Issue 37 – July, 2021

NAEPC Journal of Estate & Tax Planning

New! Download the **entire issue as one PDF file** for offline reading.

Guest Editor's Note: NAEPC Would be Better with You!
This month, we turn the reigns over to our Vice-chair of the Publications Committee to discuss his experiences with NAEPC and how you can experience the same.
Author: Harvey A. Hutchison III, JD, LL.M. (taxation), CFP®, AEP®

Growing Your Business and Network in a Virtual World: A Multidisciplinary Panel Discussion (Video)
This 90-minute multi-disciplinary panel discussion teaches back-to-basics strategies for interacting with clients in the rapidly growing virtual space from experts in the technology, legal, trust, insurance and financial planning, philanthropic, and accounting practice areas.
Learn more about the **Robert G. Alexander Webinar Series**.
Moderator: Martin M. Shenkman, CPA/PFS, MBA, JD, AEP® (Distinguished)

Features

How to Make Your Practice More Diverse and Inclusive (PDF)
Three national estate planning leaders, including two NAEPC Board Members, discuss how diversity can increase the value of your practice, make it more innovative, and grow our industry.
Reproduced courtesy of Trusts and Estates
Authors: Karen McCrae-Lee Fatt, CTFA, AEP®, CES®, Martin Shenkman, CPA/PFS, MBA, JD, AEP® (Distinguished)), and Susan J. Travis, CFP®, CTFA, AEP®

President Biden's Budget Includes Big Tax Increases – What You Can Consider for Your Clients Now (PDF)
Four national industry experts (and members of our Publications Committee) came together to summarize and discuss recent proposals from the President, and how they could impact clients now and in the future.
Portions of the article originally published in Forbes.
Authors: Al W. King, III, JD, LL.M., AEP® (Distinguished), TEP, Charles Ratner, JD, CLU. ChFC, AEP® (Distinguished), Richard L. Harris, CLU®, AEP®, and Martin Shenkman, CPA/PFS, MBA, JD, AEP® (Distinguished)

"Non-Grantor Trust Resurgence & Avoiding an Unintended Switch to Grantor Trust Status (PDF)
An original article submitted to the Journal by three national experts discusses how attorneys, tax preparers, accountants, and financial advisors

can help clients and trustees navigate a possible chaotic scene.
Authors: Joy Matak, JD, LL.M., Lisa Mela, CPA, MST, and Martin M. Shenkman, CPA/PFS, MBA, JD, AEP® (Distinguished)

Growing Your Business and Networking: A Multidisciplinary Panel Discussion – Lessons Learned from The COVID Pandemic (PDF)
This article is based on a transcript of a NAEPC webinar that featured colleagues from allied professions and discusses how various practices are marketing in the current environment.
Authors: Martin M. Shenkman, CPA/PFS, MBA, JD, AEP® (Distinguished), Greg Delisle, Thomas M. Forrest, TO, AEP® (Distinguished), Bronwyn L. Martin, MBA, ChFC®, CLU®, CLTC®, CRPC®, CFS®, CMFC®, AEP®, LACP, AIF®, CFS, Ginger Fuller Mlakar, JD, CPA, AEP®, and Gregory E. Sellers, CPA, AEP®

The Human Side of Estate Planning: Part 2 (PDF)
The second installment of an important three-part series.
Reproduced courtesy of **Trusts and Estates**
Author: L. Paul Hood, Jr., Esq. LL.M. (taxation)

The Human Side of Estate Planning: Part 3 (PDF)
The third installment of an important three-part series.
Reproduced courtesy of **Trusts and Estates**
Author: L. Paul Hood, Jr., Esq. LL.M. (taxation)

Picking the Best Retirement Plan for a Business (PDF)
Many factors go into picking the best retirement plan for a business – it is not a one-size-fit all process.
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Author: Kenn B. Tacchino, JD, LL.M , RICP

How to Avoid Common Sources of Drafting Errors (PDF)
You can avoid or lessen future conflicts over interpretation issues with proper planning at the beginning.
Reproduced courtesy of **Trusts and Estates**
Author: L. Paul Hood, Jr., Esq. LL.M. (taxation)

Estate Planning in 2021 and Beyond – What if the "For the 99.5% Act" and the "STEP Act" Catch Fire – Will the Estate Planning Arena Survive? (PDF)
This article discusses two legislative proposals being considered and planning opportunities for advisors to consider now and in the future.
Reproduced courtesy of Leimberg Information Services, Inc. (LISI)
Authors: Andrew M. Katzenstein, JD, LL.M., David Pratt, JD, LL.M., Brett S. Rosecan, JD, LL.M., and Brittany N. Newell, JD

News Nook: A Compendium of Current Affairs

Morrissette II Sets the Bar for Intergenerational Split-Dollar Life Insurance Arrangements (PDF)
Commentary on the Tax Court's recent decision in Morrissette II, and the impact it will have on the planning for intergenerational split-dollar planning.
Reproduced courtesy of Leimberg Information Services, Inc. (LISI)
Author: Howard M. Zaritsky, JD, LL.M., AEP® (Distinguished)

A Guide to Tax-Savvy Charitable Bequests (PDF)
Careful planning can dramatically cut the amount of taxes paid and increase family wealth.
Reproduced courtesy of Leimberg Information Services, Inc. (LISI)
Author: James Lange, CPA, JD

Notes of the 55th Annual Heckerling Institute on Estate Planning (PDF)
Notes and observations from Heckerling 2021 conference.
Reproduced courtesy of Leimberg Information Services, Inc. (LISI)
Authors: Joy Matak, JD, LL.M., Mary E. Vandenack, Esq., and Martin M. Shenkman, CPA/PFS, MBA, JD, AEP® (Distinguished)

NAEPC Monthly Technical Newsletter
Reproduced courtesy of Leimberg Information Services, Inc. (LISI)

NAEPC Would Be Better with You!
(Volunteer with NAEPC)
By: Harvey A. Hutchinson III, AEP®, Birmingham, AL

Upon completing my rotation through the director and officer roles within the Financial & Estate Planning Council of Huntsville (AL), I learned of the opportunity to work with the National Association of Estate Planners & Councils ("NAEPC") while attending their annual estate planning conference. As designed, the conference's rewards luncheon and smaller breakout sessions provided me the chance to meet national board members and staff. Upon hearing these individuals' stories, I was intrigued to learn more about NAEPC and how I might contribute to its mission to "… promote excellence in estate planning by serving estate planning councils and their credentialed members, delivering exceptional resources and unsurpassed education …."

My three years of voluntary service to NAEPC has been personally and professionally rewarding. In fact, my time with NAEPC has provided some of the highest returns (advancing the estate planning profession, nationally) on investment (my individual time) I've ever received! NAEPC's national office and staff are elite professionals that carry the burden of administering every part of the organization allowing me (and you) the opportunity to use our volunteer time on strategic initiatives (not on administrative tasks). A few experiences I've been able to participate in during my short time volunteering include the following:

Work on prominent, national issues. Piloted by the leadership of Mary Katherine "Kit" Mac Nee, CFP®, CRPC, Pasadena, CA and Susan J. Travis, CFP®, CTFA, AEP®, Houston, TX, the Diversity, Equity and Inclusion ("DEI") Task Force formed and began to address NAEPC's response to various national issues regarding diversity, equity, and inclusion. Not too long afterwards, NAEPC's national office and officers realized the continuing need to provide resources and training along DEI issues and moved to form NAEPC's DEI Committee. The DEI Committee has created a resource page on NAEPC's website for affiliated estate planning councils to utilize in their efforts to address DEI issues and provide training to their members (see https://www.naepc.org/about/diversity). [Note, while reviewing the resource page or this issue of the Journal of Estate & Tax Planning, don't miss the recent Trusts & Estates' article "How to Make Your Practice More Diverse and Inclusive" developed by NAEPC DEI Committee members Karen McCrae-Lee Fatt, CTFA, AEP®, CES, Tampa, FL, Martin M. Shenkman, CPA/PFS, MBA, JD, AEP® (Distinguished), Fort Lee, N.J. and New York City, and Susan J. Travis.] If you would like to learn more about volunteering with NAEPC's Diversity, Equity and Inclusion Committee, please contact NAEPC at admin@naepc.org or return a committee volunteer application.

Work with renown estate planning professionals. Guided by the leadership of Ginger F. Mlakar, JD, CPA, AEP®, Cleveland, OH, and myself, the Accredited Estate Planner® ("AEP®") Designation Committee is tasked with supporting the value and promotion of the AEP® designation (i.e., awarded only to estate planning professionals who meet special requirements of education, experience, knowledge, professional reputation, and character). Central to the AEP® designation is the "commitment to the team concept of estate planning." Also, the AEP Committee is responsible for the selection of prominent estate planning professionals to enter NAEPC's Estate Planning Hall of Fame. This recognition is to highlight an individual's distinguished service to the field of estate planning as an attorney, accountant, insurance professional and financial planner, philanthropic advisor, or trust officer. Several inductees into NAEPC's Estate Planning Hall of Fame include: Steve R. Akers (2006), Jonathan G. Blattmachr (2004), Natalie B. Choate (2004), Samuel A. Donaldson (2011), Martin M. Shenkman (2013), and Diana S.C. Zeydel (2016). For a complete list of NAEPC's Estate Planning Hall of Fame inductees, see https://www.naepc.org/designations/estate-planners/hall-of-fame. If you would like to learn more about volunteering with NAEPC's Accredited Estate Planner Committee, please contact NAEPC at admin@naepc.org or return a committee volunteer application.

Martin ("Marty") Shenkman's Collaborative Writing Experience offers aspiring estate planning authors, that are members of a local NAEPC-affiliated estate planning council, the opportunity to work with Marty in developing an article to be published within the Journal of Estate & Tax Planning. Having worked with Marty (i.e., the author of forty-two (42) books and more than one thousand (1,000+) articles, he serves as an Editorial Board Member of Trusts & Estates Magazine, CCH, and the Matrimonial Strategist) through this experience gave me behind-the-scenes perspectives and insights into the world of writing and publishing that I had never known or experienced before. If you haven't published an article before and would like to co-author an article with one of this generation's greatest estate planning writers and thought-leaders, sign-up for the next Collaborative Writing Experience. Please contact NAEPC at admin@naepc.org to learn more about Shenkman's Collaborative Writing Experience.

Build a national network of estate planning professionals. AEP® designees and Estate Planning Law Specialists (EPLS) certificants have access to special benefits that include forum events to hear from prominent estate planners. Oftentimes, these forums are structured in a way that permit attendees to speak to the presenter and fellow attendees. A recent forum event entitled "Creative Planning in Light of the Changing Political Landscape and Possible Tax Consequences" was presented by Marty Shenkman, Sandra D. Glazier, Esq., Bloomfield Hills, MI, and Abigail O'Connor, JD, MS, Anchorage, AK. Don't miss out on these future events:

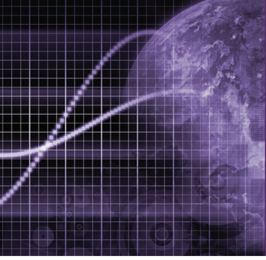
> Thursday, July 15th 3:00 p.m. to 4:00 p.m. ET – Special Social Event with Alex Sheen, Because I Said I Would Foundation, on "Promises Made, Promises Kept."
>
> Thursday, October 21st 3:00 pm to 4:30 pm ET – Forum Session during National Estate Planning Awareness Week – Topic and Speaker TBD.

If you or a colleague would like to learn more about the AEP® designation, please mark your calendar for the following event:

> Thursday, September 23rd 3:00 p.m. to 4:00 p.m. ET – "Why Earn the AEP®?"

I have had the opportunity to meet and work with more exceptional and diverse estate planning professionals with NAEPC in three years than I have ever met during my previous twenty-year financial and estate planning career. Not only does NAEPC benefit from a diverse membership and volunteer group but the individuals that volunteer gain different perspectives that will enrich their counsel to clients, employers, and communities. Take a look at the following links to NAEPC's current officers and directors to gain an appreciation of the diverse backgrounds, geographic locations, and practices of the volunteers. See https://www.naepc.org/about/board/officers and https://www.naepc.org/about/board/directors. Nevertheless, could the above group of volunteers be even better (i.e., more diverse, more inclusive, more equitable)? Yes! That said, that's where you come in – we need you! You have to take action and raise your hand and let NAEPC know you want to help it make a difference.

I implore you to volunteer with NAEPC! Your small investment of time could make significant changes to the organization that impacts the profession. Come help NAEPC meet its vision to "… be the association of choice for professionals engaged in the practice of estate planning …." Your ideas are wanted here and your voice will be heard. Please contact me (harvey.hutchinson@rocketmail.com) or Eleanor M. Spuhler, Executive Manager of NAEPC (eleanor@naepc.org) if you have any questions concerning volunteering with NAEPC. We are looking forward to hearing from you!



By **Karen McCrae-Lee Fatt**, **Martin M. Shenkman** & **Susan J. Travis**

How to Make Your Practice More Diverse and Inclusive

Set the tone for open and honest discussions about stereotypes

Would you like to increase the value of your practice? Diversity is the answer. No really. The more diverse and rich your life and your view of planning, the more varied clients you can attract. Conversely, the more diverse the clients and colleagues in your sphere, the more creative and innovative you and your practice can be.

Many people remain indifferent to diversity and the benefits it brings. The movie *Pleasantville* (if you haven't seen it you must) depicted living during a time before color as boring and stodgy. Diversity implies that we all come from the same family; it brings beauty, interest and vibrancy into our lives. This is a conversation not only about what you must do for a rewarding and profitable practice but also about what you should want to do to enrich yourself personally, your business and more! The key is to be intentional in taking steps to make it happen.

Diversity results in different perspectives at the table and hence more ideas and more creativity. On both the professional and personal level, the more different you are than me, the more interest, excitement, ideas and new viewpoints you bring to my life.

Events of the past year have not only changed our perspective when it comes to relations with others who don't act or look like us, but also it's served as a catalyst to those who've been oblivious (or worse) to the importance of diversity. Too often, we're so wrapped up in our own world that we're not aware of the richness of diversity and the challenges that individuals face daily because they're societally different. The key is to be intentional to start change.

COVID-19 has made us all pause and reconsider what's important in life. Death has become a more pronounced part of our daily lives with the evening newscasts showing the daily death tolls. COVID-19 doesn't discriminate, why do we?

Diversity means unity, and that helps all of us. In a positive way, learning about others and interacting with others who are different than we are brings light to our lives. Does it help you become a better human being? Thereby, does it help you become a better professional?

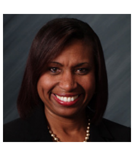
How to Start

Start talking. Have a conversation. Speak to your colleagues, speak to your peers in the profession, ideally, speak with those who have different views than you or different cultural, racial or religious backgrounds or health issues. Practically, some individuals and organizations don't have the opportunities to participate in these conversations. In those instances, turn to your professional organizations. They're becoming proactive. Perhaps there should be facilitators who can be available to mentor those conversations. Perhaps members of existing organizations should re-double efforts to bring diverse individuals to meetings and encourage their involvement. Little steps, like having a conversation, are a great way to start getting people to think about diversity.

How do you act? How do we act? Do we act from indifference? Has a colleague of yours been profiled?

What about including diversity-based content at

(From left to right) **Karen McCrae-Lee Fatt** is a wealth senior trust manager at Truist Financial Corporation in Tampa, Fla., **Martin M. Shenkman** is an attorney in private practice in Fort Lee, N.J. and New York City and **Susan J. Travis** is a client advisor and regional director at Mercer Advisors in Houston



conferences and web meetings? Why not include programs on estate or financial planning for different religious or cultural groups? What about more programming on LGBTQ+ planning?

Younger professionals often have an easier time embracing new and diverse ideas when in comfortable groups surrounded by their peers. Think about engaging our younger professionals with programing and events that intrigue and interest them, even on topics that aren't diverse but are of relevance and interest to these younger advisors.

The key and most important step in changing yourself and changing the world is to reach outside your comfort zone. Thought leader Roy T. Bennett has said, "Do Not Lie to Yourself. We have to be honest about what we want and take risks rather than lie to ourselves and make excuses to stay in our comfort zone."[1] Collaborating or helping those who are different from you culturally, racially and economically is a great way to promote diversity and enrich your life and practice. Be a mentor and/or be a mentee. Help diverse younger professionals write their first article, give their first speech or answer their questions to help them progress professionally. It often takes very little.

Is There Inclusivity?

Some suggest that some diverse practitioners aren't comfortable participating in organizations that are, for example, predominantly white. Are diverse practitioners not comfortable participating in many existing professional organizations? Are there language, cultural or just "comfort" barriers? Do those in the majority make an effort to make those who are in the minority feel comfortable? Too often not. The key is to be intentional. Reach out to include one individual.

Lack of Diversity

The social intolerance events of this year have been on the forefront of the nation's conscience. We've been forced to take a sincere look in the mirror and ask ourselves who are we, what our values are and how we communicate with one another. The estate-planning profession has also been challenged to examine whether it reflects the diversity of the environments in which we live and work and, more importantly, whether it embraces all people and cultures both as practicing professionals and clients.

According to *Wealthmanagement.com*, in 2017, 81% of financial advisors were white, 7% were Asian, 6% were African-American and 5% were Hispanic.[2] According to the Center for Financial Planning (CFP) Board, the number of Black and Hispanic CFP professionals grew 12% last year—the highest increase ever. Despite last year's gains, there are still only 3,259 Black and Hispanic CFP professionals in total—less than 4% of the 87,784 CFP professionals versus nearly 30% of the country's population.[3]

> Reflect gender-neutral terms in your client-facing forms, estate-planning documents and more.

There's no question that individuals generally feel more comfortable sharing ideas and relating concerns with those who understand their culture and who look like and identify with them. Estate planning is a practice that's universal to all individuals, regardless of race, creed, sex, gender identity, religious persuasion, disability or political affiliation. However, how can the profession bridge this gap and ensure that all people have access to ethical and high quality estate-planning services provided by individuals with whom they feel comfortable?

General Best Practices

Consider employing these practices in your own firm or office:

- Here's an easy step that costs nothing. Add to your email footer a statement of your personal pronouns. For example, Marty's are: Pronouns: he/him/his. Listing this is a statement to readers, including all prospective and current clients, that you're aware of and sensitive to gender identity. That's a simple step forward on the diversity and inclusivity continuum.
- Update organizers and questionnaires for clients to include questions that permit them to express their diversity. That sends a message that you're open to and sensitive to such matters. For example, permit

expression of religious, cultural and other concerns the client may have to planning. For example: "Do you have any religious or philosophical objectives that you would like reflected in your investment allocations?" Reflect gender-neutral terms in your client-facing forms, estate-planning documents and more.

- Make a point of attending and supporting educational/seminar topics about diversity. Those programs tend to have much lower registration than more technical topics but are perhaps more vital.
- Make a concerted effort to provide volunteer and other services to help those of lower economic wealth levels. Too much of the efforts of all the allied professionals are focused on the super-wealthy. How many financial institutions, attorneys, accountants and financial advisors serve those with under $500,000 of net worth? If you can't profitably serve lower wealth clients, volunteer for organizations that do. In 2020, $1,219,126 placed a client in the wealthiest 10% of the country's net worth.[4]

SPOT LIGHT

Horsing Around

A Day at the Races by Stephen Mangan sold for $6,968 at Bonhams Modern British and Irish Art auction on Dec. 16, 2020 in London. Mangan is a Scottish contemporary artist who's making an international name for himself. Common themes in his paintings include racecourses, beaches, stations, fairgrounds and theaters. His work has appeared and been sold at numerous auctions.

Collaborate, Educate and Cultivate

Intentional coaching away from indifference doesn't start at the top. Leadership support plays an important role and is needed to facilitate change from the top down. However, everyone must act and take part.

The authors of this piece, members of the Diversity, Equity and Inclusion Task Force of the National Association of Estate Planners & Councils (NAEPC), are working to validate the association's mission and vision of inclusion and take initiative by providing input as we structure and develop what that validation really means. One of the more significant approaches that NAEPC is now taking in fostering diverse partnerships is acknowledging the lack of diversity. Many of us feel uncomfortable not knowing what's the appropriate dialogue and response. We, like many other organizations, have established a "Diversity, Equity and Inclusion" committee that we feel sets the tone for open and honest discussions about cultural stereotypes and how we can help refrain from unspoken biases. We recognize that if NAEPC doesn't embrace diversity, we'll miss a great opportunity to move ourselves into the modern era of inclusivity. We've developed immediate, short-term and long-term goals for promoting diversity, equity and inclusivity into our organization.

Approach your local Estate Planning Council. Inquire as to the steps its taking to promote diversity, equity and inclusion. We'll only learn from each other. This isn't a quick fix, but a beginning for change. NAEPC is committed to helping local councils by sharing of ideas and best practices.

The key to change is to be intentional. It starts with conversations at the personal level, the firm level, the professional level and the corporate level. Be a part of the diversity, equity and inclusion growth of our industry.

Endnotes

1. Roy T. Bennett, *The Light in the Heart*.
2. *www.wealthmanagement.com/careers/six-charts-illustrate-financial-advice-industrys-lack-diversity/gallery*.
3. CFP Board, Center for Financial Planning, "Diversity In Action: How to Sustain the Financial Planning Profession" (2020).
4. *https://dqydj.com/average-median-top-net-worth-percentiles/*.

President Biden's Budget Includes Big Tax Increases - What You Can Consider for Your Clients Now

Al W. King, Charles Ratner, Richard Harris and Martin Shenkman

Introduction

On May 28, 2021, the Administration released its Fiscal Year 2022 budget and the Treasury Department released its General Explanation of the Administration's Fiscal Year 2022 Revenue Proposals. Tax advisors, among others, refer to the latter document as the "Green Book". The Administration's proposed a host of tax changes affecting individuals and corporations. Some of the significant proposals that many taxpayers hoped would not be included in the proposed budget, like the tax on transfers at death provision in the Sensible Taxation and Equity Promotion (STEP) Act introduced by Senator Van Hollen and others, are included. Those changes would transform tax and estate planning, raise significant revenues, and might have an impact on the reduction of wealth concentration in America.

Senators Schumer, Sanders and others have reached a deal on a $3.5 trillion Democratic-only infrastructure package. The proposal will, consistent with other proposals and comments that have been made, prohibit tax increases on individuals who make less than $400,000. Senators have also commented that wealthy and large corporations must start paying their fair share of taxes. This might result in some variation of the proposals below being enacted. Practitioners should alert clients that the substantial tax increases and changes that have been talked about since last year could be enacted soon.

Proposed Individual Tax Increases

The Green Book incorporates and further refines proposals made in the American Families Plan, which was announced on April 28, 2021. It would increase income taxation of high-income individuals, restrict tax deferred like-kind exchanges (swaps of real estate that avoid current income taxation that a sale would trigger), and much more. Some of the proposals include:

Higher Tax Rates: The top income tax rates could be bumped up from 37% to 39.6%., effective January 1, 2022. While some had expected that this increase would apply to taxpayers earning over $400,000, the proposal applies to income over $509,300 for married filing joint taxpayers, and to income over $452,700 for single taxpayers. While this is a rate increase, it is not clear from a planning perspective that the 2.6% rate differential alone would justify accelerating income into 2021. But any income acceleration should consider the capital gains rate changes below.

Capital Gains Rates Might Double: Consistent with proposals that have been discussed for a while, long-term capital gains (e.g. sale of stock, investment real estate, etc.) and qualified dividends of those with adjusted gross income over $1 million will be taxed at ordinary income rates of 37%, but only to the extent that the taxpayer's income exceeds the $1 million. That is about double the current 20% rate. This provision would apply to gains triggered after "the date of announcement", which may be April 28, 2021, the date of announcement of the American Families Plan.

Whether that date turns out to be the actual effective date of the change remains to be seen. If the effective date turns out to be prospective (meaning after 2021) and not retroactive, there could be dramatic and abrupt changes in investment, retirement, and other planning. If a taxpayer were planning on selling investment real estate, a family business, or diversifying out of a concentrated stock position or doing a life settlement with a very large policy, it might be beneficial to sell now before the rates double! The assessment could include forecasts reflecting various tax and economic scenarios to determine what might be worth pursuing. But be careful, as so much depends on the effective date of any such change. If this change is enacted, future planning, meaning beyond 2021, could be dramatically changed. Taxpayers might forecast and plan sales and income for a decade or longer into the future. Then, actions can be taken to control income realization to stay below the $1 million threshold and avoid the approximately doubled rates. This might include using installment sale treatment, charitable remainder trusts and more. Harvesting gains and losses may take on a very different approach than it has had historically.

Social Security Taxes: Another proposal is to coordinate the net investment income and self-employment taxes. Historically, high income taxpayers who earned income from a closely held business, e.g. a physician from her medical practice, paid themselves a more modest salary that was subject to Social Security taxes. The remaining profits were withdrawn as a distribution to owners that was not subject to those taxes, e.g. S corporation distributions. The savings, especially over years of work, could be substantial.

The proposal is that all passthrough business income (e.g. S corporations, limited liability companies, partnerships) of high-income taxpayers will be subject to either the net investment income tax or Social Security taxes. That might result in the restructure of closely held business entities, revisions to governing documents (e.g. partnership agreements) and changes in how profits, salary and other payments are made. This may have ripple effects on valuations, buy-out agreements, and more.

Carried Interests: Hedge fund principals may face higher taxes as carried interests will be taxed as ordinary income instead of capital gains, about a doubling of the rates.

More Audits: The administration has placed a major focus on enforcement. In fact, the American Families Plan proposes an $80 billion increase over the next ten years in the budget for IRS enforcement and compliance. The proposal would direct these additional resources be used only for enforcement on high earners and large corporations. Individuals earning over $400,000 would face a higher likelihood of a tax audit.

Estate and gift tax provisions

The Biden administration has, so far at least, not proposed changes to the estate and gift tax exemptions or rates, GRATs, etc. Of course, that may change, but perhaps for now the administration may be content to let the current exemption amount sunset in 2026 and focus its efforts on deemed realization which they may view as having a more substantial impact on wealth concentration. That said, the proposals that the Biden administration has put forth can fairly be described as “transformative”. Senator Sanders’ proposal, “For the 99.5% Act" does call for a return to lower exemptions as well as significant changes to the rules on GRATs and grantor trusts, among other things. It is possible that, ultimately, some (or all) of Senator Sanders’ proposal could be enacted along with a deemed realization system.

New Realization Tax on Transfers: Perhaps the most dramatic change under the Biden proposal, is to make the transfer of property by gift and on assets owned at death as of January 1, 2022 trigger events for capital gains tax. The proposal would assume that the donor or deceased literally sold the asset on the date of gift or death. Of course, there is no actual buyer and no sales proceeds! The gain would be measured by the excess of the fair market value of the asset at the date the gift is made or the date of the decedent’s death dies over that person’s basis in the asset.

Fortunately, there are notable exclusions, meaning transfers that would not trigger gain. For example, a transfer at death to a (U.S.) spouse would not trigger gain. Query whether the definition of “transfer to a spouse” has implications for traditional “A/B” trust planning. There is no mention of a transfer by gift to a spouse. Commentators assume that that omission was just an oversight. In any event, the spouse would take a carryover basis and gain would be triggered when he or she gives away the asset or dies owning it. More on this later.

A transfer to charity would not trigger gain, though a transfer to a charitable remainder or lead trust could apparently trigger gain attributable to the non-charitable portion. These split-interest trusts are mainstays of income, gift and estate tax planning and they are often funded with appreciated property. Depending on the design of the trust and the size of the remainder or lead interest, that type of funding could trigger substantial capital gain. Taxpayers who are currently considering these trusts will want to monitor developments with this proposal to determine if they should proceed in 2021. Taxpayers should also consider the risk of a Van Hollen proposal with a retroactive date being enacted.

A transfer to a trust would not trigger gain if the trust were a grantor trust, revocable by the grantor. When the grantor dies or the trust is no longer revocable, the gain would be triggered. Transfers by gift to irrevocable trusts that are not includible in the grantor’s estate would trigger gain. Planners structure sales to defective grantor trusts for full and adequate consideration to avoid a gift element (other than the seed cash, presumably). Even if these transactions still work under a new deemed realization system, there will be increased downside risk to a successfully contested valuation, for example. This suggests the continuing importance on proper valuation and, no doubt, the use of formula clauses to prevent transactions from containing a gift element. Beyond these transactions, the full implications of gifts of appreciated property to irrevocable trusts triggering gain would come into play in many forms of planning.

Fortunately, there is an exclusion for transfers of $1 million of gain, indexed for inflation after 2022. That exclusion would be portable between spouses so that as a unit, they would have $2 million in exclusion. The fact that the exclusion is portable suggests that “traditional” portability planning will have to be expanded to address this new rule. There is also a $250,000 exclusion ($500,00 for couples) for gain in a personal residence. The proposal addresses the basis that a recipient of a gift or devise would take in the transferred asset, but further clarification is needed.

(The “gain” at death of a life insurance policy - that is the death benefit in excess of basis - is not subject to that tax.)

If the asset transferred by gift or bequeathed at death is an interest in a family-owned and operated business, an undefined term, the tax would not have to be paid until the business is sold or is no longer family-owned and operated. Clearly, this proposal adds a new dimension to business owners’ liquidity planning.

The imposition of the capital gains tax on non-excluded transfers adds a new dimension of taxation to gifts. The realization of gain at death, again measured by the difference between fair market value a death and the deceased’s cost basis in the asset, is a major departure from current law, which provides for a stepped-up basis at death and no triggering of gain. These are transformative changes.

Tax on Trusts and Entities: There is another facet to the above realization regime. Gain on unrealized appreciation also would be recognized by a trust, partnership, or other non- corporate entity that is the owner of property if that property has not been the subject of a recognition event within the prior 90 years, with such testing period beginning on January 1, 1940. The first possible recognition event for any taxpayer under this provision would thus be December 31, 2030. This might suggest that an individual who created irrevocable trusts (or creates them now to try to avoid a reduction in exemption, which might not be incorporated into new legislation) a capital gains tax could be due on all appreciation as soon as 2030! What planning options might exist? Might trustees be able to distribute appreciated assets to beneficiaries to avoid that tax? Will trust agreements permit that? Will lots of grandchildren be receiving distributions before that date?

Business Tax Increases

The American Jobs Plan proposes several corporate tax changes including the increase corporate income tax rate to 28% from its current 21%. For those who restructured family and closely held business entities to regular or “C” corporation form to take advantage of lower corporate tax rates, this change might have them evaluate switching to an S corporation or other format. That, however, is not so simple as there can be costs in restructuring C corporations. Moving forward, the decision as to which type of business structure and choice of entity may change from what it has been since the 2017 tax law changes. Careful review of estate planning documents, especially trusts, will be needed. Changing a C corporation to an S corporation owned by irrevocable trusts will require special provisions to avoid tainting the tax favored status of an S corporation (the pass through of income to owners instead of paying a corporate tax). A great deal of analysis will be required, not just on the income tax side, but also on the estate and gift tax side to the extent that passthrough status was a key element of a wealth transfer technique.

What do clients need to know (or do) now?

It may take time for the various proposals on realization of gain on transfers to coalesce into legislation, if it ever does. On the other hand, it is possible that the Democrats push through an infrastructure or spending bill inclusive of tax legislation. There are just so many nuances to the proposal, apparent oversights and points that need further definition and clarification, both as to the law itself and the associated compliance procedures. So it's understandable that individuals might defer consideration of planning responses to the proposals until they have a much better idea of whether and how those proposals would affect them personally, in real time. But that may be too late.

Nuance and lack of clarity aside, however, there is no question that these proposals could seriously undermine the foundation of many high income, high net worth individuals 'tax, investment, estate and business succession plans. Therefore, individuals whose income and base of appreciated capital assets clearly indicate that the proposals would have significant impact on their tax and liquidity planning might ask their estate, tax, investment and insurance advisors to collaborate on an overview assessment of how things would play out if the key elements of the proposals were to become law.

Based on that assessment, client conversations could run the gamut of fact patterns and timing issues. For example, an individual who wants to make gifts of appreciated assets to use some of the current $11.7 million transfer tax exemption just in case that is reduced in the future needs to evaluate when those transfers might trigger capital gains tax if made after the effective date of the new legislation. And remember with the Van Hollen proposal that is January 1, 2021. So, immediate action might be worthwhile. But that individual's advisors might suggest techniques to unwind the transfers to avoid an unintended capital gains tax if triggered. Some advisors integrate provisions into irrevocable trusts that are a common recipient of gift transfers that permit one or more persons (trustee, one primary beneficiary, or all beneficiaries) to disclaim the transfers thereby (hopefully!) unwinding the transfers. For income tax purposes it may be possible to rescind a transaction during the same tax year if it trips over the effective date. Another approach may be to borrow money and gift the borrowed cash rather than appreciated assets.

Consider what this type of change might do to future planning? If an individual's estate will pay capital gains on all appreciation in assets he or she owned on death, the historic bias of holding assets until death so that the capital gains would disappear because of the step-up may prove costly. Instead, a totally new planning approach may become the rage. Individuals' tax and investment advisors can collaborate on projections that forecast the income and tax consequences of various approaches to timing sales for years or even decades. It might prove advantageous for some to realize some amount of gain each year before death to avoid the higher almost 40% tax on death. Advisors might suggest some adjustments to portfolios and how the investments are held. Of course, estate planning documents might benefit from amendments to permit this type of planning.

Private Placement Life Insurance

Another possible option may be in the form of a popular planning strategy often used today to minimize a client's exposure to high income and capital gains taxes, Private Placement Life Insurance (PPLI). Moving forward, PPLI could be reviewed as a potential solution to minimize the burden of a proposed or enacted increase in income and capital gains taxes. Today, PPLI policies can be structured very cost effectively. The cost of these PPLI insurance wrappers generally average 100 basis points or 1% annually. This is a low price to pay in order to possibly avoid federal and state income and capital gains taxes. These modern PPLI policies allow for a wide variety of investment opportunities. They can frequently be designed around investments of the client's choice. A PPLI policy owned by a trust providing a wrapper around trust investments may result in a zero-tax trust. Generally, if a trust owns a PPLI policy it will be sitused in one of the modern trust states with low state premium taxes such as Alaska, Delaware, South Dakota and Wyoming. The premium tax savings can average 200 basis points (i.e., 2%) or more. (Non-PPLI policies, those available commercially, will take out the 2.00% or more, regardless of the state in which the policy was purchased.)

Because you can only purchase life insurance with cash, the individual with a portfolio with built in gain will have to sell that portfolio, realize the gain, pay the taxes (albeit at a lower rate) before putting the money into a PPLI policy. If someone has an individual manager running the money it is highly possible they can continue to have that manager invest the money in the PPLI. To potentially avoid the 90-year rule a trust could own PPLI. When the insured dies they can take the proceeds and put them into a new PPLI policy and continue the strategy. As long as a policy is not a Modified Endowment Contract (MEC) money can be accessed by loans that will not be subject to income taxes. This is a way distributions can be made, as long as the insured dies with the policy still in force. Policies can usually satisfy the MEC rule by having premiums put in over four years.

Additional Considerations

There are many other planning implications worthy of at least some discussion now. Maybe a high priority would be to revisit the tax and economic implications of the way a company's buy-sell agreement is structured and funded. And it's not just the buy-sell. This change could call for a major recalibration of a business owner's liquidity needs! Maybe an intended outright bequest of appreciated property to a friend or relative should be recast with a charitable component to avoid realization of gain on death, though the use of a charitable remainder or lead trust to pass wealth at death might have to be put on the watch list. Maybe that long-deferred medical exam for life insurance should be done sooner rather than later in light of either the potential need for more liquidity due to realization or for income tax deferral purposes. Of course, any recommended adjustments would have the burden of proof that they wouldn't be counterproductive and regrettable if those proposals never do coalesce into a new set of rules.

To be sure, there is tension between waiting for clarity of the when and what of potential legislation and waiting so long that is impossible to get things in place before a new law is effective. Unfortunately, the effective date of tax legislation is often a date certain, like January 1st, not January 1st or as soon thereafter as the individual is ready. The point is that, in fairness, this time is different enough and the potential changes draconian enough, that individuals should plan on giving themselves and their advisors enough lead time to make informed decisions and implement sound plans in a timely fashion.

Non-Tax Considerations

Nevertheless, while taxes are certainly important, the key non-tax benefits to trusts in inter-generational estate planning will continue to be critical. Modern trust laws found in boutique trust jurisdictions such as Alaska, Delaware, Nevada, New Hampshire, South Dakota, Tennessee, and Wyoming will continue to play an important role in a client's overall legacy planning. In fact, today many families view the non-tax benefits of modern trust laws as important or even more important than the tax benefits. These non-tax benefits include privacy, asset protection, and the promotion of family values. As such, no matter what tax legislation is enacted, client's will continue to be concerned with keeping their trusts 'quiet' from beneficiaries with potential problems, they will continue to care about protecting their children from troubled ex-spouses and they will continue to desire investment and distribution flexibility. Many of these planning goals are achieved today and should continue moving forward. Consequently, trusts should continue to be drafted with modern trust concepts in long-term or perpetual trust states with statutes providing for directed trusts, asset protection, privacy, decanting, reformation/modification, virtual representation etc. to deal with future uncertainty. In addition, existing trusts should be reviewed and be reformed and decanted to do the same, if they have not already been drafted to do such.

Conclusion

Regardless of what finally results, these are things you need to consider and reach out to clients with now because time is of the essence.

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Non-Grantor Trust Resurgence &Avoiding an Unintended Switch to Grantor Trust status

by: Joy Matak, JD, LLM, Lisa Mela, CPA, MST, and Martin M. Shenkman, Esq.

The tax rules governing trusts have evolved over time as taxpayers and the government chiseled the landscape through countless cycles of planning, regulations, court cases, and IRS rulings. Wealth transfer practitioners use the rules to gain advantages for taxpayers, implementing strategies that are regulated and challenged by the IRS, and then litigated in the courts. Congress then breaks the cycle by passing new legislation that changes the rules, starting yet a new cycle.

A Wild Ride for Grantor Trusts Tax Consequences

For grantor-type trusts, the cycle has been a winding roller coaster stretching over generations. The grantor trust rules were originally created to stop wealthy taxpayers from using trusts to shift their income tax burdens back when trust income tax rates increased at the same rate as individual income tax rates. Congress imposed upon the settlor the obligation to pay the taxes on the income earned by any such trust when the settlor retained certain powers over the trust. With the advent of the grantor trust rules, the era of shifting income to a trust from the assets transferred to the trust came to an end.[1]

However, just as Congress closed this income tax loophole by imposing the grantor trust rules on wealthy taxpayers, many more planning opportunities were developed. The estate planning community realized that shifting an asset out of an estate for estate tax purposes, while retaining the income tax burden, could be advantageous to an estate plan as a result of the burn on the settlor's estate. While many clients may not appreciate remaining responsible for the income taxes of assets transferred to the trust, this characteristic of the grantor trust could be the most valuable estate tax minimizing feature. Tax burn over many decades could provide greater benefit than even valuation discounts. Under current law, grantor- trusts allow wealth to accumulate outside of the settlor's taxable estate, all while decreasing the value of the settlor's taxable estate by the income tax payments on the income earned inside the trust. Thus, a grantor trust enables taxpayers to make tax-free gifts in the form of income tax payments on behalf of the trust. Further, for so long as the grantor trust status remained intact, sale or swap of assets from the trust with the settlor can generally be made without income or transfer tax consequences. Finally, distributions to beneficiaries from the trust can be made without pushing out income to the beneficiary.

Grantor trusts have become ubiquitous in modern estate planning. For most wealthy taxpayers, grantor trusts are viewed as a vehicle for leveraging wealth to the next generation. Assets owned by a grantor trust can accumulate value outside of the settlor's taxable estate while the settlor depletes her taxable estate by the amount of taxes being paid

New opportunities appeared for taxpayers when the Service concluded that a sale of assets between a grantor and a grantor trust would not be recognized for income tax purposes.[2] This ruling lent support

[1] See IRC Sec. 671-678, generally, and related regulations.
[2] See Rev. Rul. 85-13.

to sales to an intentionally defective grantor trust" strategy which allowed taxpayers to freeze the value of their estates for estate tax purposes by selling assets to grantor trusts in exchange for a promissory note. There may be no gift tax consequences so long as the transaction is properly structured. That includes the trust paying fair value for the asset sold to it, the note bearing an adequate rate of interest, and the interest and payments actually being made in accordance with the promissory note, adequate seed gifts in the trust, the transactions being respected, etc. In other words, taxpayers could transfer appreciating assets, retain a fixed return, and avoid both income and transfer taxes.

Recent proposals reduce or eliminate efficacy of grantor trust planning

As grantor trusts continued to be used in planning, regulations, court cases, and IRS rulings, various legislative proposals seeking to limit the benefits of grantor trust planning have emerged.

Attacks on grantor-type trusts are not new. President Obama also included restrictions on grantor trusts in his Green Book proposals throughout his presidency. The proposals currently being considered bear much resemblance to the Obama Green Book proposals.[3]

On March 25, 2021, Senate Budget Committee Chairman Bernie Sanders (I-VT) introduced his "For the 99.5% Act"[4] (the "Act"), which would create "Special Rules for Grantor Trusts" that would require the assets of certain Grantor trusts to be included in the estate of the settlor.[5] The Act at Sec. 8 carefully constructs a new Chapter 16 to Subtitle B of the Internal Revenue Code of 1986 which, if enacted, would apply transfer taxes upon the value of those assets owned by grantor-type trusts, reduced only by taxable gifts made by the deemed owner to the trust.

Sec. 8 would create a new Sec. 2901 of the Code which reads, in relevant part: "(a)(1) the value of the gross estate of the deceased deemed owner of such portion shall include all assets attributable to that portion at the time of the death of such owner …" A "deemed owner" is defined under the new Sec. 2901 (d) as "any person who is treated as the owner of a portion of a trust" under the grantor trust rules.[6] While the Act contemplates a "reduction for taxable gifts" made to the trust by the deemed owner, the result is that all appreciation is included in the settlor's estate defeating any planning benefit. This potential change presents two possible planning approaches at this juncture. First, practitioners should broadly consider creating grantor trusts prior to the date of enactment, as it appears that these will be grandfathered under current law to avoid estate inclusion. The second approach represents a significant shift in estate planning from historic norms. If an initial gift were to be made to a non-grantor trust, inclusion of the appreciation may be avoided as the Act is currently written and as the law is contemplated to be changed by the Act. Using non-grantor trusts in lieu of grantor trusts will require tax practitioners to rethink many tax planning considerations of trust planning, as explored below.

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[3] The Treasury department issues a list of revenue proposals commonly referred to as a "Green Book." This is typically an annual occurrence as part of budget negotiations between the White House and Congress.
[4] For the 99.5% Act, S. 994, 117th Cong. (2021), available: https://www.sanders.senate.gov/wp-content/uploads/For-the-99.5-Act-Text.pdf.
[5] See the Act at Section 8.
[6] The Act refers to "subpart E of part 1 of subchapter J of chapter 1." These are the grantor trust rules which can be found at IRC §§671-679.

The Act at Sec. 8 would treat transfers from a grantor trust during the life of the deemed owner as a gift.[7] Further, if a grantor trust ceases to be treated as a grantor trust during the lifetime of the deemed owner, proposed Sec. 2901(a)(3) would treat the assets in the trust as if they were transferred by gift, less any reduction for taxable gifts that might be applicable under the proposed Sec. 2901(e). Thus, a gift tax could be imposed on the change in status. Consider the difficulties of planning for this potentially costly tax consequence. An unintentional act that negates grantor trust status could trigger substantial gain. This possibility alone will heighten the importance of regular review meetings to monitor trust administration. These provisions would also seem to prevent an individual from converting a grantor trust to a non-grantor trust to circumvent the full effects of the law. Finally, Sec. 8 of the Act introduces Sec. 2901(f) to clarify that "any tax imposed pursuant to subsection (a) shall be a liability of the trust." By making the trust liable for the tax, the Act ensures that any taxes paid will reduce trust assets rather than reducing the owner's taxable estate.

Two other relevant proposals in Congress, introduced contemporaneously with the For the 99.5% Act, would impose a capital gains tax on gift transfers, including those to a grantor-type trust.[8] These "deemed realization" proposals would treat all assets transferred by gift as though they had been sold for fair market value. Similarly, President Biden included deemed realization for gift transfers in his recently released "General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals," commonly called the Treasury Department's "Green Book."[9] Under Biden's proposal, the donor of an appreciated asset would realize a capital gain at the time of the transfer to the extent that the asset's fair market value on the date of the gift exceeded the donor's basis in that asset.[10] Distributions from grantor trusts to beneficiaries would also be deemed realization events, subject to capital gains tax to the extent that the fair market value exceeds the basis at the time of the distribution.

The deemed realization proposals cast a very wide net to catch bad actors but may inadvertently injure taxpayers of more modest means. By way of example, consider the small business owner who may not have an estate that is large enough to be subject to an estate tax, even though her or she is ready to retire from working and transfer ownership to their adult children. For this taxpayer, a deemed realization on the transfer of the business could be devastating, even if an exemption would apply and the taxpayer may satisfy the tax obligation over a term of years, as in the two proposals that are currently being considered in Congress.[11]

Practitioners should consider and educate clients about the potential for changes to grantor trust treatment as proposed under the For the 99.5% Act and deemed realization tax change to be enacted. In aggregate, these two proposals, if enacted, could trigger capital gains tax and estate tax on the same trust assets. That is a dramatic difference from that which exists under the current tax environment.

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[7] The Act at Sec. 8, proposed Sec. 2901(a)(2).

[8] H.R. 2286, 117th Cong. (2021), available: https://www.congress.gov/117/bills/hr2286/BILLS-117hr2286ih.pdf (the "Pascrell bill"). The Sensible Taxation and Equity Promotion (STEP) Act, introduced by Sen. Van Hollen, summary can be found here: https://www.vanhollen.senate.gov/imo/media/doc/One%20pager%20-%20STEP%20Act.pdf (the "STEP Act").

[9] https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf

[10] Id. at 68.

[11] The STEP Act provides closely held business owners with 15 years to satisfy the tax on the deemed realization, whereas the Pascrell bill requires payment in full within 7 years. See *supra* note 8.

All of these legislative proposals appear destined to create extra responsibilities on the trustee to engage with a professional planning team comprised of an attorney, accountant, and financial advisor who can monitor different situations and advise on potential administrative decisions or other actions that could inadvertently create a grantor-type trust, where a non-grantor trust is what is planned for as part of the estate plan.

Resurgence of Non-grantor trusts

This potential legislative backlash against grantor-type trusts may lead to an increased planning emphasis on the use of non-grantor trusts. Non-grantor trusts are entities that pay income taxes on income earned, subject to certain rules as set forth in the Code and related regulations.[12]

In a non-grantor trust, ordinary income from the trust can be from various sources, including interest, dividends, rental income, royalties, and so on, and this income can be distributed to the beneficiaries, or retained by the trust (assuming that the terms of the trust permit) and the trust will pay taxes on the income. Generally, capital gains and losses will remain inside the trust until its expiration, though there may be some exceptions (e.g. if the trust instrument permits distributions of corpus). The trust instrument will thus determine whether tax on distributions are payable by the trust or by the individual beneficiary. Practitioners should be aware that if the terms of the trust are not supportive of the current tax objectives of the client, there may be an ability to modify those terms. In some instances, the trust might include a trust protector that has the power to modify administrative provisions (if the desired changes fall within that ambit). In other instances, the trust may be decanted (merged) by the trustee into a new trust. Therefore, practitioners should be alert to the potential to modify trusts to improve tax results. While this is not always possible, it may be worth exploration.

All non-grantor trusts must be classified in one of two ways for the purpose of paying federal income taxes – as a simple trust or a complex trust. A "simple trust" requires the distribution of all income. A "complex trust" gives the Trustee discretion to either distribute the income or to hold the income within the trust. The word complex means that the trustee has more discretion, rather than the trust's terms are more complicated.

Non-grantor trusts can generally take a deduction for income that is distributed to beneficiaries.[13] In turn, when a beneficiary receives income from a non-grantor trust, the income that they receive must be reported as income when they file taxes for the calendar year that the income was received.

A non-grantor trust will be taxable in states based on the laws of each state.

SALT deduction

A non-grantor trust may be a powerful planning tool; not just for the super wealthy, but for many people who are looking to save state and/or federal income tax, while also making completed gifts for the benefit of their heirs that use up the current high lifetime exemptions before it declines. By way of example, the Tax Cuts and Jobs Act (TCJA) enacted at the end of 2017 and effective beginning in 2018

[12] See, generally, Subchapter J of the Internal Revenue Code and related regulations.
[13] This is the income distribution deduction, based upon the concepts of Fiduciary Accounting Income ("FAI") and Distributable Net Income ("DNI"). A discussion about FAI, DNI and how the income distribution deduction is calculated is beyond the scope of this article.

limited an individual's itemized deductions by capping the deduction for state and local taxes (SALT) to $10,000. Clients in high tax states (such as California, New Jersey, and New York) started to consider using their high lifetime exemptions to gift income-producing assets to a non-grantor trust situated in a state with no state income tax in order to bypass the SALT cap. Additionally, non-grantor trusts can deduct property taxes. Trusts funded with real estate provide the opportunity to deduct real estate taxes. These taxes are subject to the $10,000 annual limitation unless the property is business or investment property, in which case there is no ceiling. Note that some of the pending tax proposals including capping itemized deductions at 28%. That will create a substantive gap if the income rates are increased to 39.6%. Further, reinstating the PEAS limitation could serve to further limit deductions. These changes, if enacted, could reduce the income tax benefits of nongrantor-trust planning.

QBI deduction Section 199A

The TCJA also created a deduction for qualified business income under a newly created Section 199A (the "QBI deduction"). To the extent that a trust does not exceed an income threshold of $164,900 in 2021, the trust will be eligible to take a twenty percent deduction for qualified business income earned, so long as the taxpayer meets certain tests.[14]

Charitable giving

Non-grantor trusts which are not required to distribute all income to its beneficiaries (so-called "complex" trusts) may generally take larger charitable contribution deductions than individuals. Complex trusts may deduct up to 100% of its net income for charitable gifts that meet a three-part test: i) the amount must be paid for a charitable purpose; ii) the gift must have been made pursuant to the stated terms of the governing interest and iii) the gift amount must be traceable to income.[15] Further, because the requirements of IRC Sec. 170(a) are not applicable, trusts may be able to take a charitable contribution deduction for transfers to foreign charities.[16]

Charitable contributions made by a trust will not be deductible when the parameters of Sec. 642(c) are not met. By way of example, only complex trusts with specific language allowing for charitable contributions to be made from income are permitted to take a charitable contribution deduction. Trusts which are required to distribute all of its income annually, commonly referred to as simple trusts, may not take a charitable contribution deduction. Further, the charitable contribution must be made from income. The trust will not be permitted to take a charitable contribution deduction for transfers made from the trust's principal. Finally, non-grantor trusts are permitted to make a special election under certain circumstances to treat a contribution as paid in the preceding year, allowing for more flexible income tax planning.[17]

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[14] A detailed discussion of Section 199A is beyond the scope of this article. Please refer to IRC Sec. 199A and related regulations.

[15] See generally IRC §642(c)(1) and I.R.S. Pub. 526, Cat. 15050A (March 12, 2019). https://www.irs.gov/pub/irs-pdf/p526.pdf.

[16] This is not an exhaustive listing of the income tax benefits of using complex trusts to make charitable contributions.

[17] Treas. Reg. Sec. 1.642(c)-1(b).

Non-grantor trust administration

If the For the 99.5% Act becomes law, non-grantor trusts may become more important to estate planning to avoid the estate inclusion rules applying to grantor trusts. If the use of non-grantor trusts increases, it will become even more important that practitioners understand the rules governing them, particularly if the plan depends upon the trust being treated for income tax purposes as a non-grantor trust. Failure to properly administer a non-grantor trust can subvert the purposes of the planning by causing an involuntary conversion into a grantor-type trust and, if some recent proposals become law, included in the settlor's estate.

Collaboration among professionals involved in the planning is important to endeavor to safeguard non-grantor status. The attorney drafting the trust instrument as a non-grantor trust may not necessarily be consultedby the Trustee and others involved as post-signing decisions are made about the administration of the trust. The accountant, financial planner and trustee should all be made aware that ensuring that the trust remains a non-grantor trust is vital to the estate plan. Each professional should also understand how a non-grantor trust could inadvertently be recharacterized as a grantor trust if improperly administered so that they can avoid such circumstances and a toggling on of grantor trust status.

Grantor/grantor's spouse borrow from trust without adequate security

A non-grantor trust that makes a loan to the settlor or the settlor's spouse should ensure that the loan has both adequate interest and adequate security. To the extent that the trust makes a loan back to the settlor without adequate interest or security, the trust may be considered a grantor-type trust for so long as the loan remains outstanding. It is relatively easy for trustees to ensure that the loan bears an adequate interest rate, since the Applicable Federal Rates are issued monthly by the Internal Revenue Service.[18] However, ensuring that the loan is appropriately secured may be more of a challenge, particularly for settlors who have undertaken significant estate planning that has removed many of their most valuable assets from their personal estates. The practical issue is determining what suffices to constitute adequate security. This is why the safest route may be to assure that no loans are made to the settlor or settlor's spouse.

Additionally, loans to the settlor could be the type of transaction where an individual trustee may try to "go it alone" without professional advice. Many clients prefer to enlist friends to serve as trustees, even when it may be preferable to choose professional trustees who are more sophisticated and presumably have sufficient knowledge to avoid engaging in transactions that could taint the planning.,.

Professional advisors may be uniquely positioned to assist in the protection of the trust's non-grantor status. Perhaps a financial advisor managing the trust accounts can identify an issue when the trustee attempts to make a large transfer from the trust account back to the settlor. By understanding the issue, a financial advisor may be able to stop the loan and encourage the trustee to consult tax counsel concerning the risks of the transaction and possibly support the loan by ensuring the correct interest rate is charged and that the loan is properly secured.

Similarly, the CPA handling the income tax returns and financial records for the trust may have an opportunity to guide the client to consult with counsel to correct a loan transaction. Sometimes by the

[18] Rev. Rul. 2021-9.

time the loan becomes known to the tax preparer, it could be late in the life of the transaction: the terms of the arrangement would have been decided; money would have already exchanged hands; and one or more payments on the obligation may have already occurred. Nonetheless, if the CPA identifies the issues, it may still be feasible to endeavor to correct the transaction. If the issue is identified during the same tax year, the inappropriate or uncertain transaction may be able to be rescinded and unwound.

Trustee becomes related/subordinate

A non-grantor trust can become a grantor trust if the trustee becomes someone who is related or subordinate to the settlor. Pursuant to IRC Sec. 672, when the trustee is related or subordinate to the settlor, the trust will be a grantor-type trust and the settlor will be taxed as the owner of the assets in the trust.

Non-grantor trusts have been recharacterized as grantor trusts when the settlor and the trustee get married. Note also that the members of the new spouse's family may also be considered related for these purposes. Certainly, this is a possibility that may need to be considered when a settlor chooses a close friend to serve as trustee of a non-grantor trust.

In these situations, it is advisable to engage in proactive planning and remove the trustee before the date on which such an individual would become related or subordinate. In other words, wedding plans may need to involve reviewing outstanding trust agreements and confirming that the upcoming nuptials will not throw the estate plan into chaos.

Another way for a trust to become a grantor trust under this provision is where the trustee becomes an employee of the settlor or a company in which the settlor owns a controlling interest. Before hiring someone, who is serving as trustee, the professionals should review the terms of the trust instrument and determine how best to replace a trustee in advance of such individual's hire date. While this will add a new element of complexity to the hiring process, it could be essential when maintaining non-grantor trust status is a crucial element in the estate plan.

Note that where a trustee is a professional whose services are engaged by the settlor, as in the case where a settlor names an institutional or professional trustee, this will not, in and of itself, turn the trust into a grantor trust. A professional in this case may not be considered "subordinate" to the settlor even though the professional is providing services to the settlor in exchange for a fee. Presumably, an attorney or CPA would be required to exercise independent judgment under a code of professional conduct. Additionally, the professional must not be an actual employee, as is the case with an in-house counsel or CPA serving as a controller of a closely held business controlled by the settlor. So long as the trustee-professional had her own independent practice, such an individual would not be considered to be controlled by the settlor even to the extent the settlor hired such professional for professional services. An independent professional is generally not considered to be subordinate.

Where the status of a trust as a non-grantor trust is important to the estate plan, the drafting attorney should also ensure that language in the trust instrument would prevent the appointment of a substitute or replacement trustee who is related or subordinate to the settlor.

Section 678 ownership

Assets in a trust could be included in the estate of any individual who becomes a deemed owner of a trust by operation of IRC Sec. 678. The For the 99.5% Act takes deliberate aim at sales to Beneficiary Defective Inheritor's Trust (BDITs) strategies, requiring inclusion of some portion of the asset in a trust over which a person, other than the settlor of the trust, is deemed the owner for income tax purposes, to the extent that such a person engages in a "sale, exchange or comparable transaction" with the trust.[19]

Under the regulations, any person who "directly or indirectly makes a gratuitous transfer … of property to a trust" may be considered to be a grantor of the trust.[20] Such person may be a deemed owner, subject to the grantor trust rules, as to "any portion of a trust, with respect to which such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or such person has previously partially released or otherwise modified such a power and after [which] retains such control as would, within the principles of [IRC] sections 671 to 677 , inclusive, subject a grantor of a trust to treatment as the owner thereof."[21] Where the original settlor is taxable as the deemed owner of the trust assets, no other person would be deemed to be the grantor under Sec. 678.

On those occasions where individuals other than the original settlor could be considered a grantor for grantor trust purposes, the Act would require inclusion of the assets in these trusts in the estate of such beneficiary-owners, even where such individual may not have ever held title to the bulk of the assets held in the trust.

Death of the QSST

The For the 99.5% Act has a stated intention of ending "a Rigged Tax Code" that, according to the Act's sponsor, Senate Budget Committee Chairman Bernie Sanders (I-VT) has resulted in "an economic absurdity of two people in this country, Jeff Bezos and Elon Musk, owning more wealth than the bottom 40%" of American people and the "rigged and corrupt tax code that gives trillions of dollars in tax breaks to the wealthy and huge corporations."[22] However, the terms of the Act may result in certain inequities against small business owners who may decide to engage in planning not to avoid or minimize taxes but rather for business succession purposes.

Specifically, small businesses which are taxed as subchapter S corporations are limited in the types of shareholders they may have.[23] Transferring shares in an S corporation to an ineligible person could jeopardize the S corporation election, subjecting the entity and its owners to a double layer of tax, retroactive to the date on which the ineligible shareholder first took ownership. There are a multitude of reasons why an owner may prefer to transfer shares of stock in a closely held S corporation to a trust rather than outright to individuals. Perhaps the owner's children are too young to handle the responsibility of running the company. Maybe the owner is concerned about how the business would fare if subject to the risks of her child's divorce or other creditors. A trust may be a valid solution, but a grantor trust would not work unless the owner has sufficient other assets to pay the income taxes flowing from the income generated by the S corporation after transferring the shares. Further, as

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[19] The Act, *supra* note 4 at Sec. 8.
[20] Treas. Reg. Sec. 1.671-2(e)(1).
[21] IRC Sec. 678(a)(1) and (2).
[22] Ending a Rigged Tax Code, 117th Cong (2021).
[23] IRC Sec. 1361(c)(2).

discussed in this article, the grantor trust structure may become a disfavored vehicle for transferring assets. In any event, a grantor trust is not available to be used when the transfer of interests occurs at the death of the S corporation owner.

Planners should be careful to understand the S corporation rules and implement strategies that will not risk the election.[24] Collaboration will be key to ensure that all elections are timely made and tax returns filed appropriately to reflect that the transfer was within the S corporation rules.

If the For the 99.5% Act were enacted as written, options for an S corporation shareholder to protect the closely held business from the creditors of her heirs would become very limited. In general, there are three specific types of trusts that are eligible to be S corporation shareholders: grantor trusts, qualified subchapter S trusts (QSSTs), and electing small business trusts (ESBTs).

QSSTs are subject to stringent requirements limiting the number of beneficiaries to one and requiring annual distributions of all S corporation income to the beneficiary.[25] Because all income is required to be distributed annually, there can be no accumulation of that income inside the trust. So, even though the trust itself will not be paying taxes, the same benefits of a regular grantor trust wherein the income may be accumulated but taxable to the deemed owner do not exist for a QSST.

The Act does not appear to account for the distinction between a QSST and a typical grantor-type trust structure. As written, the Act would require inclusion of the value of the S corporation shares owned by the QSST in the beneficiary's taxable estate, less any contribution made by the QSST beneficiary. This is because the QSST beneficiary is a deemed owner of the trust by operation of IRC Sec. 678, so a QSST would presumably be subjected to the same harsh consequences as a BDIT if the Act were to become law.

It is unusual for the QSST beneficiary to make any contribution to the QSST, particularly where the QSST was funded on death of the original owner. If such a taxing construct were allowed to be imposed, the QSST beneficiary could be charged an estate tax on the full value of the shares of stock in the S corporation owned by the QSST which could be worth substantially more than when the trust had been funded, due to the QSST beneficiary's own sweat equity and efforts in sustaining and growing the business.

As a result, it may be that ESBTs will be the only proper trust vehicle remaining to own S corporation shares. An ESBT has more flexibility than the QSST but it is subject to tax at the highest individual income tax rate.[26] ESBTs are not entitled to a deduction for distributions made to the beneficiaries and are subject to very specific rules of administration.[27]

Toggling grantor trust status on and then considering whether to turn it off again

Where a non-grantor trust inadvertently switches to a grantor trust, the trust will likely experience a realization event on the deemed transfer from one taxpayer (the non-grantor trust) to another (the

[24] A thorough discussion about transferring S corporation shares is beyond the scope of this paper. Please see IRC Sec. 1361 and related regulations.
[25] For details about settling and administering a QSST, please see IRC Sec. 1361(d), and related regulations.
[26] For details about settling and administering an ESBT, please see IRC Sec. 1361(e), and related regulations.
[27] A discussion of the rules governing ESBTs is beyond the scope of this article. Please see IRC Sec. 1361(e), and related regulations.

deemed owner of the grantor trust). To the extent that any of the deemed realization proposals are enacted as written, the conversion of a non-grantor trust into a grantor-type trust would seem to result in a capital gains tax on the amount by which the fair market value of the assets exceeds the basis.

Flipping the switch back off to turn the now-grantor trust into a non-grantor trust could be troublesome if the For the 99.5% Act is enacted as written. The switch would be a deemed transfer for gift tax purposes from the grantor-type trust to a non-grantor trust, subject to a $1 million gift tax exemption. On the other hand, leaving the assets in a grantor trust could presumably result in inclusion of some part of the assets in the trust in the settlor's estate. This could be true even to the extent that the original non-grantor trust was settled before enactment of the For the 99.5% Act. It is unclear whether the executor of the settlor's estate would have the opportunity to deduct some of the value included to account for the time during which the trust was a non-grantor trust and therefore not subject to the provisions of the new Sec. 2901, if enacted.

Obviously, the legislation has not been enacted yet and there are no regulations lending any clarity as to how any such new laws might be administered. What is apparent is that professionals will need to exercise extreme caution as they consider all possible tax implications before attempting to "fix" any trust that had been involuntarily converted from a non-grantor trust to a grantor-type trust.

Conclusion

It continues to be acomplex and potentially problematic ride for grantor trusts, with many ups and downs along the way. Planners have planned, the IRS has challenged, and courts have ruled. The only step left in this cycle is for Congress to act and change the rules, so that a new cycle of planning, challenges and rulings can begin anew. If non-grantor trusts will become the new normal, it is important for practitioners to become more nimble in identifying and helping trustees to avoid those circumstances that can turn the most carefully orchestrated plan into chaos, by inadvertently forfeiting non-grantor trust status. Working together as a collaborative team, attorneys, tax preparers, accountants, and financial advisors can help avoid pitfalls and keep the trustees educated throughout the trust administration.

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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 1,200 articles. He is a member of the NAEPC Board of Directors (Emeritus), on the Board of the American Brain Foundation, the American Cancer Society's National Professional Advisor Network and Weill Cornell Medicine Professional Advisory Council.

Growing your Business and Networking: A Multidisciplinary Panel Discussion—Lessons learned from the Covid Pandemic

Background

In January 2021, NAEPC hosted a webinar featuring colleagues from the allied professions to discussion how different practices are marketing in the current environment. This article is based in part on a transcript of that webinar but revised to highlight planning and practical steps practitioners might consider moving forward. The hope is that this conversational approach will provide an informative yet informal discussion of the topic. The goal is to provide a wide array of practical marketing ideas that should "speak to" different size and types of estate planning practitioners. While the impact of Covid has continued to evolve since this program, the principles discussed should still have relevance.

Moderator and Panelists Backgrounds

Mr. Martin Shenkman (moderator) is an attorney in private practice in estate and tax planning for closely held businesses and estate administration in Fort Lee, New Jersey and New York City and is the author of 42 books and more than 1,000 articles. He serves as a Director Emeritus on the NAEPC Board of Directors.

Mr. Greg Delisle is the founder and CEO of Forward Progress, serving over 2,000 corporate clients over the past 15 years. In 2012, he created and released a social influencer development platform known as Social Jack. His company has produced over 5000 virtual events and webcasts.

Mr. Tom Forest is the president and CEO of US Trust Company of Delaware. He is the past president and founder of the personal trust division for Charles Schwab bank and Wilmington, Delaware, and a past president of NAEPC. Mr. Forest assisted the IRS with the development of fiduciary income tax returns on magnetic media.

Ms. Bronwyn Martin has been doing comprehensive financial planning for over 20 years with offices in MD and in PA, working with clients throughout the USA, and has a virtual staff of five. She is currently serving as a member of the NAEPC Board of Directors.

Ms. Ginger Mlakar serves as in-house general counsel and oversees the donor stewardship program for The Cleveland Foundation. She has been named among the Best Lawyers in America in the top 50 female Ohio Super Lawyers list by the Long Politics Magazine. She is currently serving as a member of the NAEPC Board of Directors.

Mr. Greg Sellers is a member in the Tax Division of Warren Averett, LLC, a leader of the firm's estate and trust service area, specializing in estate, gift and trust tax planning and he has been serving clients for over 35 years. He has served on the NAEPC board of Directors and is a past president of both NAEPC and of the Montgomery, Alabama Estate Planning Council.

How Covid Affected Marketing and Working with Clients

Marty: Dean, if you could give us some background in how professional practices, financial advisors, charities, CPAs, trust companies, generally marketed pre-Covid and how Covid has turned everything upside down.

Dean: Several years before Covid, we facilitated a lot of marketing events. We produced many events, in particular a lot of in-person sponsored events that were mostly educational by nature. Private or public events shared education for business development purposes. Pre-covid these were a fine approach. About two years ago, firms began to simulcast--run a program both virtually and in-person. And what we saw is that those companies or organizations that were simulcast-driven had already marketed online and were used to it. The firms that were not used to marketing online had a little bit of catching up to do with Covid in place. Pre-Covid marketing looked like more handshakes and more people in person. Then, all of a sudden, we found ourselves in this virtual world where it's not just virtual events, but almost every meeting is virtual. We've had to learn a whole lot together about functioning in a virtual environment. I think that was the biggest impact for a lot of businesses to learn.

Marty: Tom, could you comment on how you marketed pre-Covid and how you're seeing marketing now in a Covid environment? Do you see the changes that Covid has brought to marketing continuing? What do you perceive for the future?

Tom: I believe that Covid has affected the marketing by large banks significantly. For example, those of you who have been to Heckerling, have seen the exhibit booths and events where banks used to reach lawyers, accountants, etc. There was buzz about which banks would invite you to their dinner or other event. That's what we did. We marketed in that way, not only to the attorneys, CPAs, and insurance professionals, but also to clients and prospects. We would take COIs and prospects to baseball games. We have skyboxes at football games and hockey games. And with the Covid pandemic all of that stopped.

That was a huge downturn in traditional marketing for big banks and trust companies, because that's what many did.

For one virtual event planned we had Peyton Manning, Steve Young, and Aaron Andrews for an hour discussing their thoughts on the upcoming NFL playoffs with our clients, prospects, attorneys, etc. It's not the same as going in person, but this type of virtual event is something that we're pursuing now.

What will we do to market after Covid resolves? I would say for the most part, it's going to be a while before we get back to the historic marketing approach of inviting people to sporting events, dinners, and in person events. So, I have a feeling the web-based events might be here for a little bit more.

Marty: Thank you, Tom. I think it's very difficult to translate a lot of the pre-covid events into covid events, as Tom described. Let's shift gears and, Bronwyn, if you can tell us about the size of your practice, so you can show the perspective you're coming from and the nature of your practice, and maybe you can make a few comments about generally what you did from a marketing perspective, pre-covid and now, post covid.

Bronwyn: Sure, thanks, Marty. My practice has 155 clients who are individuals, couples, families, and small business owners. In March 2020 I started posting on my website that we were no longer meeting with people face-to-face and with a list of options of how to meet: phone/WebEx/Microsoft Teams. I felt it was important to let people know, we are being safe and following the rules for non-essential businesses to be closed, but that doesn't stop me being available for clients and prospects to still have discussions. Now, with the economy re-opening, the way we meet is however the person is comfortable with-to meet in person, virtually, or the true tested way--telephone. And if we are meeting in an office, to be sure that they know my office is a mask-option space.

There was a lot of hand-holding in February and March, 2020, and I made calls, knowing that meeting was not possible, to all my clients to talk to them about what was going on market-wise, reminding them of their long-term goals, and asking how do they want to deal with this new crisis that could be affecting them.

What I also started doing was texting my clients a lot more than usual, especially if I felt that they're in isolation based on meeting calls or their personal Facebook page comments that suggested they're having a tough time being in isolation. I did a lot of business Facebook, LinkedIn, and Twitter posts, with links of what experts are saying about how to deal with isolation- a reminder that they are not alone with feeling lonely and frustrated.

Marty: Thank you. Ginger, could you tell people what your sphere of the world is, because your lens is going be different than Tom's and Bronwyn's.

Ginger: I'm in the philanthropic world, focused on donor relations, with The Cleveland Foundation. Pre-Covid we had several live events at interesting places throughout the city, and we'd present information on what's happening in the philanthropic community. We were active in the local estate planning community with our local estate planning council, the Bar Association Planned Giving group; and, we were a frequent speaker and thought partner with them. We also had our own 'lunch and learns' for professional advisors throughout the region, to help them understand how they could partner with us to help their clients and their estate planning. And then with covid, it became a year in which we became a voice across the web and making all our marketing efforts virtual. We created a number of content marketing strategies and tactics, including more than 13 e-newsletters tailored by interest and focus areas of impact, frequent social media updates, a robust blog, frequent website updates. And, in response to the pandemic, we had to change our 2020 signature events to virtual; including our African-American philanthropy summits, annual meetings, donor events, including a series focused on racial equity, the PPP loans, and other strategies available to non-profits in a challenging time of having to be virtual. These events were hosted primarily on Zoom, and sometimes it was in conjunction with other community partners.

We experienced increased attention across the events and a sizeable number of new attendees. For instance, our annual meeting included not one, but *sixteen*, virtual events involving seven partner organizations and 60 speakers. We grew from a normal audience of about 1,400 people to more than *3,000* registrants with a sustained interest across the whole week, and about 43% of the registrants were new to The Cleveland Foundation.

I believe that we will be looking at doing dual events, virtual and live, because we saw that there were successes with being virtual: we were getting new audiences by being virtual.

Thank you, Ginger.

Marty: Greg, maybe you could comment and first lead off by telling people your lens, and where you're viewing marketing from.

Greg: It will be Marty, thank you. It seems that we might have had a telescopic view several years ago when NAEPC first started the webinar series, and here we are: where virtual is the normal platform for delivery of education not the exceptional platform.

I am a practicing CPA with an emphasis of practice in the estate and trust planning and compliance area, with Warren Averett. We're a regional firm with locations primarily in the southeast. The firm has a marketing department that takes care of our firm's promotion of the services in the various client areas with electronic newsletters, *pre*-Covid. Individually, we hosted monthly lunch and learns for attorneys, trust officers, financial representatives, etc. I'd also take attorney's or trust officers to lunch and did very little marketing to the general public, relying much more on referral sources from our lunch and learns and one on one lunch meetings.

When the pandemic hit, first thing that we did was we paused our Lunch and Learns and found that offering them on a virtual platform was very cumbersome because we were trying to provide continuing education to a small group of people. We suddenly became disconnected with colleagues.

With our clients, we had to be intentional in calling them, offer video conferencing, and continued physical mailings. Pre-Covid we were trying to digitize our tax organizers for clients but met a lot of resistant from our older clients. Now, post-covid, the older population is more familiar with video conferencing, more familiar with email, and more comfortable with our digitized tax organizers.

We expect we will have more people comfortable with digital communications through email and our clients supplying their information to us in a safe, digital format.

Marty: Thank you, Greg.

I have a very small boutique law firm. My feeling pre-covid, post-covid and during covid, is that the only thing anybody wants from a lawyer is free information, so I've never done anything except try to disseminate as much good quality free information as I can. And it was fascinating to see how covid transformed the marketing that we do, and one of the dynamics that no one else mentioned, and maybe it didn't affect others as much as us as an estate planning firm, but the tidal wave of work last year as people start to get planning done before the end of 2020, and dealing with this deluge of work without a lot of face to face interaction.

A cornerstone of our marketing pre-Covid was a paper mailed newsletter because sending something physical would stand out and differentiate me. And the reason I felt that was supported, was the meaningful number of people each year, that would contact me to change an address, and the people that would make comments about receiving the newsletter.

With Covid and the high volume of year-end work it became difficult to do the hard-copy newsletter. This, plus the fear of the spread of Covid by physical means from even handling the mail to handling the newsletter led, to my amazement, clients, even a lot of the much older clients, consistent with what Greg said, quickly became comfortable receiving things by email. There's less than a handful of our entire client list of last year (2019) where I had to physically print out documents and mail them by year's end. Our office was almost paperless pre-Covid, but the Covid pandemic resulted in the clients letting us go completely paperless.

The Covid pandemic had us increase our marketing efforts very quickly on webinars. I felt that by reacting quickly with a webinar on planning in the current Covid environment, a hot topic, or something of interest, it would enable us to provide a great service to clients and referral sources, attorneys, accountants, and other advisors. We added almost 30 webinar recordings to our firm website, and we covered things that were hot and relevant, like working remotely. In March and April (2020), when people were struggling with remote work, I collaborated with other colleagues, often in different specialties, bringing more expertise to the program, and did at least three webinars on remote working. And we did a program on core documents and how they should be modified for Covid, and so forth.

The webinars not only helped us reach a broader audience and expand our email database, but brought in a new business, and I think it was very successful. And the result included our adding 30 –one to two-hour webinar recordings to our firm's website, which I think is very substantial in terms of attracting new clients. So Covid pushed the marketing to a much more electronic format.

Covid has literally changed everything in terms of how we market, and I don't think that post-Covid, that's going to revert. I think we're going to continue to be responsive to new developments and quickly provide webinars on topics relevant to people such as yourselves.

(Tom) There are a lot of trust departments that have an annual policy requirement to mail at least one annual statement to the trust beneficiary. We have over 100,000 trust beneficiaries that we must, *at least*, do a year-end mailing to. So, even though they request it to be online email, we must send a physical mailing out every year.

Marty: Bronwyn? comments on growing your business in a virtual world and electronic newsletters. Do you have an electronic newsletter?

Bronwyn: Thanks, Marty. I've been using electronic newsletters for about 10 years, and my open rate is probably 10% to 15%.

Marty: Ginger? We just started adding a new electronic newsletter to professional advisors who are our primary referral source for new donors. We talked about charitable strategies and what's happening on our community on the philanthropic front in in the newsletter so in August and in

December (both in 2020) and plan to continue their distribution quarterly. Currently, we're sending out to about 1500 advisors with a 99% delivery rate and a 15% open rate We're hoping to continue to grow this reach moving forward.

Greg: The CPA firm uses electronic newsletters out to a very large database that includes clients, referral sources, and others as well separate newsletters to smaller service area or industry sub-groups that need a more laser focus on topics that resonate in their fields. Both types of newsletters are getting about a 24% open rate.

I also personally use the Broadridge newsletter service to my database of about 150 clients.

Once the pandemic was in full force we (both my firm and my own office) started sending out email alerts for newsletters, all focused around Covid resources, whether it be the IRS announcements, the SBA's directions for PPP loans, etc. and those communications were opened at a 39% rate. The results of the Covid-related information newsletters tell us that if there's content that has a real immediate interest, you get a high open rate. I also have similarly high open rates with the Broadridge service that I use.

For our older clients who aren't as comfortable with electronic newsletters, we made phone calls, had video conferences, and continued physical mailings.

Marty: Thank you, Greg.

I send out an electronic newsletter and electronic communications, and I think the webinars that I do are equivalent, if you will, to an electronic newsletter because when I send out an announcement for a webinar, the description of the webinar is really equivalent to a short article on the very topic that the webinar's addressing. We send out electronic communications on a regular basis, and using the contact managers that are available, it is incredibly inexpensive to do. And you don't have to be a tech-wizard to do it. You can hire somebody, whether it's a marketing expert like Dean, or a tech firm, to help you; and I think everybody should be doing it.

I think even if you don't want to put the resources to it, then use a canned newsletter from one of the industry groups that you can buy, so that you keep people informed.

I almost think that the change in the environment due to covid has really accelerated that many more firms are doing electronic newsletters/communication. You almost have to do it just to stay even keel. Even if it doesn't get you ahead in terms of marketing, I almost think you fall behind if you don't.

Dean: you're spot on with that. If you're not there, your competitor is. People start getting better advice or they get more frequent advice from a competitor, and you can lose that client.

If one feels overwhelmed by this discussion on e-communication remember to collaborate. We have a lot of accountants that we put together with financial advisors and with attorneys, so all the content doesn't fall on you. There's a lot of people that have good content that want to contribute. You do want to make sure it goes through compliance but collaborate.

Also, remember that people get a lot of digital things today and a lot of noise, so don't put everything in your newsletter. Put snippets in the e-newsletter, and have the snippet redirect back to your website so that people can read the rest of the article and have the opportunity to see further information about your services on your website.

Growth in a Virtual World

Marty: Let's talk about growing your business in a virtual world. Dean why don't you introduce the importance of a firm's website, talk about web presence, how Covid may have changed the importance or use of a website. What do customers want to look at as advisors in terms of the website; what to do and not do.

Dean: It depends on the target or the audience that you're serving, but we've seen mobile and tablet-based web visitors almost double in the last year. It's insane. We have some clients where as high as 70% of contacts is coming from mobile, so please make sure that you cater to that. People get frustrated easily if they can't find things, if they can't navigate. And make sure you pay attention to what we call the user experience. You'll hear the term "user interface", or "UI", or "UX", which is user experience, and make sure that if you have older visitors, you have to know how they navigate. If you have a mix of visitors, you have to know how that mix navigates on your website and make it easy to find things. The other matter is to make sure you have sections on the front page where everybody gets to. That's what we call "live action updates". So if you have a blog or if you do a newsletter, you probably have articles in that newsletter, which could be blog posts, make sure you feature those on the main page so people can have an opportunity to see that you're relevant, that you're educating, that you're helping. That really promotes that thought leadership aspect that was mentioned before.

Dean: One of the aspects that we saw grow during the pandemic was people of all ages grew their social networks

We saw that we were able to provide education through social media and where people went for personal news. One of the things that went viral, were webcasts that we converted to podcasts, providing education, and thought leadership. With more people walking during the pandemic because gyms were closed, they could listen to audio a lot of times, more than they were able to sit and watch the webinar.

Our thought is that if you understand the different ways that people consume information (social media, webinars, mailings, etc.) and be aware of where the audience "lives"-where do they consume and digest information best- then spend your advertising dollars integrating these types, we have seen business grow, as well as the networks, because of this focusing of attention on how and where.

Marty: Dean, what about SEO (search engine optimization)? How important is that? What do people need to do?

Dean: We could do a whole hour on that. I know SEO is important, pay attention to it, but keep in mind, again, SEO is all about how people find you. It is search engine optimization, that means: What questions are people asking? Those of you that are in direct contact with clients, you need to communicate to your web designer and the people providing content for your site. What is relevant? What questions are people asking? Because what SEO is, is people are looking for answers and you want to be the answer. So, keep that in mind and make sure you communicate what questions are being most frequently asked and make sure your site pops up at the time for those.

Marty: Everything that's done from a marketing perspective, must make sense for your firm objectives. So, for example, some practitioners represent only high net worth clients, other may focus on mass affluent. The message should be appropriate for the target audience. It has been apparent in my practice that if people called me because they found me from a general internet search the odds were close to 0% those might become worthwhile clients. On the other hand, if Greg as an accountant, or Bronwyn as a financial advisor, or Tom as a trust officer, if *they* referred someone to me, the odds are probably 95% plus that it's a great fit and I'm going to want them to the client.

So, we looked into, and priced, getting SEO work to make our website pop up faster and more prominently and opted intentionally not to do it, because it just proliferates calls from people that are generally not viable clients. Rather, we're trying to appeal to advisors. The point is practitioners should carefully evaluate what it is you they want their website to do. And don't do just what you think everyone else is doing, do what works for your particular practice.

Bronwyn, any comments on how you use a web presence and how Covid may have changed it? Any practical suggestions for other advisors?

Bronwyn: Thanks, Marty. I've had a website for quite some time which I update with different messages, but what did happen in 2020, which was hastened by Covid, was adding a goal barometer to the client's secure portal site. This is especially helpful when the market drops (like the significant drop that happened in March, 2020) and some people panic. The tool incorporates their financial planning goals, all their Ameriprise accounts, and they can upload and link all their non-Ameriprise accounts debt, bank accounts, etc. and these data feed into their goals barometers. When I talk to clients and they're like, "Oh my gosh, am I still going to be able to retire because the market just tanked"? I point out their goal barometer which will show the market drop did or did not affect their ability to be able to retire. I can't predict the future, but if my analysis showed the ability to retire *was* on target, I didn't see the barometer drop significantly after the market drops in 2020. The goal level(s) was back up to 100% after a short period of time [because history has shown us that we can't predict the economic landscape but over time the markets go up]. That's a great tool moving forward, so the client can see that their goal achievement has, or has not, been affected by market drops.

It's likely that a hybrid office environment will become the norm moving forward. So, another tool that we added because of not being able to meet face-to-face for several months in 2020 that will allow any of us to work nationally, and internationally, to bring on *new* clients, is the ability to have *prospects* upload all their documents securely. The documents that I have historically asked the client to bring into that first office meeting: tax returns, investment statements, pay stubs, etc., they can upload *securely* as a prospect. This is very important when we can't meet face-to-face with prospects to grow our business.

Another tool we've added (in 2020) is that when clients log into their website, they can allow me to see what they're seeing on their screen. Now that we're not meeting as often face-to-face, many people can be overwhelmed navigating another website, and especially for older people, it could be over their heads. How the tool works is that once they log into their secure portal, they can allow me to see what they're seeing on their screen, nothing else, just their financial web page that they have with me. I can point them, literally, to what they need to click on. I can point them and show, "click here, click here, click here, and here's a couple of things that we can do to help you feel more comfortable navigating your financial planning website that you have."

Secure texting has become important. Many clients don't realize that texting generally is not assuredly secure. Availing my practice of secure texting comes at an additional fee for me, but clients feel more comfortable to be able to text me securely, especially with more alarm bells going off about cyber security. So those are four big enhancements I've seen for my clients and prospects to utilize.

Marty: I find a lot of advisors look at a website, "oh, that's a marketing activity", but what Bronwyn just explained is it's not just a marketing activity, it's part of the service that we render to our client: a secure portal, calculators, forms. Those are all services to our existing clients. So, look at your website, not only as marketing and networking, but as part of the service that you provide your clients. That was a really important point.

Dean? using webinars to market your practice. If so, how, thoughts, comments?

Dean: With webinars, just like we talked about with websites and everything else, we have to make sure that we're catering to our targeted audience. Because Covid forced everybody into webinars, or webcasts, or some sort of virtual event, you want to make sure that when you have people register that you're mindful of who's in there. A lot of times people set up an event, they have people register, and then they really don't pay attention to the details of who's in the room. A lot of us are good at best practices with live events: as people are coming into the room, we greet them, we see that they register, we really take special care to make sure they are seated at the right table, they get with the right people, they talk to the right people inside the firm. Treat a virtual event the same way. Now it's time to make sure that those people feel special, they feel individual. And don't assume just because people register that they're going to show up. A lot of times in our events, we don't just send out reminder messages, we give them a personal call, we talk to them, we make sure that the topic that we're going to cover is relevant, and that they're going to get a lot out of it. We can't do that with the larger events, we have some events that climb as high as 5-, 6-, 7- 000 people, but for the smaller and more intimate events, you can certainly have that personalized touch to really just make sure they know that you're expecting them, that you're happy for them that they registered, and you're going to serve them. That's sort of the short version on webinars.

Ginger: Dean did a good overview, but we had many national continuing education events this year (2020), some virtual, but they're more give-back opportunities than marketing tactics. When we did do virtual events, they have been very well attended, and the positive has been that we've actually been able to reach many donors and partners that we weren't able to do so with the in-person events, because some of them can't drive. The average of age of most people is probably between 50 and 70. The great part is as we've been able to utilize these to connect with so many people, and sometimes we're recording them too now and being able to reuse them for multiple purposes. That's been our experience, and it has been very successful, and I think we're going to continue to look at these new ways when we're doing events moving forward.

Marty: Webinars have become the focal point of what I'll call my educational/marketing and we did one recently for client's advisors on post-election planning. The objective was to explain "What do you need to do now?" We did programs on how GRATS should be structured differently in late 2020, and so on. In addition to the planning-oriented webinars, we've also done a whole series on religion and estate planning, trying to reach new people, and showing clients that we're respectful of their beliefs, and their wishes, and their uniqueness. What I find happens when you do less common topics, is that you attract different registrants, and each webinar we add new names to our database. We record every webinar and then we post it and the accompanying PowerPoint used for the webinar on our firm's website, which has built up a base of materials of over the years. I think this is helpful for marketing itself. You don't have to be the expert in doing webinars. Dean mentioned earlier to collaborate. Collaborate with someone that's done webinars if you haven't. Then get the recordings and post them to your website. It's a great way to build a resource for clients and for referral sources to go to. We also give the recordings to various professional education groups. They post them to their website, so people can get continuing education credits when they watch them on their platforms. From my perspective, it's just another broader audience. When we do these, we post a summary of the program and a link to it on LinkedIn, so that we're pushing it out through that network as well. Many of the webinars that we do, we have them transcribed (many of the web platforms will transcribe the webinar because it's included in their service). If the platform you use doesn't do that, there are online transcription services such as Temi or Scribie that for modest charges will transcribe an hour, or two-hour webinar. We take the transcription and then use a service to clean up the transcription. Then we turn those transcriptions into articles that we then get published. We try to squeeze as much lemonade out of every project that we can and recycle those back by posting those articles, getting others to collaborate on them, and then posting those onto the website, or through other providers.

There are incredible things you can do. And you can do it on a shoestring budget. You can always collaborate. I did an article recently with Bronwyn and a few others and know that getting a group of people together to do something is just a wonderful way to get more fresh ideas. And if three other advisors in different areas are sending out an article or a webinar that you worked on with them to their clients, it's only getting you more exposure, so it's really a win-win. So, record everything you post everywhere and go further and turn them into usable articles as well.

Comments on social media?

Dean: Don't try to be on all platforms. With social media there's quite a few standards and best practices and find out where your audience visits. Also, make sure that you commit to having proper content rotation. What I mean by that is, social media is designed to be conversational. It's not designed to be all announcements, or all news, etc. You're there to engage and be conversational.

I keep it simple. I have a three-to-one policy that says three pieces of high value news-based content that we put out, two things that are personal. Humanize the post: it's not just all about you or your firm. People want to know that you're human, that you're having conversations too. So, include those before you ask anybody to a “call to action.” It's more important to have higher engagement numbers than it is to have more followers, and I think people get caught up on how many followers they have. And really, in today's world, it's better to have a smaller audience and a higher engagement.

Tom: coming from a larger organization of over 200,000 employees, we originally said there’d be no use of a social media because the risk was too great for something going wrong and infecting different systems or negative publicity, or whatever. But there's a lot of high touch clients out there with the business owners and trust people that we realized that certain people needed us have a social media presence. So, we do now allow social media, but for only certain salespeople and managers.

Bronwyn: I do use business Facebook, LinkedIn, and Twitter accounts. I post on the business account pages probably 2-3 times a week.

Ginger: Our marketing team is big into our social media presence. We currently have more than 50,000 followers across Facebook, Twitter, Instagram, LinkedIn, and YouTube. Our follower growth is up 13% year to date (2020), and we have more than 2.5 million social media impressions a year. We use this social media generally to announce our grants and other foundation news; we share stories of community impact; and, we tell donor stories. Currently, we do not use SnapChat and Tik Tok, but our marketing team is saying they're keeping an eye on it, so we shall see.

Greg: Our firm uses Clearview Social as a social media content manager, and my firm produces two or three pieces each week that individuals, who utilize social media, can push through by sharing that expert thought leadership content. I prefer to think of social media, (personally using Facebook), as trying to show the human side of our firm, showing that we are real people, not only for information, but just so the accomplishments that the firm has done, the accomplishments of the individuals, and the reach out to the community where we share our success with the community.

Marty: I think one of the things people want is free information, but quality information. Many people understand the shortcomings of some internet information and want quality information. I post articles on LinkedIn that are interesting planning situations with clients. It's a way to build the network and get people's attention. That's something that anyone can do very easily. One of the other things we *used* to do in our office, is I would have colleagues come to my office to do a series of video clips. I’d have a colleague come into my office and we would do three, four, five independent video clips on planning topics. Each video is less than 10 minutes and we posted them periodically to LinkedIn. With Covid, the filming in my office was eliminated because we weren't in our office, but we recorded 10-minute web meetings and posted those. We posted those also to a website that we've created, called laweasy.com, so that we have a consumer-facing site with much simpler information that's more digestible than the hour or two-hour long webinars that we post on our firm's site.

Dean: If you look up accountants, estate planners, attorneys, there's thousands of them, depending on your market. If you hire a firm to do your social media make sure that the firm that you're working with that they have an excellent background, they have positive reviews, and that they understand the boundaries of compliance that you have within your firm.

Marty: Final comments on what you'd continue do to adjust and grow your business?

Tom: We get up to 350 pieces of mail every Wednesday. So, what we've done, and this is all of Bank of America, and not just US Trust, Delaware, is that we're going to create a centralized mail place. That will end any mail coming into any office because we're all virtual now. Mail people will scan in all the mail and it will all be sent to the person addressed to by email; and so, we will no longer get an original piece of mail. They've implemented parts of it already, and because of everybody working virtual, we're trying this company wide. It should be interesting when we're all done with no more mail in any office.

Bronwyn: What I did with a lot of my clients when I was speaking to them about their accounts, reviewing their portfolios, and just anything that's going on in their life (March -September 2020), was I sent them a bottle of wine from where I grew up in Australia. With my top tier client's, I also did 2 other activities I hadn't thought of before. "Hey, I know you're sitting around with more time on your hands at home. Pick a book from the New York Times Best Seller's List and I'll mail you a hard copy or the e-book version." And with my 65-plus-year-old clients, living within 75 to 90 minutes distance from me, I offered to pick up groceries, prescriptions, or liquor for them. I know that the liquor consumption went up significantly in 2020. Several of my clients thought this was an email scam and so were shocked when I told them my offer was for real. I think it's something that I will continue to do moving forward only because it lends itself to our client-advisor relationship is not just all transactional. What I did starting March 13th, 2020, for the first time ever, was I started handwriting out birthday cards to *all* my clients. And I think that was appreciated, again, being in isolation. This is not a difficult activity to continue. And I really think I got new business out of just this one activity.

Ginger: I'll really pick up on what Bronwyn was talking about. Again, our work is relationship-based, and we had people just calling many of the donors and advisors to different funds, just to have a conversation with them when the pandemic started and for the first few months. People loved just hearing from someone to say, "how are you?" It wasn't a call because we wanted anything from them, we could provide information if they had any questions about what was happening at the Cleveland Foundation, but it was a way to connect with people that were feeling so isolated. And I think that technique will continue. We also did handwritten notes to people near year-end. Sometimes people just want something handwritten…and we got some really positive feedback on both of those efforts.

Marty: when anyone sends us a gift, or does something, they always get a hand-written thank you note. There's really no substitute for that.

Greg: We do the same with the note cards. I think most of us on this call are absolutely focused on the higher net worth individuals and doing estate planning for them, and that's where I will continue to focus. I want my referral sources to continue to think of me as their thought leader, and that's where my focus is going to be. In addition, as my practice has aged and realizing that a lot of my referral sources are starting to get to the point where they're handing it off to another generation of workers, I need to make sure that I am becoming that resource to that level of individual as well. So, keep connected with your resources for referrals.

Marty: I want to thank everybody from NAEPC for organizing the program and an incredible panel: Dean, Tom, Bronwyn, Ginger, and Greg. I hope you all found this as informative and helpful as I did, and good luck to all of you and I hope your 2021 marketing is successful and boosted by some of the ideas you got today.

Conclusions

The Covid pandemic has changed our behaviors around marketing to clients and meeting with clients. The panel discussion revealed several activities that could be incorporated into one's practice moving forward.

Events and meetings in 2020 had to become virtual. Virtual events created a medium to draw from a larger geographical area and allowed collaboration. Collaboration proved beneficial and a great marketing activity. Webinars on hot topics were well received.

Embrace new technology to help service your clients. Clients, including more older clients, have become familiar with e-communications. E-newsletters should lead back to your firm's website providing more information about you and your practice and ways to reach you.

Humanize your social media sites, post achievements, and rotate content.

Nothing takes the place of a handwritten card.

Don't be dependent on one marketing strategy—remember the how and where-how does a client get their information and where do they see/hear it.

Special thanks to the moderator Martin Shenkman and panelists Dean DeLisle, Ginger Mlakar, Tom Forrest, Greg Sellers.

Special thanks for the transcribed and written version of the webinar by Martin Shenkman and Bronwyn L. Martin.

By **L. Paul Hood Jr.**

The Human Side of Estate Planning: Part II

Three psychological phenomena that happen in every engagement

In the first installment of this three-part article, I provided evidence that a good estate-planning result doesn't occur in a majority of situations and introduced the Path of Most Resistance, a model that identifies and illustrates the obstacles to a good estate-planning result. In this installment, I introduce three psychological phenomena that happen in every estate-planning engagement: transference, countertransference and triangles in relationships. These three phenomena impact estate planning, either in a positive or negative way.

Transference

Transference is fairly easy to illustrate in a few examples, but psychologists frequently disagree over its meaning. Indeed, a few major schools of psychotherapy actually deny the existence of transference.

In psychology, the classical way to define "transference" is to simply say that it's a phenomenon in which people transfer feelings and attitudes, often subconsciously, from a person or situation in their past onto a present person or situation. It involves the projection of a mental representation of a previous experience or person on to the present situation or person with whom they're interacting. The recipients of the transference usually play an important role that's necessary for the projected relationship. There are usually subconscious encouragements by the client to the recipient to take on his feelings or beliefs about the situation or person.[1]

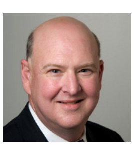
Transference occurs often in real life. For example, a boss at work reminds you of your irascible grandfather, so you're afraid to enter into extraneous conversations with him. The person in front of you in line at the grocery store reminds you of your cousin, so you strike up a conversation, even though this person is a total stranger. Or, as one psychologist wrote, "the battle cry heard from loving couples around the world: 'Stop treating me like I'm your mother!'"[2]

Transference often is witnessed in situations in which one party is in a position of confidence vis-à-vis the other, for example, psychologists, doctors and estate planners. It's very common. The person in a position of confidence plays an important role in the transference. Transference in estate planning involves projection of feelings about some event or person from the client's past onto the estate planner and the present situation. Transference can be a bad thing, but it doesn't have to be if the estate planner is aware of it and uses that knowledge to guide the client.[3]

Let's consider two examples of transference in estate planning:

Example 1: Birth order mismatch. Suppose your client is the youngest child in his family. In typical engagements, you usually default to naming the oldest child as successor executor and trustee if a client doesn't express a preference. In fact, you don't even ask and simply prepare documents appointing the oldest child as successor executor instead of another of a client's children. In this example, the client gets irate, accusing you of acting like her father, who favored the oldest sibling.

Example 2: Professional bias. You're meeting with a new client who's appearing extremely anxious and checking her watch repeatedly as you talk to her. Unbeknownst to you, the client's last experience with an estate planner went badly due to a misunderstanding about the size of the estate planner's fees and the hourly rate. The client has transferred her anxiety, which was caused by a bad experience with a past estate planner, on



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to her relationship with you.

About the best that we estate planners can do is to acknowledge that the projecting client's feelings aren't our fault and prevent taking on the client's invitation to engage based on the transference. However, what's behind and giving rise to the projected feelings indeed may be critical information for us to ferret out of the client.

In Example 1, you can apologize and be more careful in the future. In Example 2, you could ask the client about her anxiety, have a frank and open discussion about both the client's and your expectations concerning the fees and other terms of the relationship and follow up with an engagement letter that confirms what you've discussed.

When you look back at some rocky times with clients, chances are that an undetected transference lay at the heart of the difficulty. The transference can arise in many other different contexts in estate planning. For example, a client who had a bad experience with probate of a family member's estate may be hell bent on not using solely a will in her estate planning, having become visibly shaken at the mere mention of the word "probate." Digging deeper into the causes of the transference is thus critical.

Countertransference

As with transference, psychologists can and do differ about the definition of "countertransference." Indeed, there's at least one school of thought that denies the very existence of countertransference, opting to call it all transference, either belonging to the client or the therapist.

Estate planners aren't immune to the psychological process. We bring our life's experiences and psychological baggage into every estate-planning engagement, either consciously or subconsciously, whether we want to or not. Countertransference is defined as the often subconscious response of the recipient advisor to the client's actions or perceived actions. Countertransference responses can include both the advisor's conscious and unconscious feelings and associated thoughts from her past regarding things that the client says or does.

Countertransference involves displacement and projection onto the client. It sometimes is, but needn't be, harmful to the relationship, especially if the estate planner allows his personal feelings toward the client to cloud his professional judgment. On the other hand, if the estate planner is aware of his countertransference feelings and is able to deal with those feelings constructively, even being able to discuss those feelings with the client when appropriate, the countertransference can be a very helpful phenomenon in the planner-client relationship.[4]

Countertransference also can manifest itself in biases by the estate planner either in favor of or against certain estate-planning techniques.

There are all sorts of possible examples of how countertransference can arise in estate planning, but here are two examples from my practice experience:

Example 1: Flipside of birth order mismatch. Suppose that your client, who's the youngest child in her family, expresses strong negative feelings about an oldest child automatically being designated as executor just because that child was the oldest. Suppose further that you're an oldest child who feels strongly that oldest children should automatically be considered for such a fiduciary position. You routinely draft wills naming the oldest child as executor when a client says nothing to the contrary. When the client states that she wants a middle or youngest child to be her executor, you may view the client in a somewhat negative light, particularly because you also hold your own youngest sibling in contempt for actions that he engaged in and was allowed to get away with just because he was the "baby" of the family. You've allowed your decades-old disdain for your youngest

sibling to color your judgment about the client.

Example 2: Professional bias. Your new client identifies herself as an engineer. You then think to yourself, "engineers are always problem clients because they ask too many questions, reduce everything to black and white and think that they know it all" and immediately get a little defensive, condescending and short with the client about the proper estate-planning process.

In both examples, you've allowed something from your past or opinions cloud your judgment in the countertransference.

Countertransference also can manifest itself in biases by the estate planner either in favor of or against certain estate-planning techniques. Additionally, estate planners can be morally opposed or outraged by their clients' behavior to the extent that it impacts the estate planner's ability to work effectively for the client.

Triangles

A triangle is a three-person relationship system. The late Murray Bowen, MD, a psychiatrist and professor of psychiatry and a pioneer in the area of family systems theory back in the 1950s, developed the triangle as part of an eight-concept family systems theory. The triangle isn't universally used by psychologists and psychiatrists, given that Dr. Bowen's theory is but one of approximately 12 major schools of family therapy. Dr. Bowen argued that the triangle is considered the base building block of larger human emotional systems because he asserted that a three-person triangle is the smallest stable human relationship system. According to Dr. Bowen, a two-person system is unstable because it tolerates little tension before one or both participants "triangle in" a third person to reduce their anxiety that the tension between the participants caused.[5]

Dr. Bowen reasoned that a triangle can withstand much more tension than a two-person relationship because the tension can be shifted among three relationships (A-B, A-C and B-C) instead of just one, and the parties subtly shift back and forth among each other during the course of their relationship triangle. In fact, Dr. Bowen further reasoned that when the triangle anxiety becomes unbearable to one or more of the participants, a series of interlocking triangles can develop.

Learning about relationship triangles assisted me in explaining previously puzzling practice situations. As Dr. Bowen has written, "[t]he triangle describes the what, how, when, and where of relationships, not the why."[6] I often witnessed triangles in families in my estate-planning practice. I even unwittingly participated in some of these triangles as an estate planner. Triangles can involve not just living persons but also someone who's deceased. Triangles also can involve inanimate objects, for example, occupants of a certain bedroom in an antebellum home. Triangles can exist among the client and two estate planners whose ideas are at odds with one another. At least one writer has called for a family systems approach to estate planning.[7] Let's consider a couple of examples of triangles in the estate-planning process:

Example 1: The tie-breaker. You're meeting with a husband and wife about their estate planning, when they start to squabble over which of their children should be the successor executor. Frustrated, the wife turns to you, attempting to "triangle" you into the conversation on her side of the argument by commenting with a loaded question like, "What's your opinion?" or "Don't you think that he [the husband] is being hardheaded?"

SPOT LIGHT

Morning Glory

Looking Down on Mentone, France by Edgar Payne sold for $16,250 at Bonhams' California and Western Paintings and Sculpture auction on Aug. 7, 2018 in Los Angeles. Payne, who married fellow artist Elsie Palmer, asked her to postpone their wedding ceremony to later in the day, after noticing that the morning light was "perfect" for painting. Lucky for him, she was understanding.

In this example, the wife was frustrated with her husband in their communication about the choice of executors, and she attempted to reduce her anxiety by trying to find an ally.

Example 2: Aging parents. Your clients, a husband and wife who are getting on in years, are concerned about which of their children should handle their affairs when they're no longer able to do so. They decide on one of their children to be their agent under their powers of attorney and tell all of their children of their decision. Not long after this, you receive a phone call from a child who wasn't selected, expressing concern that his parents "may not be thinking clearly" in their selection of his sibling as agent, intimating his belief that his sibling has unduly influenced his parents and attempting to triangle you into the conversation. Here, the parents are viewed as one person in the triangle.

In this example, the child, suffering anxiety at the possibility of having a sibling serve as agent instead of himself, attempts to reduce that anxiety by trying to find an ally.

More to Come

In the third part of this article, I'll define and explore death anxiety and mortality salience and the role that they play in estate planning, common fears that clients face in estate planning and the complex relationship among a client's thoughts about death, the client's property and the objects of his bounty. I'll also introduce estate planners to two tools to assist purposeful estate planners in the human side of estate planning: motivational interviewing and appreciative inquiry.

Endnotes

1. *See, e.g.,* Robert J. Marshall and Simone V. Marshall, *The Transference-Countertransference Matrix: The Emotional-Cognitive Dialogue in Psychotherapy, Psychoanalysis, and Supervision,* Chapter 1, which identifies at least 26 different types of transference.
2. Dr. Ryan Howes, "A Client's Guide to Transference," *Psychology Today* (June 18, 2012), *www.psychologytoday.com/blog/in-therapy/201206/clients-guide-transference*.
3. *See, e.g.,* Thomas L. Shaffer, *Death, Property, and Lawyers* (Dunellen Press 1970). Back in 1665, in his Reflections, No. 26, Francois de La Rochefoucauld wrote, "[N]either the sun nor death can be looked at without winking." For an extensive discussion and application of the phenomenon of transference to estate planning, *see* Shaffer, Chapter 7. *See also* Louis H. Hamel, Jr. and Timothy J. Davis, "Transference and Countertransference in the Lawyer-Client Relationship: Psychoanalysis Applied in Estate Planning," 25 *Psychoanalytic Psychology*, at pp. 590-601 (2008) (Hamel and Davis).
4. *See, e.g.,* Jan Wiener, *The Therapeutic Relationship: Transference, Countertransference and the Making of Meaning* (Texas A&M University Press 2009), at p. 12.
5. For more information on Bowen Theory, *see www.thebowencenter.org.* For another very easily accessible (and short) read on the Eight Concepts of Bowen Theory, consider Roberta M. Gilbert, M.D., *The Eight Concepts of Bowen Theory* (Leading Systems Press 2006). *See also* Peter Titelman, *Triangles: Bowen Family Systems Theory Perspectives* (Haworth Press 2008); Philip J. Guerin, Jr., Thomas F. Fogarty, Leo F. Fay and Judith Gilbert Kautto, *Working with Relationship Triangles: The One-Two-Three of Psychotherapy* (The Guildford Press 1996); and Ona Cohn Bregman and Charles M. White (eds.), *Bringing Systems Thinking to Life: Expanding the Horizons for Bowen Family Systems Theory* (Taylor & Francis 2011). The last book applies Bowen Theory to such diverse organizations and relationships as pastoral training and family businesses.
6. Michael E. Kerr and Murray Bowen, *Family Evaluation* (W.W. Norton & Co. 1988), at p. 134.
7. Charles W. Collier, "A 'Family Systems' Approach to the Estate Planning Process," 30 *ACTEC Journal*, at pp. 146-149 (1994), reprinted in Charles W. Collier, *Wealth in Families* (Third edition, Harvard College 2012).

SPOT LIGHT

Follow Me

Racing by Henrietta Berk sold for $10,625 at Bonhams' California and Western Paintings and Sculpture auction on Aug. 7, 2018 in Los Angeles. A painter from the San Francisco Bay Area, Berk was recognized for the strong colors and shapes in her oil paintings. Her work was exhibited in galleries worldwide. One of her paintings still hangs in the U.S. Embassy in Peru.

FEATURE:
PERSPECTIVES

By L. Paul Hood, Jr.

The Human Side of Estate Planning: Part III

Helping clients face common fears

In the first installment of this series, I introduced a model, "The Path of Most Resistance," which illustrates why a good estate-planning result is so hard to achieve. In the next installment, I discussed three psychological phenomena that one can witness in estate planning. In this final installment, I discuss death anxiety, the issue of mortality salience (reminders about death)[1] and common fears that clients face in estate planning. I'll conclude this installment by introducing estate planners to two tools that can assist them in the human side of estate planning: motivational interviewing (MI) and appreciative inquiry (AI).

Death Anxiety

"Death anxiety" is defined as:

> . . . a complex phenomenon that represents the blend of many different thought processes and emotions: the dread of death, the horror of physical and mental deterioration, the essential feeling of aloneness, the ultimate experience of separation anxiety, sadness about the eventual loss of self, and extremes of anger and despair about a situation over which we have no control.[2]

These fears can cause people to act differently, even irrationally, from how they typically would under different circumstances. These actions often lead to conflict because the survivors joust for a piece of the decedent's property, persona or symbolism, which people seek to assuage their fears and comfort themselves for their loss. Psychologists posit that all humans develop an innate ongoing existential fear of death from a relatively early age.[3]

Psychiatrists have determined that there are at least seven reasons why people have death anxiety:[4]

1. No more life experiences.
2. Fear of what will happen to their bodies post-death.
3. Uncertainty as to fate if there's life after death.
4. Inability to care for their dependents.
5. Grief caused to relatives and friends.
6. All their plans and projects will come to an end.
7. The process of dying will be painful.

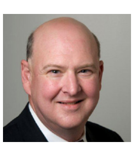
There are at least three defenses that individuals commonly employ to withstand death anxiety:

1. Avoidance of talk about mortality and other reminders of mortality (called "mortality salience").
2. Minimization of mortality through jokes about death and feeling that the concern about mortality isn't pressing enough for action at the moment.
3. A desire for symbolic immortality, which is a form of autobiographical heroism, in which individuals take actions that solidify and perpetuate causes and provide for those who are important to them.[5]

Mortality Salience

Estate planning causes people to face their own mortality. Mortality salience plays a role in estate planning by often causing people to put off their estate planning for another day, despite its apparent glaring need in particular situations. According to the research of Dr. Russell N. James III, the forms of avoidance of mortality salience are:

- Distraction: "I'm too busy to worry about that right now."



L. Paul Hood, Jr., based in Toledo, Ohio, is an author and frequent speaker on estate planning

- Differentiation: "It doesn't apply to me because I come from a family of actuarial longevity."
- Denial: "These death worries are overstated."
- Delay: "I plan on worrying about death…later."
- Departure: "I'm going to stay away from death reminders."[6]

According to the research, mortality salience causes increases in the following:

1. Desire for fame.
2. Perception of one's past significance.
3. Likelihood of describing positive improvements in writing an autobiographical essay.
4. Interest in naming a star after one's self.
5. Perceived accuracy of a positive personality profile of one's self.[7]

According to Dr. James and his research, mortality salience results in a greater attachment to and support of one's community's values over an outsider's values. This includes an increase in:

1. Charitable contributions by U.S. donors to U.S. charities over foreign charities.
2. A predicted number of local NFL team wins.
3. Negative ratings by Americans of anti-U.S. essays.[8]

According to Dr. James, external realities occasionally break through avoidance of mortality salience, including illness, injury, advancing age, death of a close friend or family member, travel plans and intentionally planning for one's death through estate planning, which cause people to tend to their estate planning. However, these external realities are unpredictable and sporadic.[9] But, the issue of procrastination and avoidance in estate planning is far more complex than just avoidance of mortality salience.

Fears of Estate Planning

People have at least 12 fears about estate planning, of which death anxiety is but one. They fear:[10]

1. Contemplating death (death anxiety).
2. Not doing the right thing.
3. The unknown.
4. Hurting someone's feelings/creating animosity/post-death squabbles.
5. Estate planners.
6. The estate-planning process.
7. Running out of money/losing security.
8. Changes in the law.
9. Facing reality.
10. Loss of flexibility.
11. Loss of privacy.
12. Probate.

Most of these fears are irrational and can be safely and properly addressed in a well-confected estate plan. Estate planning has therapeutic and anti-therapeutic consequences, the latter of which the estate planner must identify and work to ameliorate.[11] Estate planning, once done and finalized, is known to reduce death anxiety, for example, recall Ishmael from *Moby-Dick* about his will signing.[12]

> One potential consequence of death anxiety is the deterioration of the testator's decision-making capabilities.

Effects of Death Anxiety

Death of a loved one or a friend conjures up two fears in most of us: 1) the loss of a source of safety and security; and 2) a fear of our own mortality.

This often causes a split in the ego,[13] as people trick themselves through a cognitive distortion[14] into thinking that their own death isn't something that they need be concerned about at present. This typically results in

repression of thoughts of death, as they're simply too painful to be allowed into a person's consciousness. The splitting of the ego can lead to depression and other forms of psychosis as well as the loss of internal object ties.[15]

Here are two examples of cognitive distortions:

- People often compare themselves to individuals who are known to have abused their bodies, for example, Keith Richards, and say that if he can live that long after having done what he did, they'll survive too until at least his age or older.
- Older persons, whose death is more imminent, focus on medical research or make deals with themselves to get healthier, and, by so doing, think they'll live longer.

A common reason why some people don't engage in estate planning is a fear that their families will fight after their death, when their motives and activities will be subjected to unwanted intense public scrutiny.

One potential consequence of death anxiety is the deterioration of the testator's decision-making capabilities. The fear forces people into making short-sighted or ill-advised decisions that will have a lasting impact on their loved ones. Fear of making these types of bad decisions also flows out of death anxiety, as people are reluctant to act on their estate planning for fear that they'll make a bad decision. People often cope with death anxiety by making difficult decisions quickly, thereby abbreviating the stressful experience.[16] These swift decisions often are bad ones.

This oft-truncated decision-making process usually involves an erratic method of selecting information for consideration, an inadequate amount of time spent considering that information and evaluating alternatives and a lack of willingness to re-evaluate after the decision is made. Getting it done is more important than how or what was done.[17]

Humans are the only species who know cognitively that life is finite and that we're mortal. However, that cognitive knowledge, combined with the desire to procreate and survive, create what Mario Mikulincer, Victor Florian and Gilad Hirschberger call "an irresolvable existential paradox."[18] A human's survival mode causes him to put off thoughts of his own demise because survival is the goal, despite clear signs of eventual mortality. Hundreds of studies have proven that when confronted with mortality salience, humans adhere even more passionately to their view of the world.[19] Humans resort to lots of methods to avoid the fear brought on by mortality salience, including religion, work, relationships, exercise and wealth accumulation.

Terror management theory[20] (inspired by the work of Ernest Becker[21] and Otto Rank) instructs that humans grasp for any kind of immortality to cope with mortality salience, including symbolic immortality. Symbolic immortality includes our belief in an afterlife, our descendants, our favorite institutions and our body of work, wealth and accomplishments. Estate planning properly done gives clients symbolic immortality.

Separation anxiety, which is articulated in attachment theory, also contributes to inheritance conflict. Attachment theory was formulated in the 1930s by John Bowlby, a British psychoanalyst who worked with troubled children. It postulates that infants will go to great lengths, for example, crying and clenching, to prevent being separated from their parents. Attachment theory has been extended to adults and goes a long way to explaining why adults do what they do when a loved one passes away.[22] Grieving loved ones often scramble for and squabble over items that symbolically resemble the decedent's persona or successes to which they can remain associated, for example, grandma's china, dad's watch or family portraits. The financial value of these items is often irrelevant.[23]

According to the late clinical psychologist Edwin Schneidman, the closest that most people get to acknowledgment of their own mortality is a view of the

world after our death and how we'll be remembered—which he called the "post-self."[24] Schneidman viewed each person's property as an extension of one's self, which is in line with Jean-Paul Sartre's famous quote, "The totality of my possessions reflects the totality of my being. I am what I have. What is mine is myself."[25] Estate planning often is viewed as one of the last opportunities to foster one's post-self.[26]

As mentioned previously, estate planning, once faced, confers a form of symbolic immortality on the testator, who in essence gets to continue to influence and participate in the lives of the beneficiaries after death. But, fewer than half of Americans make a will.[27] Why? Fears of estate planning for most exceed the purely psychological payoff of symbolic immortality and peace of mind.

Reasons for Inheritance Fights

A common reason why some people don't engage in estate planning is a fear that their families will fight after their death, when their motives and activities will be subjected to unwanted intense public scrutiny. Because it provides a medium for the public airing of the "dirty laundry" and family secrets of testators and their families, the mere possibility of an estate squabble may cause clients stress and anxiety during the estate-planning process and cause them to put it off for that reason alone.

Why do people fight over inheritances? According to elder law attorney P. Mark Accettura, there are five basic reasons:

- Humans are predisposed to competition and conflict;
- Our psychological self is intertwined with the approval that receiving an inheritance confers;
- Humans are genetically predisposed toward looking for exclusions;
- The death of a loved one is mortality salience that triggers the accompanying death anxiety in humans; and
- The possibility of existence of a personality disorder that causes family members to distort and escalate natural family rivalries into personal and legal battles.[28]

While I agree with much of Accettura's theory, he's of the opinion that estate planning properly done through intergenerational communication for the right reasons can significantly reduce the proclivity to quarrel over inheritance. In fact, I believe that estate planning properly done can enhance a family's emotional well-being. Furthermore, estate planning poorly done without communication between the givers and receivers can exacerbate and worsen inheritance fights.

Another reason for reticence about estate planning is a concern that too much wealth given to their loved ones will blunt their self-esteem and personal drive.[29] There's ample evidence of this in some wealthy families.

Tools for Use

There are a number of tools that planners can use to assist clients/donors psychologically with respect to finishing their planning, including: reflective listening, AI and MI.

Guiding Principles of MI

MI was developed in the 1980s primarily to assist patients who had chemical dependency problems. It's a simple and elegant system whereby the client, who wants to change at some level, finds the reasons to change within himself, with the therapist merely acting as a guide. MI is based on four guiding principles:

- Resist the righting reflex (discussed below);
- Understand and explore the patient's own motivations;
- Listen with empathy; and
- Empower the patient, encouraging hope and optimism.

It has application to estate/charitable planning, where clients/donors often are ambivalent about doing their planning. By asking the right questions, we can guide the client/donor to the conclusion that he needs to get his estate/charitable planning done and reassure him that we're the right people to guide him through this process.

MI is based on the assumption that the righting reflex (that reflex that causes people to tell someone else when they're on the wrong track), which humans have and helping professsionals have often to a greater degree, is counterproductive as it encourages the other person to take up the opposing side of the argument. Advisors tend to go to this righting reflex quickly because we assume that clients want our help and opinion immediately. However, this often isn't true.

MI is based on four processes:[30]

- Engaging (establishing a helpful connection and working relationship);
- Focusing (developing and maintaining a specific direction in a conversation about change in behavior);
- Evoking (eliciting the client's own motivations for change, which lie at the heart of motivational interviewing); and
- Planning (developing a commitment to change and a concrete plan of action).

MI isn't a hoax in which the therapist tricks the patient into taking a course of action. There's a spirit to it, as discussed below. MI isn't done to or on someone; MI is done with someone. The professional using MI is a privileged witness to change, which the client usually figures out on his own.

> By properly responding to the sustain talk and encouraging the change talk, the planner can play a role in assisting clients/donors to get them the therapeutic benefits of finishing their estate/charitable planning.

The spirit of MI is based on the following four components:[31]

- *Collaborative partnership.* Among patient/client/donor and helping professional, particularly when behavior change is needed.
- *Acceptance.* It's axiomatic that the practitioner unconditionally accepts the person just as he is at present.
- *Evocative.* MI seeks to evoke from the patient/client/donor that which he already has: his own motivation and resources for change, connecting behavior change with his own values and concerns.
- *Honoring autonomy.* MI requires a certain amount of detachment from outcomes, because the patient/client/donor can make up his own mind and is free to go in any direction, even one not advised.

Communication styles. There are essentially three communication styles that form a continuum of communication,[32] and these can be used in the same conversation:

- *Direct.* Telling what to do.
- *Follow.* Listening.
- *Guide.* Middle ground, involving both.

MI spends most of its time in Guide mode, whereas most helping professionals use a follow-direct pattern, which often isn't optimal and, at worst, self-defeating.

Core communication skills. They are: asking, listening and informing.[33] Too many helping professionals spend too much time in the inform or ask/inform skillsets and not enough time listening. In my experience, as much as one quarter to one third of my estate-planning clients weren't yet ready to do some estate planning even though they were in the office, ostensibly to do just that. They often simply wanted some non-judgmental professional listening. If your clients are similar to mine, you'll miss the boat entirely at least a quarter of the time if you take estate-planning clients literally at their initial impression of wanting to do some estate planning.

Skills needed for MI. They include:[34]

- Asking open-ended questions.
- Affirming the other person.
- Reflective listening—this is very important.
- Summarizing.
- Informing and advising.

Many estate planners proceed too quickly from asking questions, most of which are closed-end in the form of yes/no and multiple choice. This line of questioning results in leading the client to the desired answer and then immediately informing and advising. If they're not being listened to, clients may decide to change professionals.

Roadblocks to active listening. In 1970, Dr. Thomas Gordon set out 12 of what he calls "roadblocks" to effective listening, which are responses by individuals that don't

constitute what he calls “active listening”:[35]

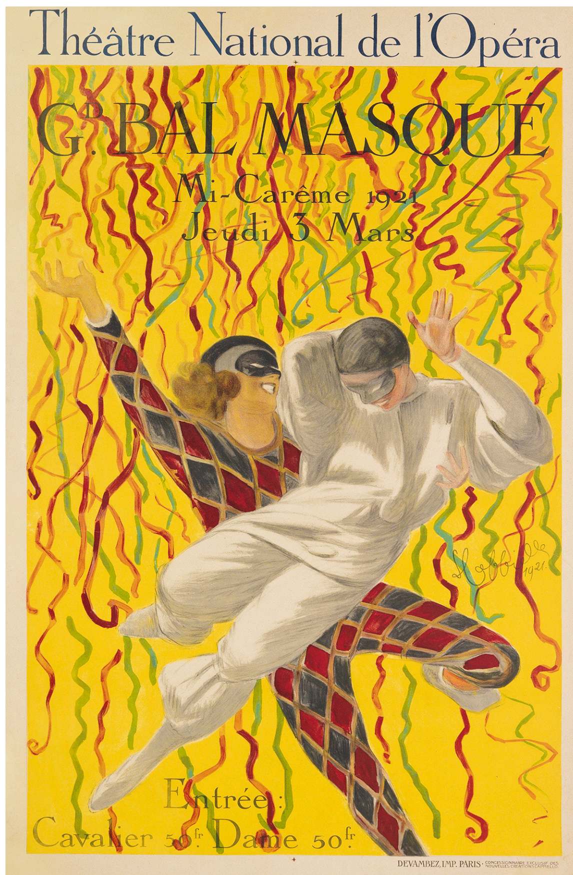
- Ordering, directing or commanding.
- Warning, cautioning or threatening.
- Giving advice, making suggestions or providing solutions.
- Persuading with logic, arguing or lecturing.
- Telling people what they should do; moralizing.
- Reassuring, sympathizing or consoling.
- Questioning or probing.
- Withdrawing, distracting, humoring or changing the subject.
- Disagreeing, judging, criticizing or blaming.
- Agreeing, approving or praising.
- Shaming, ridiculing or labeling.
- Interpreting or analyzing.

These roadblocks to active listening can end a conversation prematurely. Not only does the purposeful estate planner or other professional helper have to suspend his own needs but also the helping professional has to avoid the “expert trap” in which asking questions one after another signifies control over the conversation. This pattern may lead to an assumption, often wrong, that once the helping professional has all of the answers to the questions, there will be a solution, which, again, often isn’t true. This heightened expectation is a trap for an expert.[36] The roadblocks to active listening also are examples of the righting reflex at work, because helping professionals are predisposed to and programmed to ask and respond, quite often violating one of these roadblocks.

Reflective listening. The concept of reflective listening is easy to understand; its application to real life conversations can be difficult because of our tendency to go down the road of one or more of the 12 roadblocks set forth above, which involves the righting reflex. You simply mirror back and summarize for the client what the client just said. This is more than a mere echo; it demonstrates that you’re paying attention and can give the client a feeling that you understand him and what he’s going through.

Ambivalence. People who are thinking about making a change in their lives are ambivalent: Part of them wants to change, and part of them wants to maintain the status quo. By gently guiding clients in conversation, the planner has the clients convince themselves that the change is in their best interests. If you listen to ambivalent people discuss making that change, they’ll often engage in change talk (when they’re in favor of change—for example, completing their planning) and sustain talk (when they’re in favor of maintaining the status quo—for example, doing nothing) during the same conversation.

Planners can use the principles of MI to guide clients/donors toward closure in the estate/charitable planning process. Most clients/donors are ambivalent about doing their estate/charitable



SPOT LIGHT

Clowning Around

Théâtre National de l’ Opéra by Leonetto Cappiello sold for $2,000 at Swann Auction Galleries’ Vintage Posters auction on Aug. 1, 2018 in New York City. Cappiello was an innovator of modern poster design. Though he had no formal training, his unique style, which was often imitated, had a profound effect on modern advertising.

planning and engage in both change talk and behavior and sustain talk and behavior. By properly responding to the sustain talk and encouraging the change talk, the planner can play a role in assisting clients/donors to get them the therapeutic benefits of finishing their estate/charitable planning.

AI

The second tool that's available to estate planners is AI.

SPOT LIGHT

To The Rescue

Pop Art Superheroes (group of 3 posters) by Lee Falk sold for $1,375 at Swann Auction Galleries' Vintage Posters auction on Aug. 1, 2018 in New York City. Falk was the creator of the popular comic strips *Mandrake the Magician* and *The Phantom*. He went on to produce more than 300 plays and direct almost 100 productions.

AI represents the intersection of the words "appreciate" and "inquire." It's both a philosophy and a methodology for positive change.[37] The proponents of AI, which was conceived in the early 1980s by David L. Cooperrider, then a Ph.D. student at Case Western Reserve University in Cleveland, believe that far more progress can be made by a focus on the positive attributes of the system than on a focus on the negatives, weaknesses or shortcomings of the system because there's less resistance to enhancing what's done well, even if it means phasing out or changing some weak areas.[38]

Basis and theory underlying AI. AI is based on the theory of social constructionism, which posits that an individual's notion of what's real, including his sense of his problems, is constructed in daily life through communications with others and is subjective and able to be changed.[39] There are things that a person or organization does very well—what gives life to the person or system, and the focus is on those positives with a view toward taking one to positive changes. Contrast this with the change management or problem-solving systems, which identify problem areas and strive to solve them, ignoring that which is working well.

In addition to the social constructionist principle, AI is based on the following four principles:[40]

- *Simultaneity principle.* Inquiry creates change and should occur simultaneously.
- *Poetic principle.* We can choose what we study. People have the power to choose positivity.
- *Anticipatory principle.* Images inspire and guide future action.
- *Positive principle.* Positive questions lead to positive change.

AI involves the art and practice of asking questions that strengthen a system's capacity to understand, anticipate and heighten positive potential.

How can AI be used in estate/charitable planning? The possibilities are endless. For starters, family businesses that need succession planning can avail themselves of AI.[41] Planners can use AI with donors who are unclear about how they want their gifts used.

"The Appreciative Inquiry 4-D Model," p. 61, explains the process of AI pictorially:[42]

The desired outcome of **Discovery** is appreciating the best of what **is**;

The desired outcome of **Dream** is imagining/

envisioning what **could be**;

The desired outcome of **Design** is innovating/co-constructing/discovering what **should be**; and

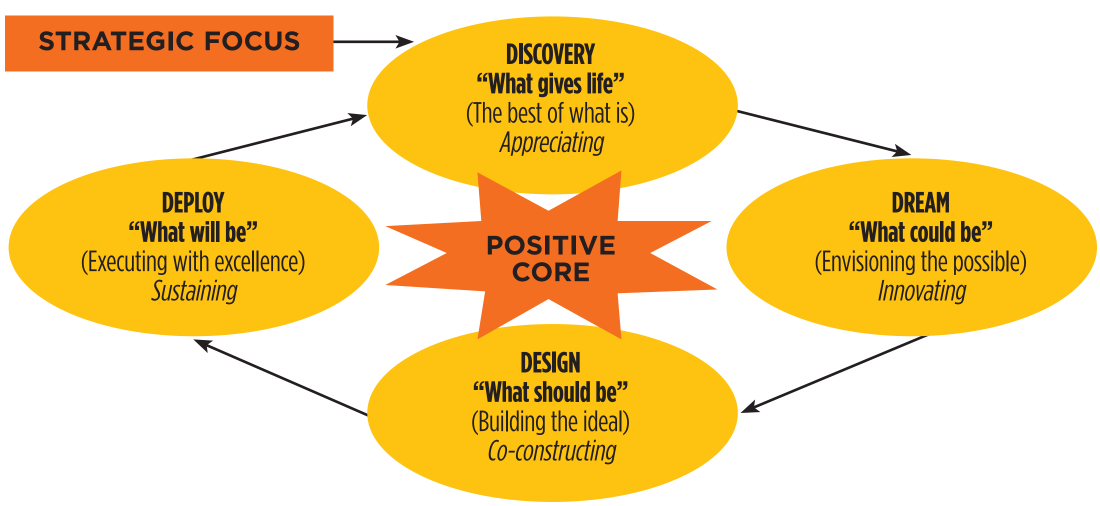
The desired outcome of **Deploy** is delivering/creating/sustaining what **will be**.

Endnotes

1. L. Paul Hood, Jr.,"Back to the School of Hard Knocks: Thoughts on the Initial Estate Planning Interview-Revisited," *Wealth Strategies Journal* (March 26, 2014) ("Hard Knocks"). *See also* L. Paul Hood, Jr., "From the School of Hard Knocks: Thoughts on the Initial Estate Planning Interview," 27 *ACTEC Journal* 297 (2002).
2. Robert W. Firestone and Joyce Catlett, *Beyond Death Anxiety* (Springer Publishing Company 2009), at p. 16.
3. Sheldon Solomon, Jeff Greenberg and Tom Pyszczynski, *The Worm at the Core: On the Role of Death in Life* (Random House 2015), at pp. 26-28.
4. *See, e.g.*, James C. Diggory and Doreen Z. Rothman, "Values Destroyed By Death," 63 *Journal of Abnormal and Social Psychology*, No. 1, at pp. 205-210 (1961).
5. Russell N. James, III, *Inside the Mind of the Bequest Donor* (self-published 2013), Chapters 4 and 5.
6. *Ibid.*, at p. 31.
7. *Ibid.*, at p. 54.
8. *Ibid.*, at p. 57.
9. *Ibid.*, at p. 46.
10. Eleven of these were discussed in L. Paul Hood, Jr. and Emily Bouchard, *Estate Planning for the Blended Family* (Self-Counsel Press 2012). Recently, Hood added the fear of probate.
11. *See, e.g.*, Mark Glover, "A Therapeutic Jurisprudential Framework of Estate Planning," 35 *Seattle University Law Review* 427 (2012).
12. On being assured that his testamentary wishes are in order after he signed his will, Ishmael describes his satisfaction: "After the ceremony was concluded upon the present occasion, I felt all the easier; a stone was rolled away from my heart." Herman Melville, *Moby-Dick; or The Whale* (Penguin Books 2003) (1851), at p. 249. *See also* Thomas L. Shaffer, *Death Property and Lawyers* (Dunellen 1970), at p. 77.
13. *See, e.g.*, Nathan Roth, *The Psychiatry of Writing a Will* (Charles C. Thomas 1989), at pp. 44, 46 and 48.
14. Cognitive distortions have been explained as "ways that our mind convinces us of something that isn't really true. These inaccurate thoughts are usually used to reinforce negative thinking or emotions—telling ourselves things that sound rational and accurate, but really only serve to keep us feeling bad about ourselves." *See, e.g.*, John M. Grohol, "15 Common Cognitive Distortions," *http://psychcentral.com/lib/15-common-cognitive-*

The Appreciative Inquiry 4-D Model

How AI works



— *https://cvdl.ben.edu/blog/what-is-appreciative-inquiry/*

distortions/0002153.
15. Roth, *supra* note 13, at p. 46.
16. Glover, *supra* note 11, at p. 437.
17. *Ibid.*, at p. 437.
18. *See, e.g.*, Mario Mikulincer, Victor Florian and Gilad Hirschberger, *Gilad* (2003). "The existential function of close relationships. Introducing death into the science of love," *Personality and Social Psychology Review* 7 (1): 20-40.
19. *See, e.g.*, James, *supra* note 5, Chapter 5.
20. Abram Rosenblatt, Jeff Greenberg, Sheldon Solomon, Tom Pyszczynski and Deborah Lyon, "Evidence for Terror Management Theory: The Effects of Mortality Salience on Reactions of Those Who Violate or Uphold Cultural Values," *Journal of Personality and Social Psychology*, Vol 57(4) (October 1989), at pp. 681-690.
21. *See, e.g.*, Ernest Becker, *The Denial of Death* (Free Press Simon & Schuster 1973).
22. Chris R. Fraley, "A Brief Overview of Adult Attachment Theory and Research," *https://internal.psychology.illinois.edu/~rcfraley/attachment.htm*.
23. I recall an unfortunate case that went to the state court of appeal twice over family portraits that could have been duplicated.
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25. Jean-Paul Sartre, *Being and Nothingness* (1943).
26. Shaffer, *supra* note 12, at pp. 81-82. *See also* James, *supra* note 5.
27. *www.caring.com/articles/wills-survey-2017*.
28. Mark P. Accettura, *Blood & Money: Why Families Fight Over Inheritance and What To Do About It* (Collinwood Press, LLC 2011).
29. Warren Buffett, in an article in *Fortune* magazine (Sept. 29, 1986), is quoted as saying the optimal amount of inheritance to leave children is "enough money so that they would feel they could do anything, but not so much that they could do nothing."
30. William R. Miller and Stephen Rollnick, *Motivational Interviewing: Helping People Change* (3rd ed). (The Guildford Press 2013) (*Motivational Interviewing*), Chapter 3.
31. *Ibid.*, at pp. 14-24.
32. *Ibid.*, at pp. 4-5.
33. *Ibid.*, at, pp. 4-5.
34. *Ibid.*, Chapter 6.
35. *See, e.g.*, *www.gordonmodel.com/work-roadblocks.php*.
36. *Motivational Interviewing*, *supra* note 30, at p. 42.
37. Natalie May, Daniel Becker, Richard Frankel, Julie Haizlip, Rebecca Harmon, Margaret Plews-Ogan, John Shorling, Annie Williams and Diana Whitney, *Appreciative Inquiry in Healthcare: Positive Questions to Bring Out the Best* (Crown Custom Publishing 2011), at p. 3.
38. David L. Cooperrider, Diana Whitney and Jacqueline M. Stavros; *Appreciative Inquiry Handbook For Leaders of Change* 2nd Ed. (Crown Custom Publishing 2008), at p. xv (*Handbook*).
39. *Ibid.*, at pp. 14-15.
40. *Ibid.*, at pp. 8-10.
41. Dawn Cooperrider Dole, Jen Hetzel Silbert, Ada Joe Mann and Diana Whitney, *Positive Family Dynamics* (Taos Institute Publications 2008).
42. *https://cvdl.ben.edu/blog/what-is-appreciative-inquiry/*. There are many different ways that the 4-D Cycle is illustrated and described. *Handbook, supra* note 38, at pp. 5 and 34. Some newer descriptions employ a 5-D model, in which the first "D" is Definition of the presenting opportunity. *See, e.g., https://appreciativeinquiry.champlain.edu/learn/appreciative-inquiry-introduction/5-d-cycle-appreciative-inquiry/*.

SPOT LIGHT

Call to Action

Woman Your Country Needs You! by unknown artist sold for $1,625 at Swann Auction Galleries' Vintage Posters auction on Aug. 1, 2018 in New York City. The propoganda poster was created circa 1917, to call on women to serve in many various capacities during the Great War.

Steve Leimberg's Employee Benefits and Retirement Planning Email Newsletter Archive Message #762

Date:03-Jun-21

Subject: Kenn Tacchino - Picking the Best Retirement Plan for a Business

"New financial planners may be hesitant to advise small-business owners about which retirement plan to sponsor because this decision requires specialized knowledge. However, the practice of suggesting the optimum plan choice is an essential financial planning skill. What's more, small-business owners crave suitable advice. In an effort to start planners on the journey to helping plan sponsors choose the best retirement plan for their clients, we present 10 examples regarding 'plan choice' issues with some introductory context concerning several topics."

We close the week with commentary by **Kenn Tacchino** that reviews the factors that go into picking the best retirement plan for a business. His content was original published in the May 2021 issue of the *Journal of Financial Service Professionals* and is reprinted here with permission.

Kenn Tacchino JD, LLM, is a professor of taxation and financial planning at **Widener University**. He is a four time winner of the School of Business Distinguished Graduate Teaching Award. He has also won the Distinguished Research Professor Award and the Distinguished Service Award. Professor Tacchino is director of Widener University's Master of Taxation and Financial Planning (MSTFP) program. in 2018 he was awarded Widener University's Distinguished University Professor Award.

Professor Tacchino has been the editor of the Journal of Financial Service Professionals since 2001. The Journal reaches a broad audience of financial planners. It is a blind-peer review publication with a competitive nature for publishing applied research for over 73 years. Professor Tacchino was formerly a full time faculty member and a consultant to The American College (1986-1991 full time and 1991-2013 consultant). He was a contributing author to two textbooks for the College, which have been used at over 250 colleges nationwide. Professor Tacchino was the former

Director of the New York Life Center for Retirement Income at the American College. Under his leadership, and with the help of leading industry experts, the New York Life Center created a popular website on retirement income and the state of the art Retirement Income Certified Professional (RICP) designation. Kenn is also the author of numerous articles on retirement topics published in academic and professional journals. He is often quoted in retirement planning articles and has made appearances on radio and television. Kenn writes for the Wall Street Journal's MarketWatch publication. His columns are popular reading for consumers seeking advice about retirement.
He received his BA from Muhlenberg College, JD from Western New England College School of Law, and LLM from Widener University School of Law.

Here is his commentary:

EXECUTIVE SUMMARY:

New financial planners may be hesitant to advise small-business owners about which retirement plan to sponsor because this decision requires specialized knowledge. However, the practice of suggesting the optimum plan choice is an essential financial planning skill. What's more, small-business owners crave suitable advice. In an effort to start planners on the journey to helping plan sponsors choose the best retirement plan for their clients, we present 10 examples regarding "plan choice" issues with some introductory context concerning several topics.

COMMENT:

Benefits of a Qualified or Tax-Advantaged Retirement Plan

New planners should stand ready to educate plan sponsors about the tax benefits of a qualified plan or tax-advantaged retirement plan.[1] For example, Emily quit her job at the end of last year to pursue her lifelong dream of opening a bakery in her favorite seaside resort. Her planner determines that she will be financially capable of saving $1,000 each month for her retirement from the proceeds of the business. She would like to know whether to use a qualified plan or to just try saving for retirement without a plan. Her planner can point out that she will be able to make before-tax contributions to the plan, she will enjoy tax-deferred growth on plan assets, and perhaps most importantly, she will get to invest money for retirement that otherwise would have gone to pay current taxes (analogous to getting an “interest-free loan” from the government). The following example helps to illustrate these advantages:

> *Example 1*—Kim is a licensed social worker who acts as a solo practitioner providing counseling services to clients. She sees the value in saving part of her earnings for retirement but does not understand the reasons to set up and install a traditional retirement plan that meets IRS requirements. Her planner recommends a simplified employee pension (SEP) plan and then calculates for her the extra savings she will have based on this “interest-free loan” from Uncle Sam. If she contributes $10,000 to an SEP and is in a combined 25 percent federal, state, and local tax bracket, she will save $2,500 in taxes and have $10,500 at the end of the year after she earns a 5 percent rate of return. If Kim had tried to save outside the SEP, she would have lost $2,500 in taxes. Her $7,500 savings would have grown the same 5 percent (total interest equals $375) but then she may have lost $93.75 in taxes on the interest she earned. At the end of the year, her account balance be would only $7,781.25. Her planner emphasizes that she will have $10,500 versus $7,781.25, which is $2,718.75 more at the end of the year because an SEP was used! Her planner than calculates that because she got to invest money that would have been lost early on to taxes, she will accrue over $32,000 more for retirement by using an SEP even after she pays taxes on the retirement distributions.

Planners should also be ready to espouse the value of after-tax Roth contributions to a 401(k) plan. Although the initial tax savings are sacrificed, the client will not have to pay any taxes on growth of the contributed funds assuming the owner complies with IRS requirements.[2] As a general rule, conventional wisdom says to choose a Roth option if the client’s tax rates are expected to be higher in retirement and to use a before-tax contribution if the tax rate is expected to be lower in retirement. However, be aware that Roth contributions are accessible without tax consequences and will not trigger extra taxes on Social Security benefits (the so-called tax torpedo) and provide for “tax diversification” of retirement withdrawals.

In addition to delivering tax advantages for the business owner and employees of the business, planners may also want to point out several other benefits of a retirement plan. For one thing, a retirement plan will help to attract and retain employees. Secondly, the plan will allow for a graceful transition in the workforce. In other words, long-service employees will have the wherewithal to retire and can be replaced by younger employees at lower salaries. Third, the retirement plan is part of effective compensation planning. And finally, the plan will provide the business owner protection if they find themselves having to go bankrupt. The following examples help to demonstrate these last two attributes:

> *Example 2*—Gregg owns a regional accounting firm, and he believes that the cost of providing deferred compensation is an add-on to his existing payroll obligations. However, Gregg's planner shows him that shifting to a program that pays both current and deferred compensation makes the most sense for effective compensation planning. After all, it's not how much the client pays employees, but how he pays them! For example, if Gregg's planner establishes a 401(k) plan with a matching contribution of 50 cents on a dollar up to 4 percent, it will be the same as giving his employees a 2 percent raise. One way to look at this is to consider if Gregg were going to give a 5 percent raise, he should instead give a 3 percent raise and the match just described—then costs remain the same. If he does it for 3 years in a row, then the plan sponsor has successfully switched from providing only current compensation to providing both current compensation and a 401(k) plan that provides a 50-cent-on-a-dollar match up to 6 percent of the employees' pay. Notice the employer did this without incurring significant extra costs.

> *Example 3*—Your client Rick owns a pizza place. He fears that at some point in the future competition may cause business problems and possible bankruptcy. If Rick contributes to a qualified plan, his plan funds will be exempt from the bankruptcy estate and protected from his creditors.

Unit-Credit Defined-Benefit Plans

A lot has been written about the demise of the traditional unit-credit defined-benefit pension plan. In fact, some new planners might think that a discussion of this plan is unnecessary. However, *these plans are essential in the small-plan market for some affluent clients*. But first some basics:

- The formula to fund a plan participant's benefit is often written as "accrual rate (e.g., 2 percent) times years of service (YOS) times final average salary (FAS)." So, a person with 30 years of service and a final average salary of $200,000 would get a $120,000 ($10,000 per month) pension.
- Annual contributions to the plan are actuarially computed and are equal to the amount necessary to fund the benefit promised to all plan participants. These annual contributions are mandatory under ERISA.3
- The plans use unallocated (or pooled) funding instead of individual accounts. In other words, money is put in a trust for all employees and not in an individual account for each employee.
- The preretirement investment risk falls on the employer, so if the markets plummet, it is the employer, not the employee, who must come up with additional funding to meet the need for promised benefits.
- Plan participants are entitled to the "normal form of benefit" provided by the plan. The normal form of benefit for a married participant is the qualified monthly paid joint and survivor annuity. The normal form of benefit for a single individual is usually a monthly paid life annuity commencing at normal retirement age.
- In addition to a joint and survivor or life annuity, alternative forms of benefits are available, such as lump-sum distributions or different types of annuities.
- No matter what type of payout is provided under the plan, clients should be made aware that it is the actuarial equivalent to an alternate form of payout. In other words, a life annuity may give a larger benefit than a joint and survivor benefit; however, their actuarial values are the same.

So why is the unit-credit defined-benefit plan an essential tool in the toolbox? The unit-credit defined-benefit plan allows a small-business owner to stockpile larger tax deductions than all of the plans that fall into the defined-contribution category. This is because all other plans (except the cash-balance plan mentioned below) limit the amount that can be contributed to $58,000 and defined-benefit plans are not restricted this way.[4]

Example 4—Virginia is the new planner's 52-year-old client who is self-employed as an IT consultant. She wants to save as much as possible for retirement. Virginia has $300,000 in net earnings. She plans to retire at 62. According to one actuary, a defined-benefit plan allows a $138,000 contribution to fund the benefit. This is a $51,060 tax savings in the 37 percent bracket. Virginia will accrue $2.36 million with a yearly benefit of $195,000. This far exceeds the tax shelter and retirement savings that are possible in a defined-contribution plan.

Example 5—A couple, Joseph and Elizabeth, are business partners in a small dental practice. Joe is 60 and Elizabeth is 58. Each earns $245,000. They plan to retire in 5 years. According to one actuary, $365,300 can go into the plan. This represents $135,161 in tax savings at the 37 percent bracket. Even better, after 5 years, they may have $2.26 million for retirement.

Two final points. First, business owners are often looking to skew plan contributions to benefit their own self-interests, and the choice of a unit-credit plan will be able to tilt annual contributions to business owners. Second, a second type of defined-benefit plan could also be considered to pile up annual tax shelter and retirement funds for a well-to-do client. This is a cash-balance plan. The cash-balance plan is a hybrid plan that provides the high contribution limits of a defined-benefit plan, but it avoids the common risks and potential runaway costs in a unit-credit plan. These plans are designed to look like a defined-contribution plan. The benefit is a hypothetical "account balance" which increases with stipulated contributions and guaranteed investment experience (e.g., 5 percent of salary per year is contributed by the plan sponsor plus a credit of, for example, 4 percent for investment earnings). Note that the cash-balance formula mitigates the interest rate risk of a unit-credit defined-benefit plan and also the cost volatility associated with these plans. In addition, it is a less expensive choice for the business because it focuses on career average earnings and not final average earnings.

401(k) Plans

The most popular type of employer-sponsored retirement plan is undoubtedly the 401(k) plan. In a 401(k) plan, the choice of a contribution formula must include elective deferrals, otherwise known as employee-salary deferrals, where a plan participant can choose to take their full salary in cash or save some of it for retirement.[5] In addition, the plan's contribution formula can include either matching contributions (an incentive used by employers to entice plan participation and meet nondiscrimination testing or safe harbor requirements) and/or nonelective contributions (employer contributions to the plan not contingent on an action by the employee).[6] Employee contributions to the 401(k) plan as well as matching contribution and nonelective contributions (when applicable) are put into a plan participant's individual account and the participant typically selects from a menu of investment options offered by the plan and allocates monies to available accounts as they see fit (called self-directed investing).

> *Example 6*—Your client Arthur owns a small service company that offers compliance software to businesses. Arthur chose to sponsor a 401(k) plan that allows employees to contribute up to 10 percent of their salary to the plan and he also provides a 5 percent dollar-for-dollar match and a 5 percent nonelective contribution. Arthur's hope is that his employees will be able to achieve enough for retirement if they join the plan early and stick with it.[7]

> *Example 7*—Your client Katie owns a small high-end home building company. She fears that some employees won't contribute to her plan and she will end up either having to limit her salary deferrals or she will not pass nondiscrimination tests that are required by the IRS. Katie's planner recommends a safe harbor contribution formula. Under a safe harbor 401(k) plan, the plan sponsor can either match each participant's contribution, dollar-for-dollar, up to 3 percent, and also match 50 cents on the dollar for the participant's contribution that is between 3 and 5 percent. Alternatively, the plan sponsor can make a nonelective contribution equal to 3 percent of compensation to each participant's account. What's more, other safe harbor design alternatives are also available. In any case, Katie will be able to maximize her salary-deferral contributions without triggering nondiscrimination testing that might limit her salary deferrals.
> Instead of a 401(k) plan, some clients choose an alternative plan known as a simple incentive match plan for employees (SIMPLE). SIMPLE plans are only available if your client has 100 or fewer employees.[8] These plans are easier to set up and less costly to administer.[9] However, the simplicity comes at a price.

Example 8—Your client Rose owns a small flower shop and is deciding between a SIMPLE and a 401(k) plan. The 401(k) plan seems to be the better choice because it is a better tax shelter. The 401(k) allows larger elective deferrals, $19,500 ($26,000 for those 50 and older) versus $13,500 ($16,500 for those 50 and older). In addition, the 401(k) plan allows larger matching and larger nonelective contributions. Also note that a SIMPLE can only have a match or nonelective contribution, but not both. Finally, the 401(k) can have a companion plan; the SIMPLE cannot.

One final note, new financial planners working with school districts, other government organizations, and not-for-profit organizations (e.g., hospitals and private colleges) might end up working with a first cousin to the 401(k) plan, known as a 403(b) plan.

SEP

Many small employers and salaried employees who also have Schedule C earnings are only looking to save a modest amount of their income. For these people, financial planners often recommend an SEP. An SEP has the advantage of being easier and less costly to establish and administer than most other alternatives.[10] It also has other advantages:

- An SEP can be established after a calendar year to apply the prior calendar year's earnings.
- In addition to low start-up and administration costs, the SEP does not need to establish a trust for plan funds. Instead, funds can be directly deposited into an IRA.
- Employers who sponsor an SEP can avoid future plan contributions. In other words, annual contributions can be skipped in this type of plan.

Example 9—Kevin works full time in the maintenance department of ABC Company and also paints houses on the side. He makes $10,000 extra each year. Kevin may decide to set aside $1,500 annually in an SEP. (Note: because of the so-called Keogh rules, the maximum contribution is limited to 20 percent of income from self-employment.) Kevin contacts any financial firm, fills out a minimum of paperwork, picks an appropriate investment option, and voila…he has saved taxes and increased his retirement nest egg.

Solo-k (Also Called Uni-k)

For a small business or a person who seeks substantial savings from their Schedule C income, the so-called solo-k plan might make sense because, unlike other plans, it allows employees to put in the maximum elective salary deferral in addition to regular plan contributions.[11]

> *Example 10*—Sally is a 35-year-old IT professional who has $20,000 in Schedule C consulting income in addition to her salary at ABC Company. She can contribute the entire amount of her consulting income ($20,000) to her solo-k ($4,000 under the 20 percent Keogh limit, plus $16,000 in elective salary deferrals).

Two other factors favor choosing a solo-k: the solo-k may utilize a Roth feature. When this is the case, there are no immediate tax savings, but qualifying distributions may be received tax free. In addition, the solo-k can have a loan feature.

Conclusion

New planners may want to think of retirement plan options in terms of their main attributes. One way to categorize plans is that all plans are either defined-benefit or defined-contribution. A second way to categorize plans is that they all are either pension plans or profit-sharing plans. Table 1 may help to summarize the differences.

TABLE 1

Retirement Plan Categories

Defined-Benefit (DB) Plans	Defined-Contribution (DC) Plans
1. Specifies the benefits an employee receives	1. Specifies the contributions an employee receives
2. The maximum is $230,000 per year in 2021 (called the Section 415 limit). This is *not* the amount put in, but the amount that can be funded. Actuarial contribution	2. The maximum in 2021 is the lesser of 100% of salary or $58,000 (called the Section 415 limit). This allows for a great deal

examples of the amount that might be put in the plan are $112,000 at age 45, and $187,000 at age 60	of tax shelter, but not nearly as much as a defined-benefit plan
3. Deduct the full 415 contribution. Whatever the actuary says to contribute	3. Deduct 25% of aggregate participant payroll (this effectively limits contributions)
4. Involves no individual accounts	4. Provides an individual account similar to a bank account
5. Unallocated funding and typically *employer* investing	5. Funding allocated to individual accounts. This is typically *employee* invested—called self-directed
6. Assigns the risk of preretirement investments to the *employer*	6. Assigns the risk of preretirement investments to the *employee*
7. Can provide for past service (funded over 10 to 30 years). This allows for even greater tax shelter	7. No past service funding. If the $58,000 was good enough, it is not important. However, doctors and others trying to shelter as much as possible will be better in a DB plan

Pension Plans	**Profit-Sharing Plans**
8. Annual funding required	8. Discretionary funding possible. (The plan sponsor can skip years)
9. No in-service withdrawals allowed	9. In-service withdrawals allowed
10. Limits on the investment of company stock (10%)	10. No limits on the investment of company stock

New planners may also want to have a partial list of the plan options from which they can choose when working with a client to determine what the optimal plan choice is for their organization.[12] The list provided in Table 2 may help.

TABLE 2

Overview of Retirement Plan Options

Plan	DB or DC/Pension or Profit-Sharing (PS)	Sample Formula
1. Unit-credit DB plan	DB/Pension	Accrual rate x YOS x FAS
2. Cash Balance	DB/Pension	Hybrid, e.g., 6% ER contribution; 3% ROR
3. 401(k) Plan	DC/PS	3 types of contributions are possible: salary deferral (also called elective contributions), matching contributions, and/or profit-sharing (also called nonelective) contributions
4. 403(b) Plan	DC/PS	3 types of contributions are allowed: salary deferral (elective) contributions, matching contributions, and/or nonelective contributions
5. SIMPLE	DC/PS	2 types of contributions are allowed: salary deferred *and* matching (3%) *or* nonelective (2%) contributions; poor man's 401(k) plan
6. SEP	DC/PS	Employer-paid percentage of salary (408 not 401 rules)

7. Solo-k (sometimes called uni-k)	DC/PS	Elective contributions do not count against 20% Keogh cap

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

Kenn Tacchino

CITE AS:

CITATIONS:

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[1] Qualified plans are governed by IRS Code Section 401 and include defined-benefit plans, 401(k) plans, profit-sharing plans, and others. Tax-advantaged plans include simplified employee pensions (SEPs), savings incentive match plan for employees (SIMPLEs), and 403(b) plans.

[2] For distributions to be qualified as tax-free, they must be made after the 5-year-tax-period beginning with the first tax year after the 5-year period beginning with the first tax year for which a contribution was made to the

account. A second requirement is that the tax-free status only applies after the participant attains age 59 1/2, is disabled, or is paid out to a beneficiary after death.

[3] ERISA is the law governing retirement plans. It is formally known as the Employee Retirement Income Security Act of 1974.

[4] In a unique circumstance, a uni-k plan can exceed the $58,000 415(c) limit. This is discussed later in the article.

[5] The annual contribution limit for elective deferrals in 2021 is $19,500 ($26,000 for a person aged 50 or older).

[6] Nonelective contributions are sometimes thought of as profit-sharing contributions.

[7] Many experts believe a “safe-savings rate” for employees who start saving early in their career is between 15 and 20 percent of their salary. This plan accomplishes this goal.

[8] An employee is anyone who had $5,000 in compensation in the prior year.

[9] Planners use IRS form 5304-SIMPLE or 5305-SIMPLE, which are easy to navigate.

[10] Planners will find the IRS form 5305-SEP used to establish these plans short and user friendly.

[11] Most plans limit contributions to the deductible amount of 25 percent of aggregate participant payroll. Solo-k plans allow Code Section 402(g) salary deferrals on top of the regular limits. In 2021, the salary-deferral limit is $19,500 ($26,000 for those aged 50 and older).

[12] Our discussion is an overview that does not cover some important plan options. Crucial alternative plan choices (e.g., employee stock ownership plans (ESOPS), cross-tested profit-sharing plans, age-weighted profit-sharing plans, “points” profit-sharing plans, money-purchase plans, target-benefit plans, etc.) exist and should also be considered in certain circumstances. Planners should look at IRS Publication 560 for a more comprehensive list of plan options.

How to Avoid Common Sources of Drafting Errors

Estate planning documents should clearly state what is meant in order to carry out client wishes and not create future interpretative conflicts.

L. PAUL HOOD, JR.

Drafting errors unfortunately occur in all sorts of estate planning and closely held entity documents. This article reviews a selection of such drafting errors and provides explanations and tips for moving forward. It does not focus on any particular type of document (e.g., wills or trusts), but, rather, on errors found in all types of those documents.

These errors are easy to make if one is not careful or fails to respect the inherent difficulty of drafting. In this computerized age of "have form will travel," the author believes that people are using forms from someone else without having read the entire form and without understanding what is in the form. That can have devastating consequences to the client and concomitant subsequent liability exposure for the practitioner drafting the document.

Rushed drafting

Rushed drafting is a sin that is easy to commit. Many lawyers overcommit and fail to consider how much time every task that they accept can take. This inability to either say no or to give reasonable expectations about turnaround time is one of the author's character flaws. The vicissitudes of daily, harried lives often cause practitioners to put things off until a deadline approaches, or the client begins to complain. Generally, this is a bad idea. Not infrequently, "just-in-time" drafting causes a scrivener to make a mistake that he or she might not have made with more time to have thought and reflected upon the draft.

This type of drafting error tends to be of two general varieties. The first category is those rushed errors that arise to a great extent by the demands of a client (or others, such as law firm supervising attorneys) for quick turnaround. The second category arises predominantly because of procrastination by counsel.

With respect to the first category, which the author refers to as "part the Red Sea—now," several different examples come to mind.

Estate planning clients frequently ask counsel to "part the Red Sea—now" for an arbitrary reason outside of the fault or involvement of counsel, e.g., they need wills because the clients are going on a trip (never mind that they needed wills before going on the trip and that they usually are more actuarially likely to die on a road close to their home than on the trip) that they did not bother to tell counsel about until shortly before departure or gifts prior to year-end (the dreaded phone call at year-end even though counsel recommended the gifting plan several months before).

Equally sinister here is the assignment that languished on the assigning lawyer's desk until the client expresses displeasure about the

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delay. The assigning lawyer usually then leaps into action and assigns the matter to the scrivener and then passes on the client's pressure about getting the drafting done quickly, which is unfair to the scrivener.

Practice tip. Treat assigning lawyers as clients, and communicate with them regularly as such.

Another frequent cause for error that falls into the category of rushed drafting is "on-the-spot" additions, revisions, or even wholesale drafting of documents, which occurs frequently during "one fell swoop" meetings with clients where revisions are requested, and the clients desire to execute the documents that same day. This also happens in probate or trust litigation where a settlement is reached "on the courthouse steps," and everyone wants to read the details into the record. The types of errors that tend to crop up in this category can be subtle and sometimes superficially harmless yet counterintuitive (e.g., failure to make corresponding adjustments to other areas of the documents necessitated by the change).

Practice tip. Again, this type of error is committed often by an overconfident scrivener who failed to accord the drafting with sufficient respect. In these situations, resist the temptation to speed up; instead, pay careful attention to the effects of the changes on the remainder of the document.

Procrastination, which is the second category of the rushed drafting error, causes more drafting errors. This generally is attributable to one of two causes.

The first cause is where the lawyer just has too much going on, or the assignment brings up uncertainty on the part of the scrivener. While there are times where inaction actually is the correct course of conduct, its price is high, both psychologically

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(to the client and to scrivener) and financially (unpaid invoices, etc.).

Practice tip. There may be little advice for the lawyer who has too much on his or her plate except to either (1) manage engagement/acceptance more prudently or realistically, and learn to give clients reasonable expectations about when the work will be completed, or (2) learn to "just say no."

The second cause is where the lawyer procrastinates, quite frequently because the lawyer does not know how to draft for the desired result. This often is a professional competency/experience issue.[1] Where the inexperienced lawyer is subject to the supervision of another lawyer, the supervising lawyer should see the procrastination as a possible manifestation of uncertainty. Too often, it is taken as a sign of failing to do the work. There is a fine line between making a new lawyer make mistakes while putting them through significant "learning bruises" and letting the scrivener dangle out on the vine of uncertainty.

Failure to accurately reflect the client's intentions or requirements

One could persuasively argue that this is the gravest drafting sin of

[1] Rule 1.1, Model Rules of Professional Conduct.

all, because the client's intentions or requirements usually are the *raison d'etre* for why the client hired the scrivener in the first place.

This class of drafting error falls into three general categories:

1. Failure to take adequate notes during the interview or discussion.
2. Failure to explain the draft to the client.
3. Outright purposeful disregard for the client's desires ("legal paternalism").

Quite often, the lawyer can reduce the error of failing to take adequate notes by reviewing and supplementing the meeting/phone call notes contemporaneously or within a short period after the event, yet most simply rely on memories to fill in the gaps, which, in the author's opinion, is a mistake. The fault for failure to adequately explain the draft to the client can be attributable to either client or scrivener. Some clients, for whatever reason, just are not capable of sitting through or handling the explanation, which is unfair to the scrivener. However, the business models of some lawyers factor out time for explanation to keep the costs down, which the author believes is ill-advised because the document ultimately belongs to the client, who should understand the material parts of the document to make sure that it comports with the client's wishes.

It is a dangerous thing to go against the express instructions of the client, but some lawyers who feel that they understand the client's situation better than the client and know best do exactly that. In the author's opinion, this class of drafting error is on the decline.

Practice tip. There is no substitute for contemporaneously reviewing meeting notes and making a list of follow-up items where the lawyer did not receive either necessary information or requested documents.

Disconnect between "wordsmithing" and "real life"

Sometimes, lawyers can write grammatically perfect sentences or paragraphs that make little practical sense or that are ambiguous. This is an easy error to make, because this error usually involves perfect or near perfect use of the language, quite often in the creation of a triggering event that might not happen or a procedure that is insusceptible of being followed in "real life." Examples of this type of error include:

- "Springing powers of attorney" or buy-sell agreement triggering events that "spring" into existence on "certification of two physicians who shall have certified after personal examination that the person is incapable." What happens if "the person" does not submit to a physical examination? What if no physician will so certify?
- Valuation formula that bear no relation to actual fair market value. In the author's opin-

ion, it is a fool's errand to try to draft a valuation formula without the assistance of qualified valuation professionals because a formula can be manipulated down the road once the issue is joined. Even if a formula can be safely drafted, it should have an expiration date and a backup appraisal method in place.

- Procedures that call for data that either does not exist or cannot be obtained without significant expense when compared to the actual value of the data.
- Procedures that are incredibly expensive given the benefit and possible alternatives, e.g., the old "three appraiser" game (i.e., you pay an appraiser, I pay an appraiser, and we split the cost of a third appraiser, and the conclusions of value are averaged) where entity valuation is concerned.
- Procedures that require a response before the sequence of events that are necessitated prior to the response reasonably can be completed.

Practice tip. The easiest way to attempt to minimize this error is by walking through an imaginary occurrence of a triggering event in detail, step-by-step, to see if the clause is susceptible of being understood and is workable.

"Your forms runneth over"[2]

This type of drafting error usually occurs where the lawyer imports a clause from another type of document that had specific considerations in that document type or for the parties involved without adequate consideration of the necessary modifications to the remainder of the document for the parties and situation at hand. This type of error often is related to the "intradocument clause conflicts" error discussed below. Examples of this error include:

There's no substitute to contemporaneously reviewing meeting notes and making a list of follow-up items where the lawyer did not receive either necessary information or requested documents.

- Importation of a clause from a corporate document into an LLC or partnership document. For instance, an annual meeting clause is erroneously inserted where no annual meeting is required by statute for an LLC or partnership—but an annual meeting may be required in such a setting if the governing documents call for one. *This type of error is on the rise, due in part to the use of "cut and paste" on the computer.*
- Importation of a clause from a testamentary trust into an inter vivos trust, or vice versa.

Practice tip. The importation of a clause from another document can be a positive or a negative depending on how careful the scrivener is with respect to its addition. The first thing to assess is whether the imported clause has any defined terms in it, whether from its original source or in the new location, which require coordination in the current instrument. Second, the procedures or substantive provisions must be carefully melded into the document.

Blank spaces in documents that get executed

Leaving blank spaces in executed documents can be quite embarrassing, especially if the error is not discovered until later because execution did not necessitate a review of the page with the blank spaces. Examples of this type of error include:

- Backup executors, trustees, or guardians.
- Number of directors, either maximum or minimum.
- Reference to another document that the lawyer did not have sufficient information to describe at the time of drafting the document.
- Failure to complete a thought while drafting.

Practice tip. Immediately prior to execution, review every page of the document with an eye toward looking for this type of error. If the lawyer is unable to complete his or her thought at that moment, use the color coding in most word processing programs to highlight it so that it will be revisited.

Failure to coordinate documents with one another

The draftsperson must examine documents that already are in place that could affect the documents in place. Probably the most common example of this drafting error is in the area of buy-sell agreements where the draftsperson has failed to consult the entity governing instruments (e.g., articles, by-laws, or operating agreements) or other documents like franchise and loan agreements. In this instance, the preceding documents may take precedence over the subsequent

[2] Hat tip to one of my excellent drafting teachers, Jerome J. Reso, Jr., Esq., of Baldwin Haspel Burke & Mayer, LLC, who actually wrote that phrase on one of the drafts that he marked up.

document and indeed negate the subsequent document or, just as bad, cause an event of default in some other agreement.

Practice tip. Insist on seeing copies of all documents that possibly could have a bearing on the efficacy of the current instrument. If the client objects or balks at providing these documents, the prudent estate planner will treat this as a red flag and decline the matter.

Inflexibility

Estate planning documents often exist for years (indeed, possibly forever in some jurisdictions), and these documents must be made, to the extent foreseeable, as flexible as they can be. Areas where inflexibility can hinder an estate plan include:

- Failure to consider the impact of changes in the laws or even the repeal of a law.
- Failure to consider contingent outcomes.
- Failure to consider the level of reasonably foreseeable physical or mental states of the parties.
- Limitation on a trustee to certain types of investments, e.g., "only in AAA-rated tax-exempt bonds." What happens when none are available?
- Failure to provide for a backup method of determining something where it is to be initially determined by reference to an index (e.g., AFR, CPI or, "prime rate") if the index is no longer available.
- Preventing "self-dealing" in a trust where self-dealing is what is contemplated at some point (e.g., purchase or sale in a buy-sell agreement).

Practice tip. It is true that in many jurisdictions decanting of an existing trust can solve problems that were not reasonably foreseeable when the document was drafted and executed. However, what the author means are failures to include reasonably foreseeable items. In any event, all documents should be drafted flexibly because, despite its growing ease, decanting involves additional expense and often the loss of some privacy.

Insist on seeing copies of all documents that possibly could have a bearing on the efficacy of the current instrument.

Intradocument clause conflicts

Although a kissing cousin of the "your forms runneth over" error, the cause for the "intradocument clause conflicts" drafting error is one of the most common. It arises principally through four possibilities:

1. Failure to carefully review the entire document prior to its execution.
2. Drafting different parts of the document at different times (including subsequent revisions of the entire agreement).
3. Revising a portion of the document without a careful and complete analysis of the impact of the revised language on the remainder of the document.
4. Using someone else's work without fully understanding it (which may be prompted by having documents on the computer and the ease or unease of "cut and paste").

Practice tip. Intradocu ment clause conflicts seem to be on the rise. The only way to attempt to prevent this error is to be very careful in the importation of a clause or even the use of a document from a prior matter in the current one. The author suggests highlighting the imported clause in color during the drafting process because the color should cause the scrivener to focus more attention on that section.

Improper or insufficient incorporation by reference

Drafting errors arising from improper or insufficient incorporation by reference may occur for any of several reasons: laziness, a desire for "shorthand" by the draftsperson, ignorance of the proper methods of incorporation by reference and when it can be done, and failure to appreciate or carefully consider the implications of importing language from another document into the subject document (the imported language or document may have some language that itself creates ambiguity or outright conflict). Examples of this sort of error include:

- Reference to a document that is supposed to be attached that may not exist, e.g., an annex or exhibit.
- Reference to a document that may exist in differing versions.
- Reference to a document, including a statute, which may be amended or replaced in the future without prescribing the effects of such.
- Reference to a trust that is not in existence at the time of execution of the document which makes the reference.

Practice tip. The scrivener needs to make certain that incorporation by reference may legally be done in the current instance before doing so. In the author's opinion, while incorporation by reference may save time and paper (although, in the electronic documents world, this will not be true), it requires serious thought prior to doing so and should only be done after other alternatives are explored. Moreover, if the scrivener chooses to proceed with incorporation by reference in the instant document, the scrivener must consider the effect of subsequent changes in the incorporated clause/document and even its extinction.

Ambiguity

Ambiguity can be part and parcel of other drafting errors. Poor usage of words or syntax, however, can create significant interpretational problems. Sloppy usage of modifiers can be troublesome. Use of words or terms that may have multiple meanings without clarifying which meaning is intended also is problematic.

Practice tip. If possible, have someone else read the draft to see if he or she gets the same meanings as were intended.

Overreliance on software in the proofreading phase

This error is of somewhat recent vintage and is a product of technology. As wonderful and amazing as they are, spell check and find-and-replace have their limitations, and, therefore, cannot be safely relied on as a proofreading function.

Practice tip. Despite technological advancements, in the author's opinion, no substitute exists for letting the document get "old and cold" before giving it a final proofread.

Defined terms

There actually are several problems in this category of drafting error, including:

- Inconsistent use of defined terms.
- Failure to define certain terms.
- Overuse of defined terms.
- Failure to use terms that are defined in the document. (This is a particular pet peeve of the author).

Despite technological advancements, in the author's opinion, there remains no substitute for letting the document get "old and cold" before giving it a final proofread.

The use of defined terms is a tried-and-true drafting technique, but it must be thoughtfully used. It is easy to miss, and it is an easy error to make.

Practice tip. Outline the key parts of the document before drafting it. At that time, also make a list of terms that will require definition.

Neglecting to specify intended default rule

Drafting errors can stem from failing to negate a legal default rule if a result other than that provided in the default rule is intended.

A significant part of the laws that estate planners encounter are laws that contain default rules that can be altered (e.g., trust law, LLC law, etc.). Scriveners must know these default rules so that the proper alterations can be made. In the author's opinion, the failure to negate a default rule when the client's situation requires negation or alteration is professional negligence.

Practice tip. When he was in practice, the author maintained a list of the statutory default rules for LLCs, partnerships, and trusts, which he found very helpful.

Failure to include provisions that tax law mandates

Various tax-related trusts have governing instrument requirements that mandate certain provisions in a qualified instrument (e.g., charitable trust language, QDOT, QPRT, GRAT, etc.) Failure to include this language can cost the qualification of the trust for tax purposes, which, in the author's opinion, is professional negligence.

Practice tip. There is no substitute for reading the regulations and using the required language.

Conclusion

Drafting is hard, takes skill, and requires much more than having a clause or form to use. Failure to give drafting its due respect often lies at the heart of a drafting error. There is no substitute or short cut for a practitioner to understand the meaning of every word in a document that he or she drafts and backs. ■

Steve Leimberg's Estate Planning Email Newsletter Archive Message #2880

Date:19-Apr-21

Subject: Andy Katzenstein, David Pratt, Brett Rosecan & Brittany Newell: Estate Planning in 2021 and Beyond - What if the "For the 99.5% Act" and the "STEP Act" Catch Fire – Will the Estate Planning Arena Survive?

"It is not so long ago that there were many Democrats vying to win the opportunity to run against former President Trump in the 2020 Presidential Election. Many of the candidates expressed their views regarding taxes imposed on the wealthy, such as the estate tax. In addition, there have been prior discussions in Washington about repealing or substantially revising techniques that wealthy individuals and families use to reduce their estate tax exposure.

Fast forward, nearly three months into a new Administration, we now have seen two proposals, the "For the 99.5% Act" and the "STEP Act," that would dramatically alter the estate planning landscape. The For the 99.5% Act, as its name suggests, is designed to affect only .5% of Americans i.e., the "ultra-wealthy" Americans, and STEP means "Sensible Taxation and Equity Promotion"; and while these proposals are just that – proposals, they give us a hint of what we can expect to be discussed and debated over the next several months.

This newsletter discusses the two proposals in detail, and includes a summary of the legislative process that would be followed for any tax legislation to become law. The authors also share some planning opportunities that advisors to the wealthy should consider now, and in the future."

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David Pratt is the Chair of the Private Client Services Department of Proskauer Rose LLP and the Managing Partner of Proskauer's Boca Raton office. Mr. Pratt is a Fellow of the American College of Trust and Estate Counsel (former Regent and current member of the Estate and Gift, Asset Protection, and Legal Education Committees) and American College of Tax Counsel, is Florida Board Certified in Taxation, and Wills, Trusts and Estates, has served on the Florida Bar's Real Property, Probate and Trust Law Section's Wills, Trusts and Estates Certification Committee, and is a former chair of the Tax Section of the Florida Bar. He is also an adjunct professor at the University of Florida's Levin College of Law and the University of Miami Law School, where he teaches in their LL.M. programs.

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Here is their commentary:

EXECUTIVE SUMMARY:

On March 25, 2021, Senator Bernie Sanders (VT) and Senator Sheldon Whitehouse (RI) introduced the “For the 99.5% Act.” Its provisions are broad and aggressive – the transfer tax exemptions would be reduced significantly (back to 2009 levels – a $1 million gift tax exemption and $3.5 million estate/GST tax exemption), the rates would go up (45% for the "average" wealthy individual, and climbing up to 65% for the ultra, ultra wealthy) and many of the transfer tax reduction techniques that are currently allowed under the law would be effectively eliminated – grantor trusts, GRATs, discount planning, to name a few. Needless the say, the estate planning world, as we know it, would be rocked. From a timing perspective, changes to rates and the basic exclusion amount would be effective on January 1, ***2022***, which is obviously good news, given the concern about making gifts in 2021. But other provisions of the new law would generally take effect on date of enactment – which could be even sooner.

Four days later, on March 29, 2021, Senator Chris Van Hollen (MD), Senator Cory Booker (NJ), Senator Bernie Sanders (VT) and Senator Sheldon Whitehouse (RI) introduced the "Sensible Taxation and Equity Promotion (STEP) Act" (also referred to as the "STEP Act"). This bill is exactly what President Biden proposed during his campaign – the elimination of the step-up in basis rule at death coupled with treating death as a recognition event for income tax purposes. In general, the bill proposes that property should be treated as sold for its fair market value when transferred by gift, bequest or to a non-grantor trust.

It is impossible to predict whether these bills will pass in their current form. In addition to being overly aggressive, the legislative process can be complicated and, while the Democrats control the Congress, passing tax legislation is easier said than done. It should be relatively easy for the House to pass legislation, as the Democrats hold the majority, albeit by a slim margin. However, it is a different road in the Senate, as a majority of bills proposed in the Senate require a 60-vote super-majority in order to pass due to the legislative filibuster. Assuming that the filibuster would prevent easy passage of any tax legislation, the other option is a budget reconciliation bill, which is not subject to the filibuster and can pass with a simple majority of 51 votes. With Democrats holding 50 seats in the Senate, budget reconciliation has already proven to be a powerful measure of passing fiscal legislation quickly (as seen with the passage of The American Rescue Plan Act of 2021 after a 51-50 vote in the U.S. Senate and a party-line simple majority in the U.S. House).

COMMENT:

The For the 99.5% Act

On March 25, 2021, Senator Bernie Sanders (VT) and Senator Sheldon Whitehouse (RI) introduced the "For the 99.5% Act." Its provisions, and some planning suggestions, are discussed below. From a timing perspective, it has an effective date of January 1, ***2022***, which is obviously good news, given the concern about a retroactive tax bill. Of course, this is only a proposal and anything can happen, but at this juncture, it is unlikely that any tax bill of this magnitude would have retroactive effect.[i]

1. <u>Basic Exclusion Amount/GST Exemption</u>. The bill proposes to reduce the basic exclusion amount to $3.5 million (with a $1M limit on lifetime gifts). There is no specific reference to a reduction in the amount of the GST tax exemption, but because IRC Section 2631(c) says the amount of the GST exemption is equal to the basic exclusion amount, a reduction in the GST tax exemption would also occur. It appears the inflation adjustment for the basic exclusion amount (and, therefore, for the GST tax exemption as well) has been eliminated. The proposed law amends "Paragraph (3) of section 2010(c) of the Internal Revenue Code of 1986 to read as follows…" and then states simply that "[F]or purposes of this section, the basic exclusion amount is $3,500,000." That language is in subparagraph (A) of Paragraph (3) of section 2010(c), and the inflation adjustment is in subparagraph (B). Significantly, there is no subparagraph (B) made part of Paragraph (3), effectively eliminating any inflation adjustment for the basic exclusion amount.

If 2020 was not busy enough for planners in anticipation of a change in 2021 under a Biden Administration, coupled with democratic control of the Congress, 2021 could be even busier. Many clients who were on the fence about using their exemptions did not pull the trigger and rolled the dice as the clock struck midnight and 2020 came to an end. Such clients now have a second opportunity, not to mention that the sheer number of potential clients will increase with a lower exemption.

It should be noted that President Biden's tax proposals during his campaign were silent regarding any proposed changes to the basic exclusion amount. However, in his plans to support women during COVID 19, he mentioned *that he would return the exemptions to 2009 levels, meaning a $3.5 million estate tax exemption and a $1 million gift tax exemption.*[ii]

Last year, there were plenty of newsletters that discussed strategies for wealthy clients to use their exemptions in anticipation of a reduction in a Biden Administration.[iii] *Planners should advise clients who did not use their exemptions last year to do so this year, as it is likely that any reduction would not be retroactive, as mentioned above.*

In addition, and subject to the discussion below regarding the "federal" tax rule against perpetuities, it may make sense to make late allocations of GST exemption to trusts that are not otherwise exempt. Often there is a mismatch between the amount of gift tax and GST tax exemption used; in these cases, before the exemption is reduced, it should be used. This may require decantings or other methods to keep assets out of a beneficiary's taxable estate.

2. Rates. The bill proposes to raise the estate tax rates to 45% for individuals with a taxable estate of $3,500,000 to $10,000,000 (up from the current 40% rate). For taxable estates of $10,000,000 - $50,000,000, the rate would be 50%. For taxable estates of $50,000,000 - $1,000,000,000, the rate would be 55%. And, for taxable estates over $1,000,000,000, the rate would be 65%. There is no mention about a change in the gift tax rates specifically, but because IRC Section 2501(a) calculates the gift tax based on the tax "…computed under section 2001(c)," the gift tax rate is increased in the same fashion. And the same holds true for the GST tax, which is tied to the highest estate tax rate.

Transfer tax brackets are not new, even though we have been under a "flat" transfer tax rate since 2006 (i.e., cumulative transfers in excess of the exclusion amount are taxed at the highest applicable rate). Under the regime of transfer tax brackets, as in the "old days" when there were multiple brackets ranging from 37% to 55% and a $600,000 exemption, advisors may want to recommend that some estate tax is paid at the first death in order to take advantage of the lower tax brackets, which will result in lower overall transfer taxes. An easy way to do this is by making a partial QTIP election (or no election at all) and paying taxes at the lower rates on the non-QTIPped portion, which will keep such portion of the QTIP trust out of the surviving spouse's taxable estate. In addition, when it is likely that the deaths of spouses will occur in relatively close proximity to *each other, it will make sense to make a partial QTIP election (or no QTIP election at all) so that a previously taxed property tax credit can be "manufactured" on the second death relating to the surviving spouse's income interest in the non-QTIPped trust (and five or five power if one is included).*

LIFE INSURANCE PLUG #1 – LIFE INSURANCE IS VERY OFTEN USED TO PROVIDE LIQUIDITY TO PAY ESTATE TAX. AND, WITH A MARRIED COUPLE, A SURVIVORSHIP (SECOND-TO-DIE) POLICY IS TYPICALLY USED, AS IT IS LESS EXPENSIVE THAN A POLICY ON ONE LIFE (ASSUMING ALL OTHER THINGS ARE EQUAL, SUCH AS INSURABILITY). IF IT IS CONTEMPLATED THAT ESTATE TAX WILL BE PAID UPON FIRST DEATH, IT WILL BE NECESSARY TO CONSIDER BUYING LIFE INSURANCE THAT WILL PAY UPON THE FIRST DEATH.

3. <u>No Basis Step-Up for Certain Grantor Trust Assets</u>. The bill proposes to amend IRC Section 1014 by inserting language that does not allow a basis step-up (or step-down) for property in a grantor trust that is not included in the transferor's gross estate. It appears that this proposal would grandfather existing grantor trusts, provided that additions are not made to the trust after the effective date.

While there are some tax lawyers who believe there is authority to conclude that assets in a grantor trust which is not included in the grantor's estate should receive a step-up in basis upon the grantor's death, the general consensus of the estate planning community is that the assets held in such a trust do not receive a basis step-up for income tax purposes. This proposed change in the law merely states the obvious. Perhaps there are heirs who have taken the position they would receive a basis step-up in this circumstance, and IRS is simply trying to shut that down.

The For the 99.5% Act, as further discussed below, would cause assets the decedent sold to a grantor trust after the effective date of the law to be included in a decedent's taxable estate. Such provision, coupled with this provision of the For the 99.5% Act, would be the worst of all worlds – estate tax inclusion of the grantor trust assets and, perhaps, no basis step-up for *those assets. These provisions will need to be coordinated before they can both become law.*

4. <u>Limits on Discounts</u>. Limits will be placed on valuation discounts. The focus seems to be on eliminating discounts for entities that own assets such as stocks, bonds and cash. In general, the new rules would eliminate any discounts for lack of control and lack of marketability for certain transfers of entity interests that consist of "non-business assets"; a non-business asset is one that is not used in the active conduct of a trade or business. If an entity holds business assets and non-business assets, when valuing the entity, a taxpayer could discount the entity but not that portion consisting of non-business assets. There are two "passive assets" for which a discount would be allowed: (a) reasonably required working capital held by the business and (b) real estate in which the transferor materially participates. Other "passive assets" are specifically excluded from being treated as used in an active business, including cash or cash equivalents, stock in a corporation or any other equity, profits, or capital interest in an entity, evidences of indebtedness, annuities, assets other than a patent, trademark or copyright which produces royalty income, commodities, and collectibles. There is also a "look-through" rule which says the assets of an entity owned by a subsidiary entity of which the parent owns at least 10% (i.e., 10% of the vote or value of the entity) are treated as being directly owned by the parent entity – this seems to be part of the proposed legislation to allow holding company interests to receive discounts when transferred so long as the subsidiary assets are used in an active business. Note that the limit on discounts would only apply, however, if the transferor, transferee, and members of the family (as defined in IRC Section 2032A(e)(2)) of the transferor and transferee have control of such entity or own the majority of interests (by value) in such entity.

Similar to the death of the grantor trust, this rule would essentially eliminate discount planning. In August of 2016, the Treasury Department proposed overly broad regulations that also would have been the final nail in the coffin for most discount planning. However, before the IRS could review and respond to the comments, on April 21, 2017, former President Trump issued an Executive Order to reduce tax regulatory burdens and, in response, on June 22, 2017, the Treasury identified eight "offending" *regulations, including the proposed regulations regarding valuation discounts; they were officially withdrawn on October 2, 2017.*

But practitioners should have known that valuation discounts had a short life expectancy and this rule, if passed, would be their death knell. Again, wealthy clients who want to consider discount planning should do so sooner rather than later.

Interestingly, the proposal does not address discounts related to transfers of partial interests in real estate not held in entities. Wealthy real estate clients will need to focus on transferring partial interests in real estate on a discounted basis.

The proposal eliminates discounts for lack of control and lack of marketability. Other discounts would seem to survive – for example, the "blockage" discount. Perhaps appraisers will come up with other discounts that can still be utilized (e.g., "COVID discounts").

5. Changes to GRAT Rules. Changes are made to GRATs. The minimum GRAT term would be 10 years, and the maximum term would be no longer than the transferor's life expectancy plus 10 years (this eliminates the ability to contribute to a GRAT a note received in a sale to an IDIT for a really long period so that GRAT payments are tied to the note payments and a zeroed-out GRAT can eliminate inclusion of some of the note in the grantor's estate if interest rates increase after the GRAT is funded). In addition, the remainder interest gift must be (1) no less than the greater of 25% of the fair market value of the property in the trust or $500,000, and (2) not greater than the fair market value of the property in the trust.

Heads you win, tails you break even – that's a zeroed-out GRAT. It has been the perfect trust to remove appreciation from an individual's estate above a prescribed rate that has been extremely low for a number of years, as it is tied to the mid-term applicable federal rate, without paying gift tax or using gift tax exemption (other than a nominal and inconsequential amount). And if drafted properly, a zeroed-out GRAT eliminates all risk of gift tax even if the value of the GRAT assets is increased on audit. This would be gone.

And a short-term GRAT practically eliminates the mortality risk with a GRAT because the GRAT assets are included in the grantor's estate if he *or she predeceases the term. With a minimum term of 10 years, the mortality risk is real.*

Individuals who have used their entire gift tax exemption and/or who have assets that could appreciate significantly may want to consider doing multiple GRATs at this time to lock them in before they go away. They may also want to consider slightly longer GRATs, as they would no longer be able to "REGRAT" (through "rolling GRATs") an annuity payment into a new short term GRAT. Of course, mortality risk must be carefully evaluated.

LIFE INSURANCE PLUG #2 – FOR ALL INTENTS AND PURPOSES, SHORT-TERM GRATS HAVE ELIMINATED THE ASSOCIATED MORTALITY RISK. WITH A TEN-YEAR MINIMUM TERM, THE MORTALITY RISK IS BACK. A LIFE INSURANCE POLICY WITH A TEN-YEAR TERM (AND, POTENTIALLY CONVERTIBLE INTO PERMANENT INSURANCE) WILL EFFECTIVELY AVOID THE MORTALITY RISK IF DEATH OCCURS WITHIN THE TERM.

6. <u>Elimination of Estate Planning Using Sales to IDITs</u>. The new rules attempt to eliminate the sale to an IDIT (intentionally defective irrevocable trust) technique by including in a grantor's taxable estate any of the assets held in the IDIT. If a distribution is made from the IDIT to a beneficiary, such transfer would be treated as a gift. If the IDIT's grantor status is eliminated during the lifetime of the grantor, the assets would similarly be treated as a gift made by the grantor. The rules would not apply to a trust that is includible in the grantor's estate (e.g., a revocable trust). However, the amount of estate tax inclusion or gift that would otherwise be deemed to occur would be reduced by the "value of any transfer by gift" the owner previously made to the trust. This rule makes it look like sales to grantor trusts are no longer effective, but gifts to grantor trusts should avoid the application of these rules. While the new rules would apply to trusts created after the date of enactment, they would also apply to any portion of a trust created before the date of enactment that is added to the trust after the date of enactment.

   This provision would essentially be the end of grantor trust planning, which has become singlehandedly, in these authors' opinions, the greatest estate tax reduction planning tool in the toolbox. It is no secret that paying income taxes on income earned on assets outside *of an individual's estate is the tax-free gift that keeps on giving, not to mention the ability to sell assets or make loans between a grantor and a grantor trust, or between grantor trusts, to shift appreciation. While a GRAT is a statutorily enacted technique and, thus, minimizes risk, the sale to an IDIT has traditionally worked if done properly and is a superior technique to the GRAT for a few reasons – there is no mortality risk, the interest rate on the note is typically lower than the rate used for the GRAT and is GST efficient.*

Because the proposed change to the law includes the value of the IDIT in the grantor's estate reduced only by the "value of any transfer by gift" the grantor made to the IDIT, even the appreciation on an asset gifted to an IDIT does not escape transfer tax. This alone means that, should this proposal become law, the use of grantor trusts for estate planning purposes is surely over.

Sales to IDITs should be implemented now in order to optimize the planning while it still exists.

7. <u>Dynasty Trust Planning Curtailed/Welcome the Federal Rule Against Perpetuities</u>. Any transfer from a trust more than 50 years after it is created would be treated as having an inclusion ratio of one for GST tax purposes, effectively eliminating the ability for trusts in states like Delaware, Nevada and Alaska (to name a few) to pass assets, in trust, from generation to generation for an unlimited number of generations without the imposition of transfer tax. The law would apply to trusts created after enactment and, what's worse, it would also apply to trusts created before the date of enactment – the law will cut off the transfer tax benefits 50 years from the date of enactment.

For all intents and purposes, Congress will be imposing its own "rule against perpetuities" of 50 years for tax purposes, and it appears that it will not be possible to decant assets from one trust to another trust to circumvent the new rule, as the 50 year countdown starts on the date of creation of the transferee trust or the transfer to the trust, whichever is earlier. Trusts created before this proposal becomes law could avoid the GST for only 50 years after the date of enactment of this proposal.

This new law would change GST planning in a substantial way. For *example, GST tax exempt trusts that are created for children will effectively need to be distributed out to grandchildren before the end of the 50 year period; if distributions to grandchildren come after that date, they will be subject to transfer tax. Provisions will need to be added to trusts that permit the trustees to make these distributions before the end of the 50 year period. Those trustees will be required to balance the children's need for assets to support their lifestyles with the tax savings if those assets are distributed to grandchildren before the end of the 50 years.*

In fact, in many cases it may mean that the GST tax exemption should not be used during life, but rather at death, because there would be a better chance that within 50 years after a transfer, a grantor's children will die and the assets will reach skip persons (and the children won't have to give up the benefit of the assets during their lifetimes). Of course, the corollary argument is that it would be impossible to pass appreciation on gifted assets for GST purposes to skip persons. This will be a difficult balancing act to work through with clients.

This change to the law will also eliminate the transfer tax benefit of creating trusts in states like Alaska, Delaware, Nevada and South Dakota (to name a few), which do not have a rule against perpetuities. If the "federal rule against perpetuities" of 50 years applies, the state law governing the trust will be irrelevant and dynastic transfer tax planning will no longer be available. Of course, the trust laws of these states will continue to be attractive for asset protection and other reasons, but the lure of the ability to avoid transfer tax at every generation will be gone.

8. Annual Gift Tax Exclusions Limited. The "present interest" requirement to get the benefit of the annual gift tax exclusion would be eliminated because there would be a cap on the amount a donor can gift if the transfer is made to a trust, or of an interest in a pass-through entity, or of an interest subject to prohibition on sale, or any other transfer of property which cannot immediately be liquidated. Those are the types of gifts that individuals claimed were present interest gifts, but the IRS thought otherwise. For example, *Crummey* trusts allowed the annual exclusion to be applied to each beneficiary even though beneficiaries practically never withdraw funds using their Crummey powers. And *Cristofani* trusts went one step further by allowing even contingent beneficiaries to be counted. With the new cap, gifts to trusts would be limited. The same would hold true for

gifts of interests in pass-through entities, as the donees generally don't control when distributions from the entity can be made. Similarly, the limitation would apply to gifts of assets that cannot be sold or immediately liquidated. The limit is two times the amount of the annual exclusion for the year of the gift. And that is for all gifts of the types listed in this new code section. The result would be that an individual would be able to gift an unlimited number of outright gifts of cash equal to the amount of the annual exclusion to as many donees as he or she wants, but would be capped at two times the annual exclusion for gifts made to trusts, or the other types of gifts listed above. Note that the inflation adjustment for the annual gift tax exclusion would remain part of the law.

This new law would have a dramatic impact on traditional gifting/life insurance trusts that are "loaded up" with beneficiaries. Crummey trusts would be eliminated. For big premium policies, alternative funding strategies will be necessary and critical. It may even make sense to make large loans to insurance trusts now in order to pay premiums later. Or maybe annual exclusion gifts to fund policies will need to be made to children and grandchildren outright, who could use those gifts to fund an LLC that would purchase and own the policy, which would be payable to the members when the insured dies.

LIFE INSURANCE PLUG #3 – A GOOD INSURANCE PROFESSIONAL WILL COMPARE THE PROS AND CONS OF ANNUAL PREMIUMS VERSUS A FULLY PAID-UP POLICY. NOW MAY BE THE TIME TO PURCHASE A PAID-UP POLICY, PARTICULARY IF THE USE OF CRUMMEY BENEFICIARIES WILL BE ELIMINATED UNDER THIS NEW RULE AND OTHER FUNDING OPTIONS ARE NOT AVAILABLE. INDEED, THIS MAY BE A GOOD WAY TO USE THE BALANCE OF AN INDIVIDUAL'S GIFT TAX EXEMPTION BEFORE IT IS REDUCED.

The "STEP" Act

On March 29, 2021, Senator Chris Van Hollen (MD), Senator Cory Booker (NJ), Senator Bernie Sanders (VT) and Senator Sheldon Whitehouse (RI) introduced the "Sensible Taxation and Equity Promotion (STEP) Act" (also referred to as the "STEP Act"). The provisions are discussed below.

1. <u>Elimination of step-up in basis at death.</u> In general, the bill proposes that property should be treated as sold for its fair market value when transferred by gift, bequest or to a non-grantor trust.

This is essentially the Canadian system, which treats death as a recognition event for income tax purposes. This rule, combined with a higher capital gains rate, as proposed by President Biden during his campaign, could be a significant revenue raiser. Moreover, it is problematic from the perspective of liquidity, as death would be a "deemed" sale, meaning there may not be a sufficient amount of cash to pay the tax, which could cause a sale of assets that would otherwise not be made. Finally, some view this rule as an administrative burden because basis information for certain assets may not be available. Indeed, Congress has gone down this path twice before in a modified way. First, in 1976, Congress instituted a carryover basis regime, but after sharp criticism from financial institutions, Congress deferred its effective date and ultimately repealed the law. Second, the carryover basis regime did become law in 2010 when the estate tax was repealed (temporarily). From a planning perspective, perhaps when death will occur in the short term, it may make sense to accelerate gain at lower tax rates and, perhaps even consider the state taxes that could be avoided based on domicile.

2. <u>Special Rules for Trusts:</u>

   a. <u>Grantor Trusts</u>: Property will be not treated as sold when assets are transferred between grantors and grantor trusts. Instead, grantor trust property will be deemed to be sold when the assets are transferred to another person, when the grantor dies or when the grantor is no longer treated as the owner of the trust. Additionally, property transferred to or held by a grantor trust will be treated as sold if such property would no longer be included in the owner's estate for estate tax purposes.

This new law would limit the effectiveness of intentionally defective grantor trusts for the purpose of deferring realization on gifts.

   b. <u>Non-Grantor Trusts:</u> Property held by a non-grantor trust will be treated as sold for its fair market value every 21 years after the establishment of the trust. As a transition rule, trusts established earlier than December 31, 2005 will have their first deemed realization in 2026.

3. <u>Exceptions and Other Special Rules:</u> Exceptions to the general rules under the bill are included for tangible personal property, transfers to spouses, transfers to charities, charitable trusts, qualified disability trusts and cemetery perpetual care funds.

   a. <u>Tangible Property:</u> Tangible personal property other than a collectible (as defined in IRC Section 408(m)), which is not held in connection with a trade or business, or for any purpose described in IRC Section 212, is excepted from deemed realization of gain at the time of gift or death of the transferor.

   b. <u>Spousal Exception:</u> If a transfer is made to the spouse or surviving spouse of the transferor, or if a transfer consists of qualified terminal interest property or of property to which IRC Section 2056(b)(5) or 2523(e) applies, such transfers are excepted from deemed realization of gains at the time of gift or death of the transferor. Instead, the realization of gain for qualified terminal interest property or of property to which IRC Section 2056(b)(5) or 2523(e) applies is recognized on the earlier of the date of the disposition of such property by such spouse or surviving spouse or the date of death of such spouse or surviving spouse. <u>Importantly, the spousal exemption does not apply if the spouse or surviving spouse of the decedent is not a citizen or long-term resident of the U.S.</u> In order for the exception to apply, the spouse must be a U.S. citizen and long-term resident, who would be subject to the existing deemed realization rules under IRC Section 877A if they subsequently expatriated.

   c. <u>Gifts and Bequests to Charity:</u> An exception is permitted for transfers made to or for the use of an organization described in IRC Section 170(c).

   d. <u>Qualified Disability Trusts and Cemetery Perpetual Care Funds:</u> An exception is granted for any qualified disability trust (as defined in IRC Section 642(b)(2)(C)(ii)) or any cemetery perpetual care fund described in IRC Section 642(i).

4. <u>Treatment of Basis for Gifts and Bequests to Which Tax Applies:</u> IRC Section 267 disallows losses for transfers to related parties. This bill proposes to apply this rule when assets are transferred by gift, but not at death. Carryover basis is eliminated, except for spouses and charities. Since built-in gains would be taxed at the time of gift or bequest under the bill, the transferee's basis in the property receives a step-up in basis equal to the value that was taxes at the time of transfer.

5. <u>Reporting Requirements:</u> Any Trust with (1) an aggregate value of assets on the last day of the taxable year in excess of $1,000,000, or (2) gross income for the taxable year in excess of $20,000, must report a full and complete accounting of all trust activities and operation for the year and the name, address and TIN of the trustee, the grantor and each beneficiary of the trust.

Essentially, the bill imposes a reporting requirement on domestic trusts similar to existing reporting requirements for existing foreign trusts with U.S. owners.

6. <u>Exclusions and Deductions:</u> Retirement accounts are not subject to capital gains tax (taxed as ordinary income), and, therefore, are not impacted by the bill. The exclusion for the sale of a principal residence of $250,000 ($500,000 if married) still applies to property treated as sold under the bill. Capital gains tax liability incurred as a result of the bill would be deductible from a decedent's estate for estate tax purposes.

7. <u>Exclusion of Gain From Transfers of Certain Appreciated Assets.</u> Individuals are provided with a $1,000,000 exclusion from tax under the bill for unrealized gains at death. In any taxable year ending before the date of the taxpayer's death, an individual may draw down $100,000 of their $1,000,000 exclusion for lifetime gifts, with any remaining amount available at death. The exclusion is adjusted for inflation.

8. <u>Deduction for Costs of Appraisal of Appreciated Assets.</u> The bill proposes to permit an itemized deduction for costs paid or incurred

with respect to the appraisal of any property which is treated as sold during the year by reason of IRC Section 1261 (gift or death).

9. <u>Extension of Time for Payment of Tax.</u> The tax on gains of assets, other than personal property of a type which is actively traded (within the meaning of IRC Section 1092(d)(1)), that are deemed to be sold under this bill may be paid over a 15-year period. The 15-year option is only available for realizations at death or under the 21-year rule for non-grantor trusts. A decedent's estate or a non-grantor trust could pay only interest for up to 5 years, and then pay the tax and interest for a maximum of 10 annual installments.

LIFE INSURANCE PLUG #4 – IF THIS RULE IS IMPLEMENTED, IT SHOULD BE A BONANZA FOR THE LIFE INSURANCE INDUSTRY. LIFE INSURANCE PROCEEDS ARE GENERALLY NOT SUBJECT TO INCOME TAX UPON DEATH OF THE INSURED AND THERE ARE NO STEP-UP RULES (OR LACK THEREOF) TO WORRY ABOUT.

<u>The Mechanics of Getting a Tax Bill Passed</u>

The legislative process can be complicated and, while the Democrats control the Congress, passing tax legislation is easier said than done. Thus, given the probability that there will be tax legislation this year, as is usually the case with a new administration, we thought it would be helpful to summarize the process.

Like all legislative proposals, the “For the 99.5% Act” and the “STEP Act” would first need to be passed through the U.S. House of Representatives and then through the U.S. Senate before being signed into law by the President. With Democrats holding a majority of seats in both the House and the Senate for the first time since 2010, this path to enactment will have less friction than in years past. However, there are still some limitations to what they can enact without bipartisan support and when they can enact it.

1. <u>Number of Votes Required to Pass.</u> The U.S. House of Representatives requires a simple majority to pass legislation. The majority of bills proposed in the U.S. Senate, however, require a 60-vote super-majority in order to pass due to the legislative filibuster. The filibuster permits a senator, or senators, to openly debate

proposals for as long as they wish before being brought to a vote. Under current U.S. Senate rules, 60 votes are required in order to end debate on a bill and overcome a filibuster. Once the debate is ended by the 60-vote super-majority, only a simple majority is required to pass legislation in the U.S. Senate.

With Democrats holding a simple majority in the U.S. Senate (by virtue of party lines and the tie-breaker going to Vice-President Harris), there has been some speculation as to whether or not they can and will reform or eliminate the filibuster. If the legislative filibuster is eliminated, all measures could pass with a simple majority, without the need to overcome the initial 60-vote hurdle. This would, of course, increase the likelihood of all Democratic legislation being passed, including the 99.5% Act and the STEP Act.

While support for filibuster reform is growing among Democratic Senators, it looks unlikely that it has much of a chance at succeeding. In order to reform or eliminate the filibuster, Democrats would need to have all members of their party in favor of creating a new Senate precedent. Three Democratic Senators have vocally opposed these changes—Joe Manchin[iv] (D-W.Va.), Kyrsten Sinema (D-Ariz.) and Pat Leahy (D-Vt.). Without unanimous Democratic support, the 60-vote filibuster hurdle will remain in place for most, but not all, proposals.

2. Budget Reconciliation. There is, however, a notable exception to the 60-vote filibuster hurdle in the Senate: budget reconciliation is not subject to the filibuster and can pass with a simple majority of 51 votes. With Democrats holding 50 seats of the U.S. Senate, budget reconciliation has already proven to be a powerful measure of passing fiscal legislation quickly (as seen with the passage of The American Rescue Plan Act of 2021 after a 51-50 vote in the U.S. Senate and a party-line simple majority in the U.S. House).

   As it stood, Democrats had two options to pass legislation through budget reconciliation in 2021: first, to determine the budget for fiscal year 2021 and, second, to determine the budget for fiscal year 2022 (which begins on October 1, 2021). Recently, however, the parliamentarian, Elizabeth MacDonough, announced that Democrats could have a chance at a third budget reconciliation bill this year. Her decision is based on her interpretation of Section 304 of the

Congressional Budget Act of 1974, which allows lawmakers to revise budget resolutions in the same fiscal year that the budget covers.

While previously Democrats would have had to wait until October at the earliest to attempt passing legislation through budget reconciliation, the parliamentarian's decision now opens the door for Democrats to introduce the "For the 99.5% Act" and/or the "STEP Act" as part of a revised 2021 budget prior to their passage of the fiscal year 2022 budget resolution, without the need for bipartisan support.

Conclusion:

The bottom line for estate planning professionals is that if these pieces of legislation pass in current form or modified form, the planning landscape will change dramatically. Assuming that change in the exemptions and rates would have an effective date on January 1, 2022, and that the other changes in the law would be effective on the date of enactment, planners should be proactive with their clients to seize on the favorable exemptions, rates and laws that are still available.

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

Andy Katzenstein
David Pratt
Brett Rosecan
Brittany Newell

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CITATIONS:

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[i] Indeed, on January 26, 2021, Mark Mazur, the Treasury Department's deputy assistant secretary for tax policy, indicated that the Biden administration was not actively considering retroactive tax increases.

[ii] See https://joebiden.com/plans-to-support-women-duringcovid19.

[iii] See Joy Matak, Sandra D. Glazier & Martin M. Shenkman: An Estate Planning Six-Part Series for Late 2020, Estate Planning Newsletter #s 2840, 2841, 2842 and 2848; A Client Letter from Barry Nelson: Time Running Out on Year End Planning, LISI Estate Planning Newsletter #2824.

[iv] See https://www.washingtonpost.com/opinions/joe-manchin-filibuster-vote/2021/04/07/cdbd53c6-97da-11eb-a6d0-13d207aadb78_story.html

Steve Leimberg's Estate Planning
Email Newsletter Archive Message #2886

Date:18-May-21

Subject: Howard Zaritsky - Morrissette II Sets the Bar for Intergenerational Split-Dollar Life Insurance Arrangements

"The Tax Court in Estate of Morrissette v. Comm'r, T.C. Memo. 2021-60 (May 13, 2021) (Morrissette II) has provided more favorable answers to several of the estate tax questions surrounding intergenerational split-dollar life insurance agreements than had the prior cases. The court now held that: (a) the policy proceeds are not includible in the gross estate of the deceased grantor of the revocable trust under Sections 2036 or 2038, because they were made in a bona fide sale for adequate and full consideration; (b) the special valuation rules of Section 2703 do not require inclusion of the cash surrender value of the policies in the decedent's gross estate; (c) the fair market values of the decedent's split-dollar rights could be calculated using the discounted cash value methodology; and (d) a 40% gross valuation misstatement penalty under Section 6662(h) was appropriate."

Howard Zaritsky provides members with important and timely commentary on *Estate of Morrissette v. Commissioner,* T.C. Memo. 2021-60*.* Members who wish to learn more about this topic should consider watching these two powerful **LISI** Webinars:

- "**Morrissette: Isn't It Ironic?**" May 27th @ 1PM ET with **Brent Berselli**
- "**Morrissette – Tax Court Moves Split-Dollar Battle to Valuation**" June 4th @ 3PM ET, with **Bob Keebler**, **Martin Shenkman**, **Espen Robak**, **Lee Slavutin** & **Richard Harris**

Howard Zaritsky is a retired estate planning attorney He is the author or co-author of numerous articles and treatises, including: Tax Planning for Family Wealth Transfers During Life, Tax Planning for Family Wealth Transfers at Death, and – with Steve Leimberg - Tax Planning with Life Insurance (all published by Thomson-Reuters/WG&L). He is a Fellow of the American College of Trust and Estate Counsel and the American College of Tax Counsel, a member of the Virginia State Bar, and former Chair of the Virginia Bar Association Section on Wills, Trusts & Estates.

Here is his commentary:

EXECUTIVE SUMMARY:

The Tax Court in *Estate of Morrissette v. Comm'r*, T.C. Memo. 2021-60 (May 13, 2021) (*Morrissette II*) has provided more favorable answers to several of the estate tax questions surrounding intergenerational split-dollar life insurance agreements than had the prior cases. The court now held that: (a) the policy proceeds are not includible in the gross estate of the deceased grantor of the revocable trust under Sections 2036 or 2038, because they were made in a *bona fide* sale for adequate and full consideration; (b) the special valuation rules of Section 2703 do not require inclusion of the cash surrender value of the policies in the decedent's gross estate; (c) the fair market values of the decedent's split-dollar rights could be calculated using the discounted cash value methodology; and (d) a 40% gross valuation misstatement penalty under Section 6662(h) was appropriate.

FACTS:

AN INTRODUCTION TO INTERGENERATIONAL SPLIT-DOLLAR LIFE INSURANCE

A popular use of private split-dollar life insurance is the inter-generational split-dollar plan. Inter-generational split-dollar involves using the "economic benefit regime" with a collateral assignment non-equity split-dollar agreement, to avoid both gift and GST taxes. Under this arrangement, a senior-generation member (grandparent) pays part of the premiums on a single life or second-to-die policy insuring the life or lives of one or more middle-generation members (child, child and spouse, or children). The death benefits are payable to a trust for the benefit of lower-generation members (grandchildren and more remote descendants). The grandparent typically pays the portion of the premium equal to the value of the present insurance coverage, under Table 2002 (IRS Notice 2002-8), or the insurer's alternative term rate, if lower. The grandparent often also makes gifts to the trustee to enable the trustee to pay the balance of the premiums.

Proponents of this concept posit that the senior generation does not make taxable gifts by paying premiums; rather, the senior generation advances funds to the trustee, with a full right to recover the greater of the cash value or the total premiums paid from the policy death benefits. The senior generation's payments are usually designed to create a sufficient cash value in the policy during the first five years to enable the trustee to pay all future premiums from the annual exclusion gifts made to the trust.

BACKGROUND: THE EARLIER CASES – *MORRISSETTE I* AND *CAHILL*

The first reported case to address the utility and results of intergenerational split-dollar life insurance was *Estate of Morrissette v. Comm'r,* 146 T.C. 171 (2016) *(Morrissette I)*, which involved the estate of Clara M. Morrissette, who had established a revocable trust and contributed to it her shares in the family's corporation, Interstate Group Holdings, Inc. (IGH), which owned and operated Interstate Van Lines. Clara was the initial trustee, but her three sons were later added as co-trustees to assist her in managing her affairs after she reached an advanced age.

In 2006, the revocable trust was amended to permit the trustee to "(i) pay premiums on life insurance policies acquired to fund the buy-sell provisions of the * * * [Interstate Group's] business succession plan, and (ii) make loans, enter into split-dollar life insurance agreements or make other arrangements." The same amendment also authorized the trustee to transfer each receivable from the split-dollar life insurance agreement, when paid by one of the three dynasty trusts Clara had created for her sons, back to the irrevocable trust owing the receivable or directly back to each son.

A few days later, the revocable trust, the three dynasty trusts, Clara's brothers-in-law, and some other trusts entered into a buy-sell agreement, under which, on the death of any of the three sons, the remaining sons and their dynasty trusts would buy the deceased's IGH stock. To fund the buy-sell agreement, each of the dynasty trusts bought a universal life insurance policy on the life of each other son. The revocable trust entered split-dollar insurance agreements with three dynasty trusts.

The revocable trust contributed $29.9 million to the three dynasty trusts to enable them to buy universal life insurance policies on each of the sons. The revocable trust was entitled to receive a portion of the death benefit from each policy equal to the greater of the cash surrender value of the policy or the aggregate premium payments on that policy. Each dynasty trust would receive the balance of the death benefit under the policy it owns on the life of the deceased, which would be available to fund the purchase of the stock owned by or for the benefit of the deceased. The split-dollar agreements included a recital that the parties intended that the agreements be taxed under the economic benefit regime, rather than the loan regime, and that the only economic benefit provided to the dynasty trusts was current life insurance protection.

The dynasty trusts executed collateral assignments of the policies to the revocable trust to secure their obligations under the split-dollar agreements. None of the trusts had the right to borrow against a policy held under this agreement. Clara reported gifts to the trusts for the 2006–2009 tax years using the economic benefit regime.

After Clara's death, the IRS determined a gift tax deficiency and penalty against the estate, treating the entire $29.9 million as a gift in 2006. The estate challenged the deficiency in the Tax Court and sought partial summary judgment regarding whether the split-dollar agreements were governed by the economic benefit regime.

The Tax Court (Judge Goeke) granted the partial summary judgment, holding that (1) the agreements in this case were clearly split-dollar life insurance agreements because the revocable trust paid part of the premiums and was entitled to recover, at a minimum, all of those premiums paid, and because this recovery would be made from, or at least was secured by, the proceeds of the policies; (2) the dynasty trusts owned the policy but, under the regulations, the economic benefit regime applied because the agreement was donative in nature and the only economic benefit provided under the agreement to the donee was the current life insurance protection. Reg. § 1.61-22(c)(1)(ii)(A)(2); see also TD 9092, § 5, 2003-2 CB 1055, 1062; (3) the value of the economic benefits provided to the nonowner for a taxable year under the agreement is equal to the sum of the cost of current life insurance protection, the amount of cash value to which the nonowner has current access during the year, and any economic benefits not otherwise described that are provided to the nonowner. Reg. § 1.61-22(d)(2).

The court rejected the IRS's contention that the dynasty trusts had a direct or indirect right in the cash values by virtue of the terms of the 2006 amendment to the revocable trust, under which the revocable trust's interest in the cash values of the policies would pass to the dynasty trusts or directly to the sons or their heirs on Clara's death. The court noted that Clara could, at any time during her lifetime, alter the terms of the revocable

trust, so that the dynasty trusts had no legally enforceable right to the cash values of the policies during Clara's lifetime. Also, the split-dollar agreements did not require the revocable trust to distribute the receivables to the dynasty trusts; Clara retained a right to those receivables. Furthermore, the court noted, the regulations look only to current or future rights to cash value "under the arrangement," and provisions of the revocable trust amendments were not part of the split-dollar agreement. Reg. § 1.61-22(d)(1).
The court also rejected the IRS's argument that the "prepaid premiums" paid not only for current insurance protection, but also for future protection, which is a benefit other than current life insurance protection and requires that the agreement be taxed under the loan regime. The court noted that this would require assuming that the dynasty trusts would otherwise be required to pay the premiums, whereas under these split-dollar agreements, the dynasty trusts are not required, but are permitted, to pay any portion of the policies' premiums. Only the revocable trust was obligated to pay all premiums.

The second reported case on point was *Estate of Cahill v. Comm'r,* T.C. Memo. 2018-84 (*Cahill*), in which the decedent, Richard F. Cahill, was the grantor of a revocable trust of which his son, Patrick, was the trustee. Patrick was also Richard's attorney-in-fact, and the executor of Richard's estate. When Richard was already 90 years old and unable to manage his own affairs, Patrick created an irrevocable trust (the MB Trust) on Richard's behalf. Patrick's cousin, William Cahill, was named as trustee and Patrick and his issue were the primary beneficiaries.

The MB Trust and the revocable trust then entered into three split-dollar agreements with respect to three whole life policies in the aggregate face amount of just under $80 million. One policy insured Patrick's life and the other two insured the life of his wife, Shannon. The MB Trust borrowed $10 million from Northern Trust, N.A., and used these funds to pay the premiums on all three policies in a single lump sum. Richard was personally liable for the loan through an agreement signed by Patrick, as his attorney-in-fact. The loan was for five years and provided for annual interest of the greater of (1) 1.5 percent or (2) the sum of 1.14 percent plus the London Interbank Offered Rate (LIBOR) for deposits with a maturity of one month. No principal payments were required during the five-year term. The MB Trust could not sell, assign, transfer, borrow against, surrender, or cancel a policy without the consent of revocable trust.

Each split-dollar agreement could be terminated during the insured's life by written agreement between Richard (through his revocable trust) and the MB Trust. Upon termination, Richard, through his revocable trust, had the following termination rights: (1) the MB Trust could retain the policy, in which case Richard's revocable trust would receive the greater of premiums paid or cash surrender value with respect to the related policy or (2) the MB Trust transfer the policy to Northern Trust in full or partial satisfaction of Richard's liability to Northern Trust.

In addition, when an insured died, Richard's revocable trust had the right to the greatest of (1) the remaining balance on the loan, (2) the total premiums paid by revocable trust with respect to the policy to which the loan related, and (3) the policy's cash surrender value immediately before the insured's death. The MB Trust would retain any excess of the death benefit over the amount paid to revocable trust.

Richard reported $7,575 in gifts to the MB Trust, as determined under the economic benefit regime of the split-dollar regulations. When Richard died, the cash surrender value of the three policies was $9,611,624. Richard's estate contended that termination of the split-dollar agreements was so unlikely that the termination rights had no value as of Richard's death, because Richard's right to terminate the split-dollar agreements was held in conjunction with the trustee of MB Trust and it would make no economic sense for the MB Trust to allow termination of the agreements. Thus, the estate treated the value of Richard's interests in the split-dollar agreements as limited to the value of the death benefit rights, which it calculated at $183,700. This value was so low because the insureds, Patrick and Shannon Cahill, had long life expectancies, giving Richard's rights a small present value.

The parties agreed that, for income and gift tax purposes, the agreements between the trusts were split-dollar agreements under the regulations, and that they were taxable under the economic benefit regime. The IRS issued a notice of deficiency claiming that Richard's rights in the split-dollar agreements were worth the $9,611,624 cash surrender value, based on the application of Sections 2036 and 2038, and Section 2703.

The Tax Court (Judge Thornton) held that: (a) Richard held on the date of his death the rights to terminate the agreement and to recover at least the cash surrender value, which although exercisable in conjunction with the trustee of the MB Trust, entitled Richard to designate the persons who would possess or enjoy the transferred property under Section 2036(a)(2) and to alter, amend, revoke, or terminate the transfer under Section 2038(a)(1). Citing *Estate of Powell v. Comm'r*, 148 T.C. 392 (2017) and *Estate of Strangi v. Comm'r*, T.C. Memo. 2003-145, *aff'd*, 417 F.3d 468 (5th Cir. 2005); (b) Richard's transfer of $10 million to the MB Trust was not a bona fide sale for an adequate and full consideration in money or money's worth, because there was finding that the facts did not establish a legitimate and significant nontax reason for the transfer. Citing *Estate of Hurford v. Comm'r*, T.C. Memo. 2008-278; (c) the facts showed that the interest received by Richard in the policies was not worth the same amount as the amount transferred, so that the transfer was not for full and adequate consideration in money or money's worth; and (d) the MB Trust's ability to veto Richard's termination of the agreements existed from the moment the agreement was entered into, so that the value of the retained rights was never equal to the $10 million transferred.

The court also held that Richard's and the MB Trust's rights under the split-dollar agreements must be valued under Section 2703(a). Section 2703(a) values any asset includible in a decedent's gross estate without regard to (1) any option, agreement, or other right to acquire or use the property at a price less than its fair market value or (2) any restriction on the right to sell or use such property. Section 2703(b) provides an exception where the restriction is a *bona fide* business arrangement, not a device to transfer property to members of the decedent's family for less than adequate and full consideration, and comparable to the terms of similar arrangements in arm's-length transactions. Here, the court held that the relevant property interests for purposes of valuation under Section 2703(a) were the contractual rights in the cash surrender value, the transfer of which was restricted by the agreements which allowed the MB Trust to prevent Richard's access to that amount and that Richard received rights that were reportedly worth $183,700 and the MB Trust received rights worth over $9 million.

The estate next argued that the difference between the $10 million that Richard paid for the policies and the $183,700 that he received in return would be accounted for as gifts, and that to count it also as part of the estate under Sections 2036, 2038, or 2703 would essentially double count that amount. The court rejected this argument, because Richard never reported the difference as a gift; the parties agreed that only the economic value of the insurance coverage was a gift. The cash surrender value remaining on the date of death represented funds that had not yet been used to pay the cost of current life insurance.

The court also rejected the estate's argument that the difference between the $183,700 and the cash surrender value would be reflected as gifts after Richard's death, because Richard's beneficiaries will receive his interest in the split-dollar agreement. Thus, the estate argued, the cost of current life insurance will continue to be treated as gifts to the MB Trust. Even were this true, the court stated, the gift of current life insurance protection to the MB Trust after Richard's death would not be a gift from Richard, but rather from the persons who succeed to his interests in the agreements. Thus, there would be no double-counting.

Morrissette II

The Tax Court ruled in *Morrissette II* that: (a) the policy proceeds are not includible in the gross estate of the deceased grantor of the revocable trust under Sections 2036 or 2038, because they were made in a *bona fide* sale for adequate and full consideration; (b) the special valuation rules of Section 2703 do not require inclusion of the cash surrender value of the policies in the decedent's gross estate; (c) the fair market values of the decedent's split-dollar rights could be calculated using the discounted cash value methodology; and (d) a 40% gross valuation misstatement penalty under Section 6662(h) was appropriate.

The Tax Court (Judge Goeke) reviewed the facts in even greater detail that he had in the earlier opinion of the court and noted that, while the petitioners agree that the fair market values of the split-dollar rights are includible in Mrs. Morrissette's gross estate because they were held by her revocable trust, the IRS sought to include the $30 million in premium payments or the $32.6 million in cash surrender value in the decedent's gross estate under Sections 2036 and 2038. The IRS argued, as it had in *Cahill*, that the revocable trust, through the split-dollar agreement, had retained the possession, enjoyment, or right to income in the transferred funds under Section 2036(a)(1), a power to designate the beneficial enjoyment of the transferred funds under Section 2036(a)(2), or a power to alter the transferred funds under Section 2038(a). As the Tax Court in *Cahill* had already stated that the rights retained in an intergenerational split-dollar life insurance agreement fell under Section 2036(a)(2) or 2038(a) (the application of Section 2036(a)(1) was not considered in that case), the court did not need to re-evaluate that issue here, but instead focused on the bona fide sale exception to both Sections 2036 and 2038.

The IRS also contended that the transfer was not a bona fide sale for adequate and full consideration, but the Tax Court disagreed. The Tax

Court applied the same analysis in *Morrissette II* that it had applied in *Estate of Powell at* 411 (2017), that the bona fide sale exception requires both (1) a legitimate and significant nontax purpose and (2) adequate and full consideration for money or money's worth. The court rejected the IRS argument that the transfers between the revocable trust and the dynasty trusts were not a "sale" as that term is ordinarily defined, because the dynasty trusts paid no consideration. The court pointed out that Section 2036 and 2038 adopt a broader definition of "sale," that includes transactions that are not commonly categorized as sales. Basically, they require only a voluntary act of transferring property in exchange for something. *Estate of Bongard v. Comm'r*, 124 T.C. 95, 113 (2005). *Estate of Stone v. Comm'r*, T.C. Memo. 2003-309 (treating a contribution of assets to a business entity in exchange for an interest in the entity as a sale for purposes of section 2036(a)). In *Morrissette II*, the revocable trust voluntarily and in good faith transferred money to the dynasty trusts in exchange for a right to repayment. Thus, the split-dollar agreement between the revocable trust and the dynasty trusts was a sale for this limited purpose.
The court then held that Clara had a legitimate and significant nontax motive for advancing the funds to pay the premiums under the split-dollar agreement. The court explained that the nontax purpose must be a genuine purpose that motivates the transaction, rather than a theoretical purpose or justification. *Estate of Bongard*, 124 T.C. at 118. The existence of additional testamentary objectives, however, does not negate the existence of a legitimate nontax purpose, as such purposes are often inextricably interwoven. *Estate of Bongard*, 124 T.C. at 121; *Estate of Black v. Comm'r*, 133 T.C. 340, 362-363 (2009).

The evidence established that Clara sought to maintain control over the company and to pass that control on to her sons and future generations. The split-dollar agreements were instrumental in accomplishing these objectives and assuring the control and succession of an active closely-held business is a legitimate nontax purpose for the *bona fide* sale exception. to ensuring that Interstate's ownership remained in her family after her sons died. Citing *Estate of Bigelow v. Comm'r*, 503 F.3d 955, 972 (9th Cir. 2007), *aff'g* T.C. Memo. 2005-65; *Estate of Strangi v. Comm'r*, 417 F.3d at 481; *Estate of Reynolds v. Comm'r*, 55 T.C. 172, 194 (1970). The court explained that:

The brothers wanted to honor their parents' wish that the three brothers inherit Interstate equally and pass the company on to their children. However, they were also realistic about the need to pay estate tax and the *possibility that they would need to sell part of Interstate to pay it. They believed that there was a significant chance that the family would lose control of Interstate if their families were not given this option . . . . The split-dollar agreements provided each brother's children with the option to exit the business and cash out their interests after the brother's death and at the same time allowed the remaining brothers and their families to purchase the interests by funding the buyout. The buy-sell provision also prevented the brothers from selling their Interstate stock to outsiders as a means to retaliate against one another for past disputes.* T.C. Memo. 2021-60 at *76.

The court also held that the split-dollar agreements served a second legitimate, nontax purpose, a smooth transition in Interstate's management. The agreements helped assure that those sons who had long worked for the company could remain with the company for their professional futures, preserving both their expertise and institutional knowledge. The court found testimony from these sons about their succession concerns to be credible.

The court acknowledged that the split-dollar agreements were also part of an estate tax saving strategy. Nonetheless, the existence of a tax motivation does not negate the existence of a legitimate nontax motive. As the court explained, "caselaw requires the presence of a legitimate, nontax purpose; it does not require the absence of a tax saving motivation." T.C. Memo. 2021-60 at *78. One son "who made most decisions relating to the split-dollar agreements, credibly testified that he would have engaged in the split-dollar agreements even if they had not provided any estate tax saving because of the nontax financial benefits that they provided." *Id.* Furthermore, the court found that the record showed the sons concerns about the correct inheritance of the company and that these were not merely theoretical justifications for the agreements.

The court rejected the argument that if the sons "stood on both sides of the split-dollar agreements," there could be no legitimate nontax purpose. A taxpayer's standing on both sides of a transaction can indicate there is no legitimate, nontax purpose for the transfer, but it is not conclusive. *Estate of Thompson v. Comm'r*, 382 F.3d 367, 382 (3rd Cir. 2004), *aff'g* T.C. Memo. 2002-246. This is particularly true when the relationship of sons, as here, was occasionally hostile. See *Estate of Stone* (resolving intrafamily disputes that had led to litigation in the past is a legitimate, nontax purpose).

The IRS also argued that the sons had complete control over the policies and could cancel them at any, because the dynasty trusts would inherit the split-dollar rights. The court rejected this argument because, while the sons, as co-trustees, had the discretion to distribute each split-dollar agreement, such distribution was not guaranteed. Moreover, the effects of the possible distribution of the split-dollar agreements after Clara's death were more relevant to the determination of the fair market value of the split-dollar rights then to whether the transfers qualified as bona fide sales. The parties to the buy-sell agreement understood their future obligations and there was credible testimony that there was no prearranged plan to terminate the split-dollar agreements upon Clara's death.

The court rejected the government's argument that purchasing life insurance policies with high initial cash values and modest death benefits proved that tax motivations were primary. The court noted that the sons had credibly testified that they choose those policies to ensure that the revocable trust would be adequately compensated for financing the premiums and that it would earn interest for funding the premiums through inside buildup in the value of the policies.

The court also rejected the IRS argument that the fact that the sons retained their father's stock after his death and the equal distribution of the insurance proceeds among the dynasty trusts showed that the buy-sell provision was not a legitimate reason for the transfer of the premiums. The court stated that it made sense that two of the sons would retain their father's voting stock as they worked for the company and they wanted to protect their careers.

The court also held that the revocable trust had received adequate and full consideration in money or money's worth for its premium payments. The court rejected the estate's argument that the fact that the transaction complied with the requirements of the economic benefit regime should mean that there was adequate and full consideration, because the regulations expressly do not apply for estate tax purposes. The economic benefit regime does not require a comparison of the amount of the premium payment with the value of the rights that the revocable trust received in exchange.

The court noted that, unlike the question of fair market value, the adequacy of consideration is not defined on the basis of a willing buyer and willing seller and is not judged from the perspective of hypothetical persons. *Kimbell v. United States*, 371 F.3d 257, 266 (5th Cir. 2004). The bona fide sale exception does not require an arm's-length transaction and an intrafamily transfer, though requiring heightened scrutiny, can constitute a *bona fide* sale. *Estate of Bongard*, 124 T.C. at 122-123; *Estate of Thompson*, 382 F.3d at 382-383. The question of adequacy of consideration requires that the consideration be similar to that which two unrelated persons would provide after negotiating at arm's length. *Estate of Bongard*, 124 T.C. at 122-123. In *Kimbell*, 371 F.3d at 265-266, the Court of Appeals for the Fifth Circuit acknowledged that an investor received a partnership interest for adequate and full consideration even though the partnership interest had a substantially lower fair market value than the assets contributed to the partnership. The key is whether the exchange is an informed trade, and investors may desire an asset for features other than its fair market value, such as "management expertise, security or preservation of assets, and capital appreciation." *Estate of Thompson*, 382 F.3d at 381. Here, the split-dollar agreements provided financial benefits other than the ability to sell or collect immediately on the split-dollar rights, including repayment plus inside buildup in the value of the policies, management succession, and efficiency and capital accumulation. The court noted that the intervening events between the transfer date, when one determines adequate and full consideration, and the valuation date, when one determines fair market value, which were significant. Clara had been in relatively good health on the transfer date, and one of the sons had been diagnosed with terminal cancer and was no longer even insurable. Clara could have outlived any one of her sons, and the split-dollar agreements were a safe investment with an adequate interest rate.

The court held that the revocable trust received adequate and full consideration on the basis of the split-dollar agreements' repayment terms that included interest earned in the form of inside buildup of the insurance policies. The minimum interest rates and the actual appreciation in the policies' cash values were higher than the interest rates that the CMM trust had been earning on the money. Respondent does not argue that the repayment terms were inadequate. The split-dollar agreements also provide the additional benefit of deferral of tax on the policies' inside buildup and the tax-exempt payout of the death benefits to the beneficiaries.

The court distinguished the facts in *Cahill*, noting that the decedent in *Cahill* was 90 years of age, while the decedent in *Morrissette II* was 75 years old, and the decedent in *Estate of Cahill* borrowed the entire $10 million premium payments from a bank while Clara had sufficient assets to pay almost 90% of the premiums herself, as well as other sources of income to repay the small loan she did obtain from the company. Perhaps more importantly, *Cahill,* unlike *Morrissette II,* did not involve active business operations and such financial considerations as management efficiency and succession, capital accumulation and family dynamics that put those financial considerations at risk. The split-dollar agreements in *Estate of Morrissette II* provided financial benefits similar to those in *Kimbell* and unlike those in *Cahill*.

The court noted that in this case, the estate tax saving was achieved not through execution of the split-dollar agreements alone, but rather through the undervaluation of the split-dollar rights. In exchange for $30 million, the dynasty trusts agreed to buy life insurance and repay the revocable trust and Clara still held the contract rights at the time of her death. However, she no longer had use of or access to the $30 million. Thus, the split-dollar agreements changed the nature of the revocable trust's relationship with the funds that it had transferred.

The court also held that Section 2703(a) did not apply to this arrangement, in a very rare victory for the taxpayer under this section. The court held that the split-dollar agreements were part of a *bona fide* business arrangement, not a device to transfer property at less than adequate and full consideration, and that its terms were comparable to similar arrangements entered into at arm's length.

The court explained that, for this purpose, a bona fide business agreement must further some business purpose. *Amlie v. Comm'r*, T.C. Memo. 2006-76. Such a purpose was established by the estate, as discussed above.

Regarding whether the agreement was a device to transfer property for less than adequate and full consideration, the court agreed with the government that some facts indicated a testamentary purpose for the split-dollar agreements, but that the mutual termination restriction was not itself a device. Device status depends in part on the fairness of the consideration received by the transferor. See *Estate of True v. Comm'r*, T.C. Memo. 2001-167, aff'd, 390 F.3d 1210 (10th Cir. 2004). Here, split-dollar agreements contained reasonable repayment terms, including an inside buildup at a guaranteed interest rate of 3% (and an actual rate of between 4.75% and 5.4%), which was comparable to long-term bonds and actually higher than the revocable trust had been earning on the transferred funds. In light of these and the other intangible benefits discussed above, the court held that the mutual termination restriction was not a device.

On whether the mutual termination restriction was comparable to split-dollar agreements between or among unrelated persons in an arm's-length transaction, the court rejected the analysis of the IRS expert, who compared the Morrissette split-dollar agreements with those entered into by publicly-traded corporations to compensate executives. The court rejected these as having "little relevance to ascertaining whether a closely held corporation or its majority shareholder would include a mutual termination restriction in a split-dollar agreement." T.C. Memo 2021-60 at *104. Also, the government instructed its expert to consider only policies owned by corporate employers, which were not applicable in this case where the corporation had no interest in the policies; the policies were owned by the dynasty trusts. The court noted that the government could not justify this limitation on the policies considered by its expert.

Additionally, the split-dollar agreements reviewed by the government's expert included some type of restriction on the employer's right to terminate the agreement unilaterally, such as vesting for years of service. Here, the senior executives had worked for the company for over 40 years and the court stated that:

[l]ong-term senior executives would likely demand a mutual termination restriction comparable to the one at issue, and the reviewed agreements provide vesting provisions. The mutual termination restriction would ensure the executives' rights to the net death benefits similar to vesting in employment compensation packages on the basis of years of service. In total, approximately 30% of the public agreements imposed some restriction on the employer's termination rights. The termination rights of another 13% are not as clear as respondent argues. T.C. Memo 2021-60 at *105.

The taxpayer was less successful in sustaining a $7.5 million valuation for the decedent's rights under the split-dollar agreements. The court explained that there were two differences between the analyses of the estate's experts and the government's expert: (a) computation of the probability-adjusted expected values of the policies; and (b) the applicable discount rates to determine the present value of those expected returns. The experts differed on both issues, but far more significantly on the second than on the first.

Each expert determined a probability-adjusted expected value for each year of the brothers' life expectancies by estimating an expected cash surrender value for each year and multiplying that value by the brothers' probabilities of mortality that year. On the expected value of the policies, one of the estate's experts valued the split-dollar rights at $7,808,314. The court rejected this valuation because the estate's expert used a blended yield rate that placed too much weight on anticipated decreases in the actual policy yields, and thereby inappropriately decreased the expected cash surrender values. The court also rejected this valuation because the expert used policy illustrations that were not issued close to the valuation date, which the court noted involve subsequent events that were not foreseeable on the valuation date are not, therefore, generally helpful. Citing *Messing v. Comm'r*, 48 T.C. 502, 509 (1967).

Both of the estate's experts used the IRS mortality table for to determine the probability of each insured dying in each year. Actually, the government's expert used tables that provided a lower valuation for the estate, which the court treated as a concession.

The court accepted the discount rates of 8.85% and 6.4% (different rates for different insurers) proposed by the government's expert, finding that they more accurately reflected the risk that the insurers would default on their payment obligations under the policies. That expert used yields that were lower than the average historic yields for both insurers, because interest rates for U.S. Treasury bonds were at a 50-year low. The court held that considering the spot yields on U.S. Treasury bonds more accurately captured the market conditions on the valuation date. The court also held that the actuarial tables negated the argument that it was difficult to determine the timing of the repayments (although a standard actuarial table does little to predict when one of the insured Morrissette sons would actually die).

The estate's experts used life settlement yields as the discount rate, producing a range of yields from 15% to 18% (one expert) or from 9.3% to 23.2% (the other expert). The court rejected these yields because life settlement yields require information regarding the varying sizes of the underlying policies, the financial strength of the insurance companies, the insureds' medical histories, mortality assumptions, and continued obligations to pay premiums. Most of this information was not available to the court. The court stated that, "[w]ithout more information, it is not possible to place the split-dollar agreements accurately within that range." T.C. Memo 2021-60 at *115.

More importantly, the court agreed with the government that the sons likely intended to terminate the split-dollar agreements on December 31, 2013 (when the statute of limitations on estate tax deficiencies regarding Clara's estate return expired), and that this should be deemed to be the maturity date of the policies, producing a fair market value of $27,857,709. The court noted that the revocable trust agreement provided that the split-dollar rights would be allocated to the respective dynasty trusts that owned the underlying policies, which would give the dynasty trusts full control over the policies and allow them to terminate the agreements on December 31, 2013.

The court also sustained a 40% gross valuation misstatement penalty with respect to the valuation of the split-dollar agreement rights held by Clara's estate. It rejected claims that the penalties were never approved by the agent's supervisors, as required under Section 6751(b). While the approval had been done without great formality, such formality is not required and the court found adequate evidence to sustain the penalty as having been approved.

The court also held that the estate had not reasonably relied on the opinions of its valuation experts. Reliance on professional advice may provide a reasonable cause defense if, under all the circumstances, the reliance was reasonable and in good faith. *Neonatology Assocs., P.A. v. Comm'r*, 115 T.C. 43, 98-99 (2000), *aff'd*, 299 F.3d 221 (3d Cir. 2002). The court stated that the estate's $7.5 million appraisal was not reasonable and the sons should have realized it. Despite the business and other nontax purposes for entering into the split-dollar agreements, the sons knew that these arrangements were being marketed as an estate tax saving strategy, and that the tax benefits would be obtained through the low valuation of the split-dollar agreements. The only purpose for valuing the split-dollar rights at $7.4 million rather than the $30 million that the revocable trust actually paid was estate tax saving.

COMMENT:

Morrissette II suggests that intergenerational split-dollar life insurance arrangements may work, though only in certain specific situations. First, there must be a bona fide nontax purpose for the arrangement. There was none in *Cahill*, but the business succession issues in *Morrissette II* provided a clear and substantial nontax purpose. Once such a purpose exists, the co-existence of tax motivations may not be a problem.

Second, the planned disposition of the decedent's rights under the split-dollar agreement to the trusts for the insureds and their descendants proved problematic in *Morrissette II*. This was the basis by which the Tax Court valued the retained rights under the split-dollar agreements at a figure far in excess of the actuarial value that the taxpayer reported on the decedent's estate tax return. Had these rights be left to, for example, a separate common trust fund for the descendants of the deceased, rather than to the specific dynasty trusts that owned the policies themselves, a different and more favorable result might have been achieved.

This aspect of the Morrissette II opinion is questionable. Clara's rights under the split-dollar agreements should be valued as of the date of her death based on the price a hypothetical unrelated person would pay for those rights. Instead, the court determined the value of those rights taking into account (a) the specific rights in the split-dollar agreements which the dynasty trusts received from the revocable trust as a result of Clara's death, and (b) the specific rights the dynasty trusts acquired when they entered into the split-dollar agreements. Under that analysis, the split-dollar agreements terminated, and each dynasty trust acquired complete control of the underlying policies which insured the life of the other two Morrissette sons pursuant to the cross-purchase arrangements. A hypothetical unrelated person who purchased the Receivables would not have had the right to terminate the split-dollar arrangements. Moreover, since the court found that one of the insured Morrissette sons was diagnosed with terminal cancer before the estate filed its estate tax return, and a second son died of brain cancer shortly thereafter, it is unlikely that the independent trustees of the dynasty trusts would have agreed to terminate the policies to obtain the cash surrender values.

Third, Section 2703, while devastating in *Cahill*, was surmounted by the taxpayer in Morrissette II principally because of the existence of a clear and substantial nontax business purpose for the agreements. One would, of course, still would have to establish that the terms of the agreement are comparable to similar arrangements entered into by persons in an arms' length transaction, but it seems likely that this will be relatively easy to overcome if there is a substantial nontax business purpose for the agreements.

Fourth, the decedent's arguments in *Cahill* were weakened because the transaction was negotiated between the trustee of the revocable trust (the decedent's son and attorney-in-fact) and his cousin (the trustee of the MB Trust). The transaction would have had far more credibility were the trustees independent and unrelated to each other. Obviously, this increases the cost of the transaction, but it is a small price to pay to give the arrangement a far more bona fide appearance.

Fifth, the use of a third-party loan to pay the life insurance premiums is not inherently inappropriate or disqualifying, but the existence of sufficient personal assets to make these payments was cited favorably by the court in *Morrissette II*. Also, it is likely that the lender required that the decedent in *Cahill* have the right to terminate the agreement, at a minimum with the consent of the trustee of the MB Trust. Also, the existence of the loan raises the presumption that the donor anticipates getting the cash out of the policy not later than when the loan becomes due. Thus, it is better if the premiums are paid from assets already held by the expected decedent, or from money borrowed against assets other than the policy.

Another approach would be to eliminate entirely the right to terminate the agreement that was deemed a power under Section 2036(a)(2) and 2038. In both *Cahill* and *Morrissette*, this power was expressly provided by the split-dollar agreement. A court has reason to be skeptical about any power of the donor to require that the policy be cashed-in, either alone or together with the donee, because the donor no longer owns the policy. The right to cash-in the policy ought to rest with the policy owner. Where a donor borrows to pay the premiums and must use the policy as security for the loan, it is likely that the lender will require that the donor have the ability to reach the cash values. Otherwise, however, such a provision is really not essential to the validity of the split-dollar agreement or the effectiveness of the arrangement. The agreement should provide what happens when the insured dies (that the premiums or cash value are repaid), and it should provide what happens if the policy is cancelled (repayment of the cash value), but it need not provide what happens if the agreement itself is terminated. Generally, contracts presume that they will be implemented, rather than terminated.

The split-dollar agreement could, instead, be silent on termination and assume that the payments by the decedent will be repaid when the insured dies or the policy is cancelled. Moreover, it could grant the right to terminate the policy and the agreement solely to the donee—the irrevocable trust. This seems both reasonable from a business standpoint, because it vests the right to terminate in the policy's actual owner, and prudent from an estate tax standpoint, because it deprives the donor of any power that could be classified as a right to control beneficial enjoyment under Section 2036(a)(2) or a right to alter or amend beneficial enjoyment under Section 2038.

Clients may object because they fear that circumstances may change and they may need to recover cash from the policy. This is not a serious problem, however, because general contract law provides that all of the parties to a contract can agree to terminate it by mutual consent. See, e.g., 29 Williston on Contracts § 73—Elements of Rescission (4th ed.). Thus, the provision in *Cahill* did not really give the donor anything that he did not already have. A right afforded by state law, however, is not a retained right to alter, amend, revoke, or terminate or to control beneficial enjoyment for estate tax purposes. *Helvering v. Helmholz*, 296 U.S. 93 (1935).

In light of the current low applicable federal rates (AFR), one could also consider replacing an economic benefit split-dollar agreement with a simple promissory note, providing for annual payments of interest at the relevant AFR, until the death of the insured, and for repayment of the entire principal at that time. The Tax Court in *Cahill* recognized that Sections 2036 and 2038 did not apply to a simple promissory note and took pains to distinguish a split-dollar agreement from a promissory note. The taxpayer may thus accept this analysis and, instead, lend the irrevocable trust an amount sufficient to pay the premiums on the insurance policies. The parties should also comply with the safe harbor under Reg. § 1.7872-15, by filing the IRS statement for each nonrecourse loan that a reasonable person would expect repayment in full.

Of course, arrangements would have to be made for paying the interest on the loan currently. Such arrangements could involve additional gifts, withdrawals from the policy cash values, or annual deemed gifts of the unpaid interest. The discount for the promissory note is likely to be less than comparable to that for a split-dollar agreement, but it should still be significant because (a) the term of the note is both uncertain (the death of the insured) and far into the future, and (b) the AFR rates are currently substantially below market interest rates. This approach also has the double benefit of simplicity and clarity. It is far less complex to draft than an intergenerational split-dollar agreement, and the parties are far more likely to understand its terms than they are those of an intergenerational split-dollar agreement.

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

Howard Zaritsky

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Estate of Morrissette v. Comm'r, T.C. Memo. 2021-60 (May 13, 2021) (*Morrissette II*); *Amlie v. Comm'r*, T.C. Memo. 2006-76; *Estate of Black v. Comm'r*, 133 T.C. 340, 362-363 (2009); *Estate of Bigelow v. Comm'r*, 503 F.3d 955, 972 (9th Cir. 2007), *aff'g* T.C. Memo. 2005-65; *Estate of Bongard v. Comm'r*, 124 T.C. 95, 113 (2005); *Estate of Cahill v. Comm'r,* T.C. Memo. 2018-84; *Estate of Hurford v. Comm'r*, T.C. Memo. 2008-278; *Estate of Morrissette v. Comm'r,* 146 T.C. 171 (2016) *(Morrissette I)*; *Estate of Powell v. Comm'r*, 148 T.C. No. 18 (2017); *Estate of Reynolds v. Comm'r*, 55 T.C. 172, 194 (1970); *Estate of Stone v. Comm'r*, T.C. Memo. 2003-309; *Estate of Strangi v. Comm'r*, T.C. Memo. 2003-145, *aff'd*, 417 F.3d 468 (5th Cir. 2005); *Estate of Thompson v. Comm'r*, 382 F.3d 367, 382 (3rd Cir. 2004), *aff'g* T.C. Memo. 2002-246; *Helvering v. Helmholz*, 296 U.S. 93 (1935); *Kimbell v. United States*, 371 F.3d 257, 266 (5th Cir. 2004); *Neonatology Assocs., P.A. v. Comm'r*, 115 T.C. 43, 98-99 (2000), *aff'd*, 299 F.3d 221 (3d Cir. 2002); *Estate of True v. Comm'r*, T.C. Memo. 2001-167, aff'd, 390 F.3d 1210 (10th Cir. 2004); Reg. § 1.61-22(c)(1)(ii)(A)(2); Reg. § 1.61-22(d)(1); Reg. § 1.61-22(d)(2); TD 9092, § 5, 2003-2 CB 1055, 1062; Slavutin, Harris & Shenkman, "Intergenerational Split Dollar, Recent

Adverse Decisions in Morrissette and Cahill—Where Do We Go from Here?" LISI Estate Planning Newsletter No. 2651 (July 17, 2018); 29 Williston on Contracts § 73—Elements of Rescission (4th ed.).

Steve Leimberg's Employee Benefits and Retirement Planning Email Newsletter - Archive Message #755

Date: 06-Apr-21
From: Steve Leimberg's Employee Benefits and Retirement Planning Newsletter
Subject: Jim Lange - A Guide to Tax-Savvy Charitable Bequests

"In this newsletter, I want to focus on the smartest solution for donations or inheritances that you leave to a charity after you and your spouse pass. There are several critical ideas to cover, but the most fundamental is: what are the tax implications to each recipient if they inherit your money? By being very selective about who receives which type of money—whether Traditional or Roth IRAs, after-tax brokerage accounts, life insurance, etc.—you can dramatically cut the share that goes to the IRS and increase the amount going to your family."

James Lange provides members with commentary that examines the tax efficiency of charitable bequests. Jim is a CPA, an attorney and a registered investment advisor.[i] He has been quoted 36 times in The Wall Street Journal. He is the author of 8 best-selling books related to IRAs and retirement plans. Members who would like a copy of Jim Lange's newest book, *The IRA & Retirement Plan Owner's Guide to Beating the New Death Tax: 6 Proven Strategies to Protect Your Family from The SECURE Act*, should complete the online order form at https://paytaxeslater.com/getbook, and we will mail you a complimentary hard cover book.

Here is his commentary:

EXECUTIVE SUMMARY:

After reading this newsletter, you are likely to think—that is so obvious. How could I and my estate attorney both have missed this? Don't feel bad. We have reviewed thousands of wills and trusts and in our experience, hardly anyone gets this right. The mistake often costs families tens of thousands of dollars or more.

I'm referring to the decisions that you make when you are crafting your estate plan and are trying to figure out *who gets what*. In this newsletter, I want to focus on the smartest solution for donations or inheritances that you leave to a charity after you and your spouse pass. There are several critical ideas to cover, but the most fundamental is: what are the tax implications to each recipient if they inherit your money? By being very selective about who receives which type of money—whether Traditional or Roth IRAs, after-tax brokerage accounts, life insurance, etc.—you can dramatically cut the share that goes to the IRS and increase the amount going to your family.

COMMENT:

In most cases, Traditional IRAs subject to exception, are going to be fully taxable to your heirs. After the dreaded SECURE Act that effectively killed the stretch IRA, income taxes will be due on your IRA within a maximum of ten years after your death. Inherited Roth IRAs have the advantage of being able to continue to grow for ten more years after your death and then can be withdrawn tax-free. After-tax dollars and life insurance are generally not subject to income taxes. All of these different types of inheritances have different tax implications for your beneficiary…unless your beneficiary is a tax-exempt charity.

First and foremost, a charity that is recognized by the IRS as being tax-exempt does not care in what form they receive an inheritance. They never have to pay taxes on the money they receive. To them, a dollar is a dollar. So, a charity will look at bequests of Traditional IRAs, Roth IRAs, after-tax dollars, or life insurance in the same light. In sharp contrast, your heirs will face substantially different tax implications depending on the type of asset they receive after your death. Please note in this newsletter we are only addressing income taxes, not estate or transfer taxes.

Imagine this scenario. You want to leave $100,000 to charity after you and your spouse die. You have both Traditional IRAs and after-tax dollars. For the sake of simplicity, I am going to say that your child is in the 24% tax bracket. So, *Who Gets What?* In most of the estate documents that we review, we see instructions directing that the charitable bequest come from after-tax funds—usually found in the will or a revocable trust. The problem is that your will (or revocable trust) does not control the disposition of your IRAs or retirement plans. By naming that charity as a beneficiary in your will or trust, you will likely be donating after-tax money to charity. The charity gets $100,000 so the “cost” of the bequest to your heirs is $100,000. Restated, the amount that your children inherit is reduced by $100,000 because you made that bequest to charity.

But what if you decide to leave $100,000 to XYZ charity through your Traditional IRA and/or retirement plan beneficiary designation? It makes no difference for the charity because they get $100,000 tax free. If your heirs receive $100,000 from your IRA, they will have to pay taxes on the money. Assuming that they are in a 24% tax bracket, that would be $24,000—leaving them with $76,000 after the government takes their share. And the tax bite is even worse if your heirs are in a higher tax-bracket or live in a state that taxes Inherited IRAs. So, if you leave your Traditional IRA money to a charity that doesn't pay taxes, you are in effect leaving your beneficiaries an extra $24,000!

This is a simple tweak to your estate plan that can be very beneficial to your heirs. On a smaller bequest, smaller savings. On a bigger bequest, even larger savings. Consider the purchasing power, after taxes, available to your beneficiary if you have $100,000 in a Traditional IRA and $100,000 of after-tax dollars, and we switch who gets what.

Scenario 1

Leave $100,000 to charity through your will or revocable trust and $100,000 to your heirs as the beneficiary of your Traditional IRA.

Impact on the charity: They get $100,000 and pay no tax.

Impact on your heirs: $100,000 IRA money - 24% taxes = $76,000.

Scenario 2

Leave $100,000 to charity through your IRA beneficiary designations and $100,000 to your heirs in your will or revocable trust.

Impact on the charity: They get $100,000 and pay no tax.

Impact on your heirs: $100,000 and pay no federal tax.

This simple switch of *who gets what* saved this family $24,000. The savings would be even greater with a larger bequest or if your beneficiary's tax bracket was higher.

Scenario 3

Let's imagine another scenario. Suppose that your child is well off and, as a parent, you are totally comfortable with reducing his or her inheritance by $100,000. Does that mean you can leave even more money to charity? Yes!

You could leave $131,579 to charity through your IRA or retirement plan beneficiary designation. The same tax implications apply. A $131,579 IRA bequest will only "cost" your child $100,000. ($131,579 times 24% = $31,579). If you left that $131,579 IRA to your children instead of charity, your children would have to pay $31,579 in taxes leaving them $100,000.

By switching *who gets what*, you accomplish one of two things:

1. You save $24,000 in federal taxes for your child, or

2. If you increase your bequest to the charity to $131,579, you still only remove $100,000 from your heir's total inheritance, and you increase the charitable gift by $31,579.

If you are only leaving a minimal amount to charity, it probably isn't worth the time and aggravation to change your documents. If you are leaving a substantial amount to charity, it probably is worth it.

Finally, the application of the concept of *who gets what* can also save families a lot of money in taxes even without any charitable bequest involved. It is likely that not all your beneficiaries are in the same bracket. The different income tax brackets of your beneficiaries may create an opportunity for tax savings by changing *who gets what*. But you will have to wait for my next newsletter to read about that technique.

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

Jim Lange

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Steve Leimberg's Estate Planning
Email Newsletter Archive Message #2889

Date:14-Jun-21

Subject: Joy Matak, Mary E. Vandenack & Martin M. Shenkman - Notes on the 55th Annual Heckerling Institute on Estate Planning

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What remained consistent this year at Heckerling was that same fast-moving delivery of vital information from tax experts that practitioners have come to expect. Much like that iconic and memorable scene from the classic I Love Lucy television series, attendees were Lucy and Ethel trying to gobble up every morsel of information that had been sent down the conveyer belt at a seemingly endless and ever-increasing pace, hoping to learn what we need to know in order to help our clients and our practices now.

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Joy Matak, JD, LLM, Mary E. Vandenack, Esq., and Martin M. Shenkman, Esq. provide members with their meeting notes on the 55th Annual Heckerling Institute on Estate Planning.

Joy Matak, JD, LLM is a Partner at **Sax** and Head of the firm's Trust and Estate Practice. She has more than 20 years of diversified experience as a wealth transfer strategist with an extensive background in recommending

#2858 Date:02-Feb-21 and implementing advantageous tax strategies for multi-generational wealth families, owners of closely-held businesses, and high-net-worth individuals including complex trust and estate planning. Joy provides clients with wealth transfer strategy planning to accomplish estate and business succession goals. She also performs tax compliance including gift tax, estate tax, and income tax returns for trusts and estates as well as consulting services related to generation skipping including transfer tax planning, asset protection, life insurance structuring, and post-mortem planning. Joy presents at numerous events on topics relevant to wealth transfer strategists including engagements for the ABA Real Property, Trust and Estate Law Section; Wealth Management Magazine; the Estate Planning Council of Northern New Jersey; and the Society of Financial Service Professionals. Joy has authored and co-authored articles for the Tax Management Estates, Gifts and Trusts (BNA) Journal; Leimberg Information Services, Inc. (LISI); and Estate Planning Review The CCH Journal, among others, on a variety of topics including wealth transfer strategies, income taxation of trusts and estates, and business succession planning. Joy recently co-authored a book on the new tax reform law.

Mary E. Vandenack is founding and managing member of **Vandenack Weaver LLC** in Omaha, Nebraska. Mary is a highly regarded practitioner in the areas of tax, benefits, trusts and estates, business exit planning, asset protection planning, executive compensation, equity fund development, business and business succession planning, tax dispute resolution, and tax-exempt entities. Mary's practice serves high net worth individuals, businesses and business owners, executives, real estate developers and investors, health care providers, companies in the financial industry, and tax-exempt organizations. Mary is a member of the American Bar Association Real Property Trust and Estate Section where she serves as a member of Council and the Planning Committee. Mary is a member of the American Bar Association Law Practice Division where she currently serves as Vice Chair of Law Practice Magazine and Division Secretary. Mary was named to ABA LTRC 2018 Distinguished Women of Legal Tech, received the James Keane Award for e-lawyering in 2015, and serves on ABA Standing Committee on Information and Technology Systems. Mary is a frequent writer and speaker on tax, benefits, asset protection planning, and estate planning topics as well as on practice management topics including improving the delivery of legal services, technology in the practice of law and process automation.

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Here is their commentary:

EXECUTIVE SUMMARY:

Attending the 55th Annual Heckerling Institute on Estate Planning was an entirely unique experience. For the first time ever, it was virtual so attendees could lounge in the comfort of their own offices or homes instead of a large ballroom surrounded by thousands of estate planning practitioners. Missing were the endless nightly cocktail hours and camaraderie that can only come from meticulously recounting the topics of that had been carefully covered during the day by tax luminaries from all over the country.

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COMMENT:

1 **Income tax pitfalls in estate planning. (Presented by Turney P. Berry, Paul S. Lee, and Melissa J. Willms**

(a) Many lifetime transfers in the form of gifts, sales, exchanges, distributions, contributions, loans, and installment obligations are made with the primary goal of reducing estate tax consequences. The transactions can have a myriad of income tax consequences that are sometimes unintended.

(b) Income tax planning is about reducing, eliminating, or deferring income tax liability of taxpayers. The most common tax situation that eliminates taxable gain is the basis adjustment at death under Section 2014 of the Code. This adjustment has been historically powerful because it is unlimited and not directly tied to whether the estate will pay estate taxes. That is, even for estates not subject to estate tax, the step up in basis has value.

(c) Gifting today.

i. Should you trigger capital gain to avoid carryover basis so that you have stepped up basis before a gift? This concern is being discussed more currently due to proposed changes in the tax laws.

ii. Panelists are reluctant generally to trigger gain early unless there is a contemplated sale in the near future. In some instances, it may make sense to pay capital gains tax today, but generally it is premature/inadvisable.

iii. Review big picture with financial adviser. Perhaps you have losses to trigger to offset gain you recognize. It may be more valuable to keep gains to offset loses.

iv. Issues of what future rates will be.

v. You can elect in (or out) of installment sale treatment.

vi. Section 1259 provides that if there is a constructive sale of a marketable security, the taxpayer will recognize gain effective the date of the constructive sale. This result can be undone using the short sale exception by Jan 30, 2022.

vii. Take a team approach with financial advisors and CPA to determine how best to proceed.

(d) Trust modification and sales.

i. Uniform basis rule in 1001(e). Sec. 1012 or 1014. The concept of uniform basis is that property acquired by gift from a decedent has a single or uniform basis, whether multiple persons receive an interest in the property and whether directly or through a trust, and that the individual interests have a basis that it is a proportional part of the uniform basis .

ii. Initially, basis starts with the basis of the property transfer under sections 1015 (gift) or (1014) testamentary transfer.

iii. Basis is modified for additions and reductions for capital improvements, or depreciation/cost recovery deductions. Nothing else changes that.

iv. The beneficiary of a trust will generally not receive all of the interests in the trust so that the beneficiary's partial interest in the trust property is reflected in the beneficiary's partial interest in the uniform basis of the asset.

v. Historical basis is shared between the "term interest" (life estate), and the "remainder interest". That sharing changes with time. As the person with the life estate gets older, their share of uniform basis gets smaller. It also changes with the changes in the 7520 rate. It also changes with the FMV of the assets.

vi. As the term interest/beneficiary ages/time passes more uniform basis is attributable to the remainder beneficiary.

vii. If trust property is distributed to a beneficiary it carries with it some of the basis, the uniform basis will be reduced.

viii. Example 1: Trust for all descendants. If all descendants die what is left goes to charity. The term interest is the interest for all descendants, it is not generation by generation. So, the term interest is the whole trust. This creates issues when you terminate a trust as almost the whole uniform basis is in the term interest.

ix. Example 2: Example 1 (FMV Equals Basis): Decedent funds a testamentary trust with $1 million of property, the basis of which is determined under section 1014 of the Code. The trust provides for a life estate for the decedent's spouse who is 55 years of age and remainder to their child. At the time of the decedent's death the section 7520 rate is 2.0%. (a) On the date of death, the spouse's life estate is worth $383,650 or 38.365% of the fair market value of the trust property, and the child's remainder interest is worth $616,350 (61.635% of the value). b. Spouse's share of the $1 million of uniform basis is $383,650, and child's share of the uniform basis is $616,350.

x. Example 2 (FMV Increases, Time Passes, and 7520 Rate changes): Same facts as above, except 5 years have passed, and the spouse is 60 years of age. The property in the trust has appreciated to $1.4 million, and the section 7520 rate is 4.0%. a. Spouse's life estate is worth $751,660 or 53.690% of the fair market value of the trust property, and the child's remainder interest is worth $648,340 (46.310% of the value). b. Spouse's share of the $1 million of uniform basis is $536,900, and child's share of the uniform basis is $463,100. Notice, despite the fact that spouse is 5 years older, the combination of a higher section7520 rate and an increase in value causes spouse's share of the uniform basis, which does not change, to significantly increase.

xi. Giving general powers of appointment to cause inclusion on a portion of the basis. This would change the uniform basis and there are special rules in the regulations governing this.

(e) 2019 PLRs on Termination or Early Commutation.

i. When a trust is terminated early with each of the term interest holder and the remainder holder receiving their respective actuarial shares of trust assets it is characterized as a taxable exchange between the term and remainder holders.

ii. PLRs 201932001 through 201932010.

iii. What are income tax consequences? There could be gift and GST tax issues as well. Taxpayer was concerned because it was an income interest that the son would have to pay ordinary income tax on termination. TP asked IRS whether it would be a capital transaction and the IRS held it would be.

iv. Remainderman had a different interest in the trust and when divided up trust it was equivalent to a taxable transaction. It was as if the remainderman who had a right to get assets in the future, they got assets today and were "buying off" someone to do so. And that was a taxable transaction.

v. Rev. Rul 72-243. However, IRS also ruled that because the entire interest wasn't transferred to a third party, the uniform basis was disregarded, and the entire amount realized by the son will be long-term capital gain.

vi. Sec. 1001(e) and Cottage Savings – when you swap things that are materially different it is deemed a sale. Whenever you are terminating a trust you need to make sure you are not having an income tax transaction, i.e. the beneficiaries should not be exchanging different kinds of interests. In most states (e.g. states with UTC) you can amend trusts. Suppose you had a similar situation and issue, and you amend the trust so that the current beneficiary could get principal distributions and the remaindermen could get income. That would make it, in a spray like trust, more difficult for the IRS to assert that there is a swap of different interests. So decant first and change the trust if you can into a discretionary trust. "Muddy the waters" so it is not clear that there are materially different interests that could trigger a taxable sale.

(f) Decanting.

i. Decanting or trust modification may raise tax issues. Is gain triggered? Is it just a movement to a new trust? Is there a gift? Is a change in beneficial interests is a gift under 2501? Depending on how different the terms of the new trust are from the old trust, a decanting may be treated as a taxable exchange of trust interest by and among the beneficiaries.

ii. No ruling list for decanting.

iii. 3 types of situations that come up.

(1) Trust with 3 beneficiaries and each wants different types of investments. You could consider decanting (discretion by trustee) or judicial modification which requires court "blessing".

(2) If you have different assets e.g. a ranch, securities, etc. you could have a deemed sale even if the value is the same as when the different assets end up in each trust are materially different -- it could be a tax problem. If it is treated like a distribution, followed by decanting, tax could be triggered. IRS looks at 1001 and Cottage Savings. If beneficiary is getting something different than what they were entitled to before.

(3) What if you put assets into a partnership first? Partnership anti-abuse rules can apply to estate planning transactions.

iv. Creditor issues should be considered.

v. If passes to a new trust is the beneficiary treated as a grantor under 678?

vi. Notwithstanding the foregoing, trust modifications and decantings should present minimal tax consequences in most instances.

(g) Conversion between grantor and non-grantor trusts.

i. Democrat tax proposals might restrict ability to plan with grantor trusts. We will still have grantor and non-grantor trusts.

ii. Grantor to non-grantor tax status changes. Rev Rule 77 402.

(1) Grantor and spouse are trustees of grantor trust. All income to child, remainder to grandchildren. Purchases interest in real estate FLP using depreciation to create losses that passed out to grantor. Before it "flips" grantor renounced the power. Treated as if grantor transferred assets to non-grantor trust, a new taxpayer, at that point. By turning off grantor trust status it turned off the grantor's liability on partnerships financing, so grantor had those amounts reduced in his liability and that was a taxable transaction under the partnership rules. So the toggling triggered gain.

(2) Crane, Tufts, and *Madorin v. Commissioner*, 84 T.C. 667 (1985). Crane provided that if you have an asset with debt in excess of basis, and if that is relieved, you have a sale or exchange treatment, and the debt is the amount realized.

(3) So the conversion during lifetime from grantor to non-grantor is treated as a deemed transfer by the grantor to a non-grantor trust and if debt is in excess of basis you have gain.

iii. A trust is a fiduciary relationship. What IRS is trying to do with grantor trust rules is identifying when the beneficiaries will be deemed to legally own the assets. If I do a sale to a grantor trust it is taxed to the grantor, and grantor owns all the assets. But if trust ceases to be grantor trust while settlor is alive, it is as if the settlor sold the assets to someone else since they are not deemed to own the assets any longer.

iv. What if grantor trust status terminates on death?

(1) Rev. Rul. 85-13 provides that grantor trust and settlor are the same income taxpayer (for "talking point") purposes.

(2) What if settlor dies with a note outstanding? Is that a sale? Is it a sale the instant after death of the grantor, at the instant of death, or the instant before death? That affects where reporting the income, if any had to be recognized, will occur.

(3) Rev. Rul. 73-183. Decedent transferred asset to the estate on death. TP tried to obtain a loss. Did not give a loss deduction in the Rev. Rul. Because going from grantor to grantor's estate is not a real transfer. Note that Sec. 1014 requires a step-down in basis.

(4) Death is concluded not to be an event to trigger income tax. It is not a taxable event.

a. Comment: A few commentators have suggested that there could be gain realization at death. The panel clearly disagreed with that view and stated that death is not a realization event under current law.

(5) This doesn't have to be the answer but a different result (i.e. that it were taxable) would have consequences beyond only estate planning.

(6) Sec. 1014 and 1015 deal with basis and disposition. If what you have are assets that are included in your estate 1014 will give you a basis change, e.g. assets in a revocable trust, assets over which there is a retained interest. Foreign trust PLRs are murkier. What about assets not pulled back into the estate?

(7) If you have carryover basis you face different issues. We had that in 1977 and 2010. If we again have a carryover basis regime, then debt in excess of basis will again become an issue on death. Panelists have different views. The reason death is not a taxable event is because of the step up in basis. If there is no step up in basis why under 1022 do they say you have carryover basis? They recognize that a transfer at death would trigger gain "but for" the step-up in basis. Suppose you have a transaction with a sale to a grantor trust and there is a note outstanding, and you die with the note outstanding. That is an income tax recognition event. So, if a carryover basis is enacted will gain be triggered?

v. Disregarded LLC.

(1) Debt merges and disappears. Grantor trust and client own LLC so it is a valid legal entity under state law, but it is disregarded for tax purposes.

(2) There was a PLR in late 2020 that has nothing to do with grantor trusts, but addresses a 368 transaction with debt in excess of basis. Question of gain addressed in 20202500014 # created a disregarded entity and said that the debt disappears, and no triggering of gain, and no cancellation of indebtedness.

(3) There is no requirement to report that you are taking this position.

(4) When the grantor dies the structure converts from a disregarded entity into a partnership (the grantor trust becomes a non-grantor trust and there are then two members). There is only one ruling on this point. Is it treated as a transfer of grantor's interest and a step up in basis on that portion (inside basis adjustment)? Rev. Rul. 99-5 does not treat it as a transfer but rather treated as if assets were included in estate and trust and estate simultaneously created a new partnership. So you get a full step in basis and a new partnership where each contributes.

(h) Non-grantor trust converted to grantor trust.

i. CCA 200923024 and PLR 201730018.

ii. Example couple involved with a trust that is a non-grantor trust. Then the couple marries, and the trust becomes grantor trust.

iii. 85-13 supports no negative income tax should result on conversion. But the CCA is different. Shareholders transferred shares to a partnership (that should have ruined S corp. election, but they were going IPO so did not address). Transferred stock to the partnership, seeded a non-grantor trust and sold for annuity. Increase in outside and inside basis (because of a 754 election). Trustee is replaced and toggled trust to grantor trust status. IRS says it has to be a deemed transfer of the partnership and there was debt in excess of basis and 77-402 cited for gain and 1001 Regs, Madorin, etc. But those were grantor to non-grantor trust changes, the opposite situation. So the CCA said no gain to be triggered in this case.

iv. Non-grantor CLAT to grantor CLAT. PLR 2001730018

(i) Partnerships.

i. Debt in excess of basis and transfer

(1) Partner A for 20% LP interests contributes asset A basis 40 FMV 100 subject to 60 of recourse debt. Normally that would trigger 20 of gain (60 debt – 40 basis). But contributions to partnership shall not be considered to be a sale or other disposition. Rather partnership rules kick in.

a. If you exchange property in a non-taxable exchange you get carry over basis so your basis in partnership interests would be 40.

b. You are putting recourse debt into the partnership, and you are only a 20% partner and 80% of the debt is being taken over by other partners so you have a reduction of liabilities of 48 dollars which is in excess of partnership basis and that creates $8 of gain.

(2) Same situation as above but non-recourse debt. You never trigger gain under non-recourse debt allocation rules. Debt in excess of basis is allocated to contributing partner as part of 2nd and 3rd tier allocations. So non-recourse debt is never a problem on contribution to partnership.

ii. Unitary basis rules.

(1) There is a rule based on Rev. Rul. 84-53 that governs how basis will be determined where different interests in the same entity (e.g. GP and LP) are owned by the same taxpayer. Under the so-called "unitary basis rule," the taxpayer will have one capital account and one basis with split holding periods. Why does a split holding period matter? If you sell at a gain, some may be STCG and some may be LTCG.

(2) Liquidating distributions allow you to get gain or loss.

(3) Current distributions can only result in gain and decrease property basis.

(4) Where a grantor and a grantor trust are partners of the same entity, a loss on liquidation or sale of the interest by either owner will be suspended until the earlier of: i. complete disposition of all of the interests by both the grantor and the grantor trust; or ii. conversion of the grantor trust into a nongrantor trust

iii. Transferring basis and capital account.

(1) The rules that determine capital account are different from the rules that determine basis in the ownership interest in the partnership.. If you gift 45% of your interest, then your capital account transfers to the donee. Note that it is always important to note exactly how capital account is being determined as there are different methods.

Under Rev. Rul. 84-53, the basis transferred to the donee would not necessarily be 45% of the donor's basis. Rather, the donee's basis is determined by a fraction, the numerator of which is the FMV of the percentage interest transferred and the denominator is the total FMV of the entire interest owned by the donor prior to the transfer. Where the FMV of the transferred interest is determined using valuation discounts, a disproportionately smaller percentage of the donor's basis will be deemed to have been transferred.

(2) Example: Assume a donor has a partnership interest that has a fair market value of $200 (the value represents a controlling interest in the partnership but reflects some discounts for lack of marketability) and an outside basis of $100. The donor gifts 45% if his or her partnership interest to a donee. Assume further that 45% transfer carries a valuation discount of 30%. As a result the gift tax

value (fair market value) of the transfer is $63 (reflecting a 30% discount on an interest which has a value before the discount of $90). Under the formula of Revenue Ruling 84-53, the transferred interest has a fair market value of $63, and the fair market value of the entire interest is $200, resulting in only 31.5% of the donor's original basis having been transferred ($63/$200). After the transfer, the donee owns 45% of the partnership interest with an outside basis of $31.50, and the donor retains 55% of the partnership interest but has an outside basis of $68.50.

(3) In some cases the partner might have been better off receiving distributions of partnership assets in-kind and selling such assets, rather than selling the partnership interest itself.

iv. Basis shifting. Must wait 7 years to get around mixing bowl rules.

v. 754 election can cause a step down. Once in place it is in place forever so think before making the election.

(j) Post-Mortem.

i. 645 election for revocable trust to be treated as part of estate.

(k) Transmuting community property.

i. Can an agreement allow for transmutation if and only to the extent that the value of the property has appreciated?

ii. Family law questions:

(1) Must define what the assets are.

(2) Who does lawyer represent?

(3) Must be mindful that divorce could be a risk.

iii. 4 states have “opt-in community property law.” If the client resides in another state, can the client invoke community property law treatment by invoking the laws of the “opt-in” jurisdictions?

iv. Move from community property state to non-community property state. What happens? It is still community property as you want the double step up. No idea what happens in the event of divorce in the non-community property state (perhaps treat it like separate property?).

(l) 678 BDOT trusts (Pseudo grantor trusts).

i. Rev Rul 85-13 does it apply to BDOTs and BDITs?

ii. 678(a)(2) if dad puts $5,000 into a trust for son and lapses and son has other rights over the trust that would make the trust a grantor trust IF son had put $5,000 into the trust, that makes the trust pseudo grantor trust then son is owner of the trust for income tax purposes. Use $5,000 since that can lapse for gift tax purposes without creating an issue. Suggestion is to look at 678(a)(1) if beneficiary can withdraw all income including capital gains then the beneficiary is taxed on all that income, and it is taxed as a pseudo grantor trust.

(m) Note sales to BDOTs.

i. If you have a trust and want beneficiary to be taxed on all income you can incorporate into the trust instrument a right for the beneficiary to withdraw all income and gain, and whether or not they withdraw or not, the beneficiary will be taxed on income. If beneficiary can withdraw all income and capital gain so that the beneficiary is deemed the “owner” (BDOT) can you then also invoke 85-13 and sell trust in a non-taxable transaction. We simply don’t know. If you do, you try to parse through the PLRs.

ii. Trust could withdraw all income from another trust and the withdrawing trust was the owner of the second trust but doesn't go so far as to say 85-13 applies so for income shifting BDOTs work great. For sales, it is riskier.

Comment: The panel did not say these transactions do not work, merely that there is more uncertainty, and it is riskier than sales to trusts that are grantor under other means.

2 **<u>Recent Developments 2020-2021. (Presented by Steve R. Akers, Samuel A. Donaldson, Sarah Moore Johnson, and contributions to materials by Steve R. Akers, Turney P. Berry, Samuel A. Donaldson, Charles D. Skip Fox, IV, Jeffrey N. Pennell, Charles A. Clary Redd, Howard M. Zaritsky' and edited by Ronald D. Aucutt).</u>**

(a) SPAC

i. A SPAC is a special purpose acquisitions company created for the purpose of acquiring or merging with an existing company.

ii. Sponsor gets warrants and 20% of target company if successful. Gets outside investors to contribute and then finds target. If closes in 2 years all owners are part of the deal.

iii. Warrants may raise tax issues. What about 2701? 2036 issues? How do you value these interests?

(b) Publication 590-B on Secure Act 10-year rule.

i. Informed that IRS said informally that it was a mistake which will be corrected.

ii. See more detailed discussion below on the SECURE Act.

(c) Federal Legislative developments (CARES Act)

i. The CARES Act waived required minimum distributions (RMDs) from retirement accounts and waived early distributions without 10% penalty for COVID-related needs.

(1) 2 provisions re: HSAs made permanent.

(2) HSA can be used exclusively for payment medical expenses. Before CARES Act, expenditures for certain medicines (nonprescription) were excluded; this has now been modified.

(3) Student loan repayments by employer. Employers can make payments up to $5,000 for tuition or student loans on an income tax free basis.

ii. Consolidated Appropriations Act 12/20.

(1) Extension from CARES Act of charitable contribution above-the-line deduction of $300 for taxpayers who take the standard deduction and do not itemize.

(2) For 2020 only: a taxpayer who takes standard deduction can deduct up to $300 to a public charity (not DAF) as an above-the-line deduction. MFJ taxpayers may deduct up to $600 (not $300).

iii. Corporate Transparency Act

(1) Key is transparency. Suspicion among other countries that US has not been transparent. Requires reporting by corporations, LLCs, and similar entities that are created by filing a document with a Secretary of State. It is unclear from the Act whether general partnerships or trusts would be subject to required reporting rules.

(2) A national registry of beneficial ownership will be created and those with 25% or significant control will have to be reported.

(3) Do you have to report just trustee or all beneficiaries? ACTEC position is that trusts should not be reporting entities, but if they are, then only the trustees should report (not the beneficiaries).

(d) Proposed legislation.

i. For the 99.5% Act.

(1) The concepts are not new. Versions of these proposals have been introduced in every Congressional session since 2010 and many of the ideas are from President Obama's Greenbook.

(2) Important to note that the proposal has already been reduced to statutory wording. This is a big deal because it makes it easier for Congress to enact. By way of recent example, the consistent basis reporting rules (i.e. Form 8971) had already been reduced to writing so it was easily attached to the highway bill and enacted.

(3) Sec. 2. Increases rates. Gifts made over $1M under $3.5M will be taxed at 39.%.

(4) Reduces exemptions.

(5) We have had history of higher rates before: from 1984-2001 we had a 55% rate, and we had a 77% during World War II.

(6) The Sanders proposal: new higher rates would apply after 12/31/21.

(7) Changes – none are retroactive.

a. Comment: This is a big change from what some had feared with a possible retroactive reduction in the exemption amounts. Some had speculated that there was a risk of a retroactive reduction in the exemption and a combination of disclaimers or formula clauses in assignments has been used to address this risk. Although the Sanders bill did not include retroactive changes to the exemption the Van Hollen proposal includes retroactive capital gains tax on transfers post 1/1/21 but it is not clear that the same mechanisms will be viable to deflect an income tax retroactive change.

(8) For the 99.5% Act Sec. 6 would eliminate use of FLPs for valuation discounts. New Sec. 2031(b) would provide for no discounts inside entity for non-business assets. Marketable securities would be valued as if transferred outside the business.

a. Comment: The historic use of FLPs and LLCs holding marketable securities to discount their values would be gone if the For the 99.5% Act were enacted as written. Practitioners should consider those types of planning steps now before a Sanders type bill is enacted but caution is in order because of the retroactive dates in the Van Hollen proposal. Consider using disclaimers or rescission arguments to negate the Van Hollen tax risks which are discussed later.

(9) Discounts will be permitted if the family does not have effective control. Family interests will be aggregated to determine control. The strength of familial relationships will not be taken into account.

(10) GRATs.

a. Minimum term of 10 years so no 2 year rolling or cascading GRATs will be permitted after enactment. This is similar to proposals by the Obama administration.

b. The remainder interest in a GRAT would have to equal greater of $500,000 or 25% of the value of the assets contributed.

(i) Comment: This provision alone will make GRATs unlikely to be used except in unusual circumstances. The “tails the taxpayer wins; heads the taxpayer doesn’t lose” proposition of zeroed out GRATs will be gone. Also, consider this requirement in light of the proposed $1 million gift tax exemption.

(11) Grantor trusts. Sec. 8 of the For the 99.5% Act proposal.

a. New Chapter 16 would have Sec. 2901 which would apply to any portion of trust grantor owns under Subchapter J and any portion of BDIT or BDOT if a sale occurred.

(i) Comment: Clearly the proposal singles out BDITs and BDOTs seeking to negate their use in planning.

b. When a settlor funds a trust the transfer of assets would be treated as taxable gift. The entire value of trust included in grantor's estate, but the grantor would get credit for initial amount of gifts.

c. 2901 would apply to trusts created after enactment.

d. Statute does not seem to apply to sales or exchanges between grantor and trust after enactment.

e. Planning: consummate sales before enactment.

(i) Comment: Some commentators have expressed concern that under the Van Hollen proposal a transfer by a note sale, and perhaps even a swap, might be deemed taxable under the Van Hollen proposal.

(12) For the 99.5% Act Sec. 9 GST inclusion ratio of 1 for any trust with term greater than 50 years (Obama had recommended 90-years). Flips trust to non-exempt trust. Any trust that does not have 50 year or shorter term would not be qualified. Existing trusts could continue 50 years from enactment and then flip to non-GST exempt.

a. Comment: It appears that trusts created post-enactment will have to have a 50-year termination provision or perhaps GST cannot be allocated to them at inception. Also, new planning will have to be considered for all trusts, including existing old GST trusts. Before the 50th year distributions may have to be made to non-GST exempt trusts if permissible. Perhaps trust assets will have to be distributed out to beneficiaries. If so, consider first employing an LLC or FLP wrapper on the assets to provide some control and asset protection. Also, consider the concept of "generation jumping" – distributing assets to the lowest then living generation.

(13) Annual gifts. 2 classes of gifts. Liquid and illiquid. $10,000 inflation adjusted gifts for marketable securities or cash. For gifts that cannot immediately be liquidated such as gifts in trusts or of LLC 2 x annual exclusion gift limited to $10,000 x 2 no matter how many beneficiaries. Crummey letters would no longer be needed.

a. Comment: What about requirement in many trust instruments that the trustee must give notice - how can that be changed? If the trustee is obligated to give the beneficiaries notice of gifts and a right to withdraw that may still have to be done even if it has no relevant gift tax consequence.

(e) Deemed Realization Bill.

i. Likelihood of this getting passed "unlikely."

(1) Comment: One of the speakers clearly believes a retroactive deemed realization bill is "unlikely" to be enacted. While a client might believe that is the case and may therefore be willing to proceed with transfers to avoid the possible

enactment of a Sanders-like bill practitioners might endeavor to document in writing to the client that the risk of a deemed realization bill, like the Van Hollen proposal is not zero and the client must assume that risk of they proceed.

ii. HR 22-82-26.

iii. Van Hollen, along with Booker, Warren, Sanders, and others, issued a statement decrying basis step up loophole and attached to it was a discussion draft of a deemed realization approach. House version would be effective 1/1/22 and Senate 1/1/21.

iv. Sec. 1261 gifts and transfers on death would be deemed triggering events and all gain would be taxed.

(1) Exceptions:

a. Gifts to spouse.

b. Trust for spouse with limits.

c. Charities.

d. Gifts to grantor trusts if include in gross estate - no gain would be realized.

(2) Gift transfers to a grantor trust that are excluded from the donor's estate are taxable. Also on subsequent events on distributions, death, etc. are taxable with an adjustment for the prior tax.

(3) For non-grantor trusts a deemed realization event will be deemed to occur every 21 years in the Senate version and every 30 years in House.

a. Comment: What happens to a QPRT whose only asset is a house? Must the house be sold to pay this tax? Will the home sale exclusion below apply? What if it is insufficient to prevent liquidation?

(4) For a house $1M of gain will be excluded. In the Senate bill only $100,000 would be excluded. The Biden proposal for exclusion from stepped up basis (and perhaps realization) was suggested to be $1M.

(5) Deferral to pay the tax of 7 or 15 years for non-liquid assets.

v. Biden administration released late April the "Made in America" plan – an infrastructure plan.

(1) Revenue raisers include C corporations.

(2) 2017 reduced rates.

(3) Biden proposal is to increase corporate tax rates back to 28%.

(4) But there is no proposed legislation to look at. Is it a flat corporate tax at 28% or some degree of progressivity 21% to 28%?

(5) Minimum tax on C corporations that show profits of huge amounts with no taxable income. Proposal says if a publicly traded C corporation shows net income to shareholders, such corporations should pay 15% minimum tax. It is anticipated that this provision, if enacted, would apply to 45 corporations and would generate $300M per corporation per year.

vi. Last week Biden announced America's family plan.

(1) Proposals for paid family leave, free college, etc.

(2) If making less than $400,000 taxes won't be affected.

(3) Treasury document suggests increasing maximum rate to 39.6% and for those making more than $1M repealing preferential rate on capital gains and dividend income so those would be taxed at 39.6% + 3.8% NIIT or about 43%.

(4) But what is "income"? Is it gross income, taxable income, what?

(5) Child tax credit was increased to $3,000 or $3,600 for this year only. Biden proposed making this permanent and refundable.

(6) Eliminating 1031 like kind exchange non-recognition treatment for gain in excess of $500,000. But is that one exchange or is it total from multiple exchanges? Planning: If clients considering 1031 exchanges do it now.

(7) Eliminate loopholes that let wealthiest Americans to pass down wealth. President Biden's plan will restrict wealth transmission/concentration by ending the step up in tax basis on death after allowances of $1 million per person, and $2.5 million per couple (if include both exemptions and real estate).

a. This may limit step up to $1M per person or $2M per couple.

b. $500,000 MFJ can exclude under Sec. 121 on sale of house. Single TP gets $250,000.

c. Consider that in 2010 could elect out of estate tax and got modified carryover basis with $1.3M of “free” extra basis but could not give any asset basis greater than its FMV. Perhaps we are looking at something like this but $1M not $1.3M.

d. But look at language that suggests gain is taxed if not donated to charity. Does that mean if an asset is not contributed to charity you are taxed on gain?

e. Perhaps the administration is looking at copying language from deemed realization proposals and using it in its proposal.

(8) No stance yet taken by Biden administration on estate and transfer taxes.

a. There is some expectation that we could still see a reduction in the exemptions, but eliminating basis step up will generate much more revenue especially given the modest revenue raised from the transfer tax.

vii. Why do we have basis step up? For administrative convenience.

viii. Lobbyists think realization at death is the intent of the Biden administration specially to raise revenue.

ix. Senate Parliamentarian permitted a 2nd or 3rd budget reconciliation this year. Rule had been only one per year. So there can be one more tax and spend bill by majority vote.

x. “These are really bold proposals…it will be difficult…there will be a lot of negotiation.”

(f) Planning in light of the above proposals.

i. Goal of using window of opportunity we have to use current $11.7M exclusion. With these proposals exemption may be reduced soon.

ii. Anti-claw back regulation makes clear that there is a real incentive to use it.

iii. Clients are reluctant to use large gifts but also now concern about retroactive change in gift exemption amount. Could trigger large, unexpected gift tax. “I can all but assure you that will not happen. To get 50 Dem Senators to vote…”

(1) Comment: At least one panelist was rather certain, as expressed above, that a retroactive reduction on the gift tax exemption, as some had speculated will not happen. That being said, if a disclaimer provision can easily be incorporated into a new trust (note that there are differing views about how this should be done and its effectiveness), or formula clauses can be easily integrated into transfer documents, should practitioners not use these safeguards “just in case?” Perhaps the specter of the Van Hollen retroactive capital gains cost might still suggest these, and other steps be used, but in that event practitioners might caution clients that there is uncertainty as to whether a disclaimer or formula clause will suffice to unwind a transaction for income tax purposes. Some have suggested it may not. Some suggest that a disclaimer, since it has the effect under state law that the transaction never occurred might suffice for negating an income tax transaction. Others suggest that a 2518 disclaimer is a transfer tax provision and may not have income tax impact. Some suggest

that rescission may be viable. See discussion later in this outline about recission.

iv. “We have had retroactive tax legislation in the past, and it would likely be Constitutional under Carlton.”

(1) “There is no best approach [to planning].”

(2) Assignment approach – incorporate into the assignment a formula that reduces the transfer to reflect a retroactive tax change. *Proctor* issue could be a problem. Proctor if you drill down to more than just the condition subsequent. That would not be the case here as this by act of Congress.

(3) Comment: Might *Wandry* avoid implication of *Proctor* for a formula that operates in the event of retroactive application of a new law? In a *Wandry* clause, the transferor fixes the amount of the units as of the date of transfer, which could be determinable based on the laws applicable on the date of the transfer. In this way, legislation that is retroactive to the first of the year that is applicable on the date of the transfer would not be a condition subsequent but rather would just be the mechanism under which the *Wandry* clause should be interpreted.

(4) QTIP’able trust approach. Client would file gift tax return making QTIP election as to excess that triggers gift.

a. Gives donor until October 15, 2022, to decide what to do, by which point, it should be clear how any new legislation might work.

b. Works like a SLAT.

c. Spouse is only beneficiary.

d. Cannot make Clayton election to allow for beneficiaries other than the spouse during the spouse’s lifetime.

e. Income must be distributed to the spouse, limiting the effectiveness of the trust.

f. If QTIP election is made because of a retroactive change in gift exemption, the election must be made on a timely filed gift tax return.

g. Comment: Due to the risks of missing the election (or making one when it is not advantageous to the client), it will be vitally important for the gift tax return preparer to understand the planning and communicate with counsel about whether and when to make the QTIP election.

(5) As a variation of the above, consider using a QTIP but perhaps include a provision in the trust that would allow the spouse to make a disclaimer. The trust instrument should indicate that in the event of a spousal disclaimer, the assets should pass to a trust for descendants. It is not clear that spouse can be a beneficiary of the disclaimer trust for an inter-vivos QTIP transfer.

(6) If the trustee or beneficiary disclaims the transfer to trust, then the trust instrument should provide that whatever is disclaimed will revert back to the donor. This way, the taxpayer portion of the transfer can be undone. The major drawback of this

strategy is that the donor would not be able to retain control over the decision to disclaim even though the donor would have all tax risk. There is some “hair” around trustee or beneficiary doing this.

a. Comment: Some commentators believe you can have the trust designate someone as a primary beneficiary and exercise a disclaimer on behalf of all beneficiaries and the trust. Others have suggested that approach may not work and rather you should have only one beneficiary of the trust and give that sole beneficiary the right to disclaim. The persons suggesting the latter approach can then use a limited power of appointment to add other beneficiaries to the trust or perhaps consider decanting after the disclaimer.

(7) Sale for note and later gift notes.

a. Consider using a Note with monthly payments

b. Trust should make some payments during 2021 before any gift of Note made

c. Sale/gift should not be part of a single plan – avoid implicating the step transaction doctrine

(8) Recission if retroactive tax change. State law may allow for recission, but it is not clear that the IRS will respect for federal tax purposes.

v. What about clients who don’t want to commit to making a gift of large amount now? Possibilities discussed:

(1) Make a gift now and retain income interest to cause estate.

(2) Transfer assets for note.

(3) IRS is looking at amending anti-claw back legislation meaning you would lose benefit of planning for this window of opportunity.

vi. Access to assets given.

(1) Clients are using SLATs for married couples to retain access to assets given away.

a. Comment: With what appears to be a burgeoning use of SLATs, practitioners should exercise caution. Consider warning clients in writing about the risks of the reciprocal trust doctrine, potential effects of the planning in the event of divorce, cautioning them about proper administration of the trusts, adhering to trust formalities, etc.

(2) What if donee (beneficiary) spouse dies first? What can be done to preserve access to the trust by the donor spouse given that the indirect access via distributions to the donee/beneficiary spouse cease?

Consider granting donee spouse a limited power of appointment of SLAT assets to a trust of which donor spouse is a beneficiary. With proper planning, the donor spouse may be able to avoid inclusion under Sections 2036 and 2038, but there could be state law creditor issues. Under the "relation-back doctrine," the donor spouse's creditors may be able to reach SLAT assets appointed to a trust for the benefit of the donor spouse. Knowing state law is important. This would not be a problem in DAPT states and there are a handful of other non-DAPT states which do not subscribe to the relation-back doctrine.

(3) Split gift election with SLATs may be feasible but raises complications and issues.

vii. Marital planning when clients enter into SLAT.

(1) Assets in a SLAT might be separate property after the transfer so how do you address the possibility of a future divorce after the SLATs are created?

(2) What if you draft a separate marital agreement that SLAT assets will be marital property in the event of divorce? That would leave the SLAT assets as the property of the spouse/beneficiary, but because the agreement would characterize those assets as marital, the donor would get more of the other assets.

(3) Consider that, even if SLATs are created for each spouse, they may still have an issue that appreciation between the two SLATs may be different.

(4) Consider whether to add a power to get assets back to the donor spouse

(5) Watch reciprocal trust doctrine so give different powers of appointment.

(6) Use a third party in one trust to appoint assets of that trust, in non-fiduciary capacity, and give the spouse such a power in the second/other trust.

viii. Self-settled trusts. 19 states permit.

(1) Risks exist as only a few PLRs have been issued that permit the use of DAPTs without estate inclusion.

(2) Use Hybrid DAPT for someone wishing this benefit but not wanting the possible risk of a DAPT.

(3) SPAT (special power of appointment trust) – this may provide another option that may be safer than a DAPT. A SPAT is an irrevocable trust (usually designed as a grantor trust) to which a grantor makes a gift for the benefit of beneficiaries

and also grants an individual a special power to direct the trustee to make distributions of trust assets to an individual within a special class of persons or anyone other than the person with the power. This type of trust can be used to give assets back to the grantor at some future point.

ix. Clean up steps to take in the current tax environment.

(1) Use excess GST exemption to allocate to trusts that presently are not GST exempt.

(2) Older promissory notes might be refinanced at lower interest rates. If refinance existing notes, the borrower should give something to the lender to induce them to take a new note at a lower rate: Add collateral, reduce the term, or pay some principal.

(g) In low interest rate environment.

i. Chart that summarizes Sec. 7520 rates since 2020.

ii. Rates are starting to increase.

iii. Some estate planning strategies become less appealing as rates rise:

(1) GRATs.

a. GRATs work best in low interest rate environment. Using short term GRAT could make sense.

b. A 99-year or longer term GRAT can provide interesting benefits. Client won't survive the term. The bet is that the 7520 rate will be higher by the time the settlor dies. The higher rate under the GRAT regulations results in a potentially significant wealth challenge from a "failed" GRAT. The GRAT Regs provide that the amount included in the settlor's estate of the GRAT principal is annuity/7520 rate at date of death. If create GRAT for 60 years with $10M. If zero out must pay an annuity of about $234,000/year. Assume 7520 rate in effect that existed 20 years ago or 6%. $234,000/.06 then $3.9 M is included in the estate. If assets in trust grow at 5% interest rate trust will have $36M in value. The difference, only about 11% of trust assets, are included in gross estate.

Comment: For clients that have used up all of their exemptions doing a 99-year GRAT may be a useful even last-minute planning technique.

(h) Filing deadlines.

i. Can file gift and estate tax returns with digital signatures until 6/30 this year.

(i) 3 administrative developments.

i. 67(e) regulations.

(1) 2017 TCJA added Sec. 67(g) to the Code, which eliminated 2% miscellaneous itemized deductions through the end of 2025.

(2) 67(e) deductions were not eliminated. Fiduciaries can still deduct expenses that are related to the administration of the trust or estate, even if they would have otherwise been deemed to have been a miscellaneous itemized deduction prohibited under the TCJA. The standard for deduction is a "but for" test: the expense would not have been incurred but for the fact that the taxpayer is a trust or estate.

ii. 642(h) provides that, in its last year of administration, an estate or trust may pass out to the beneficiaries any excess expenses for which there is no income to offset. Prior to the new guidance, an existing regulation had indicated that excess deductions were a miscellaneous deduction. As a result, expenses which would be deductible to the trust or estate may not be deductible to an individual beneficiary when passed through as an excess deduction. This created a strange result where the identity of the beneficiary rather than the character of the expense determined the deductibility of an expense. Even the IRS agreed that this was unfair.

A recently issued regulation has addressed this awkward result and will allow an individual taxpayer "look through" to the fiduciary in order to determine whether an expense passed through as an excess deduction is deductible by the individual. This "Look through" rule is more advantageous than the old regulation.

iii. Sec. 101.

(1) No longer have to reduce basis in life insurance policy by insurance cost.

(2) So if you sell a policy you don't have to reduce by cost of insurance element. This will result in lesser gain on a sale.

(3) In 2009, Treasury issued Rulings about how to subtract cost of insurance.

iv. $10,000 SALT limitation from 2018.

(1) Some states tried to restructure state tax as charitable contributions so that taxpayers could take a federal tax deduction, i.e. by recharacterizing state taxes paid as a deductible charitable contribution. Treasury quickly issued guidance indicating that it did not support the characterization of payments to states and localities as charitable contributions and concluded that it would be a prohibited quid pro quo.

(2) Some states have restructured taxing structures so that, instead of imposing tax directly on pass-through owners (i.e. S corporation shareholders, partners in a partnership, and members in an LLC), the states are instead taxing the pass-through entity directly. By way of example, where an S corporation pays the state income tax, this is treated as a reduction of the income flowing through to the individual shareholder, thereby effectively circumventing the $10,000 SALT cap. Treasury wants consistent rules but is generally permitting it.

v. Qualified Opportunity Zones (QOZ).

(1) If capital gains will no longer have preferential rates, many more taxpayers will look at QOZ to avoid/defer capital gains tax.

(2) Regulations issued in 2020 allow taxpayers to defer recognition until last day of 2026. Note that there are certain inclusion events and it’s important to understand the rules before recommending the use of QOZs.

(3) Gifts will generally accelerate the unrealized QOZ gain. However, gifts to grantor trust (or transfers at death) will not accelerate gain.

(j) Priority guidance plan.

i. User fee to get a closing letter is $67.

(k) Actuarial tables.

i. Must be updated every 10 years. Should have come May 1, 2019, and we are 2 years later and still don’t have tables. IRS said it did not have data. National Center for Health Statistics published data in August 2020. LX table showed dramatic increase in life expectancy. By age 84 said 37,800 people would be alive and now, it is more like 44,000.

ii. The impact of the revision when issued will be a smaller deduction for CRT and harder to meet 5% exhaustion test and 10% remainder trust.

(l) General Tax Developments.

(m) Moore Case. Tax Court holds that family limited partnership should be taxed in decedent’s estate at full fair market value.

i. Facts.

(1) 89-year-old TP acquired farmland.

(2) TP was negotiating sale of farm to neighbor and suffers heart attack and heat stroke and had only 6 months to live.

(3) 4 days after discharged from hospital Mr. Moore creates 5 trusts and an FLP.

a. Revocable trust provides that on death part of estate goes to heirs.

b. CLAT.

c. Irrevocable trust for benefit of kids.

d. Irrevocable trust must make distribution back to Mr. Moore's living trust if assets are included in Mr. Moore's gross estate for tax purposes.

e. FLP

(4) Transfer 80% of farm to FLP in exchange for 95% LP interest.

(5) Sells per installment sale 95% FLP interest to the irrevocable trust for a note.

(6) 2 kids are managers of managerial trust.

(7) Mr. Moore negotiated sale of farm for $16.5M.

(8) After the sale was consummated, Mr. Moore continued to live at the farm and work at farm.

(9) Without clearing it with the trustees of the managerial trust, Mr. Moore received distributions from FLP to cover his personal expenses including "loans" to kids. Tax Court had to address whether those loans were gifts.

(10) Mr. Moore then dies.

ii. What is included in Mr. Moore's estate?

(1) TP says: Value of the promissory note from the sale of the 95% of the partnership interests, discounted. Proceeds from sale of farm.

(2) IRS says full FMV of farm is included in his estate.

iii. Does 2036 apply? Mr. Moore continued his involvement with the property. He negotiated the sale of the property, made use of farm after sale, and he used partnership funds to pay personal expenses.

(1) To avoid 2036 inclusion, the TP should not have any retained possession and enjoyment. In Moore, the TP retained both possession and enjoyment of the assets.

(2) There should be a non-tax business purpose for the transaction (there was not one in Moore).

(3) One of the children filed a partition action so the stated goal of “family harmony” was not real.

(4) Creditor protection was not valid as Court found no looming claims.

iv. Powell case.

(1) Both the FMV of the discounted partnership interest and the FMV of the underlying assets are included in the estate. To avoid the possible double counting of assets, invoke Sec. 2043 to subtract the value of partnership interests received at time LP was created.

(2) Use of Sec. 2043 is not an assurance that double counting will be avoided.

v. The irrevocable trust had to make a payment to the living trust if the farm was included in the estate. The estate claimed a 2055 deduction for that payment. Court said no sec. 2055 deduction would be permitted since the expense was not determinable at death. The Court pointed out that there was no way of knowing that at the time of death what the expense would have been.

vi. Planning take-aways.

(1) Moore and Powell cases both were bad fact cases. In the situation where the grantor has not retained control over the LP, the assets should not be included.

(2) IRS is raising Powell in every case where the donor has any rights to participate in any aspect of the partnership. Per John Porter, the IRS appears to be going well beyond the rights to control liquidation and cash flows.

(3) In Moore, the Court's treatment of sec. 2043 "doubling down" on this issue in the case was surprising. Many never expected to see this 2043 issue after Powell.

Comment: Practitioners must now consider the Moore and Powell cases might consider noting to clients the potential risk that appreciation can get counted twice in determining the client's taxable estate.

(n) Nelson.

i. Nelson v. Commissioner, T.C. Memo. 2020-81 (June 19, 2020), notices of appeal to the 5th Cir. filed (Oct. 16, 2020). Tax Court respects a formula gift and sale of limited partnerships based on an appraisal within a limited time, but does not extend it to values as finally determined for tax purposes.

ii. Formed corporation in 1990s that had subsidiaries. Father died and left interests to children, decedent was one of these. She formed FLP and put 27% interest in company in October 2008 into FLP. In December 2008 made gift $2,096,000 of FLP units away (Husband split gifts with her). Transfer was made using defined value clause.

iii. Gift made 12/31. Did not have time to get an appraisal, so they said the value will be as determined by appraisal in 90-days. Following year Jan 2. Sold $20M to the trust which was a SLAT.

iv. Note that this was not the 9:1 ratio typically looked for as seed gift.

v. Sale was done by formula “as determined by appraiser in 120 days.”

vi. Gift and sale constituted almost 65% of the LP. Filed gift tax return. Husband signed to make split gift election.

vii. IRS challenged the large gift that was made. Settlement discussions. TP thought reduction was 65% to about 38% but this settlement fell through and ended up in Court. 12 years later.

viii. Issue 1– defined value clause based on appraisal. Court said the assignment did not say “ based on the value as finally determined for gift tax purposes.” Court tried to uphold it as written. So transfer based on appraised value was upheld but that triggered gift tax.

ix. Issue 2 – multi-tiered discounts were allowed (holding company and LP). The two levels were respected. The corporation had been in existence for decades and may have made a difference.

(1) Astleford case addressed this issue TC Memo 2008-128.

x. Issue 3 - amount of discounts.

(1) In valuing 27% interest in the holding company. IRS and TP appraisers agreed on 30% lack of marketability discount.

(2) On FLP only 5% discount + 28% lack of marketability discount allowed.

(3) Even with all discounting there was $4.5M gift. This was a great result, but TP still appealed.

xi. This is not a rejection of defined value clauses. Appraisers do their work; IRS doesn't find it abusive.

xii. Gift election but no issue raised. Concern that you cannot make split interest gift on a gift to SLAT unless interest is severable and diminimis

(o) Streightoff.

i. Estate of Streightoff v. Commissioner, 954 F.3d 713 (5th Cir. March 31, 2020), aff'g T.C. Memo. 2018-178.

ii. All docs signed same day and daughter signs as GP, trustee of living trust, wearing multiple hats signing in multiple capacities on the assignment documentation.

iii. 89% interest held until death. IRS says discount should be only 18%.

iv. Planning note: 18% discount is IRS opening bid on putting asset into an FLP and nothing more. This is an incredible result for dumping assets into an LP and putting interests into a revocable trust.

v. TP was not satisfied and sued and appealed using the argument that the revocable trust was not a limited partner of the LP but a mere assignee and that under Texas state law a mere assignee has less rights than an LP e.g. to accountings and to participate in extraordinary actions. This argument was not rejected.

vi. But the Court noted that daughter signed in multiple capacities and GP approved of assignment and thereby admitted trust to the partnership.

vii. 5^{th} Cir. Did not see a difference between LP and assignee, or that an LP did anything a mere assignee could do. Interestingly, the court did not reject the argument about a mere assignee so a future TP may be able to advance this position.

viii. Given the ability to terminate the partnership and liquidate the assets, which were mostly marketable securities, an 18% discount could be considered generous.

(p) 2703 PLRs.

i. Letter Rulings 202014006-010 (issued Oct. 16, 2019; released April 3, 2020); 202015004-013 (issued Oct. 16, 2019; released April 10, 2020); 202017001-006 & 011-014 (issued Oct. 16, 2019; released April 24, 2020).

ii. Agreements entered into after October 8, 1990 or modified after that date, be careful to risk of you are flunking the substantial modification test.

(q) QTIP.

i. Letter Rulings 202016002-006 (issued Oct. 30, 2019; released April 17, 2020).

ii. Surviving spouse got large principal distribution out of QTIP and relinquished income interest. They had calculated actuarial value of income interest and what was in the trust passed to a charitable trust.

iii. When spouse commuted and was paid for her income interest in the QTIP, that triggered 2519. Spouse was deemed to have made a gift of the remaining value in the trust. Remaining value in the trust was a 2519 transfer but since it went to a charity it qualified for the gift tax charitable deduction.

iv. Case made no mention 201932001 of commutation that is treated as if remainderman purchased interest and triggered large capital gains under the unitary basis rules. This was not mentioned in this ruling.

(1) Comment: Consider 2519 as affirmative planning now to use exemption and move a QTIP outside the surviving spouse's estate. Caution is in

order, however. Under the Van Hollen proposal this might trigger income tax on the transfer.

(r) Discounts.

i. Warne v. Commissioner, T.C. Memo. 2021-17 (Feb. 18, 2021).

ii. Decedent died owning 5 LLC s owning real estate with 72% to 100% of each. The estate argued for a 5-8% discount. A lack of control discount on a controlling interest. So they got 4% lack of control discount on a controlling interest.

iii. The Court said: "…given the control retained by the Family Trust, the discount should be slight."

(s) Gift tax.

i. Estate of Bolles v. Commissioner, T.C. Memo. 2020-71 (June 1, 2020).

ii. What is a loan and how can it be distinguished from a gift?

iii. Decided by Tax Court in 2020.

iv. $1,063,000 transferred by mom to son Peter as loans.

v. Estate tax return included Peter's note at value of zero. IRS said include at full face value plus interest. In the alternative IRS argued transfers were gifts not loans.

vi. Miller case looked at factors.

(1) Promissory note.

(2) Maturity date.

(3) Demand for repayment or actual repayment.

(4) Interest.

(5) Transferee had ability to repay.

(6) Reported for income tax purposes as loan.

(7) Actual expectation of repayment and intent to repay are critical.

(8) Some elements met but no formal note and no enforcement of repayment.

vii. Tax Court took hybrid approach in Bolles in that initial the transfers were initially loans. By 1989 mother new son was in trouble and removed him as beneficiary so after that transfers were gifts. Estate lost some loan arguments but had the IRS prevailed 20 years of accrued interest would have added to the estate.

(1) Planning note: If loans are not repaid don't argue uncollectible.

(t) Decanting.

i. Use to extend protections of trust for life of beneficiary.

ii. 2017 Powell-Ferri case suggested possible obligation of trustee to extend.

iii. Watch out for grandfathered GST trusts.

iv. PLRs. Letter Rulings 202011001-005 (issued Oct. 7, 2019; released March 13, 2020); 202013001-005 (issued Oct. 7, 2019; released March 27, 2020).

(u) INGs.

i. An ING refers to an intentionally defective non-grantor trust.

ii. Purpose is state income tax savings. Makes transfers and wants to avoid state income tax. For example, a California resident considering sale of a C corporation that engages in business internationally might want to avoid California income tax.

iii. To qualify as non-grantor trust.

iv. Avoid gift by having adverse parties on distribution committee. These are “fine needles” to thread through.

v. Letter Rulings 202006002-006 (issued Sept. 18, 2019; released Feb. 7, 2020); 202007010 (issued Sept. 18, 2019; released Feb. 14, 2020); 202014001-005 (issued Aug. 26, 2019; released April 3, 2020); 202017018 (issued Nov. 29, 2019; released April 24, 2020).

Comment: PLR 201410002: IRS indicated that INGs will not be treated as grantor-type trusts with respect to the Settlor or any member of the Distribution Committee and that funding an ING will not constitute completed gifts for gift/estate tax purposes.

Update 2021: IRS has included INGs in its annual no-rule list, indicating that it will not issue letter rulings until it reaches some resolution on outstanding concerns through future guidance, possibly sending a signal that INGs could be challenged at the federal level before long.

(v) PLR 202022002 - Ruling 678 trust.

i. Trust could withdraw all assets of trust but could not withdraw stock of closely held company.

ii. Trust 2 was a grantor trust as to that beneficiary. Beneficiary had created this under regular grantor trust rules.

iii. Trust 1 sold stock to Trust 2 and as sale happened Beneficiary could withdraw all proceeds.

iv. No problem saying withdrawal right made it a 678 trust. The Court said: “…the transfer of the LLC interests to Trust 2 is not recognized as a sale for federal income tax purposes because Trust 2 and Sub trust are both wholly owned by A.”

v. Rev. Rule 85-13

(w) State estate tax chart.

i. QTIP trust taxed. Move South to state with no estate tax on QTIP.

ii. Northern states cast wide net on taxing QTIP included in surviving spouse’s taxable estate even if created on death of grantor spouse at death in another state. Supreme Court has not granted Cert.

iii. 2056(b)(7) deferral of tax in exchange for included in survivor’s estate. States are taking a different approach of saying if it is included in federal it is taxable.

iv. In re Estate of Bracken, 290 P.3d 99 (Wash. 2012).

v. Was there a property right to give rise to tax?

vi. Estate of Brooks v. Commissioner of Revenue Services, 159 A.3d 1149 (Conn. 2017) court found sufficient nexus to tax QTIP. Transfers could be subject to state estate tax that were not subject to federal tax.

vii. Estate of Evans v. Department of Revenue, 2020 WL 2764495 (Ore. Tax Ct.).

viii. Room for constitutional challenge remains.

(x) State cases involving fiduciary matters.

i. Trust Protectors.

(1) Ron v. Ron (S.D. Tx. Civil Action No. 3:19-CV-00211, 2020), aff’d, 836 Fed. Appx. 192 (5th Cir. 2020),

(2) Divorce case. Protector added ex-Husband as beneficiary which outraged ex-wife settlor.

(3) Fiduciary duty is not owed to settlor.

ii. Planning point: Speaker recommends using protectors in light of all the legislative uncertainty. Could give structural powers: determine situs, governing law, governance issues, etc.

iii. Should trust protector be a fiduciary or not? Is the protector a fiduciary? Some state statutes address this. Many provide that protector is a fiduciary unless the trust instrument provides otherwise. SD and AK say the protector is not a fiduciary unless instrument says otherwise.

(1) Planning note: Be explicit in the instrument as to the protector's status.

iv. Best practices is if trust protector can direct the trustee as to a decision then the protector should be acting in a fiduciary role. If you make the protector a fiduciary you have placed a higher standard on the protector. You might be able to cover this with an exculpatory clause. And it may make it more difficult to get someone to serve.

v. If state holds protector to fiduciary standard it could be an issue for the protector to add a beneficiary.

(y) Disinheritance.

i. Procedural obstacles to disinheritance.

ii. Signed document revoking will purporting to revoke all wills and estate would pass ½ to husband and ½ to son. Court held 2002 will was not revoked by subsequent writing. Can only revoke a will by preforming a revocatory act by destroying will to revoke or by signing a new will. So singing the separate document did not suffice.

(z) Revocable trust.

i. Barefoot v. Jennings, 456 P.3d 447 (Cal. 2020),

ii. Disinherited beneficiary can challenge trust.

iii. Planning note: do a new trust so the disinherited former beneficiary is not named in the current document. Just name original date of trust and not list each trust. Don’t number each restatement.

(1) Comment: Also solves title issue. If each successive revocable trust is amended and restated then bank and brokage accounts in the name of the trust will have to be updated to reflect the amendment. If the name of the trust intentionally stays the same the need to retitle may be avoided.

(aa) Hodges. Court ruled decanting violated rule of impartiality.

i. Hodges v. Johnson, 177 A.3d. 86 (N.H. 2017).

ii. Decanting to cut out beneficiary. Through decanting, the Trustees eliminated certain of the grantor’s descendants in the new trust instrument.

iii. Removed trustees should not have expenses reimbursed as it was a serious breach of trust.

(bb) Future interest.

i. Roth v. Jelley, 259 Cal. Rptr. 3d 9. Court ruled that future interest is not terminated by agreement.

ii. If you have a settlement or trust modification you only bind the parties that are parties to the action.

iii. Assets went to widow and if not to children and if not to grandchildren. Children disclaimed interests. Assigned away by disclaimer. Remainderman were not bound as they were not noticed. To cut off a person they must be a party to the agreement.

iv. Virtual representation applies. Virtual representation requires no conflict.

(cc) Discretionary distributions.

i. Do you need to consider other resources of beneficiary? Conflicting cases.

ii. Potter.

(1) Section 50 comment e to Restatement of Trusts.

(2) General approach is to consider other resources.

(3) Reporter's notes observe that it is contrary to prior restatement 2nd of Trusts which said generally do not consider other resources.

(4) Potter relying on Restatement 3rd even though trust created prior.

iii. Trustee is not required to consider other resources.

iv. Planning point:

(1) Be explicit because of divergence of case law.

(2) Do not put too much weight on words used. "Necessary" or "appropriate" hard to determine settlor intent from this.

(3) Flexibility is important to give to trustee. Say "Trustee may but need not…" that is helpful.

(dd) Public Policy.

i. Public policy limitations to how far you can go with terms of trusts.

ii. Trust said bequest made outright if beneficiary married but if married then the bequest will be in trust. Many clients want this. Court viewed this as an encouragement of beneficiary to divorce and Court refused to uphold this on public policy grounds.

(ee) Testamentary formalities.

i. Was their compliance with will formalities because of wills done at last minute and perhaps by people without understanding of what will formalities are.

ii. 3 cases show contrasting approaches that different states use.

iii. CA Estate of Mitchell.

(1) Unsigned document. But if testator has handwritten name that can constitute a signature as that is evidence of present intent to authenticate a will.

iv. LA.

(1) Succession of Bruce. Will was properly witnessed but witness affidavit neglected to include that witnesses saw that the testator sign at end. LA law requires saying saw sign at end and testator did sign at end. LA court held will invalid since the language saying witnesses saw signing at end of will. Will invalid.

(2) LA in Carter have to sign each page. Is initialing the same as signing. LA said no.

v. NY.

(1) Ryan case in NY. Involved will signed during quarantine. Looked valid under executive order. But procedures court held satisfied general statutory requirements. It was remote execution.

(2) NY Said satisfied general statute and did not need to rely on remote execution emergency statute. Thus, will was held valid.

(ff) No contest provisions.

i. Mass unpublished opinion - Capobianco. Court upheld a no contest clause. Beneficiary asked for removal of trustee and appointment of himself as successor trustee, and asked for an accounting. But since asked for himself to be inserted as trustee which was a violation of the no-contest clause. This is a testament to the power of a no contest clause.

ii. Hunter v. Hunter discusses how to procedurally bring a suit without violating the no contest clause. In first count asked if he could ask for accounting and in count 2 if that doesn't violate the "no contest" provision then he wanted to get an accounting and reporting. "Equity abhors forfeitures." The court approved the strategy and found that asking for information and reporting was not a violation.

iii. MO has a statute that permits a test lawsuit 2014 over no contest clause. You can file to determine if it would violate no contest clause.

(gg) Cohabitation.

i. Confirm what state cohabitation began in.

ii. You may have a common law married client even if your state does not recognize common law marriage.

iii. IRS will allow marital deduction if state law recognizes the relationship.

iv. Common law marriage can lead to litigation. See recent example in Nebraska, Seivert v. Alli where court determined that original marriage date didn't apply due to lack of evidence of marriage regardless of living together and having children.

v. Factors indicating marital intent:

(1) Joint estate planning.

(2) Joint tax returns.

vi. Planning point: get an affidavit of the parties that expresses their intentions for how their relationship should be treated as a matter of state law.

(hh) Descendants definition.

i. DNA test kits have created issues.

ii. Utah case In re Estate of Heater, 466 P.3d 728 (Utah Ct. App. 2020), cert. granted.

(1) Sent $100 for each birthday.

(2) 8th year of estate probate still open.

(3) Son reached out via social media and had DNA test and found he was beneficiary of the estate. But Utah code has different conflicting definitions of descendants. Under probate code son of one and under parenting statute he was the son of another. Could he be the son of both people? Parentage act is subordinate to probate code which provides that biology prevails.

(4) Intestacy laws are to honor probably intent of decedent.

iii. Uniform probate code has not caught up to issues of DNA test kits. Status of child out of wedlock can be proven through DNA testing which can only be rebutted by clear evidence.

iv. Sperm and egg donors contracts terminate all parental rights. In early phases of ARC there were not always contracts.

v. Parent should acknowledge and not refuse support for out of wedlock child to inherit.

vi. Dibbling – siblings from same sperm donor.

vii. For 2008 and later UPC modern versions recognize ARC (assisted reproductive technology), so exclude dibbling and genetic donors. Dropped abandonment language of older statutes. Urgent need to make sure definitions in wills have intentional language to include desired persons and exclude those not desired. If want out of wedlock child to inherit, they should have ancestor openly acknowledge relationship.

viii. Rogers case mother reconnected with son. Son even lived with her for a few months. Mom stated she had no children and son asserted his rights and won. But son had been adopted by someone else. Shouldn't that have severed right of son to inherit? 5 states permit an adopted-out child to still inherit.

ix. Adoption of adult stepchild Alabama. Involved Dupont family. Was stepchild adapted as heir to be included as a beneficiary of the trust? State law in 1971 did not recognize adult adoptions.

x. Planning point: consider drafting instruments that would recognize adoption until age 21 so that stepparents will not need the permission of the child's natural parent to adopt. Such a provision could prevent anyone else from adopting the child up to age 18 at which point the child is an adult and can permit a person other than the natural parent to adopt.

xi. There are many cases involving questions of status that are decided differently. Anticipate the possible controversies.

3 <u>**CRT Stretch IRA. (presented by Christopher R. Hoyt)**</u>

(a) "Stretch IRA" means an inherited IRA where payments are made gradually over beneficiary's life expectancy. Beginning in 2020, the general rule became a ten-year liquidation and the ability to stretch was impacted. Can a CRT get a lifetime payout comparable to stretch?

(b) Retirement Plans to which the rules apply – Section 401(a), Section 408, Section 403(b), Section 457 (b). There are some differences in how certain rules apply based on type of retirement vehicle.

(c) Secure Act changes.

i. QCD can make gifts and exclude from income from age 70.5

ii. New RMD age is 72 for people who attain age 70 ½ after 2019.

iii. New life expectancy tables starting in 2022. Distributions for RMDs may fall .33 to .5% under the new tables.

iv. Someone in their 80s take out 5-9% under RMD rules.

(d) End of inheritance stretch IRA.

i. With retirement plans distributions are income in respect of a decedent ("IRD") under 691 and no step up in basis on death. So distributions from inherited account are included in the decedent's estate and treated as ordinary income upon distribution.

ii. Usual objective is to defer distributions to defer taxes and to also avoid pushing up graduated income tax brackets.

iii. Compare rules of present, past, and future.

(e) EDBs (Eligible Designated Beneficiary)

i. Spouse.

(1) Can Rollover IRA and make it his/her own. See below.

(2) Generally rollover is best from a tax perspective (but obviously the outcome may not be desirable in the event of a second or third marriage)

(3) Exception to rollover being the best strategy is when surviving spouse under 59.5 if take distribution from decedent's account have income but if move to their own IRA have taxable income and surtax, so it may make sense to leave some

part of the IRA in the deceased spouse's account for distribution purposes.

(4) Another exception is where there is a big age disparity. If 68-year-old spouse dies and 74-year-old survives, the older surviving spouse is required to take distributions. If assets are left in the deceased spouse's account and the surviving spouse is the sole beneficiary, the surviving spouse can defer until deceased spouse would have attained age 72. This allows for greater deferral of distributions from the deceased spouse's account.

(5) Surviving spouse can recompute life expectancy annually for an inherited IRA, thereby gaining an additional stretch.

ii. Minor child of decedent. Not just a minor child but must have been the decedent's minor child dependent.

(1) Can take out over life expectancy until such beneficiary reaches the age of majority, at which point, the 10-year clock starts.

(2) Majority is age 18 to 26, depending on how you read the rules.

iii. Disabled individual.

iv. Chronically ill individual.

(1) This is a harsh standard. Cannot be employed in any way.

v. Person not more than 10 years younger.

(1) Childless person names siblings not more than 10 years younger.

(2) The named beneficiary can take out over life expectancy.

(f) Distributions.

i. All funds generally paid out end of 10th year following death or remaining life expectancy of an eligible designated beneficiary

(g) Ghost life expectancy.

i. Life expectancy table and count 1/14, 1/13, 1/12 each year. This is when death occurs after required beginning date and beneficiary is a non-designated beneficiary (estate, charity, non-qualifying trust).

(h) RBD. (Required beginning date for required minimum distributions)

i. April 1 of year after you attain age 72.

ii. Must start taking distributions out of retirement account (roughly 4%).

iii. 3-month grace period.

iv. If you have not taken money out by 4/1 in year after age 72 there is a 50% penalty.

(i) Designated Beneficiaries ("DB").

i. DBs are generally a human being.

ii. To the extent either a charity or estate is named as a beneficiary, these beneficiaries will not be considered DBs.

iii. Where there is a beneficiary which is not a DB (i.e. charity or the estate) on a qualified plan, the required payout for the plan will be 5 years not 10 years.

(j) Determination Date.

i. Example: client names her 3 kids and charity = 4 as named beneficiaries.

ii. September 30 year after death is the Determination Date.

iii. The determination Date gives you time to get rid of "problem" beneficiaries (a beneficiary who does not qualify as a DB) which will change the required payout of the plan.

iv. On September 30 after death the best result from a stretch perspective is where all beneficiaries are human beings = DBs.

v. If name charity for any % of IRA, and if it remains a beneficiary on 9/30 after death it is a problem.

(1) Old law –

a. if died before RBD had to liquidate in 5 years.

b. If died after RBD used life expectancy. Ghost life expectancy.

c. Roth IRA – no ghost life expectancy liquidation is 5 years if any beneficiary is not a DB. (Should not name charity as beneficiary of Roth use taxable account).

(2) Subparagraph "h" special rules.

a. Changed generally 5 years to 10 years except in case of beneficiary is not a DB.

b. A charity is not a DB so old law still applies if on 9/1 year following death you have a beneficiary who is not a human being.

(3) Between date of death and 9/1 is to get rid of problem beneficiaries.

a. Have problem beneficiary disclaim.

b. Cash out charity by giving them their payout.

c. Divide the IRA into separate accounts and have charity in separate account so that won't taint DBs = children from getting 10-year payout.

(k) Planning.

i. What if grandchildren are named as beneficiaries?

(1) Tax bracket management.

(2) If name children and grandchildren as beneficiaries you can spread money over more tax returns and perhaps at lower brackets.

(3) Watch GST.

ii. Consider lifetime Roth conversions if you think current rates are lower than future tax rates.

(1) This will be the case if leaving to trust and trust is in high compressed tax rates.

(2) MFS is higher bracket

iii. EDBs take care of them.

iv. Use pretax dollars for charitable purposes. If estate is subject to estate tax, the estate beneficiaries will incur both income and estate taxes on the inheritance of the IRA, so a gift of the IRA to a charity will cost little. CRTs also may be considered.

(1) CRT.

a. IRA to CRT.

b. Pay income stream to charity. Make payments to income beneficiary for life or term of years but not more than 20 years. On CRT termination remainder goes to charity.

c. Key is CRT is exempt from tax so can receive IRA and not pay tax.

d. Have CRT for spouse. $1M to CRT pays 5% to spouse for life and on spouse's death pay to children.

e. By naming both a spouse (income beneficiary) and a charity (remainder beneficiary) as the beneficiary of the IRA, the estate will get a full deduction (some marital and some charitable).

f. Do not name CLT as CLTs are not exempt and tax will be assessed.

g. 2 generation charitable remainder unitrust. Typically pays 5% to an elderly surviving spouse for life, then 5% to children for life, then liquidates to charity.

h. PLR 199901023. When money goes to CRT, there will be no taxable income until distributions are made from the CRT to non-charitable CRT beneficiaries. The concept is to move IRD after death from one tax exempt trust to another tax-exempt trust (IRA to CRT)

i. Can you take extra income from CRT, and will it produce enough wealth to make up for assets that pass to charity at end of term? Premature death might make this not work; consider using life insurance to address risk of premature death.

j. In most cases, the CRT will not replace wealth if IRA is left outright to family. A CRT is best for someone with a charitable objective. Long-term CRUT is more likely to replace wealth but still not all that likely.

k. Choosing trustee and charity.

(i) Use a corporate trustee competent to administer CRT.

(ii) Choose a charity that will be around.

(iii) Choose correct type of CRT.

1. CRAT – pays fixed dollar amount, at least 5%, not more than 50% for life, or term not more than 20 years.

2. CRUT – pays a fixed percentage of at least 5%/year. CRUT deals better with inflation then does a CRAT.

3. NIMCRUT – if invests in LLC or LP may be able to accumulate wealth by deferring payout.

(iv) How long?

1. Life or term of years (but not more than 20).

2. Most people prefer life. But buy life insurance to assure heirs get something.

l. Hurdles.

(i) Uni- trust.

1. By statute minimum annual payout is 5%.

(ii) Minimum 10% present value remainder to charity.

1. Value of remainder must be 10% of FMV of property placed in trust.

2. If less, you have a taxable trust not a CRT.

3. How could it be less than 10%?

(a) High payout rate.

(b) Projected term of trust is too long.

(c) Limits term of CRUT to 55 years.

(d) If you want to get $100 in 55 years how much would you have to invest today? $10. If you want to get $100 in 70 years how much do you have to invest today? Say $6. Concept limits projected term of charitable trust.

(e) In 2021 test met only if beneficiary at least 28. If 2 beneficiaries and both same age each had to be at least 39 years old because the combined life expectancy of two people is more than any one person.

(f) Strategy – create separate CRTs.

4. Maximum life of term CRT is 20. You already have 10 years when you liquidate an IRA. It may not be beneficial to do a CRAT.

5. What about a Unitrust? What if you pay out a unitrust and payout highest permissible rate? In 2021 highest payout is 10.9% but CRT may decline in value each year.

6. Sweet spot is 5% CRT that will last 30+ years.

m. Another Hurdle – 4 tier system for CRTs.

(i) What if federal estate tax is paid?

(ii) Traditional trust has different distribution rules.

(iii) CRT has WIFO system – worst income in is first income paid out.

1. Ordinary income.

2. Capital gains.

3. Tax exempt income.

4. Corpus.

(iv) When make distributions from CRT must distribute all ordinary income CRT ever had before can distribute capital gain.

(l) Federal estate taxable estate.

i. It's a pure income tax strategy.

ii. Beneficiary who inherits IRA gets income tax deduction for federal estate tax paid. Itemized deduction on Schedule A.

iii. Beneficiary has reduced taxable income.

iv. If you have an estate with federal estate tax avoid CRT. Leave remainder to beneficiaries so they will get income tax deduction.

(m) CRT is subject to private foundation self-dealing rules.

i. Family member should not buy asset from CRT.

(n) Should not have more than one donor to CRT.

(o) Was the CRT administered in accordance with its terms?

i. Don’t name a family member you need a skilled family member to be trustee.

ii. CRT was never a valid CRT if missed requirements that makes it a taxable trust with a bad outcome.

(p) DAF.

i. Lifetime bequests cannot be given but testamentary bequests can.

4 **<u>Retroactive Revisions and Reversals. (presented by Carol A. Harrington)</u>**

(a) Introduction.

i. What actions can be addressed when a client wants to change or revoke documents that are on their face not revocable or amendable?

(1) Revoke deed.

(2) Eliminate gift.

(3) Tax Returns and Tax Elections

(4) Etc.

ii. Why.

(1) Mistake by advisor or client.

(2) Change in circumstances.

(3) Bad decision.

a. Market changed.

b. Tax law changed.

c. Donor’s circumstances of changed.

(4) Did not understand effects of action.

(5) Error by adviser.

(6) Trustee made incorrect distribution.

(7) Trustee made improper purchase of assets.

(8) Tax elections may need to be fixed retroactively.

a. Some cannot be made late.

b. Some can be made late.

c. Some might have a different result if made late.

d. Failed to qualify for exemption or deduction, e.g. marital deduction.

(9) Wrong tax advice.

a. Did not know how much exemption remained.

(10) Wrongful conduct.

a. Money damages might not suffice so want to reverse the transaction, e.g. an inappropriate gift, sale by incompetent, etc.

b. Fraud misrepresentation or theft.

(b) Considerations.

i. Third party agreements can be changed by agreement but generally only prospectively.

(1) Cooperating parties can do what they want.

(2) If they are related parties may have tax consequences.

ii. Retroactive correction may have important tax results if they will hold up.

iii. Decanting is different as it cannot be retroactive.

iv. Reformation, but it is generally prospective.

(c) Property law is the lynchpin that determines parties rights and remedies, and federal tax law generally follows underlying property law.

i. 1967 Estate of Bosch.

(1) IRS only has to give regard to highest state court.

ii. Remedies vary based on case law and each state law is different.

(d) Remedies or grounds.

i. Damages only compensation for loss but they don’t undo.

ii. We are speaking of equitable remedies.

iii. Rescission – reverses an agreement or other action

(1) This can be an agreement. Could have an agreement to purchase real estate but have provision that if the zoning change doesn’t go through parties agree sale will be rescinded. That may or may not have a tax effect.

(2) Rescission is used for undoing other kinds of actions. You can unilaterally rescind if there is a misrepresentation or fraud.

(3) Can apply to specific property.

(4) Generally will require restitution.

(5) Defenses are different.

(6) If a tort involved recission will often give property back to original party who was not the wrong doer.

iv. Reformation – essentially revision of document to confirm true intentions

(1) With retroactive effect to carry out parties wishes.

(2) Mutual mistake or unilateral mistake are basis.

(3) Law of mistake was narrow by law historically.

a. Had to be a mutual mistake of fact, etc. That has been modified.

b. In case law see vestiges of this old history.

c. Requires proof by clear and convincing legal evidence which is a high bar. So get contemporaneous information.

(4) Changed circumstances.

a. If I had known when document done I would have done it differently. This does not generally support retroactive reformation.

(5) Mistake.

a. Gifts.

(i) Unilateral mistake is an option. Because mistakes are most often unilateral, cases have been more favorable to the donor.

(ii) Difficult to prove by clear and convincing evidence.

(iii) Mistake has to be done at the time action occurred.

(6) Simches. The court ruled that “A mistake by the settlor concerning the federal estate and gift tax consequences of a provision of the trust justifies reformation.”

a. MA Court reformed a QPRT that was to go to grandchildren. They did not understand the federal tax consequences of having QPRT terminate and go to grandchildren.

b. They would not have named the children had they understood the consequences.

c. MA allowed reformation and since Supreme Court under Bosch it should bind IRS and it was reformed by QPRT terminated.

d. There might be gift tax consequences if grandchildren allowed this to happen.

(7) Suckanick. A NY appellate court reformed a revocable trust to allow a better income tax division of decedent’s assets.

a. IRA went to charity instead of to surviving spouse.

b. Wife then got property that would have otherwise gone to charity.

c. Found no drafting error but Appellate reversed that they would not have wanted those tax results if they had been properly advised.

(8) If factual circumstances changed from signing will to death with a wildly different result than what was intended, would a court consider reformation?

a. Depends on state and judge.

b. There is some case law that supports such changes, but the difficulty is to prove intent.

(9) Trust distribution errors.

a. If over distribute and can get money back you might instead just take it out of a future distribution and can make adjustment net of tax effects. But not clear this is the right income tax result but it is commonly done.

b. State law would allow trustee to recover amounts recovered.

(10) Sales.

a. Constructive trust is possible remedy

b. First National Bank of Chicago.

(i) Supposed to be 3 trustees but only 2 acting and agreed to sell closely held stock. 2 out of 3 can outvote but if document requires 3 trustee must have 3 trustees even if can vote against him.

(ii) 1981 case beneficiaries challenged sale on this basis and won and purchaser had to return stock to trust.

c. Shell purchased property but under terms of trust it is not so clear that they should have known but they may have been on notice that there was an issue. Shell Oil appealed that they should get their money back but on a procedural basis it was too late.

v. Scrivener error.

(1) Can reform retroactively.

(2) I intended to do “X” and lawyer did “Y” by making a mistake.

(3) Mistakes of law have often not been allowed. Some courts now do not bar mistake of law.

vi. Disgorge unjust enrichment.

vii. Void transaction.

(1) E.g. sale by incompetent.

viii. Restitution.

(1) Is it equitable?

(2) Got distribution from trust and spent it but would not have done it if had not received extra money. If bought fancy car may have to turn back the car but may not have to make them whole.

(3) Consider someone who got wrong deposit to bank account that you had no real reason to believe it was yours so the defense if not available as you knew it wasn’t yours.

(e) Remedies.

i. Going to court.

(1) Costly, public, etc.

(2) Court can be avoided with non-judicial settlement agreement but must get everyone to agree. Issue as to representations of minors and unborn if a conflict of interest makes virtual representation impossible.

(3) Clear material purpose of a trust may be "in the eye of the beholder" so look at local law for guidance.

ii. Disclaimers. Disclaimers allow the recipient of an interest or power to reject it with retroactive effect under certain circumstances.

(1) Property law rights at heart of this.

(2) A valid disclaimer relates back to the creation of the interest usually by treating the person disclaiming as if they predeceased.

(3) If gift is to multigenerational pot trust will disclaimer be effective if trustee disclaims. Can a gift instrument include if trust is silent?

a. Fiduciary powers cannot generally be disclaimed at common law.

b. Disclaimer of property would seem to conflict with fiduciary duties to beneficiaries.

c. If creating new trust you can make clear when trustee can disclaim and effect. You can give right to disclaim to preserve grantor's estate to later distribution to address issue of breach of fiduciary duty.

d. May be able to solve with disclaimer.

e. May not protect trustee if only have disclaimer in instrument of assignment.

(f) Parties agreement may not support tax results desired.

i. Can happen with family relationships.

ii. Can also happen with business owner and trusted employee (so donative intent can be outside just family).

(g) Backdating.

i. Treating agreement as having retroactive effect.

ii. Generally you cannot do this.

(1) Depends on who is affected.

(2) In Illinois, a lawyer was disciplined for submitting a backdated document.

(3) Use "as of language" and indicate date signed.

(4) How do you prove what agreement terms were? If you add things important for tax purposes how do you prove that was in the original agreement?

(5) backdated document from Jan. to Dec.

(6) Make it crystal clear when it was signed.

(7) If trying to hide something that is where fraud arises.

(h) What if mistake?

i. Can you sign a new agreement and reflect original agreement?

ii. In electronic age it is silly to take risk. Computers may record when document was looked at or changed.

iii. Be up front.

(i) Transfer taxes.

i. Disclaimers relate back.

ii. You have 9 months no extensions to disclaim for federal tax law purposes.

iii. Bars under property law and tax law to disclaimers.

(1) Person under 21 has 9 months from age 21 to disclaim.

(2) Distributions of property to minor is not deed under Regs to be an acceptance by a minor.

(3) This could be a long time period.

iv. Disclaimer give retroactive effect.

v. Gift - can disclaim but consider anti-lapse statute.

vi. Use disclaimer to fix marital gift that did not qualify.

vii. Can repair if unexpected death occurs. Change taxable termination to direct skip.

viii. Income tax consequences are not addressed in 2518 or in any Code Section.

(1) If disclaimer occurs in same calendar year as gift may have same effect if not 1341 and claim of right doctrine might be applicable.

ix. Disclaimers may be useful related to a gift that drastically depreciates within 9 months, repairing gifts that don't qualify for marital deduction, unexpected death right after gift.

x. Disclaimers must also comply with applicable state laws.

(j) Gifts.

i. If related parties agree, watch out gift tax consequences.

ii. If parent gifts to child and child gifts back, there could have double gifts (use of exemption by both parent and child for the same asset).

(k) Reformation for scriveners error.

i. many PLRs on errors.

ii. Harris case claimed omission of provision that disqualified gift was a typo but drafting lawyer and typist did not testify so court held that could take inference that testimony would not be favorable and did not recognize as scrivener's error.

iii. Berger in 1980, it was a mistake of understanding the law. Trust was reformed. He had thought he needed an irrevocable trust to take government job and it could have been revocable.

iv. 1998 Neil case created GRIT in 1989 IRS disqualified GRIT as it included reversionary interest so with notice taxpayer released. Then, law rescinded retroactively. However, Lange on case went the other way.

v. Breakiron 2010 QPRT went to 2 children and son wanted to disclaim and lawyer told him he could do after end of QPRT. Son sought rescission of disclaimer. District Court applied MA law and granted effective reformation and gift tax not owed.

vi. Can reform instrument to original intent but must be able to demonstrate initial intent.

vii. Mistake of law did not provide basis to reform. But most jurisdictions seem to permit this today.

viii. If you eliminate power to consume or invade before power exercised that may be treated as a qualified disclaimer.

(l) Income tax - Rescission.

i. Recission is treated as retroactive if rescission occurs in same tax year. Per Rev. Rul. 80-58, IRS treats the transaction as if it never happened if the rescission occurs in the same year. If rescission occurs in a subsequent year, the transaction is treated as a sale back to selling party.

ii. Motivation doesn't seem to matter.

iii. IRS has a no ruling policy since 2012.

iv. A rescission can have gift tax consequences.

v. If negotiating with a non-related party no presumption of gift. Need underlying property law basis as to why a gift should be inferred.

vi. Rescission is based on annual accounting concept. Look at the annual basis. Taxpayers cannot chain years together.

vii. With the annual accounting concept, it doesn't matter that the year had closed in determining the income tax consequences. Fixing the transaction in a subsequent year doesn't help.

(m) Claim of right Sec. 1341.

i. TP must recognize income in year received under claim of right Being able to deduct in a later year when repaid may not make the taxpayer whole.

ii. Cannot have restrictions on use of income but doesn’t matter if there was a claim etc. You must pay income tax.

iii. Improper trust distribution under this doctrine beneficiary must report income in year received. Cannot ignore because in a subsequent year the distribution was determined to be a mistake, regardless of whether the statute of limitations is still open. The taxpayer may get a deduction in a prior year but that may be insufficient to offset the income tax consequence incurred in the prior year.

iv. Sec. 1341 allows an option for the taxpayer to take a deduction in the year of repayment or a refundable tax credit for extra income tax paid in the prior year. Important code section.

v. Obstacles to Sec. 1341. IRS fights use of Sec. 1341 regularly and is generally hostile to the invocation of Sec. 1341.

vi. Requirements to using Sec. 1341:

(1) The deduction must be allowable even if not related to a specific code section.

(2) Sec. 162 trade or business deductions.

(3) Sec. 165 non-business losses

(4) Regulations include an example of a taxpayer having disputed commission on sale of real estate. The Taxpayer had to pay an extra commission and no deduction was allowable as it would have been deductible under sales proceeds received in a prior

year. In the example, the regulations indicate that the TP had the right to deduct.

(5) Embezzlement may not be subject to the deduction or credit allowable under Sec. 1341.

(6) Repayment must be involuntary. You cannot just decide you will change your mind and pay it back.

(n) Tax benefit rule.

i. There must have been a tax benefit in a prior year for any amounts returned to be considered income in the year of receipt. Tax benefit rule doesn't exist in gift and estate tax regime.

(o) Tax elections.

i. 9100 relief is available for certain tax elections

ii. Not available for any election the time for which is prescribed by statute. So if statute says you must make election by a specified time you cannot get relief. If extend a return you can file a new amended return if properly extended but must fix election before extended due date.

iii. 9100-3 can use for regulatory elections. QTIP election for estate tax.

iv. Generally must file for a PLR (a few exceptions).

v. Can even file for relief if tax owed. TP must have acted reasonably and in good faith.

vi. relief granted years later.

vii. Some elections can be made late e.g. split gift election so long as no return filed by either spouse. Can even be filed after taxpayer has died.

viii. Retroactive of GST exemption.

(p) Fixing mistakes.

i. Get independent help. Your judgement is often impaired, you may have a conflict of interest. What you do may look bad to others even if motives are pure.

ii. Make sure you advise of malpractice deadlines.

5 **<u>The Three Faces of Asset Protection. (Presented by Gideon Rothschild, Melissa Langa, Daniel S. Rubin)</u>**

(a) Benefits of Asset Protection Planning

i. Global diversification of assets

ii. Removing assets from jurisdictions with civil or political unrest

iii. Dynastic provisions

iv. Income tax advantages

v. Of course, asset protection

(b) Third Party Trusts are the most likely to be upheld

i. Ten Cent Rule: If any client is worried about asset protection, they should be sure not to inherit a dime outright! The rule that a self-settled trust is not protective even when the trust contains a spendthrift clause is the historic self-settled trust rule. To the extent a creditor can reach an amount the trustee could have paid to the settlor-beneficiary, asset protection won't be achieved.

ii. Perhaps consult with G1 estate planner to ensure that assets are left to G2 in trust in order to protect from G2's creditors

(c) Domestic vs. Foreign Asset Protection Trusts

i. Much harder and more expensive to litigate abroad

ii. Lawyers in foreign jurisdictions do not usually operate on contingency basis

iii. FAPTs generally have shorter statutes of limitations and higher standards of proof for fraudulent conveyance / voidable transaction actions

iv. Tax compliance: asset protection trusts are usually grantor-type trusts, but foreign trusts have significant compliance reporting requirements with heavy penalties

(d) Are you the right attorney for the job?

i. Consider competency, particularly when this is the first asset protection trust you are doing:

(1) Align with a seasoned asset protection attorney, either as co-counsel or by shadowing the specialist (consider whether or not to charge fees for time)

(2) Research and read all information available about asset protection trust planning – attend webinars/seminars to learn more

(3) Don't oversell services and capabilities

ii. Be sure not to engage in the unauthorized practice of law

(1) Make sure to engage local counsel in chosen asset protection jurisdiction

(2) Understand the local law limitations on how involved attorney licensed in another jurisdiction may be involved with the process as a matter of local law

(e) Is this the right client? Avoiding the wrong client

i. Avoid those clients who appear to be actively seeking opportunities to engage in a fraudulent conveyance

ii. No “wink, wink” clients: the client must understand that s/he has to give up access to the assets transferred to the AP trust & will not be able to just take them back

iii. INTAKE QUESTIONNAIRE

(1) A good client will consider “nest-egg” planning – that is, makes sure to carve out the assets reasonably determined to fund lifestyle for life expectancy

(2) Confirm that the client has assets that are of the type that can be moved into an asset protection trust: cash, marketable securities, bonds – real estate located in home jurisdiction is probably NOT a good asset to consider

(3) Beware of personal financial statements where client already pledged assets to lenders to secure debt – these assets cannot be moved into APTs

(4) Lawyers need to be careful not to get stuck in the middle between trustees and beneficiaries of AP trusts that they help to establish. The trustees and the beneficiaries should be working together and communicating as part of the administration of the trust.

(f) 19 states have domestic asset protection trust (“DAPT”) legislation that extends spendthrift protections to a settlor/beneficiary of a discretionary spendthrift trust.

i. The transfer by the settlor cannot be a fraudulent transfer.

ii. Better protection is achieved by using more than one beneficiary, avoiding frequent distributions to the settlor, using an independent trustee, and using less than all of the settlor’s assets.

iii. PLR 9837007 addressed an Alaska trust in which the settlor was among the beneficiaries. IRS held the transfer to be a completed gift but didn’t rule on whether the assets in the trust would be includable in the Settlor's estate at death because of the possibility of an implied agreement.

iv. PLR 200944002 addressed an Alaska Trust settled by an Alaska resident. The IRS held that the transfer was a completed gift and, should not be included in the settlor’s estate. Rev. Ruling 2004-64. Trustee’s discretion to distribute to grantor does not by itself cause estate inclusion under 2036.

v. Would the same result occur if the grantor didn’t reside in a DAPT states? In drafting, consider whether you can have a valid trust governed by laws of a foreign jurisdiction.

vi. Other steps/trusts.

(1) SLAT – spousal lifetime access trust. A SLAT can provide access and protection

(2) Inter-vivos QTIP.

(3) SPAT – special power of appointment trust.

(4) Combine irrevocable trust with entities.

(5) Trustees should act to reduce liability.

(6) Have the client execute an Affidavit of Solvency.

(7) Conduct a background search on the client.

(8) Limit the amount of the client's net worth that is funding the trust.

(9) Corroborate that the client will retain sufficient assets or future income outside of the trust to pay the client's reasonably foreseeable obligations.

(g) Attorneys should act to reduce their liability.

i. Bifurcate the engagement. First engagement letter addresses the due diligence required to permit the lawyer to understand if the next step is possible, design and implementation of an asset protection plan. Only if the first portion of the engagement is positive should a second engagement for phase 2 of the planning and implementation be issued.

ii. Due diligence should include, among other matters:

iii. Reference letter from banker and accountant.

iv. Reference letter from a person who has a long relationship with the client.

v. Color copy of client's passport and color copy of client's driver's license – also ask for spouse and children (if any) and all proposed beneficiaries of the asset protection trust.

vi. A copy of a recent utility or phone bill addressed to the client at the client's current home address.

vii. A list of any reasonably foreseeable creditors

viii. Note that bankruptcy statutes require retention of records for 10 years (not 6 years which is standard for estate planning document retention) so be sure to consider this if any engagement letter includes file retention language

(h) Drafting Considerations

i. Trustee selection - trust must have at least a resident trustee but settlor could appoint others (e.g. advisory committee) to make investment or distribution decisions. Trustee should not be related or subservient to settlor.

ii. Trust protector - Protector can have power to discharge trustees, make certain trust amendments if necessary, etc.

iii. Change of situs provision allows for subsequent changes if laws or circumstances change.

iv. Other asset protection provisions such as anti-duress clauses and flee clauses can be incorporated into trust.

v. Consider, for married clients, excluding the settlor as a beneficiary as long as he or she is married.

vi. Give third party the power to remove settlor as beneficiary, which power can be exercised even shortly before settlor's death to avoid application of Section 2036. But see TAM 19993503 which held Section 2035 applied if pre-arrangement existed.

vii. Termination powers given to trustee if continuation not in beneficiary's best interests

viii. Spendthrift provision to protect from beneficiary's creditors/former spouses.

(i) Insolvency Analysis

i. Case law is clear that it is vital to perform a valid and thorough insolvency analysis prior to implementing asset protection planning

(1) Drill down on clients' assets, focusing on those that are reachable by clients' creditors (i.e. ignore home protected by Homestead Act & protected retirement accounts)

(2) Assign a value to each asset – consider whether to get qualified appraisals or valuations to support values

(3) Determine liabilities – it's important to assign accurate values to liabilities

ii. Q. Where litigation is pending or there is some accrued liability where the value is not easily determined, what happens if the attorney's reasonable estimate of exposure turns out to be far less than the actual exposure once the case winds through the Courts/settlement process?

(1) Consider whether this is the right client to begin with

(2) Where there are pending claims/litigation: advise client that asset protection planning likely cannot protect assets from those pending claims but may be able to protect against future, unrelated claims

(3) Need to get the best valuation possible –

a. May not be able to rely on litigation attorney's estimate of exposure

b. Consider getting professional valuation

c. Don't "squeeze" it – leave a cushion to cover

(4) BUT if the asset protection transfers are later deemed to be fraudulent, the client could be at risk of losing opportunity to discharge debts in bankruptcy due to having engaged in a fraudulent conveyance

a. To hedge against this risk, add a Jones clause whereby the trust assets could be used to pay any claims that are pending as of the date when the trust is set up

b. Get a bankruptcy lawyer involved in the asset protection planning, especially when there's a claim pending

Mortensen case: in this case, the Debtor should not have filed for bankruptcy. By doing so, he opened the AP trust up to creditors. That is, the 4-year Alaska statute of limitations had already run by the time his creditors started looking to reach into the trust. By filing for bankruptcy, the debtor invoked the 10-year statute of limitations under 11 USC §548(e)(1), giving the government (and the creditors) additional time to set aside the transfers to the asset protection trust

6 **Strategic Planning. (presented by Diana C. Zeydel and Todd Angkatavanich)**

(a) Review of proposals.

i. Sanders is a transfer tax proposal.

(1) Reduce estate and GST exemption to $3.5M and eliminates indexing for inflation..

(2) Reduce gift exemption to $1M low to protect income tax.

(3) Rates from 45%-65%.

(4) Sec. 2901 grantor trusts included in gross estate of deemed owner unless grandfathered under prior law. Good news is that grantor trusts already settled and funded are grandfathered and will be subject to the old rules. Gift to a grantor trust after enactment could taint grandfathering.

a. Post effective date, grantor trusts will be included in the estate, so if you have existing grantor trusts, consider sale transactions with them now.

b. Contributions to grantor trusts are subject to Sec. 2901 which will taint them as included in the estate. It doesn't appear whether a sale would have the same problems.

(5) BDITs (Beneficiary defective trusts) are trust where the settlor transfers assets in trusts over which the beneficiary as a power of withdrawal. The deemed grantor for income tax purposes is the beneficiary so a sale or exchange (or comparable transaction) to a BDIT will be disregarded for income tax purposes.

(6) Significant changes to GRAT rules will make GRATs highly inefficient.

a. Minimum term will be 10 years.

b. Minimum gift will be the greater of 25% or $500,000.

c. What might clients do now with GRATs? You can do GRATs before effective date of Sanders Act.

d. Consider a "shelf" GRAT. Do a ladder of GRATs and fund with cash or conservative investments. In the event that the Sanders proposal is enacted as drafted, the grantor can swap in other assets at that time. It is believed that a swap transaction will not fall within Sanders proposal. But consider Van Hollen proposal impact on GRATs

(7) No valuation discounts for security partnerships.

(8) 50-year expiration date for GST trust. Exempt status expires by the inclusion ratio being reset to 1.

a. Do you have to actually terminate the trust? Can you pour it into a new trust?

b. If trust doesn't terminate by its terms in 50 years trust may not be exempt at inception and that may prevent allocation of GST.

(9) No basis adjustment on grantor trust unless estate tax included. Were Jonathan Blattmachr and Mitchell Gans correct in reading 1014 to provide that basis is stepped up even though not included in the estate. Maybe this provision suggests that there is more to their argument than conventional wisdom might have originally thought.

(10) Rules are prospective.

(11) Van Hollen and Pascrell are income tax bills about income tax realization.

a. Comment: Subsequent to Heckerling President Biden issued his budget proposal and Greenbook adopting a realization system requiring gain be recognized on gift, death and even funding certain entities. These provisions are not to be effective until 2022.

(12) New Code Sec. 1261. Transfer by gift or death is deemed a sale for FMV. It is an income tax realization event when client parts with assets.

(13) Exceptions.

a. Transfer to citizen spouse.

b. Transfer to grantor trust if included in gross estate.

c. Charity.

d. Some exception for tangible property.

(14) Income tax realization when grantor trust status ceases.

(15) Transfer to non-grantor trust is a realization event.

(16) Concern that income tax realization event may apply to indirect or direct modification to beneficiaries of a trust. Carlyn McCaffrey expressed concerned about this and the impact on decanting, as decanting might become a realization event if change rights of beneficiaries, and no one is clear on what this might mean.

(17) Phipps case concluded that adding a power of appointment would be acceptable, even if the power can be exercised in favor of a non-beneficiary. The Pascrell proposal appears to create a problem for these situations.

(18) Income tax realization every 21/30 years.

(19) Requirement for QDOT to assure US will collect income tax for marital trust to assure we have jurisdiction over assets. Also requires spouse to hold special POA over the entire trust. What does that accomplish? Not clear.

(20) Basis consistency rule.

(21) $1M exclusion at death.

(22) The retroactive nature of this bill to 1/1/21 is scary. When you discuss how to use exemption

now, you have to be able to rewind in the event that the Van Hollen version of the deemed realization proposals is enacted. There is good support for retroactive change through disclaimers, rescission, and other techniques. If we get legislative “meanness,” we might get favorable ruling from courts on trying to unwind them.

(23) This is a mark to market regime. Now valuation discounts, using qualified opportunity zones and other techniques.

(24) If you are considering doing a GRAT in anticipation of Sanders, the retroactive Van Hollen could trigger gain. If you have a Van Hollen law the gain is deferred so long as estate tax included and a grantor trust. So during duration of GRAT no gain but when ETIP ends you would have gain there so may have to swap assets out of GRAT before term ends. But with a QPRT you cannot do that. We don’t know what will happen. No way to know which “ingredients” will make it to final law. Can you stretch GRAT with a long term GRAT to defer gain under Van Hollen? Even if you have to borrow to fund swap that could still be better than an income tax.

(25) In Van Hollen, a marital deduction power of appointment trust or QTIP should defer income tax realization event.

(26) An exemption is given $100,000 for gifts and $1M for estate.

(27) Since CLT can be zeroed out it appears that they may be outside the reach of Van Hollen. Perhaps the CLT can be better to use for wealth transfer than other options. Risk with CLT is that if values decline, the taxpayer could end up giving the charity more or even all assets. If the CLT term is long enough, you might be able to construct a CLT

to get significant benefits for the family and avoid income tax realization that might otherwise occur.

(28) Arguably, both the Sanders and a deemed realization bill (either Pascrell or Van Hollen) could be enacted. Practitioners need to be prepared.

(b) What approaches to gifting?

i. Want to use available exemption but if there is retroactive legislation we may want to unwind.

ii. Sale for a note Selling assets in exchange for a note will result in little (or no) gift. Can notes be forgiven if it turns out that there will be no retroactivity? Swap in cash and use cash to repay the note? Will the Van Hollen proposal, if enacted, create a realization event in such an event?

iii. Rev. Rul. 80-58 sale of property from taxpayer a to taxpayer b. subject to capital gain at sale but the taxpayer unwound the transaction in the same tax year, and both wound up in the same position they were in prior to the transaction. This was done without a state law argument that they had a basis to rescind on the merits. It was done on mutual consent and was called a rescission. That may be the best way to conceive of mitigating Van Holland if we get "what we all say is highly unexpected" a retroactive tax change.

iv. "I think you can use the Revenue Ruling (80-58) defensively."

v. Bolles case: ensure that a family note transaction results in a valid debt so not recharacterized as a gift.

vi. While the Sanders proposal suggests note sale to a pre-Act grantor should work, but the Van Hollen proposal, any transfers could be implicated.

vii. Consider transactions between trusts. These might avoid legislative measures.

(c) Formula divisions.

i. Wandry is a formula transfer clause.

ii. Panel thinks Petter might be better. Transfer what we think we ought to transfer and have a waterfall to a receptacle that is a marital deduction trust (GPOA), charity or GRAT that produces small or no gift tax.

iii. Use a formula division to protect against valuation adjustment. Hard to know what might happen if the gift tax exemption is changed retroactively. Will formula apply retroactively? It should, but it's unclear. One issue is the Proctor case and question of a condition subsequent. What most think is that a condition subsequent is something that happens after the transfer that has an impact. But Court in Proctor was concerned about a condition subsequent to the judgement so that judgement has no tax effect because there has already been a final determination of the tax due. So not every condition subsequent is problematic.

iv. Can you use a GRAT to get this protection? What if you put $10M into a zeroed out GRAT under current law before enactment of any of the pending proposals? If gift tax exemption not retroactively reduced, you may be able to violate terms of the GRAT to trigger a full gift using up exemption. However, the planner should consider the retroactive effect of the Van Hollen proposal, which, if enacted, could subject the transaction to mark to market rules and a retroactive capital gains tax. During the GRAT term, there would be a deferral on the gains tax since GRAT is a grantor trust and also included in the estate (until ETIP ends). Perhaps a zeroed-out GRAT executed before enactment of any legislation could allow a taxpayer some breathing room to wait and see whether the Van Hollen proposal might be enacted and impose a tax retroactively to the transaction at a later point. Once the fate of the proposed legislation becomes more clear, the taxpayer could decide whether to violate Sec. 2702 violate and trigger a taxable gift.

(d) QTIP eligible trust.

i. For transfers made in 2021, taxpayers can wait until October 15, 2022 to determine whether to make a full or partial QTIP election.

ii. Hard to draft. Cannot use the same QTIP language as in testamentary instruments since it cannot contain Clayton provisions that would shift benefits to individuals other than the spouse. Clayton does not work for inter vivos trusts since the power to shift could constitute retained control. An inter vivos QTIP trust can only benefit a spouse and no other beneficiaries.

iii. Spouse can potentially disclaim in order to change the disposition of the assets.

iv. Donor cannot change disposition.

v. The fact that a QTIP has an income interest may not be terrible from a wealth transfer perspective.

(e) Defective preferred partnerships.

i. Article by Breitstone.

ii. More involved way to absorb exemption..

iii. Sec. 2701.

iv. Example: Dad has $11.7 M exemption. Makes capital contribution to FLP with preferred and common interests. Takes back preferred interest. Trust for kids takes back common interest. Must have appraisal to determine the coupon on preferred interest. Usually try to comply with Sec. 2701 to get preferred LP interests of equal value so there is no deemed gift. In 2021, the plan may be to violate Sec. 2701 intentionally so that the transfer is treated as a gift up to the full $11.7M in order to soak up exemption. Dad will still get back preferred coupon annually and have withdrawal right. Dad has used exemption but retains cash flow.

v. Regulations under Sec. 2701 offset rule at death.

vi. Need to watch Sec. 721(b) and disguised sale rules under Sec. 707 unless using grantor trust.

vii. Possible “defects” to force usage of exemption:

(1) Making the preferred interest non-cumulative

(2) The rules under Sec. 2701 allow taxpayers to choose whether to make an election to treat the payment as qualified or else elect that the interest not qualify. Taxpayers are required to make the election on a timely filed gift tax return so for transactions in 2021, the election must be made by October 15, 2022. We should know the law and its effects by then.

(f) GPOA Marital Trust.

i. Must have a cooperative spouse.

ii. Assets in trust automatically qualify for marital deduction but if spouse disclaims, the assets can pass to a dynasty type trust drafted for this purpose.

(g) Disclaimer.

i. Trustee should understand the intent of the disclaimer. It should be clear that the disclaimer is intended to avoid taxation on the transfer and consideration should be given to establishing a net gift agreement with the trust so that the payment of any taxes resulting from the transfer is the liability of the trust. This could give cover to the trustee against any claim by beneficiaries that the disclaimer violated the trustee’s fiduciary duty to them.

ii. What about beneficiaries? How many beneficiaries need to disclaim? Perhaps instead of typical dynasty trust, have single beneficiary trust for one child for lifetime and if child disclaims, the property reverts to donor but if the child does not disclaim, a trust protector would then have the power to open the class of beneficiaries.

iii. What if you do a trust-to-trust disclaimer? Trust 1 says by its terms at end of term all assets pour into trust No. 2 and give trustee of trust no. 2 the right to disclaim, in which case the transferred assets would stay in Trust No. 1.

(h) SLATs.

i. Generation 1 may not want to give away so much wealth just to preserve exemption. A non-reciprocal SLAT may (different interests in trusts, make them as different as you can) be used.

ii. What if you don't make the SLATs reciprocal? One trust is not for benefit of second spouse until first spouse dies. This way you have access to assets in at least one SLAT. Springs into being on death of spouse beneficiary of SLAT.

(i) 2704(b) Proposed regulations

i. Limitations on valuation discounts were proposed in 2016.

ii. The current Sanders proposal (in the For the 99.5% Act) differ from the proposed regulations under Sec. 2704 but have similar intent to limit valuation discounts on intra-family transfers.

iii. 2704(b) had a lot of provisions that were not workable. Sanders proposal from a practical perspective similarly unworkable and may be different to administer.

(j) "There is nothing wrong with waiting until you have a bit more vision of what will be enacted."

i. Watch date of enactment.

ii. Convince clients to prepare now. Prepare the documentation now as opportunities may be closing.

iii. Put whatever you might transfer into an entity so you can move assets on a weekend. If you have to open accounts at the 11th hour it won't happen.

iv. Put cash in entities.

(k) More on Preferred Partnership Freezes.

i. Preferred partnership freezes may not be affected by proposals.

ii. Two economic class vehicles with two distinct economic interests: frozen preferred interest and common growth interest.

iii. Must be mindful of Sec. 2701 rules. Must make sure senior preferred interest is structured as a qualified cumulative payment right. If you satisfy these requirements, parent will have full value and not have a big, deemed gift. Purpose of Sec. 2701 was to attack pre-1990 discretionary preferred interests which were considered abusive. Under Sec. 2701, taxpayer must avoid a deemed gift if preferred interest is qualified. Pre 1990 planning had been problematic because the donor would retain non-mandatory, non-quantifiable interests. Now, transactions must be compliant with Sec. 2701 and must generally be structured as a qualified payment right. Other interests will be considered. The coupon on the preferred interest must be adequate.

iv. Just because a parent receives a qualified payment right doesn't mean that all gift tax issues will be avoided. This is the "scary" thing about preferred partnership interests. There is not really a body of case law on what the coupon on the preferred should be or how it should be valued. There is not much authority.

v. Rev. Rul 83-120 provides a laundry list of factors an appraiser must consider in evaluating what the coupon should be. It is a market return that is risk adjusted. Starts with public high grade preferred. Use an appraiser who is skilled in this area and understands the complexity of the rules.

vi. A preferred interest structured as a "reasonable" payment will be an exception to the Sec. 707 disguised sale rules, but what qualifies a "reasonable" can be tricky. When Rev. Rul. 83-120 had been considered, the coupon rates were significantly higher than they are in the current planning environment, crafting around the Sec. 707 rules may require a specific election and could have income tax implications as the taxpayer goes "round and round" in order to comply with the qualified payment right. Be sure to use a grantor trust in order to avoid the income tax.

(l) For the 99.5% Act (Sanders proposal) and GST.

i. Grandfathering provision is limited as all trusts flip to inclusion ratio of 1 in 50 years.

ii. For new trust: settlors cannot allocate GST exemption unless term is less than 50 years.

iii. Prevailing sentiment during the panel discussion: "Most of these things will probably not become law."

(m) Up Gen and Down Gen Planning.

i. If wealth generated at G1 level, there might be a grandparent at G0 level with exemption that won't be used.

ii. Consider reverse up-generation estate freeze transactions.

iii. Loan at short term AFR 1.3% to parents and parents invest in assets that will increase. Then pay back loan and use gain to use exemption.

iv. Does Up-GRAT planning make sense? We usually think of GRAT from G1 to G2, but you can also do GRAT from client to client's parent. The remainder passes to client's dad. If exemption still in place you can put assets in dad's name to use his exemption.

v. Don't overshoot mark by transferring more wealth than the exemption amount.

vi. You can calibrate disposition of remainder of GRAT by including a formula provision whereby if value is in excess of $X, the difference would revert to settlor. This formula could peg to exemption at that time.

vii. How to fund gifts at G2 or G3 level. They may not have used exemption that will be wasted. Have large GST non-exempt trusts. E.g. non-GST exempt remainder trust at end of GRATs. Why not look at these GST non-exempt trusts to make distributions out to G2 or beneficiaries that they can use to fund their own gift program. If the old trust has an old and cold vehicle e.g. LLC the trust might be able to distribute non-voting interests out to the children and the kids can use those to fund dynasty trusts. These will have to be valued. Powell, Cahill, etc. should have no application here as G2 beneficiaries making gifts had nothing to do with the creation of the LLC. They just passively received non-voting interests.

(1) Comment: by definition this has a concern. If assets in trust at end of GRAT by definition it is appreciated so you have a Van Hollen issue. Might have trust borrow and distribute cash.

(2) Comment: Use loan with guarantee.

viii. In Alaska, holding a presently exercisable GPOA does not subject assets to creditors. If there is any concern about assets passing through hands of G2, you may be able to decant assets into new trust established under AK law which gives formula GPOA that G2 can exercise. That could be a more protective way of getting same result.

(n) SPACs.

i. All the rage now.

ii. Similar to what carried interest planning was 15 years ago. Many parallels but also many differences. SPACs are still in their infancy.

iii. “Pop” potential so good to plan before pop.

iv. In context of a SPAC, launching SPACs the founder vehicle. You put in $25,000 and create LLC that will hold founder shares in SPAC. Upside investors get A shares and founder gets B shares. Then go public. Once it goes public, you have 2 years to find a viable target to merge with. If no viable target found, all money in SPAC must get returned to public shareholders. If merger is successful, the peppercorn put into the founder shares will receive 20% of equity. A small investment could turn into large funds. Valuation probabilities and discounts. What will trust receive?

v. When planning with SPACs, evaluate through the lens of Powell and possible inclusion under Sec. 2036. For a SPAC, the founder vehicle has a strong argument as in Baumgart case for a bona fide sale exception since funds would be raised primarily from third party, unrelated investors.

vi. Various equity interests in SPAC “eco-system” watch out for Sec. 2701 issues.

vii. What if representing client selling business to a SPAC? Empirical data on SPACs is all roses. Nothing probably correctly sets forth risk in these SPAC transactions. Discounts may be much less than what the client anticipates.

(o) Carry planning.

(p) Regs under Sec. 1060 finalized in January. Favorable with respect to transactions with grantor trusts.

(q) Qualified opportunity (QOZ) funds.

i. New regime of carryover basis or perhaps mark to market. We will see more situations where we want to build up basis. QOFs are interesting from the overall perspective.

ii. 1400Z-2 from TCJA.

iii. Income tax provision that permit rolling over capital gain into a QOZ Fund. Defer imposition of tax on gain and maybe if you get timing right get some reduction in gain by bump up in basis to 10% (use to be 15%). After 10 year hold any future gain is not subject to capital gain. You have to pay capital gains tax on initial gain but not on future gain.

iv. Gift or sale to dynasty trust after pay first rolled over gain rest grows without capital gain going forward.

7 **<u>Review of the Past Year's Significant, Curious or Downright Fascinating Fiduciary cases. (presented by Dana G. Fitzsimmons Jr.)</u>**

(a) Turner v. Comr..

i. Lack of notice is not fatal to gifts qualifying for the annual exclusion.

(b) Shaffer v. Commissioner of Revenue, SJC-12812 (Massachusetts Supreme Judicial Court July 10, 2020)

i. MA could impose $1.8M state death tax on trust

ii. Federal QTIP election creates deemed second transfer on surviving spouse's death and MA can tax it.

iii. Husband died in 1993 domiciled in NY. Husband's will created a trust for Wife that made federal and New York QTIP elections. Wife did not have GPOA over the trust. Wife died in 2011 while domiciled in Massachusetts. Her estate included the trust on her federal estate tax return but excluded it on the Massachusetts estate tax return. Wife's estate did not file a New York estate tax return. MA assessed additional state estate tax of $1.8 million.

iv. Wife's domicile in MA at the time of her death provided a connection to the state that allows imposition of tax on the QTIP assets.

(c) Probate Case.

i. Kiknadze v. Ellis, 2020 Md. App. LEXIS 842 (2020).

(1) How do you revoke a will?

(2) Signed will. Married and filed domestic violence issues.

(3) She signed revocation of will document with same formality as a will.

(4) But she did not burn cancel tear or obliterate 2nd will and revocation instrument was not a later will but a different instrument and those are the only two ways you could revoke a will.

(5) Planning note: must follow formalities of state law to revoke a will.

(6) UPC includes a testamentary instrument that merely revokes a will. Court did not agree.

ii. St. Jude Children's Research Hospital v. Scheide, 2020 Nev. LEXIS 89 (2020).

(1) Dad estranged from son.

(2) Lawyer had original will.

(3) New will signed to change executors.

(4) Original will lost when dad moved to group home and guardian was appointed and guardian took papers in and out of storage

(5) Original will was lost but there was a copy he signed, and he wrote “updated” on it.

(6) Lower court rejected lost will even though drawing lawyer cold testify as to signing and content and second will could only testify as to its signing.

(7) Copy of lost will and neither son nor charity contested accuracy of copy or content of lost will and contents were proved by drafting attorney. Court held wasn’t’ necessary for 2nd witness to testify as to contents of will.

(8) If no copy exists both witnesses have to testify as to contents of will.

(9) Lack of physical existence is not same as lack of legal existence.

iii. Grenz v. Grenz, 2020 ND 189 (2020).

(1) Doctrine of partial invalidity stuck part of will and upheld rest.

(2) Could not work injustice to other heirs.

(3) UPC did not address so common law in ND governed.

(d) Modifications of trusts.

i. FL Demircan v. Mikhaylov, No. 3D18-2054 (3rd Dist. Florida Court of Appeals 2020).

(1) Issue was whether FL common law basis of trust modification statute still available even after UTC adopted.

(2) Preston allowed modification when settlor and all beneficiaries consented.

(3) Common law of trusts supplement except to the extent modified. If had enacted language from

UTC with statutory modification by consent this may not have been the case.

ii. Garland v. Miller, 2020 Ky. App. LEXIS 90 (2020).

(1) Distribution provisions were supposed to be attached but those pages were blank. Modification by consent of all beneficiaries permitted where trust served no material purpose due to lack of dispositive provisions.

iii. Roth case in CA

(1) Common issue not every party signed.

(2) Assumed natural order of death but that doesn't happen all the time.

(3) Settlor had living adult grandchild who wasn't a party and wasn't served with order for trust modification.

(4) 14 years later settlor's son dies before grantor's wife and grandchild challenges settlement that extinguished his interest. Court gave grandchild opportunity to be heard.

(5) Settlement agreement and court order modifying trust was held void for failure to give notice to contingent remainder beneficiary.

(6) You got to get everyone in the boat!

iv. Trust reformation case in KS.

(1) H and W created SLATs and court approved changes to make changes to one trust to make them non-reciprocal.

(2) 840 SE 2^{nd} 724 Glass case.

(3) Court did not appreciate trustees not being open with the court.

(4) Ct of Appeals approved modification removing trustees.

(5) Different result then Conti case in PA. where if trust doesn't give removal powers must go to removal statute not modification statute.

(e) Decanting.

i. DE Case. Matter of Niki and Darren Irrevocable Trust, C.A. No. 2019-0302-SG (Delaware Chancery Court 2020).

(1) Settlor trustee.

(2) Settlor divided trust between daughter and her husband.

(3) Moved trust to DE and trustees decanted to give settlor right to get principal.

(4) Beneficiaries consented and son in law got new provision giving him 50% share and right to immediate distribution if divorce.

(5) They divorced.

(6) Settlor does not want to give ex son in law 50% and trustees petitioned court to void their own decanting.

(7) Court applied doctrine of unclean hands to invalidate prior decanting.

ii. Hodges. Hodges v. Johnson, No. 2016-0130 (New Hampshire Supreme Court December 12, 2017); 2020 N.H. LEXIS 157 (2020). New Hampshire Supreme Court affirms voiding of trust decanting on the grounds that the trustees violated their UTC duty of impartiality by not properly considering the interests of the beneficiaries removed by the decanting.

iii. 2020 WY 3 No contest case in decanting clothing.

(1) This was a modification that the beneficiary called a decanting.

(2) Resulted in forfeiture of complete trust interest.

(f) POAs.

i. Tubbs case from CA.

(1) Beneficiary held presently exercisable GPOA and was also serving as trustee. Donee of power of appointment acts in non-fiduciary capacity.

(2) Trustee is required to distribute trust assets by exercise of POA.

(3) No reason results should differ because powerholder is also trustee with fiduciary powers.

ii. Estate of Eimers. Will creating power required reference to power. There was a reference to a trust in the will but not to the power. Court rejected and would not excuse non-compliance. Court cannot reform will to create compliance law doesn’t allow it to waive.

(1) Sec. 304 of the unform act permits substantial compliance.

(2) Comments note that specific reference was a historic relic.

(g) Odds and Ends.

i. Aghaian v. Minassian, 2020 Cal. App. LEXIS 1249 (2020).

(1) In re Trust of Dona v. Drury, 202 Ariz. App. Unpub. LEXIS 1409 (2020)

(2) Father did not have right to declare himself as a trustee.

ii. Kelley v. Russell, 2020 U.S. Dist. LEXIS 189989 (New Hampshire 2020).

(1) Could not amend trust to make herself sole trustee and sole beneficiary as that would not have been a trust.

(h) Trustees and beneficiaries.

i. Cleary v. Cleary, MD case.

(1) Removed settlors son as successor trustee.

(2) Conflict of interest.

(3) Settlor dies and stock put in trust for wife. Son is named as successor trustee and threatens to steal employees and form competing company. Wife fires him and he forms competitor.

(4) Court modified trust to take son out of succession of other trust to avoid conflict that would be inevitable.

ii. Paris Case AL.

(1) Is a person legally adopted as adult included as beneficiary if trust is silent? In this case, the answer was no.

(2) Planning note: Address this and ARC in new trusts.

iii. Small v. Small case form PA.

(1) Son injured by gun shot. Father provided no support and absent.

(2) Mother tried to exclude father as intestate heir, but court would not do so. Mother could only point to social and moral duty and there was no law that imposed a support duty on the father.

(i) Marriage.

i. Crawford case.

(1) H sued to enforce prenup. When couple signed joint revocable trust and funded with all assets the trust agreement operated as an implied revocation of the marital agreement.

(2) Court was moved by equities.

(j) Forfeiture.

i. Hunter v. Hunter, VA. Waiver of requirement to inform could trustee refuse to give beneficiaries info on loss in trust. Did not eliminate duty to give beneficiaries reasonably requested information.

ii. Ferguson case in Idaho.

(1) Forfeiture clause is enforceable unless probable cause existed.

(2) Signing of will exercising power of appointment gives beneficiary by its exercise rights to information as trust beneficiary.

(k) Right to purchase house.

i. Wilburn v. Mangano, No. 191443 (Virginia Supreme Court 2020).

ii. FMV was not clear enough for Court so they would not provide specific performance to enforce the right to buy a house.

iii. D signed a will giving her Home to her daughters but giving her son the option to purchase the property from his sisters for an amount equal to the tax assessed value in the year of Jeanne's death. Before she died, D signed a codicil that revised the option purchase price to "an amount equal to the fair market value at the time of my death."

iv. There is no single fixed approach to determine fair market value as applied by appraisers or Virginia courts.

(l) Distributions.

i. NV case In re Raggio Family Trust, 2020 Nev. LEXIS 21 (Nevada Supreme Court 2020).

(1) H created two trusts. W is trustee of marital trust and credit shelter trust.

(2) H's kids from prior marriage sued W for spending CST that would go to them.

(3) NV law noted privacy interest and only has to consider other resources if required. But trust did not require. The court found that using the words "necessary or proper" did not suffice.

ii. Distributions when trustee stuck in middle of dispute between beneficiaries.

(m) Arbitration agreement.

i. In re Estate of Atkinson. Successor trustee is bound by arbitration agreement signed by predecessor trustee.

(n) Trust Protectors.

i. There are only about 15 protector cases.

ii. Ron case from Texas.

(1) Ron v. Ron, 202 U.S. Dist. LEXIS 52507 (S.D. Texas 2020).

(2) Does trust protector owe fiduciary duty to settlor?

(3) Settlor created trust and gave protector power to add descendants of husband's parents as beneficiaries. Settlor and her husband divorced, and

protector added ex-husband as beneficiary. Settlor sued protector.

(4) Protector was a fiduciary but nothing in trust terms imposed a duty to settlor. Just because trust says protector should carry out trust terms doesn't make settlor have right to sue protector. No duty owed.

a. Comment: Most clients don't realize this and feel the protector will do their bidding.

(o) Tony Trust 1 in AK.

i. De Prins v. Michaels, 2020 Mass. LEXIS 650 (Massachusetts Supreme Court 2020).

(1) Court held that creditors could reach assets.

(2) Settlor lost water right suit and then put assets in DAPT then killed neighbors.

(p) Tort.

i. Intentional interference with expectancy.

ii. Some courts recognize some don't.

iii. Youngblut. Iowa says it is not a substitute for will contest but can be a remedy when probate law does not have an adequate remedy.

iv. MD has recognized this tort. 469 MD 368

v. Gomez v. Smith, 2020 Cal. App. LEXIS 888 (2020).

(1) Recognized cause of action.

(2) Daughter who blocked lawyer from meeting with client to sign new trust agreement committed tortious interference with expected inheritance.

(q) Charities.

i. Sanford Case from ME.

(1) State AG has authority to enforce trust.

(2) AG v. Sanford, 2020 ME 19 (2020).

(3) Charity named as permissible beneficiary, but it was in trustee's discretion.

(r) Trends.

i. Litigation is growing.

ii. Nature of claims expanding.

iii. Lawyer, CPA and other third parties are increasingly being brought in. These claims are increasingly being brought.

iv. Statutory innovations. State statutes are being passed very quickly. This is driving new cases. Example litigation on silent trusts, directed, trusts, DAPTs, etc. all drivers of litigation.

v. Reproductive and digital and other technologies and complex families are drivers of litigation.

vi. A lot of general practitioner/general litigators bringing claims in fiduciary litigation that experts in the field would not bring. Some of these take a scorched earth approach to litigation and it causes human damage.

vii. Concerned about speed with passage of uniform laws before development of common law.

8 **<u>Diversity, Culture and Ethics. (presented by Stacy E. Singer, Margaret G. Lodise, Akane R. Suzuki)</u>**

(a) Understand how a person's faith or culture might impact the estate planning process.

(b) If religion is important to the client consider the impact on:

i. Selection of fiduciaries. Sensitivity to religious values.

ii. Selection of guardians (for minor children) to perpetuate religious values.

iii. End of life issues. Different faiths have specific proscriptions on

iv. Disposition of remains. Client may have a preference to be buried in a cemetery affiliated with the client's religion. The Catholic Church now allows for cremation.

(c) Cultural factors influence all aspects of life, including estate planning process.

i. Example: At the core of the Asian culture is the concept of family. In many Asian countries the tradition has been for the eldest son to inherit all.

9 **ESG Investing. (presented by Robert H. Sitkoff)**

(a) Introduction.

i. Can a trustee do well while doing good with ESG investing?

ii. Trust fiduciary law governs investment management. Investment management, trustee is subject to duty of loyalty and duty of prudence elaborated by prudent investor rule with diversified portfolio, etc.

iii. Trustees have been pressured to consider ESG factors in investment decisions, e.g. to divest from fossil fuel, tobacco, or firearm companies or to consider social and other factors.

iv. Fiduciaries must balance responsibility to use sound economic reasoning against the collateral benefits of considering ESG factors. An argument can be made that moving away from heavily regulated industries such as fossil fuels, tobacco and firearms will not only provide collateral societal benefits but also may constitute sound economic judgment. Heavily regulated industries may incur substantially more costs, potentially making them poor investments.

v. Scholars have suggested that fiduciary duties are consistent with ESG others have argued that it is inconsistent with duty of loyalty.

vi. Applies to pension, charity, or trust.

(b) What do we mean by ESG?

ESG is a broad term that captures any investment strategy that considers environmental impact, social factors, and governance.

(c) History or move from socially responsible investing to today's ESG investing.

i. Roots in socially or ethically responsible investing, e.g. divestment from firms that had interests in South Africa during apartheid.

ii. Avoiding anti-social firms. E.g. avoiding firms that trade in alcohol.

iii. In 70s and 80s movement to divest from firms with interests in South Africa would be a violation of the duty of loyalty.

iv. Tension with motive and fiduciary obligations.

v. In 1990s to present a proliferation of funds and offerings that catered to socially responsible investment taste. This was evidence of interest.

vi. Vocabulary changed to add "G" for governance factors. Also it changed/evolved environmental, social, and governmental, it was not only about collateral benefits for third parties but that it would provide better returns not just do good. ESG factors may identify better investments that offer better risk adjusted returns. Rebranded from socially oriented investing to ESG.

vii. It is not always clear whether you should use ESG factors to enhance returns or for collateral benefits that third parties would experience.

viii. Clarifying – to discuss economics of ESG subject to fiduciary law need a common vocabulary.

(1) SRI use of ESG factors to achieve collateral benefit of third parties. E.g. divest from fossil fuels to improve climate.

(2) ESG to improve risk adjusted returns. This could be by active shareholding, etc. Divest from fossil fuels because they don't account from shift away from carbon, etc. The focus here is on return by using the ESG factors.

ix. Consider duty of loyalty and ESG. CA pension says they use ESG because there are sound economic reasons to do so.

x. Difference between collateral benefits and risk/return analysis is important.

(d) Duty of loyalty and ESG.

i. Trust law duty of loyalty is a sole interest rule.

ii. Trustee must administer trust solely in the interest of the beneficiaries. A "mixed motive" is prohibited. Trustee has duty not to be influenced by any motives other than the purposes of the trust.

iii. It is not regulation, it is prohibition.

iv. You cannot have a motive of anything other than the pure motive of benefiting the beneficiaries. In other words, a trustee may not be distracted from the responsibility to the beneficiaries by the motivation to benefit environmental or societal causes.

(e) Duty of loyalty and ESG for corporate and pensions.

i. Another flavor of the duty of loyalty is the corporate flavor of the duty of loyalty which is a “best interests” test. You must act in the best interests of the trust beneficiaries.

ii. The Supreme Court ruling that the duty of loyalty relates solely to the financial benefits trustee must seek on behalf of beneficiaries. ERISA act requires complete fidelity to the financial interests of the beneficiaries with no possible motivation in favor of ESG. Plan documents cannot change background policy as interpreted by the Supreme Court for pensions.

iii. Duty of loyalty in ERISA to ESG investing.

(1) Collateral benefits of ESG is impermissible.

(2) Mixed motives are prohibited.

iv. In the UK, the trustee may consider things besides financial interests.

v. In the US, ERISA applies, and fiduciaries should do risk return only.

(f) Personal trusts.

i. What if settlor or beneficiaries want ESG?

ii. Background rules.

iii. Sole interest rule.

(1) Per Restatement, Trustee must administer trust solely in the interests of the beneficiaries.

(2) As a default matter, this leaves us in a similar place as ERISA.

(3) However, there are times when the Trustee makes decisions that are within fiduciary

responsibilities, even though those decisions do not maximize financial returns. By way of example, a trust may be structured to own a family business or a vacation home which may not result in the maximum financial benefit to the beneficiaries. Thus, certain wiggle room may be afforded in the administration of private trusts that is not available under the rules governing plans subject to ERISA.

iv. Sole interest rule is a default rule – "ordinarily" trustee decisions cannot be influenced by personal views.

(1) What if beneficiaries say, "I am not comfortable with the trust investing in fossil fuels."?

(2) What if the terms of trust authorize these collateral considerations? To what extent can a settlor proscribe an express preference for ESG investing, notwithstanding risks that may be associated with such an investment plan?

(3) In the event that beneficiaries request ESG investment, should the trustee be concerned about reducing returns?

(4) What if settlor incorporates ESG investing into the trust instrument? To what extent can a donor prescribe administrative provisions in the trust? This may be similar to mandating that the trust must retain a family business or family farm. The question is not new. The same legal and economic principles apply and will be resolved in a similar way. The Trustee has the option to petition court if they believe the direction will work harm on beneficiaries.

(5) DE and OR have passed statutes to change the rules. DE says provisions of terms of trust that prescribe socially responsible investment strategy will be enforced even if it sacrifices returns.

Effectively DE law has authorized a combination of a trust for beneficiaries and a purpose trust.

v. What if you get consent and release from beneficiaries? That would likely solve the problem for the trustee, but do you have it from all beneficiaries? What about next generation of remainder beneficiaries? What about litigation from them? Should it matter that the beneficiaries requesting an ESG investment strategy have different interests than other beneficiaries of the trust (i.e. income beneficiaries vs. remainder beneficiaries)? To the extent that the income beneficiaries are the parents or legal guardians of the remainder beneficiaries, will someone else need to be appointed to represent the interests of the remainder beneficiaries?

(1) DE ESG statute says desires of beneficiaries can be considered by trustee, but it does not go further to address that financial returns can be sacrificed.

vi. Loyalty and Charitable Trusts.

(1) Not for one or more ascertainable beneficiaries but also for a charitable purpose.

(2) Duty of loyalty is to the charitable purpose.

(3) The purpose might encapsulate environmental or social goals. E.g. Sierra Club has an environmental purpose. Contrast if it is a trust for an orphan you cannot use for such purposes.

(g) Duty of prudence.

i. Can risk return ESG investing satisfies duty of prudence.

ii. UPIA shall invest as prudent investor would?

(h) Document decision analysis.

i. Maintain adequate records, e.g. IPS = investment policy statement.

ii. Writing provides discipline. It causes you to be more prudent in decision process.

iii. Permits beneficiaries to be able to take a prudent review of actions.

iv. Ongoing monitoring.

v. You have ongoing duty to monitor investments and make adjustments. You have a continuing duty to monitor trust investments and remove imprudent ones.

vi. Can only incur costs that are reasonable. Cost/benefit trade off. Specifically applicable to investment management.

vii. Active investing can be prudent per Restatement but typically are more expensive than.

viii. If you go “all in” on ESG and fossil fuels become undervalued perhaps you have to follow the math and go back in on fossil fuels.

(i) Major challenge to ESG?

i. Weak environmental compliance. Is natural gas good under ESG or bad? Is nuclear power good or bad? What about alcohol and gambling?

ii. How many women on a board? “G” governance.

iii. In the “weeds” reasonable minds and differ on how each “E” “S” “G” factors may be. How do you weigh these factors? What about a firm great in environmental but what if bad on governance?

iv. Which factors and how do you weight ESG investment? There is fluidity in the ESG factors and strategies. So does ESG produce good results? It depends.

v. Risk return ESG same rules apply. Do the same documented analysis you would do for any strategy. Factors relate to firm performance. Can you exploit that relationship for profit? Can you make money on it?

(j) Governance.

i. What is good corporate governance? It will vary from one company to another.

ii. There is empirical evidence that governance effects firm value but also there is evidence that what is best will vary from firm to firm.

iii. Good proxy for risks. ESG factors may be good proxies to measure risks that do not come up often. It might be a proxy for good management. If you can identify good managers you would be very successful.

iv. There is some suggestion that better managers are more successful at ESG.

v. Can I make money on it? Pick and choosing stocks by active investing. Theory is that market does not properly price ESG factors.

vi. Stewardship.

(1) May make money in ESG by shareholder engagement.

(2) Market might accurately price, but value will increase as governance and ESG improves.

(k) Mandatory-ness.

i. ESG is suggested that ESG is mandatory.

ii. Collateral benefits ESG is not proper under duty of loyalty.

iii. ESG risk return is consistent with duty of loyalty but not clearly consistent with duty of prudence.

iv. Any type or kind of investment is permissible if satisfy risk/return, diversification, etc.

v. Point of prudent investor rule was to change from construct that certain investment is good, and others are not.

vi. Policy point – what does it mean to have an ESG mandate as it is so variable and fluid. Cannot have a mandate that is so subject to different views.

vii. Passive investing has to be legal. There is no view that using a Vanguard total market index can be a violation of the prudent investor rule. With a small trust just going with market index has to be permitted. Purpose of prudent investor rule is to say we will look at each case.

(l) Conclusion.

i. Two points of law? Prudence permits ESG on same terms as any other investment strategy.

ii. Loyalty generally prohibits collateral benefits.

iii. Reject mandating ESG.

iv. Collateral benefits ESG is OK perhaps for charity.

v. What is custom and practice in dealing with diversification waiver.

10 **GST Conundrums. (presented by Julie Miraglia Kwon)**

(a) Gift splitting.

i. Transferor for GST purposes means the decedent as to any property subject to estate tax, and the donor as to any property subject to gift tax.

ii. If a husband and wife elect to split gifts under §2652(a)(2), each spouse is treated as a transferor of one half of the gift for GST tax purposes.

iii. In certain situations, there is a lack of eligibility for gift splitting.

iv. Generally, if you have a spouse transfer property to a trust with other spouse consent to split gifts is effective as to 3rd parties if severable from transfer to spouse. In discretionary trust, donor cannot split gifts to that trust (typical sprinkle SLAT).

v. SLAT that won't qualify for gift splitting can you still split gifts? Yes, but the split gift election will only apply to other gifts that qualify (i.e. no GST split for the gift to the SLAT).

vi. If the couple files a gift tax return and make the Sec. 2513 gift split election on return, the election applies to all gifts to third parties.

vii. Once gift is split, each spouse is transferor as one half each for GST purposes. Each spouse can decide whether to allocate GST exemption.

viii. If any portion of trust qualifies for gift splitting – no matter how small – the entire transfer may need to be split for GST purposes. Example 9 in regulations § 26.2652-1(a)(5) describes a $100,000 gift from T to a trust that gives T an annuity constituting a qualified interest under § 2702(b), and will distribute to T's grandchild GC on termination. T's spouse, S, consents to make the § 2513 split gift election to treat S as making ½ of the gift. However, the example notes that only the actuarial gift to GC is eligible to be treated as split. Nevertheless, the example concludes that becomes the transferor of 1/2 of the entire trust ($50,000) because S is treated as the donor of 1/2 of the gift to GC, and is not limited to being the transferor of less than 1/2 even though GC's actuarial interest is less than 1/2 of the entire gift.

ix. Timing of split gift election.

(1) What if did not file gift tax returns in past, e.g. did not realize gifts happened, and now realized transfers were gifts.

(2) Split gift election can be made late even after deadline for timely filed gift tax return as long as made on first gift tax return filed for that year filed by either spouse. It is effective with retroactive effect.

(b) Estate Tax Inclusion Period ("ETIP").

i. A transfer to a trust can be a completed gift for gift tax purposes but also included in the donor's gross estate because of retained rights or powers, e.g. GRAT or QPRT.

ii. If married donor makes transfer to trust subject to ETIP, the ETIP applies to entire transfer even if split gift election is made.

iii. Each spouse is deemed to be a transferor as to ½ of the transfer.

iv. Defining facts of ETIP are determined by donor spouse.

v. If no ETIP would apply to gift transfer to trust because it wasn't going to be included in estate of donor then gift splitting will not change who the actual donor is for purposes of determining if an ETIP applies.

(c) Applicable fractions and inclusion ratios.

i. Carry out to decimal places per Regs. Round to nearest 1,000ths. In very large trusts or series of events with multiple allocations of exemption over time or rolling calculations whether you are rounding properly can have a significant impact on numbers. Actually put in function that hard stops number at 1,000 so you get the correct mathematical result. See Regulations §26.2642-1.

ii. Qualified severance – and to get benefit of trusts resulting with inclusion of 0 or 1 if doing by formula you don't have an issue. Some people state the severance as a specific ratio or numerically if not rounded to the right place you don't have the actual inclusion ratio and that may make severance not qualify.

(d) Non skip beneficiary predeceases transferor.

i. 2632(d).

ii. Child that dies first gets to pick and choose any unused GST exemption. Must operate on chronological basis Pick which trust performed better.

iii. Time to file gift tax return for year in which death occurred so not retroactive all the way back. Use values of original transfers and amount of unused GST exemption = amount of GST exemption immediately before non-Skip person's death.

iv. If transferred $1M to trust for 2 children and don't allocate GST exemption and later trust divides and child dies prematurely. Use retroactive allocation to mitigate GST tax re premature death. DO you have to go to $1M of original transfer or $500,000 since only ½ of transfer flowed through to trust under which child died prematurely?

v. Retroactive allocation may require quick action if non-skip person dies late in the year.

(e) GRAT.

i. For lifetime transfers in 2001 and thereafter, the automatic allocation of GST exemption was expanded to apply to each "indirect skip," unless the transferor elects out of the automatic allocation rule.

ii. Make affirmative election out since may have remainder trust that could create allocation question.

iii. You might be deemed to be making an automatic GST allocation, and if don't want it elect out of automatic allocation.

iv. Remoteness exception for ETIP rule. Regs don't provide clues. Example 1 describes trust that provides for income payments to transferor for 9 years and then remainder to GC. If transferor dies in 9-year period trust corpus is included in estate and subject to ETIP. No discussion of remoteness exception. Does it mean that it doesn't apply? Regs don't state facts as to whether it should apply or not.

(f) Reverse election.

i. Can you use relief procedures? Phrased to only use for affirmative actions that TP can make.

ii. 2032(c) blanket election for trust.

(1) Can elect out of automatic allocations entirely

(2) Some firms routinely make elections out of automatic allocations for all of trusts regardless of plan and rely instead on affirmative manual allocations.

(3) Don't understand thinking of this – meaning don't make a blanking election out if the intention is for the transfer is intended to use GST exemption. Probably best to allow for automatic allocation.

(g) Modifications of grandfathered GST Trusts.

i. Published safe harbor in 2000.

ii. Shift in beneficial interests. A modification will result in a shift in beneficial interest to a lower generation if the modification can result in either an increase in the amount of a generation skipping transfer or the creation of a new generation skipping transfer.

iii. Modify trust by providing change will only benefit people in current or more senior generation. What if add POA is it safe if only can add people in senior generation? Have you shifted interest down?

iv. Severance of trusts. Some assume severing into per stipital lines it doesn't assure that separation by family line is different than a trust from property law perspective. Do you have authority to sever? Not always so easy. Might want to get a ruling if you are the trustee. Example 5 is helpful.

(h) 529 plan changes – does have provisions that address change in beneficiary could be subject to gift and GST tax and that GST exemption can be allocated.

11 **Diminished Capacity. (Presented by Bernard A. Krooks, Robert B. Fleming, and Tara Anne Pleat)**

(a) Diminished Capacity.

i. Diminished capacity is referring to an individual whose intellectual abilities are impaired because of illness, condition, or injury, such that that the person lacks the ability to make informed financial, medical, or personal decisions.

(b) Diminishing Capacity.

i. Diminishing capacity is not as easy to define nor is it currently contemplated directly in the Model Rules of Professional Conduct. For the purposes of this discussion, diminishing capacity refers to someone who is exhibiting signs of impaired decision-making but who in the opinion of the attorney/advisor still could make informed decisions regarding her financial, medical, or personal matters.

ii. Attorneys can use the Capacity Worksheet for Lawyers. If there is doubt, then the client should be asked to do an evaluation with a professional.

(c) Estate planners should assist clients in planning proactively for both diminished capacity and diminishing capacity.

i. Health Care Directives

ii. HIPAA authorizations

iii. Revocable Trusts

iv. Durable Financial Powers of Attorney

v. Contact Information

(d) Who should identify diminished or diminishing capacity?

i. Most lawyers are not psychologists.

ii. American Bar Association on Commission on Law and Aging has published a handbook to assist attorneys.

iii. It is of paramount importance for the attorney having estate planning documents executed to ensure client has articulated what they want to do and why. Practitioners should also be confident there is no undue influence.

(e) Settlor may be Trustee of his or her revocable trust. Settlors are rightfully concerned about the possibility of someone removing them based on incapacity. Drafters should create a structure that is protective of Settlor but ultimately allows a replacement when incapacity occurs.

(f) Powers of Attorney

i. Should agent under power of attorney be permitted to modify existing trusts?

ii. Should agent under power of attorney be authorized to modify testamentary scheme?

iii. Provisions regarding gift giving should be specific.

iv. Consider whether agent should be able to remove or replace trustees. Replacement can be specified under the trust and include details on how incapacity is determined.

(g) Use a no contest clause when contest can be reasonably anticipated.

(h) Legal and medical standards of diminished and diminishing capacity are different for different documents. Making determination is more difficult for newer clients.

(i) The end game is to ensure that a client's welfare and decisions are safeguarded.

(j) If a client makes a significant testamentary change, there is value to have the client providing an explanation in writing.

(k) To defensively protect a client's estate plan, consider consulting with litigation counsel. Defensive coordination can protect client and attorney.

i. Consider using audio and video, which has become more common.

ii. Record client interview and document signing.

iii. Ask questions that reflect testamentary capacity or contractual capacity.

(l) Team approach to estate planning can help ensure client's intentions are effectuated.

(m) Be aware of accommodating cognitive and sensory changes.

i. Use a quiet room so client can clearly hear. Minimize background noise.

ii. Conference rooms should be comfortable.

iii. Sit close to client and be clear.

iv. Supplement meetings with writings.

v. For vision, improve lighting and avoid glare.

vi. Format documents with larger print.

vii. Have magnifying glasses available.

viii. For cognitive impairment, slow down and break down topics and issues. Use an easy to follow, easy to read outline.

(n) Trustees should also engage in best practices for managing assets for beneficiaries with diminished or diminishing capacity.

i. Basic rules of conduct for fiduciaries include duty of loyalty, duty of care, duty to act in good faith, and prudent investment.

ii. Trustee should have established process for review and consideration of beneficiary requests. Independent judgment should be exercised.

iii. General Exercise of discretion

(1) Follow trust document.

(2) Balance needs of beneficiary with future needs of remainder beneficiaries.

iv. What is Trustee role in protecting a beneficiary with diminished capacity, disability, and discretion?

(1) Law and practice in traditional administration assumes beneficiary is competent.

(2) Administration of trusts for beneficiaries who have diminished or diminishing capacity presents unique challenges in communication, documentation, and settlement. Trustee protocols should be established for each area.

(3) If special needs trust or beneficiary incapacity is outside the trustee's expertise, assistance from an expert should be sought.

12 **<u>Question and Answer Panel. (Steve Akers, Samuel A. Donaldson, Sarah Moore Johnson, Carlyn S. McCaffrey)</u>**

(a) SLAT and split gifts.

i. Can't make a gift to yourself.

ii. Must be ascertainable and severable. What is value? The value should be ascertainable and hopefully have a low value. Use HEMS and take into account other resources available to the spouse to consider what is distributed.

iii. Consider not making the non-donor spouse a beneficiary from outset and give third party LPOA to appoint to new trust with spouse as beneficiary or to add spouse as a beneficiary. Perhaps that is 5-10 years out or after gift tax audit. That would be a strong position to support making a split gift election.

iv. If even a small amount qualifies then each spouse should be treated as a transferor of one half for GST purposes.

v. See Journal of Taxation article June 2007 by Diana Zeydel on gift splitting.

(b) SLAT – House.

i. What if asset transferred to a SLAT is a residence used by the couple.

ii. Spouse beneficiary can live in house under terms of trust.

iii. If marriage is good, the settlor spouse can live in the residence as well. There would be no inclusion under Sec. 2036 because in Gutchess case, there would not be an implied understanding of a retained right rather, the donor spouse is living there because of marriage to spouse/beneficiary. So that "is not a problem" per the panelists.

iv. Where does money come from to pay expenses of house? If settlor pays expenses, the payment would be a taxable gift unless the settlor has the right to live in house in exchange for payment. Be sure to have an agreement between trustee and settlor about whether the settlor will need to pay certain expenses in exchange for the right to live in the house.

v. What happens when settlor spouse dies so that the trust is no longer a grantor trust, but the trustee still needs money to pay expenses? What if surviving spouse pays house expenses? Is that a gift to the trust? This could be a problem that will need to be resolved.

(1) What if the beneficiary spouse only has discretionary right to live in the house, perhaps there can be an agreement whereby the beneficiary spouse agrees to pay expenses in exchange for right to live in the property? However, since the trust will be a non-grantor trust upon the death of the grantor, there will be taxable income to the trust and the property's basis will have to be depreciated.

(2) An alternative could be to give surviving spouse the right to pull out all income so that the survivor could be a Sec. 678 owner of the income interest in the trust, and the rental income should be ignored. Trustee might give spouse/beneficiary a term interest to live in the residence as a life tenant so that there should be no income tax consequences of the payments.

(c) SLAT – divorce.

i. How should practitioners deal with the risk of divorce when drafting SLATs?

ii. Provide in trust that spouse/beneficiary loses status as beneficiary in the event of a divorce, but then there could be a loss to both spouses of economic interests in the trust if divorce so that could be problematic.

iii. Consider whether to leave an option for the divorced spouse to remain a beneficiary but indicate that the SLAT assets will be considered as marital assets for the purposes of division as part of the divorce settlement.

iv. Problem with this approach to settlor spouse: the settlor spouse under 672(e) could still be continued to be taxed as the owner of the assets under the grantor trust rules. Sec. 682 would have afforded the settlor spouse a deduction for the payment of income taxes in this situation, but this statute was repealed for divorces after 12/31/18 by the TCJA 2017.

v. In the event of a postnuptial marital agreement provides that the beneficiary spouse will reimburse the settlor spouse for any taxes resulting from the SLAT, might the IRS take the position that the settlor spouse has an estate tax inclusion? Perhaps Rev. Rul 80-255 could be used defensively by the taxpayer to argue that getting divorced is an event of independent significance and that the right to reimbursement of taxes would not be considered a retained power under Secs. 2036 and 2038.

vi. Postnuptial marital agreement should be structured without creating an inference that there was an implied agreement inducing the donor spouse to create a SLAT. The purpose of the postnuptial marital agreement is to make clear that the SLAT assets will remain marital property for the purposes of dividing assets as part of a property settlement negotiation between the divorcing spouses.

vii. Definition of spouse – 2 ways to structure trust. Could name specific person as spouse but if we divorce then individual will be deemed deceased. That cuts spouse out. Other approach is to say in event of divorce named spouse continues to be a spouse even if divorced. Another option is the floating spouse definition. Speaker does not recommend option issue of representing both spouses.

(d) SLAT – Power to Borrow.

i. This works to give donor spouse access to funds of trust.

ii. Include express power to power.

iii. 675(2) if can borrow without adequate interest or security (require interest to avoid gift or estate issues). Payment of interest gets money into trust. Avoid Sec. 2036 issue of implied agreement that loan must be made.

a. SLAT – Creditor issues.

iv. Relation back doctrine. If donee spouse predeceases, give donee spouse right to appoint assets into a trust that donor spouse is a discretionary beneficiary.

v. Under relation-back doctrine, if POA exercised on behalf of settlor, then the original settlor will be treated as settlor of the trust under state law. Unless couple lives in a DAPT jurisdiction, creditors of donor in that case may be able to reach the trust. This could also raise estate inclusion issues under Sec. 2036 to the extent that there is an implied agreement that donee/spouse will exercise the POA on behalf of the donor spouse. Consider allowing time for the power of appointment in favor of the donor spouse to lapse. However, there could still be a sec. 2038 inclusion risk to the extent that the donor spouse is deemed to have retained control to determine beneficial enjoyment. Sec. 2038 could apply if settlor's creditors can reach trust assets.

vi. QTIP'able trust which on donee spouse's death goes into trust for donor spouse could raise Sec. 2041 issue under QTIP regulations. A possible out could be traditional state law rule allowing creditors to reach so much of the trust as the trustee in maximum exercise of discretion could distribute back to the settlor. If there's an ascertainable standard, the taxpayer may be able to argue that a Sec. 2041 ascertainable standard exception should apply to avoid inclusion.

vii. 19 DAPT states and about 10 states have rules preventing the creditors of the donor spouse from reaching assets in either QTIP or non-QTIP trust, even if they can be passed back to the original settlor spouse through exercise of a power of appointment.

viii. Few cases apply the relation-back doctrine for the benefit of creditors. The panelists surmised that "maybe we don't have the problem at all."

ix. Maybe settlor spouse will never have to be a beneficiary in any event.

(e) Memo decision in Estate of Michael Jackson.

i. Issued Monday 5/3/21.

ii. Since his death in 2009 figuring out amount of estate tax has been of interest.

iii. Decision is really bad for taxpayers. 271 pages long opinion.

iv. Valuation of 3 assets estate and IRS reached agreement on Neverland ranch and on other assets in the estate. The 3 that were litigated:

(1) Image and likeness of Michael Jackson.

a. Some states have common law right to publicity. It is a right to control the use of your name, signature, photograph, likeness, etc. Some states enacted statutory rights to this. CA has both common law and statutory right to publicity. The statutory right survives death of the person (Jackson) and survives for 70 more years.

b. With this right what is the value of it since it is a power to control economic exploitation of name, likeness etc. Estate valued it as $2,005. The King of Pop – the IRS said it was worth $434,000,000. Estate hired different experts for each asset. The expert that valued the publicity right used income approach and discounted for 10-year post death period (which is common) and came up with $3 million. IRS expert valued it at $161,000,000. Why such large differences? IRS expert said willing buyer would consider all the things you could do if there was a rehabilitation in Michael Jackson's reputation to create Broadway musical, movie, theme park, etc.

c. Tax Court said asset should be valued at date of death not what estate did with it in years following death. The court observed that at death Jackson's reputation was at an all-time low and he enjoyed an unfavorable persona. He had earned only $24 on licensing of his image. Court concluded $4.1M.

(2) Beatles Catalogue.

a. Jackson had partnered with Sony and created an ongoing cataloging warehouse to hold new songs. Jackson original had a 50% interest but because of his costly lifestyle he was borrowing against the Sony interest so at death there was a lot of debt, and the value was worth zero. IRS had said $469M. Estate expert said value was zero. Court found $227M value less $300M debt.

(3) Bankruptcy trust holding songs Jackson created and he had acquired that belonged to other artists.

a. Estate valued at $2.2M. IRS said $60M then IRS expert $114M. Tax Court in long analysis of the nature of the interests of the copyrights (5 types that each had to be independently valued) $107M close to IRS value.

(4) What about penalties? Isn’t there a substantial valuation understatement applicable? Court said no penalties to apply. Figures used on estate tax return were not so unreasonably low that penalties should apply.

(5) Lessons and conclusions.

a. Court did not like that IRS used same expert.

(i) IRS Expert lied when questioned by Court.

(ii) Because of credibility issue Court discounted IRS expert opinion.

b. Should all be valued as a block? As a whole? That the IRS said would increase value. Judge rejected that. There was a separate itemization on 706 and IRS cannot now argue for this if it didn't challenge earlier.

c. Estate's experts tax effected all future earnings. It was bankruptcy trusts not S corporations. Jones case involved S corporations and it was the first case since Gross case 20 years earlier that permitted tax effecting. The issue in prior cases is different than in the Jackson case.

(f) Legislative uncertainty - Retroactivity.

i. Disclaimer is a transfer tax not income tax doctrine. Rescission might be available if disclaimed in same year. Unclear what happens where disclaimer is made in the next year and you don't have a clear application of the rescission doctrine – will trust have to include it in gross income? Might have to rely on Sec. 1341 right to recovery.

(g) Disclaimer.

i. Who can disclaim on behalf of trust?

ii. Sec. 2518 focuses on individual disclaiming. Expresses concern unless a single beneficiary trust for single beneficiary to disclaim.

(h) Deemed realization.

i. American Families Plan.

(1) No deemed realization if donated to charity.

(2) Charity is the only apparent exception.

ii. Van Hollen discussion draft.

(1) Terminal interest.

(2) Sec. 2056(b)(5) or life estate with power of appointment are excepted, only on disposition or death.

(3) The estate trust is not included.

iii. Pascrell filed.

(1) HR 2286 by Pascrell.

(2) Exception for spouses so no deemed realization on that.

(3) Transfer to trust for spouse only deemed realization if paid to qualifying trust if distribution out or stops being qualified.

a. Qualified domestic trust. Want to be sure tax gets paid.

b. Spouse is sole beneficiary.

c. Transfer during life or surviving spouse "has the power to appoint over the entire trust." Strange wording. What does it mean? May require a power of appointment.

(4) Biden Administration - nebulous indication it wants only repeal of step-up of basis on death rule (so no gain until actual sale) but could be that there would be deemed realization on transfer as has been proposed by Van Hollen and Pascrell.

iv. Advise clients to make gifts as they normally would because the chances of deemed realization are so small it would not be worth putting a hold on specific planning.

(1) Comment NOTE: These are the speakers' comments and opinions as to 2021 planning.

(i) 529 front loading.

i. No talk of reducing gift tax annual exclusion as it relates to 529 gifts.

(j) 2004705

i. TP gave annuity interest in CRT to remainder beneficiary which was a private foundation

ii. Rev Rul 72-243 tells us that term interest is a capital asset and treated as capital gain.

(k) Term interest in QTIP.

i. What are tax consequences of a termination of spouse interest in QTIP? Sec. 2519 indicates that the spouse would be treated as having made gift of remainder interest to remainder beneficiaries and of income interest under Sec. 2511.

(l) FLP/LLC planning in light of Powell and Moore.

i. Can you have control after transfer to trust? Watch out for the prohibited powers in Sec. 2036.

ii. Instead of the client making a gift, structure the transfer as sale and meet the bona fide sale requirement. So, sell then forgive note to bolster the transaction and possibly avoid Powell / Moore implications. Make interest payable monthly and actually make payments in order to show Note was made in good faith. Use LLC as collateral and file UCC financing statement to secure the Note.

iii. Under Sec. 2036(a)(1), grantor cannot retain income from gifted interest. Cannot use FLP as a family bank for the grantor, etc.

iv. Speaker names a “distribution officer” for tax sensitive provisions and grantor should renounce any right to amend trust.

v. What about management of asset? If grantor can manage investments of the LLC, the IRS may conclude that the grantor retained the ability to control enjoyment of the LLC income. Others disagree that this right to manage investments is not the management of the LLC. It would be safer to have the trustee of the trust and not the grantor serve as the manager to control the income spigot out to beneficiaries.

vi. If amend trust agreement, there’s a potential Sec. 2035 inclusion issue. The grantor will need to survive 3 years from the date of the amendment.

(m) Partnership vs. LLC.

i. State law differs. Some treat LLCs more harshly then FLPs, e.g. Texas.

(n) Concerns for clients with $7-10M of net worth.

i. What if exemption drops they will have an estate tax?

ii. Use annual exclusions.

iii. Use GRATs.

iv. Make transfers to preserve as much of exemption as possible with gifts to grantor trust.

v. Use SLATs and transfer 3, 4 or 5M.

vi. You probably don’t need reciprocal trusts for this situation.

vii. Get financial model done as to what they need for retirement and gift the excess.

13 **<u>Client Confidentiality in Remote Work. (Presented by John F. Bergner, Jeff Chadwick, Lauren J. Wolven)</u>**

(a) Model Rule 1.6 sets forth the general rule regarding a lawyer's duty to maintain client confidentiality. Absent certain exceptions, "[a] lawyer shall not reveal information relating to the representation of a client."

i. Distinguish the duty of confidentiality form attorney-client privilege. As a general matter, the duty of confidentiality is much broader than the attorney-client privilege. All communications between a lawyer and client are confidential, but only a subset of those communications are protected by the attorney-client privilege.

(b) Identify conflicts of interest at the beginning of a relationship and continue to consider as the relationship evolves. Husband and wife have a conflict of interest. Beneficiary who is also a fiduciary may create a conflict. Representing businesses and their owners may represent a conflict.

i. In structuring the engagement letter, attorney should give thought as to who the client is and consider identifying who is not the client. Consider sending a letter to the non-client explaining that he or she is not the client in such situations as where a couple's son is attending meetings. The same type of letter should be considered for beneficiaries in a trust administration clarifying who the attorney duty runs to.

ii. From a confidentiality perspective, attorney must obtain consent to disclose information to collaborative advisors. Many attorneys rely on *Kovel* letters in which lawyers retain outside advisors, such as appraisers, in order to create attorney-client privilege.

(c) With evolving technology, consider communication methods. Include language in your engagement letter regarding how you will communicate.

(d) To fulfill duties of confidentiality, lawyers must analyze on a case-by-case basis, whether security measures are reasonable when communicating with clients.

i. In the remote environment, lawyers must consider the nature of the threat. Does an employee working at home create a greater risk to confidentiality? If so, how can client confidentiality be protected?

ii. Potential cybersecurity threats increase dramatically with remote work.

iii. All lawyers should understand and use basic electronic security measures both in and out of the office. This includes password changing, encrypting data, installing antivirus software, using secure WIFI, relying on dual factor authentication.

iv. Confidential information should be labelled.

v. Lawyers and non-lawyers should be trained in technology and information security.

vi. Conduct due diligence with respect to vendors.

(e) Safeguarding verbal communications

i. Understand how video conferencing works, including security protocols to avoid “zoom bombing”.

ii. Law firms should ensure that their video conferencing software is current, and regularly update their security software to the latest versions.

iii. Attorneys should utilize all available safety features, such as requiring passwords for meetings and enabling the waiting room function for new participants.

iv. When not in use, lawyers should cover cameras and disable microphone and camera features.

v. When speaking from home, lawyers (and clients) should be mindful of who may be within earshot, as even the presence of a family member may waive the attorney-client privilege in certain circumstances.

vi. Lawyers (and clients) should also be aware of "what" may be listening, and should manually check the privacy settings of household devices with smart technology or disable self-listening devices altogether when speaking with clients.

vii. When appearing on video, lawyers should ensure that confidential files related to other clients are not visible, and perhaps use an automated or blurred background to prevent inadvertent disclosure.

viii. To the extent possible, lawyers should avoid verbally communicating with clients in public places or using unsecured, public Wi-Fi networks to access video conferencing technology; and

ix. Finally, because technology is constantly changing, lawyers should stay as up to date as possible on current technology and cybersecurity developments.

(f) Safeguarding Written Communications

i. Written communications are virtually impossible to delete.

ii. To the extent an attorney is uncomfortable with the content of a written message, he/she should consider whether the message should be sent.

iii. Be careful about who is copied on written communications.

iv. Consider the email address that a client is communicating from.

(g) Electronic Files.

i. The beauty and danger of electronic files is that they are always there.

ii. Many lawyers have multiple devices. Care should be taken to ensure that confidential information is removed before disposing of a device.

iii. When providing documents to clients electronically, attorneys should emphasize importance of storing documents in a safe place.

(h) Ethical duties extend to supervision of other lawyers, staff, and third-party service providers. Law firm should have policies, train employees, and ensure confidentiality.

(i) Practical Suggestions

i. Embrace technology.

ii. Carve out a work space at home where complying with ethical rules of confidentiality is simplified.

iii. Invest in the right equipment for lawyers and staff.

iv. Create a routine that involves safeguarding client information.

v. Limit distractions when working at home.

vi. Overprotect client information.

vii. Over-communicate with clients and colleagues.

viii. Stay aware of legal updates.

14 **<u>Non-Citizen Spouse International Planning. (Presented by Michelle Graham, Michael Rosen-Prinz).</u>**

(a) Overview.

i. Planning for non-US Citizen spouses.

ii. Hot topics in international tax.

(b) Case Study.

i. H and W living in US for 10 years and have green cards. H has assets including business $13M, house $1M, tangibles $250,000 and securities $700,000 for total NW of $15M.

ii. Will H be considered domiciled in US for US estate tax purposes. US domiciliary subject to US tax on worldwide assets and have $11.7M exemption.

iii. If not domiciled in US small $60,000 exemption but only US assets subject to tax.

iv. Many of assets above are in US – shares in business and real property and tangible property. So most assets are subject to US estate tax.

v. No intent to move back to Brazil and US was home.

vi. Have about $3.3M subject to estate tax so tax is $1.3M

vii. If community property would change tax picture by ½.

viii. Assume that not in a community property state and all assets below to H.

ix. If not a US citizen can return to home country and take assets and escape tax so to get marital deduction deceased spouse must pass to US citizen spouse or no marital deduction. Exception is for the QDOT = Qualified domestic trust.

x. If to a QDOT marital deduction would apply. Had they incorporated a QDOT even through a disclaimer it would have avoided the tax.

xi. What if fund trust that does not qualify for QDOT and surviving spouse does not qualify as citizen? Code permits reforming a non-QDOT marital trust to qualify trust as a QDOT.

(1) Give the trustee ability to modify trust to qualify without having to go to court and file petition. E.g. Trustee can modify without court. If trust has that provision modify before filing return.

(2) If have to go to court to modify need to complete before filing return and court order will date back.

xii. Can you qualify an outright will transfer to W not citizen for marital deduction?

(1) E.g. designation on life insurance, joint tenancy, etc. There may still be opportunity to qualify for marital deduction.

(2) QDOT can be revocable.

(3) Trustee can make distributions out under a broad distribution provisions just in case surviving spouse becomes US citizen.

(4) Might want to pay tax and go back to home country.

(5) So keep a QDOT flexible.

(6) Asset transfers must be in writing, could be specific asset or group of assets.

(7) Consider a protective assignment filed with estate tax return.

xiii. What about retirement assets?

(1) Some assets cannot be transferred, e.g. a retirement account.

(2) Instead have surviving spouse enter into agreement. Make an election to remit estate tax when a distribution of corpus, so if an RMD and part is corpus there will be a payment then of a QDOT estate tax.

(3) Every time a distribution is made of corpus out of retirement plan that corpus can go into a QDOT to avoid having to calculate tax each time.

(4) Information statement has to be filed with estate tax return consisting of information as to what plan or arrangement looked like.

xiv. If surviving spouse becomes US Citizen before estate tax return has been filed and resided in US at all times can take advantage of marital deduction without a QDOT. Problem is with timing if has not already started the process to become a US citizen unlikely to be able to do this in time. If file late it may work but there may be other negative consequences.

(c) QDOT and requirements.

i. Must have US trustee. Trust document should include requirement if not won't qualify as a QDOT. US trustee is individual who is a US citizen and resident of the US.

ii. Must be an "ordinary" trust.

iii. Must be governed under US State law or DC.

iv. Copy of trust agreement must be located in US.

v. Large QDOT more than $2M. Require US Bank, letter of credit or bond.

vi. File protective QDOT.

(1) In writing.

(2) Irrevocable.

(d) Taxation of QDOT.

i. Unlike a regular marital trust, tax comes into play whenever there is a taxable event such as a lifetime distribution of principal.

ii. If QDOT ceases to qualify that is a taxable event but there is a time period to fix it.

iii. If she was a resident from time of H’s death until time became spouse she can take distributions out of QDOT without paying QDOT tax.

iv. Filing requirements for QDOT.

(1) All taxable events must be reported on Form 706-QDT.

(2) Even distributions for hardship must be reported.

(3) Form due April 15 subject to 6-month extension.

(4) If multiple QDOTs make a designated filer to coordinate reporting and collecting information for all QDOTs. Within 60days of due date others must provide information to designated filer.

v. Liability for the tax.

(1) Personal liability for trustee for QDOT tax.

(2) If multiple QDOTs trustee is only liable for tax on assets under that trustee’s control.

(3) Lien on QDOT assets to cover tax.

(e) Portability

i. It is only $60,000 so not much involved.

ii. is not allowed if decedent was a non-US citizen/non-US resident.

iii. Treaty might change result.

(1) Domicile treaty may give pro-rata share of exemption.

(2) Savings clause in treaties that say if have US citizen and if look to situs treaty.

(f) Gift tax rules.

i. No unlimited gift tax exemption for non-US citizen spouse.

ii. No special exception for spouse that becomes US citizen (i.e. the estate tax rule doesn't apply).

iii. No QDOT exemption.

iv. $100,000 indexed now $159,000 on gifts to non-citizen spouse must meet present interest requirements and qualify for terminable interest.

(1) Can I gift to ILIT using larger annual exclusion, only if the spouse has a general power of appointment at death which would defeat ILIT plan?

(g) Hot topics in International tax.

i. Exit tax exemption $744,000.

ii. Rev. proc 2020-20 substantial presence test which is one way a non-citizen 7701(b)(3) can be subject to US income tax like a citizen. This can happen by having a green card or substantial presence.

(1) Can exclude days in US and while here a medical condition arises, and they are stuck in US because of that.

(2) Form 8843 attached to Form 1040 NR.

(3) Covid emergency days can be excluded.

iii. DAC 6.

(1) Applies to EU member states dealing with reporting requirements for cross border arrangements.

(2) Privacy does not have same value in EU as in US. Generally if trying to keep something private you are suspected of doing something illegal.

(h) IRS Voluntary disclosure program.

i. In 1990s there was no program. Filed amended returns to get into compliance.

ii. People move to US and may understand they become subject to paying income tax on worldwide income but may not appreciate the regulatory obligations on companies or trusts owned in other countries, etc. and don't realize the US "long arm" in acquiring information and even how the US taxes. Until TCJA if US resident owned foreign corporation that US resident was subject under Subpart F tax and if corporation had active business operations there was no pass through to the individual which changed that so that tax passes directly on to US taxpayer.

iii. FBAR penalty greater of $100,000 and 50% if willfully did not comply.

iv. Speaker always sends in reasonable cause statement when files delinquently then when gets notice resubmits.

(i) Rev Rul. 2020 – 17.

i. 3520 not required for certain foreign trusts like a pension. No need for 3520A which are require for grantor trust by US person.

ii. FIN CEN 114 FBAR is still required.

(j) CCM 2021-002.

i. Foreign entity is classified as US tax purposes as a 7701 corporation, association, or pass-through entity.

ii. These rules go to whether or not there is limited liability for all members. If there is it may be a corporation.

iii. Default classification of no one says anything.

iv. Entity can elect to be classified as something else for US tax purposes. A check the box election.

v. If corporation elects to be treated as disregarded entity or pass through there is a realization event.

vi. CCM says classifications apply to foreign entity when it is relevant. If you make an election that makes it relevant. If an entity is not relevant as has nothing to do with US and makes an election is that an original entity? Is there a classification before the entity is relevant? It has a classification when not relevant, so if you a foreign entity you still may be a corporation under US law.

15 **SECURE Act. (presented by Natalie Choate).**

(a) IRAs different from other assets.

i. Generally all pre-tax money. “A big bag of taxable money.” Either client pays during life if not heir pays income tax after death, usually within 10 years of death.

ii. Roth IRA is an exception which will be addressed below.

iii. Other client assets generally are not subject to income tax and get a step up in basis, but that may all change.

iv. IRA 401(a)(9) subject to minimum distribution rules. We have to plan around those rules as to how long money can stay in there and when it can come up. This landscape was radically changed by Secure.

v. IRAs pass by beneficiary designations unlike other estate assets which pass by will like stocks and house.

(b) Distribution rules.

i. How long can money stay inside plan?

ii. Before SECURE, taxpayer could reasonably expect to have IRA left to children or grandchildren or trust for them and have the IRA distributed over the life expectancy of the oldest beneficiary. If child in 30s that could have been a 40-50+ year payout. This was such a great deal that it was the focus of planning.

iii. SECURE changed this. It eliminated life expectancy payout for a lot of beneficiaries. The new regime is generally 10 years after death.

iv. SECURE was enacted 17 months ago and we still don’t have regulations or any official guidance. Rumor is that the proposed regulations are almost ready.

v. Although no official guidance in March IRS issued its new edition of publication 590B for IRA owners that discusses when you must take distributions from IRAs.

(c) There is no grand strategy to beat SECURE. Planning is really more about “damage control.” There is no miracle solution.

(d) Minimum distribution rules. 401(a)(9) and Regs.

i. Code is modified by SECURE. Regs have not yet caught up.

ii. Lifetime rules tell you when IRA owner/employee must take money out of own retirement plan.

iii. Post-death rules apply to when heir who inherited plan must take out money from IRA. Post-death rules depend on plan owners RBD = required beginning date which is in the lifetime rules. Different rules if plan holder died before or after RBD. So first, determine the RBD.

(e) Hypo/Example.

i. Client comes in with 3 plans. Each may have a different RBD.

ii. Roth IRA.

(1) Roth IRAs don’t have required lifetime distributions so no RBD.

(2) So regardless of plan participant’s age, the plan participant is always “before” his RBD.

(3) It is possible to have Roth accounts inside a 401(k) and they are treated as 401(k) plans for purposes of RMDs and determining RBD.

iii. Regular IRA.

(1) Must begin distributions 4/1 year after 72 see below.

iv. 401(k) at his firm.

a. What is RBD? Depends on whether he is a 5% owner of the employer.

a. If not retired, no RBD and plan participant can work until 100.

b. If retires 4/1 following year after retirement.

v. RBDs

(1) Used to be age 70.5 when the first distributions were required to start. RBD was 4/1 of following year.

(2) Under SECURE, RBD is at age 72 year. RMDs are required to start on 4/1 of the year following the plan participant’s 72^{nd} birthday.

(f) What are the minimum distributions upon death?

i. Two factors/times.

(1) If death before RBD

(2) If death is after RBD

ii. Who is beneficiary- different beneficiaries get different status / different payout requirements?

iii. Death before RBD.

(1) Non-DB.

a. This is least favorable.

b. How do you get into this unfavorable class? Do not be a human being

c. Estate is a non-DB e.g. client forgot to fill out beneficiary form. Most plans have estate as default beneficiary.

d. Another way to be a Non-DB is you name a trust that is not a see-through trust.

e. Death before RBD and the beneficiary is a non-DB, the 5-year rule applies. All benefits must be distributed by end of year that contains the 5th anniversary after death. This gives 6 taxable years to spread distributions over.

f. No RMDs during 5 years. Only required distribution is on 12/31 of the year in which the 5th anniversary of death occurs.

g. SECURE did not change the rules for non-DBs.

h. Not filling out beneficiary forms happens “a million times a day.”

i. Why does IRS have such restrictions on this? No idea.

j. 590B gives 5-year rule example for someone who died must withdraw all account by 12/31 of end of 5th year. Why is this a mistake? Because CARES Act suspended RMDs for 2020 so as part of that change the CARES Act amended this. Remember that IRS publications have mistakes and are not authoritative.

(2) DB. Designated beneficiary means an individual or a see-through trust named by participant or plan document.

a. SECURE says DB is subject to 5-year rule but we change 5 years to 10 years, so a plain/regular DB is now subject post-SECURE to a 10-year rule unless qualifies as an EDB.

b. 10-year rule is just like 5-year rule, so no distributions are required until end of the 10th year after the year of death.

c. Die leaving IRA to DB must withdraw 100% of the account not later than 12/31 of the year that includes the tenth anniversary of the plan participant's death. Ostensibly, this allows for a stretch over 11 taxable years following death of the plan participant.

(i) Publication 590B made a mistake on this. A lot of language is carried over from prior editions without updating for modifications or eliminations by SECURE.

(ii) Page 12 example says dad died in 2020. Shows how to compute RMDs by looking up life expectancy in table and divide by age, etc. But, if father died in 2020 you don't get life expectancy payout unless beneficiary was an Eligible Designated Beneficiary (an "EDB" – discussed later). Regular DB does not get life expectancy payout but rather the new 10-year rule applies. Some have interpreted this as IRS saying the DB would have to take out distributions each year in 10-year period. This is an incorrect presumption based on the SECURE Act and what other guidance issued by the IRS about SECURE. The IRS clearly said how 10-year rule works in other parts of 590B – which is not to require any payout during the period between death and 12/31 of the year which includes the 10th anniversary of the plan participant's death. The SECURE Act clearly says that life expectancy payout does not apply to 10-year rule.

(iii) In 4 places in Publication 590B, the IRS explained the 10-year rule that says you have to take all distributions out by end of 10th year. Penalties for missing RMDs is a 50% penalty. It says you don't need to use life expectancy table as they don't apply.

(3) EDB – eligible designated beneficiary.

a. Still gets life expectancy payout like in the pre- SECURE days.

b. Pre- SECURE beneficiary would start taking payouts over life expectancy and whoever came after the first beneficiary could continue to take out distributions over life expectancy of that original beneficiary. SECURE eliminated this opportunity. Under SECURE, when the EDB dies, the successor beneficiary is subject to the 10-year rule starting from the date of the EDB's death.

c. EDB Types.

(i) Surviving spouse.

(ii) Minor children.

(iii) Disabled person.

(iv) Chronically ill person.

(v) A Person not more than 10 years older than deceased plan owner.

d. There are four different payout regimes for the above 4 EDBs.

e. Publication 590B gives preview of what IRS is planning.

(i) Client died before RBD so EDB can get life expectancy payout or can elect to use 10-year rule if she prefers according to Publication 590B.

iv. Death after RBD has different result.

(1) Non-DB.

a. No 5-year rule that ends with RBD.

b. Instead Non-DB must withdraw benefits over what would have been the remaining life expectancy (LE) of the decedent. This is called the “ghost life expectancy.”

c. Look at life expectancy. New tables coming for 2022. If die at age 73 (after RBD) has 16.4-year life expectancy. If left to estate first distribution would be following year and withdrawal would be 15.4 years which is a better deal then what a DB gets of 10-years.

d. This occurs from age death at age 73-about 80.

e. This has created “planning hysteria.”

f. Toggle plan.

(i) What if leave to see-through trust and plan holder dies from age 73-80 you may want to disqualify the trust, so it is not a see-through to get a longer life expectancy. Should we build into the trust a “kill-switch” to permit disqualification to get the ghost life expectancy? Natalie does not see this as a magic solution.

1. Consider client with 3 plans: Roth, IRA, retirement plan. If he retired and is past RBD for traditional IRA and retirement plan. You would prefer longer ghost payout. But if you disqualify the see-through accumulation trust that would have gotten 10-year rule you would have gotten a DB.

2. Past RBD ghost life expectancy rule applies. Trust will take money out over about 14 years instead of 11 fiscal years under the 10-year rule.

3. Does this save much money? No. a 10-year payout at end of 10^{th} year following death can produce more money on a present value basis then a 14-year payout that requires payout each year in that 14-year period.

4. Roth IRA if disqualify trust and client died before RBD (which is always the case for a Roth) so you would be subject the Roth to a 5-year rule. That is detrimental and should not be done.

(ii) Plan may only have a lump sum distribution option. If you have a DB that inherits a plan like that the DB can require the plan to do a direct rollover to an inherited IRA in the name of the trust. So, if it is a DB you can do a rollover of a death benefit by a direct transfer. A non-DB has no such right. The plan cannot do it.

(iii) No beneficiary other than spouse can rollover a distribution from a plan.

(iv) The toggle solution to disqualify a trust is not really a great plan.

(2) DB.

a. 10-year rule applies regardless of whether plan holder died before or after RBD.

b. DB cannot elect to get into ghost life expectancy. 590B does not mention this as an option.

(3) EDB.

a. Gets life expectancy payout EDBs still get but 590B says they will continue the pre-Secure rule “longer of payout” method.

b. EDB can take out distributions over longer of EDBs life expectancy or ghost life expectancy. That is a direct continuation of the pre-Secure rules that applied to a DB.

c. Secure is structured so EDBs get the same deal DBs use to get and this approach using the “longer of” is consistent with that. But the IRS has not extended this to the regular DB.

d. This is not an election as an EDB you get the longer of.

(g) Hypo continued – do estate plan with client.

i. What type of beneficiary will inherit? Is someone to benefit an EDB? Should you steer IRA to that EDB beneficiary?

(1) Prior plan left all assets to children in their 20s pre-Secure. Had low brackets and long-life expectancy. Set some aside for sibling using other assets. Now children earning high income and older and no longer qualify for life expectancy and don’t qualify for 10-year rule. May be better to change the plan and leave IRA to siblings since will qualify for life expectancy payout since not more than 10 years younger, etc.

ii. 4 ways to leave retirement benefits.

(1) 4 ways to leave retirement accounts:

a. Outright. Just name individual.

(i) Beneficiary will get every option minimum distribution laws allow e.g. 10-year rule or LE payout.

(ii) Adult son age 45, married, family, high income and responsible.

1. Give him benefits outright.

b. Conduit trust for beneficiary or trusteed IRA and name person as beneficiary of the trusteed IRA.

(i) These function the same for minimum distribution rules.

(ii) Many banks are offering trusteed IRA. Some thought Secure killed trusteed-IRA because people used them so bank would calculate life expectancy payout. Long payout is gone so they are not as “glamorous” but the big planning problem with the 10-year rule is when to take out money during 10-year period. You have to look at facts and tax brackets each year in the 10-year period. That is something a professional trustee in a trusteed IRA can do. There is no right answer.

(iii) The beneficiary will get the best deal he or she can get under minimum distribution rules as deemed sole beneficiary of the account.

(iv) Conduit trust.

1. Child may not be responsible.

2. Trustee must pass out benefits to the conduit beneficiary.

3. Trustee will decide investments and when to take distributions, but once trustee gets a distribution to pay it out. But can deduct expenses and pay it for the benefit of the beneficiary.

4. But in the next 10 years trust will terminate and have to pass to or for the benefit of the adult child.

(a) Advantages is more control over distribution and when they occur then an outright distributions.

c. See through accumulation trust for person.

(i) See through trust will generally qualify for the 10-year rule except for disabled or chronically ill beneficiary when it can get life expectancy.

(ii) What if concerned about divorce, creditors, addition, etc. Don't want child/heir to have outright control. So use see-through accumulation trust.

(iii) Trustee can take money out of IRA and keep it in the trust in contrast to the conduit trust above which must pay it out.

(iv) What makes it "see through" all beneficiaries of trust are humans. Example in the Regs income to spouse remainder to children on her death. Nothing more. All countable beneficiaries must be individuals to qualify for see-through trust. Cannot include a charity as a remainder beneficiary.

(v) See through accumulation trust gets 10-year rule so income from IRA hits trust and hits trust income tax rules.

d. Trust that does not qualify as a see-through trust.

(i) Non-DB gets rules above.

(h) Surviving spouse as beneficiary.

i. Gets life expectancy payout but different than other EDBs, it's a "special" deal on payouts.

ii. This is same deal as pre-Secure. Spouse was an "EDB" back then as pre-secure she got better deal than other DBs. Special deal surviving spouse gets are:

(1) Starts year after decedent's death but for SS beings later of year after decedents death or the year decedent would have reached age 72. So if H died at 65 she can leave it in account until H would have been age 72.

(2) Surviving spouse must recalculate life expectancy annually. Normally for other beneficiaries find life expectancy and reduce by 1 each year and never recalculate. With surviving spouse you never outlive the IRA because recalculate as long as leave.

(3) After death of surviving spouse it flips to 10-year rule so total is surviving spouse's life expectancy plus 10 years.

iii. Spouse also gets spousal rollover. If name spouse individually she can rollover to her own IRA. That will generally be a better deal. The rollover is the primary reason to name the surviving spouse outright as beneficiary. Not affected by Secure. If rolls it over she can name her own beneficiaries including an EDB.

iv. Conduit trust for surviving spouse.

(1) Example in pre-secure regulations – gets same deal as spouse would have received if she had received it directly.

(2) Gets life expectancy payout just like spouse would have received with life expectancy recalculated annually.

(3) Spouse is considered sole beneficiary of IRA and trust and she gets same result as an EDB (even before we had EDBs).

(4) Trusteed IRA would be the same.

(5) Planning note: don’t tie terms too closely to tax rules. Don’t forget client goals and needs of surviving spouse. For example, in 2020 there was no RMD. Put into the trust what you really want to get. If you want minimum HEMS say so.

(6) What are downsides to conduit trust and trusteed IRA for spouse? If decedent died before RBD (age 72) and surviving spouse died before the as well. If wife did not name new beneficiary the 5-year rule not the 10-year rule will apply. If use conduit trust give surviving spouse general power of appointment or giver her power to name a DB in case both die before first to die spouse would have reached age 72.

v. See through accumulation trust.

(1) Pay income for life and principal for support and on death principal goes back to beneficiaries

named by plan holder. Only payout income and principal if needed for support.

(2) Keep it a see-through trust by only naming human beneficiaries.

(3) Does not get preferential treatment a spouse would get – does not get special spousal deals. Same as before secure.

(4) EDB is worse off after Secure. This would have qualified pre-Secure as a DB for life expectancy payout. Best deal this trust can get post-Secure is a 10-year deal.

(i) Minor child.

i. Special minimum distribution rules which are not favorable. When minor reaches majority is no longer an EDB and flips to 10-year rule.

ii. If parents want older age say 45 this won't work.

iii. IRS has not yet defined majority for Secure. Would hope for objective national standard say age 26. So would not have to be distributed in full until age 36 but now IRS has not defined so it is state law that governs and could be age 18.

iv. If have family pot trust for multiple minor children not certain when flip out of EDB status occurs. When oldest child hits age of majority? No idea.

v. Parents of young children should not qualify for this fake life expectancy payout. Consider what parents ideally want to provide if qualifies for 10-year rule. If taxes paid sooner than expected just allow for that financially. Why incur cost to draft around RMDs since few parents die while children are minors. It is even more unusually for both parents to die. So don't direct effort to salvage a few extra years of deferral. Focus on client goals.

vi. Disabled and chronically ill.

(1) Disabled = Unable to work 72(m)

(2) Chronically ill – definition based on categories of daily living.

(3) Deal outright or conduit trust would qualify for life expectancy payout. They are the only class of EDB where you can have an accumulation trust that qualifies for the life expectancy payout if the sole beneficiary of the trust is the disabled individual.

(4) This was specially drafted to accommodate SNT trusts. So you can draft this to dovetail with a supplemental needs trust for a beneficiary.

(5) On death of disabled or chronically ill must pass to humans.

(6) Pre-secure could have paid unneeded funds in each year to other family members and push income to lower brackets but that is no longer available post-Secure.

(j) Not more than 10-years younger.

i. Can name as outright beneficiary or in see through accumulation trust.

ii. 10-year rule applies if name see through trust.

iii. Consider a CRT for an older beneficiary. That gives lifelong income not just life expectancy.

(k) Accumulation trust tax at trust rates.

i. Most IRAs are subject to fiduciary income tax rules.

ii. Pre-Secure you did not have to know fiduciary income tax rules since IRA paid in dribs and drabs over a very long period. Post-Secure it will pour into trust in short period of time and often at the end of 10^{th} year.

iii. 7 fiduciary facts that planners must know to deal with retirement benefits payable to trust.

(1) Trust income tax rates are compressed. Trust hits 37% bracket at $13,000 of income. In contrast, a human hits that at more than $500,000-$600,000 of income. So trust income will be in highest income bracket quickly.

(2) Trust gets DNI = distributable net income deduction for income passed through to beneficiary. This permits trust to pass income out to beneficiary. But distribution must occur within a short time of year in which income received.

(3) Not every distribution carries out DNI.

(4) Trust accounting income is not the same as federal gross income. A trust can have income and can have an income beneficiary, but it gets no deduction for paying income to beneficiary if it has no trust accounting income.

a. Pay income to spouse for life and on death principal to children. An asset payable to the trust is $1M IRA that trustee cashes in pro-rata and passes to spouse. Takes $100,000 from IRA and pays to spouse. Trustee cannot do that as it says pay spouse income and hold principal for children. $1M IRA is on day one principal not income.

b. Trust accounting income doesn't treat retirement plan distribution as income. You must draft definition of trust accounting income for retirement plan benefits that are payable to the trust. Don't rely on state law. Some state law don't work. Consider the 10% rule that UPIA said if trustee takes distribution of retirement plan from trust and its required distribution 10% is treated as income and the rest is principal and if it is not a required distribution all is principal. So if cash out $1M IRA over 10 years it is not a required distribution as there is no required distribution until end of year 10 so -0- is included as income so no income is distributed to spouse.

c. Draft a definition of trust accounting income that makes sense for retirement benefits and give trustee flexibility to pass out retirement plan benefits to beneficiaries if advisable to pass out 37% taxable income to lower bracket beneficiaries.

d. IRS will not accept 10% rule as a definition of income. It doesn't provide a fair allocation between beneficiaries. IRS will accept:

(i) Look at internal income of retirement plan and income of IRA will be defined as internal income of the plan as if it were a separate trust (e.g. income and dividends in IRA).

(ii) Unitrust definition so instead of trying to identify interest and dividends you pick between 3-5% of trust value each year and treat that as income.

e. Focus drafting attention on a usable definition.

(5) Difference between pecuniary and residuary bequests. Pecuniary is a fixed dollar amount. Residue is what is left. A pecuniary bequest does not carry out DNI (there are a few exceptions).

a. If you have a trust loaded with IRAs you don’t want a lot of pecuniary bequests as residuary beneficiaries will have to cash out IRA pay tax then pay pecuniary bequests.

(6) The separate share rule. Suppose the trust is administered as 3 equal shares for son, daughter, and charity.

a. Trustee cashes out IRA and would like to allocate to charity or to child in low-income tax bracket. You cannot do that. You must for DNI purposes must allocate pro-rata to the shares you could have used to fund.

b. If for tax purposes you could have allocated to any of the shares you have to allocate equally.

(7) No DNI deduction for distribution to charity. If deductible it is a 642(c) deduction not a DNI deduction. If you have a gift to charity coming out of a trust you must be sure it qualifies of the charitable deduction under 642(c).

(8) Difference between taking a distribution from an IRA which gives DNI and paying it out to the beneficiaries which may give you a DNI deduction. Transferring the IRA itself to a residuary beneficiary does not trigger DNI realization and does not pay out DNI.

a. Instrument should give power to transfer assets in kind and pick and choose which asset can go to which beneficiary.

b. Best if instrument drafted to say charitable bequest shall be fulfilled to the maximum extent possible from IRA.

c. You may still get there if the instrument does not have that specificity.

(l) Planning.

i. Tough to use a standard form for IRAs.

ii. Consider the class of beneficiaries.

iii. Should share for newborn convert to conduit trust?

iv. What if a child becomes disabled? May not be possible to change the estate plan. Should you turn it into a conduit trust? It won’t be a supplemental needs trust. Would be advantageous to beneficiary to have life expectancy payout. May be able to create (d)(4)(A) trust for distributions. Don’t try to qualify for tax benefits and neglect drafting for human issues.

16 **<u>Wrap Up. (Turney P. Berry, Charles A. Clary Redd).</u>**

(a) Federal Cases and Rulings.

i. Moore.

(1) Moore case was decided 4/20 TCM decision.

(2) Classic FLP case. There are dozens of cases going back to the 1990s and the end result is 2036(a)(1) requires inclusion in the decedent's gross estate of assets transferred into FLP.

(3) But the case went on to talk about the double inclusion issue of 2031, 2036 and consideration offset of 2043 and Moore is a follow on from Powell. They did not solve the double inclusion problem when values increase from date of funding until date of death. We are still left with "the specter of double inclusion."

ii. Straightoff.

(1) Assets transferred into FLP. 89% LP interests put into revocable trust.

(2) As 89% LP under Texas law decedent could compel liquidation.

(3) This amounted to transferring assets into FLP and into revocable trust and got an 18% discount which was remarkable.

(4) Don't consider this a great precedent it is too good to be true.

iii. Warne.

(1) Lifetime gift of assets to LLC and some LLC interests given to foundation and some to church.

(2) You have a valuation for gift tax purposes and the two values should offset each other but they did not because Tax Court correctly observed (although the public policy may leave something to be desired) we had a split up of the LLC. For gift tax you value what was given but for charitable contribution deduction you value what the charity received.

(3) What charities received did not have control.

(4) There was a valuation mismatch and the gift tax properly payable was presumably a debt of the decedent's estate so residuary beneficiaries under estate probably bore burden.

iv. Nelson.

(1) Formula gift and sale to an irrevocable grantor trust.

(2) Language used was shot down by Tax Court.

(3) Formula gifts should still be upheld but in Nelson they did not use the right language should have referred to gift tax values as finally determined.

v. Michigan case.

(1) Wanted to collapse life insurance trust.

(2) No Crummey letters sent so no gift so no trust and if no trust then settlor owned the policy and if settlor owned the policy then for tax purpose the ILIT could not be viable, so no material purpose to keep trust so it should be terminated.

(3) Court found absence of Crummey letters had nothing to do with validity of trust.

vi. Estate of Small (PA).

(1) Shot and died intestate at 38 and asses go ½ mom and ½ dad.

(2) Mom argued Dad wasn't around and did not support son so he should be cut off.

(3) PA cuts off inheritance for parent who does not support dependent child. Court found "child"

was adult before injury and there was no support obligation.

vii. Idaho case.

(1) Supreme Court. Joint revocable trust. Son through a testamentary power of appointment. Could son get information about the trust?

(2) A beneficiary is a beneficiary whenever added and son could go back and get information just like a beneficiary stated even though added by POA.

viii. 2020 CA Case Barefoot v. Jennings.

(1) Does the beneficiary of revocable trust has standing?

(2) What if removes beneficiary as beneficiary of revocable trust and then settlor dies. Does that give prior beneficiary the right to get information about the circumstances of removal?

(3) CA said that there was standing for that beneficiary to get information.

(4) Cases are perilous and we might need to think about drafting to see what type of information these beneficiaries should receive.

(5) We often amend and restated revocable trusts. Is that wise if we have removed a beneficiary?

ix. Wilburn.

(1) House went to daughters and by codicil gave son right to buy house by FMV. Court said could not enforce codicil since there are many definitions of FMV in Virginia.

(2) Should define approach in document not use FMV.

x. Matter of Joe St. Claire.

(1) Reformation case. A reformation of what we might consider a reciprocal SLAT. H and W created trusts, but they were reciprocal unintentionally, and the settlors did not intend them to be non-reciprocal.

(2) Kansas Supreme Court allowed trusts to be reformed.

xi. Cases 247 Recent developments defining spouse, stepchildren, etc.

(1) Drafting is deficient and needs to be worked on.

(b) Fundamentals program.

i. Basis shifting.

(1) Use FLP with grantor and grantor trusts as LPs. Each contributes assets and if follow all rules you can move assets around. It doesn't create basis but lets you move basis around among different taxpayers.

ii. PLR 2019 20010.

(1) Series of rulings.

(2) Issue in PLR requests on income taxes what happens income tax wise when all beneficiaries come together and agree under state law to terminate a trust and make distributions to income and remainder beneficiaries in accordance with actuarial interests.

(3) IRS held that there was a tax consequence. It was a capital gains tax

(4) Reasoning in rules is abysmal and makes no sense at all per speaker.

(5) Perhaps there was a material difference as to what beneficiaries had when they were going into the termination and what they got. Note that Cottage Savings was not even mentioned in the PLRs. Speaker says that there was no difference in what the beneficial interests the beneficiaries had and got it was only a question of timing via acceleration.

(c) IRA planning.

i. Overview of IRA rules and CRT rules.

ii. Move money from an IRA into a CRT without paying income tax.

iii. Beneficiaries pay income tax as funds come out of CRT.

iv. Question if IRA is paid to CRT and payments are made to the beneficiaries over their lifetime. Does that mimic old stretch IRA? Is 10% charitable required remainder worth the cost?

v. This is worth looking at but not in all circumstances. If you have a taxable estate it is not such a great strategy as you lose your 691(c) IRD deduction because of practically how the rules work as money comes out of CRT. These are the last things paid out of CRT under tier system. You need a long period of time at least 20-25, some think closer to 30 years, to make the math work.

(d) Retroactive Revisions.

i. How you go about trying to fix or get out of problems with a plan.

ii. Different types of reformation on mistakes of fact, mistakes of law, etc. Generally more allowable today then years ago based on broad restatement principals. State law will influence. UTC picked up broad concept of reformation.

iii. Courts have traditionally been easy if you have a legitimate and corroborated scriveners error. Good state law and tax law results on this.

iv. If you want a reformation because you did something and got a bad tax result may be more difficult. In most states not easy to get to supreme court of state and if you don't get to state supreme court you have a problem that IRS is only bound under 1967 Bosch case by holding of state's highest court.

v. Recission.

vi. Disclaimers. Way to unwind a transaction. How comfortable are you disclaiming by one beneficiary disclaiming and that terminates the trust and reverts asset to settlor even though there are other beneficiaries of the trust? Question asked speakers what they thought. Try to vest the interest during the disclaimer period into the person doing the disclaimer, that is safer.

(e) Trust investments and ESG.

i. ESG investing = Environmental Social and Governance. Can they enter analysis by trustee of determining investment strategy?

ii. Motivations:

(1) To pursue an investment with low risk and high reward if pursuing this objective trustee is fulfilling duty of loyalty and duty of prudence.

(2) Could conceivably make investments toward promoting ESG and at the same time fulfill duty of loyalty and prudence.

(3) Other motivation is collateral benefits. You are there looking at other perceived benefits not focusing first on investment returns. General rules of loyalty and prudence say you cannot do this. You

must look out for financial interests of beneficiaries as a trustee.

(4) Comment: Same issues apply to religious investing, but the best approach is to permit it in the trust instrument.

iii. What type of language will express settlors desires as to ESG, holding a family business and protect a trustee? Establish special circumstances under UPIA using appropriate language.

iv. Where beneficiaries want ESG, and trust doesn't provide for it. How can you get beneficiaries to express their intent sign waivers and releases, etc. Draft release under Sec. 1009 of UTC but that is not the end of the issue. For trustee to be fully protected must get all of the beneficiaries to agree. Current, remainder and contingent beneficiaries. Can virtual representation suffice? That could be difficult in this context as there could be conflicts of interest. A current beneficiary may be fine giving up returns for ESG, but remainder beneficiaries may not agree and parent purporting to operate under virtual representation may have a conflict so that they are not bound.

(f) GST Tax.

i. Impact of split gift elections under 2513. How does that impact allocation of GST exemption? General rule on allocation of GST exemption if you file late you have an effective allocation but relates to value of transferred assets as of the date of the allocation. If you file a late gift tax return with a split gift election (can only do this if it is the first return, i.e. you did not file before) it relates back to the date of the gift. This enables allocation of GST exemption on date of gift even though you are filing late.

ii. If you do a split gift it cannot create an ETIP under 2642(f) with respect to the consenting spouse. Split gift has effect for GST effect but not an estate effect.

iii. GRATs.

(1) Expect not to be engaging in GST transfers. Usually designed not to because of ETIP issue.

(2) Be careful about prospect of their being an automatic allocation 2632(c) because some GRATs meet definition of GST Trust.

(3) There is a regulatory provision that for a short term GRAT the ETIP rule doesn't apply as you may be able to argue that chance of inclusion in the estate is less than 5% under Reg. Sec. 262632.1c2 you may not have an ETIP.

(4) Elect out of automatic allocation for GRATs.

(5) How much has to be allocated to a GRAT to allocate exemption? To entire GRAT or only to remainder interest.

iv. Safe harbor (d) regarding modification of wholly exempt transfer. Applies where you do a modification of an irrevocable trust where you don't benefit lower generation or extend time of vesting. What about a decanting where all you are doing is adding transferor's spouse as new discretionary beneficiary? Spouse is not in a lower generation. But think harder it may not be safe. Adding spouse may give rise to an indirect shift if spouse outlives all other beneficiaries and extends term of trust.

(g) Asset Protection.

i. To use another jurisdiction need to be in that jurisdiction as much as possible and out of home state. Risky per speaker to have trustee or protector in home estate.

ii. Fraudulent conveyance issues.

iii. Don't gather financial information from client unless you know they are your client. Double engagement process. Get engaged first. Then with protection of attorney client privilege gather information and do insolvency analysis.

iv. To avoid self-settled trust don’t name settlor give someone ability to add the person back in. Avoid BOPA 2005. Add settlor 10 years and 1 day out.

(h) Diversity, Culture and Ethics.

i. Focusing on client not focusing on the practitioner. Who are you dealing with? Client may have different cultural expectations and understandings. It may be a different family structure. It may affect how client understands communications from the lawyer. Must have a certain amount of cultural understanding.

ii. Explain US legal system and explain how US system is different.

iii. Asian cultures – family is so important that it is assume family will make decisions about division of assets rather than by individual dictating that.

(i) International tax planning.

i. Transfers to non-citizen spouses – QDOTs = qualified domestic trusts.

ii. It is possible to make distributions out of a QDOT of trust accounting income and not have QDOT tax apply but principal distributions give rise to immediate payment of tax. You might use a unitrust approach 2056(b)(5)(f)(1) unitrust is treated as equivalent of income so you might be able to get some principal out without the QDOT tax.

iii. Severe rules apply to gifts between spouses. No marital deduction and no QDOT option just $159,000 in 2021 gift between spouses.

(j) SECURE Act.

i. March 20, 2021 IRS Publication 590B has mistakes.

(1) Example illustrating operation of the 5-year rule in the example the 5-year period includes 2020 and in 2020 Cares Act suspended distributions so it should have permitted 6 years in the example.

(2) Example of how 10-year rule operates suggests you have required minimum distributions each year during the 10-year period, but the Secure Act does not require that you can pay all on last day of 10-year period.

(k) Older individuals; cognitive issues.

i. Should we say a trustee who is faced with an elderly beneficiary or beneficiary with questions as to capacity of beneficiary the ability to hire an advocate for that beneficiary with trust funds.

(l) DNI.

i. Separate shares.

ii. Income tax return example for complex trusts.

(m) Client confidentiality and Remote Work.

i. Ethics review and considerations.

ii. Practical advice – work from home will continue so must focus on what we do not just having a place to work but the details.

iii. Paper – we secure electronic files what about paper files? What if they are at home? Is it secure? Are they locked up?

iv. Language to consider including in emails and letters.

(1) Mom wants children at meeting. They may assume you are their counsel. Inform that you only represent mom, etc.

v. Attorney client privilege is not robust. If on a zoom call talking to a client and deposed were there other people in the house that could hear you have you lost attorney client privilege?

(n) Planning for new proposals.

i. Transfer to irrevocable trust and use remaining exemption. Build in disclaimer in case there is a retroactive reduction.

ii. What if designate a beneficiary of trust to disclaim. “I strongly believe that does not work.” If you look at language of qualified disclaimer statute it is crystal clear you can only disclaim property in which you have an interest. What has actually happened after statute of limitation runs they have probably made taxable gifts. “Don’t rely on that strategy.” You need a couple of ways to proceed you could get all beneficiaries to disclaim. You could use virtual representation. Another way to approach it is to structure the trust so that there is only one beneficiary during disclaimer period then disclaim after it. If only one beneficiary he can disclaim legitimately.

iii. SLATs. There is the possibility after a SLAT is established there could be a divorce and thereafter the settlor will not have any access. How do you address that? Include provisions that if there is a divorce the SLAT is to be considered marital property in dividing up all assets. That is a good and creative approach. But maybe having that type of provision could arguably amount to a post-marital agreement remember in most jurisdictions you need to meet a host of requirements including separate representation for each spouse.

iv. Formula gifts – a defined value of formula gift could be used to protect against retroactive reduction so amount of gift is reduced. “But it is not certain that this will work.” At the time the gift is made you have a value that is unknowable under any circumstances. “We are not sure the formula gift works in this context.”

v. Can you use a GRAT or defective preferred partnership to guard against reduction? Those are creative and worthwhile of consideration. In either case you would have a violation of a provision in Chapter 14, e.g. where you try to spoil a GRAT under 2702 that would be a problem. With respect to a defective preferred partnership, e.g. take back a non-cumulative interest that violates 2701. The threatened anti-abuse rule in the no claw back regulations the IRS may not use the no claw back rules if transfers made with a retained power or interests and certain transfers under chapter 14, so consider this.

vi. American Family Plan no suggestion that a deemed sale rule would apply. Look for possible merger of various proposals.

17 **<u>Distributable Net Income (DNI). (presented by Jeremiah Doyle).</u>**

(a) 641(b) income of a trust or estate is calculated like an individual with certain exceptions.

i. Never seen an accrual basis trust or estate but it is permitted.

ii. Tax year.

(1) Must have a calendar year for trust.

(2) Estate can have fiscal year.

iii. Income is taxed to entity (trust or estate) or beneficiary and that all depends on whether distributions were made.

(1) Subchapter J is where rules for income tax rules are contained.

(2) Part 1 income taxation of trust and estates.

a. 641-646 general rules.

b. 651; 652 simple trusts

c. 661 ,662, 663 Complex trusts and estates

d. 664 CRTs

(3) Part 2 IRD income in respect of decedent.

(b) Income of estate or trust is taxed to entity or beneficiary.

i. If income from trust is distributed then the trust will get a distribution deduction limited to distributable net income and beneficiary will pick up and report that income on his own return.

ii. If no distributions made, all income reported by and taxed to trust or estate.

iii. Tax rates are brutal. Very compressed structure for trusts and estates. Once trust or estate hits about $13,000 of income all taxed at 37%. Contrast individual $500-$600,000 to get to maximum rate.

(c) Why is DNI so important?

i. Tells us amount of distribution deduction trust or estate will get. Cannot get distribution deduction for more than DNI.

ii. Also tells us how much beneficiary will have to report on his return. Amount beneficiary has to report cannot exceed DNI.

iii. DNI tells us character of distribution as distribution retains same character as it had at trust level.

iv. DNI acts as a ceiling on amount of distribution deduction to the trust and as a ceiling on the amount of distribution that beneficiary must include in income.

(d) Adjustments.

i. Personal exemption $300/$100. Much smaller for trusts than for individuals.

ii. Capital gains are taxed at trust or estate and generally cannot get distributed out.

iii. Add back net tax-exempt income less expenses allocated to that tax exempt income. Sec. 265 cannot deduct portion of fees used to earn tax exempt income.

iv. When calculating DNI start with taxable income and make adjustments. It is trust accounting income that is less any deductible expenses (whether allocated to income or principal).

v. DNI is taxable income less capital gains plus net tax-exempt income.

vi. Take away – DNI as a general rule will not include capital gains or losses which as a general rule are taxed at the trust level (how to get them in DNI is discussed below).

(e) Example 1.

i. Interests 10k, trustee fees 5k, 15k dividends.

ii. Income is 25k – 5 - $100 exemption is $19,900.

iii. DNI – 643(a) 19,900 + 100 = $20,000.

(f) Example 2.

i. LTCG $30k, Interests 10k, trustee fees 5k, 15k dividends.

ii. Taxable Income = $10k + 15k + 30k minus $5k - $100 = $49,900.

iii. DNI = $49,900 TI adjusted – 30k + 100 exemption = $20,000 DNI.

(g) Example 3.

i. LTCG $30k, Interests 10k, trustee fees 20k,+ tax exempt income of $10k.

ii. If have tax exempt income deductions of trustee fees may have to be allocated to tax exempt income. Most software programs allocate trustee fees to tax exempt income in proportion to tax exempt income is included over all items entering into DNI.

(1) $10k/$40k

iii. Regulations allow any reasonable method to allocate expenses to tax exempt income.

(h) 643(a).

i. 3 ways to get gains into DNI. You want that as it is the only way to get it out to beneficiaries and taxed at beneficiaries lower income tax rate.

ii. How allocate DNI is different for simple and complex trusts. Complex trusts have 5 other rules.

iii. 3 types of trusts.

(1) Simple trust.

a. Must distribute all trust income annually.

b. No distributions to charity that qualify for 642(c) deduction.

c. No distributions of principal.

d. Gains generally subject to tax at trust level.

e. All else is taxed to a beneficiary.

f. Code Sec. 651 652.

g. Amount beneficiary has to account for on income tax return on 652 for simple trust.

(2) Complex trust.

a. Any trust that is not a simple trust.

b. Complex has discretionary distributions of trust accounting income.

c. Any principal distributions.

d. Simple trust in year one that makes distribution of principal in a later year it flips to a complex trust.

e. If don’t make distributions all is taxed at trust level.

f. If trust makes distributions they will qualify for DNI deduction to trust and carryout DNI to the beneficiaries.

g. Sec. 661, 662.

h. Amount beneficiary has to account for on income tax return on 662 for complex trust.

(3) Grantor type trust.

(i) Simple trust.

i. Distribute all trust accounting income.

ii. When make distribution the trust will get a distribution deduction for all trust accounting income it distributes limited to DNI.

iii. Amount of distribution deduction will be reduced by tax exempt income (can't give deduction for non-taxable income).

iv. Example: Trust accounting income and DNI $9,000. That must be distributed to the beneficiary and beneficiary will pick that up on his income tax return. What if you have two beneficiaries one gets 2/3rds and one gets 1/3rd. Amount of DNI a beneficiary gets under a general rule is equal to the amount of his distribution over all distributions. Since one got 2/3rds of trust accounting income he will report 2/3rds of DNI. Trust gets distribution deduction of $9,000.

v. Suppose the trust had more than one class of income. $6,000 of dividends and $3,000 of interest. Allocate each pro rata. This concept applies to complex trust too subject to various special rules.

(j) Complex trusts.

i. 6 items/rules.

(1) General pro-rata allocation rule.

(2) Tier system.

(3) 65-day rule.

(4) Specific bequests.

(5) Special election for distributions in kind.

ii. General rule for complex trusts when special rules don't apply.

(1) Allocate DNI proportionately to beneficiaries based on distributions.

a. Distribution to beneficiary/total distributions x DNI = what beneficiary must report.

iii. Tier System.

(1) Allocation of distributions among beneficiaries is different for complex trusts. Must figure out when Tier system rule applies.

(2) If we have total distributions are greater than DNI the tier system is relevant. If a beneficiary entitled to trust accounting income and others discretionary tier system applies. Those required to get trust accounting income are known as first tier beneficiaries. Those getting discretionary distributions are discretionary beneficiaries.

(3) Two tiers of beneficiaries.

(4) Trust instrument or state version of principal and income act governs.

(5) How allocate DNI to tier system?

a. First tier beneficiaries they get allocated DNI first.

b. If there is any DNI left over it is allocated to the 2^{nd} tier beneficiaries.

(6) Contrast pro-rata rule versus application of Tier system.

iv. Special rule if charitable deduction is involved.

(1) Gross up DNI by full charitable contribution.

(2) No charitable deduction allowed for first tier beneficiary.

(3) What if have tier 1 and tier 2 beneficiaries? Charitable deduction comes into play when calculating DNI for second tier beneficiary so 2nd tier beneficiary may get distribution without income tax consequence.

(4) If everyone is discretionary they are all 2nd tier beneficiaries. Which may leave no DNI for 2nd tier beneficiaries.

v. Separate Share rule.

(1) Beneficiaries cannot dip into shares of other beneficiaries. Each beneficiary will only be taxed on DNI of their respective separate shares so you must calculate DNI of each separate share.

(2) If you want to avoid separate share rule draft a totally discretionary pot trust or have trust divide into separate trusts.

(3) Separate share rule is designed to avoid Harkness v. US problem.

(4) For the sole purpose of determining the amount of DNI the separate share rule is used. It doesn't mean you have two trusts or two tax returns. It is merely used to allocate DNI to separate beneficiaries.

(5) Mandatory not elective.

(6) Applies to both estates and trusts.

vi. 65-Day rule.

(1) Suppose you have a trust and have not distributed all of DNI by year end, but you want to get more DNI out.

(2) Under 663(b) you can make a distribution within the first 65 days of the following year and

treat that distribution (elect to have it) as if made on 12/31 of the prior year.

(3) This is not 2.5 months it is March 5 or March 6 (depending on whether there is a leap year).

(4) Elect by checking box on Form 1041.

vii. Specific Bequests 663(a)(1).

(1) If you can identify specially what beneficiary will get, $10,000, a car, a piano, no distribution deduction to the estate or trust and nothing included in beneficiary's income.

(2) Key is that in order to have an amount qualified as a specific bequest it must be a specific sum of money or a specific asset. It must be ascertainable at the date of death.

(3) What about formula clauses?

viii. Section 643(e) election for a distribution in kind to fund a bequest.

(1) If make distribution in kind the amount that carries out is generally the lower of cost basis or FMV of the property.

(2) Basis of asset is generally a carryover basis (basis to trust or estate plus any gain or loss). Holding period also tacks.

(3) Election under 643(e) - If you make a distribution of appreciated property you can elect to recognize gain at trust or estate level. Then the amount of DNI that carries out the beneficiary is then the FMV of the property not the lower cost basis. Also the beneficiary's cost basis will be the FMV as well.

ix. 643(a) capital gains in DNI.

(1) Regs have 14 examples, but they don't answer all questions and there is some ambiguity.

(2) Statute gives two requirements to meet and three options to get gains into DNI.

a. State law lets you allocate to income but must be treated consistent.

b. Have provision in trust document or local law.

c. Or trust document gives trustee right under any of the 3 methods if not violating local law.

(3) Reg. 1.643(a)-3(b)

(k) Summary.

i. Defined DNI 643(a).

ii. Difference between simple and complex trusts.

iii. General rule to allocate DNI is amount to beneficiary/total distribution x DNI.

iv. In complex trust: tier system (distributions exceed DNI); separate shares under trust document or local law; 65-day rule; specific bequests do not carry out DNI.

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

Joy Matak

Mary Vandenack

Martin Shenkman

CITE AS: