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# 2017 Heckerling Institute of Estate Planning Highlights


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# 2017 Heckerling Institute of Estate Planning Highlights

## 2704 Proposed Regs

# 2704

- “No reason to make transfers now in anticipation of these Regulations being enacted.”
- See **Planning for the Proposed 2704 Regulations**, by: Martin M. Shenkman, Esq., Jonathan Blattmachr, Esq., Ira S. Herman, CPA, and Joy Matak, Esq., an e-book published by Trusts & Estates Magazine.
- For more materials on 2704 email shenkman@shenkmanlaw.com.

# 2704

- Reporting. After August 2, 2106 some commentators suggest that you should disclose that the position in a valuation report may be contrary to position taken in the proposed regulations. But this is problematic as there are many different interpretations of the proposed regulations. It may be better to take an expansive view (i.e. that the proposed regs cover it so you disclose the variance from that interpretation) rather than have the IRS later argue that the statute of limitations has not tolled.
- "AICIPA adequate disclosure 2704" you will find suggested language. Disclosure under 301-6501(c). The transaction reported by may be contrary to the Section 2704 Regulations but those regulations have not been taken into account in valuing the interest…. No requirement that they be considered in this case. This type of disclosure attached to the gift tax return as a separate page should suffice to toll the gift tax statute of limitations. See https://www.aicpa.org/InterestAreas/PersonalFinancialPlanning/Resources/TaxPlanning/DownloadableDocuments/Suggested_Disclosure.pdf

# 2017 Heckerling Institute of Estate Planning Highlights

## Planning In Light of Repeal and Recent Developments

# Planning in Light of Possible Repeal - Overview

- What to do?
- Wait and see, but this may miss opportunities.
- What if estate tax is repealed but comes back? So if clients want to shift appreciation you don't want to trigger gift tax so
  - GRATs
  - Sales to IDITs of hard to value assets that is not intended to trigger gift tax is a viable planning option.
  - For gift and sale use a formula clause similar to a Wandry or Petter type transaction selling a dollar value of units as finally determined for federal gift tax purposes. Consider a King type clause.
  - So traditional estate planning techniques that shift appreciation should be considered even in light of uncertainties.
  - Estate freezes.

# Note Sale to Grantor Trust – Consider Woelbing in Assessing Risk of Current Transfers

- Pair of Tax Court cases settled in 2016 on favorable terms for the taxpayers. 2006 sale of non-voting stock to a trust for a note. A typical installment sale to a grantor trust. The trust had sufficient seed capital based on the 10% test some speak of. The seed was based on life insurance policies with significant cash value. The sale was subject to a defined value mechanism that caused the shares to adjust based on the final gift tax value. Mr. Woelbing died in 2009. IRS asserted gift tax deficiencies against both Mr. and Mrs. W based on her gift splitting.
- IRS Position: For gift tax under 2702 IRS asserted retained interest should be valued at zero and treated all shares as transferred by gift. For estate tax, because the note was a form of retained interest then the full value of the trust on the date of his death should be included in his estate under 2036.
- Estate of Donald Woelbing v. Commr., Tax court docket No. 30261-13.

# Consider IRS Attack on Defined Value Mechanism When Planning

- H.A. True III v. Commr., Tax Court Docket No. 21897-16.
- Defined value mechanism challenged.
- Quality appraisal firm and appeal goes to $10^{th}$ Circuit where Wandry case was heard.
- Anticipate the taxpayer prevailing in this case.

# Plan Defined Value Mechanism

- Spillover to:
  - Use charities in the planning.
  - Have a formula to kids trust and excess to charity.
  - Marital deduction trust with independent trustee.
  - Excess to a GRAT.
  - Defined value as finally determined for gift tax purposes going to charity is best option. Petter and Christiansen. Watch excess holdings and private inurement rules.
  - Using a lifetime QTIP or GRAT works just as well.
- Spillover trust or charity should have skin in the game and an incentive to audit the transaction, not merely wait for the excess spillover.
- Wandry Tax Court in memo decision said it worked. IRS has not acquiesced.
- King case with consideration adjustment – selling \$10M of units based on values as finally determined. Adjust consideration with interest. 10th Circuit blessed this type of clause but mixed results in negotiating with the IRS.
- Include a formula disclaimer wherein the trustee doesn't except anything.

# Note Sale Planning

- "I think this is one of the best techniques out there."
- Grantor trust status can shift a lot of wealth whether or not use discounted assets.
- Hard to value assets can be used to leverage the technique.
- IRS has gone after these transactions: Karmazin, Woelbing, etc.
  - Pierre case is relevant in this context. If giving LP interests and selling LP interest should not matter but in Pierre gift and sale to defective grantor trust of LLC interests. 9.5% interest given and 40.5% interest sold IRS said value was incorrect. IRS claimed since same day transaction they should be valued as the same aggregate value.
  - Put time between date of seed gift and later sale of LP interests. I prefer 30 days. 60 days is better. The longer the better.
  - What is the FMV of the consideration received? This was an issue in Woelbing. Taxpayer argued that under 7872 is that it should be valued at face. But IRS says 7872 is an interest rate safe harbor and doesn't address whether the note is properly secured, the ability of trust to pay, etc.
  - Is it a deemed retained interest? General rule of thumb is 10:1 debt to equity. But see Oshins/Hesch reality of sale article.

# Note Sale Planning

- Some practitioners like to use a guarantee instead of a seed gift. That might be OK but what is financial wherewithal of guarantor. Typically guarantee 10% of note. If not good for it, the guarantee may be illusory. For a guarantee to provide substance to the transaction there should be an ability to pay. Should pay guarantee fee.
- Big 2036 Schauerhamer case. IRS tried to ignore LP and bring all back into estate because of bad administration.
- Little 2036. If I sell LP interest into the trust for a note and what is used to pay the note are distributions from the LP just sold the IRS will argue that donor/seller has retained interest in LP interest sold. This arises in particular where there is a circular flow of funds via distribution from LP to trust and from trust as interest on note to donor/seller.
- Exception to 2036(a)(1) is bona fide sale for full and adequate consideration. Consider step-transaction issues. See the Pierre case. Space out seed gift and sale. Use a formula clause based on values as finally determined for gift tax purposes. Easy to avoid (a)(1) taint if use distributions to pay note, make the distributions from the LP at different times and in different amounts then the note payments.

# Consider FLP Cases When Planning

- Estate of Purdue v. Comr., TC Memo 2015-249.
  - The IRS challenged the transfer of assets to the FLP as not meeting the adequate and full consideration requirement. They also challenged gifts of FLP interests as not meeting the preset interest requirement.
  - Marketable securities were owned in separate accounts managed by different firms. There was also an interest in a net leased rental property.
  - The business purpose argued by the taxpayers was consolidation of assets and aggregation to meet qualified investor requirements.
  - The Court held for the taxpayers noting no commingling of personal and entity assets, assets were properly transferred to the entity, the entity formalities were adhered to, taxpayers were in good health when the entity was created.
  - The case also involved a Graegin loan which was upheld even though there were assets outside the entity that might have been used to pay estate tax.

# Consider FLP Cases When Planning

- Holliday v. Comr., TC Memo 2016-51.
  - The steps critical to the planning were all performed in a single day – contributing cash and marketable securities to the entity followed by gifts of entity interests.
  - The Court was not swayed by the taxpayer's justifications of business purposes for the transaction. Asset protection motives were dismissed as the taxpayer lived in a nursing home and the court did not see those as realistic.
  - The entity did not keep books and records. The formalities of the entity were ignored in making distributions, etc.

# Consider FLP Cases When Planning

- Estate of Beyer v. Comr., TC Memo 2016-183.
  - Assets were included in the decedent's estate under IRC Sec. 2036(a)(1) even assets purportedly sold to a grantor trust. The taxpayers violated several of the cardinal FLP "no-no's." Formalities were ignored, distributions were made to the wrong people, tax returns were filed listing incorrect owners (but amended to correct), and more. There was no bona fide sale exception as the purported business purposes were not recognized. In Beyer the Court did not accept the alleged significant non-tax reasons for creation of entity.
  - In Beyer the taxpayers claimed that the decedent wanted to keep primary investments intact. Stock was in trust they could have addressed that goal in that context. Could have named nephew as investment adviser or co-trustee. Taxpayer failed to carry burden of proof to create credible evidence. Beyer is decided on burden of proof grounds.

# Creative Use of Trust being a Grantor Trust as to another Trust

- PLR 201633021.
- Trust no. 1 had the power so that it could withdraw all income of a second trust, trust no. 2. To the extent trust no. 1 did not exercise the right to withdraw income of trust two and if it did not it lapsed.
- Can sell asset from one trust to another trust, i.e. From a non-GST trust to a GST trust.
- Having a trust be a grantor over another trust with different tax attributes can open up a range of interesting planning opportunities. If assets are sold from a QTIP trust to a new trust that is grantor a to the QTIP can the appreciation in those assets thereby be removed from the QTIPs value and reduce estate tax on the death of the second spouse? Can the new trust be GST exempt so as to effectuate improved planning? How would the IRS view such a transfer for gift tax purposes? Can a trust make a gift to another trusts?
- Are there fiduciary issues? Will modification to give withdrawal right create risks to the GST protected trust?

# 2017 Heckerling Institute of Estate Planning Highlights

## Life Insurance

# Morrissette v. Commr., 146 T.C. No. 11

- Private economic benefit split-dollar arrangement.
- ILIT pays the term cost of the life insurance, which is modest in the early years of the arrangement. Another party, such as a family member (often the insureds) or a family trust (existing funded marital –QTIP, or dynasty trust) pays the remaining portion, which is typically the bulk of the insurance cost in the early years of the arrangement. This arrangement can substantially reduce the amount of current gifts the donor/insured is required to make to the ILIT to purchase the insurance, but nevertheless can assure that the insurance proceeds are removed from the donor/insured's taxable estate
- Morrissette was in her 90s and incapacitated. She created a revocable trust (the payor) that advanced funds to be used for premium payments for life insurance owned by three dynasty trusts (formed by her conservator), under a split-dollar arrangement. Each child had a dynasty trust, and that trust used the funds received from Morrissette's revocable trust to buy a life insurance policy on the two other siblings.

# Morrissette v. Commr., 146 T.C. No. 11

- The insurance was to be used as part of the succession plan for the family-owned businesses, which included Interstate Van Lines. Family members entered into a buy/sell/cross-purchase shareholders' agreement that required the surviving children to purchase shares held by a deceased child. Morrissette's revocable trust contributed approximately $10 million to each of the three dynasty trusts, for a total of $30 million.
- Of the $10 million received, $5 million was used immediately for insurance premiums, which was sufficient to cover the anticipated cost of the insurance for each child's lifetime.
- On mom's death issue is what is the value of the receivable? Mom gets repaid with intergenerational life insurance until children's death. The valuation of the receivable at her death was about $7.5M on the $30M premium paid.
- Key - There was a non-tax reason for the split-dollar arrangement and insurance, and courts might view an arrangement that has no non-tax motives differently.

# Life Insurance Planning Agents will Love

- 2nd to die life insurance is not what many would want. Might prefer single life so can pay tax on first death to shift/protect assets that are hot (i.e. significant appreciation potential).
- With carryover basis what will be the best investment? The internal build up in a life insurance policy is not subject to income tax during lifetime and the proceeds are received on death without a built in capital gains liability.
- Consider distinction between retirement plan and insurance. In a retirement plan generate appreciation that would be capital gain to the plan holder and instead on retirement is taxed as less favorable ordinary income. Contrast to life insurance (see above). Is there a cross over point at which you should not continue funding a retirement plan because of this tax disadvantage? There is no crossover point but in a carryover basis world traditional thinking of funding a retirement plan versus buying life insurance should be rethought.

# 2017 Heckerling Institute of Estate Planning Highlights

Preferred Partnership Planning Pre & Post Trump

# Freeze/Preferred Partnership Post Trump

- Have parent’s interests given to a preferred partnership and they receive back preferred interests. Structure the plan so that the growth beyond that shifts to a trust that is not taxed under the proposed capital gains on death (mark to market) rules the Trump plan has suggested.
- Under current law you want to maximize basis. Under a Trump plan you might want to do the reverse and try to get appreciated assets out of the estate to avoid the Trump capital gains on death if enacted. Having parents structure and retain a preferred interest might do just that.

# Freeze Partnerships - Intro

- Exchange where parent gifts assets and takes back preferred equity interest. The parent is giving up the growth interest.
- Must be IRC Sec. 2701 compliant.
- A number of applications.
  - Straight preferred partnership.
  - Can use to freeze a GRAT
  - Can use it to freeze a QTIP trust, etc.
- 2701 compliant partnerships post-1990 you must comply with a right that is mandatory and quantifiable. Parent cannot opt to take or not to take the right. A qualified payment right is a common way to do this: annual payment, cumulative and at a fixed rate.
- The attribution rules are something that need to be carefully considered as they can change the analysis: Entity attribution rules; Trust attribution rules; Multiple attribution rules; Grantor trust attribution rules; Tie-breaker rules.

# Freeze Partnerships – Adequacy of Coupon on Preferred

- If adequate coupon might be 7-8% and perhaps a 5% interest may be provided so you will still have a gift because of the shortfall. There is still a gift tax component.
- Determine adequacy of coupon under Rev. Rul. 83-120.
  - What do high grade public stocks pay?
  - Adjust to yield as compared to risk adjusted market comparables.
  - Dissolution rights?
  - Coverage of coupon is very important which is influenced by capitalization of the partnership.
  - 50/common 50% preferred paying 7% versus 90%/10% paying 7%. The second partnership is much riskier than the 50/50. As a much riskier investment with weaker coverage it will require a higher coupon. Consider these factors when structuring coupon.
  - These concepts give some flexibility to structure the coupon.
- The preferred coupon will generally be significantly higher than AFR since it is different methodology.

# Freeze Partnerships – Preferred Partnership GRAT

- GRATs are subject to ETIP and cannot allocate GST to them until after the ETIP ends.
- Old and cold trust makes contribution into 2701 compliant preferred partnership. This old trust will hold the common interest. Now growth can inure to old GST exempt trust.
- Parent creates preferred partnership and takes back a 2701 complaint interest.
- Gift that interest into a long term GRAT. GRAT uses that to make annuity payments,
- At end of GRAT term the preferred interest drops into a GST non-exempt trust.
- If we end up with 10-year minimum GRATs you can minimize estate tax exposure if die in GRAT term since growth is shifted to GST exempt trust from inception. No 2036 inclusion since parent never owned that common interest.

# 2017 Heckerling Institute of Estate Planning Highlights

**Drafting in light of possible Repeal – General Comments**

# Drafting in light of possible Repeal

- Flexibility is key.
- GPOAs can provide flexibility.
- QTIP Trusts and don't make election for marital treatment so assets pass tax free at spouse's death
- Consider how close the estate tax rate is to the income tax rate.
- Consider the appreciation that will build up in a QTIP trust. If state has a 5% income tax rate, 20% federal rate and 3.8% Surtax so arbitrage between income and estate tax is only about 10%.
- Use Clayton QTIP so independent executor can flip to credit shelter type trust.
- Use GST exempt trusts when feasible.

# Drafting in light of possible Repeal

- Create a new trust, or decant an existing trust into a more robust trust, and add flexibility that current trusts crafted prior to the prospect of repeal may not reflect.
- Assure grantor trust status.
- Include a swap power described in Section 675(4)(C) and draft the language in a sufficiently flexible manner to permit reverse swaps. Under current law it can be advantageous for a settlor to swap highly appreciated assets out of a grantor trust prior to death to include those assets in his or her estate for basis step up purposes.
- Consider that under a capital gains tax on death regime the inverse of swapping highly appreciated assets into a grantor trust prior to death might prove advantageous. This might provide a mechanism to avoid the capital gains that might be incurred if those were retained. This possibility is another factor to weigh in favor of pursuing planning now.
- A broad class of beneficiaries to provide more flexibility in planning distributions and future income tax planning under whatever changes may be enacted. Also consider whether distributions to charities should be permitted.

# Drafting in light of possible Repeal

- Situs and governing law in a trust friendly jurisdiction that is likely to more quickly take legislative action in the event of a significant change in federal tax laws. If a self-settled trust is created in a DAPT state and there is a desire for estate inclusion moving the situs and governing law back to a non-DAPT home state may suffice to cause estate inclusion. Permit change.
- A flexible trust protector provision to facilitate change to address future developments without the need, if possible, of court intervention.
- Consider granting a person acting in a non-fiduciary capacity the authority to make a loan to the settlor with adequate interest but without regard to adequate security, triggering grantor trust status pursuant to Section 675(2). While this can characterize a trust as a grantor trust it can also be used as a means of providing economic benefit to a settlor if warranted.
- Consider a hybrid domestic asset protection trust (DAPT) approach. Create the trust in a jurisdiction that permits self-settled trusts and grant someone, again in a non-fiduciary capacity, the power to add descendants of the settlor's grandparents to the trust as beneficiaries. If the estate tax is repealed, the power can be exercised making the settlor a beneficiary if appropriate.

# 2017 Heckerling Institute of Estate Planning Highlights

## Wills/Rev Trusts in light of Possible Repeal

# Funding Credit Shelter vs. QTIP if all Estate Taxes Repealed

- Sample Language to add to a Revocable Trust: “If both the federal and state estate tax have been repealed, it is Grantor’s preference that the entirety of the trust estate pass to the Credit Shelter Trust and not to the QTIP marital trust unless, however, such transfer would trigger a capital gains tax on death. In the latter case, then the maximum amount may be transferred to the Credit Shelter Trust that will not trigger a capital gains tax on death if such a tax exists, and the remaining estate shall pass to the QTIP trust. Grantor gives the Independent Trustee latitude to interpret and apply these provisions in the event of tax law changes occurring after the execution of this Trust.”

# Funding Credit Shelter vs. QTIP if all Estate Taxes Repealed

- Perhaps a Clayton QTIP approach should be favored to provide more flexibility in light of current uncertainty? The executor can extend the estate tax return and use that time to determine what a new tax regime might include and then elect how much if any of the estate should pass to which trust.
- Based on prior slide/example, if assets in a credit shelter type trust would avoid capital gains on death under the new regime, push all assets by election to that trust. If instead capital gains on death might be triggered by bequests to a Credit Shelter but a QTIP-like trust might provide deferral, then push all assets to the QTIP.

# QDOT and Repeal

- Principal distributions would be subject to the equivalent of an estate tax.
- If repeal is a possibility at all favor qualifying non-citizen spouse for US citizenship to avoid the QDOT-tail.

# 2017 Heckerling Institute of Estate Planning Highlights

## Irrevocable Trusts and Inclusion

# 2038 Mechanism - Flexibility to Cause Estate Inclusion

- Consider permitting a named disinterested person, acting in a non-fiduciary capacity, i.e. not a trustee or trust protector in his or her absolute discretion, to give the Grantor one or more powers to control the beneficial enjoyment of trust property such that the subject property would thereby become taxable in the Grantor's gross estate under IRC Section 2038. For instance, the Grantor might be given such a Section 2038 power(s) over all or a specific portion of the trust property (or even specific assets) following a possible repeal of the Federal estate tax and in order to obtain a step-up in basis for appreciated trust property should that be available under the new regime.

# Sample 2038 Provision to Add to Irrevocable Trust in Interactive - 1

"**Estate Tax Inclusion; Appointer**:

- No Portion of Trust Includible in Gross Estate. It is the Grantor's intent that no portion of any trust hereunder be includible in the Grantor's gross estate or the gross estate of the Grantor's Spouse for Federal estate tax purposes. Accordingly, and notwithstanding any provision herein contained to the contrary, other than by action of the Appointer below, this Trust Agreement shall be construed and the trusts hereunder administered in accordance with and to achieve that intention.
- Powers of Appointer. The authority of the Appointer shall be limited to the authority described in this Provision. Except as may be otherwise provided herein, the Appointer shall have the sole and absolute authority (acting alone and without the

# Sample 2038 Provision to Add to Irrevocable Trust in Interactive - 2

- …consent or approval of any other person including but limited to the Trustee) in the exercise of sole and absolute discretion, and acting in an individual and non-fiduciary capacity, to grant to the Grantor one or more powers that will allow the Grantor to control the beneficial enjoyment of all, or any portion of, the trust property, such that would cause inclusion of such property in the Grantor’s gross estate under Code Sec. 2038. By way of example, and not limitation, the Appointer may grant to the Grantor the power to appoint the income of any such trust hereunder or income from any specific trust property to any person, other than the Grantor. Any such grant of power(s) by the Appointer shall be made by an acknowledged, written instrument executed by the Appointer and delivered to the Trustee.

# Sample 2038 Provision to Add to Irrevocable Trust in Interactive - 3

- Multiple Appointers. If two persons are acting as Appointer of any trust hereunder, then decisions of the Appointer shall be made by unanimous vote and if more than two (2) persons are so acting, then by a majority vote.
- Appointment of Appointer. The Grantor appoints ___________________________ to serve as Appointer hereunder (referred to in this instrument as the "Appointer"). If ___________________________ shall cease to act as Appointer hereunder for any reason, then the Grantor appoints ___________________________ to serve as successor Appointer hereunder."

# Moving DAPT- Flexibility to Cause Estate Inclusion

- For a client in a non-DAPT jurisdiction set up a self-settled domestic asset protection trust ("DAPT").
- Worried about DAPT risk – use a hybrid DAPT or 10 year +1 day waiting period to minimize the bankruptcy risk. Still not comfortable, use a inter-vivos QTIP with credit shelter back to the grantor spouse.
- If it later becomes advantageous to have trust assets included in the client's estate have a trust protector move the DAPT or QTIP (with credit shelter back) to the client's home state which does not permit DAPTs or QTIPs in the above manner. The application of home state law may suffice to cause estate inclusion.

# 2017 Heckerling Institute of Estate Planning Highlights

## Credit Shelter Trusts and Inclusion

# Credit Shelter – Estate Inclusion for Basis Step Up - General

- Credit shelter trusts.
- Estate tax may not be an issue/benefit for a credit shelter trust, but the loss of basis step-up on death of the second spouse may be a negative. How can we build in mechanism to obtain a basis step up?
- The absence of an estate tax benefit may result because the surviving spouse’s estate may prove smaller, exemption may grow, surviving spouse may die when there is no estate tax, or Trump may repeal the estate tax, etc.
- How do you get the equivalent of portability in a non-portability situation?
- There are four ways but none are perfect.

# Credit Shelter – Estate Inclusion for Basis Step Up – Distrib. Assets

- Have credit shelter trust authorize distribution of principal, better if no HEMS standard, if surviving spouse's health is fading and estate doesn't require exemption, and you want some of the trust included in the estate, distribute appreciated assets to the surviving spouse out of the credit shelter.
- Caution what if surviving spouse diverts assets to anyone other than the remainder beneficiaries? If the surviving spouse is incapacitated what might agent under POA do? Who is named as agent?
- Some trustees are uncomfortable making discretionary distributions. You do not want to make the distribution automatic, it should be discretionary.
- What will be required for an institutional trustee to become comfortable to make such a distribution? Perhaps if an institutional trustee is named, the power to make distributions should be given to a named individual. Might this be a role for a trust protector? However, might there be an issue for anyone acting in a fiduciary capacity to distribute assets outright to the spouse to the detriment of other beneficiaries? Is it to their detriment if the basis step-up is valuable to them.

# Credit Shelter – Estate Inclusion for Basis Step Up - GPOA

- Give a trust protector the ability to grant the spouse or other beneficiary a general power of appointment over some or all of the assets.
- You can grant a general power of appointment without giving a lot of authority to divert the assets. “I give you the power to appointment to appoint these assets to the creditors of your estate but you may do so only with the consent of the following specified non-adverse parties [names].”  It is the existence of the power that suffices.
- A power is not general if it can be exercised only with the consent of the creator.
- Add this power as close as possible to the date of death since you need to know the size of their estate. If you make it too far in advance the power holder’s estate may change. In many states it may not create an asset protection problem but disturbing assets as above would. In many states an unexercised general power is not reachable by the creditors of the power holder.
- The trust protector has to obtain information on the health and wealth of the person who can get the general power and this is often practically difficult. Consider exculpatory language to the protector. You can grant this power only over appreciated assets. You cannot grant the power only as to the appreciation.

# Credit Shelter – Estate Inclusion for Basis Step Up - GPOA

- Can you grant this as to only the exclusion amount? There is an issue with this illustrated in the case: Kurz v. Commr., 101 TC 44 (1993), aff'd 68 F.3d 1027 (7th Cir. 1995). In Kurz person had GPOA. If you can get GPOA by your own action you are deemed to have the GPOA even if you did not take that action. There is an exception for an act of independent significance. While assets increasing in value might be an act of independent significance, Congress raising the exemption should be, but there are no precedents.
- A formula grant should work but there is some concern because there is not full precedence. Consider a formula e.g. exemption without deductions under 2053 or 2055 since those are under the control of the surviving spouse.
- Should the person given the right to grant a GPOA or to expand a LPOA into a GPOA be a person appointed in a non-fiduciary capacity? Some practitioners believe that a trust protector is always acting in a fiduciary capacity. Might that impede granting the power?

# Credit Shelter – Estate Inclusion for Basis Step Up – DE Trap

- Trust assets could be included in the surviving spouse's estate by use of the Delaware tax trap. The surviving spouse is given a testamentary LPOA that can be exercised in a manner that springs the Delaware tax trap causing it to be taxed as a GPOA and thus creating the desired estate inclusion.
- A LPOA is taxed as a GPOA under IRC Sec. 2014(a)(3) if:
  - The holder exercises it to create a transfer in further trust.
  - The transfer gives someone else a new POA.
  - The new power can be exercised to postpone the vesting or ownership of property for a period that is ascertainable without regard to the date on which the spouse's POA was created.
- It is not clear that DE even has this law, but other states do. DE had a rule that if you had LPOA and you use it to create a new LPOA it restarts the perpetuities date.
- There was a concern that you could create a perpetual trust that was not ever subject to estate tax so if you do this the LPOA will be treated as a general power.  DE tax trap is an appealing way to bring assets into the estate since the person who knows the information to make the decision, i.e. the beneficiary, (his or her health, wealth, etc.) is in charge of the decision.

# Credit Shelter – Estate Inclusion for Basis Step Up – DE Trap

- You can spring the trap and unspring it and continue changing it until you die.
- Few states follow the DE model. It is not, however, clear that even DE does. If you are in a state that does not, you can spring the DE tax trap if you create with the LPOA that appoints in a trust that gives the beneficiary a presently exercisable general power of appointment.
- If your state has repealed the rule against perpetuities ("RAP") it is not clear if you can spring the DE tax trap. Estate of Murphy v. Commr, 71 TC 671 (1979).
- If state has a fixed set rule against perpetuities, you can make provisions to violate it If state has repealed RAP it is hard to figure out how to violate it.

# Credit Shelter – Estate Inclusion for Basis Step Up - POAST

- POAST = Power of appointment support trust.
- **Example** G1 is worth $1M and worried they may run out of money. G2 can create a trust that names G1 as a discretionary beneficiary and from which G1 can receive income. Nuance is adding G1 as a beneficiary. Structure in jurisdiction with long or no perpetuities. Create a contingent GPOA limited to the lesser of G1's unused GST exemption or unused estate tax exemption.
- **Example**: Trust assets $10M. Dad = G1. If contingent GPOA is unlimited that would trigger tax on Dad's death. At death estate tax inclusion in Dad's estate so get a basis step up. As long as G1 does not exercise the GPOA the trust remains a grantor trust as to G2.
- What if G2 dies before G1? Statistical likelihood is small but you might be able to insure against this.
- Combine the POAST technique with a GRAT. G2 creates a GRAT and may use some exemption. G2 could have used gift tax exemption but what if the POAST is the recipient of GRAT assets. When G1 dies you can allocate G1's GST exemption to the trust.
- Similarly, you could use a CLAT to pour into the POAST to save G2 exemption.

# 2017 Heckerling Institute of Estate Planning Highlights

## Community Property Trust For Basis Step Up

# Community property trust – For Basis Step Up

- AK, TN and SD allow you to obtain a community property result.
- AK allows you do to this with a community property agreement. You can do this with a trust but it is not required.
- TN and SD permit it to be done with a trust. The AK approach which permits community property by agreement, not only by trust, may be a stronger statute to achieve this result.
- NC and FL are trying to create these community property trusts statutes as well.
- Key is that it must be community property in the state in which the person died.
- This technique should work but there are no authorities that have directly addressed this technique.
- Commr. v. Harmon, 323 US 44 (1944). Electing to make something community property does not avoid anticipatory assignment of income. Harmon should be good law for the fact that this technique works.

# 2017 Heckerling Institute of Estate Planning Highlights

## GRATs – Different Planning in Light of Possible Repeal

# GRATs in Light of Possible Repeal

- Traditional GRAT: Short term rolling GRAT.
- Issues with Traditional GRAT: Rolling GRATs might be eliminated, interest rates are rising, typical back end grantor trust in GRAT instrument might not be as flexible as desired.
- New GRAT: Longer term trust with remainder to a free standing grantor hybrid domestic asset protection trust (“DAPT”).

# The New GRAT

- Longer term locks in technique if technique eliminated/restricted and locks in lower hurdle rate if not.
- Remainder to independent irrevocable trust. If desirable in light of estate tax repeal, settlor can buy out remainder from that trust and collapse the GRAT.
- Remainder irrevocable trust can be a hybrid DAPT so that if the new Trump regime makes it desirable or advantageous the settlor can be made a beneficiary of that remainder trust.
- Key with Interactive the cost of adding a free standing hybrid DAPT does not have to be that significant.
- Consider life insurance to address mortality risk.

# The New GRAT Hybrid DAPT Provision - 1

- Give the person you might call the "Designator" the right/power to add descendants of Grantor's grandparents, including grantor, as a beneficiary of the trust.
- Sample Provision to Add to Interactive DAPT (Alaska Mega-trust):

**Power to Designate Additional Beneficiaries**

- The Grantor appoints NAME as the Designator. During the Grantor's lifetime, the Designator, shall have the power, exercisable at any time and from time to time in a non-fiduciary capacity, and without the approval or consent of any person in a fiduciary capacity, to add as additional beneficiaries hereunder any person who is a descendant of Grantor's grandparents who is not already designated herein as a…

# The New GRAT Hybrid DAPT Provision - 2

**Power to Designate Additional Beneficiaries**

- …Beneficiary. Further, the Designator may at any time remove any person so added by written notice to the General Trustee, so that from the date of such written notification that added descendant of Grantor’s grandparents shall cease being a beneficiary hereunder.  The Grantor directs that this power is not assignable.  In the event that NAME dies before the Grantor dies, the successor Designator shall be such individual (other than the Grantor, any person acting as a Trustee under this instrument) whom NAME shall have designated by an instrument in writing.  Any person other than NAME acting as a Designator hereunder shall also have the power to name such additional beneficiaries as hereinabove provided.

# 2017 Heckerling Institute of Estate Planning Highlights

## GRATs – Improved Planning/Drafting

# Make GRATs Great Again

- GRATs are a good technique for uncertain times. The GRAT delivers its benefits without any potential gift tax risk.

# Don't Miss GRAT Requirements

- With a proper GRAT the full value of the transfer will be reduced by grantor's retained interests. The requirements are:
  - Annuity payment at least once a year.
  - Cannot use note or financial arrangement to pay the annuity.
  - Annuity must be fixed dollar or fixed percentage.
  - Adjustment clause must satisfy requirements in Regs.
  - Trust instrument must prohibit additions.
  - Trust instrument must prohibit commutation.
  - Trust instrument must prohibit payment to anyone other than grantor before end of qualified term.
  - Term of annuity must be for life of annuitant or term of years.
- But if there is a slip up in complying with the requirements a draconian result will occur which is a 100% gift tax. This makes it critical that clients comply with all the regulation sin the drafting and administration of the GRAT.

# Draft to Backstop Annuity Payment

- Incorporate a clause to address an inadvertent failure to pay the annuity. IRS agents often ask for proof of timely payments of annuity payments. You may argue that all the regulations require is compliance in terms of the document but this is tough to argue with an agent. Instead provide in the trust instrument that a portion of the GRAT will automatically terminate to the extent an annuity payment was not made on time.
- **Example** $5M GRAT at end of 105-day grace period $2M that belongs to grantor 2/5 of the GRAT will terminate. Argument is now that this property now belongs to the grantor not the trust.

# Draft to backstop Inadvertent Addition

- What about inadvertent additions? The problem can arise in many situations including a purchase by the grantor of assets from the GRAT, a loan to the GRAT that the IRS argues is an addition, or the property transferred to the GRAT is unvested interest in property and the vesting occurs during the GRAT term that is the date of the gift. Draft so that any inadvertent addition is required and is held in a new trust.

# Draft to Minimize Valuation Risk

- If funded with hard to value assets define annuity by formula not fixed amounts.
- Despite IRS opposition to valuation formulas but the 2702 Regulations permit exactly this.
- Define annuity amount as the amount to reduce gift to zero if IRS revaluates transferred property the annuity will adjust.
- This is for many the most important reason to use a GRAT since it is the most assured way to transfer hard to value assets and minimize risk.

# File Gift Tax Return Properly to Minimize Audit Risk

- If the value is really zero should the grantor file a gift tax return? Yes, as the Code requires it and also you want the statute of limitations to run on the valuation and other positions in the GRAT. This is particularly important if you define the annuity payment based on the value finally determined for gift tax purposes. Without filing a gift tax return this mechanism will not function.
- Be sure to include all gifts, including charitable gifts, when filing the gift tax return. If fail to list charitable gifts and only other gifts is zeroed out GRAT will exceed 25% and statute may be 6 years.

# Plan the Economics of the GRAT to Enhance Success

- Use short term GRAT to minimize mortality risk. But consider interest rate risk on re-GRAT'ing and possible change to technique.
- Short term GRAT minimizes risk of poor performance years bringing down performance of good years. A series of short term GRATs is always better. But you can immunize but that has to be done differently.
- Use an increasing GRAT annuity payment 120% per year.
- If use multiple GRATs the successful GRAT will produce a benefit to beneficiaries. But if combine two assets in one GRAT the gain on one may be offset by loss on another. In other words get granular.
- Fund with fractional interests. Use securities in a family investment entity and value at a discount from the share of the underlying assets. Transferring these types of interests without a GRAT presents a valuation risk. Make these transfers instead inside a GRAT as it makes this risk disappear.

# Love Leverage – So Leverage Your GRAT

- Leverage can help. If you want a short term GRAT and want it zeroed out, you will have to make large annuity payments. If you have to transfer assets back in kind that is problematic (costs of appraisal, shifting asset back to client). Consider a leveraged GRAT. Put asset into an LLC worth $1M and take back a $900,000 3 year note. Now transfer 100% of entity into GRAT and the annuity payments are modest and it may be funded with the cash flow from the asset.
- This is the Stacy Eastland leveraged GRAT.
- Consider whether the IRS may argue that the leverage is the GRATs use of a note to make an annuity payment on what they may argue is an unencumbered asset transfer.

# Make Your GRAT GST Exempt

- Use a sale of a remainder interest. Assume client has GST exempt trust that is perpetual. Client creates a GRAT and a remainder interest is say worth $46,000. That remainder interest that will pass to trust for children but you want to pass as a sale to a different old and cold GST exempt trust.
- Some time after the creation of the GRAT the remainder trust can enter into a sale and sell the remainder interest to that old and cold GST exempt trust. When remainder is actually paid to GST exempt trust that purchased remainder it is not a transfer from a trust and is not a taxable termination but is merely a change in an investment the GST exempt trust made years earlier.
- Trust should not be a skip person trust so if argument fails it will not be a taxable termination.

# 2017 Heckerling Institute of Estate Planning Highlights

## Portability

# Should Portability be Default Plan

- "Portability should be the default rule then have the client help demonstrate why portability should not be used. Except in extraordinary cases portability is preferable then protecting part of the appreciation from estate taxes. Document in memorandum to client that you have chosen one approach over another based on what the client felt was more important. Mention in the memorandum what are the negative consequences (what is being given up) because the client felt these less important."
- "Your decision will almost always be wrong anyway."
- **Comment**: With the rollercoaster tax law changes that have seem to become the norm is it ever possible for a practitioner to really have any certainty? All that can be done by any practitioner is to make a good faith effort to get a reasonable result weighing the ever-changing tax options and the myriad of often unquantifiable client personal goals, many of which clients struggle to delineate.

# QTIPs and Portability - Rev Proc 2016-49

- IRS could make unnecessary QTIP void. Example: Exemption was $1M and H died with $600,000 estate. Lawyer inadvertently made QTIP election and put on Schedule M on 706. That is included in surviving spouse's estate. W had $5M estate. The QTIP election was wasteful and IRS in ruling agreed to make the QTIP election void as a matter of leniency. Rev. Rul. 2001-38
- Years later when portability was enacted you would want a QTIP election in similar circumstances. Some practitioners were concerned that Rev. Rul. 2001-38 would create a problem by voiding an unnecessary QTIP. Rev. Proc. 2016-49 Addressed this.
- The new Revenue Procedure confirms the process by which the IRS will disregard a QTIP election, but it excludes from its scope those estates in which the executor made the portability election in accordance with the regulations under § 2010(c)(5)(A).

# Who Makes Portability Election

- Who can make the portability election?
- Appointed executors, e.g. appointed by court.
- Non-appointed executors. IRC Sec. 2203 provides statutory authority type executors. “The term “executor” wherever it is used in this title in connection with the estate tax imposed by this chapter means the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent.”
- Appointed executor supersedes non-appointed executors as to the right to file the Form 706 return.
- The Regulations, however, do not appear to address the situation where there is an appointed executor that does nothing.

# Who Makes Portability Election

- What should the non-moneyed spouse agreeing to file to secure portability be paid? In Swisher the spouse agreed to relinquish DSUE for $5,000 even though worth millions. Whoever advised them to accept $5,000 may be subject to the next suit. Walton v. Swisher, 3 NE 3d 1088, 2014 WL 325666 (Ind. App. 2014).

# 2519 and Portability

- Gift of any percentage of income is a gift of the remainder.
- Use affirmatively to plan to use DSUE.
- You cannot have a spendthrift limitation that prevents spouse from giving away income interest. You might provide that the spendthrift limitation shall not apply to a lifetime transfer of income interest. But be careful as this may expose the trust to the reach of creditors.
- Even after a 2519 disclaimer the surviving spouse can have an independent trustee make principal distributions.
- Contrast this with an outright bequest instead of a QTIP followed by a gift by the surviving spouse to a self-settled grantor trust.

# Portability Planning

- For small and middle size estates the one-lung QTIP trust with a professional fiduciary looks appealing. If state has state estate tax may want part of QTIP not to be deductible/marital. If no professional fiduciary set up multiple QTIPs
- Always provide ability to sever trusts.
- Use an institutional fiduciary so that someone objective and skilled can make the decisions involved.

# 2017 Heckerling Institute of Estate Planning Highlights

## Basis Consistency 1014(f) and 6035

# What property is subject to Basis Consistency Rules

- Only property which increased estate tax.
- Several aspects made clear in final Regulations. If estate is not paying estate tax because it is below exemption amount there is no basis consistency requirement.
- If there is property that qualifies for marital deduction or charitable deduction these rules do not apply
- So surviving spouse can say $50M inherited has basis different then what was on Form 706, but the reporting rules still apply.

# Who Files Report; Who Receives Report

- Who files?
  - Executor is required to file basis reports.
  - If there is no court appointed executor it is the person in charge of property.
- Who receives the reports?
  - IRS and any person receiving property.
  - If there is a trust the report goes to the trustee of the trust not to the beneficiaries of the trust.
  - Uncertainty as to revocable trust. Does report go to trustee or to beneficiaries?

# Form 8971

- Part 2 information on beneficiaries. Schedule A on which you list assets from gross estate passing to that beneficiary.
- For each item list time number for 706, estate tax value, whether or not asset resulted in increased estate tax liability.
- Notice at bottom of Schedule A is very misleading.
- Must list all assets that “could be used” to satisfy the bequest.
- If executor is a beneficiary must send himself a form as well.
- Must send to IRS.
- Draft in June said no attachments to Schedule A. Some wanted to just send estate tax return to beneficiary. June forms said don’t do that – no attachments. IRS relented in September 2016 instructions saying you can use attachments to list related property. But instructions said do not attach appraisals.

# Form 8971

- Penalties can apply even if there is no estate tax due if the parties who are supposed to get reporting forms don't get them.
- Must get beneficiary tax identification number. What if executor cannot get it? Executors must request it in writing and if not given the number say "requested" and attach copy of written letter.
- What about foreign individual not required to get a TIN? Instructions say no penalty for not providing a number.
- Power of attorney Form 2848 September instructions give detail about power of attorney to deal with Form 8971. It is not intuitive. Under description of the matter you list "civil penalties." What will beneficiary think about that?
- Cash is not reported on Form 8971 or Schedule A. So if beneficiary is receiving only cash don't list that beneficiary on Part 2. This should be the same rule for all four exceptions.

# Subsequent reporting by beneficiary

- Subsequent gift donor/beneficiary must file report.
- If asset received from gross estate I contributed to a partnership 40 years later there is a requirement of a transferee report. No statutory authority for this.
- Assets form estate passing to a trust. 20 years later asset is still in the trust. Trust is going to make a distribution to a beneficiary. Must the trustee give a report to the IRS and the beneficiary/distributee? It is not clear. Comments have requested clarification.
- Does the holder of power of appointment get a report? Does she have to give report to IRS if exercises power?

# 2017 Heckerling Institute of Estate Planning Highlights

## Settlement Agreements

# Settlement Agreements

- Private parties cannot just state they agree and have tax authorities follow it. Bosch says must look to underlying claim. Commr. V. Est. of Bosch, 387 US 456.
- In Bosch must meet state law requirements based on enforceable stat law rights. IRS must follow ruling of state's highest court. If not, then must give proper regard to other state courts.
- 4 parts to the analysis.
  - There must be a bona fide dispute. Doesn't' have to be a war but it helps.
  - Controversy that involves state law rights. A true right must exist under state law that supports result.
  - You cannot get more than you should have gotten, i.e. What you are entitled to.
  - Must be in reasonable range of outcomes had you gone to trial. Doesn't, however, require a trial.
- In many situations it is difficult or impossible to get to the highest state court for a ruling.

# Settlement Agreements

- Rev. Rul 73-142 – Regardless of Bosch if you have a lower court ruling that is contrary to another state court ruling if final and non-appealable IRS is bound by it. Be careful relying on this. Facts in ruling may differ from other situations. A trust modification was sought before death of grantor so grantor was involved in modification. Grantor had a “string” that would have caused estate inclusion. Consummated a trust modification to remove that string. The Rev. Rul. Recognizes that once have modification order that is final and parties are bound by it. Ruling hinged on fact that modification occurred prior to the event that triggered the tax, i.e.., the estate tax.
- Reformation action – language relates back to beginning date of document.
- Is there a gift, or is it a sale/exchange treatment?
- By a settlement you cannot shift interests. If you do you may shift tax consequences as well.

# 2017 Heckerling Institute of Estate Planning Highlights

## Fiduciary Liability

# Limiting Personal Representative’s Liability

- Tolling of statute of limitations. 3 years or 6 if substantial understatement but unlimited if fraud. Lesson is to file the returns and toll the statute.
- Form 4810 for prompt assessment. Can provide information required to accomplish the same? This shortens period to 18 months.
- Can request discharge from liability by filing Form 5495. Don’t think that this raises audit issue, although some practitioners feel otherwise. This doesn’t shorten statute of limitations but shortens period of time for which fiduciary can be held personally liable to six months for estate tax and nine months for other taxes.
- Spouse is not always executor. If spouse has not remarried the executor can file joint return with surviving spouse. Does executor want to do this? This will make PR jointly and severally liable with the surviving spouse.

# Can a Trustee Make a Loan to a Beneficiary?

- What is entailed in making the loan correctly? What does the trust agreement provide?
- Loans according to the speaker are investments. You are investing trust assets in that loan. So if trust is invested in securities earning 4% and needs to liquidate some of the portfolio to make a loan, can the trustee then issue a loan at the AFR at say 2%? Can you justify reducing the trust’s investment return?
- Many call loans a “chicken trust distributions.” Is it really a chicken distribution? The trustee may not want to tell beneficiary no but doesn’t want to upset other current and remainder beneficiaries when they see a distribution. This is exactly the situation when you should be cautious of making a loan.
- Some perhaps many trustees may want to address prerequisites for distribution as well as loan when the loan is not an optimal investment which is likely to be the case.

# Trustee Loan to a Beneficiary – Checklist - 1

- Too often loans are made without proper authorization? Does the trust instrument permit it? What are the prerequisites?
- Would a large loan cause too great a concentration of trust assets?
- Does trust permit concentration of investments? Could someone sue for concentration?
- Is interest rate on loan higher or lower than return on other assets that were previously held?
- Are there clear purposes of the trust that support making the loan? Is making the loan consistent with settlor's objectives?
- Can you charge the beneficiary's share of the trust? Some state statutes permit that if a loan is made from a trust to a beneficiary you automatically charge their share? If the beneficiary agrees to this if not in trust provisions this should work but if trust has a spendthrift clause it may not.
- Even if trustee does not have statutory authority to charge beneficiary share may have right to recoup. Beneficiary went bankrupt and loan discharged so trustee with discretion under doctrine of recoupment could charge beneficiary's share using equitable powers. In re Lunt 477 B.R. 812.

# Trustee Loan to a Beneficiary – Checklist - 2

- Does trust require security, interest, limit class of permissible borrowers? What due diligence should the trustee make on borrower's ability to repay, etc. In a litigation scenario should be able to corroborate how these points were considered? Even if security was not required it may be prudent for trustee to secure the loan using a UCC filing or mortgage. If you take the security and have not taken the follow up steps that could be problematic.
- Example, trustee wants to help family business stay afloat which may be a significant trust asset. Conant v. Lansden 341 Ill. App. 488. At some point the trustee should not have made loans when they knew it wasn't viable for beneficiary/borrower to repay.
- If trustee takes collateral what type of due diligence must be done? May take back a mortgage. Do you trust the beneficiary as to the value of the house? It is a private loan so they may not get an appraisal but any commercial lender would get an appraisal. It is a good idea for a trust to get an appraisal. Some due diligence should be done to corroborate that the decision by the trustee was rational. Determine what an independent lender would do and decide how much you might deviate from that.

# 2017 Heckerling Institute of Estate Planning Highlights

## State Law Developments

# Will Execution Formalities Evolving

- FL Senate Bill 206 permit persons to execute wills on line without a lawyer or witnesses. Witnesses can be satisfied by Skype or other webcam presence.
- In re Estate of Harris, 2016 WL 1588826 (Ohio Ct. App.) the drafting attorney was notary and testified that he wasn't certain that another witness actually witnessed the signing. The attorney's signature as notary was allowed to count as the required second witness. Flawed execution one witness is not valid. Have a self-proving affidavit and notary. Question is whether the notary who witnessed the execution ceremony counts as the second witness. The answer is yes.
- UPC has gone so far as to say if you have a notary signature you do not need other witnesses but it is not clear if any states have adopted this.
- Michigan case. Will not signed at all is valid under UPC harmless error provision.
- Will execution formalities are evolving in the direction of trust execution formalities.

# Nexus for State Taxation of Trusts

- Kaestner - NC held statute unconstitutional since taxed if beneficiary was domiciled in NC. Kaestner Family Trust v. North Carolina, 2015 WL 1880607 (NC Super. Ct), aff'd 2016 WL 3585978 (NC Ct. App.). No assets or trustee in NC. One beneficiary moved to NC but no distributions made to that beneficiary. Everyone agrees if distribute taxable income to a beneficiary that will be taxed by state. The issue is whether the state can tax undistributed income of that beneficiary? This case held that this was unconstitutional. The taxpayer must purposefully avail itself of the benefits of the state to be subject to tax and in this type of fact pattern the trust had not done so.

# Nexus for State Taxation of Trusts

- Linn v. Dept. of Revenue, 2 NE3d 1203.
  - Illinois trustor created in 1961 designated Ill. Law to govern. In 2006 no trustee or beneficiary were in Illinois and held no Illinois assets. Court held that trustor's domicile did not satisfy due process.
- McNeil v. Commonwealth, 67 A.3d 185.
  - PA classified trust created by resident trustor as PA trust. In 1959 PA domiciliary created PA trust. Corporate trustee was in DE and all administration took place in DE. 4 prong test in 1977 Complete Auto Transit Inc. v. Brady
  - Must have substantial nexus to taxing jurisdiction. Court noted that in Quill noted must have physical presence. Because all trustees and administration outside PA test was not met. The fact trustor and beneficiaries PA residents did not matter.

# Revocable Trust Funding

- Carne v. Worthington, 246 cal. App. 4th 548. No recorded deed just an indication on Schedule A to the client's revocable trust of the property. The court held that the listing on schedule sufficed. Recordation only important as to trustee's ownership as to third party claim
- Might this suggest listing all of a client's assets that are intended to be transferred to the revocable trust on Schedule A to at least provide a fallback position in the event the client dies before consummating the intended transfers?

# Revocable Trust as Will Substitute

- UTC law in 2/3rds of states. UTC is confident that a trust is a will substitute. UTC provides that while settlor is alive and competent the trustee only owes duties to the settlor.
- Babbit v. Superior Court, 246 Cal. App. 4th 1135 (2016). The settlors of a joint revocable trust were both trustees. The remainder beneficiaries had no rights to receive accountings, nor any cause of action while the trust was revocable.
- In re Trimble Trust, 826 NW2d 474. Mom relinquished trusteeship to bad daughter during gap period after mom incapacitated but while alive. Court said good daughter had no right to an accounting while mother was still alive.
- A recent FL case denied petition for administrator ad litem since courts are saying beneficiary has no standing.
- Be defensive: use an institutional trustee and appoint a trust protector in a fiduciary capacity with powers to act.

# Swap Powers

- Trustee was wife and mother of daughter who was beneficiary of trust. Divorced. Now ex-husband tried to exercise swap power and now ex-wife trustee refused. He tried to swap in a note and the ex-wife/trustee objected saying it was not of equivalent value as required by the trust.
- Schinazi v. Eden 2016 WL 5867215.
- In the divorce the issue of trustee and trust actions should have been addressed. It may have been preferable for all involved to have had the wife/ex-wife to be resign as trustee in favor of an independent and ideally an institutional trustee.

# Taxation Based on Corporate Trustee

- How do you determine residence of a corporate trustee?
- BofA said its domicile and principal place of business were in NC not MA. A person can only have one domicile and a business only one principal place. Court concluded that BofA was an inhabitant of MA as it maintained offices in MA, had administrative activities in MA, etc. Bank of America v. Comr. of Revenue, 2016 WL 3658862 (Mass.).
- This issue comes up when a trust is about to recognize large capital gains. Does trustee resign to break nexus to a high tax state? If the trustee does not resign is that a breach of fiduciary duty?

# 2017 Heckerling Institute of Estate Planning Highlights

## Charitable Giving

# Substantiation of charitable gift

- Charitable contributions may remain one of the few planning areas left.
- Taxpayers must follow requirements to properly document donations.
- Beaubrun v. Commr, TC Memo. 2015-217 – 4 years to get corroboration was too late.
- Brown v. Commr., TC Memo 2016-39 – No contemporaneous records so deductions claimed by a pastor were denied.
- French v. Commr., TC Memo 2016-53 – get bank consent which is required for an easement.
- Payne v. Commr. TC Summ. Op. 2016-30– Donated personal property and claimed $170,000 deductions for personal property but the taxpayer presented no meaningful corroboration for the contribution. IRS found no credibility to corroboration. Penalty imposed.

# 2017 Heckerling Institute of Estate Planning Highlights

## Asset Protection

# States with Legislation

- 40% of states have some type of asset protection trust legislation.
- Most states do not recognize spendthrift for creditors. Since 1997 16 states and most recently Michigan have DAPT legislation.

# Spendthrift Trusts and UTC

- Spendthrift trust provides for beneficiary and recognized in every state by statute or under common law. Spendthrift trust can be pierced for necessaries, for spouse, etc.
- 502c of UTC beneficiary cannot transfer interest in a trust in violation of a spendthrift provision and a creditor may not reach distribution by trustee before receipt.
- 504b UTC provides that a creditor cannot compel distribution from a discretionary trust even if expressed as a standard and even if trustee has abused discretion.
- 504c if trustee has abused discretion a court may order a distribution for support or maintenance for spouse, child or former spouse.

# Favor Discretionary over Support Trust

- Support trust gives trustee power to pay trust income to provide for support and maintenance. A support trust is protective of beneficiary's interests as beneficiary is only entitled to distributions for support. A spendthrift provision should be included.  Issue might claim be included within HEMS?
- A discretionary trust – distributions wholly in discretion of trustee. Beneficiary creditors cannot compel trustee to pay. The interest of the beneficiary does not qualify as a property right so even preferred creditors like spouses may be prevented access. It may not provide protection in some jurisdictions from such super creditors.

# QPRTs Provide Some Protection

- Other self-settled types of trusts like GRAT, QPRTs, CRUTs, etc. commonly used for estate planning purposes the issue is whether that interest is treated as reachable by creditors?
- It is to the maximum extent trustee can distribute. QPRTs are commonly used to lever age settlor's unified credit but also provides some asset protection. Settlor has transmuted interest in real property to a right to reside in the residence for a term of years.
- If settlor forces sale of property it will convert to a GRAT and creditor would only have right to that distribution.
- In a QPRT the grantor can point to estate tax benefits as primary intent or purpose of establishing the QPRT not asset protection. Establishing other non-asset protection purpose is important – but what happens if repeal occurs?

# SLATs

- This is a trust for the benefit of the spouse that should include other sprinkle beneficiaries. If both the client and spouse are citizens unlimited distributions can be made to spouse. Can be incomplete gift trust by settlor retaining a veto power.
- Risks of SLATs are premature death or divorce. Could provide in a DAPT jurisdiction that if settlor is unmarried he or she becomes a beneficiary of the trust. Could use a floating spouse provision, the person who settlor is married to at any particular time. Could give non-fiduciary power to make loans to settlor. Could give donee spouse a LPOA in favor of spouse but this may not avoid self-settled trust exposure because of relation back doctrine so use self-settled trust jurisdiction.

# SLATs

- A trust in a DAPT jurisdiction with an institutional trustee may be better than a SLAT in the home state with the spouse as a trustee. No means of measuring risks and comparing.
- In a divorce is the SLAT corpus considered? Perhaps a post-nuptial agreement may be useful.
- If client establishes trust for spouse and spouse established trust for the other spouse, trusts should not be identical (i.e., not reciprocal). Trusts should be sufficiently different that creditors cannot argue that reciprocal trusts leave both spouse in same position. They would be uncrossed if too similar in asset protection context just like in tax context. Consider different beneficiaries, different lifetime powers, different trustees and different powers. Consider using self-settled trust jurisdictions.

# Trust Asset Protection Checklist

- The greater the beneficiary’s access the less protection.
- Include sprinkle power to many beneficiaries, rather than limiting to single person.
- Should have at least one independent trustee, especially important to a DAPT. This may reduce arguments that there is a prearranged understanding.
- Even for non-self-settled trust using a bank or trust company is best. Give a third party protector the power to remove and replace.
- Beneficiary receipt of distributions should solely be in trustee’s discretion without any standards and should be able to make distributions for the benefit of the beneficiary and not direct.
- Consider including a spouse or significant other as a beneficiary so distributions can be made to that person and not to the beneficiary.
- Long term trust, ideally perpetual or the maximum period permitted under state law. Consider using a jurisdiction that repealed RAP, 27 states have done this.

# Trust Asset Protection Checklist

- Encourage the trustee to acquire a home or invest in beneficiary's business and make loans instead of making distributions that could be reached by creditors or which could become marital property.
- Consider automatic termination in favor of another beneficiary if the first beneficiary is deemed insolvent or provide that an attempted attachment by a creditor eliminates that beneficiary's rights.
- Beneficiary power to withdraw principal may make property available to creditors so avoid ascertainable standards, 5/5 powers, etc.
- If trust owns real estate it should be in LLC. Divide trust into two: one holding real estate and one holding marketable securities.
- Consider decanting to improve an existing trust. If home state does not have decanting statute move trust by naming a trustee in a state with a strong decanting statute like NY or AK and moving the trust and then decanting.

# Use Powers of Appointment

- GPOA versus LPOA. No state permits a LPOA to be reached by a creditor. In some states a GPOA is not available to creditors until exercised.
- Donee of a LPOA could exercise serially.
- Give LPOA to spouse of beneficiary and she can exercise only when no creditor problems. This may even be better than having the intended person be a direct beneficiary.

# Retirement Assets for Protection

- Retirement assets under ERISA pension plans are exempt.
- State law governs protection of IRAs and inherited IRAs. Supreme Court has ruled that inherited IRAs not protected in bankruptcy filing so consider a trust as a beneficiary, conduit or accumulation trust. Some states have enacted legislation protecting inherited IRAs. But even if state law does you don't know where beneficiaries will reside. So use trusts.

# 2017 Heckerling Institute of Estate Planning Highlights

## Divorce

# Qualified Plan v. IRA in Divorce

- Qualified plan need QDRO which is a divorce court order with precise requirements for 401(k). An IRA will not require a QDRO and can divide by property settlement agreement.
- Options to consider:
- Rollover - but the surviving spouse has control and can name her kids from her first marriage.
- Consider use of life insurance – plan to new spouse and insurance to children from prior marriage.
- Split retirement plan between kids and spouse.
- Name a two generation CRT – spouse 5% for life then 5% kids, then remainder to charity.

# Qualified Plan v. IRA in Divorce

- Qualified plan law supersedes state law.
- Children from prior marriages named as beneficiaries. Federal law trumps this and if you die your spouse is entitled to 100% of assets in your 401(k) unless she exercised a waiver.
- A prenuptial agreement is not effective as a waiver. To be a valid waiver you must be married. In prenup say “we will sign all documents after marriage to make the waiver valid.” But must follow up.
- With an IRA the kids form the first marriage will get the IRA assets.

# Trust Accessibility in Divorce - 1

- Is trust to be considered as part of the marital estate?
- Mass. Has considered trusts as part of marital estate if more than an expectancy and then subject to division.
- Court decided when divorce took place 11 beneficiaries, Husband, 2 siblings and grandchildren and not a closed class because other descendants would be added as born.
- Ascertainable standard of sorts was included: support, etc.
- Lower court said it was part of the marital estate and said value was 1/11 x full value since husband was one of 11 beneficiaries and gave wife 60% to wife.
- Appealed. Court noted that it was manipulative of trustees to stop making payments on eve of divorce

# Trust Accessibility in Divorce - 2

- SJC decision. Found that it was a mere expectancy so it is not subject to division. Note that does not mean it cannot impact how marital assets are divided.
- Lessons
  - Don’t include ascertainable standard.
  - Better to have pooled trust for many beneficiaries then a trust just for one child.
  - Even if you don’t practice in Mass. You have no idea where beneficiaries may eventually reside.
- State law is changing. Mass. Is out there but it is not that unusual a case. Under a conflicts of laws application, it will be the laws of the jurisdiction that governs the divorce that may determine the rights of the beneficiaries.

# 2017 Heckerling Institute of Estate Planning Highlights

## Avoiding Malpractice

# Pre-Engagement

- Not taking a bad case could be every bit as important as taking a case.
- Every attorney in the firm should have authority to turn down a case if it protects the firm.
- Look at the cost to a practitioner of taking a potentially poor cases/client. Lost time and unbillable time dealing with an unhappy client. Lost focus on good clients.
- How can we screen clients? What type of due diligence should we do on a client?
- How many lawyers have they had/fired?
- If client has significant assets overseas what issues might this suggest?
- Consolidated search programs can be used, e.g. Lexis Nexis Accurint product for $20 get info on background, holdings, etc.
- Have a written policy on what due diligence you do so that no client can claim they have been singled out. Get client permission in writing to do the due diligence. Perhaps include it in the engagement letter.

# Engagement Letters - 1

- Engagement letters are not required but are preferable.
- If represent more than one client what should be in the engagement letter, e.g. if multiple generations or groups of beneficiaries.
- Model Rule 1.7 joint representation is prohibited when there is concurrent conflict of interest. Can proceed if lawyer believes he or she can provide competent and diligent representation to all clients, the representation will not be prohibited by law, the representation does not involve the assertion of a claim by one client against another, and they each give informed written consent.
- Must address how you will treat confidential information between clients. ACTEC suggest that clients agree that all information be shared. Attorneys have undivided duty of loyalty to each client.
- What if someone else pays fees, e.g. a parent for a child or one of a group pays for all (e.g. one sibling pays fees for all). That doesn't change the duties counsel has to the non-paying clients. You can accept compensation from another if there is no interference with counsel's judgement and you have consent.

# Engagement Letters - 2

- What happens if you might change engagement after you have begun? Initial relationship is presumed to be an arm's length transaction. Once you start the relationship will the change violate the fiduciary duty? How do you prove subsequent engagement was not a product of undue influence.
- If client is bequeathing bequest to pool boy 23 states require reporting suspected elder abuse. Do you see evidence of undue influence? Banks, SEC and other institutions compel reporting elder abuse and impose a standard of care.
- Watch conflict of interests. If selling property from one generation to another generation be worried not only about IRS but that someone may accuse you of representing people on both sides of the transaction? Did you make disclosures of conflict and get a waiver?
- If one of clients is paying bill others may assume favoritism. If you cannot agree to have all be responsible for fees what might counsel do? What if one of the beneficiaries stops paying? Can you fire them? Should have that if you terminate one client that client will not object to your using information to help remaining clients and that they will not object to use of confidential information.

# 2017 Heckerling Institute of Estate Planning Highlights

## Questions; More Info

# Additional information

- Contact Martin M. Shenkman via email at shenkman@shenkmanlaw.com
- Obtain a copy of the article on drafting for repeal from the BNA booth by Blattmachr and Shenkman (some portions of which were included in this presentation).