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

"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.

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.

This outline contains our notes and observations from Heckerling 2021, with no promises made that these morsels will be as tasty as the ones eaten by Lucy and Ethel, nor that they do justice to the presentations or that they are fully accurate. Either way, they will hopefully provide a food for thought."

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.

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.

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 **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).**

(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. 5th 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 **Retroactive Revisions and Reversals. (presented by Carol A. Harrington)**

(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 **The Three Faces of Asset Protection. (Presented by Gideon Rothschild, Melissa Langa, Daniel S. Rubin)**

(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 **Review of the Past Year's Significant, Curious or Downright Fascinating Fiduciary cases. (presented by Dana G. Fitzsimmons Jr.)**

(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 2nd 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 **<u>Diminished Capacity. (Presented by Bernard A. Krooks, Robert B. Fleming, and Tara Anne Pleat)</u>**

(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 **Question and Answer Panel. (Steve Akers, Samuel A. Donaldson, Sarah Moore Johnson, Carlyn S. McCaffrey)**

(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 **Client Confidentiality in Remote Work. (Presented by John F. Bergner, Jeff Chadwick, Lauren J. Wolven)**

(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 **Non-Citizen Spouse International Planning. (Presented by Michelle Graham, Michael Rosen-Prinz).**

(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 72nd 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 10th 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 10th 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 **Distributable Net Income (DNI). (presented by Jeremiah Doyle).**

(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 2nd 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:

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