NAEPC
Journal of Estate & Tax Planning
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Leimberg Information Services, Inc.

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

Date:11-Jan-17

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

Heckerling Institute 2017 – Day 1 Notes

By Martin M. Shenkman, Esq.

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

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

c. **<u>Comments from a discussion with Barry Flagg</u>**.

   i. What brings you to Hecklering?

      1. "*I'm an exhibitor, for the 15th year in a row. My company, Veralytic publishes pricing and performance research and product ratings for life insurance.*

      2. *These tools provide advisers a "ruler" to measure whether a client is being charged a fair and competitive price, and whether the client is actually getting good performance on, cash value life insurance. Financial planners, trust officers, independent insurance advisers and brokers, and others, use these tools to advise their clients.*

      3. *Heckerling is the premier gathering of estate planning professionals. There is no other place or time to find this many thought leaders in the industry in one place*."

   ii. What trends do you see in life insurance that estate planners should be aware of?

      1. "*The insurance industry has relied on tax benefits to drive sales for the better part of 40 years. A host of the techniques are no longer viable. For example, 412(i) and 419(i) uses of insurance as private retirement plans and private captives are under scrutiny. The estate tax had driven many sales but that has diminished with the large exemptions, and may even evaporate as a motive if Trump repeals the estate tax. The focus will change*."

      2. "*There is a lot of insurance that has been sold in past years and much of it may need to be repurposed. The information to evaluate those existing policies is needed to determine what to do next. Veralytic is the measurement tool to evaluate these policies*."

      3. **<u>Example</u>**: On a recent engagement I reviewed 1,000 ILITs. Of those 600 had excessive charges but only two of the 600 had insureds with taxable estates under the current exemptions. We used the West Point Draft of the Best Practice Standards provides a decision making framework as a decision tree to evaluate options. Some opted to cancel, some sold in secondary market, and so on. This is what needs to be done with many existing policies.

   iii. How significant can the results of a policy analysis be?

      1. "*The differential between good and bad pricing can be substantial, over more than what many realize. If you measure what the client is being charged you can determine where you are in terms of pricing. The difference can be 80% in hard dollar costs. The difference can be due to different companies. The process is complex as there are more than 10,000 pricing combinations to consider: gender, age, tobacco use, price or volume break points, funding strategies, etc. Do a factorial -- it can be that many permutations. You need to examine the actual pricing in the policy, not the illustration*."

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

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

iv. Reg. Sec. 20.2010-2(a) you can only make the election on a timely filed and complete estate tax return.

e. Portability regulations do not cause issues with respect to basis consistency.

f. Computation of the DSUE amount.
   i. In 2012 when portability became permanent the 706 had no provision for the calculation of the DSUE but the IRS accepted or deemed it "as if" the return was properly prepared.
   ii. After 2011 Form 706 there is a box with the information to calculate the DSUE.
   iii. See Form 709 page 4.
   iv. The DSUE is the lesser of: (i) the BEA (basic exclusion amount); or (ii) the excess of the decedent's AEA (applicable exclusion amount) minus (the taxable estate and adjusted table gifts.

g. Opt out of portability
   i. Do nothing – don't file.
   ii. File a Form 706 and indicate opting out.

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

i. Must file complete and properly prepared return.
   i. Final regulations made clear that a return with mistakes can still qualify. Return does not have to be perfect but must reflect good faith effort to convey all information.
   ii. This is a similar standard to determine if the filing of a return starts the tolling of a statute of limitations.
   iii. You must in all instances sign the return. If the return is not signed it will not suffice for portability.
   iv. If solely to elect portability the executor does not have to provide value of assets that pass to spouse or charity. Example $4M estate you are filing only for portability and if all assets left to surviving spouse or QTIP (or combination of spouse and charity) no need to get valuation of assets. Just describe assets.
   v. If estate is $8M and all passes to spouse you must value all assets and obtain appraisals
   vi. For some small estates may need appraisal **<u>Example</u>**: I leave $4M to wife and rest to children must value what goes to wife to know the amount that

will pass to children. **Example**: I leave $10,000 to my spouse, and the balance to children. If this was a $5M estate must value all assets.

vii. The regulations require that you value the marital if value of the marital will determine the value for other tax benefits. But those only arise if there is a taxable estate (e.g., special use valuation), etc. Basis is not considered an estate tax benefit for this purpose. Is the filing requirement itself an estate tax advantage?

viii. Short form, the Form 706 EZ, for portability was never provided.

j. What if the return was not filed on time?

   i. What if no return filed within required nine months and thereafter discovered that portability may have been lost?

   ii. IRS will grant 9100 relief if the estate is below the threshold. Rev. Proc. 2014-18.

   iii. If over threshold, e.g., $6M estate all passing to surviving spouse, if fail to file on time you do not get portability and will not qualify for 9100 relief. You are out of luck.

   iv. Generally, for 9100 relief need to show that you had consulted an adviser, etc. The PLRs seem not to mention this so perhaps the IRS is giving leniency to smaller estates.

k. Code versus Regulation differences.

   i. Follow the regulations when there is a difference.

l. Gift tax paid.

   i. Regulations cleaned up many of the issues in this area.

   ii. If you made a gift and paid a tax that is not considered to affect how much DSUE you leave to your surviving spouse.

   iii. H1 and W married and in 2003 made $3M gift resulting in a $2M taxable gift (the exemption being $1M). When H1 later died his estate was $10M all passing to W. His DSUE under the code would be $5 BEA minus $3M gift = $2M DSUE which is incorrect. The Regulation correct this to reflect that H1 only used $1M of his exemption so that his DSUE should be $5 BEA - $1M gift = $4M DSUE. Reg. Sec 20.2010-2(c)(1)(ii)(B)

   iv. Code says adjust for taxable gifts. Paid tax on $2M. Regulations say that if you paid it on any adjustable taxable gifts don't use that to adjust DSUE just use the amount of exemption used, $1M not $3M above.

m. Use of DSUE by surviving spouse.

   i. Can only use last deceased spouse's DSUE.

   ii. If client is going to remarry may lose prior spouse's DSUE if new spouse dies.

      1. **Comment**: Consider prior to the marriage funding an irrevocable trust with the unused DSUE to safeguard it from this risk. If the client wishes access to the funds, consider funding a self-settled asset protection trust ("DAPT"). That should use the DSUE and safeguard it without putting the assets out of the client's reach. If the client is concerned about perceived risks of the DAPT consider as an alternative a 10 year and 1-day delay before he or she can benefit, or use a hybrid DAPT approach not naming the client as a

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

iii. Black Widow issue – concerned about serial marriage. But are allowed to use exemption/DSUE of prior spouses. **Example**: H1 and W married. $5M exemption. W marries H2 and on Feb 2, 2011 makes gift of $5M. H2 dies later and leaves exemptions. Later W marries H3 and following that makes gift using H2s DSUE amount. Portability is elected. A month later marries H4 and following the marriage makes a gift to use H3's children. 2010-3b W was able to use H1, H2 and H3 DSUE amounts so long as used these before later husband died. This was contrary to what Congress initially intended.

iv. A similar result could be achieved by creating a non-marital trust for each spouse but Congress did not seem to worry about this.

n. Audit issue.

i. Return remains open but only the amount not the entire return remains open for audit.

ii. The IRS can audit the return of the deceased spouse through the period of time during which the surviving spouse's return can be audited. Reg. Sec. 20.2010-3(d).

o. Non-resident aliens ("NRA").

i. A US citizen is subject to US estate tax on worldwide estate regardless of where they live.

ii. If a resident alien, you are subject to estate tax on worldwide assets. You get full exemption.

iii. NRA only is taxed on assets in fact in the US. Unified credit is $13,000 equivalent to $60,000 exemption (this was the estate tax exemption until 1977). That is all that is given. The $13,000 credit is not portable. Portability does not apply unless a treaty provides otherwise.

iv. NRAs do not get a marital deduction for assets passing to a non-citizen spouse unless the assets pass into a QDOT. They do get a marital deduction for a US citizen spouse.

p. QDOTs and portability.

i. Portability does not mesh well with QDOTs.

ii. A QDOT looks like a QTIP but is not taxed like one. You must have a US trustee. Any principal paid to non-citizen spouse during his/her lifetime are treated as property left to a non-citizen spouse from the original decedent. So they don't come out against surviving spouse's exemption but against the deceased spouse's exemption. So a QDOT only defers the timing of the tax result. Incidence of tax stays with first spouse. So you cannot determine the DSUE until the surviving spouse dies or becomes a US citizen you don't know how much of the exemption will be used. If surviving spouse is getting a ported exemption by a QDOT cannot use it to offset lifetime gift.

iii. There are treaties with 14 countries and 10 of those have provisions that might affect the DSUE.

q. GST and portability.

i. You cannot port GST exemption. Portability deals with unified credit but not with GST exemption. Not clear why Congress took this approach.
ii. If client wants to use portability may need to create a reverse QTIP for the surviving spouse in amount of unused GST exemption to use first spouse to die's GST exemption. You cannot do GST planning with an outright distribution to spouse.

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

vi. There is no "one-size-fits-all" analysis.
vii. Portability should be the default rule then have the client help demonstrate why portability should not be used. Except in extraordinary cases portability is preferable then protecting part of the appreciation from estate taxes. Document in memorandum to client that you have chosen one approach over another based on what the client felt was more important. Mention in the memorandum what are the negative consequences (what is being given up) because the client felt these less important. "Your decision will almost always be wrong anyway."
viii. **Comment**: With the rollercoaster tax law changes that have seem to become the norm is it ever possible for a practitioner to really have any certainty? All that can be done by any practitioner is to make a good faith effort to get a reasonable result weighing the ever-changing tax options and the myriad of often unquantifiable client personal goals, many of which clients struggle to delineate. Perhaps the best answer is for the estate planning attorney an all allied advisers to encourage (push) clients to have an annual review to keep their planning on track.

s. Planning.
   i. Advantages of portability is simplicity. You may no longer need credit shelter trust. But not really. Portability includes using a QTIP trust which is as complicated as a credit shelter trust.
   ii. **Comment**: The speakers incredible 171-page detailed single space outline for this presentation suggests that the use of the word "simplicity" in the same discussion as "portability" can't possibly be fair.
   iii. So while portability can be simple it is often not.
   iv. Basis advantage. With a credit shelter trust those assets don't get a basis step up on the second death (unless a mechanism is used to achieve that) [**Comment**: see planning for this later in this outline].
   v. For retirement benefits portability creates tremendous simplicity as you can avoid a conduit trust etc.
   vi. Disadvantages of portability when spouse dies that appreciation is included in the estate. The DSUE is frozen at point of first death. If instead had left in credit shelter trust that appreciation would be out of the estate.
   vii. If surviving spouse following the death of the first spouse made gift of DSUE amount into an irrevocable grantor trust all the appreciation avoids tax so that the DSUE amount is not frozen by being used on first spouse's death.
   viii. GST exemption is not portable, but it effectively is if you use QTIP planning and reverse QTIP.
   ix. Portability leaves estate tax open but that is really only as to the DSUE amount that the IRS can adjust.
   x. 2001-38 IRS could make unnecessary QTIP void. Example: Exemption was $1M and H died with $600,000 estate. Lawyer inadvertently made QTIP election and put on Schedule M on 706. That is included in surviving spouse's estate. W had $5M estate. The QTIP election was

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

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

b. If the couple funds non-reciprocal SLATs during their lifetimes for asset protection and other reasons there may be only modest exemption left to plan for.

3. State level bypass trust.
4. 2519 plan to use DSUE with QTIP. This has assets growing at same pace and out of estate.
5. Use DSUE and surviving spouse makes gifts.

u. Types of trust plans.

i. Outright "I love you will" with disclaimer. This is good in that it is simple. Allows tremendous flexibility. Surviving spouse will have the maximum flexibility. "They have a tendency not to use it." Consider disclaimer permitted from QTIP to bypass since it is already in a trust.

ii. Disclaimer versus QTIP planning. Disclaimer – surviving spouse cannot redirect.

iii. Consider QTIP with partial QTIP election.

iv. 2519.

1. Gift of any percentage of income is a gift of the remainder.
2. Use affirmatively to plan to use DSUE.
3. You cannot have a spendthrift limitation that prevents spouse from giving away income interest. You might provide that the spendthrift limitation shall not apply to a lifetime transfer of income interest. But be careful as this may expose the trust to the reach of creditors.
4. Even after a 2519 disclaimer the surviving spouse can have an independent trustee make principal distributions.
5. Contrast this with an outright bequest instead of a QTIP followed by a gift by the surviving spouse to a self-settled grantor trust.
6. **Comment**: Code Sec. 2519 states that, if the surviving spouse who is the beneficiary of a QTIP trust with respect to which the marital deduction is elected disposes of all or part of the income interest in that QTIP trust, the disposition will be treated as if the entire interest in the QTIP trust, i.e., its full value, is deemed given by the surviving spouse. Several hurdles need to be cleared in order to achieve the Code Sec. 2519 results. Code Sec. 2519 does not provide that the disposition of all or a portion of the income interest causes the entire value of the QTIP trust to be deemed a gift. Rather, the gift transfer under Code Sec. 2519 is equal to the value of the entire trust, less the value of the income interest relinquished. The income interest is treated as an ordinary transfer. The combination of the two transfers results in a gift of all of the interests of the trust. No matter how derived, the net result of the disposition of all or a portion of the income interest will cause the full value of all of the assets of the QTIP trust to be treated as a gift by the surviving spouse.

v. For small and middle size estates the one-lung QTIP trust with a professional fiduciary looks appealing. If state has state estate tax may

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

vi. Clayton QTIP.

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

vii. Always provide ability to sever trusts.

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

v. Credit shelter trusts.

i. Estate tax may not be an issue/benefit for a credit shelter trust, but the loss of basis step-up on death of the second spouse may be a negative. How can we build in mechanism to obtain a basis step up?

ii. The absence of an estate tax benefit may result because the surviving spouse's estate may prove smaller, exemption may grow, surviving spouse may die when there is no estate tax, etc.

iii. How do you get the equivalent of portability in a non-portability situation?

iv. There are four ways but none are perfect.

1. The easiest is with a non-marital trust that authorizes distribution of principal, better if no HEMS standard, if surviving spouse's health is fading and estate doesn't require exemption, and you want some of the trust included in the estate, distribute appreciated assets to the surviving spouse out of the credit shelter.

a. Caution what if surviving spouse diverts assets to anyone other than the remainder beneficiaries? If the surviving spouse is incapacitated what might agent under POA do? Who is named as agent?
b. Some trustees are just uncomfortable making discretionary distributions. Assets will be added to probate estate. If there is a revocable trust the assets can be transferred into a revocable trust (even by POA if spouse is incapacitated).
c. You do not want to make the distribution automatic, it should be discretionary.
d. **Comment**: What will be required for an institutional trustee to become comfortable to make such a distribution? Perhaps if an institutional trustee is named the power to make distributions should be given to a named individual. Might this be a role for a trust protector? However, might there be an issue for anyone acting in a fiduciary capacity to distribute assets outright to the spouse to the detriment of other beneficiaries? Is it to their detriment if the basis step-up is valuable to them?

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

to the appreciation (but OK as to appreciated asset). What about making the grant of the general power automatic?

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

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

e. You can spring the trap and unspring it and continue changing it until you die.
f. Few states follow the DE model. It is not, however, clear that even DE does. If you are in a state that does not, you can spring the DE tax trap if you create with the LPOA that appoints in a trust that gives the beneficiary a presently exercisable general power of appointment.
g. If your state has repealed the rule against perpetuities ("RAP") it is not clear if you can spring the DE tax trap. it is also not clear that you can avoid springing it.
h. Estate of Murphy v. Commr, 71 TC 671 (1979) turned on the intricacies of rule against perpetuities. RAP applies to suspension of vesting, ownership or alienability. In many states they have adopted rules, e.g. Virginia and Wisconsin, that say you can suspend vesting and ownership so long as you don't suspended alienability. So long as the trustee can sell assets it doesn't matter. So trustee's ability to sell assets doesn't trigger estate tax.
i. If state has a fixed set rule against perpetuities, you can make provisions to violate it If state has repealed RAP it is hard to figure out how to violate it.

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

w. State estate tax and GST tax must be factored into portability planning.
i. State only QTIPs.

ii. GST QTIPs.
iii. So you often won't get the simplicity many anticipate.

x. Tax Basis Revocable Trust and the Joint Estate Step-up Trust ("JEST").
   i. Other ways to maximize basis using GPOAs.
   ii. Tax basis revocable trust. Goes back to TAM 9308002.
   iii. Developed to get community property like basis treatment in a non-community property state.
   iv. When first spouse dies surviving spouse can revoke trust as to what she put in. First spouse has GPOA to appoint property they did not put in. Because of this it is argued that the entirety of trust, i.e., both halves, are included in estate of first spouse to die. IRS said all is included in gross estate but no basis steps up on second ½ because it is deemed transferred within 1 year of death rule, as they deemed the transfer only to be effective at the moment of death. So IRS position is that this does not work.
   v. There is also a step transaction issue to this planning.
   vi. The JEST endeavors to circumvent the defects of the above 1993 ruling. JEST provides the first spouse has GPOA over part contributed but to extent of surviving spouse's applicable exclusion amount it goes to a trust for descendants so it circumvents 1014(e). This should work and should provide a double basis step up.

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

z. Portability and Marital Agreements.
   i. Identify that there is portability and the election.
   ii. Define who portability executor is. Use a defined term so it covers case of no court appointed executor.
   iii. When spouses have different size estates you should put in a mechanism to have person with smaller estate to make portability election and compensate them for the cost of making the election.
   iv. Conflicts waiver.
   v. Administrative clauses as to how portability executor will act.

1. Require the portability executor to give the surviving spouse a copy of the Form 706 and all attachments (and perhaps state filings as well).
2. Require the portability executor to provide copies of all supporting documentation for the estate tax return.

vi. What if have DSUE amounts from prior marriage? There is a possibility of losing it. Consider if before the marriage to have them use the DSUE before marriage. If they won't do that one spouse will lose the DSUE consider buying life insurance to insure.

vii. For a married couple with no prenuptial agreement consider recommending a post-nuptial agreement addressing just DSUE.

viii. Address in the prenuptial agreement who should pay for the preparation of the return?

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

3. **Monday: Afternoon: Recent Developments: Belcher, Aucutt, Hughes, and Porter-Part 1 – 2704 Proposed Regulations.**

a. Why discuss the 2704 Regs?

i. 2704 addresses an issue that has been around for some time.

ii. 2704 Regulations were aimed at the Harrison case and the Kerr case. *Kerr,* 113 T.C. at 463-64.

iii. Problem aimed at 2704 is real, it bothers the IRS that practitioners can create entities and discount values.

iv. Even if estate tax repeal occurs most practitioners believe that the gift tax will be retained and hence valuation will remain relevant.

v. **Comment**: If Trump's proposed capital gains on death is enacted the value of assets will have to be determined for that purpose. So the issue of discounts would still have to be addressed.

b. Background and Timeline of 2704 Regulations.

i. Harrison case.

ii. 1990 2704 enacted.

iii. 1992 2704 Regulations enacted.

iv. States became estate planner friendly in terms of applicable restrictions that supported discounts.

v. 2003-4 Priority Guidance Plan.

vi. Legislative proposals.

vii. 2009-2012 Obama administration the Greenbook included a proposal about valuation discounts and revenue estimates were quite find tuned suggesting someone had a draft of proposed Regulations.

viii. 2010-2013 Greenbook included items that were reflected in the proposed regulations: Would create an additional category of disregarded restrictions that would be ignored in transfers to family, assignee interests

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

ix. Regulations discussed at professional meetings and in tax press.

x. August 2, 2016 Proposed Regulations issued.

xi. September 21, 2016 House introduced bill to protect family farms and businesses saying that the proposed regulations should have no force and effect and that no federal funds may be used to finalize or support, etc. The bill lapsed.

xii. January 2017 bill reintroduced.

c. **Comment**: See **Planning for the Proposed 2704 Regulations**, by: Martin M. Shenkman, Esq., Jonathan Blattmachr, Esq., Ira S. Herman, CPA, and Joy Matak, Esq., an e-book published by Trusts & Estates Magazine.

d. Purpose.

i. Make 2704 applicable again to achieve its intended purpose.

ii. Since initial publication in 1992 much had changed.

1. Court cases clarified that 2704(b) only applied for purpose of liquidating entire entity: Kerr, Jones, Harper.
2. A non-family owner with nominal ownership defeated family control in Kerr.
3. ULPA – exception that applied if restriction no more restrictive than applicable law was irrelevant because you could not be more restrictive than applicable law.

iii. Want to narrow regulatory exceptions. Lapses are taxable – Harrison Case. Regulations provided an exception. The Proposed Regulations narrow the exception so it does not apply to death bed transfers defined as 3 years within death. IRS new people would question 3-year period. Some have suggested 1 year others have suggested using an annuity definition.

iv. Another example of narrowing regulatory exception is the exception that deals with comparison to local law. Proposal would eliminate that exception. This was a mistake and a different threshold should be substituted.

v. Another approach is to create a new category called "disregarded restrictions" which should be ignored by appraisers in determining FMV. These are provisions that limit a restriction that limits an individual's right to liquidate his or her interest.

vi. Like applicable restrictions the disregarded restrictions did not distinguish generally between cooperative and dysfunctional families, or between operating and non-operating businesses. It was intended to reach artificial bells and whistles that artificially inflated valuation discounts.

vii. Nothing in the proposed regulations is intended to eliminate all minority discounts if regulations become final.

viii. As a response to Kerr the proposed regulations included a provision that would apply to lapses and disregarded restrictions saying the only non-family interest that would be considered is a non-family interest that meets 4 tests:

1. Held more than 3 years

2. At least 10%
3. In aggregate more than 20%
4. Each family owner has a put right

ix. These were intended to assure that this interest was created just before a transfer or that the interest was significant. Goal was to prevent small transfer to a charity that later would be repurchased for pennies on the dollar.

x. **Comment**:
   1. A third party (unrelated) equity holder must have at least 10 percent interest, the aggregate interests of all third parties must be at least 20 percent and those interests have to have been held for three years to be considered.19 For purposes of determining if the family controls the entity, it's irrelevant that a key employee of a family business holds a 15 percent interest in the entity unless the "20% third party test" is satisfied in the aggregate. The regs suggest that any percentage of third party interests will not be relevant if held less than three years prior to transfer.
   2. Example: Taxpayer is diagnosed with a terminal illness and negotiates a succession plan with a key employee, transferring a 25 percent equity interest in the business to her. In the following year, Taxpayer transfers 45 percent of his interests in the business to a trust for the benefit of his children. Since the key employee didn't hold her 25 percent equity interest for at least three years as of the date of transfer of the 45 percent interest to the trust, the third-party test isn't satisfied – even though there was a pure non-tax motive for transferring interests to the key employee and despite the fact that the key employee's interests hold real economic power.
   3. From a practical perspective, most family business enterprises will be precluded from giving equity to a third party or charity in an attempt to bolster restrictions for discounts.

xi. Proposed regulations addressed the fact that at the time the statute was enacted LLCs were hardly used, so the proposed regulations include control definitions for an entity that is not a corporation or partnership. Discussed type of entity you were when created under law; not what box was checked under the check the box regulations.

xii. "imposed or required to be imposed by federal or state law" which is an exception to an applicable restriction has been redefined to exclude a default statute. If you can choose an alternative statute it is not, then imposed or required to be imposed.

xiii. Disregarding an applicable or disregarded restriction means you pretend it does not exist for valuation purposes. When you disregard a restriction that does not mean you assume a fact that was not there, e.g., the put right or minimum value. There is no intent for a deemed put right.

xiv. The transfer to an assignee is a lapse under 2704(a) it is not tested under 2704(b).

xv. Effective date 2704(a) lapses and 2704(b) effective on date of publication. The proposal with respect to disregarded restrictions was 30 days after publication since this is deemed a legislative regulation and it cannot be effective before that 30-day date.
xvi. 3-year rule and lapses. In proposed regulations a lapse was deemed to occur at moment of death. That will be corrected in final regulations so that it will not be made retroactive to someone who made a transfer before the regulations became effective and died within three years.
xvii. The Regulations were not finalized by December 31. They will not be enacted by January 20, 2017.
xviii. Hearing on December 1, 2017. The hearing was 6 ½ hours. 36 witnesses including lawyers, accountants, appraisers, family business owners, owners of franchisees, and representatives of business associations. Many alternatives to the 3-year rule were presented. It was suggested to exclude passive assets and exempting operating businesses from proposal.

e. Targeting passive businesses.
   i. Some commentators express that they viewed the proposed regulations as targeted non-operating businesses. Example, the minimum value is a passive concept. For an operating business that does not really happen.

f. Broad interpretation.
   i. Applicable restriction language. Was in original 2704(b) Regulations. Prior to Kerr IRS felt this could apply to liquidation rights and withdrawal right if more onerous than state law default rule. If ignore language in the governing agreement you look to the state law default rule. Proposed Regulations say it is a restriction to liquidate the entity in whole or part. Look at language in governing documents, if nothing provided for, then look to state law rules. If family using control test can remove this, then ignore it.
   ii. D owns 76% interest and each child owns 12% and agreement requires consent of all partners to liquidate. This is a voting restriction. Requirement that all partners consent is an applicable restriction and since all of the family members can remove it, then it is ignored for valuation purposes. What if agreement requirement is 60% vote and D dies owning 12% interest do you assume the 12% interest carries with it the right to liquidate the partnership? The proposed regulations assume the voting restriction is ignored.
   iii. The notion that the regulation would cause the transfer of a 12% interest to be a lapse of a power that interest never had is problematic.

g. Minimum value and put right.
   i. Proposed regulations create a new level of restrictions on withdrawing from the entity.
   ii. Disregarded restrictions, 4 types:
      a. Limits holder's ability to withdraw either a time restriction (cannot withdraw for 10 years) or a vote (need 60% of vote).

b. Limits or permits limitation of amount that can be received by holder of interest to an amount less than the minimum value. Minimum value means interest share in entity which is the FMV as finally determined under 2031 or 2512 of property held by entity reduced by outstanding obligations. This is the net value of the entity x the ownership interest. Any restriction that prohibits a withdrawing partner from getting less than this minimum value appears to have to be ignored.
c. Limits time or defers payment, e.g., LP can withdraw but must wait one year to get paid proceeds of withdrawal.
d. Payment of portion of redemption proceeds in anything other than property but property excludes notes that might be issued by partners or related parties.

2. What is the disregarded restriction? The features associated with the withdrawal right? Or do you assume withdrawal right doesn't exist. **Example**: LP agreement permits withdrawal and LP to receive FMV of interest. Also says the FLP can pay LP within a year and with a note at AFR over 10 years. FMV of interest is not necessarily minimum value. Can IRS ignore this and assume a withdrawal right at FMV? If you strip all these provisions out, you have effectively a withdrawal right at a pro-rata share of the entity's net asset value.
3. A different view.

h. Appraisers.
   i. Nothing needs to be done now.
   ii. The proposed regulations will affect the standards of value so appraisers will have to work closely with tax advisers to know what to do.

i. Reporting.
   i. After August 2, 2106 some commentators suggest that you should disclose that the position in a valuation report may be contrary to position taken in the appraisals. Must refer to the proposed regulations and say that position was taken contrary to the regulations.
   ii. But this is problematic as there are many different interpretations of the proposed regulations. It may be better to take an expansive view (i.e. that the proposed regs cover it so you disclose the variance from that interpretation) rather than have the IRS later argue that the statute of limitations has not tolled.

j. No reason to make transfers now in anticipation of these Regulations being enacted.

4. **Monday: Afternoon: Recent Developments: Belcher, Aucutt, Hughes, and Porter – Estate Tax Repeal**.
   a. Trump proposals.
      i. Trump proposals could be costly and contentious.
      ii. Trump tax agenda includes repeal of the death tax but subjecting capital appreciation taxable at death over $10M but transfers to private

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

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

c. Congress will have to address increasing deficits.

i. If repeal the estate tax is not large revenue raiser but then allows carryover basis that increases the tax burden.
ii. The income tax was enacted in 1913 and the estate tax in 1916. Neither said anything about basis of assets received from a decedent. In 1921 included a rule for basis of assets at death. 1930 supreme Court decision resolved this. Then as string provisions began to be subject to estate tax issues arose.
iii. Estate tax does not pay for step up in basis.
iv. Step up in basis at death may make sense from a perspective of fairness but it also addresses the lack of Americans keeping record. There is a resistance to carryover basis a no one wants to look back to determine basis.
v. How will they prioritize what is to be paid for?

d. Alternatives to the current system.
i. Canadian system. No estate tax but on disposition of asset there is a capital gains tax. Tie revenue from estates to income tax. Capital gains on gift and death. These could have exemptions onto this structure (e.g. Trump's $10M and special rules for family farms), etc. Under Canadian system still have valuation issues, like 2704. Canadian estate planning focuses on how to reduce valuations and tax free dispositions like life insurance.
ii. An alternative system is make inheritances and gifts and treat it all as income.
iii. Another approach is an accessions tax. The recipient pays the tax. Recipient includes gift or inheritance on income. This moves emphasis from estate to the recipient.
iv. The estate tax is despised.
v. $20B is collected and $19.6B is incurred in costs planning for this.
vi. There is revenue that has to be replaced if the estate tax is repealed.
vii. Tax reform is coming but it is likely to start with businesses. May see many deductions curtailed. Might see large LLCs and corporations pay an excise tax.
viii. Optics are an issue. You have several billionaires in the cabinet.
ix. Basis will be an issue. How will it be addressed in tax reform or repeal?

e. If Estate Tax Repeal Occurs How Long Might It Last
i. Republicans may want tax reform completed by August recess.
ii. Some Republicans think they will get control of the Senate in 2018 and might want to wait to get more through then.

f. What to do?
i. Wait and see, but this may miss opportunities.
ii. What if estate tax is repealed but comes back? So if clients want to shift appreciation you don't want to trigger gift tax so
1. GRATs
2. Sales to IDITs of hard to value assets that is not intended to trigger gift tax is a viable planning option.

3. For gift and sale use a formula clause similar to a Wandry or Petter type transaction selling a dollar value of units as finally determined for federal gift tax purposes. Consider a King type clause.
4. So traditional estate planning techniques that shift appreciation should be considered even in light of uncertainties.
5. Estate freezes.

iii. We had this discussion in 2009. If the client can wait until after we know what is going on we all may be better off. But many clients cannot or do not want to wait.

iv. Point out to clients that you cannot predict what will happen.

v. Flexibility is key.

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

g. **Comment**: There are a number of steps practitions might consider when structuring new trusts in light of possible repeal and a possible capital gains on death:

i. Many of the recipient/donee trusts to be used in the above planning should be structured in a robust and flexible manner to address the uncertainty of future tax legislation. Depending on the size or nature of the transaction, it may be worthwhile to create a new trust or decant an existing trust into a more robust trust to add flexibility that current trusts crafted prior to the prospect of repeal may not reflect. This could include any array of common trust powers, and several less common or new ones. Consider any or all of the following:

ii. Assure grantor trust status.

iii. Include a swap power described in Section 675(4)(C) and draft the language in a sufficiently flexible manner to permit reverse swaps. Under current law it can be advantageous for a settlor to swap highly appreciated assets out of a grantor trust prior to death to include those assets in his or her estate for basis step up purposes. Under a capital gains tax on death regime the inverse of swapping highly appreciated assets into a grantor trust prior to death might prove advantageous. This might provide a mechanism to avoid the capital gains that might be incurred if those were retained. This possibility is another factor to weigh in favor of pursuing planning now.

iv. A broad class of beneficiaries to provide more flexibility in planning distributions and future income tax planning under whatever changes may be enacted. Also consider whether distributions to charities should be permitted.

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

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

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

v. Prior to 1014(f), taxpayers could whipsaw the IRS. This could be done by the executor including an asset, e.g., a parcel of real estate valued using a large discount on the estate tax return. Later, a beneficiary sells the same property after the statute of limitations on estate tax audit has tolled, and takes a different and inconsistent position with what the executor took on the estate tax return. The beneficiary might take the position that the discount was excessive and therefore use a higher value and thus generate a lower capital gains. Courts only imposed a duty of consistency when the beneficiary was the executor. Now under new IRC Sec. 1014(f) there is a duty of consistency.

vi. But the duty of consistency only applies to those who have an estate tax. Thus, for estates below the estate tax threshold or marital property there is no duty of consistency.

vii. Under IRC Sec. 6035 the executor who have to file a federal estate tax return must furnish notice to beneficiaries within 30 days after return is filed. If executor fails to comply there is a $250/failure. Maximum penalty cannot exceed $3M per year. If there is willful failure the penalty is 10% of the amount that should be shown on return. For a $10M estate that is a $1M penalty. 6035 applies to all executors for which a return is filed regardless of the duty of consistency

viii. Temporary regulations were intended to confirm notices of delays for due date. Finalized in December 2nd 2016 confirming June 2016 date for first reports.

ix. Proposed regulations address a number of issues in the statute.
    1. Final estate tax value caps the recipient's initial basis. If heir invested that is not intended to limit overall basis for those improvements, just initial basis.
    2. Consistency requirements apply until its basis in hands of whoever holds it no longer depends on the basis in the hands of the decadent. So if given several times rules still applies.
    3. If subject to debt to you report value net or gross? It doesn't matter for 1014(f) how you report it, it is the gross number
    4. 1014(f) is only taxable property. If there is no estate tax due there is nothing subject to consistency. If tax is due every asset in the estate contributes to that tax liability with the exception of property that qualifies for charitable or marital, household effects that don't require appraisal valued over $3,000, etc.
    5. **<u>Comment</u>**: The de minimus rule is based on the Proposed Regulations excluding items governed by Treas. Reg. §20.2031-6(b) which provides as follows: "Special rule in cases involving a substantial amount of valuable articles.—Notwithstanding the provisions of paragraph (a) of this section, if there are included among the household and personal effects articles having marked artistic or intrinsic value of a total value in excess of $3,000 (e.g.,

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

6. What if you find an asset that was not reported on the return? The basis is zero under the proposed regulations. Not clear how that will be resolved.
7. 6035 reporting requirements affect a much broader universe of property. If only reason you are required to file a return that is not a required return for IRC 6035 so those reporting requirements don't apply.
8. Form 8971 is due to IRS and Schedule A to that form is due to each beneficiary. Idea is that each beneficiary only gets a copy of their Schedule A so you don't have to inform each beneficiary of all estate assets.
9. If distribution is made to a trust the recipient is the trustee. Some comments have suggested giving a choice as to whether you give report to trustee or look through the trust and give it to the beneficiaries.
10. Proposed regulations address life estate and contingent beneficiary.
11. If executor sells no need to report.
12. If not sure who will get which property can list all on schedule A so no need to amend the Schedule A to indicate or confirm that only certain assets received.
13. You must supplement the information on Schedule A if a missing beneficiary is found or there is a disclaimer. Any change that makes the information incomplete. If there is an estate tax audit you must supplement the information. If there is a probate estate or revocable trust you don't have to provide the supplemental filing until 30-days after the distribution.
14. Due date is a big issue.
15. Subsequent transfers were the subject of many comments. If you make a gift of inherited property you have to give a Schedule A to that recipient and file with the IRS so that the IRS will have information to match it against the selling donee.

x. When final regulations are issued forms will again be revised.

xi. Issues.

1. Schedule A indicates that the beneficiary has received property when in fact they may not have been.
2. Beneficiary is getting a list of assets that he or she may receive some or none of.

3. What if beneficiary is a trust that has not been created at the time the form has to be filed so that there may be no tax ID number for the estate.

b. **State Taxation**.

i. New Jersey is only change and repealed estate tax effective 1/1/18.

1. **Comment**: For a detailed discussion of the repeal and planning considerations see: Martin M. Shenkman, Richard Greenberg & Glenn Henkel, "New Jersey Estate Tax Has Been Repealed! What's Next?" Estate Planning Newsletter #2466 (October 19, 2016).

ii. Kaestner.

1. NC taxed trust income solely by virtue of having a beneficiary in NC. Court held that this was unconstitutional. Looked at minimum contacts requirement of due process clause. Basing taxation on state of domicile is constitutional but requires more than just that.

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

2. See Nenno article on web on state taxation. http://www.actec.org/assets/1/6/Nenno_state_nongrantor_tax_survey.pdf

iii. Bank of America Case – MA.

1. How do you determine residence of a corporate trustee?

2. BofA said its domicile and principal place of business were in NC not MA. A person can only have one domicile and a business only one principal place. Court concluded that BofA was an inhabitant of MA as it maintained offices in MA, had administrative activities in MA, etc. Bank of America v. Comr. of Revenue, 2016 WL 3658862 (Mass.).

3. This issue comes up when a trust is about to recognize large capital gains. Does trustee resign to break nexus to a high tax state? If the trustee does not resign is that a breach of fiduciary duty?

c. Priority Guidance Plan.

i. Grantor trust.

1. 1014(a). This will likely restrict position some have taken arguing for basis step-up.

ii. Valuation of promissory notes.

1. 7872 if use required AFR on promissory note it is not a gift.

2. IRS has seen many of these notes and on death the executors are discounting the notes.
3. **Example**: $100,000 note to child and mid-term AFR. For gift tax purposes no gift involved. But for estate tax purposes how do you value the $100,000 note? Appraisers will suggest looking at security, interest rate, child/borrower's credit worthiness, etc. The estate tax regulations say that the only difference in value of the note from the face value is if there was a change in the interest rate from date of issuance to date of death. But this is a proposed regulation has not been finalized and it differs from what appraisers would say.

iii. Defined value formula clauses.
1. Trying to provide clarity.

iv. Spousal support in divorce trust
1. IRC Sec. 682 does not contain definition of income. Is it fiduciary accounting or taxable income?
2. **Comment**: Problem with alimony is former spouses have to interact. So instead put it in a trust. No need for interaction. There are a number of uses: (1) If there is a family business. Example: Wife is 10% owner in family business and cannot give to ex-husband. Perhaps she can put 5% of her interest in an alimony trust and the ex-husband can receive income for term of years then reverts to family; (2) What if one ex-spouse is uninsurable and cannot get insurance? Use alimony trust to guarantee alimony to hold assets since no insurance is feasible; (3) Use an alimony trust to protect an ex-spouse that is not financially sophisticated; (4) Address financial insolvency risk. What if ex-spouse's career is risky? Example, professional athletes. Average NBA $5M earnings 60% broke a few years after retirement. Most professional athletes if there is alimony owed must won't be able to pay it. Use an alimony trust if client is going to get support from a professional athlete so payments will continue if becomes involvement or bankrupt. There is no income tax deduction on set up of an alimony trust. It is a grantor trust but IRC Sec. 682 says not taxed on income distributed to former spouse. Will be taxed directly on income, same character. If trust has $50,000 of income and $100,000 is paid, recipient spouse is taxed only on $50,000 of income. However, it is still not clear what "income" is taxed to former spouse. Is it fiduciary accounting income or taxable income? This issue is on IRS priority guidance plan. Define in trust instrument what income shall be defined at. Might also say that if IRS changes rule former spouse will reimburse for tax payments made.

v. Loan guarantees and impact of discounting to present value.
1. Regulations should be issued soon.

vi. Proposed regulation uniform definition of a child under IRC Sec. 152.

vii. Final regulations on carryover basis in 2010.
viii. 6166 Proposed Regulations.
1. Key issue is security.
2. Trying to replace existing regulations which were applied to former 6166.
ix. Material participation of trusts and estates.
1. IRC Sec. 469.
2. More important due to Medicare Surtax.
x. Private trust companies are still in the hopper but dropped off this list.

d. PLR 201634015
i. Son is beneficiary of trust set up by parents and has right to appoint whatever is in trust but even though the trust called it a GPOA it is a LPOA.
ii. Reformation to make it a LPOA and wanted IRS to respect that the GPOA was not released/converted to a LPOA.
iii. IRS said no since court said under state law they could correct for scrivener's error so no release of a GPOA.
iv. Key to securing ruling was that the state court said it was a correction of scrivener's error. This was not a modification of the trust by agreement. The correction was effective from inception.

e. Woelbing Case.
i. Pair of Tax Court cases settled in 2016 on favorable terms for the taxpayers. 2006 sale of non-voting stock to a trust for a note. A typical installment sale to a grantor trust. The trust had sufficient seed capital based on the 10% test some speak of. The seed was based on life insurance policies with significant cash value. The sale was subject to a defined value mechanism that caused the shares to adjust based on the final gift tax value. Mr. Woelbing died in 2009. IRS asserted gift tax deficiencies against both Mr. and Mrs. W based on her gift splitting.
ii. For gift tax.
1. 2702 IRS asserted retained interest should be valued at zero and treated all shares as transferred by gift.
2. IRS transferred value of the gifts.
iii. For estate tax.
1. Because the note was a form of retained interest then the full value of the trust on the date of his death should be included in his estate under 2036.
iv. IRS Settled in 2016 with Mr. W's estate but Mrs. W's estate remains open.
v. The fact of no change suggests that the IRS accepted the defined value clause so fewer shares should have been transferred because of the adjustment mechanism. So those shares would be transferred on Mr. W's death to Mrs. W as marital deduction.
vi. Mrs. W died in 2013.
vii. There may have been a part of the settlement an agreement to include those shares in Mrs. W's estate.

viii. You cannot cite a settlement as precedent but IRS could have pursued the defined value clause in the Woelbing but they did not.
ix. Estate of Donald Woelbing v. Commr., Tax court docket No. 30261-13.

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

g. Estate of Johnson v. Commr. Tax Court Case No. 11708-16.
    i. SCIN.
    ii. Requires premium on interest or principal.
    iii. In Johnson there was a principal premium because of back-loading of payments.
    iv. The estate reported gain on the cancellation of the note on the decedent's final income tax return not on the estate's first income tax return generating a debt deduction. The IRS disagrees with this approach.
    v. Similarities to Davidson case with an aggressive SCIN and IRS assessed a significant deficiency. Malpractice case is on appeal.

h. FLP Cases.
    i. Estate of Purdue v. Comr., TC Memo 2015-249.
        1. The IRS challenged the transfer of assets to the FLP as not meeting the adequate and full consideration requirement. They also challenged gifts of FLP interests as not meeting the preset interest requirement.
        2. Marketable securities were owned in separate accounts managed by different firms. There was also an interest in a net leased rental property.
        3. The business purpose argued by the taxpayers was consolidation of assets and aggregation to meet qualified investor requirements.
        4. The Court held for the taxpayers noting no commingling of personal and entity assets, assets were properly transferred to the entity, the entity formalities were adhered to, taxpayers were in good health when the entity was created.
        5. The case also involved a Graegin loan which was upheld even though there were assets outside the entity that might have been used to pay estate tax.
            a. **<u>Comment</u>**: Under the current tax regime where maximization of income tax basis is so important, planning may more often than in the past retain the non-marketable assets that will benefit from a step up in income tax basis, e.g., depreciable real estate, family business interests, etc. and transfer assets not as likely to benefit from a basis step up (e.g., life insurance, or borrowings on the appreciated assets). This can shift value out of the taxpayer's estate and

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

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

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

iv. All three cases involved marketable security LLCs or FLPs but "nature of assets is not predictor of failure."

v. In Holliday and Beyer taxpayers failed to respect the entity itself. In Beyer made distributions to trust that no longer owned interests. Failure to respect formalities of entity created was the downfall.

i. Rev. Proc. 2016-49.

i. **Comment**:
1. The executor of an estate electing portability of the decedent's unused applicable exclusion amount (deceased spousal unused exclusion amount, or DSUE amount) may wish to make a QTIP election without regard to whether the QTIP election is necessary to reduce the estate tax liability to zero.
2. Before "portability" the IRS issued a ruling to help taxpayers. Perhaps taxpayers and advisers have been skeptical that the IRS would just be a nice guy, so advisers worried about how that old "nice IRS" ruling might interact with the new concept of portability. Rev. Proc. 2001-38, 2001-24 I.R.B. 1335, provided a procedure by which the IRS will disregard and treat as a nullity for

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

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

j. Morrissette v. Comr.

   i. Morrissette v. Commr., 146 T.C. No. 11.
   ii. Used economic benefit not loan regime.
   iii. On mom's death issue is what is the value of the receivable? Mom gets repaid with intergenerational life insurance until children's death. The valuation of the receivable at her death was about $7.5M on the $30M premium paid.
   iv. **Comment**:

      1. In a private economic benefit split-dollar arrangement, the ILIT typically pays only the term cost of the life insurance, which is modest in the early years of the arrangement. Another party, such as a family member (often the insureds) or a family trust [e.g., an existing funded marital (QTIP) or dynasty trust] pays the remaining portion, which is typically the bulk of the insurance cost in the early years of the arrangement. This arrangement can substantially reduce the amount of current gifts the donor/insured is required to make to the ILIT to purchase the insurance, but nevertheless can assure that the insurance proceeds are removed from the donor/insured's taxable estate
      2. 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. 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. There was, however, also a non-tax reason for the split-dollar

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

3. See:

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

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

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

v. French v. Commr., TC Memo 2016-53 – get bank consent which is required for an easement.
vi. Payne v. Commr. TC Summ. Op. 2016-30– Donated personal property and claimed $170,000 deductions for personal property but the taxpayer presented no meaningful corroboration for the contribution. IRS found no credibility to corroboration. Penalty imposed.

n. Conservation easement cases.
   i. Adding restriction to prohibit change in use of property without consent of charity holding the covenant.
   ii. Large income tax deduction FMV at highest use minus FMV at current use.
   iii. IRS fully inspects these and requires all details of formalities be complied with. Must follow the formalities.
   iv. Notice 2017-10 issued Jan 3rd. It is not a listed transaction if after 2009 there is a syndicated partnership where the promotional materials promise charitable deduction more than 2.5 times what was invested.

o. Uniform Acts.
   i. FL Senate Bill 206 permit persons to execute wills on line without a lawyer or witnesses. Witnesses can be satisfied by Skype or other webcam presence.

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