - viii. What is tax effect of charging order? Some say it gives leverage to debtor because creditor will be taxable on phantom income. This is based on Rev. Rul. 77-137, 1977 CB 178. In ruling since assignee had such rights income would be charged with income. This could be problematic for a creditor. But it is not clear that this would apply in a charging order situation. GCM 36960 assignee may not have sufficient rights and control to be taxed.
 - ix. How plan?
 - x. Should still follow formalities notwithstanding the act. Title assets in entity. Maintain books and records of entity. Keep insurance up to date. All distributions should be in proportion of ownership interests. No personal use assets should be held in the entity as it will look like an alter-ego. If you must have personal use assets rent pursuant to arm's length agreement.
- g. Inter-Vivos QTIP.
- i. Money spouse wants \$5.4M in poorer spouse's name. Could make outright gift but problem is that she may have creditor issues. Using an inter-vivos QTIP could be a better approach.
 - ii. Upon beneficiary spouse's death property can revert as a bypass trust back to the donor spouse and won't be included in the donor's estate. This does not necessarily control the creditor issue. Will this be deemed as self-settled trust under NY law "It very well might be." Some states have expressly modified statute to avoid this issue.
 - iii. Can pass property to spouse, no gift tax, not available to either spouse's creditors (not available to beneficiary spouse's creditors since in a spend thrift trust) and can come back to donor spouse without being a self-settled trust under many state laws.
- h. SLATs.
- i. Third party spendthrift trust is protected from creditors. Since 1871 Nichols v. Eaton. You are free to dispose of assets however you wish and if you put a restriction on someone inheriting you may.
 - ii. If trust is a discretionary trust creditor cannot force trustee to make distribution.

- iii. Donor spouse might have indirect access to assets in SLAT if distributions to beneficiary spouse are used for mutual benefit.
- iv. This is a third party trust that should be protected from creditors.
- v. Risks are of divorce, or that beneficiary spouse pre-deceasing.
- vi. Address divorce by using a floating spouse clause.
- vii. Give a disinterested third party a LPOA to appoint property back to donor spouse.
- viii. Death can be addressed with LPOA to spouse or third party to appoint back to donor's spouse or have life insurance to compensate for loss of access.

20. Retirement Plans.

- a. Challenges of estate planning for retirement benefits.
 - i. Cannot discount values of retirement plan assets.
 - ii. Plan participant cannot give it away. It will destroy status of the plan assets.
 - iii. Can you give an IRA to QTIP during lifetime to use up spouse's exemption and come back to plan participant, etc. Theory is that the lifetime QTIP is defective grantor trust as to owner so transferor/plan participant should still be treated as owner for income tax purposes. There is a Reg for Roth and for Reg IRAs that says if you make a lifetime gift of an IRA it is no longer an IRA. Reg does not make an exception for a grantor trust. So result is unclear and risk is great.
 - 1. Comment: Jonathan Blattmachr express a different view of this in the wrap up speech on Friday.
 - iv. Damage control – retirement plan – if do correct planning you will hand bucket to heir and they can continue to withdraw. If you don't do correct planning it is akin to dumping cash on the beneficiary.
- b. Steps.
 - i. Gather information. See Questionnaire at end of materials.
 - ii. Choose beneficiary for the plan.
 - iii. Design delivery – how will you deliver asset to beneficiary chosen.
 - iv. Passes by beneficiary designation for each retirement plan not by will.
 - Three choices
 - 1. Surviving spouse.
 - 2. Young human beneficiary.
 - 3. Charity.
 - v. If you choose a different beneficiary than the above the plan assets will be rapidly distributed after death and the tax costs high. Might then need life insurance to address economics of the plan.
- c. Three devices to defer taxable income to spouse.
 - i. All stem from spousal rollover.
 - ii. Surviving spouse can rollover deceased spouse IRA.
 - 1. Any other beneficiary that inherits retirement plan must take distributions no later than a year after the plan owner died over life expectancy. Surviving spouse does not have to start right away. She can defer any distributions until she reaches age 70.5.

2. At age 70.5 surviving spouse gets another advantage. Other beneficiaries (i.e., non-spouses) have to take out plan dollars over their life expectancy (at age 70 that is 17 years). Entire plan must be liquidated in that time frame. A surviving spouse at age 70 can use a different life expectancy, i.e. the uniform lifetime table which is based on life expectancy of someone age 60. This is used to measure distributions. Under this table at age 70 you have 27 years to take distributions and it doesn't stop at age 97 it continues to extend. So even though take minimum distributions each year IRA can be worth more in the future. This will provide better deferral and greater likelihood of assets for remainder heirs to receive.
 3. 3rd advantage surviving spouse gets is she can name her own beneficiaries and they can start all over again. That does not happen with non-spouse beneficiaries. A common question is that if a beneficiary inheriting an IRA dies in the middle of distributions, if there is a payout period that started when participant died, and non-spouse beneficiary dies before end of that payout period, then the distributions continue (per the original schedule and the successor beneficiary just continues to take the same distribution).
 - iii. The above make it far preferable to name surviving spouse as beneficiary.
- d. How do you deliver funds to the surviving spouse?
- i. Second or later marriage may want to use a trust so that you don't have the surviving spouse name her children from a prior marriage as beneficiaries instead of the deceased plan participant/spouse's children from his prior marriage.
 - ii. Can you just name a QTIP? Problem is a QTIP trust is not the same as the surviving spouse and does not have same benefits, it is actually one of the worst forms of beneficiary. Cannot do a spousal rollover so you lose many advantages. Example: left \$1M IRA to QTIP start distributions immediately based on life expectancy of surviving spouse and may be distributed over 17 years. How does that protect children of first marriage because by the time the surviving spouse dies all plan assets have been distributed. Trust might have saved some distributions for children from prior marriage. If you make IRAs payable to trust with idea that they will be accumulated, remember the trust tax rate is 40% at just about \$12,000 of income. The trust top tax bracket, faster payout, etc. This is not a winning option to protect the intended children.
 - iii. So if client does not wish to name the surviving spouse outright a QTIP is not optimal to use as an option to leave retirement benefits. Instead evaluate leaving retirement plan benefits to the surviving spouse and buy life insurance for kids. Alternatively leave IRA to kids and buy life insurance for the surviving spouse.
 - iv. One solution proposed is to have surviving spouse sign agreement that she will name children intended as beneficiary. How does that help them? How can you know who she names as beneficiary? Court order to examine

beneficiary designation? How know where she will open account? How can you control what she spends? What if you can limit so that she can only spend minimum distributions? That won't work because if you limit surviving spouse's ability to access funds will prohibit a rollover.

- v. Some think that with a Roth there is no issue since no taxes. So wrong! A Roth IRA is more valuable than a regular IRA and deferral is even more important. When you make an IRA payable to trust for spouse it will cease to exist (i.e., be distributed down) by the time the surviving spouse reaches mid-80s (Roth or regular). Rollover Roth no requirement to take distributions and she can name her own beneficiaries and they can start distribution.
- e. Young Person as Beneficiary.
 - i. Next choice for beneficiary is a young individual such as child or grandchild. Advantage of naming them is that they have a long life expectancy. Young grandchildren might have 65 year payout which is a long tax deferral period.
 - ii. Can name see-through trust and get same benefits for young individual, i.e. you get life expectancy payout.
 - iii. You could name custodian for plan but that ends at age 21 etc. depending on state law. Banks are hesitant to serve as custodian.
 - iv. What if you have multiple children?
 - v. Simplest approach is to name them and they will split up into separate inherited IRAs. Becomes more complex if you want to use a trust. IRS has an irrational rule regarding trusts. If you name as beneficiary the Natalie trust and trust says on death trustee will cut up into separate trust shares and administer each as a see-through conduit trust. IRS says because they are all beneficiaries under same trust even though the trust mandates that the retirement assets be split into three separate trusts (no discretion to shares, etc.) the IRS says oldest child's life expectancy controls for all of those trusts. To avoid this result you have to name the separate trusts on the beneficiary designation form. You must say divide IRA into equal shares on my death and pay each separate share to a separate trust. The division must be made at beneficiary designation level. "More attention is paid to getting separate life expectancy deal than is often justified." Do you really want the result? In many cases having a family pot trust may be advantageous for young children. The significance of a 60 versus 70 year payout may not make that much of an impact. If the trusts are conduit trusts and the trustee must payout immediately to the child you will get separately life expectancies. But if they are separate trusts but are not conduit trusts and if a child dies his/her share passes to the other siblings, the RIS will say that the life expectancy of the oldest child will govern.
 - vi. What if starts payout over 40 years and dies after 30 years. What payout period applies to the children? Children step into her shoes and have 10 years left to take distributions. Transfer IRA out of trust to the children. This by writing to IRA provided and telling them that the trust is

terminating and transferring assets out to beneficiaries please do an IRA to IRA transfer from the trust IRA to beneficiary IRAs.

- f. Charitable beneficiary.
 - i. Best possible choice as beneficiary because it is not taxable at all and no tax beats tax deferral.
 - ii. Best way to deliver bequest to charity is to name charity directly in the beneficiary form.
 - iii. Some charities say they cannot get money out of an inherited IRA unless they first create an inherited IRA for it because of money laundering rules. This can be quite cumbersome. Alternative is that you can make it payable to a trust who might expedite then complete paperwork and gift to charity.
 - 1. Comment: Based on the presentation earlier this week on the developments and likely future reporting trends this is likely to become much more burdensome.
 - iv. If going direct to charity it is tough to make a mistake.
 - 1. But if to a trust that has charitable beneficiaries if all the residuary beneficiaries are charities that is easy. If not it is a problem. If all are charities you can cash out the IRA and transfer cash to the charity. The advantage of transferring the IRA direct to the charity is that you avoid any gross income to the trust.
 - 2. If the trustee cashes out the IRA the trust will have taxable income. If immediately pay over to charities you will get an offsetting charitable income tax deduction. But if you delay sending money to the charity you have taxable income in year one and no charitable deduction since a trust does not get an income tax deduction for money set aside for charity.
 - 3. If all beneficiaries are charity the trust itself may be defined as charitable.
 - 4. Consider filing IRC Sec. 645 election and then trust would get set aside deduction for income set aside for charity.
 - 5. If all residuary are not charitable it is complex.
 - 6. If can direct IRA to charity at drafting stage (IRA pay charitable share first) it works. But if the trust was not drafted in that manner and you have multiple assets, e.g. \$1M IRA and \$2M other assets. Document must allow disproportionate assignment. If it says 1/3rd to each beneficiary. If trustee cashes out IRA then there is \$1M taxable income that has to be allocated equally to each share since none have been funded. Instead transfer IRA intact to charity in fulfillment of its share and let the charity cash in the IRA and you use other assets for the other non-charitable beneficiaries. Or pay off all non-charitable beneficiaries first and in the next taxable year you only have a charitable beneficiary. So in that latter you can cash in IRA since only a charitable beneficiary income will go to charity.
 - a. Comment: A practical problem is that for smaller estates that don't face estate tax families may well not hire counsel

and endeavor to handle on their own not realizing the complexity involved.

- g. Credit Shelter and IRA.
 - i. Portability is the way to go.
 - ii. Example: Married couple with \$10M in wife's IRA. What can you do about estate tax planning? In old days did a bypass trust? Now could just use portability.
 - iii. Why not rely on portability? It is not guaranteed. Must file estate tax return on first death. Surviving spouse could remarry and new spouse dies and lose DSUE from first spouse. State estate tax may not recognize portability. These are all valid reasons a planner might say to use a bypass trust (credit shelter trust). But if only asset is a retirement plan you have huge income tax sacrifices to give up portability. On death W leaves \$5M outright to H and \$5M to credit shelter trust. But that credit shelter IRA amount will be liquidated more rapidly (say 17 years) so income tax will be accelerated and at higher rate. With state estate taxes, e.g. Mass \$1M exemption and no portability, run a projection as to how much income tax are they paying versus how much estate tax is being saved. The income tax cost may well exceed the state estate tax savings.
 - iv. Lawyer should draft beneficiary designation
 - 1. Comment: Yes but will client pay? Some wealth managers offer to do this as an extra service making it even more difficult for counsel to convince the client of the need for involvement (in the client's mind, cost).
 - v. Clients don't always follow through getting beneficiary designations updated or done correctly. Each plan has its own limits and nuances. Most IRA sponsors believe they have no responsibility to get in touch with beneficiaries.
- h. Special needs trusts and IRAs.
 - i. Cannot name special beneficiary outright.
 - ii. If you name a SNT trust that is a conduit trust it will give beneficiary immediate income that may disqualify for government benefits. So this is not an option. Maybe. Some state laws may permit taking distributions from a conduit trust and put into (d)(4)(A) trust.
 - iii. More likely option is a SNT but on death terminates and goes outright to other beneficiaries.
- i. Other factors.
 - i. State law creditor rights.
 - ii. Spousal right of election.
 - iii. Lots more.

21. **Chapter 14 Minefield.**

- a. Big picture of Chapter 14.
 - i. Use as an example for many of the discussions following a hypothetical master family entity, e.g., FLP, with \$10M assets.
 - ii. Chapter 14 can attack different transactions for entity from different angles. Many ways chapter 14 can apply.

- iii. Broad presumption when junior and senior family members getting together they are trying to strike a sweetheart deal. But that is not always true. But this is the presumption that underlies all of Chapter 14.
- iv. Enacted with 2036C repeal
- v. Two basic approaches.
 - 1. 2701 deemed gift if have transfers of certain interests to next generation and retained interests by parents or senior generation. Perceived abuse was shifting of value to junior generation.
 - 2. Look at master entity and consider it as a balloon. If you squeeze one side down, the common, you inflate the other side or the preferred.
 - 3. Under subtraction method for gift tax purpose the common given away might be squeezed down to a value of say \$500,000 and the preferred might be \$9.5M because of all the discretionary rights (Christmas tree ornaments).
 - 4. But if discretionary right were never exercised value shifted to common. That was the abuse Chapter 14 was trying to attack.
- vi. Congress responded with concept of “applicable retained interest.” This is the right practitioners need to consider. Notion was that if you have a transfer and parent has held back an applicable retained interest and that will be valued much less than previously (i.e., under prior law) and perhaps it may be valued at -0-, thereby magnifying the gift value.
- b. 2701 applies if you have a transfer of an equity interest to a member of the family and the applicable family member retains an applicable retained interest.
 - i. Must have a transfer. This is broadly defined to include capital contribution, change in capital structure, etc. If child puts in assets and recapitalize the master entity that too may be a transfer.
 - ii. Must be transfer to member of family. This is a junior family member.
 - iii. Applicable family member is the parent/senior family member.
 - iv. Rights that cause issue are a distribution right, the right to receive distributions in a controlled entity. Must be with respect to a controlled entity. The family member must have control. In a partnership any interest as a general partner will cause control.
 - v. The second is extraordinary payment right. This is a right to discretionary puts, calls, nonexercise or exercise of which will impact value.
 - vi. 2701 acknowledges that if rights are not discretionary but mandatory value won't be zero and gift value may not be increased. The most typical is a qualified payment right. Example, cumulative payable at least annually at a fixed rate. If you stumble on a right that doesn't seem to satisfy you can make a qualified payment election on a gift tax return.
 - vii. Mandatory and qualified payment right, e.g. balloon preferred right, or liquidation participation right. Conventional wisdom is that if you blow it up it's a gift of everything. This draconian result will not always be the case as you may have a liquidation payment right that might be valuable. If 10 years may have some value, if 50 perhaps not much.
 - viii. Marketable securities, not applicable.

- ix. You can have distinction between voting rights and that is outside the reach of 2701.
- x. Vertical slice exception.
 - 1. One slice of a bigger issue. If you have two different shares and you give proportionately have of each you are outside of IRC Sec. 2701 because if you are giving a proportionate percentage of all interests no opportunity to shift values as 2701 tries to address.
 - 2. Be careful if you make an attempt at vertical slice and a family member has a retained right it may fail as a vertical slice.
 - 3. Family LLC recapitalized and mom took back capital interest only in a 20 year partnership. Sons received preferred interest. IRS said it was a 2701 transfer as it was a recap. Mom's retained capital interest was a distribution right because she had a right to receive a distribution of capital that was apriority. IRS position is if profits interest goes to children retained capital interest was a distribution right.
- c. Attribution rules are important and complex.
 - i. Entity attribution rules
 - ii. Trust attribution rules attributed to beneficiary assuming maximum exercise of discretion.
 - iii. Grantor trust attribution rules. Grantor may be considered owner.
 - iv. Possible that grantor and child can both be considered owners of same interest under 2701 attribution rules then must go to tie-breaker rules. Consider type and class of interest. If subordinated interest bias is to attribute to next or lower generation and if senior interest bias is to attribute to senior generation.
- d. Can do 2701 compliant preferred partnership.
 - i. Must structure preferred interest as priority cash flow with liquidation preference that are quantifiable.
 - ii. This lends itself nicely to planning if you do it correctly
 - iii. Priority return and priority liquidation preference and separately the growth.
 - iv. Example QTIP and want to freeze value and want cash flow to surviving spouse. QTIP might make capital contribution to partnership and GST exempt trust make contribution. Make QTIP interest a preferred interest so appreciation above what goes to QTIP shifts to others. Can use in a GRAT.
 - v. What if GST exempt and non-Exempt trusts have can use this type of planning to shift growth into GST exempt trust.
 - vi. Compliance with 2701 requires that you don't trigger -0- valuation rule because you satisfied an exception.
 - vii. Make sure coupon is adequate. Not all gift tax issues are off t able. If take back preferred coupon of 5% but appraiser determines it should be 8% you still have a deemed gift component. Rev. Rul. 83-120 consider to determine adequacy of coupon. Start with what public preferred pay then adjust for risk. Look at make-up of partnership. How risky of an

investment is it? Say you have a 50/50 preferred common versus a 90/10. Preferred coupon will have to be higher to equal par.

- viii. Distribution right, exception is if parent retains same interest or interest that is subordinate. This is why a reverse partnership can work.
- e. 2701 - where are red flags?
 - i. If recap into different classes look at class.
 - ii. Preferred partnership.
 - iii. Recapitalization
 - iv. Extraordinary payment rights.
 - v. What rights do children get?
 - vi. Private equity has 2701 implications, profits interests, etc.
- f. 2704.
 - i. 2704(a)
 - 1. Anti-Harrison rule from a 1987 Tax Court case. As a GP he had right to cause liquidation of entity at any time. Successor to his interest at death would not have that right. Estate said what estate received was an interest that did not have liquidation right so therefore it should be valued lower. 2704 was enacted to prevent this sort of disappearing value.
 - 2. Does it by lapse concept. 2704(a) applies to lapse of voting or liquidation right.
 - 3. If happens during life amount of gift is difference in value before/after lapse.
 - 4. Also applies to estate value.
 - 5. Lapse is a restriction of a liquidation right. Liquidation right is a withdrawal right. Does not need to be right to liquidate the entity itself. It could be but does not need to be.
 - 6. Exception for transfer even though it may effectively result in a lapse. Example, I have 75% of shares and you need 70% to liquidate. I transfer 10% to my kids so my right to liquidate disappears. This is not a lapse because the interest has not been restricted or eliminated.
 - 7. Must be controlled entities.
 - 8. Take away – be careful if restructure if you think voting rights might disappear. Many of these provisions may impact value for transfer tax purposes but may not impact value for contract or economic purposes. This type of mismatch can create problems.
 - ii. 2704(b)
 - 1. Additional regulations have received much discussion.
 - 2. Designed to disregard what were considered illusory restrictions on liquidation of entity. If you have restrictions on liquidation of family entity they may be ignored. If would lapse after transfer or family can get together and remove it, then ignore it for valuation purposes. Family entity is GP decedent had 76% interest. Only need 70% to liquidate under state law. Have agreement that can only liquidate if unanimous consent. This is an applicable

restriction that will be disregarded when parent dies and value his interest for his estate tax purposes. This is because state law gave right to liquidate at 70%.

3. Kerr Case involved two limited partnerships in Texas. Restrictions on ability of LP to withdraw. Under Texas law only needed 6 months' notice to withdraw. LP agreement said LP could not withdraw so said should be ignored. Tax Court said 2704(b) was aimed at liquidation of entity itself. This was a restriction on the ability of a partner to liquidate his interest and that is not what statute speaks to. 5th Circuit considered this and found that charity had an interest so immediately after the transfer the charity as a partner the requirement that the family would have the right to remove the restriction could not be met because of charity's involvement as a non-family member
4. 2704(b) (4) Secretary by regulation may provide further regulations. Status of this is uncertain.
5. Greenbook proposals suggests creating "disregarded restrictions" which is the withdrawal right in the Kerr case. Some suggestions that charities and non-family members may be disregarded.

g. 2703.

- i. This is a disregarding provision.
- ii. Transfer tax provision in both gift and estate context.
- iii. Statute provides that value of any property will be determined without regard to option or agreement or contracts to acquire assets, or if restriction son rights to use or sell property.
- iv. Starting point of statute is that restriction of taxpayer is to be ignored unless taxpayer can overcome burden of proof which is quite high.
- v. Wealth of pre-2703 case law.
- vi. See these in partnership agreements, buy sell agreements. Argument has been applied in context of family limited partnerships.
- vii. This statute was aimed at "sweetheart" deal. Family LP FMV \$10M. Enter into buy sell stating that buyout is \$1M. Contractually enforceable. Son is legally obligated to buy and estate legally obligated to sell for \$1M. 2703 was designed (as well as pre-2703 law) we will not respect \$1M value because the value was really \$5M. This would have failed both pre- and post-2703 law.
- viii. Applies to agreements entered into after October 8, 1990 or those earlier agreements modified after that date.
- ix. If you can establish that arrangement was a bona fide business arrangement, not a device to transfer value, and comparable to arm's length agreements, and so on it can overcome burden of proof.
- x. A book value buy out e.g. Joseph Lauder case, could be problematic.
- xi. When there is an opportunity for mismatch, agreement will be valued for tax without restriction and economics follow contract, estate may be obligated to sell for \$1M but value in estate may be \$5M. Potentially contentious and problematic impact on taxes.

- xii. Application in Strangi and Church cases.
 1. IRS argued that property is underlying assets not partnership interest and that the partnership arrangement in its entirety should be ignored. Court in Strangi and Church said you cannot ignore nature of asset. In Hollman case 2703 was applied to LP that had Dell stock and gifts of LP interest made.
 2. Right of first refusal if you tried to transfer outside LP in tests outside family it would be brought back at discount. These were not reflective of real business arrangement. Court did not rule on comparability test.
- xiii. When look at buy sell agreement consider pre-2703 law and 2703. Consider when looking at FLPs, options and other arrangements. Be cautious of mismatches.
- h. 2702.
 - i. GRATs and QPRTs. These are carve outs to a broader valuation rule.
 - ii. Congress goal was to address old common law GRIT. Pre 1990 parent would put assets into GRIT and retain income interest and value income interest based on interest rate and remaining value will be taxable gift. But if trust was invested for growth parent would take back a lot less income then estimated. So 2702 says if make this type of transfer into a trust, unless you take back a quantifiable retained interest, your interest as parent/transferor will be valued at zero. Conceptually similar to preferred partnership.
 - iii. Exceptions are provided for a GRAT and a QPRT/PRT. What is being taken back is quantifiable so you get credit.
 - iv. Greenbook proposals include 10 year minimum, elimination of zeroed out GRAT, prohibition of swap, and more. If these changes were made
- i. Preferred Partnership GRAT.
 - i. Mom takes back preferred interest and gifts to a loan term GRAT 10 years plus and uses that to fund GRAT payments.
 - ii. You shift growth to dynasty trust.
 - iii. If die during GRAT period you have contained the interests includable.
 - iv. Woebling case is a recharacterization of sale to grantor trust as a disguised transfer so note was not a qualified interest and gets no value for the subtraction method so it is a gift of the entire value to the trust.
 - v. 2702(c) deemed transfer on join purchase. Be careful. H puts in money into family entity and son does and H takes back term interest it may be deemed a gift of entire value.

22. **Wrap Up.**

- a. Introduction.
 - i. We have to continue the transition from **estate tax planners** to **estate counselors** and the breadth of topics at this year's institute from trust administration, elder law, income and basis planning, foreign reporting, planning for aging, financial instruments and insurance, are directing us all in that direction.

- ii. *Josh Rubenstein's presentation on change* set the theme for how client needs and the environment have and are continuing to change, how the profession should evolve in response (but not all planners are, see below) and how this year's course offerings at Heckerling is leading this evolution.
- iii. We can develop deeper and more significant relationships and provide a greater level of service to clients, and clearly differentiate ourselves and our services by transitioning to a new approach/model of planning. As a counselor annual meetings are essential. As a mere scrivener of wills or "estate tax planner" getting a client back once in every 3 to 5 years can be a challenge.
- iv. How estate planning must be more integrated with financial planning is integrated throughout our discussion.
- v. To address the changing environment, new
- vi. Trusts & Estates Magazine Survey.
 - 1. Practice area that best describes practice focus.
 - 2. 97% trusts and estates.
 - 3. 45% general practice.
 - 4. 42% asset protection.
 - a. (*Richard Franklin's discussions of lifetime QTIPs and Daniel Rubin's discussion of asset protection planning without DAPTs; the Pfannenstiehl trust matrimonial case was reviewed in the Fiduciary Update presentation.*)
 - 5. 39% business succession planning.
 - a. (*Sam Donaldson's fundamentals program on Business income tax; Paul Lee's discussions of Partnership planning.*)
 - 6. 35% business law.
- vii. New services offered by practitioners.
 - 1. 43% have not changed services offered since ATRA!
 - a. How could any estate planning practice survive doing what it did before ATRA?
 - b. If 43% of those surveyed by Trusts & Estates have not changed services the figures for attorneys generally must be even higher.
 - c. Note that only a small portion of the client wealth levels of served in the T&E survey was ultra-high net worth clients. So this was not a case of \$50M clients receiving the same estate tax oriented planning as before. It means that survey respondents have not modified their service offerings.
 - 2. 25% trust administration.
 - a. (*Dana Fitzsimmons fiduciary case update; Mark Parthemer discussions of trustee selection; Nancy Henderson's presentation on trust to trust transfers, and Steve Akers probate planning program*).
 - 3. 22% elder law.

- a. (*Bernie Krooks presentations on special needs planning; Diana Zeydel's discussion of planning for diminished capacity*)
 - 4. 14% income tax.
 - a. Note how low income tax is and that it did not even make the chart of what clients want from estate planners.
 - i. (*Rob Romanoff and Suzanne Shier presentation on trust design; Lawrence Brody and Donald Jansen insurance planning discussion*)
 - viii. Top concerns of clients seeking services.
 - 1. 67% avoid probate.
 - a. This should really give way to Boomers concerns of cash flow for decades of post-retirement life and worries about Alzheimer's and dementia.
 - 2. 65% minimize discord among beneficiaries.
 - 3. 38% prevent heirs from mismanaging inheritance.
 - 4. 25% asset protection.
- b. Aging Issues.
 - i. Aging population.
 - ii. Client population is aging and their needs changing along with it. *Diana Zeydel and Bernie Krooks gave statistics.*
 - iii. Financial decision making ability begins to decline at age 60.
 - iv. Long term care lapse rate.
 - 1. Women age 65 have 38% lapse rate. Cognitive decline is primary reason.
 - 2. What it means to estate planning generally.
 - 3. Documents are not enough.
 - v. Privelege and how advising aging clients might impact this was addressed *by Diana Zeydel and more generally by Stephanie Loomis-Price.*
 - vi. Revocable trusts.
 - 1. Powerful tool for aging and chronically ill clients.
 - a. Case law and UTC 603 limited/no reporting while grantor is alive. *Tseng v. Tseng* case was discussed in the *Recent Developments program, the Q&A Session, and by Dana Fitzsimons fiduciary update.*
 - b. Need checks and balances.
 - c. Care manager, CPA as monitor, trust protector.
- c. Assuring client's financial future.
 - i. Respect the tails (forecast range for \$10M net worth from \$5.7M to \$56.7M – Wells Fargo forecast). \$10M invested for 20 years the low end of the forecast could be so low that gifts should be structured to maximize client access (e.g., non-reciprocal SLATs with life insurance to guard against premature death). The high end of the forecast range suggests that gifting should be more aggressive than many planners might pursue. The point is don't plan for current or likely wealth, but factor in the risk of tail

results so that wherever on the range of possible outcomes the client is well served.

- ii. Medicaid Planning: Even wealthy clients care about this. Cost of care can be very expensive. Must understand different types of government benefits and which ones your client is receiving.
- iii. Rethink the gift provision in POA/Revocable Trust.
 - 1. New construct for annual gifts (Bessemer Trust forecast).
 - 2. Endowment construct.
 - 3. Stop using only annual gift exclusion as the basis. For most clients no gifts permitted may be the best option to minimize elder financial abuse.
 - 4. For wealthier clients determine maximum gifts that are economically viable while retaining financial goal, e.g. 80% confidence level of having adequate financial resources at say age 95, then forecast gifts through an iterative process to determine the maximum economic gifts that can be made without compromising the financial target. This flips traditional gift planning on its head by starting with the economics that are appropriate for the client.
 - 5. Once maximum economic gifts are determined then the sources (buckets) from which they can be paid can be prioritized to accomplish tax and other goals (e.g., annual exclusion gifts, gifts from a DAPT if the risk of that trust is perceived as significant, etc.).
 - 6. This process vests the children/heirs in the financial forecast/estate planning process.
- iv. Domicile.
 - 1. Not primarily about estate tax in decoupled states but rather financial survival.
 - 2. Income tax planning benefits and expense benefits. (Jack Meola of Eisner Amper model).
 - 3. Move after incapacity.
 - 4. Case law.
 - a. Provisions in health proxy and financial power.
- d. Human Aspects of Planning.
 - i. Mikel is about religion not just Crummey powers. Religious considerations and estate planning. Clauses for Jewish, Christian, Buddhist, B'hai' and Islamic arbitration clauses illustrated.
 - ii. Implications of mandatory arbitration and what can be done.
 - iii. Courts generally won't uphold mandatory arbitration, even religious arbitration.
- e. Think beyond trusts and taxes.
 - i. Help clients with holistic wealth transfer.
 - ii. Estate Planners typically focus on financial assets and the transfer of those assets to successive generations. Clients are increasingly concerned about the potential negative effects of transferring large amounts of wealth to heirs.

- iii. Engage clients in a discussion of ways that they can capturing their human capital and identifying their core values so that those values can direct the client's estate planning decisions.
 - iv. Estate planning today is based on three fundamental assumptions. The first is that a person's wealth can be summarized on a balance sheet. The second is that if transferring some financial wealth is good, then transferring more is better. The third assumption is that the first place you should go to do your estate planning is an estate planner. What if all of these fundamental assumptions are actually all fundamentally wrong?
 - v. My favorite saying: "Estate planning should not be merely about the transfer of wealth, but about the transfer of values as well."
- f. Charitable giving for boomers
- i. Will be different form past norms.
 - ii. The trend is for participation not just writing checks. This will change the focus of charitable planning to include more emphasis on, for example, donor agreements, etc.
 - iii. *Kathryn Miree's on Non Profit Board Service* presentation was right on target as many of our clients, and we as professionals will increase our personal involvement.
 - iv. Consider Boomer attitudes towards charitable giving.
 - v. "U" shaped charitable giving curve. Those at lowest and highest income levels give the most percentage to charity. Studies have revealed that low end givers are not giving more because of religious fervor but rather because of a wealth effect. They tend to have lower income in retirement but comparatively larger wealth and therefore they can give a large percentage of low post-retirement giving. Rethink charitable planning for this group. It is not about income tax but non-tax considerations. Example, help them plan for donor agreements, etc.
- g. Income Tax Planning.
- i. Basis step-up.
 - ii. Tennessee and Alaska community property trust.
 - iii. Opportunity for basis step up.
 - iv. Grantor trust considerations.
 - 1. Buying assets back.
 - 2. Swap power considerations (article with Bruce Steiner in *Trusts & Estates* magazine exploring use of lines of credit and a range of practical and technical issues of making swap powers work).
 - v. POA gift power to create GPOA in agent. While this could cause estate inclusion can it provide a basis step up? It may not as a result of IRC Sec. 1014 (e). Thanks to Richard Greenberg, Esq. for this comment.
 - vi. NIIT and implications to reporting UTC 813. (*Rob Romanoff's presentations*). Broadening the class of beneficiaries to sprinkle income to lower bracket taxpayers and fill up non-taxable NIIT buckets may also require disclosure of the trust to many more beneficiaries unless the trust is expressly structured to avoid this result.
- h. State planning – states getting tougher.

- i. States are becoming much more astute at evaluating the use of various trust, entity and estate planning techniques to break residency and domicile.
 - ii. NY LLC ruling. (*Recent Developments*).
 - iii. Indiana QPRT ruling.
 - iv. NY law change so that DING won't work.
 - v. A number of recent cases discussed state efforts to track trust income. Taxpayers have had some victories but it does illustrate the aggressive tack many state tax departments have taken.
- i. Estate Tax Planning.
 - i. Steinberg and net net gifts. (*Recent Developments*).
 - ii. Chapter 14 see presentation by Todd Angkatavanich.
 - iii. Lessons from Davidson. (*Recent Developments*).
 - iv. IRA planning ideas.
 - 1. Transfer to a defective Grantor trust might in fact work. Risky, but an interesting position to consider.
 - v. SLATs.
 - 1. Couple domiciled in NJ with \$7 million net worth funds two non-reciprocal \$500,000 SLATs providing asset protection, significant state estate tax savings in a relatively simple and inexpensive plan. It could be coupled with life insurance (*Daniel Rubin discussed in his session*). At 70% confidence level NJ estate is about \$1.3M and \$3.2M outside estate but largely reachable. 17-46 to 48. (Model by US Trust).
 - 2. BDTs. PLR 200949012.
- j. Conclusion.
 - i. Collaboration.
 - ii. Client instruction letter to coordinate team.

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