NAEPC
Journal
of Estate & Tax Planning

Click here to view Issue 25

Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2484

Date: 01-Dec-16

From: Steve Leimberg's Estate Planning Newsletter

Subject: **Marty Shenkman's Notes from the 42nd Annual Notre Dame Estate Planning Institute – DAY ONE OF TWO**

The **42nd Annual Notre Dame Tax and Estate Planning Institute** was held on **October 27th and 28th** at the **Century Center** in South Bend, Indiana. Members should click this link to review the meeting agenda: 42nd Annual Notre Dame Tax and Estate Planning Institute**.**

In addition to estate planning topics for high net worth individuals, this year's Institute featured a regulatory update discussing the proposed valuation discount regulations under Section 2704. Topics As in the past, we clustered related topics together so that continuity can be enhanced. Of particular interest was the Thursday afternoon cluster on the use of trusts, culminating in a panel discussion on the three prior trust topics. A similar cluster dealt with charitable planning.

Over the course of many years, **LISI** has been delighted to provide members with **Marty Shenkman**'s notes from the proceedings at the **Heckerling Institute on Estate Planning**. Marty was a speaker at the **Notre Dame Tax and Estate Planning Institute** and has graciously agreed to share his amazing meeting notes from the sessions with **LISI** members.

Martin M. Shenkman, CPA, MBA, PFS, AEP, JD is an attorney in private practice in Fort Lee, New Jersey and New York City who concentrates on estate and closely held business planning, tax planning, and estate administration. He is the author of 42 books and more than 1,000 articles. Marty is the Recipient of the 1994 Probate and Property Excellence in Writing Award, the Alfred C. Clapp Award presented by the 2007 New Jersey Bar Association and the Institute for Continuing Legal Education; Worth Magazine's Top 100 Attorneys (2008); CPA Magazine Top 50 IRS Tax Practitioners, CPA Magazine, (April/May 2008). His article "Estate Planning for Clients with Parkinson's," received "Editors Choice Award." In 2008 from Practical Estate Planning Magazine his "Integrating Religious Considerations into Estate and Real Estate Planning," was awarded the 2008 "The Best Articles Published by the ABA," award; he was named to New Jersey Super Lawyers (2010-15); his book "Estate Planning for People with a Chronic Condition or Disability," was nominated for the 2009 Foreword Magazine Book of the Year Award; he was the 2012 recipient of the AICPA Sidney Kess Award for Excellence in Continuing Education; he was a 2012 recipient of the prestigious Accredited Estate Planners (Distinguished) award from the National Association of Estate Planning Counsels; and he was named Financial Planning Magazine 2012 Pro-Bono Financial Planner of the Year for his efforts on behalf of those living with chronic illness and disability. In June of 2015 he delivered the Hess Memorial Lecture for the

New York City Bar Association. His firm's website is www.shenkmanlaw.com where he posts a regular blog and where you can subscribe to his free quarterly newsletter Practical Planner. He sponsors a free website designed to help advisers better serve those living with chronic disease or disability which is in the process of being rebuilt: Chronic Illness Planning

Because of the length of Marty's commentary, **LISI** has made his notes available to members through the following links:

- 42nd Annual Notre Dame Tax and Estate Planning Institute- Day 1

- 42nd Annual Notre Dame Tax and Estate Planning Institute- Day 2

Important Reminder: Join Marty and **Jonathan Blattmachr** for a free webinar titled **"Estate Tax Repeal Is Not a Temporary or Permanent Certainty: How to Plan Now"** on Mon. Dec. 12, 2016, from 1:00 PM - 2:00 PM EST. Sponsors: Peak Trust Company and Interactive Legal

President-elect Trump has proposed repealing the estate and gift tax. The Republicans control both the House and Senate so might this be a possibility? While many advisers say it can never happen, none of the pundits anticipated a Trump victory either. The better approach is to consider what repeal of the estate tax might mean, how it would affect clients with estate planning that is in process now, and how it may affect clients in the future. Many taxpayers have begun to vigorously pursue estate planning strategies out of concern that proposed valuation discount restrictions (Proposed Regulations under IRC Sec. 2704) might become law. What should be done with these plans? In many, perhaps most, cases, planning should continue, but perhaps with some "tweaks." Could the gift tax be repealed? How might that affect planning? What about the proposed capital gains tax on death in lieu of an estate tax? If the gift and estate tax were repealed tomorrow what should you do? How might will, trust and power of attorney drafting be affected?

To register for Marty and Jonathan's webeinar, simply click on the following link:

- https://attendee.gotowebinar.com/register/3707450233736758787 Webinar ID: 312-645-547, Access Code: 940-251-711 After registering, you will receive a confirmation email containing information about joining the webinar.

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

Marty Shenkman

42^{nd} Annual Notre Dame Tax & Estate Planning Institute
Notes from Day 1 of 2
By: Martin M. Shenkman

1. **Jeff Pennell - Current Developments**.
   a. **Comment.**
      i. Professor Pennell announced at the Notre Dame presentation that he is "retiring" from the travel/lecture circuit shortly. That will be a loss for us all. Few presenters convey the breadth and depth of information in a presentation that Professor Pennell has. Even fewer with the clarity and precision that he does. He has challenged our views on the law and planning, and is willing to take views contrary to those that may be held by other practitioners, and as such has been incredibly valuable to all of us. I've often changed how I practice as a result of insights from his presentations. His lectures will be missed.
   b. Revenue Procedure 2016-55 - Inflation adjustments.
      i. $5,490,000 is the 2017 basic exclusion amount.
      ii. Annual exclusion remains $14,000.
      iii. Annual exclusion IRC Sec. 2523(i)(2) for $149,000 for non-citizen spouse.
      iv. IRC Sec. 1(e) $12,500 trust in maximum bracket.
   c. CRUT Calculations.
      i. PATH Act Sec. 344 amended 664(e). See Priority guidance plan.
      ii. Unitrust must have minimum 5% payout. The greater of the stated percentage or 5% must be used. You may also provide a make-up provision so in a future year if there is excess income you can make up deficiency from prior years. NIM-CRUT.
      iii. Estate of Schafer v. Comr., 145 TC NO. 4 (2015) involved termination of a CRUT. On creation the remainder was valued lower by ignoring the net income cap In Schafer annual payout was 11% which would never be met because of net income cap. Taxpayer wanted to use 5% cap when calculated remainder. IRS argued no, ignore cap.
      iv. If trust is terminating and paying off lead beneficiary/charity, or in tradition CRT paying off lead beneficiary and remainder a charity, how do you calculate respective portions of commutation when you terminate?
      v. Valuation is relevant at times, such as determining the lead and remainder interests for charitable deduction purposes. Should the net income limitation be reflected when determining the lead interest and the remainder interest? Taxpayer wanted to maximize the value of deduction and argue value of remainder is greater. So taxpayer said the net income limitation will reduce amount taxpayer is paid during the lead interest and that this limitation should be considered. Valuation of deduction it is clear you ignore the limitation in determining contribution deduction.

vi. Remainder must have a minimum 10% value. That requirement must be satisfied. Schafer case dealt with unusual fact situation. Two trusts with payouts of 10% and 11% respectively, each with a net income limitation. Remainder interest was below required 10% remainder. Taxpayer said you should consider restriction on lead interest in order to evaluate the 10% test. Taxpayer said that they met the 5% requirement but court said rule is that you ignore the limitation just as you would if you valued the deduction itself.
vii. IRS had been inconsistent in how it mandated these calculations be made.
viii. But if you terminate trust and divide between charity and taxpayer you have to respect the limitation which increases what charity gets. These positions are inconsistent. Must apply consistent rules and ignore net income cap at creation for 10% test, and now also ignore it when determining the termination distribution. Thus the lead interest is calculated in the same manner on creation and termination.
ix. PATH Act dealt with issue at termination of charitable remainder trust. Holder of lead interest may gift lead interest to charity thereby accelerating the remainder interest. Alternatively both the lead individual interest, and the charitable remainder interest, may sell to third party.
x. IRS has argued that you must reflect the income limitation that would reduce the value of the income interest. This meant the deduction on giving income interest to charity would be smaller. PATH Act said ignoring limitation for deduction but consider it down the road should be eliminated. Thus, the PATH Act requires consistency in all situations. So now if you terminate a CRUT early the lead interest would be worth more. You now value the lead interest at formation and termination.

d. Priority guidance plan includes guidance on the valuation of promissory notes for transfer tax purposes. This was newly added in 2015 perhaps as a result of the Davidson case.
e. Aggregation.
i. Estate of Pulling v. Comr., TC Memo 2015-134. The aggregation argument advanced by the IRS in Pulling may have relevance to the concepts in the proposed 2704 regulations. IRS argued real estate in FL should be aggregated to real estate next to it owned by a family FLP which was not controlled by the decedent but which was owned by family members. IRS wanted to say decedent and family controlled adjacent property and that because of this control it should be presumed that the decedent’s property had access to a road on that adjacent property and this increased the value of the decedent’s otherwise landlocked parcel. The Court said Congress has authorized family aggregation in some places but not this.
ii. This is relevant to the proposed 2704 Regulations which have a family aggregation aspect to them.
iii. According some commentators, the 2704 Regulations are an intentional effort to advance the family aggregation in a manner that was unsuccessful in Pulling.

iv. The IRS is aware that Rev. Rul. 93-12 "gives away the store" and they are trying to walk it back.
    1. Comment: Even if the Trump proposal to repeal the estate tax is enacted, valuation rules, and the aggregation concept, may still have relevance. If the Trump plan incorporates a capital gains on death (similar to the Canadian system) or perhaps even a capital gains on gift (which some have suggested) how will those assets be valued absent actual sales? If they are to be valued some of the same complexities we face today in determining value may remain relevant.

f. FLP cases.
    i. Three recent cases.
        1. Estate of Purdue v. Comr., TC Memo 2015-249.
            a. 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.
            b. Marketable securities were owned in separate accounts managed by different firms. There was also an interest in a net leased rental property.
            c. The business purpose argued by the taxpayers was consolidation of assets and aggregation to meet qualified investor requirements.
            d. 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.
            e. 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.
                i. **<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.
        2. Holliday v. Comr., TC Memo 2016-51.
            a. 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.

b. 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.
c. The entity did not keep books and records. The formalities of the entity were ignored in making distributions, etc.

3. Estate of Beyer v. Comr., TC Memo 2016-183.
    a. 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.
    b. 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.

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

iii. 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.

iv. **<u>Comments</u>**:
    1. Ignoring the formalities of an entity or transaction seems to be the Achilles heel of so many plans. Yet clients seem so inclined to let this happen thereby undermining their planning. Too many clients believe that once the documents are completed/signed they are done with their planning and they simply fail to return to let the advisers that crafted the plan help administer it. Consider including in your engagement letter/retainer agreement a warning that if clients do not return of annual reviews that their planning will not work. Caution clients in correspondence that they must address formalities of administration post signing for planning to have any likelihood of succeeding. The failure to administer plans properly is also a failure of the planning team to collaborate. If the client does not return to the estate planner on at least an annual basis to review administration and operation of the entities, trusts and other plan components, CPAs preparing income tax returns should warn the clients of how vital this is. Wealth advisors managing assets that might be part of the plan should do likewise. If all advisers

sang the mantra of annual or more frequent meetings so all advisers can assist in plan administration perhaps more clients would hear the message repeated in several of the cases above.

2. The short time periods in the Holliday case are reminiscent of so many other cases in which taxpayers and practitioners seem to ignore the step-transaction doctrine. This doctrine is not only vital to planning FLP/LLC transactions but too much of the 2704 planning wave (which might turn into a trickle in light of Cathy Hughes comments discussed later in this outline) it is worth examining this doctrine as a reminder to all.
3. Consider the compressed time frames in the Kite case and the impact that time frame had on the results: March 28, 2001 distribution of FLP interests from the QTIP and March 30, 2001 sale for a deferred private annuity.
4. The IRS has often raised the step-transaction doctrine in the context of family partnership transactions wherein taxpayers are endeavoring to use FLP or LLC structures to create discounts. See, e.g., Senda 433 F. 3d 1044; Shepherd v. Commr. 115 T.C. 376 (2000), aff'd 283 F. 3d 1258 (11th Cir. 2002). In Pierre II, the Court held that the various steps were all part of a single transaction structured as separate steps to reduce gift tax. Pierre II, 999 T.C.M. (CCH) 1436.
5. However, the applicability of the doctrine is far broader. A number of cases have addressed the application of the step transaction doctrine: Linton v. US, 638 F. Supp. 2d, 1277 (W.D. Wash. 2009); Heckerman v. U.S., No. CO8-0211-JCC, 2009 WL 2240326 (W.D. Wash., July 27, 2009); Pierre v. Comm'r. 99 T.C.M. (CCH) 1436 (2010). The Linton court focused on the crafting of a scheme that consisted of pre-arranged parts of a single plan. The court found that the interdependence test was met because the taxpayers would not have undertaken one or more of the steps without the other integrating acts. The Linton court also noted that the existence or nonexistence of real economic risk of a change in asset value during the time period between steps is determinative of whether the step transaction doctrine will apply.
6. Endeavor to structure transactions so that there can be a real economic risk during the interim steps of any plan. Can the value of marketable securities fluctuate during an interim period creating the potential for real economic loss? If a major customer or vendor ceased doing business might that impact the value of the assets while held?
7. In determining the applicability of the step transaction doctrine, one or more of three tests are often considered, as follows:
    a. Binding Commitment Test: This test is triggered if there is a binding commitment from the outset to undertake each

component or step in a plan. Penrod v. Comm. 88 T.C. 1415 (1987).

b. End Result Test: If the IRS can demonstrate that the various steps are really pre-arranged parts of a single transaction that are intended from inception to achieve a particular end result.

c. Mutual Interdependence Test: Each possible step involved is evaluated to ascertain whether steps are meaningless unless all other steps occur. The instant transaction seems to be comprised of steps that can each have independent viability. So, while this test might be problematic, it might be feasible to minimize, though not eliminate, the risk of its application.

g. Marital Deduction and portability.

   i. Rev. Proc. 2001-38 was a taxpayer friendly marital deduction leniency that nonetheless raised worries amongst practitioners in light of the later enactment of portability.

   ii. Revenue Procedure 2016-49 was enacted to provide assurance to taxpayers about an issue that many have pondered. The new Rev. Proc. addresses portability and QTIP elections. Rev. Proc. 2016-49 supersedes Rev. Proc. 2001-38 but does not change availability of taxpayer relief.

   iii. The facts or situation is that a taxpayer made a QTIP election by mistake. And wanted to "undo" the QTIP election that was not needed. The IRS permitted this in Rev. Proc. 2001-38 so that it enabled the estate avoided no inclusion in estate of surviving spouse.

   iv. **Comments**.

      1. Advisers worried whether the Rev. Proc. 2001-38 procedure to void and nullify QTIP elections provided as a kind gesture by the IRS in Revenue Procedure 2001-38 going to make it questionable as to whether a taxpayer living in a portable world could make an otherwise unnecessary QTIP election to maximize the available unused estate tax exclusion amount, i.e., to maximize the DSUE.

      2. 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.

      3. Example: Husband dies with $2 million estate. There is no need to make a QTIP election (i.e., to qualify the estate for the estate tax marital deduction) because there will be no estate tax on a $2 million estate (assuming that most of husband's exemption was not used before he died for gifts). Nonetheless, the executor of husband's estate might wish to make a QTIP election on the entirety of the $2 million since by qualifying the entirety of the estate for the marital deduction the surviving wife can preserve the entirety of the husband's $5 million inflation adjusted exemption.

The surviving wife might wish to do this “just in case.” She might worry that a future Congress might reduce the exemption amount and that this might preserve (grandfather) it. She might have substantial assets in her own name.

4. The revenue procedure treats as void QTIP elections made in cases where all of the following requirements are satisfied: (1) The estate’s federal estate tax liability was zero, regardless of the QTIP election, based on values as finally determined for federal estate tax purposes, thus making the QTIP election unnecessary to reduce the federal estate tax liability; or (2) The executor of the estate neither made nor was considered to have made the portability election as provided in § 2010(c)(5)(A) and the regulations thereunder.
5. What are the consequences if the QTIP election is treated as void? The property for which the QTIP election is disregarded will not be includible in the gross estate of the surviving spouse under Code Sec. 2044, and the spouse will not be treated as making a gift under Code Sec. 2519 if the spouse disposes of part or all of the income interest with respect to the property. Finally, the surviving spouse will not be treated as the transferor of the property for generation-skipping transfer tax purposes under Code Sec. 2652(a).

h. PLR 201515004.
   i. Had all income general power of appoint IRC Sec. 2056(b)(5) marital trust and inadvertently made a QTIP election when did not need to since a (b)(5) marital deduction is automatic and no election needed.
   ii. The QTIP election was unnecessary as the power of appointment trust automatically qualifies for a marital deduction without any election.
   iii. Why are they pushing this on the QTIP election? Because before spouse dies spouse can relinquish life estate in the power of appointment and accelerate the remainder. If you do that in a QTIP this would trigger Sec. 2519 and they wanted to avoid a 2519 trigger. Taxpayer wanted to be under 2514 as there will be consideration and there is an offset, under 2519 there may not be any offset.

i. Redstone case.
   i. Estate of Redstone v. Commr., 145 C No. 11 (2015).
   ii. Son Edward litigated against his father Mickey. Brother agreed to transfer some of stock in family business to children in exchange for which father agreed to give a share of ownership of the company. IRS asserted Edward made a taxable gift to his children. The IRS Lost because of consideration offset – Edward made the transfers to settle litigation.
   iii. Consideration to avoid gift tax does not need to come from the donee. Edward gave stock to his kids in exchange for stock from his father. That was the consideration that avoided the gift tax to Edward. If settlement of the litigation results in a gift from dad and a transfer to kids the offset reduced the gift.

iv. But the father did make a gift that should have been subject to gift tax. No return was filed in 1972 so the statute of limitations did not run. Not clear if IRS is opening his estate for this.

   1. **Comment**: If Trump repeals the estate and gift tax (it is certainly unclear that even if the estate tax were eliminated whether or not the gift tax would also be eliminated in light of the gift tax serving as a backstop for the income tax) what becomes of issues like this? What becomes of the audits in process? If the transfer tax system in its entirety is repealed what happens to all the current 2704 transfers in process? Might current transactions be structured in a manner that permits estate inclusion if the tax is repealed?

j. Davidson litigation and controversy pending with estate suing Delloite tax for failed SCIN transaction.

   i. ILM 201330033.

   ii. Sale to a defective grantor trust for a note that was structured as an interest only balloon payment SCIN.

   iii. The tax adviser billed over $5.2M in fees.

   iv. **Comments**: Is the linkage of the components of the plan advisable? The facts in Davidson in short are: Age 86 with $2B+ net worth. Did series of sales to trusts for SCINs. To have a FMV on sale for SCIN must incorporate either a premium on the interest rate or a premium of the note principal. Mr. Davidson did sales to trusts for SCINs and contributed the notes to GRATs with 5 year term. The GRAT will return property to grantor at FMV of gift plus 7520 rate of about 2%. One note had 13%+ premium. If he died before note due it was gone/cancelled. If he lived, the GRAT reduced the value of the note gifted to the GRAT. Mr. Davidson died 50 days after the transaction. IRS said you cannot use mortality tables. Taxpayer said they could as had physicians stating he had more than 50% likelihood of surviving. The IRS also said mortality tables could not be used for SCIN. Note that in Davidson the steps on the transactions were largely completed within one month's time with several steps on a single date. See comments above concerning the step-transaction doctrine.

k. Morrissette v. Commr. 146 TC 11 (2016).

   i. Private split-dollar. Mom paid premium for insurance on children's lives. Insurance policies financed buy sell agreement between children. The insurance is split dollar. Mom funded the premiums via a loan and on maturity (death of children) mom gets repaid the greater of the cash value or premiums she paid. Transfer is not a gift because she has the receivable, i.e. she gets paid back her loan when a child dies.

   ii. Mom paid $30M in premiums.

   iii. Mom's estate claimed that the value of the split-dollar loans receivable were only worth $7.5M.

   iv. Where did the value go? Why the difference in value? Some explain that the future payment is discounted to present value. Pennell says this is not the "accurate reflection." When the valuation of the receivable is resolved the primary reason the receivable is worth less is the initial startup cost of the policy. So in early years there is a "hit" to cash surrender value due to commissions, mortality risk, etc.

v. Estate of Levine v. Commr. Docket No. 9345-15 was dismissed on the basis that the Morrissette holding would control.

vi. **Comments**:

1. The IRS made several arguments in the case. The first was argued that the entire $30 million transfer was a taxable gift. It assessed gift taxes and penalties totaling more than $15.5 million. The taxpayer, Morrissettes's, position was that this was a split-dollar arrangement and the only gift was the unreimbursed "economic benefit cost" was a gift each year, and therefore the amount of taxable gift was very modest.
2. This type of split-dollar loan transaction, in which an older person advances money to a trust to pay the premiums for a life insurance policy on a child under a split-dollar loan arrangement are commonly used in estate planning. Many practitioners, commentators, and appraisers view the valuation of the note differently than the comment above. The split-dollar loan receivable is not payable until the child's death which could be decades off and is a time uncertain. The value should be based on a "fair market value" as the appropriate measure of value. This receivable should therefore be discounted to reflect these factors. The values determined by an independent appraiser may result in the parent/lender's estate is often greatly reduced when the parent dies before the child.

l. Proposed Sec. 2801 Regulations.

i. If an expatriate or former US citizen or resident makes a gift the transferred is subject to a tax.

ii. Prop. Treas. Reg. Sec. 28.2801-1-7 addresses how these transfers must be reported.

iii. Treasury estimates that only 1,000 taxpayers may be affected.

iv. These rules may apply if:

1. A US citizen or resident receives a "covered gift or bequest."
2. The transferor had a 5 year average income tax liability in excess of $124,000 or a net worth of $2M, etc.
3. The transfer exceeds the annual gift exclusion.
4. The transfer is not subject to one of several exceptions provided for.

v. **Comment**: If Trump repeals the estate tax and perhaps even the gift tax would this inheritance-like tax under IRC Sec. 2801 remain in the law?

m. IRC Sec. 1014 and 6035.

i. Prop. Treas. Reg. Sec. 1.1014-10 and 1.6035-1 were issued March 2, 2016 to provide guidance on the basis consistency rules.

ii. **Comments**:

1. There is no need to report cash or IRD items. Proposed §1.6035-1(b) defines the property to be reported on an Information Return

and Statement(s) as all property included in the gross estate for Federal estate tax purposes with four exceptions: cash (other than coins or paper bills with numismatic value); income in respect of a decedent; those items of tangible personal property for which an appraisal is not required under §20.2031-6(b); and property that is sold or otherwise disposed of by the estate (and therefore not distributed to a beneficiary) in a transaction in which capital gain or loss is recognized.

2. §1.6035-1(b)(1)(iii) excludes tangible property for which an appraisal is not required under Treas. Reg. Sec. 20.2031-6(b). Articles having a value of less than $3,000 can be excluded from the basis consistency requirement and reporting.

n. CRATs.
   i. CRATs to qualify cannot fail an exhaustion test that the charitable remainder beneficiary should receive 10%. Rev. Rul. 70-452, 1970-2 CB 199. With interest rates so low that it is impossible to structure a CRAT to meet this requirement unless the taxpayer is at least age 72 (based on a 1.8% 7520 rate).
   ii. The IRS has provided some leniency to make it feasible to structure CRATs in a low interest rate environment. If the next annuity payment would reduce the trust corpus below 10% of the initial value that remainder is paid to the charity and the trust terminated. Rev. Proc. 2016-42.

o. State taxation of trusts.
   i. Kaestner Family Trust.
      1. 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. Must purposefully avail yourself of benefits of state to be subject to tax and in this type of fact pattern the trust had not done so.
   ii. Bank of America v. Comr. of Revenue, 2016 WL 3658862 (Mass.).
      1. The trust was created by a Mass. Grantor but the question was whether the corporate trustee was an "inhabitant" of Mass. Because the corporate trustee had 200+ offices in Mass, and conducted trust administration activities in Mass, made it a Mass "inhabitant" even though its corporate headquarters and principal place of business were in North Carolina.
   iii. **Comment**: When CPAs prepare income tax returns they should be careful to inquire as to the residence of trustees. With such a mobile population it may not be safe to assume that the trustees reside in the same state. It is unlikely that clients give much thought to where they live or where family

appointed trustees live or move. One idea (see Comments by Al King later in this outline) to address jurisdiction over fiduciaries or other persons is to have an LLC formed that holds certain fiduciary and other functions. Query that if that concept expands how it will impact state taxation.

p. Wyly case.
    i. In re Wyly, 2016 WL 3098200 (Bankr. ND Tex).
    ii. SEC fraud case that forced Wyly brothers into bankruptcy. Two decisions dealing with offshore allegedly grantor trusts.
    iii. IRC Sec. 674 deemed control Wyly brothers had over the trust.
    iv. Bankruptcy Court in Texas. IRS is party as there is a large tax deficiency against the bankrupt estate.
    v. The Southern District of NY has walked back the opinion with respect to vanilla income tax grantor trusts. Bankruptcy Court in Texas is saying that the arrangements are not trusts and are a mere sham or façade and the alleged grantors are just agents acting as puppets for Wyly brothers. Therefore the implications for day to day grantor trust rules should not be "a big deal."
    vi. **Comments**: While the concerns Wyly initially created for practitioners may have calmed some lessons remain. The concept of a pattern of conduct is problematic in so many situations. Clients so often do not understand the need to meet annually with legal counsel. Identifying inadvisable (or inappropriate) patterns of payments, investments, etc. is something that may well come up with periodic reviews.

q. IRC Sec. 678.
    i. IRC Sec. 678. Example - Give beneficiary power over a trust to cause beneficiary to get taxed as if the grantor.
    ii. PLR 201633021 - Section 678 - Person Other Than Grantor Treated as Substantial Owner.
    iii. Not told what makes it subject to 678. Deals with decanting. Trust 1 made a transfer of all assets to Trust 2. PLR says the deemed grantor of Trust 1 becomes the deemed grantor of Trust 2 even though Trust 1 created Trust 2.
    iv. Treas. Reg. Sec. 671-2(e)5. Deemed grantor identity does not change. What are the implications?
    v. IRS states that losses of the trust offset gains of the trust but if losses exceed gains the excess losses do not flow out to the deemed grantor. Typical description of grantor trust is that the trust tax consequences flow to grantor and that is not true and this is confirmed in the PLR.

r. In Terrorem Clauses.
    i. In Terrorem clauses have been the subject of a lot of activity relating to whether these clauses work. Almost without exception in recent cases courts have routinely said they do not work. The exception to that is if the action was found to be brought without reasonable cause.
    ii. If court finds that there was a legitimate cause of action, even though you lose, that legitimate litigation prevents in terrorem clause from becoming operable. Courts are in the business of doing equity and weighing

credibility of evidence and an in terrorem clause denies us the ability to perform that function.

iii. Estate litigation is exploding. You would think courts would welcome these clause but they do not. Courts have expressed concern over the possibility of a perpetrator inserting a no-contest clause in a will to hide a undue influence issue.

iv. The Uniform Probate Code (UPC) provides that a provision in a will purporting to penalize an interested person for contesting the will relating to the estate is unenforceable if probable cause exists for institution proceedings.

v. Parker v. Benois, 160 So. 3d 198 (Miss. 2015) held the in terrorem clause void as against public policy and noted that the courts exist to determine the truth.

vi. **<u>Comments</u>**: The explosion of court activity concerning In Terrorem clauses might suggest that other options might be considered. Inter-vivos transfers, especially to irrevocable trusts, might deflect later challenges. If the trusts are in place for many years before death and are part of a consistent and clear pattern they may be even more difficult to challenge. The dispositive scheme may also be confirmed while the testator is alive and can serve as a witness. Several states have enacted pre-mortem validation statutes to permit just this type of action. The interested parties are given notice of the existence of the testator’s will, trust or other dispositive document. Those persons are given a specific period of time in which they can challenge the validity of the document they were notified about. If they do not bring an action contesting the validity of the document within the specified time they are barred from bringing a claim in the future.

s. Binding Arbitration.

i. Another approach is to require binding arbitration. We are finding that courts are holding that binding arbitration provisions are also invalid. One off application of this is an elder law case. KY Supreme Court decision said holding of durable POA did not have authority to agree to a binding arbitration provision in a nursing home admission agreement. The agent did not have the power to weight the fundamental right to a trial by jury.

ii. Department of Health and Human Services issued final regulations to any nursing home that receives federal money. These regulations say that binding arbitration in nursing home agreements is invalid as a contract of adhesion.

t. State law developments. Relevant to planners and drafters everywhere.

i. Drafting flaws.

1. Issues have arisen interpreting the intent and application of class members in a class gift. If one person in that class is not alive to take what do you do with the share they would have received if they had been living? Does it go to other class members or does state anti-lapse statute apply?

2. If leave an estate to 3 children equally anti-lapse statute says child's descendants stand in deceased child's shoes instead of other siblings taking. But how might the language in the instrument affect this?
3. Issue in question is whether gift involved is a class gift or whether remaining members take to the exclusion of them. In re Estate of Holbrook, 140 A.3d 788 (Vt. 2016) … divided equally to the six of you and to the seven grandchildren. How divide?
4. In re Estate of Lello, 2016 IL App. (1st) 142500 case do children of deceased sister get her share? "To my sister…and to my wife…to share and share alike in equal shares or to the survivor or survivors of them." Drafting lesson is that most state law implies a condition of survivorship even if you don't state it. Must draft into document to address anti-lapse statute. If you want siblings not issue of deceased sister to take you must draft it.
5. If you are in a uniform probate code (UPC) state you must say more to turn off rules. Must add explicit reference to what happens in absence of survivorship.

ii. Joint estate plans: Joint will or joint trust.
   1. Challenge is if H wants to govern where W's property goes.
   2. How can you make this happen? You can create a single trust if that trust becomes irrevocable on the death of the first to die. If this occurs the surviving spouse has made a gift of the remainder interest. If the remainder interest is to a family member under IRC Sec. 2702 it may be the full value of the property, not just the present value of the remainder. But most of the cases are not driven by tax factors.
   3. Planning sometimes becomes irrevocable on first to die. Butler v. Butler, 193 So. 2d 713 (Ala. 2016) – pour over wills but the documents did not say survivor could not change will so survivor changed where residue of estate went. The will should have been made "irrevocable." The wills in Butler expressly stated that they were not contractual. Nothing prohibited the surviving spouse for changing the dispositive scheme.
   4. Taylor v. Roberton, 2016 WL 1229888 (Miss. Ct. App.) document said could only be amended with consents of spouse. Court said that consent of spouse provision only can apply while spouse is still alive so desire for plan to become irrevocable when first spouse died failed.
   5. Will contracts. "There are better ways to exert control." Pennell states "Don't do them! Because case law is rife with examples that they do not work. They seldom accomplish the intent of the testators who purport [to] make them. There are better ways to accomplish control over than another person's property if that is the client's intent. …The reality is that court routine, with a

vengeance, it would seem, refuse to honor the apparent intent of testators who purport to bind themselves."

6. **Comment**: On a number of occasions practitioners have been challenged for not doing exactly what Professor Pennell advises against, making a will contract. The quote above may well prove helpful following a death when the heirs challenge a practitioner for not having recommended a will contract.
7. Consider gift tax consequences.
8. **Comment**: If in fact Trump repeals the estate tax the number of estate "plans" (or perhaps non-plans) completed by general practice attorneys with limited or no estate planning expertise, or by clients using on line web services, will likely burgeon. Query whether the growth in elective share, will contract, in terrorem and other cases can be correlated with the increase in the exemption which may have accelerated the number of documents done by non-specialists.

iii. Disqualification for Misconduct.

1. State laws disqualify a surviving spouse for misconduct like adultery.
2. 3 cases have recently been published: In re Estate of Peterson, 2016 WL 2992474 (Mich. Ct. App.); In re Estate of Racht, 2016 WL 2909701 (Pa. Super. Ct.).
3. 12-13 states have these types of statutes, including Michigan.

iv. Elective Share.

1. There has been an explosion of elective share cases. A common issue is determining which non-probate assets or transfers should be subject to the reach of an elective share claim. What is included in the "augmented estate" the surviving spouse can claim against? See UPC Sec. 2-205.
2. Beneficiary designations may not be included in share of surviving spouse.
3. Bays v. Kiphart, 2016 WL 2064789 (Ky.). Wife was terminally ill and modified her plan cutting out her husband. In issue was change made to life insurance beneficiary designations. The court held the insurance proceeds were beyond the reach of the husband's elective share.
4. Beren v. Beren, 349 P.3d 233 (Colo. 2015). The court held the surviving spouse was not entitled to an equitable adjustment to the elective share based on appreciation during the period of contest. The court did permit interest to be paid on the delayed distribution of the elective share. See UPC 2-202(a). Colo. law views the elective share as a pecuniary amount and not as a fractional interest in the estate.
5. Dinin v. Patten, 116 A.3d 275 (Conn. 2015). This reached the opposite conclusion of Beren because of CT law views the elective

share as a fractional interest in the estate not as a pecuniary amount.

6. Ammerman v. Callender, 245 Cal. App. 4^{th} 1058 (2016) – A pecuniary is different than a fractional share. The share of the royalty income earned during an extended period of probate administration $67M of income. What is the fraction for the surviving spouse and other family members?
7. Elective share calculation and marital funding. A pecuniary vs fractional share.

v. Debts
1. Carlson "Pay all my debts." Real estate is held TOD does will require repayment of debt that is not probate real estate? Court held yes. But do you really want to pay off long term mortgage? Most clients think of credit card debt but without specificity are non-probate assets covered? What about mortgages? Do you really want to accelerate this? "Pay my debts" is boilerplate language. State law mandates any way. The language is really meant to describe from what source you pay debts not whether you should. Carlson reminds us that this common provision deserves more attention.

vi. Execution of Wills.
1. 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 a the required second witness.
2. Flawed execution one witness is not valid .Have a self-proving affidavit and notary.
3. 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.

vii. Divorce.
1. If make will after divorce UPC Sec. 2-804(b) treats as if the divorced spouse disclaimed.
2. Issue in some cases Haste v. Vanguard Group, Inc. 2016 WL what if will makes provision for relative of former spouse? What about ex brother in law? In the Haste case the relative of the divorced spouse was permitted to take under that will as the removal of the former spouse did not apply to the family member of the former spouse.
3. Some cases have held that the former spouse's relative only inherits if survives the former spouse.
4. Estate of Mower, 2016 WL 2647566 (Wash. Ct. App.) brother of former spouse inherited.

5. Never adopted step children but provide for them in the will. If you divorce spouse what happens to step children named in will?

viii. Revocable Trusts

1. Gap period between grantor losing capacity and dying, what happens?
2. Create a trust and are your own trustee until you become incapacitated then successor trustee takes over.
3. During successor trustee's administration remainder beneficiary wants an accounting as next beneficiary.
4. Problem 603 UTC takes a "remarkable" position. While alive the trust is the functionally equivalent of a will. Will execution formalities? If grantor makes poor investments the residuary taker cannot sue since while alive it is akin to an estate and remainder beneficiary has no cause of action while grantor is alive. Grantor is the only one to challenge the trustee's performance. Problem is that what occurs when grantor is incompetent – the gap period.
5. Cases are wrestling with whether remainder beneficiaries have a cause of action while the settlor is alive.
6. Babbitt v. Superior Court, 246 Cal. App. 4th 1135 (2016). Settlors of a joint revocable trust were their own trustees. The remainder beneficiaries had no right to receive accountings while the trust settlors were acting as trustee.
7. Tseng v. Tseng, 352 P.3d 74 (Or. Ct. App. 2015) the probate court does not have authority to order the trustee to provide an accounting or information regarding trust assets and transactions while the trust was still revocable unless the deceased settlor was incapacitated.

ix. Trustee removal

1. UTC 706 standard.
2. UTC 411 reform trust to add power to remove and replace even though could not just remove the trustee.
3. Is this a gap in the UTC?

x. Trustee liability.

1. In re Burton Trust, 2015 WL 7455910 (Mo. Cir. Ct.). The bad guys were the corporate trustee and the grandson yet the life-tenant co-trustee was held to be jointly and severally liable. The lesson is that even with a corporate co-trustee the individual co-trustee is not off the hook if problems occur.
2. Gadair v. Orchin, 2016 WL 350988 (D. DC) trustee moved and failed to give insurance company a forwarding address. Policy lapsed for non-payment.
3. In re Mark Family Trust, 2016 WL 4145851 (NJ Super. Ct) exoneration provisions in trust did not prevent family member trustee from being found liable.

xi. Real estate in trust.

1. Can you create a trust for real estate without a deed? "I transfer property on Schedule A to trust."
2. Can you put real estate in a trust without executing a deed? Court held yes. Carne v. Worthington, 246 Cal. App. 4th 548 (2016).
3. Deed proves valid title but does not change result of transfer.

xii. Divorce.
1. Bentley v. Bentley, 2016 WL 1613975 (Ala. Ct. App.) case. Is a third party trust available in divorce? In Bentley it was an FLP interest not a trust interest.
2. Gift from parent to child.
3. Is it marital property? Case held it is.

xiii. Power of attorney.
1. Liberty Bank v. Byrd, 482 S. W. 3d 746 (Ark. Ct. App. 2016) husband used power of attorney to change title to assets into a revocable trust. The alteration in title and hence dispositive provisions was deemed a breach of his fiduciary duty under the POA.
2. Stehlik v. Rakosnik, 24 Neb. App. 34 (2016) the power had a generic gift power. Fraud argument because the power did not have an express power to make gifts for the agent's/powerholder's benefit. Nebraska law presumes constructive fraud. It did not matter that the power holder was a beneficiary of the principal's will.

xiv. Reformation.
1. UPC Sec. 2-805.
2. Pennell predicts that we will see an explosion of reformation cases. In Duke Case in CA they will reform a will without statutory authority. Estate of Duke v. Jewish National Fund, 352 P.3d 862 (Cal. 2015).
3. DE Flynt case DE court said it would not reform a trust. DE is known as a trust friendly state. Flynt court held that DE is announcing that they respect settlor intent. In re Trust Under Will of Flint.
4. There is a tension highlighted by these two cases

2. **<u>2- Natalie Choat - Death and Taxes: The Inherited IRA</u>**.

a. With IRA on death must typically open an account as an inherited IRA. Bank cannot take instructions unless you first become their customer. That can create administrative problems.

b. If you name a charity as a beneficiary, just name the charity as beneficiary on the beneficiary designation form.

i. There might be a practical problem with this simple approach. One development officer said they are having a problem with IRA providers when they ask for a check. The providers insist that the charity first open an account for an inherited IRA. But to do that the anti-money laundering rules require name, address and Social Security number of each board member, and inquires as to foreign citizens, etc. For large charitable boards that is onerous if not impossible.

c. Estate tax.
   i. Once an IRA is retitled must address estate taxes. What special wrinkles affect IRAs? An IRA is reported on the annuity schedule of Form 706 estate tax return even though it is not an annuity. Reported as a collection of securities. You list the account number and all assets.
   ii. Consider what the IRA value that was reported for the decedent's minimum distribution purposes (RMD). IRS receives Form 5498 reporting the IRA value of account to IRS. This is value normally used to compute minimum distributions. How does Form 5498 compare to what is reported on the estate tax return?
   iii. IRS can go back and assess a penalty for failure to take RMD if the estate value is greater than the value on Form 5498. It doesn't matter if the IRA is going to charity in its entirety, it is still due. There is also no statute of limitations unless Form 5329 was filed to start statute of limitations if filed might reduce this to 3 or 6 years.
d. IRA and Alternate valuation date ("AVD").
   i. If on death IRA is worth $1M and reported on estate tax return as collection of securities. Six months later at AVD, there has been trading in account since death and account is worth less. What is AVD approach for an IRA?
   ii. Do you look at account in total or at individual securities inside the account? Is the IRA a single asset for AVD purposes or is it comprised of each underlying asset/security that comprises the total?
   iii. For estate tax purposes AVD is six months after death, or if earlier the date the assets was sold or distributed.
   iv. The IRS answered some of the AVD issues on November 17, 2011 Proposed Regulations. Prop. Reg. Sec. 20.2032-1(c).
   v. Retitling the account to name of a beneficiary is not a distribution or disposition of the account so that the AVD would still apply (i.e., the value would not be determined as of an earlier date of retitling).
   vi. IRA accounts are often divided into separate accounts for each beneficiary. Also accounts are transferred from one account to another. These will not cut off the AVD.
   vii. The events that can occur between date of death and the AVD is a distribution from the IRA, e.g. securities distributed out of IRA to the beneficiary, or the asset inside the IRA is sold. This will set the valuation date.
e. Basis Reporting.
   i. Must report to beneficiaries of the estate.
   ii. Does not apply to IRAs as reporting requirements do not apply to IRD.
   iii. What about a Roth IRA? Date of death value of Roth IRA is irrelevant to income tax treatment since with a Roth whether the distributions are tax free or not and that determination has no bearing on value at DOD.
f. Executor responsibilities with an inherited plan or IRA.

i. Completing a rollover started by the decedent before death is a potential concern.
ii. For example, the decedent had taken money out of an IRA and put into his or her checking account, and planned to deposit those funds into new account but died before completing the rollover. Since 2011 the executor could get a hardship waiver of the extension. Prior to this change it was not clear that the IRS would ever allow a post-death rollover. The legislative history listed death as a hardship. Other events include a decedent who was mentally disabled and withdrew money from an IRA without understanding the consequence. After death a late rollover was permitted. There is a requirement. An executor can complete a pre-death distribution and rollover after death but once the executor rolls-over the IRA, the executor cannot name a beneficiary, so it reverts back to the estate as the default beneficiary. So how much will this help? If the rollover is into an existing IRA with a beneficiary that may be respected. If estate beneficiary and IRA beneficiary are not the same person it could be problematic.
iii. New development twist concerning 60 day waiver. Had to apply for a PLR and thousands were granted. That is a costly problem. IRS gave a reduced fee for this. Now regular PLR user fee of $10,000 applies. Most taxpayers wont' find it worthwhile to apply.
iv. Could self-certify if hardship that entitles you to waiver is one of 11 causes on IRS list. You take money to new institution and deposit it with that new provider. Tell them it is a rollover contribution and certify to them using form letter in revenue procedure and are completing within 30 days of that reason ceasing to prevent me from completing the rollover (or a reasonable time). The 11 reasons include: financial institution error (you deposit into IRA and institution put into taxable account), illness or death of family member, and others.
v. If could not complete a rollover because of the death of a family member, what demarcates that the event no longer stops you from completing the rollover?
vi. 11 items do not use death of participant. So executors must quickly look to try to determine whether the decedent took a large distribution because if the executor cannot complete the rollover within 60 days the estate will need a hardship waiver with a PLR procedure and $10,000 as you cannot certify.
vii. Might there be fraud from the self-certification process?

g. IRA paid to estate or trust.
   i. If surviving spouse can withdraw funds he or she can rollover to his or her own IRA. Decedent left to estate but surviving spouse is sole beneficiary of the estate she can roll it over.
   ii. If instead the decedent left the IRA to trust and surviving spouse can take it out of a trust IRS recognizes in PLRs dating back 20 years that she can take the money and roll it over. Unfortunately, none of these can be cited as precedent.

iii. Some IRA providers will not accept the rollover without the taxpayer spouse getting a private letter ruling. Some IRA providers will accept these through an estate or trust based on their reading of the documents, or with a legal opinion but not a private letter ruling.
iv. Consider spousal right of election to get IRA out of estate (pick that asset if feasible under state law) and use this approach. PLR 200152040.

h. Decanting.
    i. Consider see through trust rules.
    ii. If trust does not qualify can you fix it by decanting to a trust that does qualify? Speaker not certain that this can be done. If money passes out of one trust to another, the trust had to be irrevocable at decedent's death. How can that be met if the trust did not exist at the decedent's death?

i. Correct problems.
    i. Bona fide dispute about who is entitled to benefits or an undue influence case (in final days decedent named home health aide), or there is a scrivener's error.
    ii. Go to court to have it reformed or settle bona fide dispute and change based on judgement.
    iii. This will be respected for minimum distribution rules.

j. Reformations.

k. Disclaimers.
    i. Disclaimer of inherited IRAs can be used as a post-mortem planning tool. IRC Sec. 2518.

l. Delay acceptance of acceptance until it is determined that there will be no disclaimer If there is a request for distribution include a statement that the beneficiary is not accepting the entire account.

3. **<u>3A Cushing – Aging Population</u>**.
    a. Elder law is the new focus of estate planning.
        i. 8 million people needed long term care in 2012.
        ii. 27 million people will need long term are in 2050.
        iii. Estate planning goals should include:
            1. Assets will pass as client wishes.
            2. Minimize taxes if applicable.
            3. Avoid probate.
            4. Protect assets from long term care.
        iv. **<u>Comments</u>**: I believe a key issue in estate planning not in the above list is protecting clients as they age and through the inevitable decline of cognitive abilities and frailty that generally entails. The optimal age for making financial decision is age 60. Worrisome is that our perception of our financial making capabilities does not decline as our actual abilities due. The difference between declining abilities and perception creates a growing exposure that those perpetrating elder financial abuse can exploit. For example, see the comments in Pennell's outline above concerning planning with a revocable trust during the "gap" period as he called it.
    b. Medicaid to pay costs of custodial care in a nursing hope setting. Operated by states but generally funded by the federal governing.

i. Countable vs. non-countable assets.
ii. Categorical eligibility.
iii. Financial eligibility.

c. Long term annuity as long as possible not to exceed life expectancy.
    i. Beneficiary must be state to extent of benefits paid.

d. Zahner v. Sec. Pennsylvania Dept. of Human Services, 802 F.3d 497 (3rd. Cir. 2015).
    i. Before Deficit Reduction Act - Half a loaf theory. Client with $300,000 gift away $150,000 and keep $150,000. A penalty period kicked in and state would not pay. How long before eligibility begins? Divide $150,000 by divisor (average cost for private care in that state, e.g. $131/day in LA).
    ii. At end of penalty period money is gone and penalty is gone but you saved $150,000. The number varied depending on the private pay rate.
    iii. 2006 Act changed the beginning date. While you made $150,000 transfer under new rules you are not eligible because you are not disqualified by transfer but because you have $150,000. Tried to eliminate half a loaf approach.
    iv. Zahner is several cases that were consolidated. Annuity structure to run for period for which had to pay privately. This was a way to get around prohibition of half a loaf theory. Buy annuity to pay nursing home privately. Penalty begins on date of transfer. Zahner planning is not widely accepted but some are trying to use it.
    v. Some courts won't recognize the short term annuity because the return is insufficient. They view it as a mere assets. But case upheld short term annuity as valid.

e. Trusts.
    i. If the trustee of an inter-vivos self-settled trust can use income or principal to benefit the settlor the trust income or principal over which the trustee has discretion will be consider a countable asset.
    ii. 1993 OBRA and a Medicaid qualifying (really disqualifying) trust.
    iii. Exception for testamentary trust for spouse.
    iv. Lookback period for resources transferred increased from 3 to 5 years by DRA 2005.
    v. Exceptions include:
        1. Transfers of resources to the person's permanently and totally disabled or blind child or a trust for such child.
        2. Transfers of the home the nursing home resident had used as a principal residence to the spouse or a child under 21 who is blind or permanently and totally disabled.

f. Planning.
    i. Irrevocable income only Medicaid trust.
    ii. Is the transfer of property to the trust a completed gift? A transfer is an incomplete gift for gift tax purposes if the donor retains the right to designate the final beneficiaries. Treas. Reg. Sec. 25.2511-2(c).
        1. **Comment**: In light of the possibility of estate tax repeal under a Trump administration practitioners might wish to include in new

irrevocable trust instruments a mechanism to re-vest trust corpus in the settlor's estate. This mechanism will not work because the donor had to retain the right to designate final beneficiaries. If that is done the gift to the trust will be incomplete from inception which in more traditional estate tax planning may not be desired. Instead a different mechanism will have to be used to later re-vest title for estate tax purposes in the settlor.

iii. Self-settled trust created by applicant. If grandpa sets up trust for grandchild that is a third party trust. This is a trust created by the client for himself or herself in case he or she goes into a nursing home.
iv. There is a 5 year look back so the sooner you plan the better.
v. If income or principal can be used for the benefit of the settlor anytime then those assets are considered countable.
vi. Client typical has home, bank account, etc. Transferring assets to irrevocable trust as long as client can get the income may not adversely affect the client. This leads to "irrevocable income only Medicaid trust." Draft trust so that as long as settlor is living pay income to settlor and if married to spouse. But the trust document must expressly prohibit any principal to be paid to or for the benefit of the settlor.
vii. Trustee cannot be permitted to use principal for benefit of client/settlor. May be set up with child as trustee. Settlor should not be a co-trustee, although it may be feasible.
viii. Trustee in its discretion can pay principal to class consisting of client's issue. This facilitates removing assets out of trust if cannot get through the 5 year lookback.
ix. Settlor can reserve right to tell trustee to make distribution to one or more of the children or specified charities. This provides settlor some control over the children. This makes the trust an intentionally defective grantor trust.

g. Life estate.
    i. If property is transferred subject to a life estate the life tenant is responsible for paying all expenses of ownership.

h. Basis in Home.
    i. Property acquired by husband and wife prior to 1977 100% of the property is included in the estate of the first spouse to die.
    ii. Gallentstein v US, 91-2 USTC Para. 60,088; aff'd 975 F.2d 286 (6th Cir. 1992).
    iii. 2040(e) property acquired prior to 1977 and owned jointly and passes to survivor 100% included in the estate and gets basis step up.
    iv. Basis is what should have been includible, don't only rely on Form 706.

i. Basis in home transferred to heirs without retained life estate.
    i. Estate of Guynn v. US. 437 F.2d 1148 (4th Cir. 1971).
    ii. Mother transferred property to children and no one thought of using a trust.

iii. Parent may or may not have gone into nursing home and then dies. What is basis to children? Carryover basis results from the gift of the house so that the children may incur a large capital gain.

j. Is there a way to include the property back in the parent's estate? If the parent lived in property and did not pay rent to the children/owners there may be an implied life estate absent a formal one. The IRS argued that while there was no formally retained life estate there was an implied life estate and that sufficed to create estate tax inclusion. This same argument might be advanced to support a basis step up.

4. **<u>4A – Krooks – Family Health Care, Social Security and More</u>**.
   a. Caution – many different nuances that apply state by state.
   b. Statistics.
      i. 40 million Americas over age 65 = 13% of the population. By 2030 20% of Americans will be 65+
      ii. People are living longer. Men age 65 live an average of 14 years. Women age 65 live an average of 20 years. Education and wealth correlate with longevity so clients of estate planners may live longer on average. Increasing age means greater concern of dementia and the risks associated with it.
      iii. Estate tax not a concern at current exemption levels 3-4,000 a year pay estate tax.
   c. Elder planning goals.
      i. Holistic approach.
      ii. Preserve client autonomy.
      iii. Create surrogate decision making. Creating advance directives. Who should make decisions?
      iv. Services practitioners can and should provide can be expanded to address these goals.
   d. Elder abuse.
      i. Most state statutes define elder as someone over age 60.
      ii. Most people think "it will never happen to me." But it does.
      iii. Challenge is getting client to part with assets in order to protect them.
   e. Agent.
      i. Who should the client name? What if you have several children?
      ii. Do they really trust them?
      iii. Can you name a monitor?
      iv. You should compensate them. It takes time. A trustee gets paid so should an agent be paid.
      v. Major issue in many cases is getting a bank to accept the POA regardless of doing everything right.
      vi. If a client lives in more than one state technically you only need a home state POA but why not get a power on the other state form that will be more readily recognized.
      vii. Second marriage issues? Who is in charge? Second spouse or children from first marriage?
      viii. Is cost a factor?

ix. Quality of life issues?
x. What if the client does not have anyone to make health care decisions? No third party institution will do this.

f. Alternative to POA.
    i. Revocable living trusts have not been commonly used in NY although common in other states. Using trusts not so much as to avoid probate but to manage assets during incapacity instead of relying primarily on POA. Each spouse can be initial trustee and name bank as successor trustee. The financial institution would not be at risk of committing elder abuse.

g. Retirement.
    i. Retirement planning services.
    ii. Key issue for most clients is "Will I have enough money to retire?"
    iii. Consider all sources: Social Security, retirement accounts, pensions, assets, income from continued work, etc.
    iv. Retirement accounts are considered to be an available resource. In some states if taking out distribution then corpus of retirement account is not considered to be an available resource. If taking RMD remainder of account may be an exempt asset.

h. Social Security.
    i. More important than ever before for retirement clients.
    ii. Several categories.
    iii. Retirement benefits.
        1. 2/3rds of Americans get ½ or more of their income from Social Security.
        2. 1/3rd of Americans get 90%+ of their income from Social Security.
        3. Amount you get depends on average earnings over the past 35 years. It is also a function of when you take it. Retirement age use to 65 now is 66 and is creeping up to 67. Most people take it early, by age 65. They do this because they have paid into the system their entire lives and they don't want to miss payments by dying early. This is the case even if financial planners and calculators show how much more can be received if defer the payments until age 70. It is an emotional decision not a rational decision.
        4. Most you can get in 2016 is $2639/month and if you wait to 70 over $3500.
        5. Baby boomers have started to retire and GAO projections suggest there may not be sufficient funds in the system.
        6. 2017 small COLA for Social Security.
        7. If you need the money now and it will affect your quality of life then you should be taking it. If your family has short or long life expectancy consider that. What types of investment opportunities do you have? What about income tax impact of receipt of Social Security? There is MAGI = modified adjusted gross income which includes ½ of Social Security benefit and if over $32,000 MFJ you will pay income tax on 50% or 85% is taxable. Consider state income taxation.

iv. Survivor benefits.
v. Disability benefits.
vi. **Comment**: Clients can name a "representative payee" in the event of their disability. If counsel prepares a durable power of attorney naming a different person as agent, what becomes of the potential conflict of authority? See similar comments below concerning law term care coverage.

i. Providing for long term care.
    i. It is not only about financing it.
    ii. Aging in place. Many clients prefer to stay in their homes.
    iii. Continuing care retirement communities. Range of care so resident never has to move out, just move up the spectrum of more services in the facility. These typically have a high entrance cost in terms of large six figure deposits some of which may be refundable following death.
    iv. Assisted living. This may include custodial care in an apartment like setting. This may include several meals a day, and other services, etc. but not by licensed care.
    v. Nursing homes are medical institutions that provide 24 hour care. Because of Medicaid requirements there are generally 2+ residents per room. Costs are $8-12,000/month+.

j. Paying for long term care.
    i. How pay for PD, Alzheimer's disease and other challenges of aging.
    ii. Health care system pays for acute illnesses but if you are elderly and struggle with chronic illness the Medicaid system does not pay for that type of care.
    iii. You must pay for this out of pocket unless you have purchased long term care insurance. Only 7% of long term care is paid for by long term care insurance.
    iv. So you can self-insure or try to go on Medicaid which is what many middle class try to do.
    v. $95,000 is average cost but in some states it can be more than $20,000/month.
    vi. This is a major national problem that is exacerbated by fact that 70% of all Americans will need some type of long term care. Americans are not good savers and average savings are small relative to possible long term care costs.
    vii. 70% of Americans age 65 and older will need long term care. Average duration is 4 years. Medicate does not pay it is a common misconception that it does pay. It doesn't. Spouses have responsibility. Most people do not realize they have a liability for their spouse. This is a particular issue for second marriages later in life.

k. Long term care insurance.
    i. Insurance agents say age 55 is the sweet spot to buy long term care coverage, but many clients face competing financial strains.
    ii. Underwriting is strict for long term care. If you wait you may not qualify.
    iii. Benefits will increase over time from compounding for inflation.

iv. There are only 7 million policy holders. New policy sales are way down from 2002.
v. Insurance companies invests premiums in diversified bond portfolio but the very low interest rates for years has undermined calculations of return.
vi. Insurance companies underestimated lapse rates.
vii. 80% of companies that use to sell it have left the market. There has been a shake-out in the industry.
viii. Insurance companies discovered that more women are filing claims. Wife took care of husband who died and then when wife was ill there was no on to care for her so costs were higher. Insurance companies petitioned states and now charge sometimes 50% premium for female insureds.
ix. Insurance industry adjusted to this with new products. Insurance companies discovered that many people did not buy because if did not need care money was lost. Consumers viewed this differently than say car or home insurance, they wanted the use of it or the felt it to be a waste.
x. Insurance helps in family dispute issues – example one child very wealth one not. Insurance preserves estate for children since one needs it.
xi. **<u>Comments</u>**:
    1. Lapse rates for long term care insurance are about 1-2% per year. Considering that long term care coverage can be in force for three plus decades, the compound result are rather dramatic. More than 1/3rd of all long-term care policies will lapse. Men age 65 have a 32% probability of lapse and women age 65 have a 38% probability of lapse. Women have higher lapse rates, tend to outlive men, and tend to spend many years single after a spouse dies in their later years. The financial vulnerability of elderly woman is thus particularly worrisome. Twenty-three percent (23%) of those with long term care coverage lapsed their policy in the four year period preceding their obtaining care.
    2. Insurance companies are now permitting policyholders to name a person who can receive notice if the premium has not been paid called a "lapse designee."
    3. What if the client named Child-1 as agent under a durable power of attorney, Child-2 as lapse designee on her long term care policy and Child-3 as Representative payee for Social Security. What happens in terms of managing an incapacitated client's financial affairs.

l. Deductibility of LTCI.
    i. Lumped together with other medical expenses and can only be deducted to extent exceed 10% of AGI.
    ii. Limited by chart as well.
        1. Age 40 or less $390.
        2. Over age 70 $4,870.
    iii. Some states have state income tax credit or deduction for LTCI.

m. Client with C corporation can deduct 100% of LTCI premium for say a key executive. Not subject to ERISA so you can discriminate. No imputed income to employee even when a claim is filed.

5. **<u>3B and 4B - Paul Lee and Turney Berry – Proposed 2704 Regulations</u>**.
   a. **<u>Comment</u>**:
      i. See the discussion by Cathy Hughes of Treasury later in the outlines as her comments and views, if reflected in the final Regulations, could have a profound impact on planning. There have been a number of commentaries published in LISI on Cathy Hughes comments. The bottom line is that the Treasury has indicated that a less onerous interpretation of the Regulations was intended and should be reflected in the final Regulations. She further commented that it is unlikely that the Regulations will be finalized before next year. Yet, the content of the final regulations and their effective date all remain unknown.
      ii. To complicate matters further, President-elect Trump has proposed a repeal of the estate tax. It is not clear what will become of that proposal or whether the gift tax would be included in any repeal of the "death tax." This complicates planning further. Clients may need to consummate transfers before the unknown effective date of the proposed 2704 Regulations whose content is unknowable, but that planning should now contemplate the potential of the repeal of the estate tax. See Steve Leimberg's Estate Planning Newsletter by Jonathan Blattmachr & Martin Shenkman, "Trump Wins, Republicans Control House and Senate, A Brave New World for Estate Planners," LISI Estate Planning Newsletter #2478 (November 10, 2016) at http://www.leimbergservices.com.
      iii. In many if not most cases planning should proceed because of the uncertainty as to whether repeal might ever occur or the form it will take. Further, if planning results in the transfer of wealth to robust, flexible, irrevocable trusts that may be an advantageous result regardless of the repeal or not of the estate tax.
      iv. However, practitioners should give consideration to incorporating further flexibility into inter-vivos 2704 and other planning in light of this uncertainty. For example, if transfers are contemplated to irrevocable trusts it might be useful to include a mechanism to cause trust corpus to be included in the settlor's estate should that prove advantageous under Trump tax legislation. The trust could give the trustee, or perhaps a third party acting in a non-fiduciary capacity, a power to grant grantor the right to control beneficial enjoyment so that would cause estate tax inclusion in the grantor's estate under IRC Sec. 2038. A corporate trustee may be unwilling to exercise such a power, so that it may be advisable to grant the power to an individual. It may also be advisable for that person not to act in a fiduciary capacity. When grantor dies a step up in basis for trust assets could be realized if those assets were included in the estate under estate tax rules in effect as of date of repeal. Thus it can be advantageous to create and fund a trust, not have it included under IRC Sec. 2036(a), and structure it so that creditors cannot attach trust assets. If the trustee does

not grant the power, no estate tax inclusion will occur. If the trustee does grant the power, there will be estate tax inclusion. It might be advantageous to grant the trustee the right to select which assets to grant this power over. If an asset has declined in value, it may be preferable to avoid changing the basis at death.

b. **Comment**: The summary of the Proposed 2704 Regulations below is excerpted and/or adapted from various sources by this author including Steve Leimberg's Estate Planning Newsletter ("LISI") #2448 (August 22, 2016) at http://www.leimbergservices.com, by Martin Shenkman, Jonathan Blattmachr, Ira S. Herman & Joy Matak, "Proposed 2704(b) Regulations Will Zap Discounts, Wealthy Taxpayers Should Plan ASAP," and Wealth Management, Shenkman, "Using GRATs Prior to the Effective Date of the 2704 Proposed Regulations," August 16, 2016. The following is **not** a summary of the materials provided at the Notre Dame conference by Lee and Berry.

c. The new Regs are a game changer for many clients. Many wealthy clients, and every practitioner that advises wealthy clients, needs to understand the significant implications to planning presented by these Proposed Regulations. Wealthy clients might need to react to this quickly, although the impression of most commentators is that they will not be effective in 2016 and may not be effective for well into 2017 or even later (and perhaps never if Trump repeals the estate tax).

d. In many cases, it would be worthwhile to complete significant planning steps before the effective date of the Regulations, which remains uncertain. Valuation discounts have been the elixir that has driven the estate tax minimization machine for decades. These Proposed Regulations may eliminate valuation discounts and thereby make it far more difficult for wealthy taxpayers to minimize estate taxes.

e. The new Regs govern the valuation of interests in corporations and partnerships for estate, gift, and generation-skipping transfer (GST) tax purposes. They address the treatment of certain lapsing rights and restrictions on liquidation which have been used in determining the fair market value of transferred interests for estate planning purposes. The stated goal of the Regs is "to prevent the undervaluation of such transferred interests." However, as demonstrated below, the Proposed Regulations appear to exceed this objective and distort it in a number of complex ways.

f. The Proposed Regulations strengthen the rules governing "Applicable Restrictions" and add a new tier of restrictions that apply to valuation matters referred to as "Disregarded Restrictions." Some of the changes are illustrated below:

    i. Control: The Proposed Regulations Sec. 25.2701-2 define what constitutes control of an LLC or other entity or arrangement that is not a corporation, partnership, or limited partnership to clarify that a 50% ownership interests or a GP position will constitute control even if the overall equity in the enterprise is quite small.

    ii. State Law Restrictions: According to the Treasury, the current regulations have been rendered substantially ineffective in avoiding what the Treasury considers to be abusive valuation discounts by changes in state laws. Since the promulgation of the initial 2704 regulations, many state statutes governing limited partnerships and LLCs have been amended to provide statutory rules that bolster support for discounts. For example, some of these state law changes now limit liquidation of the entity only on the unanimous vote of all owners (unless provided otherwise in the partnership agreement), and to eliminate the statutory default provision that had allowed a limited partner to liquidate his or her limited partner interest. These rules often provide that a limited partner may not withdraw from the partnership unless the partnership agreement provides otherwise. The current regulations except from the definition of an "applicable restriction" any restriction on liquidation that is no more restrictive than that of the state law that would apply in the absence of the restriction. The Tax Court viewed this as a regulatory expansion of the statutory exception to the application of section 2704(b) contained in section 2704(b)(3)(B) that excepts "any restriction imposed, or required to be imposed, by any Federal or State law." Each of these statutes is designed to be at least as restrictive as the maximum restriction on liquidation that could be imposed in a partnership (operating) agreement. The result is that the provisions of a partnership agreement restricting liquidation generally fall within the regulatory exception for restrictions that are "no more restrictive than those under state law," and thus do not constitute Applicable Restrictions under the current regulations. The Proposed Regulations prohibit consideration of these restrictions unless they are mandatory under state law and not merely default provisions. Further, anticipating that practitioners could persuade states to enact special statutes with mandatory restrictions, the Proposed Regulations negate the consideration of these as well. Prop. Reg. Sec. 25.2704-2 redefines the definition of the term "applicable restriction" by eliminating the comparison to the liquidation limitations of state law.

iii. Restrictions on Interest Versus Entity: Courts have concluded that, under the current regulations, section 2704(b) applies only to restrictions on the ability to liquidate an entire entity, and not to restrictions on the ability to liquidate a transferred interest in that entity. Kerr v. Commissioner, 113 T.C. 449, 473 (1999), aff 'd , 292 F.3rd 490 (5th Cir. 2002). Thus, a restriction on the ability to liquidate an individual interest is not an applicable restriction under the current regulations. The Proposed Regulations make it clear that this distinction is no longer relevant.

iv. Assignee Interest: Taxpayers have attempted to avoid the application of section 2704(b) through the transfer of a partnership (LLC) interest to an assignee rather than to a new or substituted partner (member). Again, relying on the regulatory exception for restrictions that are no more restrictive than those under state law, and the fact that an assignee is allocated partnership income, gain, loss, etc., but does not have (and thus may not exercise) the rights or powers of a partner, taxpayers have successfully argued that an assignee's inability to cause the partnership to liquidate his or her partnership interest is no greater a restriction than that imposed upon assignees under state law. Kerr, 113 T.C. at 463-64; Estate of Jones v. Commissioner, 116 T.C. 121, 129-30 (2001). Courts have agreed that assignee status of the transferred interest is not an Applicable Restriction. The Proposed Regulations would confirm that there will be no valuation differential for this and would amend Treas. Reg. §25.2704-1 to clarify the treatment of a transfer that results in the creation of an assignee interest.

g. Adapting GRATs to secure discounts before the effective date of the 2704 Regulations.
    i. The greater the value of the annuity interest, the smaller the taxable gift involved in the creation of a GRAT. A lower interest rate increases the actuarial value of the retained annuity. Thus, the same annuity payments will produce a lower taxable gift at a lower interest rate. Most important to the regulations is the impact on the value of the assets transferred to the GRAT. The lower the value, the lower the required annuity payment required to reduce the value of the gift to the GRAT to near zero. If a non-controlling interest in a family business is transferred to a GRAT prior to the effective date of the regulations, that value may be discounted, perhaps significantly. If that same GRAT is funded after the effective date of the regulations, that discount may be dramatically reduced or eliminated. This will increase the value of the gift and hence increase the amount of the annuity payment required to reduce the value of that gift to near zero. If the appropriate circumstances are present, it may be possible that the cash flow from the entity can pay the annuity amount and avoid leakage of equity interests into the client/grantor's estate. This may only be achievable if valuation discounts are available. The factors to achieve this might include:
        1. The value of the discount is sufficient.
        2. Cash flow from the entity is adequate.
        3. The grantor's life expectancy is such that the GRAT can be for a sufficient term that the results are obtainable.
    ii. Thus, depending on the facts, completing a GRAT prior to the effective date of the regulations might not only be valuable to leverage more wealth out of the estate, but also, it might be essential to the viability of the plan.
    iii. Example 1: A family business is valued at $15 million and generates an 8 percent dividend distribution. Ten percent is contributed to a GRAT before the effective date of the regulations. The pro-rata enterprise value is $1.5 million, which is discounted to $1 million. The actual dividend on the 10 percent interest is $1.5 million x 8 percent = $120,000. A 10-year GRAT is created. The required annuity payment of $110,000 results in a taxable gift of $1,497.00. On this basis, the cash dividend from the equity interests will suffice to make the annual annuity payment if the transaction is consummated before the regulations become effective.
    iv. Example 2: Planning for the same family business is undertaken, but the 10 percent interest is contributed to a GRAT after the effective date of the regulations. The pro-rata enterprise value is $1.5 million, which can't be

discounted. The actual dividend on the 10 percent interest is $1.5 million x 8% = $120,000. A 10-year GRAT is created. The required annuity payment of $165,000 results in a taxable gift of $2,245.50. On this basis, the cash dividend from the equity interests won't suffice to make the annual annuity after the regulations become effective. Thus, in kind payments will be required. This will require an appraisal each year. Further, the "leakage" of business equity back into the grantor's estate won't again be able to benefit from discounts on future post-effective date transfers. This suggests several potential benefits of completing the GRAT planning before that date.

v. Rolling and Cascading GRATs: A common application of the GRAT technique was short term, typically 2-yearGRATs, often done in a series (for example, four GRATs each holding a different asset class). If the assets in or more of the GRATs grew substantially in value, that excess would inure to the beneficiaries, and the remaining GRATs (that is, those that failed) would have used little or no exemption so that the downside is limited. This excess might simply have remained in the GRAT at the end of a 2-year GRAT term. In some instances, if significant appreciation occurred during the term (for example, in the first year of a two year GRAT) [something missing here?] the client/grantor might have substituted cash or Treasuries (non-volatile assets) for the interest in order to immunize (lock in) the appreciation inside the GRAT and outside the estate. This would minimize or eliminate the risk that the highly appreciated asset might decline in value in later years thereby undoing the wealth transfer that might have occurred. This all becomes more complex to monitor and address if the term of the GRAT is extended in the current planning environment.

vi. Historically, the unsuccessful GRATs (that is, those that didn't realize sufficient appreciation) would be recycled. A number of points should be noted concerning the application of this technique. President Obama has repeatedly recommended legislative change to curtail this short-term "rolling" GRAT technique (for example, a minimum 10-year GRAT term). If Hillary Clinton is elected, she may push those changes as part of a similar tax agenda. So even if initial GRATs can be created, the potential for future use may be limited.

vii. Although short term rolling GRATs has been a favored strategy, a risk of using that approach is that GRATs may not survive potential changes to the estate and gift tax law by the next administration. Another risk is that if discounts are essential, or perhaps even useful, to the success of the GRAT, the reduction or elimination of discounts as a result of the regulations are cause to re-evaluate the optimal GRAT strategy . Accordingly, one might reconsider using a longer term GRAT to secure the discounts rather than a short term GRAT that may have more leakage of the underlying discounted asset back into the grantor's estate. Thus, while rolling GRATs may have been the favored GRAT strategy in the past, this may not be the optimal approach now.

viii. Immunizing GRATs: A successful GRAT with significant upside could be immunized by swapping out the highly appreciated asset and substituting a low volatility asset, such as cash. This would serve to lock in the appreciation realized outside the taxable estate. One difficulty with a longer term GRAT is that early success may be offset by future failure in asset performance. This was discussed above briefly. If a volatile asset is gifted to a GRAT, appreciates significantly, remains in the GRAT and then declines, some or all of the wealth shift can be lost through this volatility. The client might address this risk in part through a swap power (power of substitution under IRC Section 675(4)(C)) to capture and immunize the volatility in a GRAT. The grantor could exercise the power of substitution when the assets inside the GRAT have appreciated significantly such that freezing that level of appreciation to secure the benefit inside the GRAT for the remainder beneficiaries makes sense. In other words, if an asset in the GRAT doubled in value and the grantor swaps that volatile asset out of the GRAT for an equivalent value of cash the cash inside the GRAT will not lose value and the appreciation will be secured (locked in). . By the grantor substituting a less volatile asset, such as cash, and removing the appreciated asset out of the GRAT the gain that was made cannot be lost. This could be done by a purchase from the GRAT which is a grantor trust or the exercise by the grantor can exercise a swap power over a GRAT without a negative gift tax consequence.1 A swap power should also succeed if the trustee has an obligation to confirm that the property substituted is of equivalent value.2

ix. Mortality Risk of Longer GRATs: Another negative of a longer term GRAT is that death within the term of the GRAT will undermine the plan by likely causing a substantial portion, if not all, of the assets of the GRAT to be included in the grantor's gross estate for federal estate tax purposes. The probability of death within the term of a GRAT can be estimated using the 90CM mortality tables, which are based upon the 1990 census. You might address this risk by:

1. Using a tier of GRATs to increase the likelihood of the grantor outliving some.
2. Insure the risk (for example, if the longest GRAT is 10 years, purchase 10-year term life insurance).
3. Quantify the risk by having an actual life expectancy analysis completed for the grantor, and use that knowledge to set the term of the GRAT.

h. 99-Year GRAT: A variation of the different applications of traditional GRAT planning discussed above the "99-year GRAT," which applies the GRAT technique in a manner that appears to comply with the technical requirements of the Treasury Regulations and that seeks to take advantage of the potential for a significant increase in interest rates between the date the GRAT is established (at today's historically low rates) and the date of the client's death. It might be anticipated that the current historically low interest rates may increase by that time. If the interest rates rise sufficiently the 99-year GRAT approach could significantly reduce the portion of the entity interests the client contributed to such a GRAT that's included in his estate. If the client completes a 99-year GRAT prior to the effective date of the regulations, then discounts may be permitted. If the client dies following the effective date of the regulations, and more than three years after the transfer, it may be possible that the payment back to the client's estate on death may not be subjected to discounts. If this in fact were the case, it would provide additional advantage to a 99-year GRAT.

6. **5A – Heidi Freeman – Perfect Modern Trust**
    a. **Comment**: With the possibility of a Trump repeal of the estate tax reconsideration of what constitutes the "perfect" trust might have to evolve See comments above, for example, as to adding additional flexibility to re-vest ownership in the estate of the settlor in case repeal or other potentially dramatic changes might warrant.
    b. Complexity.
        i. Funding and operating a modern trust might sound daunting to a client but in reality it is likely not more complex than funding and operating a business entity that many clients are more familiar with.
    c. Benefits of third party modern trusts; Characteristics.
        i. Long term.
        ii. Divorce and creditor (predator) protection.
        iii. Trust friendly jurisdiction.
        iv. Complex trust for income tax purposes.
            1. May save state income tax of home state if income retained in trust in trust friendly jurisdiction.
            2. If trust has sprinkle power can distribute to beneficiaries in lower brackets. Contrast with assets inherited out right which have no flexibility to sprinkle income. Trust must be GST exempt to pay to lower generation beneficiaries.
        v. Asset management via trust structure.
        vi. Gives beneficiaries more flexibility to do his or her own planning based on the security of knowing that the trust assets are protected and can be relied on.
    d. Beneficiary planning.
        i. If beneficiary inherits outright no protection.
        ii. Prenuptial agreement only protects against one particular creditor that spouse. A trust can protect from all spouses and creditors.
        iii. Marital agreements can be cumbersome and many engaged people do not wish to sign them.
        iv. Could put assets into a charging order protected entity? Creditor of owner of company/entity cannot just take assets out of company but when distribution is made out of the company the charging order gives that distribution to the creditor. So beneficiary's access to funds from entity may be cut off with a charging order.
        v. DAPT is protective but not as strong protections as can be provided by a third party trust.

vi. Homestead exemptions and other state law exemptions but these vary, are cumbersome and many states don't have good exemptions.

e. Client excuses.

i. Clients frequently make excuses about not wanting to bequeath (inherit) in trust.

ii. Not enough wealth.

iii. No taxable estate. It is not only about estate taxes but all the other benefits noted above.

iv. I don't want to skip my children. Using a GST trust doesn't skip children, it is just a client misconception of what a generation skipping trust does.

v. I don't want to rule from the grave. This is really a concern about inflexible trusts but modern trusts do not need to be flexible. Build in flexibility with powers of appointments.

f. Complexity of trust versus business entity.

i. No adviser would suggest running a business as a sole proprietorship so why should gifts/bequests be different?

ii. Assets need to be retitled into the business or trust.

iii. Income must be deposited into the business or trust account and expenses paid out of those accounts. Beneficiary expenses generally need to be paid from trust or business account (but depending on the trust some may be paid from trust).

iv. Annual financial report are required or advisable for the business and similar accounting should be done for trust assets.

g. Modern versus Traditional trust drafting.

i. Purpose of modern trust is creditor/predator protection, i.e., focus is on empowering but protecting the beneficiary. Traditionally trusts were focused on controlling the beneficiary's access to trust assets. Thus, modern trust drafting considers what the beneficiary wants which is often control over assets and trustee decisions.

h. Beneficiary controlled trust.

i. Bifurcate trustee roles with trustee and investment trustee so beneficiary when capable so he or she can control investments.

ii. Second trustee position is the distribution trustee who should be independent from the beneficiary and grantor. IRC 672 defines related, subordinate, etc. Cannot be beneficiary's spouse, descendant, sibling or ancestor. Other that the restrictions the beneficiary could pick anyone they choose to be the distribution trustee, e.g. a buddy, although in many institutions an institutional trustee can be used.

iii. Another approach uses one trustee and make it a directed trust naming an investment advisor or committee made up of family members. Adviser or committee directs trustee.

iv. Consider opting out of prudent man rule so trust could invest in anything an individual might invest in, such as the beneficiary's own business. This makes the business a trust owned and hence protected asset.

    v. Permit holding personal use assets so trust can buy personal use asset, e.g., vacation home and permit the use of it so they have both use but it remains protected.
    vi. Beneficiary cannot be the sole trustee as it would be a general power of appointment putting all assets back in beneficiary's estate and reachable by creditors.
    vii. Beneficiary could have a limited or special (i.e., non-general) power of appointment. Primary beneficiary can appoint assets at death among anyone other than estate, creditors or creditors of estate. This gives broad flexibility to control who and how next generation inherits.
    viii. Give independent person right to limit or expand powers of appointment.

i. Common tax powers that might not be helpful.
    i. Beneficiary as trustee with HEMS distribution standard. This is not often advisable (although most beneficiaries want it) in some states exception creditors (special classes of creditors) can stand in the shoes of the beneficiary and force assets to be distributed from the trust (e.g., divorcing spouse or child for child support payments). A fully discretionary trust may be preferable.
    ii. A power to withdraw the greater of $5,000 or 5%. This is a minimum access that can be granted without causing full estate inclusion. This may not be necessary and can be harmful from a creditor exposure problem. If the trust is sufficiently flexible as to the beneficiary the beneficiary can get money without this. Lapse under 678(a) is taxable 5% of trust is taxed to beneficiary and 95% is perhaps a complex trust. The next year there is another lapse and more of the trust becomes grantor. In most instances practitioners ignore this tax consequences.
    iii. Mandatory distributions of income, e.g., in a bypass trust. This is a dangerous power as it forces distributions into beneficiary's hands where it is exposed and may prevent accumulation in trust to avoid state income tax or to sprinkle to lower bracket beneficiaries.
    iv. Many trusts terminate at specified ages, e.g. ½ 30 and remaining ½ at age 35. This terminates all protections afforded by the trust. Guesstimate 95% of trusts have such provisions.
    v. Incentive provisions. For example, $X dollars on graduating, income matching, etc.

j. Powers.
    i. Mechanism to take away power of appointment from beneficiary, or limit class, e.g., parent's descendants.
    ii. Limit or exclude beneficiary from having right to fire and replace trustees. Include power holders who can change trustees. Another modification is to limit replacement power to solely naming professional or institutional trustees.
    iii. Modify investment powers and perhaps have the beneficiary as only a co-investment trustee to provide some limitations by a requirement for joint actions.

k. Keep flexibilities in trust.

i. Even if current beneficiary is not capable future beneficiaries may be so you may leave them in for later use.
ii. Fully discretionary trust provides flexibility.
iii. Independent trustee or trust protector can have power to grant or modify or limit or eliminate powers of appointment.

l. Can one trust fit all?
i. For wealthy beneficiary a fully discretionary trust works well. The wealthy beneficiary would want control to fire trustee, etc.
ii. If you have a lower earning beneficiary, e.g., teacher, should you do something different? Incentive provisions often don't work to encourage beneficiary to continue working. But the discretionary trust can accomplish this.
iii. Spendthrift beneficiary may be best dealt with by using the same fully discretionary trust but you might wish to modify the controls such a beneficiary has over the trust.
iv. Special needs beneficiary may be served with a fully discretionary trust to assure not disqualified but may have to modify controls depending on beneficiary's capabilities.
v. Minor or "bad" beneficiary. May give them no controls over the trust but you might still use a fully discretionary trust. Consider whether controls should be added at some point.

m. Trust enhancements.
i. Situs. Usual default is home state but that may not be optimal from a tax, legal, creditor protection, etc. Some states have eliminated common law rule against perpetuities. Some states limit exception creditors. Other states have statutes that allow certain exception creditors for fully discretionary trusts. Need nexus to a different trust friendly state. This is usually achieved by hiring trust company in the trust friendly state. Move to trust friendly state to possibly avoid home state income tax. May change administrative law or trustees to achieve this.
ii. Institutional trustee to avoid discomfort of friend or family knowing assets and distributions. Professional trustee will administer trust better.
iii. Should flexibility be added to force estate inclusion to get step up in basis? If there is a beneficiary with excess estate tax exemption grant him or her a power of appointment using a formula clause to avoid over including assets in the trust. This is similar to the formula that funds a bypass trust up to a specified amount with balance to a QTIP trust.
iv. Power of appointment could be given to other family members. If there is an older family member with a modest estate they may be made a beneficiary to later be granted a generation power of appointment for basis step up purposes. You can require consent by a non-adverse party to exercise the power to control the exercise of that power. It may not be required to inform the power holder that they have the power of appointment.

n. GST Exempt.

        i. Exempt the trust from GST whenever possible and permit trust to last as long as state law will permit.

   o. What to do with a less than optimal trust.
        i. Use trustee's power of distributions to appoint to a new trust with more favorable provisions.
        ii. Some trusts have a decanting clause, if not use state law.
        iii. Some states will permit decanting rom HEMS trust to a fully discretionary trust but not all will permit this.
        iv. Court reformation may be possible.
        v. Form a business entity in the trust to "soak up" income in the trust to minimize distributions.
        vi. If trust agreement says decanting not permitted than it is not permitted.
        vii. If the trustee is not granted authority to distribute asset currently decanting may not be possible.
   p. If state law does not permit decanting you may be able to move the trust to a new jurisdiction that permits decanting.

7. **<u>6A - Al King – Modern Trust Structures</u>**.
   a. Population, demographics.
        i. Aging population triggers greater demand for modern trusts.
        ii. Millennials, boomers and others all have different views of planning but they all view modern trusts favorably.
        iii. Baby boomers considered age of adulthood age 18. Generation X age 21. For millennials adulthood is said to be age 30.
        iv. Boomers.
            1. 13% of the population.
            2. 77 million people.
            3. Ag3 52-70.
            4. Will transfer $30 Trillion to heirs in the next 30-40 years.
   b. Statistics.
        i. 16 Trillion globally and $6 trillion US set to change hands.
        ii. $54 Trillion in US by 2018 wealth anticipated. This is an increase from $46 Trillion in 2013.
        iii. 70% of inherited wealth is gone by the 2nd generation and 90% by the third generation.
        iv. What percent of Americans believe it is important to leave an inheritance to their children/heirs?
            1. 76% of those 18-46.
            2. 55% of Baby boomers.
            3. 73% of those age 67+.
        v. 61% of high net worth parents are not confident that their children are well prepared to handle a financial inheritance.
        vi. 73% of those age 18034 have no idea of their assets versus their debts.
        vii. Millennials' expect to inherit $1 million when in fact the average inheritance will only be $177,000.
        viii. Many view inheritance as their retirement plan.

ix. 1/3rd of boomer expect to leave money to charity. Consider adding power to give to charity in trusts.

x. **Comments**: The above statistics provide valuable insight into a range of critical issues that indicate guidance clients and their heirs would benefit from. Consider the disconnect between the number of Boomers who feel leaving an inheritance is important and the number of heirs (Millennials') who believe that it is. This might well suggest that Boomer heirs except inheritances more than Boomers themselves rate that as important for them to do. More concerning are the figures of what Millennials' expect to inherit versus the average anticipated inheritance. The average estimated inheritance of $177,000 may also be very misleading as high net worth parents of Millennials' may bequeath large amounts thereby skewing the average higher, meaning that most Millennials' will inherit much less. Will these dichotomies result in more malpractice risks for practitioners as the disappointment of potential heirs seems baked in to the above statistics?

c. Core and Excess Capital.

i. How do you get clients comfortable to gift to irrevocable trusts?

1. I need $X to live on and am comfortable shifting the rest out.
2. There is no net worth that coordinates with gifting it is all relative to spending, etc. It really ties in to the client/prospective donor's mentality.
3. The estate tax is not the motivator for most giving. The estate tax is important but there are more important factors.

ii. Lifestyle and emergency reserve.

1. This is defined as core capital.
2. Investment allocation should be for security. A balanced mix of liquid traditional asset classes.
3. Transfer strategy is "minimum amount that must always remain in the estate (trust)."

iii. Excess capital.

1. These are funds for children, other heirs and charity.
2. This is defined as excess capital.
3. Funds can be invested more aggressively. Tailor the investment allocation to the risk profile of the beneficiaries.
4. This is an amount that can be safely transferred out of the estate (trust).
5. Incentive trust assets to promote fiscal and social responsibility.

iv. **Comments**:

1. Planning can be more flexible. If the trusts used are non-reciprocal spousal lifetime access trusts, especially if backstopped with life insurance to address the risks of premature death (determined by financial forecasting), and/or self-settled trusts (DAPTs) even core capital can be transferred safely. In fact, unless this view is taken the ability to protect core capital from creditors and predators may be too limited. Similarly, the approach to excess capital can be

taken more broadly as well. If assets are transferred to non-reciprocal SLATs or DAPTs the descendants or other heirs as well as charities can all be made beneficiaries so that no distinction needs to be made in terms of planning for excess versus core capital. The aggregation with flexible modern trust planning can provide more security for the client while moving more assets out of the estate (assuming that remains relevant after Trump tax legislation). If assets are aggregated and what might otherwise have been designated as excess capital is also available to the client, perhaps a more aggressive overall asset allocation may be tolerable, leading to a greater growth in overall net worth.

d. Client objectives.
    i. Family governance.
    ii. Control and flexibility of trust administration.
    iii. Control and flexibly in trust investment planning and management.
    iv. Privacy.
        1. Secrecy is gone.
        2. Privacy as to court proceedings.
        3. Quiet trusts (see below).
    v. Asset protection.
    vi. Tax savings.
    vii. Family management.

e. Trustees.
    i. 70% of wealthy families do not use corporate trustees.
    ii. **Comment**: With the flexibility and control that can be exercised using a modern directed trust, the advantages of trust friendly jurisdictions, the ease of providing multiple mechanisms (e.g. a trust protector) to change corporate trustees, it is puzzling how this statistic can be so high. Is the low use of corporate trustees a result of the other advisers (attorney, CPA, wealth manger, etc.) not educating clients as to the advantages of modern trust structures?

f. Once beneficiaries understand the flexibility and benefits of a modern trust they would want funds retained in trust and not distributed but too often they do not have the full knowledge.
    i. **Comment**: Considering this comment and others in this outline a strong message of the presentation is that practitioners need to engage "next-gen" to educate and inform them. Traditional estate planning practice does not focus on that but rather on the completion of a plan and documents for the senior generation.

g. Reporting.
    i. Foreigners are moving trusts to US because US has not signed on to foreign reporting requirements that most foreign governments have agreed to. This is a 180 degree change from past.

h. Duty to inform and notify.
    i. Should all beneficiaries, some, or none be notified of the trust's existence and other pertinent information?

ii. Quiet trusts are better for asset protection. Not knowing may help protect trust assets. Not having a beneficiary receiving statements that may be discoverable may reduce risk.
iii. Some state laws permit quiet trusts, others do not.
iv. Could give protector the power to turn on or off notification of beneficiaries.
v. **Comments**:
    1. A "quiet" trust is one for which disclosures of information concerning the trust don't have to be made. Why might your client want a trust to be "somewhat" quiet? Your client might not want heirs seeing a statement that reflects the many millions of dollars they have in a trust while they are hoping that they learn how to become financially prudent and begin saving for their retirement. Seeing big numbers might well dissuade them from getting on the financial path your client, their parents, feel is in their best interest.
    2. Many states have enacted laws permitting silent trusts. Often when these are done disclosures are limited until a beneficiary attains a specified age. The Uniform Trust Code Sec. 813 requires keeping qualified beneficiaries reasonably informed and Sec. 105(b)(8) prohibits waiving the duty to inform qualified beneficiaries over 25 years of age.
    3. Many clients find the entire idea of notifying beneficiaries of a trust surprising. But that may be due to the fact that many people think of individual family trustees who tend to ignore many trust formalities, including communication with beneficiaries.
    4. A significant issue is what liability the legions of individual trustees may have to beneficiaries they've kept uninformed about the existence of a trust without a documented basis for doing so, and often without any basis in the law or trust instrument for doing so. Practitioners should inform individual trustees that if they have not reviewed with trust counsel the disclosures they are required to make, or should make, to beneficiaries they might face significant liability.
    5. While the concept of a quiet trust sounds enticing to many clients in theory, a trust that is too quiet may be dangerous. If no one who has an interest in the trust receives disclosures, who will be watching the trustee's actions that has a vested interest in the outcome of the trust? On the opposite extreme, some institutional trustees take the position that, unless the trust provides limitations and state law permits it, they will send a statement of all trust assets to every beneficiary and every person named in the trust. Who might that include? Potentially a large number of people might get notice. Modern trust drafting favors listing all descendants as beneficiaries in many types of trusts A broad pool of beneficiaries gives the trustee wider latitude to distribute trust funds for whoever might be in need. Also, having a large pool of

beneficiaries gives the trustee more options to spray income to beneficiaries in lower tax brackets, thus saving income tax every year. But every one of those beneficiaries may not be on the list to receive a copy of the trust financial data.

6. Modern trusts may include a number of provisions to assure that the trust is characterized as a grantor trust for income tax purposes. Common provisions to achieve that status are to give a person the power to loan the settlor (the person who set up the trust) money from the trust without adequate security. Another common technique is to give a person the right to add a charity to the class of beneficiaries of the trust. Many modern trusts include a position called a trust protector. This is a person often granted a limited but important list of powers, such as the right to replace an institutional trustee, change the situs and governing law of the trust, and so forth. All these persons may also be on the trust company list for receiving a full disclosure of all trust finances. This trust might have far more information going to more people than any client might be comfortable with.

i. Directed Trust.
    i. Duemler v. Wilmington Trust Co., No. CA 20033 NC (Del Ch. Nov 24, 2004).
    ii. Directed trust invested in a non-diversified portfolio with risky assets that had to be diligently monitored.
    iii. Administrative trustee forwarded prospectus to investment adviser. The investment adviser did not provide the trustee with direction. There was a significant decline in the value of the investment.
    iv. Directed trust statute upheld.
    v. Investment adviser must make decisions in isolation without oversight from general or administrative trustee.
    vi. Compare directed versus delegated trust.

j. Investments.
    i. LLC used frequently to hold investments.
    ii. If on investment committee it could create a state problem. While all agree that it is not a 2036 or 2038 problem it could raise a state tax issue. NY held if LLC has only securities not an issue.
    iii. Investment asset are located where administered.

k. Additional modern trust tools/techniques.
    i. Directed trust.
    ii. Special purpose entity (SPE).
        1. An LLC can be owned by the trust and may handle investment management.
        2. A member of the client/grantor's family or a family adviser can be named as a manager of the LLC.
        3. The trust could be the sole member of the LLC.
        4. The LLC should be set up in the trust friendly jurisdiction not in the grantor's home state.

5. The SPE could have a board of managers, a trust protector, investment committee, and distribution committee instead of these functions being incorporated into the trust instrument directly.
6. Will this SPE provide liability protection to the persons serving in these capacities in contrast to their serving as individuals named directly in the trust?

iii. Trust protector company.

iv. Private family trust company (regulated or not regulated).

1. Growing trend for UHW families.
2. Facilitates sophisticated asset diversification.
3. Governance.
4. Privacy.
5. SEC exemption.

8. **<u>7A - Alexander Bove – Trust Protectors</u>**.

a. Introduction.

i. "…the addition of a protector and the added flexibility it offers, has effected a sort of mini-revolution in trust law and practice."

ii. First protector statute was in Cook Islands in 1989.

iii. First US trust protector statute was enacted in 1997. South Dakota.

iv. Definition – a person who is the holder of a power which when invoke is capable of directing a trustee in matters relating to the trust and in respect of which matters the trustee has a discretion and includes a person who is the holder of a power of appointment or dismissal of trustees.

v. A trust protector is nothing more than a trust advisor with a different name (although often given greater powers than the traditional trust adviser).

b. Fiduciary status.

i. There seems to be a question as to whether the protector acts in a fiduciary capacity or not.

ii. Some believe that if document specifies that protector is a fiduciary he or she is, and if it states that the protector is not a fiduciary then he or she is not. This is not necessarily correct. Protector is there solely to protect interests of the trusts and the beneficiaries. If the protector is there for the beneficiaries' welfare there are some duties that go along with that.

iii. Even if instrument states that the protector is not a fiduciary, how does that relate to the powers that the protector has?

iv. A protector can have either or both fiduciary powers or personal powers. It is not possible to have a power that is both fiduciary or personal. There must be a division. If a beneficiary of a trust and has the power to veto distributions and the power to remove and replace the trustee. Are they both personal powers? A power you can use to benefit yourself (no standards, no one to answer to) is a personal power. If you have to answer to someone it is a fiduciary power.

v. Good faith action versus retaliatory action? With a personal power there is no good faith requirement.

vi. How does it benefit a client to put a person in such an important position and not have it characterized as a fiduciary duty.

vii. Whether the protector acts with a fiduciary responsibility may depend on the power involved and the facts. For example, if the settlor named his daughter as protector and gave her the right to remove beneficiaries, it would seem that should be characterized as a personal power. So if the daughter in that capacity removed her siblings and named her descendants as beneficiaries it should be a permissible exercise of a personal power. In contrast if the settlor named his attorney as a protector and the attorney removed the settlor's children as beneficiaries naming his own the power should be viewed as a fiduciary not personal power and the attorney's actions a breach of that fiduciary responsibility.
viii. Can trust instrument draft away the fiduciary status of a protector who would otherwise be acting in a fiduciary capacity?

c. Protector in domestic trusts.
    i. Consider local tax implications.

d. Protector use.
    i. Consider a protector for most trusts. This is not to say use a protector in every trust, but do consider whether it is appropriate.

e. What powers to give a protector.
    i. Consider
        1. Possible conflicts between the protector and the trustee.
        2. Resist the temptation to give as many powers as possible to the protector.
        3. There is no "standard" set of powers.
        4. Endeavor to anticipate powers that may be relevant to the plan and circumstances.
        5. Anticipate powers that might be better held in the hands of someone other than the trustee or the beneficiaries.
    ii. Powers that might be given.
        1. Remove, add and replace beneficiaries (consider whether it is preferable for the protector to hold this power instead of the beneficiaries).
        2. Veto or direct trust distributions.
        3. Add or delete beneficiaries.
        4. Change situs and governing law of the trust.
        5. Veto or direct investment decisions.
        6. Consent to the exercise of a power of appointment.
        7. Determine whether an event of duress has occurred.
        8. Amend trust administrative provisions.
        9. Approve trustee accounts.
        10. Terminate the trust.
        11. Mediate disputes between the beneficiaries and trustees.
    iii. Power that cannot be given.
        1. Cannot further illegal purpose.
        2. Cannot be given power to violate public policy.
        3. Cannot be given blanket authority to prevent any beneficiary from seeing a copy of the trust.

a. **Comment**: See discussion of quiet trusts in Al King's presentation above.

4. Cannot deny a beneficiary the right to an accounting.

f. What is relationship between protector and trustee.
   i. Key to the relationship is whether the protector is deemed to be acting in a fiduciary capacity.
   ii. If the power is a personal power held in a non-fiduciary capacity the protector cannot be forced to exercise that power. The trustee should have no duty to consider or react to a personal power held by a protector and should have no duty to look into the protector exercise, or non-exercise, of that power.
   iii. A trustee cannot rely on a protector's improper instruction and avoid any responsibility. Contrast this to a directed trust in which the trustee can rely on direction for investments by a trust investment adviser.
   iv. Protector has powers over trust but is not a trustee.
   v. UTC addresses in context of a party with powers over trust and without using term "protector." Trustee should follow instructions of such a party/protector unless it results in a breach of trust. If trustee is unclear the trustee might then petition a court for instructions which defeats much of the point of a protector.
g. Case law.
   i. No US case law dealing with duties of protector.
   ii. Robert McLean Irrevocable Trust v. Davis, 283 S.W. 3d 386 (Trust Mo. Ct. App. 2009). The trust said trust protector was a fiduciary. Protector who was lawyer could remove and replace trustee. Trustee was wasting trust assets, e.g., $150,000 stereo for beneficiary, $50,000 for a fence. This was a SNT that was supposed to provide for beneficiary for the rest of his life. The beneficiary's life expectancy was 27 years. 18 months later trust was almost bankrupt.
   iii. Lower court held for the protector because court was uncertain what protector's duties were. There is now law in Missouri on what a protector's duties are.
   iv. Speaker - clearly the person as protector should have duties to the beneficiary.
   v. Court said trust stated protector was fiduciary so had duties to beneficiary.
   vi. When did protector know of issues? When should protector have acted?
h. Schwartz v. Wellen 2014 WL 1572767 (DSC April 17, 2014).
   i. Protector could not sue since was not a party in interest.
i. Bermuda case concerning removal of trustee.
   i. Issue was whether it is a fiduciary power to be able to remove and replace the trustee.
   ii. Trust protector may not have to act at all times and constantly review the protector remains bound by fiduciary rules.
j. State laws.

1. 7 or 8 states say protector is not a fiduciary unless trust provides otherwise.
2. Other states state protector is a fiduciary unless trust states otherwise.
3. A trustee has a duty to monitor as a fiduciary.

k. Springing Protector.

i. Trust may not need a protector. May need a protector when an issue arises, e.g. deleting a beneficiary or decanting and trust does not provide for decanting.

ii. Draft a provision that permits the appointment of a protector at a future date.

l. Term.

i. Consider having a term for a protector to obviate the need for termination or resignation. When term ends it is over.

9. **<u>8A Susan Lipp, Kim Kamin, Al King, Alexander Bove, Hugh Magill – Trust Structures</u>**.

a. Primary Fiduciary Functions.

i. Discretion over income/principal for independent trustee.

ii. If beneficiary/trustee limited by ascertainable standard.

1. **<u>Comment</u>**: While many clients want the beneficiary to serve as a trustee thereby necessitating a HEMS standard caution should be exercised. A HEMS distribution standard could jeopardize the protections the trust affords. In some states a support trust (i.e., one with a HEMS distribution standard) in contrast to a discretionary trust, are reachable in divorce. See Matter of Daniel Kloiber Dynasty Trust u/a/d December 20, 2002, 2014 WL 3924309 (Del. Chan., Unpublished, August 6, 2014).

iii. Asset allocation.

b. Private trust companies.

i. Strong on administration and asset management.

ii. Significant costs.

c. Common law model.

i. All fiduciary duties would be held by and discharge by a single fiduciary or co-fiduciaries.

ii. Responsibilities of others, e.g.,

iii. 1986 First state to adopt bifurcated or directed trust statute to allocate responsibility for asset management but by design can be used for any fiduciary functions.

iv. 40 states recognize directed trusts.

v. Standard of conduct differs by jurisdiction.

vi. Leads to more complex structures but these provide more flexibility.

vii. Issue of communication and collaboration becomes critical with the persons acting in various capacities.

d. Family structure changing.

i. How many family structures exist in US today?

ii. Census identified 10,000 different structures.

iii. Much of thinking about fiduciary structures and trust design is based on traditional nuclear family with biological children. While this is common, it is only the 4th most common structure. It is critical to consider this in evaluating how to address structure of trusts.
iv. Must think creatively and carefully about which allocation of fiduciary responsibility will serve which family.

e. Beneficiary goals.
    i. Beneficiaries come to trust process anticipating significant flexibility.
    ii. Expect trustee to manage complexities of taxation, situs, etc.
    iii. Reallocation of principal.
    iv. Duty of prudence, loyalty and so forth.
f. Trust design/Grantor intent.
g. Full service trust companies.
    i. Some people need the full range of trust services.
    ii. May name family co-trustee with institution.
    iii. As a result many large trust companies have full trust services and that may include directed trust operations in those trust friendly jurisdictions so that clients can pick whatever level or type of trust administration fits.
    iv. Types of trust administration:
        1. Private trust company (see below).
        2. Full trustee and performing all tasks.
        3. Family trustees and rely on outside help, e.g., attorney, CPA, trust company, etc. Family member may delegate out trust administration to a trust company that will perform as agent for the family trustee. This might include not only investment management but administration.
        4. Directed trust. Not for everyone but there is a large and growing group that this suits. As wealthier families with complex asset situation such as operating business and don't want any issues with diversification, etc. Institution is typically named. Fees are a major concern. Fees are low because trustee is doing less but the overall costs could be more depending on what else is done. The fee for separate investment management, trust services, etc. may overall exceed a more traditional trust structure.
h. Jurisdiction attributes.
    i. States that have directed trust may have other advantages to facilitate such trust planning, e.g., like low or no state income tax. May wish trust to invest in assets that a typical trustee might not be comfortable doing, e.g., real estate. There is liability but it is very reduced, e.g., gross negligence or willful misconduct standard.
    ii. Asset protection is better in some of these states too.
    iii. Drafting trust protectors when state law does not have a statute providing for the position can be uncertain.
i. Private trust company.
    i. Why would a family want a private trust company?
    ii. Where would you set up one?

iii. What is the difference between a regulated or unregulated one.
iv. Fee practitioners have done these.
v. A private trust company is another option of who can serve for the family.
vi. Owned by family or special purpose trust or dynasty trust.
vii. Often structured as LLC.
viii. Not available to the public. Public trust companies are not affected these are not competition. Private trust companies often need to rely on public trust companies to administer the private trust company. Often public trust companies set up private trust companies in a turnkey manner.
ix. Regulation is reduced from that which a public trust company in the same state would face.
x. If client has single family office it will interact with private trust company with service agreement. The private trust company could take over the family office and operate it through the private trust company.
xi. 6-10 degrees of kinship from a common ancestors. Can include spouses, key employees, and family controlled charitable entities.

j. Why create a private trust company?
   i. Privacy. Avoids working with strangers at public trust company.
   ii. Efficiency in managing family trusts. Doing all of this in house in family office can be more economical.
   iii. Ability to cater to investments family wants. This might be less diversification holding a family business. Some states may relax rules on prudent investors and diversification but there are still responsibilities.
   iv. Potential protection of personal liability for trustees. Most state statutes require no bad faith, cannot be reckless, etc. Mere negligence may be protected by LLC wrapper and E&O insurance. This is preferable to individual family members acting in their individual capacity.
   v. Avoid SEC regulation. If fit under rules for family office may be excluded. If family has an RIA if transition to private trust company may only face state bank regulation and not SEC regulation.

k. Where?
   i. Most popular regulated jurisdictions:
      1. New Hampshire.
      2. Texas.
      3. South Dakota.
      4. Tennessee.
   ii. Unregulated:
      1. Wyoming.
      2. Nevada.
   iii. Florida and Ohio are becoming more popular.

l. Cost.
   i. $250,000 for regulated.
   ii. $75,000 unregulated.

m. Offshore versus Domestic.
   i. Due diligence for foreign trusts is quite costly and complex.
   ii. Tax reporting, US regulations, etc.

iii. On shore trust is much simpler and less costly.
iv. FAPT without due diligence is $25,000 - $40,000 +. Some of the due diligence exercises can be as costly as creating the trust.